# Re D & D Securities & Lilly

**IN THE MATTER OF:**

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

**and**

**D & D Securities Inc. and Patrick Lilly**

2016 IIROC 35

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

Heard: August 31, 2016 in the City of Toronto
Oral Decision: August 31, 2016
Written Decision: September 28, 2016

**Hearing Panel:**
Fred Chenoweth, Chair, Selwyn Kossuth and Lou D'Souza
**Appearances:**
Elissa Sinha, Senior Enforcement Counsel of the Investment Industry Regulatory Organization of Canada
Sean Grayson, Barrister and Solicitor, for the Respondents

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# REASONS FOR DECISION

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## Introduction

¶ 1 A Hearing Panel of the Investment Industry Regulatory Organization of Canada ("IIROC") was convened on August 31st, 2016 in accordance with Rule 15 of the IIROC Dealer Member Rules of Practice and Procedure to review a Settlement Agreement ("Settlement Agreement") dated August 4th, 2016 negotiated between the Enforcement Department of IIROC ("Staff"), D & D Securities Inc., and Patrick Lilly ("Respondents") in accordance with Rule 20.35 of Part 10 of the IIROC Dealer Member Rules (the "Rules") and Rule 15 of the Dealer Member Rules of Practice and Procedure.

¶ 2 The Settlement Agreement was submitted to the Hearing Panel for its acceptance or rejection. After considering the material filed and the oral submissions of Staff and Counsel for the Respondents, the Panel unanimously accepted the Settlement Agreement and issued an order accordingly. These are the Panel's reasons for doing so.

## The Allegations

¶ 3 In the Settlement Agreement, the Respondents admit the following contraventions of IIROC Dealer Member Rules:

(a) From 2011 to 2014, the Respondents failed to ensure compliance with regulatory requirements with respect to (a) avoiding misuse of confidential information, (b) identifying, managing, and disclosing conflicts of interest, potential conflict of interest, and Outside Business Activities ("OBA") and (c) supervising retail accounts, contrary to IIROC Dealer Members Rules 38,

18.14, and 2500.

(b) From January 2012 to May 2015, Patrick Lilly engaged in business conduct that is unbecoming a registrant by failing to ensure that D&D fulfill representations made to IIROC that it would develop and improve its sales compliance program, contrary to IIROC Dealer Member Rule 29.1.

**Statement of Facts**

¶ 4 Staff and the Respondents agreed with the facts set out in the Settlement Agreement and acknowledged that the terms of the settlement contained in the Settlement Agreement were based upon those specific facts.

**Overview**

¶ 5 In 2011, 2013, and 2014, IIROC Compliance Staff examined D&D for compliance with regulatory requirements. At each examination, D&D was found to have deficiencies that were both "Repeat" and "Significant" relating to:

(a) Controls for avoiding the misuse of confidential information;

(b) Identification, management, and disclosure of conflicts of interest, potential conflicts of interest, and Outside Business Activities ("OBAs"); and

(c) Retail account supervision.

¶ 6 Despite representations by Lilly that these deficiencies had been, or would be, addressed by D&D, some of the deficiencies persisted. In 2015, Lilly failed to respond to Compliance Staff in a timely and adequate manner.

**The Respondents**

¶ 7 D&D is registered as a Dealer Member with IIROC. D&D is primarily engaged in investment banking and advisory, activities, however it also maintains retail clients.

¶ 8 Lilly is the President, CEO, UDP, CCO, and a Director of D&D. Lilly first became registered with D&D in 2008 as CCO and assumed the roles of UDP and CEO in 2011.

**Compliance Reviews**

¶ 9 The IIROC Business Conduct Compliance ("BCC") and Trading Conduct Compliance ("TCC") groups conduct periodic reviews of IIROC Dealer Member firms to assess their compliance with IIROC requirements. The review by BCC is referred to as a Business Conduct Examination or "BCE". Where BCC and TCC conduct a review together, it is called an Integrated Compliance Examination or "ICE". BCC and TCC are referred to collectively herein as "Compliance Staff".

¶ 10 In the course of BCE or ICE, Compliance Staff attend at the Member's premises and review documents and interview key compliance personnel. Compliance Staff may also access the Member's computer systems remotely and request documents, reports and information.

¶ 11 Following a BCE or ICE, Compliance Staff identify deficiencies or concerns and impose requirements to effect changes necessary for compliance with IIROC's requirements. Deficiencies are often discussed by Compliance Staff with the Member while the examination is ongoing and/or at an exit meeting. Deficiencies, recommendations and requirements are documented in a BCE or ICE Report signed by the Vice President of the relevant compliance group(s) and provided to the Member.

¶ 12 The Member is required to provide a written response to the BCE or ICE within a specified timeframe indicating what corrective measures will be taken (the "Response"). IIROC expects that any representations made in the Response will be fulfilled and that the Member's CCO and UDP will ensure that appropriate action is taken and completed expeditiously in accordance with representations given on behalf of the Member.

¶ 13 Compliance Staff maintains an on-going dialogue with Members to resolve issues identified in the BCE and ICE Reports. If issues are not remedied by the subsequent BCE or ICE, they will be identified in future examinations as "Repeat".

**D&D Examinations**

¶ 14 Between 2011 and 2014, Compliance Staff conducted three reviews of D&D's sales compliance procedures, policies and practices. The relevant dates are as follows:

| Year | Report Date | D&D Response Date |
|---|---|---|
| 2011 (BCE) | November 30, 2011 | January 13, 2012 |
| | *Follow-up* 1 February 23, 2012 | *Follow-up* 1 March 5, 2012 |
| | *Follow-up* 2 March 7, 2012 | *Follow-up* 2 March 20, 2012 |
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| 2014 (ICE) | January 21, 2015 | March 19-May 20, 2015 |

¶ 15 Each of the above noted Reports was addressed to Lilly as UDP and CCO and each of D&D's Responses was signed by Lilly. Lilly was the primary D&D contact for all of the compliance reviews.

¶ 16 The 2011 BCE Report contained a number of Repeat findings from previous years. There were Repeat findings in the 2011, 2013, and 2014 examinations that remained unresolved, despite assurances by Lilly.

**Compliance Deficiencies**

(a) *Deficient Controls for Avoiding Misuse of Confidential Information*

¶ 17 The 2011 BCE and the 2013 and 2014 ICE's identified concerns about the placement, timing, and monitoring of securities on D&D's Grey and Restricted Lists. This was a Repeat Significant Item that had been raised with predecessors of Mr. Lilly at D&D in the 2003, 2005, and 2008 reviews.

¶ 18 The 2011 BCE indicated that in 2009 and 2010, there were delays in adding issuers to the Grey and Restricted Lists as follows:

(a) With respect to one issuer, D&D prepared a proposed letter of engagement on December 15, 2009, however the issuer was never added to the Grey List and was only added to the Restricted List on December 24, 2009, when the letter of engagement was delivered; and

(b) With respect to a second issuer, D&D communicated an expression of interest in an underwriting deal on December 2, 2010, however this issuer was not added to the Grey List until December 17, 2010.

¶ 19 In the 2011 Response, Lilly represented that steps had been taken to log and document Grey and Restricted listings as far as practicable and that D&D policies and procedures had been revised to better contain confidential information.

¶ 20 D&D advised that in 2011, it spent significant time and funds moving the firm to an automated compliance system. D&D first engaged and implemented an automated system from Subserveo. It then engaged and implemented a system from Position Watch. These systems were to assist in the monitoring of grey and restricted list matters. The new systems did not do automated "look-back" checks for trading done in a security before it was added to the Grey or Restricted List but they permitted manual viewing of historical trades in securities that had been listed.

¶ 21 In the 2013 ICE, Compliance Staff identified trading of securities on the Grey and Restricted Lists which was not queried. In late 2011 and 2012, SI, a D&D compliance employee who was responsible for

maintaining the Grey and Restricted Lists and reported to Lilly, traded securities of two issuers in his personal account after they had been added to the Grey List. Specifically:

(a) On February 9, 2012, Lilly added the first issuer to the Restricted List. On March 28, 2012 at 10:50 a.m., SI removed the issuer from the Restricted List, but he backdated the removal to 10:00 a.m. At 10:51 a.m., SI added the issuer to the Grey List, however, he did not backdate that change. SI's actions created a 50 minute gap from 10:00 to 10:51 a.m. where trades would not be flagged on the following day's exception report. On March 28, 2012, at 10:16 a.m. SI sold holdings in the issuer in his personal account. When the sale was entered, the security was on the Restricted List, however by backdating its removal, SI concealed his trading in a Restricted security.

(b) On November 10, 2011, SI purchased units in an issuer. On November 11, 2011 at 10:01 a.m., Lilly directed SI to add the issuer to the Grey List, and indicated that it was likely to move to Restricted later that day. At 10:09 a.m., SI sold his units, prior to adding the issuer to the Grey List at 10:22 a.m.

¶ 22 There were no queries of the above trades by Lilly or anyone else at D&D. Lilly advised Staff that he was not aware of the trading until it was raised by BCC during the 2013 ICE.

¶ 23 SI's conduct was contrary to the policies and procedures of D&D. SI's employment with D&D was terminated in March 2014.

¶ 24 In the 2013 Response, Lilly represented that D&D's Policies & Procedures would be edited to provide for daily queries as to whether trading had occurred and that D&D was exploring more timely alternatives for adding matters to the Grey and Restricted Lists. D&D retained Risk Management Services Inc. ("RMS"), and corporate counsel to review, recommend and revise its policies and procedures and D&D did revise its policies and procedures based on RMS's review and recommendations.

¶ 25 However, in the 2014 ICE, BCC and TCC again identified concerns about the timeliness with which items were added to the Grey and Restricted list, and supervision of trading in securities on the lists, similar to the concerns that had been identified in the 2011 BCE and 2013 ICE.

(b) *Conflicts of Interest and Outside Business Activities*

¶ 26 The 2011 BCE identified concerns with respect to Conflicts of Interest and OBAs. In particular, D&D was unable to provide a current list of registrants involved in OBAs and there were no formal procedures outlining the review process of OBAs, despite a written policy requiring D&D to implement processes for disclosure, identification, approval and supervision of OBAs.

¶ 27 In response, Lilly indicated that a "sweep" of all registrants was completed in 2010, declarations were logged and filed, and that such a "sweep" would be formally implemented going forward.

¶ 28 The 2011 BCE also identified a failure to supervise a conflict of interest for a disclosed OBA by a D&D employee who was on the board of a publicly traded company. Lilly told Enforcement Staff that there was no trading of that issuer at D&D but this was inaccurate. Lilly was aware of the employee's OBA and potential conflict of interest, but did not take steps to monitor and supervise it.

¶ 29 In the 2013 ICE, BCC found that, although D&D registrants were canvassed as to their OBAs in 2011, five registrants failed to complete the 2011 Annual Disclosure Form and thus the canvass was not complete. Moreover, D&D failed to canvass its registrants as to their OBA in 2012. Finally, there were no formal procedures for the process of vetting and approving OBA.

¶ 30 Lilly was responsible for maintaining and updating the National Registration Database ("NRD"), however OBAs for at least two D&D registrants that were disclosed to D&D in the 2011 canvass were not filed on NRD.

¶ 31 In the 2013 Response, Lilly advised that the 2012 annual canvass was delayed and conducted shortly after the 2013 ICE with a more robust document, and that the 2013 canvass was being conducted concurrent with the preparation of the 2013 Response. Lilly also advised that he would update NRD over the holiday period.

¶ 32 However, in the 2014 ICE, BCC again found that 5 employees had not completed the 2013 Annual Disclosure Form, and that NRD had not been properly updated to reflect the current status of OBAs.

(c) *Retail Account Supervision*

¶ 33 In the 2011 BCE, BCC indicated that significant discrepancies were found between core Know Your Client ("KYC") information found on client New Account Information Forms ("NAAFs") and the information coded on D&D's internal electronic system. Thus, the KYC information on the electronic system could not be relied upon for supervisory review or making recommendations to clients. Further, a number of NAAFs were outdated. BCC directed D&D to undertake to review all client files to ensure the integrity of its KYC data.

¶ 34 In D&D's 2011 Response, Lilly represented that the discrepancies arose from a system changeover and that the corrected KYC information had been recovered, reviewed and uploaded. Lilly also stated that "data integrity checking is proceeding". He subsequently represented in his Follow-Up Response that the KYC data "appears to have been corrected".

¶ 35 Commencing in 2011 a data sweep was conducted to review client account data for active files. An individual was hired to assist in this matter. During the process account data was updated and approximately 600 accounts were closed.

¶ 36 Despite the foregoing efforts, similar issues were identified in the 2013 ICE. BCC sampled 25 retail accounts and found that for nine accounts, NAAFs were incomplete and for eight accounts there were inconsistencies between client investment objectives and risk tolerance stated on the NAAFs and D&D's electronic recordkeeping system.

¶ 37 In the 2013 Response, Lilly indicated that D&D was preparing a "KYC documentation project for Q1 of 2014" and that changes would be closely monitored and documented to ensure that the back office system matched the client file.

¶ 38 However, it appears that steps taken by D&D and Lilly were ineffective since in the 2014 ICE, BCC identified 12 retail accounts, out of a sample review of 20, in which there were discrepancies between the NAAFs and D&D's electronic system.

¶ 39 BCC also identified sustainability concerns in seven of the 25 retail accounts sampled in the 2013 ICE where the client's portfolio did not seem to match the risk tolerance and objectives recorded in the client's NAAFs. Neither Lilly nor anyone at D&D queried the allegedly unsuitable holdings, even after the 2013 ICE was delivered.

**Lilly Failed to Respond to Compliance Inquiries in a Timely Manner and Fulfill Representations to IIROC.**

¶ 40 The 2014 ICE was delivered to D&D and Lilly on January 21, 2015 with a Response required by March 6, 2015.

¶ 41 Lilly did not respond to the 2014 ICE by March 6, 2015. He did not request an extension or make any attempt to speak with BCC about the delivery of D&D's Response before the due date.

¶ 42 On March 11, 2015, Compliance Staff inquired as to the status of the Response and reasons for failure to reply. On March 13, 2015, Lilly advised that he had been busy with other priorities and that his consultant had been working on another assignment, but was now working with D&D and that there would be a further update after a meeting scheduled for March 16. Following the March 16 meeting, Lilly advised BCC that he was working with his consultant and would update BCC further later that week.

¶ 43 On March 19, 2015, Lilly delivered an annotated version of the 2014 ICE with some comments. Lilly's annotations did not fully address the deficiencies identified in the ICE. Lilly later acknowledged to Staff that his response was inadequate.

¶ 44 Between March 19 and May 20, 2015, Lilly submitted additional material to Compliance Staff by email. However, on May 20, 2015, Compliance Staff advised that the submissions were "unclear" and requested a summary indicating how each deficiency was addressed. Lilly assured that such a summary was "in progress", however no summary was ever delivered.

¶ 45 As described herein, Lilly represented to Compliance Staff in D&D's Responses that each of the deficiencies at issue in these proceedings had been, or would be, addressed. However, the deficiencies persisted indicating that the representations were not fulfilled.

**Joint Settlement Recommendation**

¶ 46 Staff and the Respondents agreed to the following terms of settlement:

(a) The Respondents shall complete the Remedial Steps (described in paragraph 52 of the Settlement Agreement) by October 30, 2016, and shall report by that date on completion and execution to IIROC's Vice-President of Enforcement, and as thereafter required by the Vice-President of Enforcement to ensure that the Remedial Steps are completed satisfactorily;

(b) Lilly shall successfully re-write the CCO examination by October 30, 2016;

(c) D&D shall pay a fine of $15,000; and

(d) Lilly shall pay a fine in the amount of $7,500

(e) D&D agrees to pay costs to IIROC in the sum of $5,000.

¶ 47 In the Settlement Agreement, the Respondents agreed with and undertook to complete the following Remedial Steps to remedy the deficiencies at issue in the Settlement Agreement:

(a) With respect to avoiding misuse of confidential information, the Respondents shall:

i. Review D&D's policies, practices and procedures regarding adding securities to the Grey and Restricted list and provide the results of the review and details of any steps taken or planned to ensure that securities are added in a timely manner and that trading is appropriately supervised;

ii. Develop and deliver a training session for all D&D registrants with respect to adding securities to the Grey and Restricted lists, and trading in such securities;

(b) With respect to identifying, managing and disclosing conflicts of interest, potential conflicts of interest, and OBA, the Respondents shall:

i. Review, update and implement D&D's policies, practices and procedures for the identification, disclosure, approval and supervision of conflicts of interest and OBA;

ii. Forthwith survey all D&D registrants and explain any measures implemented to address existing conflicts and/or OBAs;

iii. Update NRD to be consistent with the results of the survey;

(c) With respect to supervising retail accounts, the Respondents shall:

i. Ensure that D&D's Know Your Client ("KYC") information is accurate and current for all clients who have traded in the last two years; and

ii. Confirm that the KYC information on D&D's electronic recordkeeping system matches the documentation signed by the client and implement any changes required to achieve

consistency between the electronic system and client documentation.

**Mitigating Factors**

¶ 48 It was submitted by Senior Enforcement Counsel and Counsel for the Respondents that the Hearing Panel should take into consideration the following mitigating factors:

(a) The Remedial Steps set out above that the Respondents have undertaken to complete as part of the terms of settlement;

(b) In addition, the Respondents have committed to increase their resources invested in compliance at D&D. Specifically, D&D is taking steps to hire a qualified individual and has specifically budgeted funds for additional compliance staff;

(c) D&D has also recently appointed an additional director to its board of directors, formerly comprised only of Lilly. The Panel heard that the appointee was a senior lawyer with substantial experience in the securities industry, including experience with compliance. The additional director was also to be an employee of the company;

(d) There have been no client complaints against D&D during the period at issue and there is no evidence of client harm; and

(e) The Respondents do not have any disciplinary history.

**Terms of Settlement**

¶ 49 The Panel noted that the Settlement Agreement set out certain terms of settlement to which the parties had agreed:

(a) This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive of Rule 15 of the Dealer Member Rules of Practice and Procedure. The Settlement Agreement is subject to acceptance by the Hearing Panel;

(b) The Settlement Agreement shall become effective and binding upon the Respondents and Staff as of the date of its acceptance by the Hearing Panel;

(c) 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;

(d) If the Hearing Panel accepts the Settlement Agreement the Respondents waive his/her/its' right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal;

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

(f) The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel;

(g) Staff and the Respondents 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;

(h) Unless otherwise stated, any monetary penalties and costs imposed upon the Respondents are payable immediately upon the effective date of the Settlement Agreement; and

(i) 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.

**Discussion**

¶ 50 In coming to its conclusion, the Panel considered the evidence before it including the facts set out above, the submissions of both Staff and the Respondents and the law to which it was referred. In addition, the Panel considered the IIROC Sanction Guidelines and the explanation by Staff that the Guidelines were simply there to assist Panels and were not binding.

¶ 51 The Panel considered the case of *Re Milewski* [1999] I.D.A.C.D. No. 17, Bulletin No. 2605, August 5th, 1999. *Re Milewski* stands for the proposition that:

> "Although a settlement agreement must be accepted by a District Counsel before it can become effective, the standards for acceptance are not identical to those applied by a District Counsel when making a penalty determination after a contested hearing. … A District Counsel considering a settlement agreement will tend not to alter a penalty that is considered 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 Counsel will reflect public interest benefits of the settlement process in its consideration of specific settlements. …A penalty under a settlement agreement is likely to be at the low end of the spectrum in view of the fact that a settlement is negotiated, permits the Association Staff to avoid the cost of a contested hearing and guarantees them a favourable result."

¶ 52 The Panel was also guided by the decision in *Re Clark* [1999] I.D.A.C.D. No. 40, Bulletin No. 2674, December 14th, 1999, which concluded that:

> "In considering a settlement under By-Law 20.26, the Panel should not simply substitute its discretion for that of staff when negotiating the settlement. The Panel must be cognizant of the importance of the settlement process and should not interfere lightly in a negotiated settlement."

¶ 53 During the hearing, the Panel expressed its concern as to whether the penalties proposed in the agreed set of facts, and in particular, the modest amount of the fines would achieve the objective of general and specific deterrence or whether the limited fines would fall outside of a reasonable range of appropriateness, given the penalties and fines proposed in previous cases. The concern was compounded by the limited information contained in the settlement agreement which informed the Panel as to the size of the Dealer Member and the nature and extent of the Dealer Member's business. At the hearing and on the consent of both Staff and the Respondents, the Panel was made aware that the Dealer Member presently had 19 registrants, six of whom were non-trading. The Panel was advised that the revenue of the Dealer Member was comparatively modest. The Panel further learned that the majority of the Dealer Member's income arose from merchant banking activities and that the firm intended further reductions in its retail account business. On this issue, the Panel found the decision of the Ontario Securities Commission in *Re Magna Partners Ltd.* to be persuasive. At paragraphs 57 and 58 of that decision, the Commission cited with approval the principle that when determining sanctions, *an SRO or commission must apply the principle of proportionality*. Not to do so is an error in principle. The Commission went on to say that:

> "In this case, we believe that the Decision lacked proportionality in that the IIROC Hearing Panel did not appear to appropriately take into account the small size of the registrant and its limited regulatory capital. During the hearing before the IIROC Hearing Panel, IIROC acknowledged that the Applicant was a small firm, with a risk adjusted capital of $293,000.00 as of August 31, 2010. The Applicant had been in early warning since June 2010. In our view, a penalty of $100,000.00 is not appropriate to the size of the firm and it regulatory capital. A penalty of that size would be considered a minor deterrent to a large member of the industry, but could

cause the failure of a much smaller member firm such as the Applicant."

¶ 54 The second area of concern expressed by the Panel was the issue of whether or not the Remedial Steps and Lilly's rewrite of the CCO examinations, both to be completed by October 30th, 2016, held a realistic prospect of being completed or of offering the investing public the protection that penalties were designed to achieve. In this respect, the Panel took some comfort from the fact that another compliance staff member, in addition to Mr. Lilly, would be hired for the purpose of augmenting the compliance regime at D&D. In this respect, the Panel noted the funds to hire further personnel had been set aside prior to the time of this hearing. Finally, the Panel was persuaded by the submissions of Staff that if the terms of the settlement agreement to which the Respondents had agreed were not complied with, there were clear provisions under Rule 20.42 and 20.45 pursuant to which an expedited hearing might be held to impose any of the significant penalties described in Rule 20.45, should the Respondent fail to comply with the terms of the present settlement agreement.

¶ 55 The Panel also considered that the administrative shortcomings identified at the subject registrant were restricted to three distinct areas, being (a) controls for avoiding misuse of confidential information; (b) conflicts of interest and outside business activities; and (c) retail account supervision. It was further noted that in this particular circumstance, there had not been client complaints against D&D during the period at issue, nor was there any evidence of client harm. Further, the Respondents did not have a disciplinary history. The Panel also noted that the Respondents had voluntarily undertaken to complete the remedial steps, including increasing the resources invested in compliance at D&D. Specifically, D&D is taking steps to hire a qualified individual in the compliance area and has specifically budgeted funds for additional compliance staff. Their plan is to double the size of the compliance staff from one to two individuals. The recent addition of a well qualified second director familiar with compliance and the undertaking of the registrant to complete the Remedial Steps detailed above, will in the minds of the Panel, increase the prospect of achieving compliance.

RESULT

¶ 56 Accordingly, for all the above reasons, the Hearing Panel, after some hesitation, agreed to accept the settlement agreement herein.

Dated at Toronto, Ontario, this 28th day of September, 2016.

Fred Chenoweth, Chair

Selwyn Kossuth

Lou D'Souza

# SETTLEMENT AGREEMENT

## I. INTRODUCTION

1. IIROC Enforcement Staff ("Staff") and the Respondents, D&D Securities Inc. ("D&D") and Patrick Lilly ("Lilly") (together, the "Respondents"), 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 ("the Investigation") into the conduct of the Respondents.

3. The Investigation discloses matters for which the Respondents 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 Respondents jointly recommend that the Hearing Panel accept this Settlement Agreement.

5. The Respondents admit to the following contravention of IIROC Dealer Member Rules:

   a) From 2011 to 2014, the Respondents failed to ensure compliance with regulatory requirements with respect to (a) avoiding misuse of confidential information, (b) identifying, managing, and disclosing conflicts of interest, potential conflict of interest, and Outside Business Activities ("OBA"), and (c) supervising retail accounts, contrary to IIROC Dealer Members Rules 38, 18.14, and 2500.

   b) From January 2012 to May 2015, Patrick Lilly engaged in business conduct that is unbecoming a registrant by failing to ensure that D&D fulfill representations made to IIROC that it would develop and improve its sales compliance program, contrary to IIROC Dealer Member Rule 29.1.

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

   a) The Respondents shall complete the Remedial Steps (described in paragraph 52) by October 30, 2016, and shall report by that date on completion and execution to IIROC's Vice-President of Enforcement, and as thereafter required by the Vice-President of Enforcement to ensure that the Remedial Steps are completed satisfactorily;

   b) Lilly shall successfully re-write the CCO examination by October 30, 2016;

   c) D&D shall pay a fine of $15,000; and

   d) Lilly shall pay a fine in the amount of $7,500.

7. D&D agrees to pay costs to IIROC in the sum of $5,000.

## III. STATEMENT OF FACTS

### (i) Acknowledgment

8. Staff and the Respondents 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

9. In 2011, 2013, and 2014, IIROC Compliance Staff examined D&D for compliance with regulatory requirements. At each examination, D&D was found to have deficiencies that were both "Repeat" and "Significant" relating to:

   a) controls for avoiding the misuse of confidential information;

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10. Despite representations by Lilly that these deficiencies had been, or would be, addressed by D&D, some of the deficiencies persisted. In 2015, Lilly failed to respond to Compliance Staff in a timely and adequate manner.

### B. The Respondents

11. D&D is registered as a Dealer Member with IIROC. D&D is primarily engaged in investment banking and advisory activities, however it also maintains retail clients.

12. Lilly is the President, CEO, UDP, CCO, and a Director of D&D. Lilly first became registered with D&D in 2008 as CCO and assumed the roles of UDP and CEO in 2011.

**C. Compliance Reviews**

13. The IIROC Business Conduct Compliance ("BCC") and Trading Conduct Compliance ("TCC") groups conduct periodic reviews of IIROC Dealer Member firms to assess their compliance with IIROC requirements. The review by BCC is referred to as a Business Conduct Examination or "BCE". Where BCC and TCC conduct a review together, it is called an Integrated Compliance Examination or "ICE". BCC and TCC are referred to collectively herein as "Compliance Staff".

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16. The Member is required to provide a written response to the BCE or ICE within a specified timeframe indicating what corrective measures will be taken (the "Response"). IIROC expects that any representations made in the Response will be fulfilled and that the Member's CCO and UDP will ensure that appropriate action is taken and completed expeditiously in accordance with representations given on behalf of the Member.

17. Compliance Staff maintains an on-going dialogue with Members to resolve issues identified in the BCE and ICE Reports. If issues are not remedied by the subsequent BCE or ICE, they will be identified in future examinations as "Repeat".

**D. D&D Examinations**

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19. Each of the above noted Reports was addressed to Lilly as UDP and CCO and each of D&D's Responses was signed by Lilly. Lilly was the primary D&D contact for all of the compliance reviews.

20. The 2011 BCE Report contained a number of Repeat findings from previous years. There were Repeat findings in the 2011, 2013, and 2014 examinations that remained unresolved, despite assurances by Lilly.

**E. Compliance Deficiencies**

*(a) Deficient Controls for Avoiding Misuse of Confidential Information*

21. The 2011 BCE and the 2013 and 2014 ICEs identified concerns about the placement, timing, and monitoring of securities on D&D's Grey and Restricted Lists. This was a Repeat Significant Item that had been raised with predecessors of Mr. Lilly at D&D in the 2003, 2005, and 2008 reviews.

22. The 2011 BCE indicated that in 2009 and 2010, there were delays in adding issuers to the Grey and Restricted Lists, as follows:

    a) With respect to one issuer, D&D prepared a proposed letter of engagement on December 15, 2009, however the issuer was never added to the Grey List and was only added to the Restricted List on December 24, 2009, when the letter of engagement was delivered; and

    b) With respect to a second issuer, D&D communicated an expression of interest in an underwriting deal on December 2, 2010, however this issuer was not added to the Grey List until December 17, 2010.

23. In the 2011 Response, Lilly represented that steps had been taken to log and document Grey and Restricted listings as far as practicable and that D&D policies and procedures had been revised to better contain confidential information.

24. D&D advised that in 2011, it spent significant time and funds moving the firm to an automated compliance system. D&D first engaged and implemented an automated system from Subserveo. It then engaged and implemented a system from Positon Watch. These systems were to assist in the monitoring of grey and restricted list matters. The new systems did not do automated "look-back" checks for trading done in a security before it was added to the Grey or Restricted List but they permitted manual viewing of historical trades in securities that had been listed.

25. In the 2013 ICE, Compliance Staff identified trading of securities on the Grey and Restricted Lists which was not queried. In late 2011 and 2012, SI, a D&D compliance employee who was responsible for maintaining the Grey and Restricted Lists and reported to Lilly, traded securities of two issuers in his personal account after they had been added to the Grey List. Specifically:

    a) On February 9, 2012, Lilly added the first issuer to the Restricted List. On March 28, 2012 at 10:50 a.m., SI removed the issuer from the Restricted List, but he backdated the removal to 10:00 a.m. At 10:51 a.m., SI added the issuer to the Grey List, however he did not backdate that change. SI's actions created a 50 minute gap from 10:00 to 10:51 a.m. where trades would not be flagged on the following day's exception report. On March 28, 2012, at 10:16 a.m. SI sold holdings in the issuer in his personal account. When the sale was entered, the security was on the Restricted List, however by backdating its removal, SI concealed his trading in a Restricted security.

    b) On November 10, 2011, SI purchased units in an issuer. On November 11, 2011 at 10:01 a.m., Lilly directed SI to add the issuer to the Grey List, and indicated that it was likely to move to Restricted later that day. At 10:09 a.m., SI sold his units, prior to adding the issuer to the Grey List at 10:22 a.m.

26. There were no queries of the above trades by Lilly or anyone else at D&D. Lilly advised Staff that he was not aware of the trading until it was raised by BCC during the 2013 ICE.

27. SI's conduct was contrary to the policies and procedures of D&D. SI's employment with D&D was terminated in March 2014.

28. In the 2013 Response, Lilly represented that D&D's Policies & Procedures would be edited to provide for daily queries as to whether trading had occurred and that D&D was exploring more timely alternatives for adding matters to the Grey and Restricted Lists. D&D retained Risk Management Services Inc. ("RMS"), and corporate counsel to review, recommend and revise its policies and procedures and D&D did revise its policies and procedures based on RMS's review and

recommendations.

29. However, in the 2014 ICE, BCC and TCC again identified concerns about the timeliness with which items were added to the Grey and Restricted list, and supervision of trading in securities on the lists, similar to the concerns that had been identified in the 2011 BCE and 2013 ICE.

*(b) Conflicts of Interest and Outside Business Activities*

30. The 2011 BCE identified concerns with respect to Conflicts of Interest and OBAs. In particular, D&D was unable to provide a current list of registrants involved in OBAs and there were no formal procedures outlining the review process of OBAs, despite a written policy requiring D&D to implement processes for disclosure, identification, approval and supervision of OBAs.

31. In response, Lilly indicated that a "sweep" of all registrants was completed in 2010, declarations were logged and filed, and that such a "sweep" would be formally implemented going forward.

32. The 2011 BCE also identified a failure to supervise a conflict of interest for a disclosed OBA by a D&D employee who was on the board of a publicly traded company. Lilly told Enforcement Staff that there was no trading of that issuer at D&D but this was inaccurate. Lilly was aware of the employee's OBA and potential conflict of interest, but did not take steps to monitor and supervise it.

33. In the 2013 ICE, BCC found that, although D&D registrants were canvassed as to their OBAs in 2011, five registrants failed to complete the 2011 Annual Disclosure Form and thus the canvass was not complete. Moreover, D&D failed to canvass its registrants as to their OBA in 2012. Finally, there were no formal procedures for the process of vetting and approving OBA.

34. Lilly was responsible for maintaining and updating the National Registration Database ("NRD"), however OBAs for at least two D&D registrants that were disclosed to D&D in the 2011 canvass were not filed on NRD.

35. In the 2013 Response, Lilly advised that the 2012 annual canvass was delayed and conducted shortly after the 2013 ICE with a more robust document, and that the 2013 canvass was being conducted concurrent with the preparation of the 2013 Response. Lilly also advised that he would update NRD over the holiday period.

36. However, in the 2014 ICE, BCC again found that 5 employees had not completed the 2013 Annual Disclosure Form, and that NRD had not been properly updated to reflect the current status of OBAs.

*(c) Retail Account Supervision*

37. In the 2011 BCE, BCC indicated that significant discrepancies were found between core Know Your Client ("KYC") information found on client New Account Information Forms ("NAAFs") and the information coded on D&D's internal electronic system. Thus, the KYC information on the electronic system could not be relied upon for supervisory review or making recommendations to clients. Further a number of NAAFs were outdated. BCC directed D&D to undertake to review all client files to ensure the integrity of its KYC data.

38. In D&D's 2011 Response, Lilly represented that the discrepancies arose from a system changeover and that the corrected KYC information had been recovered, reviewed and uploaded. Lilly also stated that "data integrity checking is proceeding". He subsequently represented in his Follow-Up Response that the KYC data "appears to have been corrected".

39. Commencing in 2011 a data sweep was conducted to review client account data for active files. An individual was hired to assist in this matter. During the process account data was updated and approximately 600 accounts were closed.

40. Despite the foregoing efforts, similar issues were identified in the 2013 ICE. BCC sampled 25 retail accounts and found that for nine accounts, NAAFs were incomplete and for eight accounts there were

inconsistencies between client investment objectives and risk tolerance stated on the NAAFs and D&D's electronic recordkeeping system.

41. In the 2013 Response, Lilly indicated that D&D was preparing a "KYC documentation project for Q1 of 2014" and that changes would be closely monitored and documented to ensure that the back office system matched the client file.

42. However, it appears that steps taken by D&D and Lilly were ineffective since in the 2014 ICE, BCC identified 12 retail accounts, out of a sample review of 20, in which there were discrepancies between the NAAFs and D&D's electronic system.

43. BCC also identified suitability concerns in seven of the 25 retail accounts sampled in the 2013 ICE where the client's portfolio did not seem to match the risk tolerance and objectives recorded in the client's NAAFs. Neither Lilly nor anyone at D&D queried the allegedly unsuitable holdings, even after the 2013 ICE was delivered.

**Lilly Failed to Respond to Compliance Inquiries in a Timely Manner and Fulfill Representations to IIROC**

44. The 2014 ICE was delivered to D&D and Lilly on January 21, 2015 with a Response required by March 6, 2015.

45. Lilly did not respond to the 2014 ICE by March 6, 2015. He did not request an extension or make any attempt to speak with BCC about the delivery of D&D's Response before the due date.

46. On March 11, 2015, Compliance Staff inquired as to the status of the Response and reasons for failure to reply. On March 13, 2015, Lilly advised that he had been busy with other priorities, and that his consultant had been working on another assignment, but was now working with D&D and that there would be a further update after a meeting scheduled for March 16. Following the March 16 meeting, Lilly advised BCC that he was working with his consultant and would update BCC further later that week.

47. On March 19, 2015, Lilly delivered an annotated version of the 2014 ICE with some comments. Lilly's annotations did not fully address the deficiencies identified in the ICE. Lilly later acknowledged to Staff that his response was inadequate.

48. Between March 19 and May 20, 2015, Lilly submitted additional material to Compliance Staff by email. However, on May 20, 2015, Compliance Staff advised that the submissions were "unclear" and requested a summary indicating how each deficiency was addressed. Lilly assured that such a summary was "in progress", however no summary was ever delivered.

49. As described herein, Lilly represented to Compliance Staff in D&D's Responses that each of the deficiencies at issue in these proceedings had been, or would be, addressed. However, the deficiencies persisted indicating that the representations were not fulfilled.

## F. Mitigating Factors

***Remedial Steps***

50. The Respondents have committed to increasing the resources invested in compliance at D&D. Specifically, D&D is taking steps to hire a qualified individual and has specifically budgeted funds for additional compliance staff.

51. D&D has also recently appointed an additional Director to its Board of Directors, formerly comprised only of Lilly.

52. The Respondents specifically undertake to take the following remedial steps to remedy the deficiencies at issue in this Settlement Agreement (collectively, the "Remedial Steps"):

a) With respect to avoiding misuse of confidential information, the Respondents shall:

i. Review D&D's policies, practices and procedures regarding adding securities to the Grey and Restricted list and provide the results of the review and details of any steps taken or planned to ensure that securities are added in a timely manner and that trading is appropriately supervised;

ii. Develop and deliver a training session for all D&D registrants with respect to adding securities to the Grey and Restricted lists, and trading in such securities;

b) With respect to identifying, managing and disclosing conflicts of interest, potential conflicts of interest, and OBA, the Respondents shall:

i. Review, update and implement D&D's policies, practices and procedures for the identification, disclosure, approval and supervision of conflicts of interest and OBA;

ii. Forthwith survey all D&D registrants and explain any measures implemented to address existing conflicts and/or OBAs;

iii. Update NRD to be consistent with the results of the survey;

c) With respect to supervising retail accounts, the Respondents shall:

i. Ensure that D&D's Know Your Client ("KYC") information is accurate and current for all clients who have traded in the last two years; and

ii. Confirm that the KYC information on D&D's electronic record-keeping system matches the documentation signed by the client and implement any changes required to achieve consistency between the electronic system and client documentation.

53. In agreeing to the penalty proposed at paragraph 6 of this Settlement Agreement, Staff has considered the commitment of resources and planned expenditures to be incurred by D&D in hiring additional compliance staff and completing the Remedial Steps.

***No Client Harm***

54. There have been no client complaints against D&D during the period at issue and there is no evidence of client harm.

***No Disciplinary History***

55. The Respondents do not have any disciplinary history.

## IV. TERMS OF SETTLEMENT

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

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

58. 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.

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

60. 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.

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

62. 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.

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

64. 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 "4th" day of August, 2016.

**"Witness"** **"D&D Securities Inc."**

**Witness** **D&D Securities Inc.**

**AGREED TO** by the Respondent at the City of "Toronto" in the Province of "Ontario", this "4th" day of August, 2016.

**"Witness"** **"Patrick Lilly"**

**Witness** **Patrick Lilly**

**AGREED TO** by Staff at the City of Toronto in the Province of Ontario, this "11" day of August, 2016.

**"Witness"** **"Elissa Sinha"**

**Witness** **ELISSA SINHA**

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 "31st" day of "August", 2016, by the following Hearing Panel:

Per: "Fred Chenoweth"

Panel Chair

Per: "Lou D'Souza"

Panel Member

Per: "Selwyn Kossuth"

Panel Member