

Re Suppal

IN THE MATTER OF:

The By-Laws of the Investment Dealers Association of Canada (IDA)

and

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

and

Ravindra Kumar Suppal

2014 IIROC 45

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

Heard: October 9- 12, 2012 in Winnipeg, Manitoba
Written Submissions Completed: November 15, 2012
Decision and Reason: June 10, 2013
Penalty Heard: December 5, 2013
Penalty Decision: February 10, 2014
Penalty Decision Reasons: September 30, 2014

Hearing Panel:

Thomas J. D. Kormylo (Chair), William Welton, Claude Tétrault

Appearances:

Tayen Godfrey and Gil Gauthier, for IIROC
Ravindra Kumar Suppal, Respondent

PENALTY DECISION REASONS

I. INTRODUCTION & SUMMARY

¶ 1 In its Decision and Reasons issued on June 10, 2013, this Panel found that all three contraventions alleged in the Notice of Hearing issued by IIROC on June 26, 2012 were proven to the required standard.

¶ 2 The contraventions proven were as follows:

Count 1

From June of 2005 until April of 2010, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to an account (the "**Account**") established for the Chemawawin First Nation Development Trust (the "**Trust**") contrary to IIROC Rule 1300.1(a) IDA Regulation 1300.1(a) prior to June 1, 2008).

Count 2

From May 2007 until April 2010, the Respondent made unsuitable trades in the Account of the Trust contrary to IIROC Rule 1300.1(q) (IDA Regulation 1300.1(q) prior to June 1, 2008).

Count 3

From September 2009 until April 2010, the Respondent made unauthorized trades in the Account of the Trust contrary to IIROC Rule 29.1.

¶ 3 In this Panel's Decision and Reasons, it reviewed the allegations in IIROC's Notice of Hearing statement of particulars and considered the circumstances surrounding the actions of the Respondent which led to the contraventions, which can be briefly summarized as follows:

Three individual First Nation Trustees of a Trust formed by a First Nation for the purpose of supporting the future development of the First Nation and the First Nation members, approached the Respondent for investment advice in connection with the investment of funds of the Trust. The Trust Indenture governing the operation of the Trust contained certain guiding principles which required that the initial settlement amount be preserved in perpetuity and that the Trust's investment policy be dedicated to safety of the capital of the Trust in perpetuity. The Trust Indenture required that in making decisions for the Trust, the Trustees act by a majority of the four Trustees, with the Corporate Trustee being one of the majority. The Respondent proceeded to open an investment account for the Trust naming only the First Nation Trustees as persons authorized to give investment instructions on behalf of the Trust. The Respondent ultimately invested substantially all the funds of the Trust in the Account in 123 mutual funds.

¶ 4 Following a hearing held on December 5, 2013 (the "**Penalty Hearing**"), this Panel issued its Penalty Decision on February 10, 2014 and ordered the following sanctions against the Respondent:

- (a) A global fine of \$150,000 in respect of all charges, inclusive of disgorgement of commissions earned in the amount of \$137,000, payable upon such terms as IIROC may permit;
- (b) A one year suspension from registration with IIROC, provided that the Respondent shall not thereafter be registered until successfully re-writing Conduct and Practices Examination;
- (c) A three year period of close supervision upon becoming registered and returning to the industry following the expiration of the period of suspension, and during such three year period, the Respondent shall not hold the position of branch manager or compliance manager with any Member Firm; and
- (d) The Respondent shall pay costs in the amount of \$20,000 to IIROC upon such terms as IIROC may permit.

¶ 5 The implementation of the sanctions ordered by the Panel was deferred for 30 days until March 13, 2014, when they became effective, to allow the Respondent an opportunity to appeal the Penalty Decision should he so choose.

¶ 6 At the time the Penalty Decision issued, this Panel advised that its reasons for imposing the penalties would follow. The reasons are now set out below.

II. FACTORS TO BE CONSIDERED WHEN ASSESSING A PENALTY

¶ 7 Prior to the Penalty Hearing, the Panel was provided with the IIROC Staff Hearing Book which included the Dealer Member Disciplinary Sanction Guidelines (the "**Guidelines**") issued by IIROC. The Guidelines are comprised of a "General Principles" section, which provide a framework for assessing the gravity of a particular breach and include a list of "Key Considerations" relating to the imposition of sanctions applicable to the specific breaches of the rules committed by the Respondent, as well as the sanctions recommended by IIROC for breaching such rules.

¶ 8 IIROC Counsel and the Respondent each provided the Panel with prior decisions of other panels for the purposes of illustrating how the Guidelines, the General Principles and the Key Considerations had been applied to specific fact situations by those panels.

¶ 9 The decisions provided by the Respondent, for the most part, involved decisions imposed by panels following settlements and accordingly, although considered by the Panel, they were not as helpful as the decisions made by panels following a hearing. The Panel noted, and the Respondent acknowledged at the

Penalty Hearing that several cases submitted by the Respondent for the Panel's consideration were not overly helpful, because the nature of the conduct was quite dissimilar to the present situation. The Panel is cognizant of the fact that the decisions referred to us by IIROC Counsel and the Respondent are not decisive. The Panel acknowledges, however, that penalty decisions should be consistent with penalties imposed by other panels in similar circumstances.

¶ 10 The Panel fully appreciates that neither the Guidelines nor the suggested sanctions are binding on it and that the Panel has significant latitude when considering the General Principles and the Key Considerations identified by IIROC and it can freely exercise its discretion when determining the appropriate sanctions to be imposed upon the Respondent.

¶ 11 The decision in *Re Gareau* 2011 IIROC 72, referred to us by IIROC Counsel, includes the following observation of the panel in that case regarding the purpose of the Guidelines which this Panel endorses:

"The publication of sanction guidelines is an approach that has been adopted by other regulatory bodies. The goal is that hearing panels treat such guidelines as indicative of industry expectations and as relevant to a penalty determination, although they are neither exhaustive nor determinative. The guidelines do not prescribe specific results but set out factors that panels should take into account in determining penalties. The guidelines are careful to preserve the individualization of sanctions and not suggest a blanket approach. In part 2 of the Sanction Guidelines at page 8 it states:

Sanctions should be based on the circumstances of the particular misconduct by a Respondent with an aim at general deterrence.

Emphasis is placed on investor protection and market integrity. The guidelines say:

Registrants who choose to act in ways that threaten the integrity of the capital markets must have the expectation that they will be held accountable through enforcement action by regulators.

Thus in addition to the individual circumstances of a Registrant who is subject to sanctions, there is an overall public policy goal and objective that must be taken into account by panels when they are fashioning disciplinary sanctions for infractions of IIROC's regulations and by-laws. The balancing of these two interests underscores the very difficult tasks that a panel, such as the present one, must undertake."

¶ 12 The Guidelines endorse the concerns expressed by the panel in *Re Derivatives Services Inc.* [2000] I.D.A. No. 26, at page 3, when considering an appropriate penalty, where the panel identified the main concerns to be the following:

1. *Protection of the investing public;*
2. *Protection of the Investment Industry Regulatory Organization's membership;*
3. *Protection of the integrity of the Investment Industry Regulatory Organization's process;*
4. *Protection of the integrity of the securities markets; and*
5. *Prevention of a repetition of conduct of the type under consideration."*

¶ 13 The panels in the decisions referred to us by IIROC Counsel have accepted the approach that sanctions should be crafted with an aim towards general deterrence. The panel in *Re Wilson* 2011 IIROC 47 cited, with approval, the approach taken by the panel in *Re Harding* [2011] IIROC 65 and expressed in paragraph 26 as follows:

"As stated in the Guidelines, sanctions should be based on the particular misconduct of the respondent with an aim of general deterrence which will be achieved if a sanction strikes an appropriate balance by addressing a registrant's specific conduct, but also being in line with industry expectations."

We accept that approach.

III. SUMMARY OF FINDINGS

¶ 14 We have considered the circumstances of this case and in particular the gravity of the Respondent's misconduct and his relative responsibility in the context of the 14 Key Considerations identified in the Guidelines and have found as follows:

Harm to clients, Employer and/or the Securities Market.

¶ 15 At the Penalty Hearing, the Respondent disputed that there was any harm to his client, as there was no monetary loss and he suggested actual financial loss had to be shown in order to demonstrate harm. He referred the Panel to numerous cases where serious financial harm to clients had occurred and distinguished his situation from those cases and the penalties assessed under those circumstances. Harm under the Guidelines is, in our view, meant to involve factors other than actual monetary loss to the client. In this case there is no dispute, the Trust suffered no actual financial loss. There was, however, clearly, a high level of exposure to the client as a result of the Respondent investing essentially all of its funds in high risk investments, in complete disregard for the investment objectives under the Trust Indenture. In our view, the Respondent's conduct exposed his client to significant risk and, as a result, was harmful to his client.

¶ 16 The integrity of the securities market is dependent upon all of the participants complying with the rules and regulations of the applicable securities regulatory authorities. IIROC's regulation of its members and the enforcement of its rules is paramount to the regulatory system. The failure to maintain proper records by a member impairs IIROC's ability to audit transactions and adversely impacts the integrity of the capital markets. The Panel concluded in its Decision and Reasons that the Respondent failed to take sufficient steps to adequately know his client when opening the Account, which resulted in the Account being opened improperly, making it difficult to properly audit the Account and thereby harming the integrity of the capital markets.

Blameworthiness and Degree of Participation

¶ 17 The Guidelines provide that unintentional or negligent conduct should be distinguished from manipulative, fraudulent or deceptive conduct and that isolated incidents should be distinguished from repeated, pervasive or systemic contravention of the rules.

¶ 18 The findings of the Panel regarding the manner in which the Respondent opened the Account are summarized in the Decision and Reasons of this Panel [par. 155 and 156]. Given Mr. Suppal's education, background and experience and his admission that he fully understood the terms of the Trust Indenture, the misleading manner in which the Account was opened, in the opinion of the Panel, went beyond oversight or an innocent mistake and could not be considered unintentional or negligent, but rather, in the view of the Panel, constituted a carefully orchestrated scheme to open the Account in a manner that would avoid scrutiny and detection of the overriding effect the Trust Indenture had over the manner in which the Account was opened and the manner in which funds of the Trust were to be invested.

¶ 19 While there was no evidence that the Respondent engaged in similar conduct on other files, the intentional deception perpetuated by the Respondent in relation to the subject Account continued throughout the years he handled the Account. In this Panel's Decision and Reasons [par. 137], we concluded that the initial NAAF constituted misleading disclosure concerning the client and in essence was an attempt by the Respondent to justify not having to secure the approval of the Corporate Trustee for any trading instructions. We also considered the new NAAF subsequently prepared by the Respondent showing client objectives as 100% high risk, immediately prior to investing the proceeds of the Bond into various mutual funds, to be evidence of a continuing pattern of deception. In this Panel's Decision and Reasons [par. 184], we concluded that the Respondent proceeded with unauthorized trades throughout, knowing full well that the Trust Indenture required decisions of the Trust to be authorized by the Trustee.

¶ 20 The Respondent is well educated with a long history in the industry. There are no extenuating circumstances or mitigating factors which affected the Respondent's blameworthiness.

Degree of Participation

¶ 21 The Guidelines indicate a distinction should be drawn between direct perpetrators and those with a lesser level of complicity. The Respondent in this case was the direct perpetrator of the misconduct, which he

acknowledged at the Penalty Hearing and in his written submission.

Extent to which the Respondent was Enriched by the Misconduct

¶ 22 There is no question the Respondent earned substantial commission as a result of his misconduct in investing the funds of the Trust over the period in question. According to the evidence (which was not refuted), the redemption of the Bond generated income to the Respondent, and the reinvestment of the proceeds into 123 mutual funds generated commission of \$137,000 to him. The Respondent submitted at the Penalty Hearing that part of those earnings (approximately \$28,000 in commissions and \$8,000 of the \$40,289 generated from the sale of the bond) were shared with his Broker. There was no independent evidence in that regard produced by the Respondent at the initial hearing or at the Penalty Hearing. While the Respondent claimed to have the best interests of the beneficiaries of the Trust in mind when he invested the funds of the Trust in inappropriate investments, there is no question he was enriched to a very considerable extent as a result of his misconduct.

Prior Disciplinary Record

¶ 23 The Respondent has been in the industry for 35 years without any history of prior disciplinary misconduct with IIROC or the IDA. There is no evidence of any subsequent disciplinary matters.

Acceptance of Responsibilities, Acknowledgment of Misconduct, Remorse

¶ 24 The Respondent has taken no responsibility for his misconduct and has expressed no remorse. At the initial IIROC interview and during the course of the initial hearing, there was never any acceptance of responsibility shown by the Respondent and at the Penalty Hearing, the Respondent again refused to accept responsibility for his misconduct and made it clear to the Panel that he felt he did nothing wrong. To the contrary, at the Penalty Hearing, the Respondent spent a considerable amount of time professing his innocence, despite the findings of the Panel to the contrary. In his written submission provided to the Panel at the Penalty Hearing, the Respondent stated at p. 6, par. 16, "...I do not agree with the findings against me..." and later in that same paragraph stated, "I do not expect to receive any credit on the grounds of remorse."

¶ 25 In essence, the Respondent maintains that since his compliance department did not object to the manner in which he set up and traded the Account and since the Account increased in value over the period in question, he should not be admonished for his actions. In our view, the failure of the Respondent's compliance department to delve beyond the NAAF prepared by the Respondent and appreciate the client was the Trust and that its objectives and trading were governed by the Trust Indenture is unfortunate, but does not relieve the Respondent from responsibility. Likewise, because the markets generally recovered from their low point in 2008 during the period in question does not legitimize the Respondent's misconduct.

¶ 26 The Guidelines indicate that an admission of wrongdoing by a respondent can be considered a mitigating factor, because it implies remorse and an acknowledgement of responsibility [p. 10, par. 3.6]. The Respondent has admitted no wrongdoing, shown no remorse and accepted no responsibility for his actions.

Credit for Cooperation

¶ 27 While the Respondent did not voluntarily come forward and report his misconduct, there is no evidence that he refused to cooperate with IIROC during the course of the investigation.

Voluntary Rehabilitative Efforts

¶ 28 The Guidelines indicate that remedial efforts prior to or following a decision should be taken into consideration as mitigating the seriousness of the conduct [p. 11, par. 3.8]. Inherent in that assessment of rehabilitative efforts in the Guidelines is the belief that rehabilitative efforts can be considered to be evidence of remorse. While the Respondent has advised the Panel that he has taken some courses since the complaint was lodged in September 2010 to better himself as a financial advisor, he has exhibited no remorse for his actions and, in fact, in his written submission at the Penalty Hearing he stated, "I do not expect to receive any credit on the grounds of remorse." [p.6, par.16] Notwithstanding that the Respondent filed evidence that he had successfully completed numerous courses, including the Chief Compliance Officer's Qualifying Examination on April 26, 2011, his refusal to acknowledge his misconduct at the Penalty Hearing, or show any remorse, leads

the Panel to discount the rehabilitative effect that course and the others have had on the Respondent.

Reliance on the Expertise of Others

¶ 29 The Guidelines accept that a respondent's culpability may be tempered by reliance upon others [p. 11, par. 3.9]. The Respondent maintained that he regularly sought guidance from the firm's Chief Compliance Officer, Chief Executive Officer, Vice President of Sales and Vice President of Operations [Penalty Hearing Submission p. 8, par. 21]. No evidence of such reliance was provided at the initial hearing by anyone other than the Respondent. Given the Panel's finding concerning the Respondent's credibility and the Panel's conclusions regarding the Respondent's deliberate attempt to misconstrue the client and the nature of the Account by preparing misleading account opening documentation, the Panel has reservations on whether or not such persons were properly aware of the facts to provide any meaningful advice on the propriety of the Respondent's conduct. Orchestrated concurrence can hardly be seen as a bona fide reliance on the expertise of others.

Planning and Organization

¶ 30 The Guidelines indicate planning and organization should be considered as aggravating factors [p. 11, par. 3.10]. The Respondent maintains that he never attempted to mislead anyone. We have found numerous instances of deliberate deception on the part of the Respondent in order to justify his conduct and avoid detection, which are described in detail in our Decision and Reasons. In particular, we found that the NAAF and the supporting documentation prepared by the Respondent constituted misleading disclosure concerning the client and in essence was an attempt to justify not having to secure the approval of the Corporate Trustee for any trading instructions [par. 17]. We have also concluded the Respondent's actions were not inadvertent, innocent or negligent, but rather indicative of a continuing pattern of deception. Overall, the conduct of the Respondent demonstrated careful planning and organization and constituted a major aggravating factor.

Multiple Incidents of Misconduct Over an Extended Period of Time

¶ 31 The Decision and Reasons of the Panel identifies numerous incidents of misconduct on the part of the Respondent throughout the period in question in relation to the Account of the Trust and the trading conducted on behalf of the Trust by the Respondent. The inaccurate, misleading NAAF's that were completed by the Respondent, the failure to obtain clear, unequivocal consent of the Corporate Trustee to the various trades made on behalf of the Trust and the multiple instances of improper investments being acquired, distinguish this case from others to which we were referred. Admittedly, no other clients and no other accounts were involved, however the fact the Respondent's misconduct continued over an extended period of time, in our view, significantly increases the culpability of the Respondent. The misconduct, in our view, cannot be considered as a single incident merely because the misconduct involved only one client and one account.

The Vulnerability of the Victim

¶ 32 The Guidelines provide that the vulnerability of the client should be taken into account in determining the relative culpability of a respondent. In the NAAF's prepared by the Respondent, the three First Nation Trustees were described as sophisticated, and the Respondent maintains in the material submitted at the Penalty Hearing that the Trust was sophisticated, by virtue of the three First Nation Trustees' sophistication and the sophistication of the Corporate Trustee (which the Respondent avoided adding as a person having trading authority over the Account on the NAAF when opening the Account). The Panel is prepared to assume the sophistication of the Corporate Trustee and assume that such sophistication was material in the decision by the settlor of the Trust to include the Corporate Trustee as one of four Trustees and insist that the Corporate Trustee approve of any decision made by the Trustees on behalf of the Trust. We are of the opinion that the failure of the Respondent to name the Corporate Trustee on the NAAF when opening the Account and the failure of the Respondent to obtain the unequivocal consent of the Corporate Trustee to the investment decisions made on behalf of the Trust, significantly increased the vulnerability of the client and should be considered as an aggravating factor when considering the relative culpability of the Respondent. While the client was the Trust, the ultimate beneficiaries of the Trust, namely the members of the First Nation, cannot be overlooked. The long term financial health of the First Nation and its members is dependent on the prudent investment of the funds of the Trust, which left them particularly vulnerable.

Failure to Cooperate

¶ 33 There is no evidence before us that the Respondent failed to cooperate with IIROC. The Panel appreciates that the Respondent's decision to exercise his right to defend the allegations of IIROC cannot be considered a failure to cooperate or an aggravating factor.

Significant Economic Loss to the Client and/or the Member Firm

¶ 34 There was no financial loss to the clients or the Dealer Member.

IV. SANCTIONS

¶ 35 In addition to the 14 Key Considerations, the following additional considerations are identified at p. 12 of the Guidelines with respect to the imposition of sanctions:

4. Use of Sanctions

As set out above, sanctions should be remedial in nature and "fit" the misconduct. Sanctions should effectively address the conduct in question in such a way as to discourage and prevent future misconduct by the respondent, and at the same time, promote general adherence to industry rules and standards.

4.1 Fines

It is generally accepted that monetary fines serve to express general condemnation of specific misconduct. Fines will generally increase in relation to the relative severity of specific misconduct. Severity is measured in relation to all of the factors set out above.

4.1.1 Deductibility Of Fines

As a result of the Supreme Court of Canada's decision in *65302 British Columbia Ltd. V. Canada*, [1999] 3 S.C.R. 804, fines imposed by a self-regulatory organization on its Members and their approved persons may be deductible as business expenses for income purposes. As this may undermine a fine's intended effects, Hearing Panel could consider income tax deductibility in determining the appropriate amount of the fine.

4.1.2 Credit for Internal Sanctions

In imposing sanctions, a credit should be accorded for any fine or suspension that may have been imposed upon a respondent by his/her own Dealer Member firm arising out of internal disciplinary action.

4.1.3 Disgorgement

At present, Dealer Member Rules specifically restrict the levy of a fine to a maximum of \$1,000,000 per contravention for Approved Persons and \$5,000,000 for Dealer Members. As well, a Hearing Panel may require a respondent to pay an amount equal to three times the profit made or the loss avoided by the respondent as a result of the commission of the contravention in question, including any commissions earned, or other benefits obtained from the impugned transactions. However, disgorgement is a sanction — it is not restitution.

4.2 Suspension Of Corporation Membership or Approved Person Status

4.2.1 Suspension

A suspension may be appropriate where:

- there have been numerous serious transgressions;
- there has been a pattern of misconduct;
- the respondent has a disciplinary history,
- the misconduct has an element of criminal or quasi-criminal activity; or

- the misconduct in question has caused some measure of harm to the integrity of the securities industry as a whole.

4.3 Permanent Bar From Approval or Expulsion/Termination of Membership

A permanent ban from approval of an individual or the termination or membership or expulsion from the Corporation is a severe economic penalty and should generally be reserved for cases where:

- the public itself has been abused;
- where it is clear that a respondent's conduct is indicative of a resistance to governance;
- the misconduct has an element of criminal or quasi-criminal activity; or
- there is reason to believe that the respondent could not be trusted to act in an honest and fair manner in all their dealings with the public, their clients, and the securities industry as a whole.

Hearing Panel may consider imposing a fine and requiring disgorgement even when a registrant is permanently barred in egregious cases involving significant harm to clients and/or to the integrity of the securities industry as a whole.

4.4 Other Remedies

To address the misconduct effectively in any given case, a Hearing Panel may design specific remedial sanctions other than a fine, disgorgement or suspension. For example, a Hearing Panel may impose sanctions that:

- (i) require a Dealer Member firm to submit for the Corporation approval and/or implement procedures for improved future compliance with regulatory requirements;
- (ii) require a Dealer Member firm to implement heightened supervision of certain individuals or branches / departments in the firm;
- (iii) limit the activities of a registrant, including suspending or barring a registrant from acting in a supervisory capacity; or
- (iv) require professional re-qualification by the writing of an exam or the successful completion of a remedial course of study.

This list is illustrative, not exhaustive, and is included to provide examples of the types of sanctions that may design to address specific misconduct.

V. SPECIFIC VIOLATIONS

¶ 36 IIROC Counsel directed the Panel to the following directions in the Guidelines relating to recommended sanctions for the violation of the specific rules which this Panel found the Respondent had contravened (IIROC Staff Penalty hearing Book, par. 13-22):

Guideline 3.2 - Failure to Know Client

14. Guideline 3.2 addresses Rule 1300.1(a), commonly known as the "Know Your Client" rule. The Guideline points out:

The Know Your Client rule is of paramount importance for the securities industry... Knowing your client is a fundamental ongoing obligation that a registrant is required to meet in order to be able to act in the best interests of his/her clients.

15. S.3.2 of the Guidelines propose the following be considered, in addition to the General Principles, where a breach of the "Know Your Client" Rule has occurred:

- a. Nature and extent of failure to know your client;
 - b. Magnitude of losses directly attributable to the failure to know your client;
 - c. The level of sophistication of the client;
 - d. Extent of due diligence conducted to determine the essential facts of the client.
16. It recommends the following sanctions:
- a. Fine: Minimum of \$10,000;
 - b. Re-write of CPH;
 - c. Period of close and/or strict supervision;
 - d. Period of suspension (in most egregious cases).

Guideline 3.1 - Unsuitable Recommendations

17. Guideline 3.1 deals with Rule 1300.1(q), also known as the suitability rule and notes that:
- The core of a registered representative's business activity is to make recommendations for his/her clients. Registrants have a basic duty to ensure that the recommendations are suitable, and in accordance with the clients' investment objectives and risk factors and a failure to do so constitutes a breach of the registered representative's fiduciary duty to the client.
18. It proposes the following be considered, in addition to the General Principles, where a breach of the "Suitability" Rule has occurred:
- a. Extent of due diligence conducted with respect to the recommended security;
 - b. Magnitude of losses directly attributable to the unsuitable recommendations;
 - c. The number of clients affected;
 - d. The level of sophistication of the clients;
 - e. The existence of any pattern of making unsuitable recommendations;
 - f. Presence of any ulterior motive.
19. It recommends the following sanctions:
- a. Fine: Minimum of \$10,000;
 - b. Disgorgement of profits;
 - c. Re-write of CPH;
 - d. Period of close and/or strict supervision;
 - e. Period of suspension (in most egregious cases involving elements of deception and misrepresentations)

Guideline 3.7 - Unauthorized Trading

20. Guideline 3.7 deals with a breach of Rule 29.1 where unauthorized trading occurs. It notes that:
- When a registrant executes trades without the knowledge or consent of his/her client, the registrant has breached his/her ethical obligations to his client.
21. Guideline 3.7 proposes the following be considered, in addition to the General Principles, where "Unauthorized Trading" has occurred:
- a. Number of unauthorized trades

- b. Underlying reason for executing unauthorized trades;
 - c. The number of clients affected;
 - d. Period of time unauthorized trading took place;
 - e. Suitability of unauthorized trades;
 - f. Magnitude of losses, if any.
22. It recommends the following sanctions:
- a. Minimum fine of \$15,000.00;
 - b. Disgorgement of profits;
 - c. Period of close and/or strict supervision;
 - d. Re-write CPH;
 - e. Period of suspension (in most egregious cases involving large number of large value trades).

VI. SUBMISSIONS

IIROC Submission

¶ 37 ¶IIROC Counsel submitted that the following sanctions would be appropriate for the Respondent, given the findings of liability of this Panel as set out in the Decision and Reasons:

- a. A global fine in the amount of \$150,000;
- b. A three year suspension;
- c. A successful re-write of the Conduct and Practices Examination before returning to the industry;
- d. A 12 month period of close supervision upon return to the industry; and
- e. Costs in the amount of \$20,000.

Respondent's Submission

¶ 38 The Respondent submitted that he did nothing wrong and emphasized his client did not suffer any financial loss and, in fact, the Trust realized a better return over the period in question than it would have if the funds were invested in secure investments. He maintained that his conduct did not qualify as egregious and therefore, and because of his age (he is 63), no suspension should be imposed. The Respondent relied on a number of decisions where no suspension was imposed and, in particular, on the decision of the panel in the *Re Steinhoff* [2011] IIROC 54 matter and specifically on the following comments of the panel [par. 90 and 91]:

¶ 90 Suspension of any length beyond the range of a normal vacation is, for a registered representative, an extremely serious matter. A suspension of one year, what the IIROC panel ordered here, is tantamount to the termination of the registrant's career. At a minimum, it requires the registrant to build a book from scratch, a process that takes years and enormous effort. That assumes a clean slate. A person in their mid-fifties, like Steinhoff, attempting the task following the expiry of a mandated suspension, even a person with Steinhoff's apparent energy, is likely to find it impossible to build much more than a shadow of their former career.

¶ 91 Steinhoff made a serious mistake. Does the public interest demand that she lose her career over it? She has been in the business now for 25 years. She has no previous regulatory sanctions. There is no basis to conclude that she acted dishonestly or for an improper motive, or has ever done so. Although her mistake unquestionably harmed the Ks, there is no evidence that she represents any ongoing threat to her clients, to potential new clients, to the reputation of the securities markets or of IIROC or its members. Although a significant sanction is appropriate given Steinhoff's contravention of the suitability requirement, the parties should address whether a suspension in these circumstances would

be appropriate.

¶ 39 As regards the imposition of a fine, the Respondent submitted that he was not in a financial position to pay any fine and he directed the Panel's attention to the conclusion reached by the panel in *Re Cornacchia*, [2011] IIROC 25, expressed at par. 39 as follows:

39. *Following a review of the authorities, we are of the view that "ability to pay" in respect of the imposition of a fine on a respondent is a principle of which we need to take notice.*

¶ 40 The Respondent provided his tax returns for 2010 and 2011, which showed nominal income in those years. No net worth statement was provided, nor were tax returns provided for the period during which the Respondent traded the Account of the Trust, except for the return for 2010, which showed taxable income of approximately \$73,000.

¶ 41 The Respondent advised the Panel that he had lost almost 100 clients since the investigation commenced and indicated that he is currently under strict supervision which results in the imposition of a 10% fee by the Dealer on his commissions.

¶ 42 The Respondent submitted that under the circumstances, his penalty should be limited to a reprimand.

¶ 43 The Respondent requested that the Panel defer implementation of the sanctions if they included a fine or a suspension, to enable him to file an appeal with the Manitoba Securities Commission.

VII. ANALYSIS

¶ 44 After hearing the submissions of IIROC Counsel and the Respondent and after reviewing the precedent decisions provided by IIROC Counsel and the Respondent, as well as the relevant provisions of the Guidelines referred to above, the Panel considered the circumstances of the Respondent's misconduct.

Failure to Know Client

¶ 45 The Know Your Client Rule is of fundamental importance to the industry. For the reasons set forth in its Decision and Reasons, it is clear to this Panel that there was a blatant failure on the part of the Respondent to undertake the necessary due diligence to know his client and appreciate who his client was. That failure increased the vulnerability of the client by excluding the Corporate Trustee from participating in the investment decision process.

Unsuitable Recommendation

¶ 46 For the reasons set forth in its Decision and Reasons, this Panel found that the Respondent implemented a large number of unsuitable trades on behalf of the client over a significant period of time and by doing so, he exposed a vulnerable client to significant risk. The Respondent's actions constituted a breach of his fiduciary obligations to his client. While the Respondent may have held an honest belief that the investments made for the client would have generated a higher rate of return, there is no question that they were unsuitable and that the Respondent profited considerably by investing all the funds of the client in 123 mutual funds.

Unauthorized Trading

¶ 47 For the reasons set forth in its Decision and Reasons, this Panel found numerous instances where the Respondent failed to obtain clear unequivocal authorization from the client and found some instances where he conducted trades with full knowledge that the client did not approve of the intended trades.

Mitigating Factors

¶ 48 The following mitigating factors are relevant:

- (a) the client suffered no economic loss;
- (b) the Respondent has been in the industry for 35 years and has no discipline history with IIROC or the IDA;
- (c) the Respondent cooperated with the IIROC investigation;

- (d) the Respondent has voluntarily taken several courses.

Aggravating Factors

¶ 49 The following aggravating factors are particularly relevant:

- (a) the Respondent has not taken any responsibility for his misconduct, he has expressed no remorse, and he refuses to accept the impropriety of his actions and the potential harm he exposed the client to;
- (b) the Panel found that the Respondent's misconduct in setting up the Account of the client was not inadvertent and went beyond negligence, to the extent that this Panel found his actions to be carefully orchestrated and a deliberate attempt to mislead;
- (c) the Panel observed that the Respondent acted with flagrant disregard for the instructions given by the Corporate Trustee;
- (d) the Panel found the Respondent's testimony lacked credibility;
- (e) the Respondent attempted to avoid responsibility for his actions by orchestrating the concurrence of his compliance department;
- (f) the Respondent's misconduct generated significant economic benefits to him while exposing a vulnerable client to significant potential harm;
- (g) the misconduct which the Respondent has been found to have committed, failing to know his client, unsuitable investments and unauthorized trading, was egregious and constituted breaches of the fundamental obligations of an investment advisor.

VIII. ASSESSMENT

¶ 50 The aggravating factors listed above are of a very significant nature and, but for the lack of any disciplinary history and the good fortune that the client suffered no financial loss, warrant the imposition of very harsh sanctions. The mitigating factors referred to above cannot be overlooked and the Panel has given them considerable weight when determining the sanctions to be imposed upon the Respondent.

IX. CONCLUSION

¶ 51 In determining the appropriate sanctions, the Panel considered carefully the circumstances surrounding each of the three infractions in the context of the Key Considerations and the Guidelines outlined above. The Panel agrees with the principles set forth therein. The Panel also considered the Respondent's submission and the cases he referred to and the submission of IROC Counsel and the cases he referred to.

¶ 52 The imposition of appropriate sanctions is not an exact science. In each case, there are mitigating and aggravating factors that must be considered. In the case before us, the most compelling mitigating factor is that the Respondent had no prior regulatory history over the previous 35 years in the industry, which would suggest he was of very good moral character prior to the subject misconduct. While we are cognizant of that fact, we note the Guidelines provide that where the misconduct is very serious, it can nullify the mitigating effect of having no prior disciplinary history. In our view, the seriousness of the misconduct in this case, to a very large extent, nullifies the Respondent's disciplinary history. Nevertheless, the Respondent's 35 year history must be taken into account.

¶ 53 The Guidelines provide that admission of wrongdoing is usually considered a mitigating factor. The Respondent did not admit any wrongdoing and in the normal course that would be a neutral factor. However, in this case, not only did the Respondent not admit responsibility for his actions, at the Penalty Hearing he vehemently denied having done anything wrong, despite the findings of this Panel to the contrary.

¶ 54 The Panel found the Respondent's conduct to be egregious and found the Respondent's attempts to justify his conduct at the initial hearing and at the Penalty Hearing to be incredulous. His lack of insight into the impropriety of his conduct or the significance of its potential impact on the Trust and its beneficiaries and on

the integrity of the securities industry as a whole is most disturbing. His refusal to accept responsibility and his persistent denial that he did anything wrong is of grave concern to the Panel and constitutes a significant aggravating factor. His failure to properly comply with the Know Your Client rule was calculated and deliberate and a further aggravating factor. The Guidelines indicate that suspension is warranted only in egregious cases and that a permanent bar is reserved for the worst cases and the worst offenders; cases where there is reason to believe the Respondent could not be trusted to act in an honest and fair manner in all dealings with the public, his client, and the securities industry as a whole. The Panel found the circumstances surrounding this case fall short of warranting a permanent bar, nevertheless, the Panel did find this to be a case where the imposition of a suspension is necessary. In the Panel's view, a one year suspension together with the other sanctions we have ordered satisfy the Guidelines and take into account the mitigating factors and, at the same time, sufficiently protect the investing public, the IIROC Membership, the integrity of the IIROC process and the capital markets in general, and will serve to prevent and deter a repetition of the conduct in question.

Suspension

¶ 55 IIROC Counsel has recommended a three year suspension followed by a 12 month period of supervision and referred us to a number of decisions which were helpful, although distinguishable because losses were suffered by clients in those cases, whereas in this case there were no financial losses, or because the conduct was inadvertent, whereas in this case the conduct was calculated and deliberate. The Respondent also referred us to a number of cases, most of which are of limited assistance. We have considered whether a shorter period of suspension would serve the interests of IIROC, the security markets and the public good.

¶ 56 On balance and having regard to the unique circumstances of this particular case and relying on the Guidelines rather than dissimilar precedents, this Panel has agreed with IIROC Counsel in principle that a suspension is necessary, but we have determined that a one year suspension of the Respondent (rather than a three year suspension as proposed by IIROC Counsel) is sufficient and appropriate when combined with a three year period of close supervision (IIROC Counsel proposed a period of one year of close supervision). During the period of close supervision, the Respondent would be prohibited from holding the position of branch manager or compliance manager with any Member Firm. The Respondent's submission that no suspension should be imposed is irreconcilable with the conduct of the Respondent and the objective of deterrence. In our view, a one year suspension with three years of close supervision is warranted under the circumstances, having regard to the Respondent's mitigating factors, and provides sufficient general deterrence and appropriately addresses IIROC interests, the public interests and the integrity of the capital market.

Fine

¶ 57 As regards the imposition of a fine, IIROC Counsel has recommended a global fine of \$150,000. The Respondent has submitted that he has no income to pay any fine. While the Respondent's income may make it difficult to pay a fine, an equally relevant factor is whether the Respondent has assets to pay a fine. No information was provided by the Respondent on that issue. We note that a fine is deductible as a business expense and that the Guidelines provide monetary fines serve to express general condemnation of the specific misconduct and generally should increase with the severity of the specific misconduct. As indicated above, this Panel finds the Respondent's conduct to have been egregious. It follows that the fine reflect our view of the misconduct. Under the circumstances, we are prepared to order the imposition of a \$150,000 fine, as recommended by IIROC Counsel, inclusive of disgorgement of commissions earned in the amount of \$137,000. Payment shall be on such terms as IIROC may permit.

Rewrite Examinations

¶ 58 With respect to the obligation to rewrite examinations, IIROC Counsel recommended the Respondent successfully rewrite the Conduct and Practices Handbook Examination before returning to the industry. Given the nature of the misconduct, the Panel agrees with the recommendation of IIROC Counsel and orders that the Respondent successfully rewrite the Conduct and Practices Handbook Examination before returning to the industry after his suspension expires.

Costs

¶ 59 As regards costs, the Panel has reviewed the cases provided by IIROC Counsel and the Respondent and the decisions referred to therein and appreciates that an award for costs is discretionary and should not constitute an additional penalty against the Respondent, but rather should be reflective of the time and effort expended by IIROC and should represent the Panel's assessment of the portion of such costs the Respondent ought to bear. An award for costs should not have the effect of inhibiting a member or an approved person from advancing a defense to any disciplinary proceeding IIROC might initiate. The factors to be considered by a Panel in addressing the issue of costs include but are not limited to the following:

- the degree of success of a respondent;
- the necessity of calling the witnesses and incurring the expenses that were incurred;
- the degree of cooperation by a respondent and the extent of agreement on proving facts by admission or otherwise;
- the financial circumstances of a respondent, including the effect of any fine or other sanction imposed;
- the costs should not be capable of being considered a penalty.

¶ 60 IIROC Counsel has submitted that an order for costs in the amount of \$20,000 should be granted by the Panel. At the Penalty Hearing, IIROC Counsel submitted a breakdown of some of IIROC's investigation and hearing costs which totaled \$172,448. The Panel was advised that other recoverable costs were not included on the breakdown. IIROC Counsel submitted that \$20,000 would be fair and reasonable under the circumstances. Dealer Member Rule 20.49 addresses the issue of costs and provides as follows:

20.49 Assessment of Costs

- (1) In addition to imposing any of the penalties set out in Rule 20.33, Rule 20.34 or Rule 20.45, the Hearing Panel may assess and order any Corporation Staff investigation and prosecution costs determined to be appropriate and reasonable in the circumstances...

¶ 61 The determination of costs was not provided to the Respondent prior to the penalty hearing and he had no opportunity to cross-examine IIROC Staff on the particulars of the items included.

¶ 62 In reviewing decisions of other panels on the issue of costs, it appears to be generally accepted that since a successful respondent cannot get its costs from IIROC and since the power to award costs is one-sided, a "conservative approach" to granting an order for costs should be adopted.

¶ 63 The Panel appreciates this was a complex investigation which culminated in a four day initial hearing and the filing of a very significant volume of documentation by both parties, as well as a written submission by counsel and a one-day penalty hearing. Without reviewing in detail the cost determination submitted by IIROC Counsel, the Panel is satisfied that the costs incurred by IIROC were substantial.

¶ 64 Having regard to the serious nature of the charges, the success of IIROC on all counts, and the lengthy time spent in the hearings and producing the documentary evidence, we are prepared to accept the \$20,000 amount requested by IIROC Counsel as a fair and reasonable award of costs in this case. Accordingly, the Panel award IIROC costs in the amount of \$20,000.

Disposition

¶ 65 As set forth in this Panel's "Penalty Decision" dated February 10, 2014, the panel has ordered the following sanctions against the Respondent:

- (a) A global fine of \$150,000 in respect of all charges, inclusive of disgorgement of commissions earned in the amount of \$137,000, payable upon such terms as IIROC may permit;
- (b) A one year suspension from registration with IIROC, provided that the Respondent shall not thereafter be registered until successfully rewriting the Conduct and Practices Examination;
- (c) A three year period of close supervision upon becoming registered and returning to the industry

following the expiration of the period of suspension, and during such three year period, the Respondent shall not hold the position of branch manager or compliance manager with any Member Firm; and

- (d) The Respondent shall pay costs in the amount of \$20,000 to IIROC upon such terms as IIROC may permit.

¶ 66 The implementation of (a)-(d) above were stayed for a period of 30 days from the date of release of the Penalty Decision to allow the Respondent an opportunity to appeal the decision of this Panel.

DATED at Winnipeg, Manitoba this 30th day of September, 2014.

This Decision may be signed in counterpart.

Thomas J. D. Kormylo, Chair

William Welton

Claude Tétrault

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