

# Re Axford

IN THE MATTER OF:

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

**and**

**Derek George Laidlaw Axford**

2013 IIROC 36

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

Heard: June 10, 2013

Decision: June 10, 2013

## **Hearing Panel:**

The Honourable Fred Kaufman, C.M., Q.C., Chair, Mr. Peter Bailey and Mr. Peter Gribbin

## **Appearances:**

Diana Iannetta, Enforcement Counsel

Melissa MacKewn, for the Respondent

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## **REASONS FOR THE DECISION RENDERED AT THE CONCLUSION OF THE HEARING**

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¶ 1 IIROC Enforcement Staff and Derek George Laidlaw Axford (the “Respondent”), having reached agreement on the disposition of two contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies alleged against the latter, submitted a Settlement Agreement to the Panel on June 10, 2013. At the conclusion of the hearing, having heard from both parties, the Panel accepted the Agreement, reasons to follow, and these are the reasons.

### **Introduction**

¶ 2 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 the IDA to carry out its regulatory functions, and the Respondent consents to be subject to the jurisdiction of IIROC.

¶ 3 An investigation carried out by IIROC revealed that:

- i. from April 2010 to August 2011, in the manner described below, the Respondent failed to use due diligence to ensure that investment recommendations were suitable for his clients, contrary to IIROC Dealer Member Rule 1300.1(q); and
- ii. from April 2010 to August 2011, in the manner described below, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to orders accepted, when his clients purchased certain inverse exchange traded funds, contrary to IIROC Dealer Member Rule 1300.1 (a).

¶ 4 The Rules provide as follows:

**1300.1**

**Identity and Creditworthiness**

- (a) Each Dealer Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.  
.....
- (b) Each Dealer Member, when recommending to a client the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such client based on factors including the client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account or accounts' current investment portfolio composition and risk level.

**The Facts**

¶ 5 The facts of this case, as set out in the Settlement Agreement, are as follows:

**A. Acknowledgment**

- 1. 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.

**B. Overview**

- 2. Axford recommended the purchase of certain inverse exchange traded funds (defined herein as the "IETFs"), which are described in the prospectuses as riskier or highly speculative securities, to clients who had only a medium or medium high risk tolerance noted on their "Know Your Client" forms.
- 3. Axford did not believe the IETFs were high risk securities.
- 4. As set out below, Axford's recommendations to clients to purchase the IETFs was based on his view that securities were generally over-valued and accordingly, the markets would decline. The purchase of the IETFs was intended to take advantage of that decline and reduce clients' exposure to the long equities market.
- 5. For the reasons set out herein, Axford failed to ensure that, during the relevant periods, his recommendation to clients to purchase the IETFs was suitable for them.

**C. Registration History**

- 6. Axford was first registered with the IDA in 2002 and became a registrant of IIROC on June 1, 2008.
- 7. Axford holds a Bachelor of Science degree in Applied Mathematics.
- 8. Axford was employed with RBC Dominion Securities Inc. ("RBCDS") from January 2002 to March 2012, when he resigned.
- 9. Axford is currently employed with Worldsource Securities Inc. as a Registered Representative.

**D. IETFs and Axford's Strategy**

- 10. ETFs are securities that trade on an exchange that track the performance of an underlying benchmark or index. The underlying assets to the benchmark or index may be stocks, bonds or other assets such as commodities.
- 11. "Inverse" or "short" ETFs, seek to deliver the opposite of the performance of the index or

benchmark they track. The holdings in these funds include equities, but can also include derivatives including swaps and forward contracts.

12. The IETFs at issue are the ProShares Short S&P 500 (the “ProShares IETF”) and the Horizons BetaPro S&P/TSX 60 Inverse ETF (the “Horizons IETF”) (collectively referred to herein as, the “IETFs”).
13. The prospectus for the ProShares ETF states that the fund was riskier than similarly benchmarked exchange-traded funds that do not use leverage.

*The Fund is different from most exchange-traded funds in that it seeks inverse returns and only on a daily basis. The Fund also is riskier than similarly benchmarked exchange-traded funds that do not use leverage. Accordingly, the Fund may not be suitable for all investors and should be used only by knowledgeable investors who understand the potential consequences of seeking daily inverse investment results. Shareholders should actively monitor their investments.*

14. The prospectus for the Horizons IETF describes the fund as highly speculative and involving a high degree of risk.

*Units of the ETFs are highly speculative and involve a high degree of risk, some not traditionally associated with mutual funds. No ETF by itself constitutes a balanced investment plan. An investor may lose a portion or even all of the money that he or she places in an ETF.*

...

*The risk of loss in trading derivatives can be substantial. In considering whether to buy Units of an ETF, the investor should be aware that trading derivatives can quickly lead to large losses as well as large gains. Such trading losses can sharply reduce the net asset value of an ETF and consequently the value of an investor’s Units in the ETF. Market conditions may also make it difficult or impossible for an ETF to liquidate a position.*

15. In or about early 2010, Axford formed the view that stocks were overvalued and that the market was going to decline. This view was based on Axford’s detailed macroeconomic assessment of the value of securities in the market from such metrics as: (a) the Shiller CAPE 10 Ratio; (b) Tobin’s Q Ratio; and (c) the Market Cap to GDP Ratio. Axford also considered the then record level of consumer debt both in the United States and Canada.
16. As a result of his analysis, Axford recommended to clients that they re-balance their portfolios by selling their long equity positions and investing the proceeds in a combination of: (a) cash; (b) low risk securities; and (c) the IETFs. Pursuant to this strategy the positions in the IETFs were the largest of the three categories, often comprising over 50% of the client’s account.
17. Prior to recommending his strategy, Axford prepared, for his own use, a financial model to demonstrate the potential effects on the return that would be achieved on the IETFs if the market moved up or down. This model took into account the daily resetting and cumulative features of the IETFs.
18. In Axford’s view, this strategy would decrease his clients’ risk exposure.
19. Despite the statements in the prospectuses and other research, Axford was of the view that the IETFs were not riskier or highly speculative products.

#### **E. AB’s Accounts**

20. AB is currently 77 years old, and retired. Prior to retirement, she was a registered nurse for 45 years.
21. In late 2003, AB opened a Registered Retirement Investment Fund (RRIF) account at RBCDS

with Axford as her investment advisor. In early 2005, she opened a cash account at RBCDS, also with Axford as her investment advisor.

22. In May 2008, Axford asked AB to update her New Account Application Form (“NAAF”). The NAAF for the RRIF account indicated that AB had “limited” investment knowledge, and recorded her Investment Objectives and Risk Factors as follows:

*Investment Objectives:*

- 20% Income
- 0% Long Term Growth
- 40% Medium Term Growth
- 40% Short Term Growth

*Risk Factors:*

- 20% Low
- 60% Medium
- 20% Medium-High
- 0% High Risk

23. In January 2009, AB opened a Tax Free Savings Account (TFSA). The NAAF for this account recorded her Investment Objectives and Risk Factors as follows:

*Investment Objectives:*

- 50% Long Term Growth
- 50% Short Term Growth

*Risk Factors:*

- 100% Medium-High

24. In April 2010, based on the analysis described above, Axford recommended his strategy to AB, including the purchase of the IETFs in AB’s RRIF and TFSA accounts.
25. As a result, in April 2010, the IETFs comprised approximately 57% of AB’s RRIF account. Horizons IETF, which was purchased in the TFSA, comprised approximately 95% of that account.
26. Four to six months after the purchase, both IETFs began to decline in value. AB became concerned about the decline and Axford advised her to continue to hold the IETFs as he viewed them as longer-term investments.
27. In or around April 2011, AB instructed Axford to sell the IETFs in both accounts. By this date, she had held them in her account for almost one year.
28. Axford voluntarily provided a commission discount to AB of at least \$1,600, on the sale of the IETFs.
29. AB suffered losses on the sales of the IETFs but achieved a positive annualized return on her overall portfolio for the duration of time that she was Axford’s client.
30. Axford knew and understood that AB had only medium and medium high risk tolerance noted on her NAAF and did not have any high risk tolerance noted.
31. Axford was of the view that his strategy would decrease the risk level of AB’s account and that it was appropriate for AB to hold the IETFs on a longer-term basis.

32. Both IETFs were described in their prospectuses as riskier or highly speculative securities. Each involved taking a view that the market would generally decline. Large positions in these securities were not suitable for AB based on the risk tolerance she noted on her NAAFs.
33. Based on the foregoing, Axford failed to use due diligence to ensure that his recommendations were suitable for AB based on her investment objectives and risk tolerance, contrary to Dealer Member Rule 1300.1(q).

**F. The IETFs Recommended to Other Clients**

34. In addition to AB, pursuant to his strategy, Axford recommended and purchased the IETFs in a significant number of other accounts for clients who did not have a stated tolerance for high risk, or had a minimal tolerance for high or higher than medium risk stated on their NAAFs. The purchases were made as part of the strategy discussed above. In most cases, this resulted in large concentrations of the IETFs purchased in these accounts.
35. 36 other clients with no tolerance for high risk investments recorded on their NAAFs purchased the same two IETFs.
36. A number of these clients suffered losses as a result of their purchasing and holding the IETFs, although they also achieved gains from the other investments in the accounts (such as government bonds, GICs and money market funds).
37. Based on the foregoing, during the material time, Axford failed to use due diligence to ensure that his recommendations were suitable for these clients based on their investment objectives and risk tolerance as stated on their NAAFs, contrary to Dealer Member Rule 1300.1(q). He also failed to fully appreciate the risk profile of the IETFs, contrary to Dealer Member Rule 1300.1(a) during the material time.
38. Axford has cooperated with IIROC throughout its investigation.
39. Axford states that he always acted in what he believed to be in each of his clients' best interests.

**Terms of Settlement**

¶ 6 The terms agreed upon by Staff and the Respondent are as follows:

- (a) a suspension from approval in any registered capacity with IIROC for a period of four months;
- (b) a fine of \$30,000;
- (c) a requirement that the Respondent successfully complete the Conduct and Practices Handbook ("CPH") course prior to seeking re-registration; and
- (d) a requirement that the Respondent be placed under close supervision for a period of six months upon re-approval.

The Respondent also agreed to pay costs to IIROC in the amount of \$2,500.

**Discussion**

¶ 7 It is well settled that a hearing panel, in assessing the sanctions agreed upon by the parties, will examine whether or not they "strike a reasonable balance between fairness to the Respondent in the circumstances and the need to protect the investing public, the industry membership, the integrity of the discipline process, the integrity of the securities market and prevention of a repetition of the offence" (*Re Bereskin*, 2010 IIROC 37). Or, as was said in *Re Milewski*, [1999] IDACD No. 17, the penalties set out in a settlement agreement should not be set aside unless they "clearly fall outside a reasonable range of appropriateness."

¶ 8 In assessing what is a "reasonable range," panels are guided by a number of factors, including the IIROC Dealer Member Disciplinary Sanction Guidelines, previous regulatory decisions in similar

circumstances, the harm caused to clients, the degree of blameworthiness of the respondent, the extent to which the respondent was enriched by the misconduct, the existence, if any, of a prior disciplinary record, and the acceptance of responsibility, including co-operation and remorse.

¶ 9 For breaches of the type in issue in this case, the Guidelines recommend a minimum fine of \$10,000, disgorgement of profits, a rewrite of the CPH examination, a period of close and/or strict supervision and, in egregious cases, a period of suspension.

¶ 10 As stated above, the Respondent recommended the securities in question to 37 clients with no tolerance for high risk investments, resulting in losses to a number of them. However, we are satisfied that his conduct, while wrong, was not manipulative or fraudulent, and that he acted in what he believed to be the best interests of his clients. Also, although he earned commissions on the sales, there is no evidence that this was his motivation.

¶ 11 The Respondent has been registered with IIROC since 2002 and he has no prior disciplinary record. He has admitted that his conduct was in violation of IIROC Dealer Member Rules, and he has co-operated fully with IIROC, thereby avoiding a long and costly investigation, as well as a lengthy (and again costly) hearing.

¶ 12 The proposed penalties fall within the range sanctions imposed in similar cases, where fines have ranged from \$20,000 to \$200,000, where suspensions ranged from none to seven years, where rewrites of the CPH examination were required and where, in some cases, suspensions were ordered. (See *Re Delacourt & Stewart*, 2011 IIROC 69; *Re Dyck*, 2012 IIROC 31; *Re Hanna*, 2012 IIROC 71; *Re Jones*, 2012 IIROC 48; *Re Beaulne*, 2012 IIROC 61; *Re Kasten-Brown*, 2011 IIROC 73, and *Re Gareau*, [2005] IDACD No. 25.

## **Conclusion**

¶ 13 As stated in the Guidelines, “the core of a registered representative’s business activity is to make recommendations to his/her clients,” and “registrants have a basic duty to ensure that the recommendations are suitable, and in accordance with the clients’ investment objectives and risk factors.” This is a fiduciary duty, and “a registrant who makes unsuitable recommendations has breached his/her fiduciary duty owed to the client. Put differently (and again in the words of the Guidelines), where “recommendations are unsuitable for the client, the registrant has breached his position of trust and failed to fulfil the most basic of responsibilities towards the client.”

¶ 14 Considering all relevant factors, we concluded that the proposed settlement fell within a “reasonable range” and should, therefore, be accepted.

Given in Toronto, Ontario, this 10th day of June 2013.

Hon. Fred Kaufman, Chair

Peter Bailey

Peter Gribbin

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