Re Jones

In the matter of:

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

and

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

and

James Gwilym Jones

2012 IIROC 48

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

Heard: June 3, 2012 at Calgary, Alberta
Written Decision: August 10, 2012

Hearing Panel:
Alan V.M. Beattie, Q.C. (Chair), Kathleen Jost, Donald Milligan
Appearances:
David McLellan - Enforcement Counsel
Christine E. Silverberg, Counsel For the Respondent
The Respondent was unable to attend

REASONS FOR DECISION

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1. INTRODUCTION

¶ 1 A Settlement Agreement was entered into May 22, 2012 between James Gwilym Jones ("the Respondent") and the Investment Industry Regulatory Organization of Canada ("IIROC") in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.

¶ 2 The Settlement Agreement contains a complete Statement of Facts, a description of the Contraventions and the Terms of Settlement (all below). In the Settlement Agreement the Respondent admits to the contraventions. Staff of IIROC and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement. It is stated that the Settlement Agreement is subject to acceptance by the Hearing Panel and if the Panel accepts the Settlement Agreement, the Respondent waives his right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

¶ 3 A Settlement Hearing Book was provided in advance of the Hearing by IIROC to the Respondent and his Counsel, and members of the Hearing Panel.

2. SETTLEMENT AGREEMENT

¶ 4 The Settlement Agreement includes the following:

STATEMENT OF FACTS

(i) Acknowledgment

9. For the purposes of this Settlement Agreement only, Staff and the Respondent agree with the facts set out in this Section and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

10. The Respondent James Jones ("Jones") was a Registered Representative responsible for the accounts of six clients (three married couples). The Respondent failed to use due diligence to ensure that recommendations were suitable for his clients when he pursued an aggressive growth trading strategy for these clients, who were either retired or approaching retirement and inexperienced investors. Total losses for these clients were approximately $1,174,000.

Registration History

11. Jones has been a Registered Representative since July, 1993. In 2001, he joined Dundee Securities Corporation, which in 2004 became DWM Securities Inc. ("Dundee").

12. At all material times, Jones was a Registered Representative at a Dundee sub-branch office in Calgary.

13. Jones was the lead in a team of three employees. Transactions were recorded with his broker code and it was Jones' practice to approve and sign all client forms.

Employment Termination

14. In March, 2009 Dundee suspended Jones as a result of a public complaint from a client. In December, 2009 Jones' employment at Dundee was terminated.

15. Jones has not worked in a registered capacity for a Member firm since March, 2009.

Clients - RR and JS

16. In or around October, 2001, RR and JS opened accounts with Jones. RR was then a 53 year old teacher and his spouse, JS, was a 55 year old physiotherapist.

17. The 2001 New Client Account from ("NCAF") for their RSP states that the couple had a stated net worth of $350,000, and a combined income of $111,000. Although they had limited investing experience, their investment knowledge is listed as "good".

18. The NCAF lists investment objectives of 0% - 80% - 20% (income - capital appreciation - speculative) and risk tolerance of 0% - 80% - 20% (low - medium - high). They also held a non-registered trading account with identical parameters.

19. RR and JS were looking to Jones for financial advice and direction as they approached retirement. RR would be entitled to a small pension in retirement but they were going to be relying on their investments for income. They also owned portions of some rental properties from which they received minimal income after expenses.

20. In April, 2005, RR and JS, now aged 57 and 59 respectively, met with Jones and/or his staff in order to update their RSP account documentation as they were now retired.

21. Although retired, their NCAF listed investment objectives of 0% - 30% - 70% (income - capital appreciation - speculative) and risk tolerance of 0% - 30% - 70% (low - medium - high). These stated investment objectives and risk tolerance parameters were actually higher than when they had first opened the account in 2001 and before they retired.

22. The stated investment objectives and risk tolerance parameters were inconsistent with the clients' true financial situation, investment knowledge, investment objectives and risk tolerance.

23. There were no NCAF updates after April, 2005.

24. RR and JS relied upon and followed Jones' recommendations for the investments in their accounts. In addition, approximately 90% of the trades were solicited.

25. Through Jones' own research, investment ideas and trading activity, the risk exposure in the portfolio increased over time.

26. As of January, 2008, approximately 59% of the RR/JS investment portfolio held oil and gas stocks including 26% in junior issuers. Nearly all of the remainder of their portfolio held financial stocks and equity mutual funds. They did not hold fixed income securities to generate income.

27. These holdings, which were highly concentrated in resource stocks, reflected an extremely high degree of risk and were not suitable for a retired couple needing income from their investments.

28. Between January, 2007 and December, 2008, the RR/JS portfolio lost approximately $176,000, or a 51% decline. During the same time period the S&P/TSX Index declined approximately 27%.

29. RR and JS have received total compensation from Dundee in the amount of $37,439.00 with respect to their losses.

Clients - DM and MM

30. DM and MM were long time clients of Jones. In 2004, they retired from their employment as a physician and music teacher. Although no client account updates were completed at that time, in September, 2006 they converted their accounts from RRSP's to RRIF's and completed an NCAF.

31. The September 2006 NCAF states that the couple, then 62 and 59, had a combined stated net worth of $900,000, and an income of $40,000. Although they had limited investing experience, their investment knowledge is listed as "good".

32. The NCAF lists investment objectives of 0% - 60% - 40% (income - capital appreciation - speculative) and risk tolerance of 0% - 60% - 40% (low - medium - high).

33. DM and MM did not have a pension and relied on their investments for income.

34. The stated investment objectives and risk tolerance parameters were inconsistent with the clients' true financial situation, investment knowledge, investment objectives and risk tolerance.

35. Between 2004 and December, 2008, MM corresponded with Jones' staff and expressed concerns on many occasions with respect to the very high level of risk in their portfolio. She asked if they should be reallocating their portfolio to "something more conservative". Despite these concerns, Jones did not make any substantial changes to the portfolio to reduce the risk.

36. DM and MM relied upon and followed Jones' recommendations for the investments in their accounts. In addition, approximately 90% of the trades were solicited.

37. Through Jones' own research, investment ideas and trading activity, the risk exposure in the portfolio increased over time.

38. As of January, 2008, approximately 68% of the DM/MM investment portfolio held oil and gas stocks including 39% in junior issuers. Nearly all of the remainder of their portfolio was in financial stocks and equity mutual funds. Their portfolio did not contain any fixed income securities to generate income.

39. These holdings, which were highly concentrated in resource stocks, reflected an extremely high degree of risk and were not suitable for a retired couple needing income from their investments.

40. Between January, 2007 and March 2009, the DM/MM portfolio lost approximately $724,000, or a 59% decline. During the same time period the S&P/TSX Index declined approximately 31%.

41. DM and MM have received total compensation from Dundee in the amount of $238,792.00 with respect to their losses.

Clients - NC and LC

42. NC, a retired business owner and his wife, LC were long time clients of Jones. They were unsophisticated investors who had both achieved a grade 10 education. They had no pensions and relied on their investments for income.

43. NC and LC had numerous accounts with Jones. In October 2001, LC completed a NCAF for her registered account which states that the couple had a combined net worth of $550,000, income of $32,000 each, and despite limited investment knowledge, her investment knowledge is listed as "good". She was then 64 years old.

44. The 2001 NCAF lists investment objectives of 10% - 80% - 10% (income - capital appreciation - speculative) and risk tolerance of 10% - 80% - 10% (low - medium - high).

45. Despite the couple's ongoing need to rely on their investments for income, beginning in 2004 the investment objectives and risk tolerance parameters in their accounts were increased on multiple occasions. By April, 2008 the investment objectives in the accounts had reached 0% - 30% - 70% (income - capital appreciation - speculative) with risk tolerance of 0% - 30% - 70% (low - medium - high).

46. The stated investment objectives and risk tolerance parameters were inconsistent with the clients' true financial situation, investment knowledge, investment objectives and risk tolerance.

47. NC and LC relied upon and followed Jones' recommendations for the investments in their accounts. In addition, approximately 90% of the trades were solicited.

48. Through Jones' own research, investment ideas and trading activity, the risk exposure in the portfolio increased over time.

49. As of January 31, 2008, approximately 89% of the NC/LC RRIF account held resource stocks including approximately 59% in junior issuers and/or private companies. Their portfolio did not contain any fixed income securities to generate income.

50. These holdings, which were highly concentrated in resource stocks, reflected an extremely high degree of risk and were not suitable for a retired couple needing income from their investments.

51. Between January, 2007 and March, 2009, the NC/LC portfolio lost approximately $274,000, or a 74% decline. During the same time period the S&P/TSX declined approximately 31%.

CONTRAVENTIONS

7. The Respondent admits to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

a) From April, 2005 to March, 2009, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to his clients, RR and JS, contrary to IIROC Rule 1300.1(a);

b) From April, 2005 to March, 2009, the Respondent failed to use due diligence to ensure that the recommendation of any security for his clients, RR and JS, was suitable for such clients based on factors including the clients' financial situation, investment knowledge, investment objectives and risk tolerance contrary to IIROC Rule 1300.1(q);11

c) From September, 2006 to March, 2009, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to his clients, DM and MM, contrary to IIROC Rule 1300.1(a);

d) From September, 2006 to March, 2009, the Respondent failed to use due diligence to ensure

that the recommendation of any security for his clients, DM and MM, was suitable for such clients based on factors including the clients' financial situation, investment knowledge, investment objectives and risk tolerance contrary to IIROC Rule 1300.1(q);

e) From March, 2004 to March, 2009, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to his clients, NC and LC, contrary to IIROC Rule 1300.1(a); and

f) From March, 2004 to March, 2009, the Respondent failed to use due diligence to ensure that the recommendation of any security for his clients, NC and LC, was suitable for such clients based on factors including the clients' financial situation, investment knowledge, investment objectives and risk tolerance contrary to IIROC Rule 1300.1(q).

TERMS OF SETTLEMENT

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

a) The Respondent agrees to pay a fine to IIROC in the sum of two hundred thousand dollars ($200,000.00);

b) The Respondent shall be prohibited from registration with IIROC in any capacity for five (5) years;

c) The Respondent agrees to pay costs to IIROC in the sum of ten thousand dollars ($10,000.00).

3. SUBMISSIONS OF IIROC

¶ 5 The foregoing Agreed Statement of Facts, Contraventions and Terms of Settlement were reviewed by Mr. McLellan, Enforcement Counsel for IIROC.

¶ 6 IIROC referred to pertinent parts of the Settlement Hearing Book including IIROC Dealer Member Rules 20.33(2) ("Penalties") and 20.36 ("Hearing Panel Powers"); IIROC Rules of Practice and Procedure Rule 15 ("Settlement Hearings"); Dealer Member Rules in IDA By-Law Rule 1300.1(a) and (q) ("Supervision of Accounts", including "Suitability Determinations Required When Recommendation Provided").

¶ 7 IIROC emphasized that the Dealer Member Rule Commentary 3.2 ["Failure to Know Your Client - Dealer Member Rule 1300.1(a) and (b)" is pertinent to this case (set out below in Reasons for Decision). IIROC stated that the foregoing circumstances are precisely what took place in the present case for the following reasons:

1. The Respondent did not consider the circumstances of the couples which is of paramount importance. Some complained and had issues about their holdings. His advice was not at all appropriate in circumstances where they were looking for guidance. There was a lack of fixed income holdings.

2. Their portfolios lost 50% to 74% of value. Granted the market dropped significantly during the time period but not to the extent of the drop experienced in these portfolios. There was too high a concentration in the resource sector.

3. The level of sophistication of the clients was low.

4. The Respondent knew these clients and their circumstances. He was overly aggressive with the growth strategy. He should have listened more to what the clients were saying. The fact that their stated objectives became more aggressive is very hard to understand.

¶ 8 IIROC also referred to the IIROC Dealer Member Disciplinary Sanction Guidelines and emphasized the importance of the sections entitled "Disciplinary Sanctions as Deterrence", "Harm to Clients", "Blame Worthiness" and "Degree of Participation". He particularly emphasized the circumstances of this case involving 90% of the trades being solicited by the Respondent, very significant portfolio declines being

approximately twice the market declines, the clients were retired or close to retirement and the investments were totally out of line with what these clients required. It is incomprehensible that their risk level was shown as increasing when the clients were getting older and more vulnerable and the three couples lost at total of more than $1 million (the Member Firm has compensated two of the couples for a portion of their losses).

¶ 9 IIROC also referred to the facts in favour of the Respondent being that he has been cooperative with IIROC, has been out of business since March, 2009, it has been very hard on him and has created a tremendous economic strain.

¶ 10 IIROC referred to three cases as providing guidance in determining the reasonable range of penalties (discussed in Reasons for Decision section, below):

Re Wilson (2011) IIROC 47, July 26, 2011 (Ontario District Council)

Re Phillips (2011) IIROC 60, November 16, 2011 (Pacific District Council)

Re Gareau (2011) IIROC 72, January 2, 2012 (Saskatchewan District Council)

¶ 11 IIROC submitted that the circumstances of this case are egregious to the point that a substantial fine of $200,000.00 and a suspension for a period of five years is appropriate. Counsel made reference to ***Re Milewski*** (1999) I.D.A.C.D. No. 17, July 28, 1999 (Ontario District Council) for the often quoted passage 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".

4. SUBMISSIONS OF THE RESPONDENT

¶ 12 12. Ms. Silverberg, Counsel for the Respondent, submitted that the Settlement Agreement should be accepted by the Panel. She referred to the Respondent having accepted responsibility, that both the Respondent and his wife have lost their livelihood and will not be able to be in the investment business. The Respondent is not in good health.

5. REASONS FOR DECISION

¶ 13 In the Settlement Agreement the Respondent admits to the Contraventions of IIROC Rules, IDA By-Laws, Regulations or Policies set out above. The Hearing Panel accepts that the Contraventions have been established.

¶ 14 The Contraventions are contrary to IIROC Rules 1300.1(a) and (q):

RULE 1300

SUPERVISION OF ACCOUNTS

1300.1.

Identity and Creditworthiness

(a) Each Dealer Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.

Suitability Determination Required When Recommendation Provided

(q) Each Dealer Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.

¶ 15 As submitted by Counsel for IIROC Guideline 3.2 of the IIROC Dealer Member Disciplinary Sanction Guidelines is particularly pertinent in this case. It follows:

3.2 Failure to Know Your Client - Dealer Member Rule 1300.1(a) and (b)

The Know Your Client rule is of paramount importance for the securities industry. All registrants must make diligent and business-like efforts to learn and record the essential financial and personal circumstances, and the investment objectives of each client. 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.

Considerations in Addition to General Principles

1. Nature and Extent of Failure to know your client.

2. Magnitude of losses directly attributable to the failure to know your client.

3. The level of sophistication of the client

4. Extent of due diligence conducted to determine the essential facts of the client.

Recommended Sanctions

- Fine: Minimum of $10,000.
- Re-write of CPH.
- Period of close and/or strict supervision.
- Period of suspension (in most egregious cases)

Counsel for IIROC also reviewed the opening section of the Disciplinary Sanction Guidelines:

GENERAL PRINCIPLES

The following principles and rules are proposed to provide a framework for assessing the gravity of a particular breach of the Dealer Member Rules, and help to determine which sanction(s) is reasonable in the circumstances.

1. Main Concerns When Determining An Appropriate Penalty

As set out in *Re Derivative Services Inc.*, [2000] I.D.A.C.D. No. 26, at page 3, a Hearing Panel's main concerns in determining an appropriate penalty are:

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.

The penalty imposed in a specific proceeding should reflect the Hearing Panel's assessment of the measures necessary in the specific case to accomplish these goals, ranging from a reprimand to an absolute bar, and may take into account the seriousness of the respondent's conduct and specific and general deterrence.

¶ 16 We agree with the Submissions of Counsel for IIROC (above, pp. 7, 8). Some guidance is provided by the cases upon which he relied.

¶ 17 In ***Wilson*** (above) the respondent made unsuitable investment recommendations for the account which was opened to receive the payment of approximately $640,000 from a divorce settlement. The client was in her forties with four dependent children. The New Client Account Agreement indicated that the account was to be a margin account. The client did not realize she was opening a margin account and did not understand the added risk of the margin account. Her investment objectives were shown as "aggressive growth" and her investment knowledge as "high/expert". The account was also set up as a discretionary trading account. The client was devastated by the conduct of the respondent who she trusted and relied upon. The misconduct took place over a 3.5 year period and involved approximately 120 trades. The respondent acknowledged that he

failed to properly review the New Account documents. The client had a low tolerance for risk and needed to preserve capital because of her family circumstances and her inability to earn additional income. The only mitigating factor was that the respondent had no prior disciplinary record. The following penalty was imposed: Fine of $75,000; disgorgement of the commissions earned in the amount of $26,000; five year suspension from registration with IIROC; successful rewriting of the appropriate examinations; costs $10,000.

¶ 18 In ***Phillips*** (above) over a seven month period the respondent purchased securities in the accounts of two clients which were not suitable for them. The father was an eighty-two year old retiree and the respondent was responsible for all of his assets of approximately $668,000. In 30 purchases on 17 different days, 70% of the client's holdings were placed in high risk speculative junior mining stocks and small cap income trusts. The accounts lost in excess of $169,000. The daughter was 57 years old and divorced. She had a total net worth of $475,000 and an annual income of $20,000. 90% of the assets were invested in high risk speculative securities and the account lost in excess of 50% of its value. They were particularly vulnerable clients and the respondent knew this. The securities were totally inconsistent with the clients' investment objectives and low tolerance for risk. Penalty imposed was: Fine of $290,000; disgorgement of profits of $10,350; suspension for three years; successfully complete all appropriate courses; if re-registered strict supervision for the first two years of re-entry to the securities industry; costs $15,000.

¶ 19 In ***Gareau*** (above) the respondent inaccurately recorded in the New Client Application Forms the risk tolerance and investment objectives of two couples, all of whom were retired and reliant on their investment portfolio. The inappropriate investments included a hedge fund on margin, and limited partnerships, some of them on margin. He recommended that a fixed income bond yielding as high as 6.7% be sold to buy equity mutual funds. He recommended extensive use of margin accounts and failed to take extensive positive steps to reduce the margin once it reached excessive amounts. The clients were relatively unsophisticated and relied on the respondent heavily for his expertise and advice. Not all the investments were high-risk but it was the extensive, almost exclusive, investments in equity mutual funds that caused the panel to conclude the portfolios were inappropriate. The clients had complained. Losses of one couple were in excess of $600,000; they received a settlement of $500,000 from the respondent's firm, $100,000 of which was contributed by the respondent. The respondent continued to be associated with the firm. Penalty imposed was: Fine of $100,000; disgorgement of commissions of $47,383; suspension for one year; successfully retake the CPH examination; if re-registered, strict supervision for one year; costs $20,000.

¶ 20 We agree with the rationale in the ***Milewski*** decision (above) about panels not altering the terms of a settlement agreement unless the penalty "clearly fall(s) outside a reasonable range of appropriateness".

¶ 21 Applying the general principles of protection of the investing public, protection of the integrity of the IIROC process, protection of the integrity of the securities market, prevention of a repetition of conduct of the type under consideration, and general deterrence, leads us to the conclusion that the penalties agreed upon between IIROC and the Respondent in the Settlement Agreement fall within the reasonable range established in the decisions, are appropriate and should be accepted.

¶ 22 We have taken into consideration the factors referenced by Counsel for the Respondent (above). However, a serious disciplinary response is required in the circumstances of this case.

¶ 23 The Hearing Panel advised, at the conclusion of the Hearing, that we accepted and we signed, the Settlement Agreement. We confirm that decision.

¶ 24 The Respondent, in the Settlement Agreement, agreed to the following terms of settlement, which we have accepted as appropriate:

(a) a fine of $200,000;

(b) the Respondent is prohibited from registration with IIROC in any capacity for five (5) years;

(c) the Respondent shall pay costs to IIROC in the sum of ten thousand dollars ($10,000).

¶ 25 We consider the fine and the five year suspension appropriate especially considering that the Respondent's advanced age makes the suspension tantamount to a lifetime prohibition. We consider the amount of the costs to be within the reasonable range and although they will not fully cover IIROC's costs, they reflect the reduced involvement and cost for IIROC resulting from the Respondent's cooperation.

August 10, 2012

A1an V.M. Beattie, Chair

Kathleen Jost - Industry Representative

Donald Milligan - Industry Representative