Re TD Waterhouse Canada

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

TD Waterhouse Canada Inc.

2018 IIROC 44

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

Heard: November 2, 2018
Decision: November 2, 2018
Reasons: November 21, 2018

Hearing Panel:
Christopher Portner, Chair, Leo Ciccone and Shaine Pollock
Appearance:
Elissa Sinha, Enforcement Counsel
David Hausman, Counsel for the Respondent
In Attendance:
Kevin Bresler, CCO
Daniel Wolski, In-house Counsel

REASONS FOR ACCEPTANCE OF SETTLEMENT AGREEMENT

I. INTRODUCTION

Settlement Agreement

¶ 1 On November 2, 2018, Enforcement Counsel for the Investment Industry Regulatory Organization of Canada ("IIROC") and counsel for TD Waterhouse Canada Inc. (the "Respondent") submitted a Settlement Agreement between IIROC and the Respondent dated October 10, 2018 (the "Settlement Agreement") to the Hearing Panel for acceptance or rejection pursuant to Section 8215 of IIROC's Consolidated Enforcement, Examination and Approval Rules (the "Consolidated Rules"). Following a hearing at IIROC's offices in Toronto, the Hearing Panel accepted the Settlement Agreement and these are our Reasons for such acceptance.

Contravention

¶ 2 The Respondent admitted that, between 2010 and 2015, it failed to adequately supervise the trading of one of its former Registered Representatives, David Gary Durno ("Durno"), to ensure compliance with Dealer Member Rules, contrary to Dealer Member Rules 38.1 and 2500.

Agreed Penalty

¶ 3 The Respondent agreed to pay a fine of $140,000 and costs of $10,000.

II. THE FACTS

Overview

¶ 4 The facts on which the parties have agreed are set out in Part III of the Settlement Agreement, a copy of which is attached to these Reasons. By way of a brief summary, from 1997 to 2016, the Respondent employed Durno as an Investment Advisor. In or about October 2015, one of Durno's elderly clients, SS, for whom Durno had recommended and implemented active trading in new issue securities and government bonds, submitted a complaint to the Respondent.

¶ 5 The Respondent's investigation of the complaint by SS lead to a review of other clients of Durno's. Based on its review, the Respondent concluded that the commissions generated in the accounts of SS and two other clients were excessive and it was apparent that Durno had been trading for SS and the two other clients to generate excessive commissions for himself, contrary to the financial interests of the clients.

¶ 6 In July 2018, an IIROC Hearing Panel accepted a Settlement Agreement between Staff of IIROC and Durno in which Durno admitted that, between 2010 and 2015 he had failed to adequately consider and address the interests of two clients, contrary to Dealer Member Rule 29.1 and, after March 26, 2012, Dealer Member Rule 42.2. Durno agreed to pay a fine of $150,000, inclusive of disgorgement, submit to close supervision until December 2018, and pay costs of $5,000.

Mitigating Factors

¶ 7 The Respondent took the initiative to expand its investigation beyond the accounts of SS and paid compensation to SS and two other clients in the aggregate amount of approximately $550,000 even though the other two clients had not complained to the Respondent.

¶ 8 The Respondent has improved its supervision of commissions generated by its investment advisors by implementing and improving an electronic trade surveillance system, which is continually reviewed and updated by the Respondent. In addition, the current filters and parameters for trade review would facilitate the detection of trading that generates excessive commissions.

¶ 9 The settlement reflected in the Settlement Agreement was concluded at an early stage of Staff's investigation and the Respondent's prompt acknowledgement of its failure to supervise Durno reduced the resources and time required to investigate and resolve the matter.

III. THE ROLE OF THE HEARING COMMITTEE

¶ 10 Pursuant to subsection 8215(5) of the Consolidated Rules, the Hearing Panel may only accept or reject the Settlement Agreement. Enforcement Counsel referred the Hearing Panel to *Re Milewski*[1] in which the District Council stated that:

> 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 settlements.[2]

¶ 11 In determining whether to accept the Settlement Agreement, the Hearing Panel should also be satisfied with respect to the following three considerations described in *Re Donelly*[3], each of which we address below:

(a) The agreed penalties must be within an acceptable range, taking into account similar cases;

(b) The agreed penalties must be fair and reasonable, that is, proportional to the seriousness of the contravention, and considering other relevant circumstances, and should appear to be so to members of the public and industry; and

[1] [1999] I.D.A.C.D. No. 17.
[2] *Supra*, at page 10.
[3] 2016 IIROC 23 at para. 5.

(c) The agreed penalties should serve as a deterrent to the respondent and to industry.

IV. ANALYSIS

¶ 12 As to whether the agreed penalties are within an acceptable range, we have considered the penalties levied in seven previous IIROC cases submitted to us by the parties, which deal with supervision issues by financial institutions generally similar to those described in the Settlement Agreement. The penalties levied in these cases range from a low of $90,000 for the fine and $10,000 for costs in Re Leede & Bergen4 to a high of $200,000 for the fine and $20,000 for costs in Re Scotia Capital.5 In the submission of counsel for the parties, the $140,000 fine and costs of $10,000 on which the parties agreed in this matter represents the approximate mid-point of the penalties levied in the cases, which they submitted for our consideration and is warranted given the mitigating factors described in paragraphs 7, 8 and 9 above and the limited number of clients who were affected. For the foregoing reasons, we agree that the agreed penalties are within an acceptable range.

¶ 13 We also agree that the agreed penalties are fair and reasonable having taken into account the mitigating factors which are described above including, in particular, the fact that the Respondent provided compensation to Durno's clients.

¶ 14 IIROC's Sanction Guidelines state that the purpose of sanctions in regulatory proceedings is to protect the public interest by restraining future conduct that may harm the capital markets.6 Accordingly, sanctions should be significant enough to prevent and discourage future misconduct by the respondent and deter others from engaging in similar misconduct.

¶ 15 IIROC's Sanction Guidelines cite the case of Re Mills7 in which the Hearing Panel stated that industry expectations are of particular relevance to general deterrence and that excessive penalties may reduce respect for the process, thereby diminishing their deterrent effect.

¶ 16 As the Respondent has been subjected to the penalties, which are proportionate to its contravention of IIROC's Dealer Member Rules, we are satisfied that the penalties will act as a specific deterrent to the Respondent and provide a general deterrent to the industry.

V. CONCLUSIONS

¶ 17 For the foregoing reasons, the Hearing Panel has concluded that the Settlement Agreement is in the public interest and, accordingly, is accepted.

Dated this 21st day of November, 2018.

Christopher Portner

Leo Ciccone

Shaine Pollock

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 TD Waterhouse Canada Inc. ("TDW" and the "Respondent").

[4] 2015 IIROC 37.
[5] 2017 IIROC 48.
[6] IIROC's Sanction Guidelines February 2, 2015 at paragraph 1 of Part I.
[7] [2001] I.D.A.C.D. No. 7 at page 3.

PART II – JOINT SETTLEMENT RECOMMENDATION

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

PART III – AGREED FACTS

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

Overview

4. The Respondent did not adequately supervise the trading of one of its former Registered Representatives, David Gary Durno ("Durno"). Durno recommended and implemented active trading in new issue securities and government bonds for two senior clients that generated large commissions and was not in their financial interests.

5. The commissions generated by Durno frequently exceeded the commission thresholds for selecting accounts for monthly review that are set out in the Dealer Member Rules ("DMR"). TDW failed to identify, query or prevent Durno's trading and accordingly did not adequately supervise its employee in the instances described below.

6. After receipt of a complaint from one of Durno's clients, TDW conducted an expanded investigation to include other clients. As a result of that review, TDW compensated the two clients referred to in this Settlement Agreement and a third client.

The Respondent

7. TDW is and was at all material times a Dealer Member.

8. Pursuant to DMR 38.1, TDW is required to establish and maintain a system to supervise the activities of its Registered Representatives. DMR 2500 establishes minimum standards for retail account supervision and provides guidance on the means to be used by Dealer Members to meet their supervisory obligations.

9. TDW maintains a two-tier system of supervision. According to DMR 2500(III) and (IV), TDW was obliged to conduct daily and monthly reviews of retail customer accounts to detect, among other things, excessive trade activity, conflicts of interest, and inappropriate/high risk trading strategies. Accounts may be selected for review on a basis reasonably designed to detect improper account activity and the DMR state that a Dealer Member may meet this obligation by:

   i. at Tier 1, reviewing the activity of all customers charged gross commissions of $1500 or more for the month; and

   ii. at Tier 2 reviewing the activity of all customers charged gross commissions of $3000 or more for the month.

10. TDW included these thresholds in their selection criterion for daily and monthly account review.

11. The trading described below for SS and MH frequently generated monthly commissions in excess of $1500 and $3000, as referenced in DMR 2500. However, TDW did not identify or address any issues with regard to the commissions.

Durno's Trading and the Commissions Generated

12. From 1997 to 2016, the Respondent employed Durno as an Investment Advisor. In 2016, TDW terminated Durno's employment for cause as a consequence of his failure to act in the financial interests of the clients referenced in this Settlement Agreement.

13. In or about October 2015, Durno's client, SS, submitted a complaint to TDW. TDW investigated the activity in the accounts of SS and expanded its review to other clients of Durno's. Based on that review it became apparent that Durno had been trading for SS and two other clients to generate excessive

commissions for himself, contrary to the clients' financial interests.

14. These clients were in accounts where they paid commissions on every transaction, except when they purchased new issue securities in which case the issuer paid a commission that was generally larger than the amount that the client would have paid.

15. In July 2018, an IIROC Hearing Panel accepted a Settlement Agreement between Durno and Staff in which Durno admitted that between 2010 and 2015 he failed to adequately consider and address the interests of two clients, contrary to DMR 29.1 and, after March 26, 2012, DMR 42.2. Durno agreed to pay a fine of $150,000 inclusive of disgorgement, submit to close supervision until December 2018, and pay costs of $5000.

SS

16. SS was born in 1922. As of 2010, SS' Know-Your-Client ("KYC") information reflected that she had average investment knowledge, was retired, had a total net worth of $2.3 million ($2 million was liquid) and an annual income of $75,000.

17. In 2010, SS' stated risk tolerance for her primary account was 30% low risk, 60% medium risk, and 10% high risk. Her investment objectives were 50% income and 50% long-term capital gains. KYC updates in 2011 and 2012 reflect a changed risk tolerance to 40% low, 40% medium and 20% high.

18. The trading recommended and conducted by Durno for SS was active with the turnover rate in three of the five years exceeding two times. SS did not document an interest in short-term trading. However, Durno obtained SS' authorization prior to effecting all trades and she received trade confirmations and account statements.

19. Between 2010 and 2015, SS' cash account had an average annual balance of approximately $2 million and generated net profits of approximately $24,968.

20. Overall, between 2010 and 2015, Durno's trading for SS generated commissions for TDW and himself of $471,643, $258,643 of which were paid by SS and the balance by issuers. TD received approximately half of these commissions.

21. In the 72 months between 2010 and 2015, commissions generated on SS' cash account exceeded $1500 in 62 months and exceeded $3000 in 57 months. In 2012 and 2013, SS' cash account generated commissions greater than $3000 every single month.

22. During this period, most of the securities traded in SS' accounts were government bonds and medium risk new issue securities. Durno regularly sold and repurchased the same bonds within one month. The new issue securities purchased were also generally sold shortly after purchase.

23. After receiving and investigating SS' complaint, TDW compensated her for, among other things, the difference between the commissions she paid and the fees she would have paid in a fee-based account. Durno contributed approximately 13% to the compensation paid to SS before his employment was terminated.

24. TDW also expanded its investigation to other clients of Durno.

MH

25. MH was born in 1921. As of 2010, MH's KYC information reflected that she had average investment knowledge, was retired, had a total net worth greater than $1 million and an annual income of $25,000-$50,000. A 2012 update reflected a total net worth of $1,460,000 ($560,000 liquid), annual income of $40,000, and a reduction in investment knowledge from average to none.

26. In 2010, MH's risk tolerance was low. In 2012, MH's risk tolerance was updated to 80% medium, 20% high. Her investment objectives were 50% income and 50% long-term capital gains.

27. The trading recommended and conducted by Durno for MH was active with the turnover rate in three of the five years exceeding two times. MH did not document an interest in short-term trading, however

Durno obtained MH's authorization prior to effecting all trades and she received trade confirmations and account statements.

28. Between 2010 and 2015, MH's account with the Respondent had an annual average balance ranging from $494,522 to $611,250 and generated net profits of approximately $48,330.

29. Overall, between 2010 and 2015, the Respondent's trading for MH generated commissions for TDW and himself of $162,284, $126,946 of which was paid by MH and the balance by issuers. TDW received approximately half of these commissions.

30. In the 72 months between 2010 and 2015, commissions generated on MH's cash account exceeded $1500 in 43 months and exceeded $3000 in 25 months.

31. During this period, most of the securities traded in MH' accounts were government bonds and medium risk new issue securities. Durno regularly sold and repurchased the same bonds within one month. The new issue securities purchased were also generally sold shortly after purchase.

32. MH did not complain, however TDW voluntarily compensated her for, among other things, the difference between the commissions she paid and the fees she would have paid in a fee-based account. Durno did not contribute any amount to the settlement with MH.

Failure to Adequately Supervise

33. Overall, between 2010 and 2015, the clients' costs described above would have been significantly lower in fee-based accounts. The commissions paid by the clients reduced the returns of their investment portfolios.

34. Further, for new issue securities, the issuer paid a commission on purchases that was generally larger than the client would have paid on secondary issues. This was beneficial to Durno and consequently TDW. The clients paid no commission on the purchase of new issue securities.

35. The commissions generated for the clients addressed in this Settlement Agreement frequently exceeded the prescribed thresholds for monthly review specified in DMR 2500. The accounts of SS, MH and the other client compensated by TDW often appeared on the monthly reports generated for Tier 1 and Tier 2 review.

36. TDW ought to have identified the active new issue and bond trading and required Durno to explain:

    a. why the active trading was consistent with the clients' investment objectives

    b. how the trading was in the clients' financial interests; and

    c. whether the clients ought to have been in fee-based accounts given their active trading and transactional costs.

37. However, TDW never issued any supervision queries or identified any issues with respect to the commissions generated by Durno's trading and this enabled him to continue to trade in a manner that was contrary to the financial interests of the clients and beneficial to himself and TDW.

38. After SS complained and TDW investigated, TDW concluded that the commissions generated in the accounts of SS, MH and one other client were excessive and that Durno's trading was not solely for the purpose of increasing the clients' remuneration, but was rather for his own benefit. Durno admitted in his settlement with Staff that he failed to adequately consider and address the interests of SS and MH. However, TDW failed to detect Durno's misconduct in its monthly reviews.

Mitigating Factors

39. As described above, TDW took the initiative to expand its investigation beyond the accounts of SS who complained directly and offered compensation to MH and another client even though they never complained. TDW has made all three clients whole in regards to their trading costs. Durno has only made a small contribution to the compensation paid to SS.

40. Overall, Durno generated gross commissions of slightly less than $1.2 million from the trading for SS, MH and the other client between 2010 and 2015. TDW retained approximately half of these commissions and has paid approximately $550,000 in compensation.

41. The risk profile of the securities Durno traded for SS and MH was consistent with their stated risk tolerance.

42. Some of Durno's short-term bond trading was conducted over month-end. This made it more difficult to detect its repetitive nature.

43. TDW has improved its supervision of commissions generated by its investment advisors both from clients and on new issue securities by implementing and improving an electronic trade surveillance system which is currently centralized within TDW's head office. This system has been continually reviewed and updated by TDW and the current filters and parameters for trade review would facilitate detection of trading that generates excessive commissions.

44. This settlement was entered into at an early stage of Staff's investigation in this matter. TDW's prompt acknowledgement of its failure to supervise reduced the resources and time required to investigate this matter and led to an early resolution.

PART IV – CONTRAVENTIONS

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

    Between 2010 and 2015, the Respondent failed to adequately supervise the trading of a Registered Representative to ensure compliance with Dealer Member Rules, contrary to Dealer Member Rules 38.1 and 2500.

PART V – TERMS OF SETTLEMENT

46. The Respondent agrees to the following sanctions and costs:

    a) Fine of $140,000; and

    b) Costs of $10,000.

47. 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

48. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.

49. 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

50. This Settlement Agreement is conditional on acceptance by the Hearing Panel.

51. 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.

52. 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.

53. 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.

54. 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.

55. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.

56. 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.

57. 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.

58. 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

59. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.

60. A fax or electronic copy of any signature will be treated as an original signature.

DATED this _"10"_ day of October, 2018.

"Witness"	"TD Waterhouse Canada Inc."
Witness	**TD WATERHOUSE CANADA INC.**
"David De Biasi"	"Elissa Sinha"
Witness	Elissa Sinha Enforcement Counsel on behalf of Enforcement Staff of the Investment Industry Regulatory Organization of Canada

The Settlement Agreement is hereby accepted this "2" day of "November", 2018 by the following Hearing Panel:

Per: "Christopher Portner"
Panel Chair

Per: "Leo Ciccone"
Panel Member

Per: "Shaine Pollock"
Panel Member