

Re Clarke

IN THE MATTER OF:

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

and

Gary Clarke

2016 IIROC 12

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

Heard: December 30, 2015 in Vancouver, British Columbia
Decision: December 30, 2015

Hearing Panel:

Wade Nesmith, Chair, Barbara Fraser, Robert Travers

Appearances:

Lorne Herlin, Enforcement Counsel

Gary Clarke (absent)

SETTLEMENT HEARING DECISION

¶ 1 This matter came before the Panel as a result of a Settlement Agreement (the “Agreement”) between Gary Clarke (“Clarke” or the “Respondent”) and the Investment Industry Regulatory Organization of Canada (“IIROC”). A copy of the Agreement is attached to this decision. The Panel heard submissions from Enforcement Counsel, Mr. Herlin, on December 30, 2015. The Respondent chose not to attend the hearing and was apparently unrepresented, but his consent to the Agreement was evidenced by his signature on the Agreement. Following submissions, the Panel approved the Agreement, with reasons to follow. These are the reasons.

¶ 2 In the Agreement, Clarke admitted to the following contraventions of IIROC Dealer Member Rules:

1. Between August 2011 and December 2012, he failed to use due diligence to ensure that the recommendations that he made for the account of his clients JE and KE were suitable for them, contrary to IIROC Dealer Member Rule 1300.1(q);
2. In September and October 2011, he engaged in discretionary trading for the account of his clients JE and KE without the account having been approved and accepted as a discretionary account, contrary to IIROC Dealer Member Rule 1300.4; and
3. Between November 2011 and December 2012, he failed to use due diligence to ensure that the recommendations that he made for the account of his client RB were suitable for him, contrary to IIROC Dealer Member Rule 1300.1(q).

¶ 3 The conduct admitted to involves recommending unsuitable investments and what is commonly known as discretionary trading. The details are set forth in the Agreement. It involved 3 retired clients with little or no public capital markets experience. It occurred over the space of 16 months. Total losses were approximately

\$74,000. The lack of suitability allegations resulted mainly from the prolonged use of what are known as “inverse ETFs”; i.e., exchange traded funds that contain solely short positions. These securities are generally viewed as highly speculative and requiring daily monitoring, and are usually reserved for only the most sophisticated of investors. Clarke recommended these securities because of his view that the market was generally over-valued. He did not engage in churning. However, his use of these securities was inappropriate for these individuals, the manner in which he used them was inappropriate (holding over long periods of time) and he was mistaken in his view of the future direction the market. In short, his conduct and the unfortunate results provide a classic case of why these securities are to be used only in rare circumstances by highly sophisticated individuals.

¶ 4 Mr. Herlin submitted, and the Respondent agreed, that a settlement including a fine of \$30,000, a two month suspension, a requirement to complete the Conduct and Practices Handbook course prior to re-approval, and a 6 month period of close supervision following re-approval would be appropriate, and we agreed. We were advised that the Respondent is no longer employed in the industry.

¶ 5 A Panel’s power when reviewing a settlement agreement is clearly set out in Rule 20.36. How its discretion should be exercised has been the subject of a number of decisions, both by hearing panels and by courts reviewing those decisions. One of the tests generally used indicates that unless a proposed penalty falls clearly outside a reasonable range of appropriateness, the settlement should be approved. Mr. Herlin referred us to a number of cases including, among others, *Re Axford* 2013 IIROC 36, *Re Bateman* 2014 IIROC 38, and *Re Brodie* 2013 IIROC 12 and 2013 IIROC 39, and those cases demonstrated clearly to us that the proposed penalty does not fall clearly outside a reasonable range of appropriateness.

¶ 6 For the reasons indicated above, we accepted the Agreement.

Dated at Vancouver, British Columbia this 30th day of December, 2015.

Wade Nesmith, Chair

Barbara Fraser

Robert Travers

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. Enforcement Staff of the Investment Industry Regulatory Organization of Canada (IIROC) and the Respondent, Gary Clarke (Clarke), consent and agree to the settlement of this matter by way of this agreement (the Settlement Agreement).
2. IIROC Enforcement Staff (Staff) have conducted an investigation (the Investigation) into the conduct of Clarke.
3. The Investigation discloses matters for which Clarke may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (the Hearing Panel).

II. JOINT SETTLEMENT RECOMMENDATION

4. Staff and Clarke jointly recommend that the Hearing Panel accept this Settlement Agreement.
5. Clarke admits to the following contraventions of IIROC Dealer Member Rules:
 - a) Between August 2011 and December 2012, he failed to use due diligence to ensure that the recommendations that he made for the account of his clients JE and KE were suitable for them, contrary to IIROC Dealer Member Rule 1300.1(q);

- b) In September and October 2011, he engaged in discretionary trading for the account of his clients JE and KE without the account having been approved and accepted as a discretionary account, contrary to IIROC Dealer Member Rule 1300.4; and
 - c) Between November 2011 and December 2012, he failed to use due diligence to ensure that the recommendations that he made for the account of his client RB were suitable for him, contrary to IIROC Dealer Member Rule 1300.1(q).
6. Staff and Clarke agree to the following terms of settlement:
- a) payment of a \$30,000 fine;
 - b) a two month period of suspension;
 - c) a requirement that he successfully complete the Conduct and Practices Handbook course prior to being eligible for approval; and
 - d) upon re-approval a 6 month period of close supervision.
7. Clarke agrees to pay costs to IIROC in the sum of \$2,500.

III. STATEMENT OF FACTS

(i) Acknowledgment

8. Staff and Clarke agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

Overview

9. Clarke was the Registered Representative who responsible for the accounts of JE, KE, and RB.
10. Clarke recommended that they purchase units of inverse exchange traded funds (ETFs) and short sell shares. These recommendations were not suitable for them because, among other things, of their limited investment experience and they resulted in their investment accounts having a level of high risk securities which exceeded their stated risk tolerance levels.
11. In addition, Clarke engaged in discretionary trading in the account of JE and KE.

Clarke

12. Clarke first began working in the securities industry in 1988.
13. From March 2004 to October 2013, Clarke worked as a Registered Representative at the Prince George business location of Raymond James Ltd. (Raymond James).
14. Clarke has not been an IIROC Approved Person since October 2013.

JE & KE

15. JE and KE are married. JE was born in 1946 and KE was born in 1953.
16. JE and KE own and operate an automobile repair business (the Company).
17. The Company held an insurance policy which was issued by Manulife Financial Corporation (Manulife). In 1999 the Company received shares of Manulife when it converted from a mutual life insurance company to a publicly-traded company.
18. JE and KE decided that they wanted to sell the Manulife shares because they were approaching retirement. The shares were not held in an account.
19. As a result in July 2011, JE and KE met with Clarke to discuss the sale of the Manulife shares. JE's

neighbor had previously introduced JE to Clarke.

20. During the meeting JE and KE told Clarke that they only wanted to invest the proceeds from the sale of the Manulife shares. JE and KE had never bought or sold shares of a publicly-traded company.
21. In July 2011, JE and KE opened a margin account in the name of the Company (the Company Margin Account).
22. At all material times, Clarke was the Registered Representative who was responsible for the Company Margin Account.
23. The Client Account Agreement which JE and KE completed on behalf of the Company Margin Account indicated that their:
 - risk tolerance level was 50% medium risk and 50% high risk;
 - investment objectives were 50% growth and 50% speculative;
 - estimated net liquids assets were \$200,000; and
 - estimated net fixed asset were \$1,000,000.
24. The Client Account Agreement also indicated that JE and KE each had limited experience with investing.

Initial Deposit into the Company Margin Account

25. On July 21, 2011, 6,502 shares of Manulife were deposited into the Company Margin Account.
26. On or about August 9, 2011, all of the Manulife shares were sold. The net proceeds of the sale were approximately \$90,124.

Clarke's Trading Strategy

27. At all material times, Clarke believed that the shares of publicly-traded companies were generally over-valued and that equity markets were going to decline. Accordingly, as detailed below, for the most part Clarke recommended that JE and KE use the proceeds from the sale of the Manulife shares to purchase units of inverse ETFs and to short sell securities.
28. Both strategies are designed to profit when the prices of stocks decrease. Therefore, they have low diversification benefits with one another.

Purchase of Inverse ETFs in the Company Margin Account

29. ETFs are securities that trade on an exchange that track the performance of an underlying benchmark or index. The underlying assets to the benchmark or index may be stocks, bonds, or other assets such as commodities.
30. Inverse ETFs seek to deliver a daily return that is the inverse (opposite) of the daily performance of the index or benchmark that they track.
31. Clark purchased units of the following three inverse ETFs for the Company Margin Account:
 - i. Horizons BetaPro Comex Silver Inverse ETF, which tracks Comex silver futures contracts for a subsequent delivery month;
 - ii. ProShares Short Russell 2000, which tracks the Russell 2000 Index; and
 - iii. ProShares Short S&P 500, which tracks the S&P 500 Index
(collectively, the Three Inverse ETFs).
32. These Three Inverse ETFs are described in their respective prospectuses as involving a "high degree of

risk” or using “investment techniques and derivatives that may be considered aggressive”.

33. In particular, the prospectus for the Horizons BetaPro Comex Silver Inverse ETF states:

These ETFs are very different from most other exchange-traded funds.

...

The Inverse ETFs do not and should not be expected to return the inverse (i.e., -100%) of the return of their referenced futures contracts over any period of time other than daily.

...

These ETFs’ returns over periods longer than one day will likely differ in amount and possibly direction from the performance of their referenced futures contract, for the same period. This effect becomes more pronounced as the volatility of a referenced futures contract(s) increases.

Investors should monitor their investment in an ETF daily.

...

Each investor should carefully consider whether their financial condition and/or retirement savings objectives permit them to buy Units of an ETF. Units of the ETFs are highly speculative and involve a high degree of risk, some not traditionally associated with mutual funds. No ETF by itself constitutes a balanced investment plan. An investor may lose a portion or even all of the money that he or she places in an ETF. {underlying added}

34. The prospectuses for both the ProShares Short Russell 2000 and the ProShares Short S&P 500 state:

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

Investment Objective

The Fund seeks daily investment results, before fees and expenses, that correspond to the inverse ... of the daily performance of the Index. **The Fund does not seek to achieve its stated investment objective over a period of time greater than one day.**

....

Risks Associated with the Use of Derivatives – The Fund uses investment techniques and derivatives that may be considered aggressive. Because the Fund’s investment in derivatives may involve a small investment relative to the amount of investment exposure assumed, losses may exceed the amounts invested in those instruments. {underlying added}

35. Further, inverse ETFs were discussed in IIROC Notice 09-0172 dated June 11, 2009, which states:

Exchange-traded funds (ETFs) that offer leverage or that are designed to perform inversely to the index or benchmark they track, or both, are growing in number and popularity. While such products may be useful in some sophisticated trading strategies, they are highly complex financial instruments that are typically designed to achieve their stated objectives on a daily basis. Due to the effects of compounding, their performance over longer periods of time can differ significantly from their stated daily objective. Therefore, leveraged and inverse ETFs that are reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets.

Short Selling in the Company Margin Account

36. Short selling entails the sale of a security which the seller does not own. It is a speculative practice done in the belief that price of a stock is going to fall and the seller will then be able to cover the sale by buying the security back later at a lower price, thereby making a profit on the transactions.
37. Short selling is generally considered a high risk strategy since there is no maximum loss that a short seller can incur because there is no limit to how high the price of a security can rise.
38. The Raymond James *Policy & Procedures Manual* states that typically investors who engage in short trading “should be relatively sophisticated and have a higher risk tolerance”.
39. On behalf of the Company Margin Account, Clarke short sold shares of large sized companies whose shares were listed on US stock exchanges.

Holdings in Company Margin Account

40. As detailed in the following table, as of August 2011 the Company Margin Account was heavily concentrated in units of the Three Inverse ETFs and short positions (the high risk positions).

Month End	Portfolio Equity Value	Absolute Value of High Risk Positions	Percentage of Holdings in High Risk Positions
July 31, 2011	\$98,700.36	\$0.00	0.00%
August 31, 2011	\$84,793.20	\$52,446.37	61.85%
September 30, 2011	\$106,943.90	\$206,565.50	193.15%
October 31, 2011*	\$147,591.81	\$85,245.35	57.76%
November 30, 2011	\$148,672.32	\$233,469.70	157.04%
December 31, 2011	\$157,758.95	\$122,602.17	77.71%
January 31, 2012	\$144,923.33	\$205,227.72	141.61%
February 29, 2012	\$143,398.58	\$188,792.22	131.66%
March 31, 2012	\$119,053.41	\$235,011.85	197.40%
April 30, 2012	\$109,201.76	\$247,422.51	226.57%
May 31, 2012	\$127,952.14	\$298,558.35	233.34%
June 30, 2012**	\$45,080.51	\$116,732.52	258.94%
July 31, 2012	\$41,924.54	\$116,918.30	278.88%
August 31, 2012	\$34,123.07	\$122,968.13	360.37%
September 30, 2012	\$30,856.03	\$99,754.48	323.29%
October 31, 2012	\$39,737.13	\$92,924.35	233.85%
November 30, 2012	\$32,003.06	\$100,215.08	313.14%
December 31, 2012	\$32,492.19	\$99,906.47	307.48%

*In October 2011, \$58,000 was deposited into the Company Margin Account.

**In June 2012, \$90,000 was withdrawn from the Company Margin Account.

41. Further, despite clear disclosure in the prospectus for each of the Three Inverse ETFs about the suitability of holding them for periods longer than a single day, the Company Margin Account held them for several months.

42. In or around January 2013, JE and KE transferred the Company Margin Account to another Dealer Member.

Losses in Company Margin Account

43. The Company Margin Account incurred a loss of approximately \$51,923.
44. Based on the foregoing, the purchase of units of the Three Inverse ETFs and the short selling of shares was not suitable for JE & KE given their financial situation, investment knowledge, investment objectives, and risk tolerance level.

Discretionary Trading in the Company Margin Account

45. At no point did Clarke obtain written authorization for discretionary trading, and the Company Margin Account was never designated and approved as discretionary by Raymond James.
46. Between September 11, 2011 and October 11, 2011, JE and KE were outside of Canada on holiday. While they were away they did not have any contact with Clarke.
47. During this period Clarke placed the following nine orders for the Company Margin Account:

Settlement Date	Order	Quantity	Security	Price	Proceeds/ Cost
September 19, 2011	Sell	400	Alaska Air Group	\$60.020	\$23,774.04
September 19, 2011	Buy	500	Pall Corp	\$43.830	\$22,317.50
September 26, 2011	Sell	1,000	Red Hat Inc.	\$40.530	\$40,125.72
September 27, 2011	Buy	1,000	Citigroup Inc.	\$23.500	\$24,303.50
September 28, 2011	Sell	450	Alaska Air Group	\$57.210	\$25,460.51
September 28, 2011	Sell	1,000	Horizons Silver Inverse Class A Units	\$11.000	\$10,696.50
October 3, 2011	Sell	1,000	Citigroup Inc.	\$26.400	\$26,074.50
October 7, 2011	Buy	1,350	Alaska Air Group	\$52.7735	\$72,047.72
October 12, 2011	Buy	600	Lululemon Athletica Inc.	\$51.880	\$31,245.50

48. Clarke used his discretion with respect to the type of security, quantity, price, and/or timing of these nine orders.

RB

49. RB is a pilot who owns a flight service company. He was born in 1960.
50. In January 2007, RB opened a margin account for his company (the RB Company Margin Account) with the Prince George business location of Raymond James.
51. In November 2009, Clarke became the Registered Representative who was responsible for the RB Company Margin Account when the Registered Representative who was previously responsible for the account transferred his registration to another IIROC Dealer Member.
52. In November 2009, RB also opened a margin account which had both a US and Canadian dollar component (the RB Margin Account).
53. At all material times, Clarke was the Registered Representative who was responsible for the RB Margin

Account.

54. The Client Account Agreement which RB completed in November 2009 on behalf of the RB Margin Account indicated that his:
- risk tolerance level was 50% medium risk and 50% high risk;
 - investment objectives were 50% growth and 50% speculative;
 - estimated net liquids assets were \$100,000;
 - estimated net fixed asset were \$600,000; and
 - approximate annual income from all sources was \$40,000.
55. The Client Account Agreement also indicated that RB had limited experience with investing.

RB Margin Account

56. As of October 31, 2011, the total value of the assets in the RB Margin Account was approximately \$16,472, of this amount approximately \$9,094 was invested in shares of ProShares Short Russell 2000.
57. In or around November 2011, RB informed Clarke that he was not pleased with the performance of the RB Margin Account. In response, Clarke recommended that he short sell shares. Clarke did inform RB that short selling was a high risk strategy. However, Clarke indicated that the risk could be mitigated with the use of stop loss buy orders. A stop loss buy order is an order to buy a security once it has reached a certain price.
58. RB agreed to the short selling strategy on the condition that there would be stop loss buy orders entered for each short position in order to limit any potential losses.
59. Beginning in November 2011, Clarke began to short sell shares of large sized companies whose shares were listed on US stock exchanges on behalf of the RB Margin Account.
60. Clarke failed to place stop loss buy orders on a timely basis for all of the short sales that he placed on behalf of the RB Margin Account. In particular, for six of the eight short sales that he made for the RB Margin Account, Clarke did not place a stop loss buy order until seven days to ten months after the short sale was made.
61. As set out in the following table, as of November 2011 the RB Margin Account was highly concentrated in units of ProShares Short Russell 2000 and in short positions (the High Risk Positions).

Month End	Portfolio Value	Absolute Value of High Risk Positions	Percentage of Holdings in High Risk Positions
November 30, 2011	\$13,318.39	\$34,425.95	258.48%
December 31, 2011	\$11,641.95	\$9,094.55	78.12%
January 31, 2012	\$10,323.94	\$17,555.76	170.05%
February 29, 2012	\$11,041.53	\$21,302.99	192.94%
March 31, 2012	\$8,704.57	\$22,926.42	263.38%
April 30, 2012	\$4,932.84	\$24,981.71	506.44%
May 31, 2012	\$6,408.49	\$45,197.83	705.28%
June 30, 2012	\$2,481.95	\$25,656.36	1033.72%
July 31, 2012	\$2,181.00	\$38,114.96	1747.59%

August 31, 2012	\$241.18	\$39,703.50	16461.86%
September 30, 2012	(\$2,685.18)	\$18,703.96	-696.56%
October 31, 2012	(\$2,077.73)	\$17,423.31	-838.57%
November 30, 2012	(\$4,060.33)	\$18,790.33	-462.78%
December 31, 2012	(\$4,587.58)	\$18,732.46	-408.33%

62. Further, despite clear disclosure in the prospectus about the suitability of holding the units of ProShares Short Russell 2000 for periods longer than a single day, the RB Margin Account held them for numerous months.

Losses in the RB Margin Account

63. As noted in the table above, by September 2012 the RB Margin Account had lost all of its value and in fact RB actually owed money.
64. In February 2013, RB had to deregister approximately \$8,200 from his Registered Retirement Savings Plan to cover the negative equity value of the RB Margin Account.
65. From October 31, 2011 to the closing of the RB Margin Account in February 2013, the account lost approximately \$23,684.
66. Based on the foregoing, the purchase of units of the inverse ETF and the short selling of shares was not suitable for RB given his financial situation, investment knowledge, investment objectives, and risk tolerance level.

IV. TERMS OF SETTLEMENT

69. This settlement is agreed upon in accordance with IROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member *Rules of Practice and Procedure*.
70. The Settlement Agreement is subject to acceptance by the Hearing Panel.
71. The Settlement Agreement shall become effective and binding upon Clarke and Staff as of the date of its acceptance by the Hearing Panel.
72. The Settlement Agreement will be presented to the Hearing Panel at a hearing (the Settlement Hearing) for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.
73. If the Hearing Panel accepts the Settlement Agreement, Clarke waives his right under IROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
74. If the Hearing Panel rejects the Settlement Agreement, Staff and Clarke may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.
75. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
76. Staff and Clarke agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.
77. Unless otherwise stated, any monetary penalties and costs imposed upon Clarke are payable immediately upon the effective date of the Settlement Agreement.
78. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

79. The Settlement Agreement may be signed in counterparts, by facsimile, and/or by electronic mail in portable document format.

AGREED TO by Gary Clarke at the City of Prince George in the Province of British Columbia, this 11 day of December, 2015.

“Michael Kazakoff”

Witness

“Gary Clarke”

Gary Clarke

AGREED TO by Staff at the City of Vancouver in the Province of British Columbia, this 16th day of December, 2015.

“Shannon Mathieson”

Witness

“Lorne Herlin”

Lorne Herlin

Senior Enforcement Counsel

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

ACCEPTED at the City of Vancouver in the Province of British Columbia, this 30th day of December, 2015, by the following Hearing Panel:

Per: “Wade Nesmith”

Panel Chair

Per: “Barbara Fraser”

Panel Member

Per: “Robert Travers”

Panel Member

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