

Re Tremblay

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

François Tremblay

2012 IIROC 50

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

Hearing held on July 11, 2012, in Montréal
Decision rendered on August 16, 2012

Hearing Panel:

Me Claude Bisson, Mr. Jean André Élie, Mr. Jean Morin

Appearances:

Me Myriam Giroux-Del Zotto, Enforcement Counsel

Me François Guimont (Dunton Rainville), Counsel for the Respondent, François Tremblay

DECISION ON SETTLEMENT AGREEMENT

¶ 1 This decision pertains to a Settlement Agreement signed and submitted by virtue of rules 14 and 15 of the Rules of Practice and Procedure;

¶ 2 This Settlement Agreement signed on May 31, 2012 is appended in its original to form part of this decision as though herein cited at length;

¶ 3 Until January 4, 2012, the date of his departure and of the termination of his approval with IIROC, Respondent had for four years held the position of Vice-President and Manager of the Montréal branch of Laurentian Bank Securities Inc. (LBS);

¶ 4 Since then, he has been employed with a financial institution, in a position ungoverned by IIROC;

¶ 5 For twelve years before going to work for Laurentian Bank Securities Inc., the Respondent worked for a variety of investment firms;

¶ 6 On February 8, 2008, LBS hired Mr. A as a registered representative (retail) at its Laval branch;

¶ 7 Three months later, IIROC imposed on Mr. A and his employer the requirement of "close supervision" of his daily transactions, with monthly reports to be kept by LBS;

¶ 8 At the same time, and in connection with this requirement, Mr. A was transferred to the Montréal branch, under the supervision of the Respondent who had not participated in his hiring at Laval;

¶ 9 Not only did the Respondent carry out the "close supervision" imposed by IIROC, he decided to make it "strict supervision", with the consequence, among others, that the Respondent would individually preapprove

every transaction for each of Mr. A's clients;

¶ 10 From the outset, Mr. A already had two clients, a couple, Mrs. B and Mr. C, some of whose investments were leveraged Exchange-Traded Funds (ETF);

¶ 11 The complaint in this matter covers the period from October 2008 to April 25, 2010, on which date these investors wrote to LBS to inform it of the situation which had become financially disastrous;

¶ 12 At the branch managed by the Respondent, the only situation of this type ever to arise concerns the representative Mr. A and his clients Mrs. B and Mr. C – at least only the latter filed complaints;

¶ 13 The losses incurred by the latter, small investors with modest incomes, totaled \$168,000, in large part reimbursed by LBS after the complaints were lodged;

¶ 14 As an officer of a firm active within the investment industry, the Respondent was subject to the obligations imposed on dealer members by the rules enacted by IIROC, specifically Rule 1300.1 (a), (p) and (q), and Part IV A of Rule 2500;

¶ 15 The complaint alleges the following misconduct by the Respondent, which the latter admits is well-founded:

- i. ignorance of the complexity and risks inherent in leveraged Exchange-Traded Funds, which prevented him from acquiring sufficient competence to adequately supervise the activity in two accounts under the management of a representative under his supervision; and
- ii. failing to ensure that the recommendations regarding these investments made by this representative to two retail clients were appropriate for these clients;

¶ 16 What the Settlement Agreement reveals, in substance, is this:

- i. the situation went on for a year and a half;
- ii. the Respondent always considered that leveraged Exchange-Traded Funds involved only a moderate level of risk;
- iii. the Respondent did not put any questions to the LBS Compliance Department;
- iv. the Respondent ignored the troubling features of these funds, even though IIROC had reported them in its Guidance Note 09-0172 dated June 11, 2009;
- v. the Respondent did not bother to determine whether the situation of Mrs. B and Mr. C had any of these features; and
- vi. as the months passed, the Respondent, from an initial proportion that was consistent with the investment objectives of Mrs. B and Mr. C, allowed the percentage of ETFs in these accounts to grow out of all proportion such that, in May 2009, the portfolios of these investors were comprised almost exclusively of leveraged Exchange-Traded Funds;

¶ 17 Even the very clear warnings issued by IIROC in June 2009 in Guidance Note 09-0172 do not seem to have had any impact on the Respondent and did not awaken him to the noncompliant situation of these investors;

¶ 18 So to review, the penalties agreed to between the parties and which we are being called upon to examine in application of rules 36 and 37 of the Rules of Practice and Procedure are as follows:

- a fine in the amount of \$22,000;
- a 12-month ban, effective the date of our decision, from submitting an application to IIROC for approval in any capacity;
- obligation to pass the Branch Managers Course before presenting an application for approval with IIROC in order to hold a position as a supervisor of Approved Persons;

- costs in the amount of \$3,000.

¶ 19 The public is entitled to rely on irreproachable conduct from securities industry participants, and this is all the more true when a case of prolonged misconduct is due to an officer's behavior;

¶ 20 The role of a Hearing Panel is to contribute to protecting the public by deterring participants from using an approach that is inconsistent with that of an informed supervisor and by obeying the rules that the profession may institute to protect the different categories of investors;

¶ 21 The Respondent should have considered the risks and, in doing so, he would not have authorized the representative under his supervision to make such investments;

¶ 22 As for the Settlement Agreement, the role of the Hearing Panel is limited to either accepting or rejecting it;

¶ 23 The Hearing Panel must ask itself, not whether it would have imposed the same penalties as those agreed to but, rather, whether what has been presented to it is reasonable given the circumstances and the applicable criteria;

¶ 24 It has been emphasized that the Respondent has no disciplinary history and, in this instance, did not conduct himself with any malicious intent, and that he derived no benefit from the alleged trading. He also cooperated fully in the investigation;

¶ 25 In its presentation entitled Dealer Member Disciplinary Sanction Guidelines, IIROC lays out certain considerations regarding various forms of misconduct;

¶ 26 On page 39, paragraph 4.3 discusses failures in the duty of supervision prescribed under Rules 1300 and 2500. It reads as follows:

"The Ultimate Designated Person (or Branch Manager appointed by Ultimate Designated Person) is responsible for establishing and maintaining procedures for account supervision and shall ensure that the handling of client business is within the bounds of ethical conduct, consistent with just and equitable principles of trade and not detrimental to the interests of the securities industry."

¶ 27 Then, still on page 39, in the event of a breach of conduct by a supervisor (which is the case here), it suggests a minimum fine of \$25,000;

¶ 28 The Settlement Agreement provides for a fine of \$22,000. This penalty may seem low, but a sanction must be examined as a whole to determine whether it is adequate;

¶ 29 In the present case, the parties have put the emphasis on the terms of the 12-month ban which, unusually, applies not only to the exercise of branch manager functions or supervision functions but to "...approval in any capacity with IIROC";

¶ 30 In the few cases cited to us, the prohibition component was never that restrictive;

¶ 31 The preceding considerations convince us that the disciplinary sanction, viewed as a whole, is neither inadequate nor unreasonable but, rather, within the bounds of the acceptable;

¶ 32 **FOR THESE REASONS**, the Hearing Panel accepts the Settlement Agreement as appended and gives effect to it from this date.

Montreal, August 16, 2012

Claude Bisson, Chair

Jean André Élie

Jean Morin

SETTLEMENT AGREEMENT

I. BACKGROUND

1. Enforcement Staff of the Investment Industry Regulatory Organization of Canada (Staff) and François Tremblay (the Respondent) consent and agree to the settlement of these matters by way of this settlement agreement (Settlement Agreement);
2. The Enforcement Department of the Investment Industry Regulatory Organization of Canada (IIROC) has conducted an investigation (the Investigation) into the conduct of the Respondent.
3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada (IDA) and Market Regulation Services Inc. Pursuant to the Administrative and Regulatory Services Agreement between the IDA and IIROC, which came into force June 1, 2008, the IDA has retained IIROC to provide the necessary services for the IDA to carry out its regulatory functions.
4. The Respondent consents and agrees to be subject to IIROC's jurisdiction;
5. The Investigation disclosed matters for which the Respondent may be disciplined by a Hearing Panel appointed pursuant to Part C of Schedule C.1 to Transition Rule No. 1 of IIROC (the Hearing Panel).

II. JOINT SETTLEMENT RECOMMENDATION

6. Staff and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement;
7. The Respondent admits to the following contraventions of IIROC Rules and Guidance, and IDA By-Laws, Regulations or Policies:
 - (a) Between October 2008 and April 25, 2010, the Respondent failed to use due diligence, contrary to Rule 1300.1 (a), (p) and (q) and to Part IV A of Rule 2500 of the IIROC Dealer Member Rules:
 - a. By neglecting to ensure adequate supervision of the accounts of retail clients of a registered representative under his supervision;
 - b. By neglecting to ensure that the recommendations made to two (2) retail clients of a registered representative under his supervision, concerning leveraged Exchange-Traded Funds, were appropriate for these clients.
 - (b) Between October 2008 and April 25, 2010, the Respondent failed to use due diligence by neglecting to take reasonable means to inform himself of the features and risks inherent in leveraged Exchange-Traded Funds, in order to acquire sufficient competence to adequately supervise orders for these products in the accounts of clients of a registered representative under his supervision, contrary to IIROC Dealer Member Rule 1300.1 (a).
8. Staff and the Respondent have accepted the following terms of settlement:
 - (a) A \$22,000 fine;
 - (b) A 12-month ban on presenting an application for approval with IIROC in any capacity;
 - (c) The obligation to pass the Branch Managers Course before presenting an application for approval with IIROC to hold a position as a supervisor of Approved Persons.
9. The Respondent agrees to pay IIROC costs in the amount of three thousand dollars (\$3,000).

III. STATEMENT OF FACTS

(i) Acknowledgment

10. 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

SUMMARY OF THE RESPONDENT'S ALLEGED MISCONDUCT

11. The Respondent failed to adequately supervise the activities of a registered representative under his strict supervision at his branch, by neglecting to learn the essential facts relative to two (2) clients of this representative and neglecting to take every measure to obtain accurate and sufficient knowledge of the complexity and risks associated with the use of leveraged Exchange-Traded Funds (ETF) in the account of these two (2) clients to be able to evaluate their suitability.

THE RESPONDENT

12. From April 1996 to February 1997, the Respondent worked at Richardson Greenshields of Canada (Richardson), an IDA Member firm, as a registered representative. Subsequently, in or around November 1996, Richardson merged with RBC Dominion Securities Inc. (RBC), another IDA Member firm;
13. Towards the end of March 1997, the Respondent, who is still in the employ of RBC, was approved as a registered representative and assistant branch manager;
14. In or around February 1999, the Respondent was approved as a branch manager with RBC;
15. Subsequently, from around January 2000 until around August 2000, the Respondent who is still in RBC's employ, held the position of "recruiting manager";
16. In or around September 2000 until around June 2003, the Respondent was approved as a vice president, branch manager and registered representative with RBC;
17. In or around June 2003, until around March 2007, the Respondent was approved as a registered representative and vice-president in the employ of TD Waterhouse, an IDA Member firm;
18. Around May 2007 until December 2007, the Respondent was in the employ of Desjardins Securities Inc., another IDA Member firm, with whom it occupied the position of registered representative and vice-president;
19. Around December 2007 until around May 31, 2008, the Respondent was working at Laurentian Bank Securities (LBS), an IDA member firm;
20. On June 1, 2008, the Respondent became a registrant of IIROC;
21. From around June 1, 2008 until around January 4, 2012, the Respondent worked at LBS, an IIROC member dealer;
22. At the material time, the Respondent was the manager responsible for the supervision of the registered representative (retail), Mr. A;
23. Notwithstanding the duty of close supervision required of LBS by IIROC, the Respondent always exercised strict supervision of Mr. A's daily transactions;
24. As of this date, the Respondent is no longer registered in the employ of an IIROC member; however he holds the position of Senior Advisor, Best Practices, Business and Advisor Development at National Bank Financial, an IIROC dealer member.

INEFFECTUAL SUPERVISION DUE TO LACK OF KNOWLEDGE OF LEVERAGED ETFs RESULTING IN FAILURE TO ADEQUATELY EVALUATE THE SUITABILITY OF USING SUCH PRODUCTS

25. On or around February 8, 2008, Mr. A was hired by the Laval branch of LBS;
26. On or around May 2, 2008, at IIROC's request, LBS agreed to be subject to the following condition so

that Mr. A might act as a registered representative (retail) for its firm:

- (i) that LBS fill out and keep in the Respondent's employee file a monthly close supervision report on Mr. A's daily transactions.
27. To ensure better supervision of Mr. A's activities, on or around April 28, 2008, Mr. A was transferred to the Montréal branch;
 28. On or around April 28, 2008, the Respondent was acting as vice-president and manager of the Montréal branch;
 29. At all material times, except during a short period over the summer of 2009, the Respondent was always the manager responsible for the supervision of Mr. A's activities;
 30. Effective April 28, 2008 or around this date, the Respondent, who was required to exercise close supervision of Mr. A's activities, was instead exercising strict supervision thereof. Practically speaking, the Respondent was filling out a strict supervision report and individually pre-approving all the transactions for all of Mr. A's clients;
 31. During the period between October 2008 and April 25, 2010, no other representative besides Mr. A required close or strict supervision of their activities by the Respondent;
 32. To accomplish the supervision of Mr. A's activities, the Respondent made sure that the following information was communicated to him and physically available at his office:
 - (i) A copy of all of the New Account Application forms for each of Mr. A's clients;
 - (ii) The details of all of the daily trades recommended by Mr. A, submitted as they occur.
 33. When authorizing the execution of a trade recommended by Mr. A, the Respondent would follow these steps:
 - (i) Read the details of the trade recommended by Mr. A;
 - (ii) Send, if necessary and in writing, a request for details regarding the recommended trades;
 - (iii) Look at the client's New Account Application form to ascertain the suitability of the recommended trades;
 - (iv) Have a portfolio summary and a breakdown of the assets pulled from the Croesus system;
 - (v) Approve or refuse the recommended to trade;
 - (vi) Submit a monthly report of the supervision of Mr. A's activities to Ms. "D", assistant to Mr. "E", Vice-President, Finance and Chief Compliance Officer at LBS.
 34. To the Respondent, leveraged ETFs involved a moderate degree of risk. The Respondent and Mr. A had numerous opportunities to discuss their assessment of the risks inherent in trading leveraged ETFs, given the strict supervision that the Respondent exercised over Mr. A's activities;
 35. During the period between October 2008 and April 25, 2010, the Respondent did not submit any questions to the LBS Compliance Department about leveraged ETFs, even though he could have. The Respondent was content with his own analysis, based on his years of experience in the financial field and his reading of the prospectus. He did not seek to confirm or challenge his assessment to make sure that he was able to carry out his supervisory role adequately and effectively;
 36. When the Respondent first acquainted himself with the prospectus on leveraged ETFs, he would have read, notably, about the following specific features:
 - (i) Leveraged ETFs are for sophisticated investors with an above average-risk tolerance;
 - (ii) These financial products are recommended for people with financial market experience who have traded in equally complex financial products before.

37. To evaluate the investor profiles of Mrs. “B” and Mr. “C”, both of whom were clients of Mr. A, the Respondent would look at their client file and ask questions of Mr. A. Just looking at the new account application forms of Mrs. B and Mr. C, both filled out on March 8, 2008, would have revealed the following facts about them:
- (i) They were retired and had low incomes;
 - (ii) Their knowledge of investing was good but not excellent;
 - (iii) They were aiming for 60% long-term capital gains, 20% short-term capital gains, and had reserved 20% for speculation;
 - (iv) They had no other brokerage accounts besides those held with LBS.
38. When the Respondent took over supervision of Mr. A, Mrs. B and Mr. C held leveraged ETFs in their portfolios purchased in accordance with recommendations by Mr. A, but in proportions that respected their investment objectives;
39. In or around mid-June 2008, to support Mr. A in developing his business, the Respondent and LBS agreed to grant a total exemption on the latter’s professional service fees on the accounts of Mrs. B and Mr. C for a period of three months. At the same time, the Respondent asked Mr. A to update the new account application forms for these two clients. Despite this update, Mrs. B and Mr. C’s investor profiles remained unchanged;
40. At the time of the update, the Respondent did not question the investment strategy recommended by Mr. A to Mrs. B and Mr. C, which was to invest more in leveraged ETFs;
41. A comparison of the information on the original new account application forms of Mrs. B and Mr. C with that found on their update forms shows that the only significant change made is the addition of the following comments:
- (i) For Mrs. B:
 - [TRANSLATION] *“At the client’s request and at the advisor’s suggestion, and the investment advisor explained the risks. \$11,900 of Horizon BetaPro Energy Bear will be purchased.”*
 - *“No fees or commission will be billed until September 30. Free of charge.”*
 - (ii) For Mr. C:
 - [TRANSLATION] *“At the client’s request and at the advisor’s suggestion, and the investment advisor explained the risks. \$31,000 of Horizon BetaPro Energy Bear will be purchased.”*
 - *“No fees or commission will be billed until June 30, 2008. Free of charge.”*
42. The comment “at the client’s request, and the investment advisor explained the risks” appears on the update forms of both Mrs. B and Mr. C and was added at the initiative of Mr. A;
43. However, when the update forms were signed, Mrs. B and Mr. C asked Mr. A to add the mention “and at the advisor’s suggestion” to correct the comment added by the latter, which falsely led one to believe that the purchase of Horizon BetaPro Energy Bear was initiated by them rather than by Mr. A. The two (2) clients then willingly initialed these additions;
44. Generally speaking, where the Respondent is concerned, there is an excessive concentration of a financial product in a client’s brokerage account when the latter’s portfolio consists of this product in a proportion of 50% plus one;
45. Between late September and October 2008, the portfolios of Mrs. B and Mr. C consisted of more than 50% leveraged ETFs. However, despite this situation and the fact that the Respondent considered

himself perfectly informed of the risks and features specific to leveraged ETFs, the latter did not intervene with Mr. A to question him about the investment strategy recommended to these two (2) clients. He did not intervene even though there was a substantial gap between the risk profiles approved by Mrs. B and Mr. C on their new account application forms and the composition of their portfolio. There was no later update of Mrs. B and Mr. C's information to reflect this situation;

46. Between March 17 and 31, 2009, the Respondent approved the execution of two (2) leveraged ETF trades in the account of Mrs. B, and two (2) trades of the same financial product in the account of Mr. C. Following these trades, Mrs. B's portfolio was composed of approximately 59% leveraged Bear Plus ETFs and Mr. C's portfolio, 68% leveraged Bear Plus ETFs;
47. Between May 20 and 22, 2009, the Respondent approved two (2) stock market transactions involving leveraged ETF securities in Mr. C's account and five (5) trades involving the same security in Mrs. B's account. After these trades, the composition of Mr. C's portfolio was 99% leveraged ETFs, and Mrs. B's portfolio, 98%;
48. On or around May 22, 2009, Mrs. B's and Mr. C's portfolios consisted almost exclusively of leveraged ETFs, in spite of the profile and personal characteristics of the two investors. The Respondent did not find it necessary to intervene with Mr. A to obtain explanations on why there was such a high concentration of leveraged ETFs in the accounts of these two (2) clients;
49. On or around June 11, 2009, IIROC published Guidance Note 09-0172 concerning the obligations of dealer members that sell leveraged and inverse Exchange Traded Funds (ETFs). In this notice, IIROC reiterates the following:

“(…) 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. (…).”
50. At the material time, all of the information published regarding leveraged ETFs including, in particular, the guidance note published by IIROC, did nothing to alter the Respondent's perception of the risks inherent in the use of leveraged ETFs, nor his assessment of the suitability of these products in the accounts of Mrs. B and Mr. C;
51. In the course of its 2009 inspection, IIROC's Business Conduct Compliance Department questioned the suitability of Mrs. B's investment objectives considering her pensioner's status;
52. The questioning of the LBS Compliance Department might have been another opportunity for the Respondent to review with Mr. A the suitability of the investment strategy recommended to Mrs. B and Mr. C, but he did not do so;
53. The total losses on the combined value of Mrs. B's and Mr. C's portfolios attributable to the use of leveraged ETFs are evaluated at approximately \$168,000;
54. On or around April 25, 2010, Mrs. B and Mr. C sent a written complaint to LBS, in which they criticize it and Mr. A for failing to use due diligence in the exercise of supervision and in the investment recommendations that were made to them considering their personal and financial circumstances.

IV. TERMS OF SETTLEMENT

55. This settlement is agreed to in accordance with Dealer Member Rule 20.35 to 20.40 inclusively, and Rule 15 of the Dealer Member Rules of Practice and Procedure;
56. The Settlement Agreement is subject to acceptance by the Hearing Panel;
57. The Settlement Agreement shall become effective and binding upon the Respondent and Staff from the

date of its acceptance by the Hearing Panel;

58. 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;
59. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives his right, under IIROC Rules and any applicable legislation, to a disciplinary hearing, review or appeal.
60. 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 in relation to the matters disclosed in the investigation.
61. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
62. Staff and the Respondent 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.
63. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent shall be payable immediately on the effective date of the Settlement Agreement;
64. Unless otherwise stated, suspensions, prohibitions, expulsions, restrictions and other conditions or terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Montreal, in the Province of Quebec, this _____ day of May, 2012.

“Me François Guimont”

Me François Guimont

Dunton, Rainville

Representing the Respondent

“FRANÇOIS TREMBLAY”

FRANÇOIS TREMBLAY

RESPONDENT

AGREED TO by Staff of IIROC at the City of Montréal, in the Province of Québec, this _____ day of May, 2012.

WITNESS

“MYRIAM GIROUX-DEL ZOTTO”

MYRIAM GIROUX-DEL ZOTTO

Enforcement Counsel, for Staff of
IIROC

All rights reserved © 2012 The Investment Industry Regulatory Organization of Canada