

Re Kunz

IN THE MATTER OF:

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

and

Blaine Albert Kunz

2017 IIROC 23

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

Heard: March 21, 2017 in the City of Calgary, Alberta

Decision: March 21, 2017

Written Reasons: April 19, 2017

Hearing Panel:

The Hon. René P. Foisy, (Chair), John H. Wells and Martin Davies

Appearances:

David McLellan, Enforcement Counsel

James Heelan, Q.C., for Respondent, Blaine Albert Kunz

Blaine Albert Kunz (present)

ACCEPTANCE OF SETTLEMENT AGREEMENT

A. INTRODUCTION

¶ 1 IIROC Enforcement Counsel and the Respondent, Blaine Albert Kunz (hereinafter referred to as the “Respondent”) consent and agree to the settlement of this matter by way of this Settlement Agreement. (Attached hereto as Schedule “A”).

¶ 2 The IIROC Enforcement Department conducted an investigation into the conduct of the Respondent. The parties have entered into a Settlement Agreement.

B. JOINT SETTLEMENT RECOMMENDATION

¶ 3 IIROC and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

- For the purposes of this Settlement Agreement, the Respondent agrees with the facts set out in Part III of the Settlement Agreement.
- The Respondent was a Registered Representative of (“RR”) responsible for accounts of client SM and his corporation, AB Ltd. (together the “Client”).
- The Respondent failed to know SM, who had fair investment knowledge.
- The Respondent failed to use due diligence to ensure that his recommendations were suitable for the Client when he employed an investment strategy which involved the use of options, margin and a concentration in energy sector securities.

¶ 4 The Respondent admits to the following contraventions of IIROC Dealer Member Rules:

- **COUNT 1:** Between approximately December 2010 and April 2013, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to his client, contrary to Dealer Member Rule 1300.1(a).
- **COUNT 2:** Between approximately December, 2010 and April 2013, the Respondent failed to use due diligence to ensure that recommendations were suitable for his client, contrary to Dealer Member Rule 1300.1(q).

C. REGISTRATION HISTORY

¶ 5 The Respondent has been a Registered Representative since 1988 and has been employed in a branch of CIBC World Markets Inc. (“CIBC”) in Medicine Hat, Alberta since 1991. In addition, he was the Branch Manager of this branch between 1995 and 2013. He obtained his CIM designation in December 2014.

D. FAILURE TO KNOW YOUR CLIENT

¶ 6 SM lives in Alberta where he owns (through a numbered corporation, referred to herein as “AB Ltd.”) a strip mall which consists of a gas station, car wash and a liquor store. When SM opened the account with Kunz in 2010, he was 41 years old. He and his spouse, FM, are both directors of AB Ltd., but she did not deal with the Respondent concerning the account.

¶ 7 In late 2010, SM sold the gas station for approximately \$1.5 million, which resulted in net sale proceeds of \$1.2 million.

¶ 8 SM had been involved in small businesses and he had some limited knowledge and experience in financial markets. Therefore, he sought and relied upon the advice and expertise of the Respondent with respect to the investment of the \$1.2 million.

¶ 9 Following several face to face meetings, on December 7, 2010, the Respondent opened a new corporate account for AB Ltd. The account, which was fee-based, also had options approval for covered writing, buying and spreading. The new client application form (“NCAF”) for AB Ltd., contained the following information, and reflected certain particulars of SM personally and of AB Ltd:

AB Ltd.	Representative authorized to enter orders:
Type of Business: Retail Gas Station	SM (Director); FM (Director)
Total Net Worth	\$1.7 M
Investment Knowledge	Fair
Investment Objectives:	30% Short Term Gains 30% Medium Term Gains 40% Long Term Gains
Risk Tolerance:	20% Low 50% Medium 30% High

¶ 10 There were no updates to the AB Ltd., account documentation following the completion of the initial NCAF in December, 2010.

¶ 11 For the period of December 2010 to April 2013 (“Relevant Period”), the Respondent failed to learn and remain informed of the essential facts relative to the Client as the stated investment objectives and risk tolerance

parameters in the account were inconsistent with the Client's investment knowledge, investment objective and risk tolerance.

E. UNSUITABLE RECOMMENDATIONS SM/AB LTD.

¶ 12 The Respondent recommended a predominately long-term investment strategy to SM. However, he pursued a strategy which involved a high degree of risk.

¶ 13 The Respondent recommended the use of options, which are classified as high risk securities. He primarily employed an option strategy known as a "Bull Put Credit Spread", in which the client earns premium income while limiting the downside risk. An investor will sell a put option to receive premium income and simultaneously buy a put option with a lower strike price on the same underlying security to limit downside risk.

¶ 14 Typically, Bull Put Spreads are used by investors who want to generate income (from the net premium received) and who expect that the price of the underlying asset will go up moderately in the short term.

¶ 15 However, although a spreading strategy limits downside risk, the strategy still involves short term speculation on the price of the underlying security and has the potential to create short term trading and realized losses if the options are assigned to the client. In addition, the level of risk increases with the number of open options contracts.

¶ 16 Overall, there was a high degree of sector concentration in the account. Between June 2011 and December 2012, energy sector concentration ranged between 30% and 70%. This high degree of concentration further increased the risk level in the account.

¶ 17 The Respondent also employed use of margin in the account, which increased the level of risk. The account was in a negative cash position for 25 consecutive months, with the margin position ranging between 21.5% and 55.8% of the market value of invested securities during the relevant period. In November 2011, the level of margin reached a high of approximately \$(715,000) against a market value of invested securities of approximately \$1,282,000, reflecting a margin position of 55.8%.

¶ 18 The Respondent entered into a number of contracts each month, and in certain months as many as 15 options contracts in the Client's account. This number of positions increased the level of risk in the account.

¶ 19 In the Relevant Period, the account contained medium and high risk holdings not in keeping with the parameters set out in the KYC Investment Objectives. In addition, the risk was amplified by sector concentration.

¶ 20 In the Relevant Period, the account experienced a net loss of \$463,587, representing a 39% decline.

¶ 21 During the same time period, the S&P TSX Composite Index decreased by 7.4%. The market value of the account was considerably more volatile than the performance of the S&P TSX Composite Index, which is indicative of an elevated level of risk.

¶ 22 The investment strategy employed by the Respondent involved the use of margin, options and a concentration in energy sector securities. This strategy presented a degree of risk which was contrary to the Client's stated investment objectives and risk tolerance parameters.

¶ 23 An agreement was reached with the client which provided compensation for the losses sustained.

F. TERMS OF SETTLEMENT

¶ 24 This settlement is agreed upon in accordance with IIROC Dealer Member Rule 20.35 to 20.40, inclusive.

¶ 25 The Respondent agrees to the following sanctions and costs:

- (a) A fine in the amount of \$70,000.00;

(b) Costs in the amount of \$5,000.00.

G. DECISION

¶ 26 The Panel was referred to a number of cases. The sole issue before the Panel is whether to accept or reject the Settlement Agreement see: *Jones (Re)*, 2015 LNIROC 5. Enforcement counsel provided a copy of the decision *Re Milewski [1999] 1 D.A.C.D. No. 17.*, which contains the following statement:

“A District Council considering a Settlement Agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness. Put another way, the District Council will reflect the public interest benefits of the settlement process in its consideration of specific settlement.”

¶ 27 In this case, while the lapses of the Respondent were serious, we note that the Respondent’s actions:

- (1) involved one client, thus was not a behavioural pattern;
- (2) the Respondent was forthcoming and assisted the investigation;
- (3) the Respondent had no previous incidents and had not received any prior warnings;
- (4) this account was on a fee basis and not a commission; and,
- (5) the client received full restitution.

¶ 28 In all of the circumstances, the Settlement Agreement is reasonable, appropriate and reflects the public interest benefits of the settlement process.

¶ 29 Accordingly, the Panel accepts the terms of the Settlement Agreement and give effect to it as at the 23rd day of February, 2017.

Dated at Edmonton, Alberta this 19 day of April, 2017.

The Hon. René P. Foisy

John H. Wells

Martin Davies

Schedule “A”

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

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

PART II – JOINT SETTLEMENT RECOMMENDATION

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

PART III – AGREED FACTS

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement.
4. The Respondent, Blaine Albert Kunz (“Kunz”) was a Registered Representative (“RR”) responsible for the accounts of client SM and his corporation, AB Ltd. (together the “Client”).
5. Kunz failed to know SM, who had fair investment knowledge.
6. He failed to use due diligence to ensure that his recommendations were suitable for the Client when he employed an investment strategy which involved the use of options, margin and a concentration in energy sector securities.

Registration History

7. Kunz has been a Registered Representative since 1988 and has been employed in a branch of CIBC World Markets Inc. (“CIBC”) in Medicine Hat, Alberta since 1991. In addition, he was the Branch Manager of this branch between 1995 and 2013. He obtained his CIM designation in December 2014.

Client – SM /AB Ltd.

Failure to Know Your Client

8. SM lives in Alberta where he owns (through a numbered corporation, referred to herein as “AB Ltd.”) a strip mall which consists of a gas station, car wash and a liquor store. When SM opened the account with Kunz in 2010, he was 41 years old. He and his spouse, FM, are both directors of AB Ltd., but she did not deal with Kunz concerning the account.
9. In late 2010, SM sold the gas station for approximately \$1.5 million, which resulted in net sale proceeds of \$1.2 million.
10. SM had been involved in small businesses and he had some limited knowledge and experience in financial markets. Therefore, he sought and relied upon the advice and expertise of Kunz with respect to the investment of the \$1.2 million.
11. Following several face to face meetings, on December 7, 2010, Kunz opened a new corporate account for AB Ltd. The account, which was fee-based, also had options approval for covered writing, buying and spreading. The new client application form (“NCAF”) for AB Ltd. contained the following information, and reflected certain particulars of SM personally and of AB Ltd:

AB Ltd. Type of Business: Retail Gas Station	Representative authorized to enter orders: SM (Director); FM (Director)
Total Net Worth	\$1.7M
Investment Knowledge	Fair
Investment Objectives:	30% Short Term Gains 30% Medium Term Gains 40% Long Term Gains
Risk Tolerance:	20% Low 50% Medium 30% High

12. There were no updates to the AB Ltd. account documentation following the completion of the initial NCAF in December, 2010.

13. For the period of December, 2010, to April, 2013 (“Relevant Period”), Kunz failed to learn and remain informed of the essential facts relative to the Client as the stated investment objectives and risk tolerance parameters in the account were inconsistent with the Client’s investment knowledge, investment objectives and risk tolerance.

Suitability

14. Kunz recommended a predominately long-term investment strategy to SM. However, he pursued a strategy which involved a high degree of risk.
15. Kunz recommended the use of options, which are classified as high risk securities. He primarily employed an option strategy known as a “Bull Put Credit Spread”, in which the client earns premium income while limiting the downside risk. An investor will sell a put option to receive premium income and simultaneously buy a put option with a lower strike price on the same underlying security to limit downside risk.
16. Typically, Bull Put Spreads are used by investors who want to generate income (from the net premium received) and who expect that the price of the underlying asset will go up moderately in the short term.
17. However, although a spreading strategy limits downside risk, the strategy still involves short term speculation on the price of the underlying security and has the potential to create short term trading and realized losses if the options are assigned to the client. In addition, the level of risk increases with the number of open options contracts.
18. Overall, there was a high degree of sector concentration in the account. Between June, 2011 and December, 2012, energy sector concentration ranged between 30% and 70%. This high degree of concentration further increased the risk level in the account.
19. Kunz also employed use of margin in the account, which increased the level of risk. The account was in a negative cash position for 25 consecutive months, with the margin position ranging between 21.5% and 55.8% of the market value of invested securities during the relevant period. In November, 2011, the level of margin reached a high of approximately (\$715,000) against a market value of invested securities of approximately \$1,282,000, reflecting a margin position of 55.8%.
20. Kunz entered into a number of contracts each month, and in certain months as many as 15 options contracts in the Client’s account. This number of positions increased the level of risk in the account.
21. In the Relevant Period, the account contained medium and high risk holdings not in keeping with the parameters set out in the KYC Investment Objectives. In addition, the risk was amplified by sector concentration.
22. In the Relevant period, the account experienced a net loss of \$463,587, representing a 39% decline.
23. During the same time period, the S&P TSX Composite Index decreased by 7.4 %. The market value of the account was considerably more volatile than the performance of the S&P TSX Composite Index, which is indicative of an elevated level of risk.
24. The investment strategy employed by Kunz involved the use of margin, options and a concentration in energy sector securities. This strategy presented a degree of risk which was contrary to the Client’s stated investment objectives and risk tolerance parameters.
25. An agreement was reached with the client which provided compensation for the losses sustained.

PART IV – CONTRAVENTIONS

26. By engaging in the conduct described above, the Respondent committed the following contraventions of IIROC’s Rules:

Count 1

Between approximately December, 2010 and April, 2013, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to his client, contrary to Dealer Member Rule 1300.1(a).

Count 2

Between approximately December, 2010 and April, 2013, the Respondent failed to use due diligence to ensure that recommendations were suitable for his client, contrary to Dealer Member Rule 1300.1(q).

PART V – TERMS OF SETTLEMENT

27. The Respondent agrees to the following sanctions and costs:
 - a) A fine in the amount of \$70,000; and
 - b) Costs in the amount of \$5,000.
28. If this Settlement Agreement is accepted by the Hearing Panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

PART VI – STAFF COMMITMENT

29. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of paragraph 30 below.
30. If the Hearing Panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

31. This Settlement Agreement is conditional on acceptance by the Hearing Panel.
32. This Settlement Agreement shall be presented to a Hearing Panel at a settlement hearing in accordance with the procedures described in Sections 8215 and 8428, in addition to any other procedures that may be agreed upon between the parties.
33. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the Hearing Panel.
34. If the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to waive all rights under the IIROC Rules and any applicable legislation to any further hearing, appeal and review.
35. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another Settlement Agreement or Staff may proceed to a disciplinary hearing based on the same or related allegations.
36. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.
37. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel and IIROC will post a full of copy of this Settlement Agreement on the IIROC website. IIROC will also publish a summary of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement.
38. If this Settlement Agreement is accepted, the Respondent agrees that neither he nor anyone on his behalf

will make a public statement inconsistent with this Settlement Agreement.

39. The Settlement Agreement is effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

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

DATED this 23rd day of February, 2017.

“Witness” _____

Witness

“Blaine Albert Kunz” _____

Blaine Albert Kunz

“Nargis Bakhtiary” _____

Witness

“David McLellan” _____

David McLellan

Enforcement Counsel on behalf of Enforcement
Staff of the Investment Industry Regulatory
Organization of Canada

The Settlement Agreement is hereby accepted this 21st day of March, 2017, by the following Hearing Panel:

Per: “Rene P. Foisy” _____

Panel Chair

Per: “John H. Wells” _____

Panel Member

Per: “Martin Davies” _____

Panel Member

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