Re Floyd & McDonald

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

Charles Floyd

and

James Gordon McDonald

2013 IIROC 27

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

Heard: April 15, 2013
Decision: May 27, 2013

Hearing Panel:
Shelley L. Miller, Q.C. (Chair), Martin Davies, William Welton
Appearances:
Paul Smith, Counsel for IIROC
Respondents Appearing for Themselves

PENALTY DECISION

INDEX

INTRODUCTION

¶ 1 In its Decision and Reasons issued on January 22, 2013, this Panel found that all three contraventions alleged in the Notice of Hearing issued by IIROC on June 12, 2012 were proven to the required standard.

¶ 2 The contraventions proven were as follows:

Count 1

Between April and December 2008, Floyd acted contrary to IIROC Dealer Member Rule 1300.1(q) [before June 2008 –IDA Regulation 1300.1(q)] by failing to ensure recommendations he made for a client were suitable for the client.

Count 2

Between September and November 2008, Floyd acted contrary to IIROC Dealer Member Rule 1300.4 by using discretion with respect to purchases in a client account.

Count 3

Between April and December 2008, McDonald acted contrary to IIROC Dealer Member Rule 1300.1(p) [before June 2008-IDA Regulation 1300.1(p)] and IIROC Dealer Member Rule 2500 [before June 2008-IDA Policy 2] by failing to adequately supervise a client account to ensure that holdings in the account were suitable for the client.

¶ 3 In this Panel's earlier decision of January 22, 2013, it reviewed the allegations in IIROC's Notice of Hearing statement of particulars which were to the following effect:

¶ 4 One Leonard Stokes ("Stokes") opened an account at the Edmonton branch of Union Securities Ltd. ("Union") at the invitation of Floyd in the spring of 2008 to invest the proceeds of his inheritance from his parents' estates. Although Stokes wanted to invest for his retirement with a view to attain, among other things, 70% capital preservation, Floyd strongly recommended the bulk of the inheritance funds be placed in one stock. That stock was in Bell Canada Enterprises ("BCE"), a corporation that at the time was subject to a takeover bid. Floyd represented to Stokes it would certainly come to fruition in the fall of 2008. Problems with the takeover bid emerged after the stock was purchased and which were widely reported in the news media between April and September. In the event, the transaction was not consummated. Further, in mid-September, 2008 when all securities were rapidly increasing and decreasing, Floyd recommended Stokes convert his regular cash account with the BCE holding to a margin account. Floyd then strongly suggested significantly more and larger purchases of common stock shares. At its peak, the amount borrowed in the margin account was over $480,000. IIROC alleged Floyd placed Stokes' funds in an overconcentration in one stock and then used the margin account excessively in September and October to actively trade in common shares. Further, three such trades in September 2008 were not authorized by Stokes before they occurred.

¶ 5 IIROC contended that, as branch manager, McDonald failed to ensure proper supervision of the account, had not approved the New Client Application Form ("NCAF"), failed to confirm the investment objectives, had not corrected or addressed any of the alleged unsuitable securities in the account, and had not queried the application for a margin account for Stokes. As well, IIROC contended he took no action to address the amount of margin used in the account.

LIABILITY DECISION FINDINGS

¶ 6 In its liability decision, this Panel found that Stokes, a 60 year old engineer planning for his retirement, was not sophisticated and relied heavily upon Floyd for his expertise and advice. This Panel found that Floyd

knew his recommendation to invest virtually all the inheritance in BCE did not conform to the client's stated investment objectives in the NCAF. Floyd admitted providing no cautionary advice to Stokes of the risks of loss in following his recommendation. Further, Floyd then continued to recommend holding BCE stock over the ensuing months, despite concerns expressed by Stokes that the share price was falling and the takeover bid was in jeopardy. Floyd admitted in this testimony that such risks of loss, which ultimately occurred, were in fact within his knowledge and experience prior to making his recommendations.

¶ 7 Approximately seven months after Stokes acted upon Floyd's initial recommendation to invest his $350,000 inheritance, it was all lost. There was no evidence that this loss, or any portion of it, has been restored to the client by either of the Respondents since October, 2008.

¶ 8 This Panel found that McDonald displayed a lack of due diligence in ensuring that an inexperienced investor, aged 60, was aware of the risks in putting virtually all of his inheritance into a trade involving a security subject to a known uncertainty. He failed to verify whether Stokes was apprised of the risks of opening a margin account or if it was suitable for him. He failed document his questioning of Floyd about trading in unsuitable securities in the margin account or to document his supervisory measures in that regard which was a failure of his supervisory responsibility given his knowledge from the NCAF that Stokes was not sophisticated and his investment knowledge was limited.

PENALTY HEARING

¶ 9 At the hearing on April 15, 2013 for penalty, IIROC submitted that the appropriate monetary penalty for the Respondent Charles Floyd ("Floyd") was a fine of $100,000.00, disgorgement of profits of $5860.00, and payment of 75% of IIROC's costs. IIROC further submitted that while a permanent ban was available on the facts of this case, IIROC sought only a suspension for 18 months, a condition that if Floyd becomes re-registered, he successfully rewrite the Conduct and Practices Handbook ("CPH") examination, and he is to be subject to strict supervision upon re-entry to the investment industry for the first 12 months, followed by a period of close supervision for a period of 6 months.

¶ 10 IIROC ("IIROC") submitted that the appropriate disposition in the case of the Respondent James McDonald ("McDonald") was a fine of $35,000.00, a 12 month suspension from acting as a branch manager or in any supervisory capacity, a condition that McDonald successfully rewrite the CPH examination, before McDonald becomes re-registered as a branch manager, he must successfully rewrite the Branch Manager's Course or equivalent, and payment of 25% of IIROC's costs. IIROC provided to the parties and this Panel particulars of its costs in the total amount of $25,662. IIROC noted its calculation did not include travel costs of its counsel or its witnesses and then indicated it would reduce the costs claim to the sum of $20,000.00.

¶ 11 In support of its submissions, IIROC referred to the "Dealer Member Disciplinary Guidelines" and to certain case authorities.

AS TO FLOYD

¶ 12 IIROC Member Rules 20.33 and 20.34 provide that where the Respondent was an Approved Person, the Hearing Panel may impose any one or more of the following penalties:

(a) A reprimand

(b) A fine not exceeding the greater of:

  (i) $1,000,000 per contravention; and

  (ii) An amount equal to three times the profit made or loss avoided by such Approved Person by reason of the contravention

(c) suspension of approval for any period of time and upon any conditions or terms;

(d) terms and conditions of continued approval;

(e) prohibition of approval in any capacity for any period of time;

(f) termination of the rights and privileges of approval;

(g) revocation of approval;

(h) a permanent bar from approval with IIROC; or

(i) any other fit remedy or penalty.

¶ 13 The list of sanctions in the above form was reproduced in the Notice of Hearing served on Floyd. IIROC also submitted that Rule 20 authorized the Hearing Panel to impose costs of the investigation and hearing proceedings. IIROC submitted that the main concern for a Hearing Panel on the penalty aspect was to impose sanctions that will serve to protect the public, IIROC members, the self-regulatory process, the integrity of the securities markets and to prevent recurrence of the conduct. It submitted the penalty should reflect the need to address specific deterrence of the Respondents and general deterrence to other registrants. Further, the penalties must be proportionate to the conduct in question having regard to the harm to the client, the employer, the investing public and the securities market. IIROC noted that it was not seeking disgorgement of Floyd's commissions upon the initial investment, but only upon the transactions made under the margin account.

¶ 14 IIROC contended that the sanctions requested to be applied to Floyd were supported not only by the Disciplinary Guidelines, but were also in line with other applicable case authority, specifically *Re Gareau 2011 IIROC 72, Re Phillips 2011 IIROC 60 and Re Steinhoff 2012 IIROC 2.*

¶ 15 The decision in *Re Gareau* at paragraph 12 contains a useful discussion of the purpose and application of the Disciplinary Sanction Guidelines as follows:

> *"The publication of sanction guidelines is an approach that has been adopted by other regulatory bodies. The goal is that hearing panels treat such guidelines as indicative of industry expectations and as relevant to a penalty determination, although they are neither exhaustive nor determinative. The guidelines do not prescribe specific results but set out factors that panels should take into account in determining penalties. The guidelines are careful to preserve the individualization of sanctions and not suggest a blanket approach. In part 2 of the Sanction Guidelines at page 8 it states:*
>
> > *Sanctions should be based on the circumstances of the particular misconduct by a Respondent with an aim at general deterrence.*
>
> *Emphasis is placed on investor protection and market integrity. The guidelines say:*
>
> > *Registrants who choose to act in ways that threaten the integrity of the capital markets must have the expectation that they will be held accountable through enforcement action by regulators.*
>
> *Thus in addition to the individual circumstances of a Registrant who is subject to sanctions, there is an overall public policy goal and objective that must be taken into account by panels when they are fashioning disciplinary sanctions for infractions of IIROC's regulations and by-laws. The balancing of these two interests underscores the very difficult tasks that a panel, such as the present one, must undertake."*

¶ 16 The decision in *Re Steinhoff* contains the following comments in addressing penalties as a deterrent at paragraph 14 of its penalty decision:

> *The Guidelines, in addressing penalties as a deterrent state:*
>
> > *"Registrants and Dealer Member firms have significant responsibilities that they must meet if investors are to be protected and market integrity maintained. Registrants who choose to act in ways that threaten the integrity of the capital markets must have the expectation that they will be held accountable through enforcement action by regulators. Sanctions should be based on the circumstances of the particular misconduct by a respondent with an aim at general deterrence.*
> >
> > *General deterrence will follow from an appropriate decision and deter others from engaging in*

similar misconduct and improve overall business standards of the securities industry. This can be achieved if a sanction strikes an appropriate balance by addressing a registrant's specific misconduct, but also being in line with industry expectations. As was observed by the Hearing Panel in Re Mills [2001] 1. D.A. C.D. No. 7 April 17, 2011, at p 3:

> *Industry expectations and understandings are particularly relevent to general deterrence. If a penalty is less than industry understandings would lead its Members to expect for the conduct under consideration, it may undermine the goal of the Association's disciplinary process: similarly, excessive penalties may reduce respect for the process and concomitantly diminish its deterrent effect. Thus the responsibility of the District Council in a penalty hearing is to determine a penalty appropriate to the conduct and the respondent before it, reflecting that its primary purpose is prevention rather than punishment.*
>
> *(Guidelines, p.8)*

¶ 17 Both Respondents made oral submissions at the penalty hearing. Floyd submitted he was negatively surprised by IIROC's position on the fine at $100,000 since he had been informed before the contested hearing that IIROC was seeking a fine of $50,000. He said he could not afford a suspension of 18 months. Floyd did not make specific representations as to the amount of costs or apportionment proposed between the Respondents, the conditions of rewriting the CPH or submitting to strict and then close supervision for the time periods requested upon registration.

¶ 18 Subsequent to the oral submissions on April 15, 2013, Floyd submitted letters from his psychiatrist and his former employer. Floyd's psychiatrist's letter indicated that Floyd sought treatment in 2009 as a result of personal issues compounded by occupational stressors which were impacting his ability to maintain his level of productivity and function. It said he was suffering emotional upheaval due to the investigation and wished to find restitution so he could continue his profession. It also said Floyd had become somewhat more insightful about his shortcomings and was open to try to improve. The letter from Floyd's former employer dated February 5, 2013 indicated he was terminated as of February 5, 2013 for lack of performance. IIROC, in response, noted that Floyd's psychiatric treatment commenced in 2009 which was subsequent to his conduct under review in these proceedings.

SUMMARY OF FINDINGS

¶ 19 The fourteen key considerations contained in the Guidelines which panels may consider when assessing the gravity of the conduct in a specific case are reviewed in turn below.

Harmed clients, Employer and/or the Securities Market

¶ 20 As was stated by the Panel in *Re Gareau* at paragraph 15:

> *The core duty and responsibility of an investment advisor is to make suitable recommendations in accordance with the clients' objectives and risk factors, and to properly obtain instructions before implementing trades.* ***Where almost total reliance is placed on the investment advisor, as it was in the present case, the responsibility to make suitable investments is heightened. (emphasis added)***

¶ 21 This Panel finds that Floyd's conduct caused significant harm to Stokes by purchasing securities in the amounts and in circumstances that were not consistent with Stokes' investment objectives and tolerance for risk having regard to his age and long term retirement objective.

Blameworthiness

¶ 22 In response to IIROC's contention that Floyd was a direct perpetrator of the loss, Floyd again denied that he solicited the client's account or that the trades were unsuitable. He repeated that Stokes' account was never designed as a portfolio, and that the financial conditions prevailing at the material times were the market's sharpest decline in world history. He said he did not foresee the losses which occurred.

¶ 23 While continuing to reject blame, Floyd revealed that he had a previous history of depression. In response to questioning by this Panel, Floyd confirmed that he was not suggesting any existing psychiatric condition was responsible for his conduct at the material times. This Panel noted that the evidence showed the commencement of his current psychiatric treatment was well after the conduct under investigation took place.

Degree of Participation

¶ 24 Floyd asserted that everyone in the office knew what everyone else was doing and none had voiced any objections. This Panel took this assertion to imply that because McDonald and others at Union were well aware of his trading strategy and activity in relation to Stokes, Floyd was not solely responsible for his misconduct. This Panel concludes that Floyd was the perpetrator of the losses. The fact that others at Union may have known about his aggressive strategy or unsuitable trades does not relieve Floyd from responsibility for his misconduct.

Extent to which Respondent was enriched by the misconduct

¶ 25 IIROC sought disgorgement of only those commissions that related to the trades in the margin account which were estimated by IIROC to stand in the sum of $5860.00. As stated, Floyd offered no specific response to this contention. This Panel is satisfied that Floyd must disgorge the commissions of $5860 as a result of the unsuitable trades on the margin account.

Prior Disciplinary Record

¶ 26 IIROC noted that Floyd had a prior disciplinary history with its predecessor organization, IDA, and the Toronto Stock Exchange for a discretionary trading contravention in 1980 resulting in a fine of $1250 and a suspension for 3 months plus a direction to pay costs of the investigation. The second contravention was in 1993 when Floyd was suspended for one year and fined $15,000 for a discretionary trading violation.

Acceptance of Responsibility, Acknowledgement of Misconduct and Remorse

¶ 27 In response to IIROC's submission that he had expressed no remorse, Floyd considered expressing remorse would be tantamount to admitting guilt. Floyd said he was guilty only of being "too positive" and not knowing "the other side of his client". Floyd expressed regret for losing Stokes as a client and a friend. He also regretted that he had also lost money on the trading strategy, that he suffered embarrassment and humiliation over the proceedings and his disclosure of the fact of the investigation to each of his clients and friends. He noted that he lost some clients as a result of the disclosure and some of his optimism and enthusiasm which was a signature feature of his personality and professional demeanor. He specifically denied feeling any remorse or any responsibility for Stokes' losses at the penalty hearing but instead continued to blame the market conditions and Stokes for failing to meet the margin call.

Credit for Cooperation

¶ 28 Although Floyd did not self-identify a breach of the rules or report any infractions, IIROC agreed that he cooperated in the course of the investigation.

Voluntary Rehabilitative Efforts

¶ 29 This Panel heard no evidence that Floyd has undertaken any voluntary rehabilitative efforts since the commencement of the investigation, save his seeking psychiatric treatment for his emotional upheaval and stress. In the latter regard, the physician's comments were qualified in stating only that in his opinion Floyd had become somewhat more insightful about some of his underlying shortcomings and was open to trying to improve in this area.

Reliance on Expertise of Others

¶ 30 Floyd and McDonald in their joint submissions emphasized that Union's compliance department was aware of the trades Floyd had made for Stokes. The implication of this submission was that by its silence, Union's compliance department must have acquiesced in, or tacitly approved of the same. They also argued that IIROC should have called the head of that compliance department as a witness, as it was too expensive for the

Respondents to do so. Even if Union's compliance department was aware of the trades Floyd had made, this Panel does not accept that passive acquiescence by Floyd's supervisors or others in the firm in these circumstances entitled Floyd to abrogate his responsibility to his client, his firm and the securities industry as a whole to ensure that his recommendations were suitable for Stokes.

Planning and Organization

¶ 31 IIROC asserted that the trades made by Floyd were planned and organized. Floyd offered no specific argument in response other than to say that his strategy was known and communicated to the client and to his office colleagues. This Panel concludes that Floyds' actions were not a rash or temporary lapse of judgment, but instead resulted from numerous transactions undertaken as part of a deliberate organized aggressive investment strategy. However, unlike the registrant in *Re Gareau*, who made no attempt to conceal his misconduct, this Panel finds that Floyd did attempt to dissuade Stokes from contacting Floyd's superiors for the reason that it would get him into trouble. In the view of this Panel, such conduct indicated Floyd knew, or at least strongly suspected, that his activities, if complained of, might well result in restriction of his trading activity or punishment. Further, when asked for an action plan by Stokes to reverse the losses, Floyd untruthfully claimed to have an action plan that he was discussing with his head office. The only reasonable conclusion this Panel can draw from that conduct is that it was designed to conceal Floyd's own wrongdoing. As such it is an aggravating factor.

Multiple Incidents of Misconduct over an Extended Period of Time

¶ 32 The wrongful conduct in this case was not a random or isolated incident. The unsuitable recommendations occurred over a period of time as a result of an aggressive investment strategy that was planned over a long interval. As well, the discretionary trades occurred on three separate occasions. In this Panel's liability decision, it documented several other instances of misconduct, including purchasing BCE stock before funds were deposited, purchasing securities before the margin account was established, and requesting Stokes to not elevate his complaints to Floyd's superiors.

Vulnerability of Victim

¶ 33 This Panel concluded that Stokes was an unsophisticated investor, befriended by Floyd when on a consulting assignment away from his home. Stokes had shared personal information about his parents' illnesses and expectation of receiving a substantial inheritance. He was induced by Floyd to open the account after making it clear that he intended the inheritance to finance his retirement. Stokes desired and expected a conservative investment strategy to meet low risk objectives. He was lulled into a false sense of security over the course of many social and professional conversations that he could achieve positive results because of Floyd's very considerable experience and expertise. In these circumstances, Floyd was responsible to prevent Stokes from making unsuitable investments without prior adequate warning of the risks, but Floyd neglected or refused to do so.

Failure to Cooperate with Investigation

¶ 34 This issue was dealt with under CREDIT FOR COOPERATION discussed above.

Significant Economic Loss to Client

¶ 35 In the circumstances, the loss of $350,000.00 was highly significant in that it represented the entirety of Stokes' inheritance which was intended as savings for his retirement. That sum was lost over a period of about 7 months due to Floyd's misconduct.

¶ 36 The Sanction Guidelines state as follows:

> 4. Use of Sanctions
>
> > As set out above, sanctions should be remedial in nature and "fit" the misconduct. Sanctions should effectively address the conduct in such a way as to discourage and prevent future misconduct by the respondent and at the same time, promote general adherence to industry rules and standards.

4.1 Fines

It is generally accepted that monetary fines serve to express general condemnation of specific misconduct. Fines will generally increase in relation to the relative severity of specific misconduct. Severity is measured to all of the factors set out above.

4.1.3.

At present, Dealer Member Rules specifically restrict the levy of a fine to a maximum of $1,000,000 per contravention for Approved Persons and $5,000,000 for Dealer Members. As well, a Hearing Panel may require a respondent to pay an amount equal to three times the profit made or the loss avoided by the respondent as a result of the commission of the contravention in question, including any commissions earned, or other benefits obtained from the impugned transactions.

4.2 Suspension of Corporate Membership or Approved Person Status

4.2.1. Suspension

A suspension may be appropriate where:

- There have been numerous serious transgressions
- There has been a pattern of misconduct
- The respondent has a disciplinary history
- The misconduct has an element of criminal or quasi- criminal activity
- The misconduct in question has caused some measure of harm to the integrity of the securities industry as a whole

4.3 Permanent Bar from Approval or Expulsion/Termination of Membership

A permanent ban from approval of an individual or the termination of membership or expulsion from the Corporation is a severe economic penalty and should generally be reserved for cases where:

- The public itself has been abused
- Where it is clear that a respondent's conduct is indicative of a resistance to governance
- The misconduct has an element of criminal or quasi- criminal activity, or
- There is reason to believe that the respondent could not be trusted to act in an honest or fair manner in all their dealings with the public, their clients, and the securities industry as a whole.

¶ 37 This Panel noted that the Sanction Guidelines emphasize, with respect to unsuitable recommendations (Dealer Member Rule 1300.1(p)), the importance of the relationship of trust and confidence that exists between a registrant and client. Paragraph 3.6 specifically addresses discretionary trading, the essence of which relates to lack of proper written authorization by the client.

CASE AUTHORITIES

¶ 38 As stated, in respect of the sanctions applicable to Floyd, IIROC cited as guidance decisions in *Re Gareau*, *Re Phillips* and *Re Steinhoff* (*supra*). *Re Gareau* concerned an active registrant who was represented at a 5 day contested hearing on allegations that he made unsuitable recommendations to two retired couples and made one discretionary transaction for one of the couples. Losses were significant for one client in the sum of approximately $600,000 in an account of $1,200,000. Gareau expressed remorse at his penalty hearing. The

hearing panel removed and suspended his active registration for one year and imposed a fine of $100,000.00.

¶ 39 *Re Phillips* concerned a non-active registrant who made unsuitable recommendations to two clients and discretionary trades for one of them. Although she also committed other violations of preparing income tax returns without the firm's consent and filling a client's "buy" order with a "sell" order from her own account, the panel considered the gravamen of the case was the unsuitable recommendations. The two accounts combined began with $806,000 and the losses combined totalled $238,000. Phillips filed a response and made one appearance but did not attend the contested hearing. The panel suspended his active registration for three years and imposed a fine of $290,000.00.

¶ 40 *Re Steinhoff* concerned a registrant who invested the sum of $125,000 which represented the down payment on the new home of a young married couple and which they wanted to be available the following June which was three months away. The registrant invested the funds in stocks in June utilizing significant margin. When the account was sold out in October, it netted approximately $55,000. The panel held the amount in the margin account was not consistent with the clients' objectives. Moreover, the registrant did not recommend liquidation after the market did decline in the very early going when the loss would have been minimal. Instead, she wrongly encouraged her clients to stay the course when she knew they had a deadline for making the down payment. The panel found that her conduct was egregious, that she attempted to deflect her responsibility back on the clients when the portfolio had to be sold and lied to her member firm about who brought up the use of margin. She had not accepted responsibility nor had she demonstrated any remorse. The hearing panel imposed a fine of $100,000, a suspension of 18 months, disgorgement of commissions, a requirement that she rewrite the CPH before she was re-registered and be subject to strict supervision for 12 months upon her re-registration and then a further 6 months of close supervision, plus payment of IIROC's investigative and prosecutorial costs of $20,000.

¶ 41 As to the application for suspension and monetary penalty, Floyd contended that his case was different from the case authorities cited by IIROC but offered no specifics except to say that he could not afford an eighteen month suspension.

CONCLUSIONS

¶ 42 This Panel concludes Floyd's conduct was egregious in ways similar to the registrant in *Re Steinhoff*. Not only was Floyd the direct perpetrator of the unsuitable recommendations and discretionary trades, he also attempted to deflect responsibility for the losses on to his client and the prevailing market conditions. The regrets Floyd expressed at the penalty hearing all centred on his own losses, including loss of clients, loss of his optimism, loss of his pride, loss of his employment and loss of his friendship with Stokes. He also regretted that he had not hired a lawyer.

¶ 43 This panel found Floyd's attempt to justify his conduct both at the liability and penalty hearing as merely the actions of an enthusiastic, if overzealous, stock broker to be disingenuous. His efforts both at the liability and penalty hearing to defend his conduct as reasonable were riddled with unpersuasive circumlocutions, selective memory and lack of candor. He contended that Stokes was at once sophisticated, (in large thanks to Floyd's own teachings) and foolish, (for selling to meet a margin call rather than borrowing more money). Floyd's steadfast refusal to face the reality of his failed conduct explains his continued grim determination to disavow responsibility and remorse for the significant harm to the client. Floyd's attitude was especially disturbing in view of the two previous findings of similar wrongful conduct as it also signals that sanctions previously imposed have not to date educated him as to proper conduct.

¶ 44 This Panel found that his psychiatrist's comments about Floyd's voluntary efforts at rehabilitation fell short of an endorsement that Floyd recognizes that his conduct in the Stokes account was contrary to the Dealer Member Rules referenced in Counts 1 and 2. They also contained no endorsement of any meaningful commitment by Floyd to desist in the repetition of any such conduct in future. This Panel heard no evidence to suggest Floyd had enrolled in any industry courses since the investigation began nor taken any steps to make any restitution of Stokes' financial losses.

¶ 45 The fact that Floyd has suffered an emotional and professional toll is accepted as a mitigating factor. It

is also accepted that he cooperated with the investigation. However Floyd's unwillingness to accept responsibility for his wrongful conduct and his related prior discipline history are aggravating factors in determining the appropriate penalty for specific and general deterrence. Nor in this Panel's view can Floyd seek refuge in McDonald's or Union's passive acquiescence in his aggressive trading activity which in the circumstances Floyd was, or should have been, aware was unsuitable. Floyd's planning and organization were deliberate and wilful, especially as regards the discretionary trading which is a further aggravating circumstance. Assuming that IIROC did change its position on the proposed monetary sanction from the outset to the conclusion of the proceedings to one of $100,000 from $50,000, this Panel considers IIROC would not in any event be bound by any such representation made before the entirety of the evidence was presented.

¶ 46 The Guidelines indicate suspension is warranted only in egregious cases. This Panel is satisfied this is one such case. Indeed, despite its submission that a permanent ban would also be appropriate in these circumstances, IIROC sought instead a suspension for 18 months followed by a period of twelve months of strict supervision followed by a period of six months of close supervision. Given the foregoing findings, this Panel carefully considered the factors in respect of a permanent ban, including the following:

- Floyd's conduct is indicative of a resistance to governance
- it is Floyd's third offence
- there is reason to believe that the respondent could not be trusted to act in an honest or fair manner in all his dealings with the public, his clients, and the securities industry as a whole.

¶ 47 This Panel observed that despite his medical treatment to date, Floyd displayed a singular lack of insight as to the impropriety of his conduct or the significance of its impact upon his client and the integrity of the securities industry. During the proceedings, this Panel noted occasions on which Floyd was careless with the truth. If Floyd has successfully deceived himself to this date that he is not at fault for the consequences to Stokes, this Panel has reason to suspect he will continue to deceive himself, his clients, and his supervisors. Such a future risk of harm extends to the public and the securities industry as a whole. These are factors that suggest a suspension, even one of 18 months in duration, is insufficient for Floyd and that instead a permanent ban is necessary to protect the public.

¶ 48 This Panel was mindful that a permanent ban is a severe economic penalty even without consideration of the monetary sanctions sought. Factors weighing against a permanent ban are that Floyd's misconduct had no element of criminal or quasi- criminal activity. Further, he is now aged 67 and, even with an 18 month suspension, he will be prevented from employment in the investment industry for a significant portion of his remaining working life. Finally, there were no case authorities submitted where a permanent ban was imposed. In fact, the panel in *Re Phillips* also considered but declined to impose a permanent ban. The bases for that decision were that no prior similar case prohibited the registrant from seeking reregistration and because the panel concluded the penalties and conditions imposed were sufficient to protect the public and were consistent with case precedents.

¶ 49 This Panel does not accept the absence of case authority to support imposition of a permanent ban as a compelling reason against such a penalty. If a hearing panel is satisfied on the evidence that a suspension will not achieve the requisite specific deterrence to as registrant or general deterrence to others who may be similarly tempted to cross the boundary against unsuitable trading behavior, such a penalty must be considered. This Panel is gravely concerned that Floyd is and will be continuously ungovernable. It has serious doubts that his professional attitude can be appropriately adjusted with strong and continuous encouragement and supervision to instill in him the importance of always observing the language and the spirit of the Member Dealers Rules.

¶ 50 After due consideration, this Panel has concluded that the appropriate punishment to fit the misconduct in these circumstances consists of a fine of $100,000.00 together with a permanent ban. In addition, this Panel concludes that Floyd must disgorge the profits of $5860.

¶ 51 This Panel is aware that an order of costs should not be punitive so as to prevent the mounting of a defence. It considered the particulars of IIROC's proposed bill of costs to be reasonable having regard to the investigation and prosecution over 5 days of hearing. It is noted that Floyd offered no objection to the costs calculation or the proposed apportionment of 75% against him. This Panel accordingly also concludes that Floyd should pay the proportionate share of $15,000.

AS TO MCDONALD

¶ 52 IIROC submitted that McDonald's supervision of Floyd's conduct in respect of Stokes' account was in effect non-existent in that he failed to prevent the unsuitable investments Floyd repeatedly made on behalf of Stokes. IIROC contended that McDonald's conduct harmed not only the client but the integrity of the industry as a whole. IIROC noted that like Floyd, McDonald also has not expressed remorse during these proceedings. This Panel reviewed the Guidelines' listed factors in respect of McDonald's conduct and made the following findings.

SUMMARY OF FINDINGS

Harmed clients, Employer and/or the Securities Market

¶ 53 IIROC contended that McDonald's failure to evidence the performance of any reasonable supervision of Floyd's conduct was egregious in the circumstances in that there were red flags in the daily reports, which were there to be seen. It said that McDonald could have taken simple action to prevent or mitigate the losses which ultimately ensued but in omitting to do any of those things, McDonald's conduct harmed both the client and the integrity of the securities market.

¶ 54 McDonald in his submissions detailed his employment history and noted that he had completed courses in options, commodities, branch managers, directors and partners. He submitted that he did not seek out the position of branch manager but took it on to ensure other office personnel could maintain their occupations. He submitted that he did review the daily reports and although there are no notations, other than his initials, he performed the requisite due diligence as the environment in the Edmonton office allowed regular discussion with all registrants as to their trading activity.

Blameworthiness

¶ 55 McDonald restated that he was well aware of the trades undertaken by Floyd and that the firm's compliance department, not McDonald, was responsible to approve the margin account. He also adverted to diagnosis of a serious illness requiring active medical treatment during the activities in question. Unlike Floyd, he did not produce any corroborating medical documentation. In any case, he confirmed on questioning by this Panel that the condition caused no outward symptoms and was not a factor contributing to his conduct.

Degree of Participation

¶ 56 As noted, McDonald maintained that he did review the daily reports with sufficient diligence and regularly discussed with Floyd his trading activities on behalf of Stokes.

Extent to Which Respondent was enriched by the Misconduct

¶ 57 There was no evidence or contention by IIROC that McDonald was directly enriched by the misconduct of Floyd.

Prior Disciplinary Record

¶ 58 McDonald had been a member of the industry for many years with no prior disciplinary history.

Acceptance of Responsibility, Acknowledgement of Misconduct and Remorse

¶ 59 As noted, McDonald claimed that he did review the daily reports and the firm's compliance department was ultimately responsible for approving the margin account, and by extension, it also reviewed the trading records and the trading activity of Floyd. He specifically denied acceptance of any responsibility for the loss of the client's investment of over $350,000. He also asserted that he had no remorse to express.

Credit for Cooperation

¶ 60 McDonald did not self-identify a breach of the rules or report any infractions, however IIROC agreed that he cooperated in the course of the investigation. McDonald contended that he applied much time in transmitting the numerous documents to IIROC and on more than one occasion.

Voluntary Rehabilitative Efforts

¶ 61 McDonald has evidenced no voluntary rehabilitative efforts such as retaking any industry courses since the commencement of the investigation to the date of the penalty hearing.

Reliance on Expertise of Others

¶ 62 McDonald repeatedly relied on the fact that Union's compliance department approved the margin account and, in turn, all the trades in question. The Panel rejects equally for McDonald the notion that passive acquiescence by his supervisors might render unsuitable conduct suitable and obviate the need for McDonald to perform the duties of a branch manager.

Planning and Organization

¶ 63 There is no suggestion that McDonald participated in the planning and organization of the aggressive strategy by Floyd. However the turbulent market conditions at the time indicate that a reasonable branch manager should and would have conducted deeper due diligence inquiries to ensure that the registrant had provided sufficient warning to the client of the risks of such course of action.

Multiple Incidents of Misconduct over an Extended Period of Time

¶ 64 There were multiple incidents of unsuitable recommendations over time, including the initial BCE trade in April, the two separate purchases, the intermittent purchases and repeated trades purchased on margin. McDonald insisted that he was well aware of all the trades that Floyd was making despite the fact that he made no notations or comments concerning the same on the daily reviews. His alleged avowed awareness of all the relevent details of the trading activity was inconsistent with the absence of any notes of comments or questions written on even one occasion in the time period under consideration with respect to warnings to the client and advance authority for all trades. The only conclusion this Panel can logically draw from this evidence is that McDonald saw nothing wrong with Floyd's conduct and for that reason asked no pertinent questions of Floyd and made no pertinent notes of any such inquiries at the material times.

Vulnerability of Victim

¶ 65 McDonald did not at any time contact Stokes directly to verify that he appreciated and agreed to run the risks to his account, despite the fact that he had met Stokes and in the face of the multiple trades evidencing a clearly aggressive and high risk trading strategy.

Failure to Cooperate With Investigation

¶ 66 This Panel is satisfied that McDonald provided cooperation with the investigation.

Significant Economic Loss to Client

¶ 67 McDonald was aware that Floyd was investing Stokes' entire inheritance of over $350,000 and knew that he was at an age where he would be considering retirement. This Panel concludes that he knew or should have known of the implications of pursuing such an aggressive strategy in the market conditions prevailing at the time. In particular, he admitted knowing that the proposed BCE takeover was not a certainty.

CASE AUTHORITIES

¶ 68 IIROC submitted that the Sanction Guidelines address the failure to supervise and in the circumstances of the trades made by Floyd, when the markets were very turbulent, the opening of a margin trading account for a client with conservative account objectives should have registered concern for a branch manager. In support of its contention that McDonald should receive a penalty of $35,000 and a suspension from acting in a supervisory capacity for one year, IIROC cited *Re Mills* [2000] I.D.A. C.D. No. 41, *Re Youden* [2005] I.D.A.

C.D. No. 52, *Re Murdoch* 2012 IIROC 23, *Re Donnelly* 2012 IIROC 32 and *Re Bergh* 20122 IIROC 41. IIROC contended that despite McDonald's prior clear record with the industry associations, the dearth of his supervisory performance should weigh against the imposition of a minimum fine. IIROC submitted that McDonald should be required to repeat the CPH course to remind him of the standards established for the investment industry. IIROC submitted that if McDonald were ever to seek to re-register in a supervisory capacity after the period of suspension sought, he should be required to take the branch manager's course or equivalent before such re- registration.

¶ 69 The panel in *Re Mills* considered it was unlikely Mill's conduct would be repeated and noted that he was no longer in the role of branch manager. It imposed a fine of $50,000 but no suspension as supervisor. In *Re Youden* the panel found that the registrant did not completely fail to supervise the registrant and did not attempt to minimize his involvement. He had no prior history, nor was he motivated by profit. Youden received a fine of $70,000 but no suspension.

¶ 70 IIROC also referenced cases of *Re Murdoch* 2012 IIROC 23, *Re Donnelly* 2012 IIROC 32 and *Re Bergh* 20122 IIROC 41, for the authority to suspend McDonald from acting in a supervisory capacity for a suitable period of time. In *Re Murdoch*, pursuant to a Settlement Agreement, the panel accepted that there was not a complete failure of supervision on Murdoch's part and he had voluntarily resigned as branch manager in December, 2011, several months before the penalty hearing. He readily accepted responsibility for his errors and omissions regarding his failure to effectively supervise the client's accounts. The aggravating factors were obvious red flags, his failure to evidence his inquiries of the registrant and his monitoring of the client accounts, the fact that he did not contact the client to confirm that the client understood and agreed with the trading activities in the account and that the client was vulnerable. Murdoch was fined $50,000, ordered suspended from acting as branch manager or in any other capacity for 12 months and to pay costs to IIROC.

¶ 71 In *Re Donnelly*, the mitigating factors included the fact that the branch manager had no previous disciplinary history and that he was misled by registrants. The aggravating factors were that several of the clients had little or no income or low net worth. The branch manager received a fine of $50,000 and was given a 45 day suspension.

¶ 72 In *Re Bergh* pursuant to a Settlement Agreement the Panel noted the aggravating factors, among other things, were that Bergh erred in ignoring red flags and in not ensuring the investments were appropriate for the clients. It was accepted that his conduct was not negligence but rather bad judgment calls. Mitigating factors were that he became concerned about the high degree of risk being assumed by clients, and directed the registrant to advise clients of the risk. Thus he was found to warrant a lesser penalty than in other similar cases. Bergh received a fine of $22,000 and a suspension of one year as supervisor.

¶ 73 In response, McDonald cited *Re Johnson* 2012 IIROC 19 and *Re MacDonald* 2012 IIROC 68 as more applicable cases to his circumstances. McDonald submitted he has now lost his taste for management "until he gets cornered again". He cited as mitigating factors that he cooperated fully with IIROC during the investigation by providing voluminous amounts of documents and resending such documents when they went astray while in IIROC's possession. He noted that he had been diagnosed with cancer since the events under consideration took place. He noted that he could not afford the cost of legal representation at these proceedings. He noted that he had taken numerous industry courses and spent many years as a volunteer of the industry's Alberta District Council for no remuneration. He stated, in the same way that Floyd did, that he could not express remorse as he considered that would be tantamount to admitting guilt. He said it was not his responsibility to sign and approve the margin account and that Union's compliance department was in accord with the opening of the margin account for Stokes. He also noted that he, like Floyd, lost money at this time. He concurred with the costs submission of IIROC.

¶ 74 In *Re Johnson* the facts were that an 85 year old widow opened an account with $10,000 in January 2001 but in June 2003 the account was dramatically increased to $500,000. Johnson made no inquiries as to whether those circumstances necessitated any change to the investment objectives or risk tolerance. Shortly after the registrant implemented his unconventional investment philosophy which had 50% of the account invested in gold and other precious metals securities, the value of the account rose to $845,000. In March 2006

the New Client Account Form ("NCAF") was revised to show risk tolerance of 60% growth and 40% speculative. Johnson failed to inquire of the registrant if there were facts to justify the revised risk tolerance, investment objectives or suitability of significant holdings in gold and precious metals.

¶ 75 The panel noted that Johnson had a spotless record as a registrant for over 40 years and 14 years as a branch manager which was a factor in his favor. He respected the unusual investment philosophy of the registrant he supervised and believed the registrant worked only with clients who were completely conversant with and agreed to its implementation. He never questioned the suitability of the portfolio for a 90 year old woman which the panel found negated any illicit motives or desire for personal benefit. He also acknowledged his defaults, cooperated with IIROC and voluntarily stepped down as branch manager. An aggravating factor was that he knew the client had concerns about the holdings in her account, but he did not meet to canvas the same until almost a year later. The panel there could not determine if the client had actually lost money as a result of the failed supervision. Johnson admitted that he failed to adequately supervise the account activity of one of a registrant's clients because of undue reliance on the registrant. A settlement agreement was accepted in which Johnson would pay a fine of $20,000 and contribute $1000 in costs.

¶ 76 In *Re MacDonald*, six married couples who were inexperienced investors and retired or nearly retired suffered losses in the range of 50-74% due to unsuitable recommendations from the registrant. That MacDonald ignored numerous red flags including the facts that the clients were retired or nearing retirement, their investment objectives and risk tolerance parameters were increasing as they aged, nearly all the trades were solicited, there was extremely high concentration in holdings which reflected a very high degree of risk that was not suitable for clients, the clients were inexperienced and the investments in their portfolios were overly aggressive. The mitigating factors included the facts that the branch manager had been cooperative, had a clear prior record after a long career, had accepted responsibility for his failures and entered into a negotiated resolution of the dispute. A settlement agreement was confirmed which required MacDonald to pay a fine of $40,000, pay costs and accept a prohibition from acting in a supervisory capacity for 5 years.

CONCLUSIONS

¶ 77 This Panel considers the case at hand to be distinguishable from *Re Mills* where the panel considered it unlikely the branch manager's conduct would be repeated. This Panel derived no such assurance from McDonald's submissions. It is not clear whether McDonald still holds the position of branch manager. Unlike *Re Youden*, where the registrant did not completely fail to supervise the registrant and did not attempt to minimize his involvement, McDonald cannot claim such mitigating circumstances. In *Re Murdoch*, the aggravating factors there were similar to those in the case at hand. On the other hand, McDonald cannot assert mitigating factors such as only incomplete failure of supervision on his part, voluntarily resignation as branch manager or acceptance any errors or omissions on his part. Instead, an aggravating factor for McDonald was that like Floyd, he endeavored to minimize his involvement by deflecting the responsibility to Union's compliance department and the market conditions.

¶ 78 In *Re Donnelly*, the branch manager had no disciplinary history, like McDonald, which is a similar mitigating factor. However, Donnelly had also been misled by the registrant which is a mitigating factor not present in McDonald's case.

¶ 79 This Panel considers the aggravating factors here, as in *Re Bergh*, were McDonald's errors in ignoring red flags and not ensuring the investments were appropriate for the client. However McDonald does not have the benefit of the mitigating factor in *Re Bergh* where the branch manager directed the registrant to advise clients of the risk.

¶ 80 This Panel accepts that McDonald has had a long career with a clear record, as well as volunteer work to the industry association which are mitigating factors. However unlike Johnson, McDonald seems unaware that he has committed any defaults and there is no evidence to demonstrate his recognition of any omissions on his part. Another distinguishing feature is that in *Re Johnson* there was no clear evidence that the client actually lost money as a result of the failed supervision. However, in the case before this Panel, the loss of Stokes' entire inheritance of over $350,000 occurred under McDonald's watch.

¶ 81 It is evident from the foregoing review of case authorities that the fines in these branch manager cases have ranged from $20,000 to $70,000. The fines differ because each case turns on its own particular facts. What this Panel considers the key factor here is that McDonald does not recognize any errors or omissions on his part or the harm he had caused to the client and the investment industry. This is an aggravating circumstance because it indicates that despite the many courses taken in his career, his long tenure and the service he has volunteered to the investment industry, he does not yet appreciate even at this date that he could have prevented or mitigated the losses with a reasonable amount of due diligence. The fact that Floyd and McDonald both assert that all the facts were disclosed to each other in their regular discussions, in this Panel's view, puts some shared responsibility on McDonald's own shoulders for the client's losses.

¶ 82 McDonald agreed with the proposed disposition as to costs. As regards the duration of the suspension as a branch manager, McDonald indicated he never desired to be a branch manager which implies that he would not take it on again. If that were so, the imposition of a suspension for 12 months from acting as a branch manager or in any supervisory capacity would be a hollow deterrent. However, McDonald also alluded to the fact that he might well reconsider such a role if he was "cornered". It is accordingly vital that this Panel impose a set of sanctions that will be fit for McDonald, given the mitigating and aggravating factors in this case. The disposition must be one that will provide sufficient specific deterrent to him and sufficient general deterrent to other branch managers or supervisors from engaging in similar conduct in order to foster compliance by industry participants and confidence in the industry policies and processes. This Panel accordingly accepts the submissions of IIROC as regards McDonald.

PENALTIES

¶ 83 Based on the foregoing this Panel orders that Floyd:

a) pay a fine of $100,000;

b) pay disgorgement of commissions of $5860;

c) pay costs of $15,000 representing 75% of the IIROC costs of $20,000;

d) be permanently banned from registration.

¶ 84 Based on the foregoing this Panel orders that McDonald:

a) pay a fine of $35,000;

b) pay costs of $5,000 representing 25% of the IIROC costs of $20,000;

c) be suspended from acting in any branch manager or in any supervisory capacity for a period of 12 months commencing June 3, 2013 and ending June 3, 2014;

d) be ineligible for reinstatement until he has rewritten and passed the CPH examination;

e) be ineligible for reinstatement as branch manager or in any supervisory capacity until he has rewritten and passed the branch manager's course or equivalent.

Dated at Edmonton this 27th day of May, 2013

Shelley L. Miller, Chair

Martin Davies

William Welton

ADDENDUM

¶ 1 I am in agreement with the majority of the Panel as to its evaluation of Floyd's lack of suitability for re-registration. However I want to separately express a procedural concern about the imposition of a permanent ban in this case. In a recent decision in *R. v. Thompson* [2013 A.J. 1546], the Ontario Court of Appeal reminded

the sentencing judge that while he was not bound by a joint submission from the defence and Crown counsel in a criminal assault case, he erred in his decision to give no meaningful reasons why he significantly increased sentences except for recognizing the "general need to respect such submissions and his reference to maximize penalties." Furthermore, it said that the sentencing judge gave no advance warning to counsel and did not give them the opportunity to make submissions or lead further evidence on the issue. The Court of Appeal then reduced the sentence to the length proposed in the joint submission for reasons that the jurisprudence is clear that a sentencing judge should not depart from a joint submission unless satisfied that the recommended disposition would be contrary to the public interest and bring the administration of justice into disrepute.

¶ 2 I note that the circumstances in R. v Thompson are very different from the facts at hand. First, even though the jurisprudence is clear that a court is not bound by a joint submission in any event, Floyd's case did not involve a joint submission as to the penalty. There is thus no risk to future settlement agreements in IIROC cases grinding to a halt if this Panel "jumps" the submission of IIROC. Second, IIROC expressly stated in its submission that the facts were sufficient to warrant a permanent ban, so there is nothing to suggest that IIROC required an opportunity for additional submissions or be otherwise prejudiced by the result. Finally, I am satisfied that this Panel has given meaningful reasons why it elected to increase the penalty from that expressly sought by IIROC.

¶ 3 My concern is that in the circumstances, Floyd was justified in assuming from what was said at the penalty hearing both by IIROC counsel and this Panel, that his worst case scenario would be a long suspension followed by strict and then close supervision. Based on his submission one could reasonably infer that if for him an 18 month suspension was unaffordable, then a permanent ban would be equally so. However, it is conceivable to me that Floyd may have had additional submissions to make against a permanent ban had he been alive to the fact that this Panel might decide to impose it. Given that he was not accorded such notice, or the opportunity to speak against such a penalty, I would have imposed the suspension penalty and conditions as submitted by IIROC.

Shelley L. Miller, Chair