

Re Kelly

IN THE MATTER OF:

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

and

John Gordon Kelly

2015 IIROC 08

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

Heard: October 22, 2014
Decision: October 22, 2014
Reasons: February 12, 2015

Hearing Panel:

Thomas J. Lockwood, Q.C. (Chair), Daniel Iggers and Guenther Kleberg

Appearances:

Rob DelFrate Enforcement Counsel for IIROC

John Fabello Counsel for John Gordon Kelly

John Gordon Kelly

DECISION AND REASONS

A. BACKGROUND

¶ 1 On October 2, 2014, IIROC Staff and John Gordon Kelly (“Respondent”) entered into a Settlement Agreement.

¶ 2 The Settlement Agreement provided that it would only become effective and binding upon the Respondent and Staff as of the date of its acceptance by a Hearing Panel.

¶ 3 On October 22, 2014, this Hearing Panel convened. We carefully reviewed the Settlement Agreement. We also considered the written and oral submissions of Staff and the oral submissions of Counsel for the Respondent. The parties jointly recommended that the Settlement Agreement be accepted.

¶ 4 After a short period of deliberation, we unanimously accepted the Settlement Agreement on October 22, 2014. At that time, we advised that written Reasons for our Decision would follow. These are those Reasons.

B. THE SETTLEMENT AGREEMENT

¶ 5 The salient provisions of the Settlement Agreement are as follows:

“I. INTRODUCTION

1. IIROC Enforcement Staff (“Staff”) and John Gordon Kelly (the “Respondent”), consent and agree to the settlement of this matter by way of this agreement (the “Settlement Agreement”).
2. The Enforcement Department of IIROC has conducted an investigation (the “Investigation”) in the conduct of the Respondent.

3. The Investigation discloses matters for which the Respondent 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 the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.
5. The Respondent admits to the following contraventions of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:
 - a. Failed to use due diligence to learn and remain informed of the essential facts relative to his client, JRM, contrary to Dealer Member Rule 1300.1 (a) (IDA Regulation 1300.1 (a) prior to June 1, 2008); and
 - b. Recommended the purchase of securities to a client, JRM, without using due diligence to ensure that the recommendations were suitable for the client based on her financial situation, investment knowledge, investment objectives and risk tolerance contrary to Dealer Member Rule 1300.1.(q) (IDA Regulation 1300.1 (q) prior to June 1, 2008).
6. Staff and the Respondent agrees to the following terms of settlement:
 - (a) A fine in the amount of \$10,000; and
 - (b) A six (6) month period of strict supervision.
7. The Respondent agrees to pay costs to IIROC in the sum of \$2,000.
- III. STATEMENT OF FACTS
 - (i) Acknowledgement
8. Staff and the Respondent 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. The Respondent opened an account for new client, JRM, a single 72 year old retiree, in July 2007. Following a face to face meeting with her, the Respondent determined that JRM's investment objectives were "Balanced", which required that a percentage of her assets be allocated to lower risk, fixed income investments. Shortly thereafter, the Respondent recommended investments in her account which consisted solely of equity mutual funds, which did not meet the requirements of the "Balanced" objective.
10. The Firm's compliance group queried the investments and the "Balanced" objectives and suggested that changes to the asset allocation be made. Instead of changing the asset allocation as suggested, the Respondent asked JRM to sign an account update which changed her objectives to "Growth". This allowed the account to remain invested in the equity mutual funds while still generating the cash flow which the Respondent understood JRM to want. As a result, JRM's account was exposed to more risk than was appropriate given her actual objectives and financial situation.
11. In 2010, following a decrease in JRM's account value, as well as a decrease in the monthly distributions that JRM was receiving from her investments, the Respondent recommended changes to the portfolio, with a view to increasing the distributions. The Respondent recommended a portfolio of three securities which resulted in an increased monthly distribution,

but also increased the risk associated with her investments. These investments were inconsistent with JRM's actual and recorded investment objectives and were unsuitable for her.

Registration and Disciplinary History

12. Since March 1987, the Respondent has been registered as a Registered Representative with a Toronto, Ontario branch of BMO Nesbitt Burns Inc. ("BMO"), an IIROC Dealer Member.
13. In September 1996, the Respondent entered into a settlement agreement with the IDA in which he admitted to opening accounts for 3 clients and accepting trading instructions from undisclosed third parties on those accounts. The Respondent agreed to pay a fine and to rewrite the Conduct and Practices Handbook examination. In the 24 years the Respondent has been registered he has not been subject to any other regulatory proceedings or an internal discipline or client complaints.
14. On June 1, 2008, the Respondent became a regulated person of IIROC.

The Client – JRM

15. JRM became a client of the Respondent in July 2007. She had been referred to the Respondent by a friend who had previously worked with the Respondent.
16. On or about July 17, 2007, the Respondent met with JRM for the first time. At that meeting, a New Account Application Form ("NAAF") was completed. This included the relevant Know Your Client ("KYC") information for JRM. At the time, JRM was a single 72 year old retiree. Her investment knowledge was recorded as "Minimal/None" and her previous investment experience consisted solely of GICs.
17. JRM had net liquid assets of approximately \$290,000 which represented all of her total assets. This amount consisted primarily of the proceeds from the sale of her home. JRM was looking to invest \$250,000.
18. During her meeting with the Respondent, JRM's investment objectives were recorded as "Balanced", which the NAAF described as:

My emphasis is on preserving the money I have invested, with enough growth to keep me ahead of inflation. With few exceptions, I have a low to moderate tolerance for risk, but I am willing to accept short-term price volatility in order to achieve better long-term returns. I may or may not require income from my portfolio at this time.
19. The Balanced objective allows for an asset mix of 0-40% cash and equivalents, 30-70% fixed income, and 30-70% equities.
20. The Respondent presented 3 potential investment strategies to JRM. The first consisted of an investment in GICs, which would provide limited return. The second consisted primarily of bonds, which would have a slightly greater return, but would only pay interest semi-annually. The third option presented consisted of an investment in T-series mutual funds, which would provide JRM with monthly distributions of 8% per annum.
21. The distributions from the T-series funds were to be reset on an annual basis to total approximately 8% of the net asset value of the fund at the beginning of the year. At the time, this represented a monthly distribution of approximately \$1,500. If the unit value of the funds fell, the distributions would be reset to a reduced amount at the beginning of the following year. Conversely, if the unit value of the funds rose, the distributions would reset to a higher amount.
22. The Respondent did not adequately explain that the T-series distribution could include a return of JRM's capital. Though the Respondent did make an effort to advise JRM of the potential volatility of investing in mutual funds, he did not adequately explain the potential downside exposure and the risks associated with either bonds or GICs. Ultimately, JRM agreed to the

- purchase of the mutual funds.
23. The proposed purchase, as noted on JRM's NAAF, was for the \$250,000 to be invested equally in the T-series of "MFC Growth Income" (the "Mackenzie Fund") and "DYN Global Dividend" (the "Dynamic Fund"). The Mackenzie Fund was a Canadian balanced mutual fund, which invested in both fixed income and equity securities of primarily Canadian based companies. The Dynamic Fund was a global equity fund.
 24. On July 18, 2007, two mutual funds were purchased in JRM's account. However, instead of the Mackenzie Fund, the Respondent purchased the T-series of the Mackenzie Founders Fund (the "Founders Fund"). This was a fund of funds, which held an equal weighting of four global equity funds. Accordingly, instead of half of the initial investment being made in a Canadian balanced fund, the full amount was invested solely in global equities, with no allocation to fixed income.
 25. On July 20, 2007, the Firm's Compliance group questioned the suitability of 100% equity holdings in an account that was marked as "Balanced". BMO Compliance suggested that the Respondent to "reduce equity in the account to 70% by August 23, 2007."
 26. The Respondent did not recommend reducing the equity holdings in the account. Instead, less than a month after the initial NAAF was completed, the Respondent asked JRM to complete an update to her KYC information, despite the fact that there was no actual change to her financial circumstances. The updated KYC form changed her investment objectives from "Balanced" to "Growth", which the NAAF described as:

My emphasis is on the potential for above-average return. With few exceptions, I am willing to accept a moderate-to-high level of risk to achieve it. I will tolerate short-term price volatility in the pursuit of long-term growth. I have little-to-no requirement for income from my portfolio at this time.
 27. The "Growth" objective no longer required any allocation to fixed income securities. The Respondent mailed JRM the KYC update form, which she signed on August 9, 2007 and returned to him. The Respondent did not adequately discuss the increase in the potential downside exposure and risks associated with account holdings consisting entirely of global equities.
 28. Between July 2007 and November 2010, the value of JRM's mutual fund holdings declined by approximately \$42,000, net of distributions. In addition, the monthly distributions decreased from over \$1,500 per month when the investments were initially made to approximately \$1,100 in 2010.
 29. In or around October 2010, in response to JRM's concerns about the reduced distributions and the reduced market value of her account, and in an attempt to obtain a higher monthly distribution for JRM, the Respondent recommended the sale of the mutual funds and the purchase of securities of three issuers.
 30. In October and November 2010, the mutual funds were sold and the proceeds were used to purchase trust units of Avenir Diversified Income Trust ("Avenir"), Retrocom Mid-Market Real Estate Investment Trust ("Retrocom") and Pizza Pizza Royalty Income Fund ("Pizza Pizza"). A Deferred Sales Charge was incurred on the sale of one of the mutual funds.
 31. The anticipated yield from these trust units would have increased the monthly distributions of JRM to approximately \$1,400 per month. However, these purchases also resulted in JRM's entire account being concentrated in portfolio of securities with increased risk over the prior portfolio, which increased the potential downside risk to which she was exposed.
 32. By April 2011, following cuts to the distributions of Avenir and Pizza Pizza, the monthly

distributions to JRM had declined to approximately \$1,100 per month.

33. In May 2011, the units of Retrocom were sold and shares of Superior Plus Corp (“Superior”) were purchased in JRM’s account. Following these transactions, the monthly distributions increased to almost \$1,300 per month, however JRM’s account remained invested in only three securities.
34. Following the purchase of shares of Superior, the Firm’s Compliance group again questioned the appropriateness of JRM’s account holdings and specifically noted that a significant portion of her indicated net worth was concentrated in three securities.
35. The Respondent advised the Firm’s Compliance group that JRM had realized a gain on the sale of the units of Retrocom and that he had used the proceeds to purchase shares of Superior which had a higher payout. He further advised that “the client has had to give up some security to receive a maximum return with reasonable risk. She cannot live on 1.30% GIC’s and/or 3.493% five year Bell bonds or 3.14% five year BMO bonds.”
36. No further steps were taken at the time to recommend changing the holdings in JRM’s account.
37. In September 2011, the Firm’s Compliance group again inquired about the holdings in JRM’s account. The Respondent’s Branch Compliance Officer asked the Respondent to confirm certain client information and to comment on the “suitability of growth objective given minimal investment knowledge, older age and small net worth and income.”
38. The Respondent replied that JRM “totally relies & lives on this income. If investments were switched to bonds, I would have to sell the bond \$ send her principle [sic].”
39. Following a meeting with the Branch Compliance Officer, the Respondent was asked to update JRM’s KYC information to reflect a “Balanced” objective, and to reduce the equity in the account to 70% or less.
40. Following further discussions between the Respondent, the Branch Compliance Officer and the Branch Manager, the request to reduce the equity was rescinded. Instead, the Respondent agreed to recommend the sale of one of the holdings and to replace it with a lower risk, exchange traded fund.

Client Complaint and Settlement

41. In July 2012, JRM complained to BMO. In November 2013, JRM and BMO agreed to a settlement, pursuant to which JRM received \$41,247.03. The Respondent has paid this full amount.

Mitigating Circumstances

42. At all times, the Respondent sought to maximize the income for JRM, which is what the Respondent understood JRM’s main and overriding investment goal to be.

Summary

43. Despite JRM’s relative lack of investment knowledge and experience and the material impact on her net worth associated with a significant drop in her capital, the Respondent nonetheless recommended implementing an investment strategy consisting of 100% equities. This was done with the well-intended goal of enhancing the monthly distributions to JRM.
44. When this asset allocation was questioned, instead of recommending an adjustment in the account holdings, the Respondent recommended updating the account objectives, even though JRM’s circumstances had not changed.
45. Following a significant drop to the value of the account and in an attempt to obtain higher distributions, the Respondent made recommendations that further increased the risks to the

account by concentrating JRM's investments in three securities, which were unsuitable for a person in her situation.

IV. TERMS OF SETTLEMENT

46. 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.”

C. SUBMISSIONS

¶ 6 Both Staff and Counsel for the Respondent made extensive submissions as to why, in their respective views, the Settlement Agreement should be accepted by the Hearing Panel. These submissions included the following:

(a) Staff

- (i) The penalties proposed are commensurate with the admitted conduct.
- (ii) The penalties proposed are consistent with IROC's Dealer Member Disciplinary Sanction Guidelines (“Guidelines”). An analysis of the Guidelines was provided.
- (iii) The penalties proposed are in keeping with previous IROC and IDA Decisions. An analysis of a number of these Decisions was provided.
- (iv) The Respondent's conduct was not manipulative or fraudulent.
- (v) The Respondent worked with BMO Nesbitt Burns and the client to settle her complaint and to reimburse her for her losses. A financial settlement was reached pursuant to which the client received an amount in excess of \$41,000.00. The settlement amount was paid by the Respondent.
- (vi) The Respondent has not been enriched by his conduct.
- (vii) The Respondent cooperated fully with IROC Staff and admitted that his conduct was in violation of the IROC Dealer Member Rules.
- (viii) By entering into the Settlement Agreement, the Respondent has avoided the necessity of IROC conducting both a protracted investigation and a lengthy Hearing.

(b) The Respondent

- (i) Agrees with the submissions made by Staff.
- (ii) The Respondent was well-intended. He thought that he was acting in the best interests of the client.
- (iii) Client was made whole. Payments made and to be made by the Respondent are well in excess of fees earned.
- (iv) Respondent did provide advice to client. However, he agrees that not sufficient advice was given as client was vulnerable and unsophisticated.
- (v) Settlement Agreement sends a strong message to both the Respondent and the investment industry. The Respondent has received and understood the message.
- (vi) General deterrence is achieved by the Settlement Agreement.

D. DECISION and REASONS

¶ 7 This Hearing Panel must determine whether the proposed sanctions “strike a reasonable balance between fairness to the Respondent in the circumstances and the need to protect the investing public, the industry membership, the integrity of the discipline process, the integrity of the securities markets and prevention of a repetition of the offense.”

Re Bereskin [2010] IIROC No. 37 at para 5.

¶ 8 It is clear that a Hearing Panel should not reject the penalties set out in the Settlement Agreement unless they “clearly fall outside a reasonable range of appropriateness.”

Milewski (Re), [1999] I.D.A.C.D. No. 17 at p. 13-14.

¶ 9 The Guidelines, while not binding on the Hearing Panel, are intended to provide a framework to guide the exercise of our discretion in determining sanctions which meet the general sentencing objectives.

¶ 10 Registrants hold a privileged position in the securities industry. These privileges are balanced by the responsibilities set out in the Dealer Member Rules, including the obligation to know your client and to make suitable investment recommendations.

¶ 11 Here the client was a 72 year old retiree at the time her account was opened. She had minimal to no investment knowledge. Her previous investment experience consisted solely of GICs. She invested over 80% of her net worth with the Respondent.

¶ 12 The Respondent, nevertheless, recommended an investment strategy consisting of 100% equities. When this asset allocation was questioned by the Member’s Compliance Department, the Respondent recommended updating the account objectives, instead of an adjustment in the account holdings, even though the client’s circumstances had not changed.

¶ 13 Following a significant drop in the value of the account, in an apparent attempt to obtain higher distributions, the Respondent made recommendations that further increased the risks to the client by concentrating her investments in securities which were unsuitable for a person in her situation.

¶ 14 At the relevant period of time, the Respondent had been in the securities industry for more than 20 years. He should have known that his actions were not in the best interests of his client. He had an obligation to ensure that his client was not exposed to undue risk. Consequently, we do not view the intentions of the Respondent, as set out in paragraphs 42 and 43 of the Settlement Agreement, as being of a mitigating nature.

¶ 15 We do note, however, that the conduct in question involved only one client and, although the account activity took place over several years, the volume of trading was not significant.

¶ 16 After carefully reviewing the Settlement Agreement, the submissions of the parties, the Guidelines and prior similar Decisions, we unanimously concluded that it was in the public interest for the Hearing Panel to accept the Settlement Agreement and we did so.

DATED at Toronto this 12th day of February, 2015.

Thomas J. Lockwood, Q.C., Chair

Daniel Iggers

Guenther Kleberg

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff (“Staff”) and John Gordon Kelly (the “Respondent”), consent and agree to the settlement of this matter by way of this agreement (the “Settlement Agreement”).
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II. JOINT SETTLEMENT RECOMMENDATION

4. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.
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III. STATEMENT OF FACTS

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8. Staff and the Respondent 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.

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21. The distributions from the T-series funds were to be reset on an annual basis to total approximately 8% of the net asset value of the fund at the beginning of the year. At the time, this represented a monthly distribution of approximately \$1,500. If the unit value of the funds fell, the distributions would be reset to a reduced amount at the beginning of the following year. Conversely, if the unit value of the funds rose, the distributions would reset to a higher amount.
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23. The proposed purchase, as noted on JRM’s NAAF, was for the \$250,000 to be invested equally in the T-series of “MFC Growth Income” (the “Mackenzie Fund”) and “DYN Global Dividend” (the “Dynamic Fund”). The Mackenzie Fund was a Canadian balanced mutual fund, which invested in both fixed income and equity securities of primarily Canadian based companies. The Dynamic Fund was a global

equity fund.

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29. In or around October 2010, in response to JRM's concerns about the reduced distributions and the reduced market value of her account, and in an attempt to obtain a higher monthly distribution for JRM, the Respondent recommended the sale of the mutual funds and the purchase of securities of three issuers.
30. In October and November 2010, the mutual funds were sold and the proceeds were used to purchase trust units of Avenir Diversified Income Trust ("Avenir"), Retrocom Mid-Market Real Estate Investment Trust ("Retrocom") and Pizza Pizza Royalty Income Fund ("Pizza Pizza"). A Deferred Sales Charge was incurred on the sale of one of the mutual funds.
31. The anticipated yield from these trust units would have increased the monthly distributions to JRM to approximately \$1,400 per month. However, these purchases also resulted in JRM's entire account being concentrated in portfolio of securities with increased risk over the prior portfolio, which increased the potential downside risk to which she was exposed.
32. By April 2011, following cuts to the distributions of Avenir and Pizza Pizza, the monthly distributions to JRM had declined to approximately \$1,100 per month.
33. In May 2011, the units of Retrocom were sold and shares of Superior Plus Corp. ("Superior") were purchased in JRM's account. Following these transactions, the monthly distributions increased to almost \$1,300 per month, however JRM's account remained invested in only three securities.
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36. No further steps were taken at the time to recommend changing the holdings in JRM's account.
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38. The Respondent replied that JRM "totally relies & lives on this income. If investments were switched to bonds, I would have to sell the bond \$ send her principle [sic]."
39. Following a meeting with the Branch Compliance Officer, the Respondent was asked to update JRM's KYC information to reflect a "Balanced" objective, and to reduce the equity in the account to 70% or less.
40. Following further discussions between the Respondent, the Branch Compliance Officer and the Branch Manager, the request to reduce the equity was rescinded. Instead, the Respondent agreed to recommend the sale of one of the holdings and to replace it with a lower risk, exchange traded fund. On October 7, 2011, JRM's Pizza Pizza units were sold and units of BMO Covered Call Canadian Banks ETF were purchased in her account.

Client Complaint and Settlement

41. In July 2012, JRM complained to BMO. In November 2013, JRM and BMO agreed to a settlement, pursuant to which JRM received \$41,247.03. The Respondent has paid this full amount.

Mitigating Circumstances

42. At all times the Respondent sought to maximize the income for JRM, which is what the Respondent understood JRM's main and overriding investment goal to be.

Summary

43. Despite JRM's relative lack of investment knowledge and experience and the material impact on her net worth associated with a significant drop in her capital, the Respondent nonetheless recommended implementing an investment strategy consisting of 100% equities. This was done with the well-intended goal of enhancing the monthly distributions to JRM.
44. When this asset allocation was questioned, instead of recommending an adjustment in the account holdings, the Respondent recommended updating the account objectives, even though JRM's circumstances had not changed.
45. Following a significant drop to the value of the account and in an attempt to obtain higher distributions, the Respondent made recommendations that further increased the risks to the account by concentrating JRM's investments in three securities, which were unsuitable for a person in her situation.

IV. TERMS OF SETTLEMENT

46. This settlement is agreed upon 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.
47. The Settlement Agreement is subject to acceptance by the Hearing Panel.
48. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

49. 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.
50. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives his/her/its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
51. 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.
52. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
53. 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.
54. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
55. 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.

AGREED TO by the Respondent at the City of Toronto in the Province of Ontario, this 2 day of October, 2014.

“Witness” _____

Witness

“John Kelly” _____

Respondent

AGREED TO by Staff at the City of Toronto in the Province of Ontario, this 2 day of October, 2014.

“Witness” _____

Witness

“Rob DelFrate” _____

Rob DelFrate

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

ACCEPTED at the City of Toronto in the Province of Ontario, this 22 day of October, 2014, by the following Hearing Panel:

Per: “Thomas J. Lockwood” _____

Panel Chair

Per: “Daniel Iggers” _____

Panel Member

Per: “Guenther Kleberg” _____

Panel Member

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