

Re St-James

IN THE MATTER OF:

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

and

Élizabeth St-James

2020 IIROC 02

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

Hearing: December 10, 11, 13 and 14, 2018, in Montréal
Decision: February 2, 2020

Hearing Panel

Mr. Alain Gélinas, Chair, Mr. François Gervais and Mr. Yves Julien

Appearances:

Ms. Fannie Dubuc, Enforcement Counsel

Ms. Julie-Martine Loranger, for Élizabeth St-James (hereinafter, the Respondent)

DECISION ON LIABILITY

¶ 1 The matter before us pertains to whether the supervision exercised by the Respondent in the Montréal office of Mackie Research Capital Corporation (Mackie) between 2009 and 2014 was adequate.

¶ 2 Further to a Notice of Hearing dated May 8, 2018, Staff of the Investment Industry Regulatory Organization of Canada made the following allegations.

Count 1

From August 2009 to September 2012 and from December 2012 to July 2013, the Respondent failed to adequately supervise activities in a customer account by a registered representative under her responsibility, in accordance with supervision conditions imposed on this registered representative by the Approval Committee of the Quebec District Council, contrary to Rule 38.4 (a) and Rule 2500 of the IIROC Dealer Member Rules; and

Count 2

Between July 2013 and March 2014, the Respondent failed to adequately supervise a registered representative under her responsibility in accordance with supervision conditions imposed on this registered representative by the Approval Committee of the Quebec District Council, contrary to Rule 38.4(a) and Rule 2500 of the IIROC Dealer Member Rules.

¶ 3 The hearing was held on December 10, 11, 13 and 14, 2018. The members received the latest Stenographer's Notes on February 26, 2019.

The facts

¶ 4 Substantial documentary evidence was filed by both parties. However, we excluded the stenographer's notes on the testimony provided by Mackie's compliance officer during the material period, given that the latter was not called before the Hearing Panel (Stenographer's Notes of December 10, 2018, p. 17). The Hearing Panel did, however, allow Mackie's current VP Compliance to present the factual sequence of events, without comment or opinion on the information, since he was not present at the material time and is not an expert witness.

¶ 5 Regarding the account statements, the figures mostly agree for both parties (Stenographer's Notes of December 10, 2018, p. 23). However, the experts' interpretations of these figures on either side diverge significantly.

Testimony by the investigator

¶ 6 IIROC called the investigator Stéphane Gauthier to give evidence (Stenographer's Notes of December 10, 2018, p. 59). The latter is the investigator assigned to the Respondent's case. The investigation commenced on September 3, 2014 and initially concerned the supervision effected by the Respondent at Mackie's Montréal branch. The material period extends from September 2008 to March 2014.

¶ 7 The investigator testified that the Respondent had responsibilities concerning the supervision of the Montréal branch from September 2008 to March 2014 (Stenographer's Notes of December 10, 2018, p. 67). As of September 22, 2008, the Respondent was registered as "branch manager and registered representative" (Exhibit P-10, p. 10.20 and Exhibit P-14).

¶ 8 The investigator added that the Respondent had no supervisory role between October 2012 and the end of December 2012 (Stenographer's Notes of December 10, 2018, p. 75) except for the representative Daniel Dubois (Dubois), who is the object of Count 2.

¶ 9 On December 24, 2012, the Respondent resumed her supervisory duties (Exhibit P-52).

¶ 10 In 2013, once again, the Respondent no longer had supervision of all of the representatives, but would retain supervision of Mr. Dubois until the latter's departure in March 2014 (Stenographer's Notes of December 10, 2018, p. 77 and Exhibit P-52).

¶ 11 At the material time, the Respondent was responsible for the supervision of four or five representatives (Stenographer's Notes of December 10, 2018, page 81 and Exhibit P-12).

Count 1

¶ 12 The triggering element that allegedly led the investigator to question the Respondent's supervision is the investigation of the representative Samuel Kloda (Kloda) following a client complaint. He noted that Kloda had been placed under close supervision by IIROC, from the moment of his transfer to Mackie. The close supervision had already been imposed with his previous employer (Exhibit P-1, pages 1.25, 1.27 and 1.28). Furthermore, the representative Kloda had been dismissed for cause by his previous employer.

¶ 13 Here is an excerpt from the condition imposed by IIROC on the representative Kloda:

The Dealer Member employing Mr. Kloda must complete and file with IIROC-Québec a monthly Close Supervision Report of Mr. Samuel Kloda's daily activities in the manner prescribed by IIROC, with periodic reviews by IIROC every six months to determine if the condition should be maintained, modified or lifted.

¶ 14 The investigator entered into evidence Mackie's policies and procedures manuals dated June 2011 and

2012 (exhibits P-50 and 51). Here are some of the passages highlighted by the investigator:

Page 51.201: “Minimum Standards for Retail Supervision”: IIROC sets out mandates with regard to supervision, “Minimum Standards for Retail Account Supervision” that provide specific requirements for Head Office and Business locations trading reviews, complaint handling, etc. The requirements that follow are based on IIROC Rules and the Minimum Standards.

Page 51.197, section 28.2, second paragraph: However, it is IIROC expectation that supervisors take a more granular approach to reviewing activity.... “What to look for”: These reviews should be carried out to attempt to detect, among other things: ...- Lack of suitability - securities purchased/sold do not appear to fit in the stated investment objectives on file; Excessive trade activity [...] Inappropriate/high risk [...] strategies [...]

Page 51.198: “Evidence of Supervisor Reviews”.

¶ 15 Regarding the evidence of supervision, the investigator mentions [translation] “that there must be notes, there must be inquiries... There must be questions, evidence, notes, questions and answers” (pages 51.202 and 51.68).

¶ 16 The redacted Stenographer’s Notes of the Respondent’s interview of July 24, 2014, were entered into evidence as Exhibit P-12. The Respondent’s interview by the investigator was conducted in French.

¶ 17 Entry into evidence of the second interview of the Respondent, dated February 9, 2015, was taken under advisement (Exhibit P-18; Stenographer’s Notes of December 10, 2018, page 135). The Hearing Panel allowed it into evidence because it considers it relevant to have an overall view of the supervision effected by the Respondent.

¶ 18 Investigator Gauthier testified that the triggering element in this matter was the client complaint. A ComSet event report was filed by Mackie on May 28, 2013 regarding the client complaint against representative Kloda. It mentions that the matter was settled on August 23, 2013 for the sum of \$17,333. At the time of the complaint, the client, a woman, was 62 years old.

¶ 19 The investigator mentioned that one allegation of the complaint was to the effect that representative Kloda had promised the client to return the account to a value of \$85,000 (Stenographer’s Notes of December 10, 2018, page 139; Exhibit P-26).

¶ 20 In response to the client complaint, Mackie’s senior compliance officer admitted, on August 23, 2013, that a risk tolerance of 100% was inconsistent with the client’s profile. Here is the relevant passage: “Therefore we feel that a risk tolerance of 100 % seems inconsistent with your profile” (Exhibit P-33, Stenographer’s Notes of December 10, 2018, p. 143).

¶ 21 Following a hearing held on November 14, 2016, a Hearing Panel of IIROC accepted a settlement agreement between IIROC Staff and the representative Kloda (2016 IIROC 50). The latter admitted his liability regarding, notably: 1) investments that were unsuitable for his client; 2) failure to respect the Know-Your-Client rule with regard to this same client; and 3) excessive trading for the purpose of generating additional commissions in the client’s account.

¶ 22 The settlement agreement mentions that the client opened an RRSP account with representative Kloda at Mackie on August 3, 2009. At the time of opening the account, the client was 58 years old, divorced and retired. The Hearing Panel accepts the settlement agreement into evidence given that it is relevant, but recognizes the specific nature of the admissions in such a context.

¶ 23 Investigator Gauthier emphasized that the trading strategy deployed in the client’s account was unsuitable given her investor’s profile (Stenographer’s Notes of December 10, 2018, page 145). The Hearing Panel is conscious that Gauthier does not have expert status and is testifying as an investigator.

- ¶ 24 The investigator confirmed that he noted the red flags mentioned in paragraphs 18 and 19 of the Notice of Hearing (Stenographer's Notes of December 10, 2018, page 146).
- ¶ 25 Regarding Exhibit P-29, the investigator emphasized that it is an RRSP account opened by the client on August 3, 2009. The client is retired and was 58 years old at the time. He noted that the client's investment knowledge is limited and she is inexperienced. The client had \$200,000 in assets, with \$100,000 in liquid assets. Her income was \$30,000. He noted her investment objectives, namely 80% short-term capital gains and 20% medium-term. With a risk tolerance of 50% low and 50% high, as an investigator, he considers this fairly aggressive. The account was to be used to trade securities on the TSX (Stenographer's Notes of December 10, 2018, pages 147 and 148). The form was approved by the Respondent.
- ¶ 26 The investigator testified that the New Client Application Form was updated on November 2, 2009 (Exhibit P-30). He found that the update was made within a very short timeframe, namely three months after the account was initially opened. The information was essentially unchanged except for the fact that the high-risk tolerance factor was increased to 100%. It was also broadened to include the opportunity to trade small-cap securities on the TSXV. The update was approved by the Respondent.
- ¶ 27 The investigator saw no questioning or notes by the Respondent that might have explained why the profile changed suddenly and became so aggressive in three months. The investigator was of the opinion that the Respondent should have asked questions when the account was first opened.
- ¶ 28 He emphasized the context of a client with \$100,000 to invest, with objectives of 80% short-term capital gains - implying high-risk trading - who was dealing with a new Mackie representative who was under close supervision and who was dismissed for cause by his previous employer. To the investigator, approving a New Client Application Form is not just a signing formality, but also a risk evaluation of the account (Stenographer's Notes of December 10, 2018, pages 150 and 151).
- ¶ 29 The investigator noted the payment of \$11,742 in commissions by the client between August 2009 and August 31, 2013 (Stenographer's Notes of December 10, 2018, page 156 and Exhibit P-34). For him, this was another red flag.
- ¶ 30 Analysis of the account statements allowed the investigator to observe that it was clearly a strategy intended to seek short-term capital gains on volatile securities (Stenographer's Notes of December 10, 2018, page 157, Exhibit P-35).
- ¶ 31 He emphasized the combination of trades in junior securities, coupled with a good deal of interest in gold sector securities. As an investigator, he considers that these constitute high-risk trades which are also considered red flags (Stenographer's Notes of December 10, 2018, page 159, Exhibit P-36).
- ¶ 32 The investigator conducted a profit and loss analysis for the period between 2009 and June 30, 2013, the timeframe during which the Respondent was supposed to be supervising Kloda. He estimated the losses at \$23,296, in return for commissions of \$11,742. For the investigator, this was another red flag (Stenographer's Notes of December 10, 2018, page 160, Exhibit P-37 amended and D-4). He found no trace of supervision in respect of these facts. The loss represented approximately 61% of the initial value of the account (Stenographer's Notes of December 10, 2018, page 164).
- ¶ 33 He also calculated the portfolio's turnover rate, taking the total value of the positions acquired and dividing by the average value of the account. He arrived at a figure of 10.9 for 2011, which seemed high to him and accordingly constituted another red flag (Stenographer's Notes of December 10, 2018, page 166, Exhibit P-38).
- ¶ 34 The investigator obtained from Mackie the report of the Respondent's interventions in the accounts handled by Kloda and the other representatives, for the period from September 9, 2008 to July 22, 2014 (Stenographer's Notes of December 10, 2018, page 173, Exhibit P-43).

¶ 35 He found just one intervention by the Respondent, in a problem concerning an account in debit. The account had been placed in a margin position following a transaction, which led to a debit. To the investigator, this was not an intervention for suitability reasons, nor a matter of “churning”. This intervention was simply to deal with a debit from a trade. (Stenographer’s Notes of December 10, 2018, pages 173-174).

¶ 36 He found no other trace of supervision by the Respondent in regard to the client’s portfolio turnover rate. As the investigator, he was of the opinion that, in supervision matters, a portfolio turnover rate of 10.9 in 2011 should have attracted attention. Moreover, in September 2011, over \$1,500 in commissions should have triggered the monthly supervision required of a supervisor (Stenographer’s Notes of December 10, 2018, page 179, Exhibit P-44).

¶ 37 Exhibit P-45, which covers the period from August 2009 to February 2011, according to the investigator, shows no supervision of the client’s account by the Respondent.

¶ 38 The investigator also examined the supervision reports signed by the Respondent regarding representative Kloda. He found the following handwritten note on the last supervision report: “Last month one complaint also keeping an eye on him” (Stenographer’s Notes of December 10, 2018, page 183, Exhibit P-47).

¶ 39 Regarding the \$2,148 in commissions in September 2011, he found that the account contained \$25,578 in equity. He noted that the portfolio was often in large part invested in a single security; it was then resold and reinvested in a different security, and so on (Stenographer’s Notes of December 10, 2011, page 186 and Exhibit P-20). For the investigator, this seemed enormously aggressive for a small RRSP account owned by a retired lady and handled by a representative under close supervision.

¶ 40 Regarding supervision, he found just one mention, “new issue”, and checkmarks. These last were meant to verify the profits on the transactions (Stenographer’s Notes of December 10, 2018, page 187 and Exhibit P-20).

¶ 41 Regarding the absence of supervision in September 2011, the Respondent apparently mentioned that Kloda’s trades were earning profits and that a note explained why one commission was larger. It was due to the fact that it was a new issue (Stenographer’s Notes of December 10, 2018, page 190, P-20, P-20.4 and P-20.5).

Count 2

¶ 42 Exhibit P-48 was entered into evidence. It is the registration committee’s decision of November 28, 2011, which imposed close supervision of the representative Dubois on site. To the investigator, it was therefore up to the Montréal branch supervisor to provide that supervision (Stenographer’s Notes of December 10, 2018, page 194).

¶ 43 According to the NRD records, between November 9, 2011 and March 21, 2014, the Respondent was the supervisor at that branch. (Exhibit P-48).

¶ 44 Exhibit P-49 contains the close supervision reports that the Respondent was supposed to sign each month for the representative Dubois between November 2011 and March 2014.

¶ 45 The report contains the following mention: “I hereby certify the supervision has been conducted (for the month).....of the activities of Daniel Dubois by the undersigned”, and it is signed by the Respondent. The report mentions that all of the clients’ accounts were checked on a daily and monthly basis in accordance with prescribed standards (Stenographer’s Notes of December 10, 2018, pp. 196 and 197).

¶ 46 Representative Dubois was required to be under close supervision “on site” for the entire duration of his employment at Mackie.

¶ 47 During her interview, the Respondent admitted to the investigator that she did not supervise the

transactions for the period between July 2013 and March 2014 when Dubois left the firm. She was present on site but it was DL who was reviewing everyone's transactions out of Toronto, including those by representative Dubois. If there was no problem, the Respondent signed the report (Stenographer's Notes of December 10, 2018, page 200).

¶ 48 The Respondent admitted to the investigator that she had relied on DL's work (Stenographer's Notes of December 10, 2018, page 213 and Exhibit P-18). Exhibit P-9 shows that DL became the supervisor of the Montréal branch as of July 3, 2013.

¶ 49 On cross-examination, the investigator summarized the sequence of events as follows: 1) the Respondent did supervision from 2009 to September 2012; 2) CC did supervision from September to December 2012; 3) the Respondent resumed supervision in December 2012 until July 2013; and 4) DL took over supervision effective July 2013 (Stenographer's Notes of December 18, 2018, pp. 237 and 238).

Cross-examination of the investigator

¶ 50 During cross-examination, counsel for the Respondent entered several exhibits into evidence.

¶ 51 The investigator allowed that the client had been investing with representative Kloda for a long time. She was his client at CIBC Wood Gundy. He acknowledged that in 2007, the account took a more aggressive turn (Stenographer's Notes of December 11, 2018, p. 23).

¶ 52 Counsel for the Respondent mentioned that the 2008-2009 period was marked by the financial crisis. The amount transferred to Mackie was \$39,036.96, whereas the client's assets had at one point reached a high of nearly \$88,000 while at CIBC Wood Gundy (Stenographer's Notes of December 11, 2018, p. 50).

¶ 53 The evidence shows that the client had known Kloda for about 18 years (Stenographer's Notes of December 11, 2018, p. 55). Some securities were from the client's account at CIBC Wood Gundy (Stenographer's Notes of December 11, 2018, p. 57 and ss.) Two transferred funds were resold in order to purchase mining and tech stocks (Stenographer's Notes of December 11, 2018, p. 58).

¶ 54 While the investigator allowed that the Toronto Stock Exchange is a major market, he emphasized that the gold sector is a volatile market.

¶ 55 He also allowed that the Respondent only had to review the monthly statement of commissions paid by the client once in eight years. However, he added, it is a small account that does not trigger the \$1,500 threshold, barring exceptional circumstances. However, to his mind, this does not preclude looking at other account statements (Stenographer's Notes of December 11, 2018, p. 88).

¶ 56 The investigator also allowed that there was a Black Monday in 2011 and that this event could have had an impact on the Canadian market (Stenographer's Notes of December 11, 2011, pp. 94 to 98).

¶ 57 He allowed that a compensation of \$17,733 was allegedly offered to the client, which the latter allegedly accepted (Stenographer's Notes of December 11, 2018, p. 104).

¶ 58 The complaint brought by the client's daughter mentions that the latter is not happy about the loss suffered in her mother's account. She refers to a meeting that took place at her home with the representative Kloda. The complaint mentions that, at the time, the representative Kloda allegedly told his client not to worry and promised to restore the portfolio value to \$85,000 with some stock market trades (Stenographer's Notes of December 11, 2018, pp. 105 and 106).

¶ 59 The investigator acknowledged that one would have to go back to the period at CIBC Wood Gundy to find an amount of \$85,000 in the client's account.

¶ 60 Commenting on the report by the expert Tanguay, the investigator allowed that the greatest losses were, with one exception, caused by securities that were held longer (Stenographer's Notes of

December 11, 2018, p. 110).

¶ 61 The investigator then countered that when the New Client Application Form was updated on November 2, 2009, which update raised the high-risk tolerance from 50% to 100%, he found no note or supporting document, despite the fact that the representative Kloda was under close supervision (Stenographer's Notes of December 11, 2018, pp. 132 and 133). The Respondent's reply to the investigator was that she had relied on the representative Kloda's version [translation] "Well, it's what the lady wanted" (Stenographer's Notes of December 11, 2018, p. 132).

Expert report from IIROC Staff

¶ 62 Mr. Jacques Tanguay was declared an expert witness in the field of compliance (Stenographer's Notes of December 11, 2018, p. 154). His report was entered into evidence by unanimous consent (Stenographer's Notes of December 13, 2018, p. 189).

¶ 63 The expert Mr. Tanguay was of the opinion that, given the regulatory supervision obligations, and the standards and practices in effect at the material time for count 1, the Respondent did not adequately supervise the activities of the representative Kloda in respect of the client's account. He underscored the following elements:

- The account type (RRSP);
- The client's profile (age, net personal assets, previous employment);
- The client's investment knowledge and her investment objectives as shown on the New Client Application Form (August 3, 2009) and the subsequent update (November 2, 2009).

¶ 64 In the face of these elements, he was of the opinion that the Respondent should have inquired about and questioned the information far more actively, in order to verify whether the information collected adequately and correctly reflected the needs and objectives of representative Kloda's client.

¶ 65 With the exception of two elements, the expert found no evidence to show that there had been routine daily or monthly supervision of representative Kloda in respect of the client's account and in a close supervision context. This is especially true for the period between July and September 2011 when excessive trading (churning) was observed.

¶ 66 For the entire material period of the Statement of Allegations, namely from August 2009 to September 2012 and from December 2012 to July 2013, he found traces of only two supervision elements for representative Kloda. One trade allegedly led the account to be debited on July 26, 2011 and another supervision element in September 2011 mentioned that one sale was a new issue.

¶ 67 The expert Tanguay found no evidence that representative Kloda had been asked any questions when the client's account began to incur significant losses in July 2010 and the months that followed.

¶ 68 Regarding Count 2, the expert Tanguay was of the opinion that the Respondent did not adequately supervise representative Dubois.

¶ 69 Even though it was very clear to him that the District Council decision had imposed on-site supervision of representative Dubois by a qualified supervisor and that the Respondent was the designated supervisor in this regard, he found no documentary evidence that such supervision had been conducted on a routine basis, either daily or monthly, for the period of July 2013 to March 2014.

¶ 70 Rather, it seems that supervision of the representative Dubois was done by a supervisor at the head office in Toronto. The expert emphasized that the Respondent's role was limited to filling out and signing the supervision report required by IIROC.

¶ 71 Getting back to count 1, the expert Tanguay disagreed completely with the position of the expert

Boyce to the effect that there was no reason to question the trades and investments made by representative Kloda in the client's account.

¶ 72 Concerning count 1, he was of the opinion that the expert Boyce, though fully informed of the requirement of strict supervision of representative Kloda, did not give due consideration to this requirement when analyzing the investment profile, trades and the quality of the investments in the client's account.

Respondent's Submissions

¶ 73 On the second day of the hearing, exhibits EST-1 to EST-12, EST-17 to EST-20, EST-21 (a) to (h) and EST-22, were entered into evidence (Stenographer's Notes of December 11, 2018, pp. 111 to 129).

Respondent's testimony

¶ 74 The Respondent testified in her own defense. She is currently a sales assistant and trader (Stenographer's Notes of December 13, 2018, p. 103). At the time of the hearing, she was still employed with Mackie in Montréal.

¶ 75 In 2008, she supervised four to five representatives. Between 2008 and 2013, the Respondent supervised three to four representatives (Stenographer's Notes of September 13, 2018, pp. 104 and 105).

¶ 76 As a branch manager, she was paid a fixed salary and was not entitled to a performance bonus (productivity).

¶ 77 She participated in hiring representative Kloda but did not initiate that contact (Stenographer's Notes of December 13, 2018, p. 105).

¶ 78 The Respondent admitted that, as branch manager, she signed Kloda's strict supervision report and she approved the New Client Application Forms (Stenographer's Notes of December 13, 2018, p. 106).

¶ 79 She testified that she looked at the client's information, the person's place of residence, age, occupation, circumstances and experience before signing the New Client Application Form. In this matter, the representative Kloda had known the client for about 18 years (Stenographer's Notes of December 13, 2018, pp. 106 and 107).

¶ 80 The Respondent testified that she spoke with representative Kloda when the account was opened in August 2009 and she looked at the content of the portfolio. She was of the opinion that the assets being transferred were not far off from the objectives and risk tolerances mentioned in the New Client Application Form (Stenographer's Notes of December 13, 2018, p. 109).

¶ 81 In September 2009, she did not request an update of the form but noted a discrepancy between the composition of the account and the initial objectives. The client's investment funds had been sold in order to purchase, among other things, shares in a high-tech firm. She admitted that, at that point, the portfolio had gotten riskier. Representative Kloda, instead of changing the portfolio content, allegedly spoke to the client and asked her to update her objectives (Stenographer's Notes of December 13, 2018, p. 110).

¶ 82 The Respondent signed the form that changed the risk tolerance of Kloda's clients to 100%, thus permitting purchases on the TSX Venture, and she admitted that purchases had already been made on this market.

¶ 83 Regarding supervision, she emphasized that she looked at the commission reports every morning (Stenographer's Notes of December 13, 2018, p. 113).

¶ 84 She would ask the representative to submit notes to her, describing the time of the call, the purpose of the call and the actions taken (Stenographer's Notes of December 13, 2018, p. 114).

¶ 85 Given that representative Kloda's office and her own were in close proximity, the Respondent emphasized that she could hear representative Kloda's telephone conversations. She could tell if he was

talking to the client or to her daughter (Stenographer's Notes of December 13, 2018, p. 118).

¶ 86 She emphasized that the commissions earned by representative Kloda were minimal.

¶ 87 The Respondent was not surprised at the increased activity in representative Kloda's client's account after July 25, 2011. She had seen a note to the effect that the client wanted to do a lot of trading and that she did not want an investment that would be a long-term holding (Stenographer's Notes of December 13, 2018, pp. 119 and 120).

¶ 88 She invoked three main arguments, namely that the proximity of the offices enabled her to exercise adequate supervision, that representative Kloda informed her on paper of any trades that were made and, finally, that the commissions being invoiced were modest.

¶ 89 In terms of the more than \$1,500 in commissions in one month, the Respondent stated that she would have questioned representative Kloda if she had not already had the answer.

¶ 90 The Respondent had access to a "share drive" supervision system. The system is also accessible to the compliance department in Toronto. For part of her supervision period, namely from January 2013 to January 2014, no mention appears regarding either representative Kloda or the client. The Respondent mentioned that this could be explained notably by the fact that the trading was in line with the objectives and that "basically, there was no problem" (Stenographer's Notes of December 13, 2018, p. 130).

¶ 91 For the period 2008, 2009 and up until 2012, the Respondent testified to the fact that there was just one entry for representative Kloda concerning the client's account in the supervision system (share drive). The entry states that the client's account was found to be in debit for a sum of \$20,000 (Stenographer's Notes of December 13, 2018, p. 131).

¶ 92 It was only towards 2012 that the Respondent began to input clients' birth dates on a supervision list (Exhibit P-45.1). This addition was made after a visit by CC to the branch. The latter had noted that there should be particular emphasis placed on a client's age and the relative risks of clients' accounts and that the client's name had not shown up (Stenographer's Notes of December 13, 2018, pp. 132 and 134).

¶ 93 The Respondent emphasized that the client had wanted to stay with the firm after the settlement (Stenographer's Notes of December 13, 2018, pp. 135 and 136).

¶ 94 The Respondent admitted that she wanted to give up being a supervisor in fall 2012 and return to a sales assistant position (Stenographer's Notes of December 13, 2018, p. 142).

¶ 95 The Respondent admitted to the investigator that representative Kloda was closely tracking gold and oil stocks while he was under supervision (Stenographer's Notes of December 13, 2018, pp. 143 and 144).

Cross-examination of the Respondent

¶ 96 Enforcement Counsel cross-examined the Respondent on her testimony during the investigation. The Respondent had the following comments about her supervision role during the investigation and the cross-examination:

[TRANSLATION]

Mr. SÉBASTIEN TISSERAND:

Q. [300] Would you evaluate the information entered on New Client Application Forms? In terms of relevance, in terms of appropriateness, for instance, the personal financial profile, the person versus his or her objectives or profile.

A. Well, of course, when it's a new client, we don't necessarily have the portfolio.

Q. [301] Hum-hum.

A. Certainly, we looked at the objectives, and then the client's profile, what he did...

Q. [302] But you have no parameters to guide you by saying: "That makes no sense. That makes sense"?

A. Well, I could tell you that when I started out, it was less... less established.

Q. [303] Hum-hum.

A. And then I think, with the years, these are things that have tightened up with regard to age and all that. (Stenographer's Notes of December 13, 2018, p. 147; Exhibit P-12, pages 56 and 57)

.....

A. Well, as in... take for instance, in the case of... I think it was Mrs., when the account was transferred, the content already was not in accordance with the objectives, so that at the time, he would have had to sell things and then invest in less risky things because, back when he took over the account, already it didn't fit. So... (Stenographer's Notes of December 13, 2018, p. 150; Exhibit P-12, p. 75)

.....

Q. [412] ... then, after that, it just didn't work, and not long after, he updated. Did he set objectives like that at random? Is that it? Is that how he worked? Because, you know, normally, it should have been discussed with the client. "Well, yeah, me, I'm ready to take some risks." That shouldn't change in just...

A. Yes. Well, I think there is a part where, for him... Well, of course, some things are more speculative than others, but I think there are some things that he did not consider speculative. You know, in the sense that they were moderate to him, but ultimately, they are now considered speculative. I think that he might have had a little, maybe just a little trouble perhaps... not understanding exactly, but I think that for him, moderately speculative, was perhaps not what we consider moderate today.

Q. [413] O.K., which means that he would have initially set the objectives according to this perception that he had.

A. Yes, that's it. (Stenographer's Notes of December 13, 2018, pp. 152 and 153; Exhibit P-12, pages 77 and 78)

.....

A.... then the client, he wanted to hang onto his mutual fund, but it didn't fit in... in... you know, anywhere, which is why I sent the letters, to make sure that the client was... you know, aware that there was a risk associated with this, that this was really what he wanted.

Q. [506] What did you talk about?

A. It was... well, about an account that isn't.... (the client in this matter)

Q. [507] Right.

A. Accounts that weren't...

Q. [508] But that isn't my question. You refer to letters, what are you talking about?

A. Oh, the letters?

Q. [509] Yes.

A. They were letters that I sent afterwards, regarding other accounts.

Q. [510] "Afterwards", meaning when?

A. Well, after the update of Ms.... (the client) was already done, it was... that's before. After, later, I sent letters to certain clients.

Q. [511] But can you be more specific as to when you sent the letters, in your recollection?

A. As I recall... Some letters... It seems to me that it was more 2012, 2013, but... I would have to check.

Q. [512] And what were these letters?

A. They were letters to clients asking... overall, it was just to confirm that they knew that there was some risk to their account, and I was giving them my name so they could contact me if there was a problem.

Q. [513] And those letters, were sent by you, is that right?

A. Those letters, well, it was in... with the Compliance Department, we had discussed a way to make sure of certain things for clients, specifically, who had... who had or wanted to increase the risk in their account.

Q. [514] In the accounts handled by Mr. Kloda?

A. In the account... yes, for Mr. Kloda.

Q. [515] And in the account of Ms.... (the client), did you ... you didn't send a letter, is that right?

A. No, there was no letter to Ms.... (the client).

Q. [516] Why is that?

A. Because it was... the letters, they were sent after Ms.... (the plaintiff) had already done her update. And they ... the letters were sent to accounts that were in the process of being updated.

(Stenographer's Notes of December 13, 2018, pp. 153 to 156; see also Exhibit P-12, p. 148).

¶ 97 The Respondent admitted that she did not speak with the client before her complaint was filed (Stenographer's Notes of December 13, 2018, p. 156).

¶ 98 She, moreover, admitted that she did not attend the meetings with the clients or communicate with them concerning their investment objectives (Stenographer's Notes of December 13, 2018, p. 157).

¶ 99 The Respondent confirmed to the investigator that, at the material time, there was no "client management" system for recording the representatives' notes (Stenographer's Notes of December 13, 2019, p. 158).

¶ 100 She also admitted having noticed the increased risk tolerance in other accounts handled by representative Kloda. Here is the relevant passage from the cross-examination:

[TRANSLATION]

A. She, I think she was one of the first (the client), you know, in this situation where the risk was increased.

Q. [534] What do you mean? What does that mean «the situation where the risk was increased»? What are you referring to?

A. Well, it's because there were other situations, afterwards, where the risk did not agree with what was on the KYC form, where Sam was asked why it didn't agree, where instead of telling me "we arrange the account to fit", he would ask the client... He would do an update, because the client wanted to keep what he had in the account. So, they were the ones who [...] *comfort letters*. But she

was before, before there were, like, others that occurred, that made us think “Well now, maybe we better check, because...”

Q. [535] Why check? Because there was a problem?

A. Because there was more than one where... where he was increasing the risk. We just wanted to make sure that the clients were okay with that.

Q. [536] So what you are saying today, is that Sam Kloda was found to have numerous client accounts for which he increased the risk tolerance with the securities that were purchased, but the purchased securities were, in fact, riskier than what was on the KYC, is that right?

A. Yes, there were other situations.

(Stenographer’s Notes of December 13, 2018, pp. 162 and 163).

¶ 101 The Respondent admitted that she might possibly have sent a letter to the plaintiff if the latter’s account had come to her attention a little later (Stenographer’s Notes of December 13, 2018, p. 164).

¶ 102 She admitted to an investigator that she routinely had to remind representative Kloda about what he said he would do (Stenographer’s Notes of December 13, 2018, p. 181).

¶ 103 With regard to the perception of risk, the Respondent admitted, during the investigation, that she was comforted by the fact that representative Kloda was tracking the gold sector very closely. Here is the relevant passage:

[TRANSLATION]

Q. [640] ... regarding your vision, did you maybe discuss the subject with him at all?

A. Yes. Well, it is certain that if... if I send a request: “Okay, you made such and such a trade,” I’m not sure because, at bottom, I didn’t always say: “that’s not okay.” I would tell him: “In my opinion, maybe that doesn’t work with the risk tolerance, can you explain your view of things to me?” Then, he would say to me: “Well, you know, this gold stock here, I am tracking it very closely.” You know, to him, it wasn’t necessarily high risk, but moderate instead, because he tracked gold closely, plus, you know, he didn’t leave it in the account without... without monitoring.

...

Q. [643] It doesn’t change... it doesn’t change the risk level.

A. It doesn’t change the risk level, it... It changes his perception, I think, of the risk he is taking for the client, for himself, and for me...

(Stenographer’s Notes of December 13, 2018, pp. 185 and 186; Exhibit P-18, p. 145 and 146; Exhibit P-18 was entered into evidence in its entirety – Stenographer’s Notes of December 13, 2018, p. 165).

¶ 104 The Respondent also admitted on cross-examination that she relied entirely on representative Kloda’s explanations. Here is the relevant passage:

[TRANSLATION]

Q. [562] Let me stop you here. Is it accurate to say that, as a supervisor, you contented yourself with the explanations that Kloda gave you regarding his investment strategy, and notably, regarding Ms. ... (the plaintiff)’s account, what Ms.... wanted?

A. In Ms’s (the client) case... yes, I relied on the representative, on Mr. Kloda’s explanations.

Q. [563] In her case?

A. Yes, in her case, it was...

Q. [564] Is it accurate to say that, in this excerpt which you just read, you recognize that Mr. Kloda had a view of the risk level of the securities he was trading that might differ from your own view or the view of the firm?

A. Yes, but in the case of... (the plaintiff), she was at a hundred percent (100%) risk already, it wasn't a... There was no discussion about that.

(Stenographer's Notes of December 13, 2018, pp. 187 and 188).

¶ 105 The question whether on some days the portfolio was in large part bought and resold the same day, the Respondent [translation] "does not recall whether there "was any questioning about that, or any discussion; it was never noted. To the Respondent, representative Kloda's client wanted to "trade" (Stenographer's Notes of December 13, 2018, pp. 194 and 195).

The Respondent's expert report

¶ 106 Mr. Lawrence Boyce was declared an expert in compliance matters (Stenographer's Notes of December 13, 2018, p. 208).

¶ 107 The expert Mr. Boyce drafted a report in which he answered the following questions concerning Count 1:

- In isolation and for the period in litigation, does any of the item listed in paragraph 18 and 19 constitute a flag?
- After reviewing and analyzing ... account during the period in litigation, what are your views on each items listed in paragraph 18 and 19? Please provide your opinion on each item.
- Considering your opinion to questions 1 and 2, are you of the view that together there were sufficient red flags that would have required additional measures or actions by Elizabeth St. James?
- In view of your opinion to questions 1, 2 and 3, did Elizabeth St. James meet the regulatory expectations prevailing at the time of the events?

¶ 108 The expert responded that the activities in the RRSP account of representative Kloda's client were consistent with her investment objectives and risk tolerance as shown on the New Client Application Form and there is no reason to question the investment factors or subsequent trades as being unsuitable. Here is a relevant passage from his position:

Barring any glaring inconsistencies in the information on a NCAF, in my opinion a Supervisor is entitled to rely on its accuracy, particularly when it is signed by the client as Ms. ... (the client) was.

....

Therefore, in my opinion there is no basis in the information in the new account applications for Ms. St. James to have questioned the information including the level or risk tolerance or the objectives. (Boyce report, p. 7, par. 32)

.....

In that regard I reiterate my previous observations: that absent anything inconsistent the Supervisor is entitled to accept what is on the NCAF at face value. (Boyce report, p. 9, par. 34)

¶ 109 The expert Boyce was also of the opinion that "there's nothing in the rules that specifically say that under close supervision you have to do something extra" (Notes of December 13, 2018, p. 218).

¶ 110 The expert Boyce challenged the assumption that representative Kloda's client was a vulnerable person. To begin with, he pointed out that the latter had no need to withdraw funds from her RRSP account to

meet her subsistence needs. He noted that she is a retired teacher, educated, and able to understand investing. She has some experience with investing, including the experience of having suffered losses. (Boyce report, p. 7, par. 32)

¶ 111 The expert Boyce was of the opinion that the trades effected were not excessive. The Looper formula, in his opinion, is applicable only in the context of a normal account with a long-term objective. It cannot be applied to a portfolio with an 80% short-term capital gain objective. (Boyce report, p. 9, par. 35)

¶ 112 The expert Boyce was also expected to answer the following questions concerning Count 2:

- What were the regulatory expectations in relation to supervision practices in the industry for a registrant under a condition of close supervision from July 2013 to March 2014?
- Back to the period in litigation, what did a condition of close supervision require for a supervisor?
- Reference is made to paragraphs 53 and 54 of the reply, what was the impact of these changes? And why were these changes made by IIROC?
- What is your opinion of paragraphs 22 to 29 of the Statement of Allegations based on the actual regulatory expectation prevailing at the period in litigation?

¶ 113 The Respondent's expert witness was of the opinion that supervision of the representative Dubois at the material time was consistent with generally accepted practices in the industry for the material supervision period, including close supervision. (Boyce report, p. 3, par. 6)

¶ 114 The current tendency is, in his opinion, to allow greater flexibility in terms of the supervisory structure.

¶ 115 He concluded as follows that on-site supervision was the most effective:

Therefore, in my opinion keeping supervision of one Approved Person's account with one person while all the rest of the Approved Persons in an office were being supervised by someone else would result in a less effective supervision system. (Boyce report, p. 13, par. 59)

The Hearing Panel's Analysis

¶ 116 Supervision and, more generally, compliance is intended to protect the client, the firm and the financial industry. It is an essential line of defense to ensure the adequate regulation of financial intermediaries.

¶ 117 Clause 4 (a) of Rule 38 titled Compliance and Supervision imposes on a supervisor the obligation to fully and properly supervise each partner, Director, Officer, Registered Representative, Investment Representative or agent in accordance with IIROC Rules and the written policies and procedures of the Dealer Member.

¶ 118 Such full and proper supervision must, in our opinion, be reinforced in the case of close supervision.

¶ 119 The Hearing Panel is of the opinion that full and proper supervision imposes a duty of competence and diligence to raise questions, show transparency and document the supervision effected.

¶ 120 The supervisor must be able to rely on adequate policies and procedures, an appropriate structure, sufficient means and the constant support of the firm.

¶ 121 The work of the supervisor is complex and involves numerous challenges. The supervisor must be able to assert himself/herself, to ask difficult questions and to question the actions and trades made on the clients' behalf.

¶ 122 In *Re MacDonald* (2012 IIROC 68), another hearing panel commented as follows on the important role of the supervisor:

¶ 7 Dealer Member Rule 2500 sets out the minimum standards for retail customer account supervision and are not repeated in their entirety in this Decision. The Respondent, as a branch manager, was responsible for first-tier reviews to detect on a daily and then monthly basis various types of compliance breaches. The Respondent was also responsible for the review of new client account applications. A review of new client account applications must include a review to ensure that recommendations made for any account are appropriate for the client and in keeping with his or her investment objectives. Branch management supervision includes a review of suitability, a review of any inappropriate or high risk trading strategies and excessive trade activity.

¶ 8 The decision in *Youden (Re)*, [2005] I.D.A.C.D. No. 52, at paragraph 95, refers to the *Re Mills* decision that commented on the duties of a branch manager. In *Re Mills* the panel described the role of branch managers as follows:

Branch managers have an important role under the self-regulatory system in our securities markets. The obligations requiring supervision of retail customer accounts are intended to ensure appropriate handling of customer accounts for the benefit of both the customer and the firm....

... A branch manager should be alert to facts that, even with honest and trustworthy registered representatives, may indicate a need for further investigation. It is sometimes necessary that a manager go beyond discussions with a registered representative and address an issue directly with the customer.”

¶ 123 Full and proper supervision does not demand perfection, however. It seeks a balance between the protection of the clients, the legitimate interests of the firm and the efficiency of capital markets.

¶ 124 The Hearing Panel is of the opinion that delegation outside the branch pursuant to Rule 38, clause 4 (b) was not possible without IIROC’s consent, given the fact that a specific decision by the Approval Committee of IIROC’s Québec District had imposed close supervision on site.

¶ 125 Rule 2500 – Minimum Standards For Retail Customer Account Supervision (hereinafter Rule 2500) – decrees the minimum requirements necessary to ensure that a Dealer Member has in place procedures to properly supervise Retail Client account activity.

¶ 126 However, the Rule does not preclude Dealer Members from establishing a higher standard of supervision and, in certain situations, a higher standard may be necessary to ensure proper supervision (Rule 2500 – Introduction). The Hearing Panel is of the opinion that the imposition of close supervision and even more so of close supervision on site demands heightened supervision. It must be kept in mind that representative Kloda had been terminated for cause from his last job.

¶ 127 Rule 2500 recognizes that compliance with the Know-Your-Client rule and suitability of investment requirements is primarily the responsibility of the Registered Representative. The supervision aspect is very important, however.

¶ 128 An effective supervisory environment fosters the business objectives of the Dealer Member and enables the Dealer Member to meet regulatory requirements and its obligations to its clients.

¶ 129 A Dealer Member, via the supervisor, must conduct enhanced supervision of trading by Approved Persons who have had a history of questionable conduct (Rule 2500 – section I.C.4).

¶ 130 This requirement is heightened when imposed in a specific manner. Representatives Kloda and Dubois were in such a situation.

¶ 131 A Dealer Member must maintain records of supervisory review for seven years. It must be possible to transfer these records to IIROC promptly. The records must include the name of the person who conducted

the review and when, inquiries made, replies received and actions taken (Rule 2500 – I.F). Well-documented written records of supervisory review protect the client, the Approved Person, the Dealer Member, as well as the industry’s image.

¶ 132 The evidence shows that the supervision review record for the client’s account did not meet these requirements. Simple checkmarks, bits of paper kept by the representative concerning the trades effected, or the proximity of the offices do not meet the quality criteria required in a highly regulated industry.

¶ 133 The supervision review records are the daily history of a major compliance aspect in the firm. To be effective, these records must be complete, accurate and verifiable, and documented in writing.

¶ 134 The Know-Your-Client rule is also essential in the financial industry. The new client application process is an important benchmark, because it allows the Registered Representative and the supervisory staff to maintain accurate and complete information on each client, and to conduct the necessary review to ensure that the recommendations made are suitable for the client and in keeping with his investment objectives (Rule 2500 – II Introduction).

¶ 135 A Dealer Member must have systems and procedures to supervise trading activity in retail accounts. The systems and procedures must provide reasonable assurance that the Dealer Member is meeting its regulatory obligations, including those to clients (Rule 2500 – III.b).

¶ 136 Procedures must be able to identify patterns of activity that are not apparent by reviewing trades singly (Rule 2500 – III.B.3).

¶ 137 The Dealer Member’s procedures must be risk-based, as specified in Rule 2500 I C. 4 :

At a minimum, a Dealer Member must conduct enhanced supervision of trading by Approved Persons who have had a history of questionable conduct. Evidence of such conduct can include trading activity that frequently raises questions in account reviews, frequent or serious customer complaints, regulatory investigations, frequent account credit problems or failure to take appropriate remedial action on account problems identified.

(Our emphasis)

¶ 138 Representative Kloda clearly fell in the category of an Approved Person whose activities required heightened supervision by the Respondent, through adequate documentation of the actions taken to fulfill her responsibility. There should have been explanatory notes concerning questions she may have had, notably regarding the veracity and exhaustiveness of the information on the New Client Application Form and the client account updates. These explanatory notes should have laid out representative Kloda’s reasoning, and that of the Respondent with respect to the high degree of risk and the aggressive trading strategy employed in the client’s account. These notes should have mentioned the actions taken by the Respondent as part of her supervision.

¶ 139 The first-tier review of the trades effected must be able to detect unsuitable trading, undue concentration of securities, excessive trade activity, inappropriate or high-risk trading strategies and quality downgrading of client holdings (Rule 2500 – IV.A). Each of these elements was present in representative Kloda’s case.

¶ 140 The expert Boyce invited us to take a literal approach to the matter. It must be admitted that the question posed to the latter concerning Count 1 was limited: “In isolation and for the period in litigation, do any of the items listed in paragraphs 18 and 19 constitute a flag?”

¶ 141 To the expert Boyce, if the information contained in the New Client Application Form or its update is consistent with the trades effected, there can be no red flag. The supervisor may therefore rely entirely on the information provided. Here is his position:

In that regard I reiterate my previous observations: that absent anything inconsistent the Supervisor is entitled to accept what was is on the NCAF at face value. (Boyce report, p. 9, par. 34)

¶ 142 The Hearing Panel prefers the holistic approach of the expert Tanguay, who examined the question from an overall standpoint. This approach recognizes the evolving nature of the client's investment objectives, risk tolerance, as well as the features of the products and markets.

¶ 143 When a new account is opened, whether or not it is a transfer, the supervisor must ask himself/herself whether the information that is provided and the account features seem logical. The same goes for the update. In most cases, the answer will be easy. When in doubt, the supervisor must make inquiries and document the answers obtained.

¶ 144 Supervision, and more broadly speaking, compliance, requires having a global vision of the client's circumstances and the actions taken on his/her behalf.

¶ 145 The Hearing Panel is of the opinion that all of the red flags mentioned in paragraphs 18 and 19 of the Statement of Allegations were present for representative Kloda. They do not all have the same impact when taken individually, but as a whole, they paint a very clear picture for the Hearing Panel.

¶ 146 All the red flags are the result of two principal actions, namely: faulty supervision of the representative Kloda by the Respondent when the account was opened on August 3, 2009, and the perpetuation of this faulty supervision when the New Client Application Form was updated on November 2, 2009. The incorrect assessment of the Know-Your-Client rule and the investment suitability rule led to high-risk trading, excessive commissions, an excessive concentration of securities, an excessive number of trades, inappropriate trading strategies and, finally, a quality downgrading of the client's holdings.

¶ 147 Having approved the New Client Application Form and its update, the Respondent failed to use due diligence and became the witness of a spiral of inappropriate trades.

¶ 148 The Hearing Panel is of the opinion that the New Client Application Form filled out at the time of the transfer should have been subjected to a far more thorough analysis by the Respondent, and should have been documented. From the outset, the New Client Application Form raised questions. The client opened an RRSP account on August 3, 2009. When the account was opened, the client was 58 years old, divorced and retired. She had \$200,000 in assets and an annual income of \$30,000. Her risk tolerance was defined as 50% "low" and 50% "high". Her investment knowledge was listed as average. The form says that her objectives are 80% short-term capital gains and 20% medium-term capital gains.

¶ 149 A retired person is not necessarily vulnerable, but should receive special attention from the representative and supervisor. Such a client often will not have another opportunity to recover from a poor investment choice.

¶ 150 The account had already suffered heavy losses before being transferred to Mackie, the representative Kloda had been terminated for cause at CIBC Wood Gundy, and close supervision had been imposed on him at Mackie.

¶ 151 The representative Kloda had, moreover, been under close supervision by his previous employer since March 2006 and had been disciplined by the Montreal Exchange in 2001 (Exhibit P-1, pages 1.61 and 1.62).

¶ 152 The account of Kloda's client was comprised of mining and oil stocks, as well as two funds. Is an objective of 80% short-term capital gains compatible with the RRSP account of a retired person with an annual income of \$30,000? The question deserved to be analyzed and documented.

¶ 153 The Respondent admitted to the investigator that the account was unsuitable for the client from the outset (Exhibit P-12, p. 75).

¶ 154 The change to the form that increased the risk tolerance to 100% High should also have been the

subject of diligent analysis and documented. The update was now intended to regularize a portfolio that was already deficient.

¶ 155 The evidence shows that the Respondent relied on the information provided by the representative Kloda. Letters were sent to other clients of representative Kloda in the same situation, but not to the client to whom Count 1 refers.

¶ 156 The sale of the high-income fund and the dividend fund, which represented approximately 45% of the portfolio value, and the purchase of more volatile securities, made the same day from the proceeds of the sale, should also have raised supervision questions. These trades were made only 16 days after the account was opened.

¶ 157 We are still talking about the RRSP account of a retired person with limited income. The sale of these funds substantially eliminated the safety aspect of the portfolio. Henceforth, the account was made up of mining and oil stocks.

¶ 158 With the proceeds of the sale and the same-day purchase of securities of gold and high-tech companies, the portfolio had a higher concentration in the raw materials sector.

¶ 159 The Hearing Panel is not ruling on the quality of the securities but on the quality of the supervision. The aggressive strategy aimed at more volatile securities should have attracted attention. The Respondent admitted that she relied on the representative Kloda for this client's account.

¶ 160 The absence of written documentation concerning the actions taken by the Respondent and the replies she received reveal a considerable weakness in regards to supervision, particularly since it was supposed to be close.

¶ 161 At the time of the transfer to Mackie, the securities in the portfolio had already lost over \$30,000, having a book value of \$79,250.75 compared to a market value of \$37,744.73 (Boyce report, p. 5, par. 16). It is true that several trades in natural resources securities, principally gold, increased the portfolio value to \$53,217.39 towards the end of September 2009. The portfolio was invested in a proportion of 45.7% in Iamgold and Yamana Gold securities (Boyce report, p. 5, par. 19).

¶ 162 The Yamana shares were purchased in early 2008 at a price of \$13,469 and were resold on October 20, 2009 for a sum of \$9,955, which is a net loss of \$3,514. The Iamgold shares were purchased on September 23, 2009 and sold approximately two weeks later for a profit of \$90 (Tanguay report, p. 13).

¶ 163 The portfolio value even reached \$64,938.78 in late December 2009 (Boyce report, p. 5, par. 20).

¶ 164 The Respondent and her expert are therefore arguing that certain trades were profitable.

¶ 165 A deficiency of supervision and, more generally, compliance cannot be excused by the vagaries of the market. A deficient supervision system jeopardizes investor protection, the stability of the firm and the image of the industry. The persons whose job it is to ensure supervision and compliance are the sentinels of protection and stability.

¶ 166 The portfolio subsequently lost value, reaching \$55,298.09 at the end of 2010. The portfolio at the time was composed, in a proportion of 93%, of two junior tech securities and one junior gold security (Boyce report, p. 6, par. 21).

¶ 167 After that there was little trading until June 2011, the portfolio being invested in junior securities. In late June 2011, the portfolio was composed of two junior securities and its net value stood at \$31,797.41 (Boyce report, p. 6, par. 22).

¶ 168 In late September 2011, the portfolio value was \$25,577.87, including \$5,477.07 in cash and one junior gold security. In September 2014, the portfolio value was now only \$13,939.72 (Boyce report, p. 6, par. 25).

¶ 169 Regarding the excessive trading, the year 2011 was especially problematic. For the 12-month period ending December 31, 2011, 34 trades were made. The portfolio suffered a 41% loss. It went from a value of \$39,351 as at December 31, 2010 to \$23,108 as at December 31, 2011. The client was charged \$4,375 in commissions.

¶ 170 The 27 trades effected between July 25, 2011 and September 14, 2011 led to a net loss of \$564.54 for the client (Tanguay report, p. 13, par. IV).

¶ 171 The Tanguay report notes the following facts concerning these short-term trades for the period:

- 3 purchases and 5 sales were executed in July 2011;
- 4 purchases and 5 sales were executed in August 2011;
- 5 purchases and 5 sales were executed in September 2011;
- 8 of the 12 purchase transactions were liquidated the same day;
- 1 purchase transaction was liquidated the next day;
- 1 purchase transaction was liquidated 3 days later;
- 1 purchase transaction was liquidated 4 days later;
- the commissions charged to the client totaled \$3,398 (Tanguay report, p. 14).

¶ 172 The expert Tanguay equates the strategy to « day trading » (Tanguay report, p. 22, par. 66).

¶ 173 In matters of excessive trading (churning), we generally rely on the Looper formula (Boyce report, p. 9, par. 35). The Looper decision defines churning as follows:

The churning of a securities account occurs when a dealer, acting in his own interest and against those of his customer, induces transactions in the customer's account which are excessive in size and frequency in light of the character of the account.

(In the matter of Looper and Company, 38 S.E.C. p. 304)

¶ 174 The Looper formula measures annual turnover by dividing the total cost of purchases made during a given period by the average amount invested during that period. As a rule, a rate of two (2) suggests churning, a rate of four (4) is indicative and over six (6+) is conclusive that there is churning in the account.

¶ 175 In this matter, the rate is 10.9.

¶ 176 The expert Tanguay emphasized that the cost-to-equity ratio could also have been used. This ratio is determined by dividing all of the commissions and fees by the portfolio's average value (Tanguay report, p.23, par. 70).

¶ 177 In the matter before us, we arrive at a total cost-to-equity ratio of 14.9%. The client needed a return on investment greater than 14.9% if there was to be any hope of capital appreciation.

¶ 178 The expert Boyce was of the opinion that the Looper formula is applicable for a normal account but not for an account seeking an 80% short-term capital gain.

¶ 179 The Hearing Panel is of the opinion that a trading strategy involving these many trades in an RRSP account held by a retired person with an income of \$30,000, an account that had already suffered heavy losses, was a red flag. The situation should have led the Respondent to question these trades and document them.

¶ 180 All the more so since many trades were substantial compared to the portfolio size. From July to September 2011, the average value of the portfolio was \$28,080. Of the 13 trades effected during those three

months, 10 were for a value greater than \$20,000 and the largest trade was for a value of \$28,825. We note the purchase of a leveraging investment (Daily Financial Bull 3X) (Tanguay report, p. 23).

¶ 181 So many trades, and their scope within such a short lapse of time, should have triggered a red flag from the Respondent.

¶ 182 The Boyce report notes a price decline in the index in July and August 2011 (Boyce report, p. 6, par. 24). The expert Tanguay found it curious that the expert Boyce would use the date of August 8, 2011, namely the date when the index reached its lowest point, whereas 17 of the 29 trades occurred after this date. He concluded as follows:

The conclusion I draw from the above, is that Mr. Boyce took as a benchmark the lowest possible value of the index during the relevant period in order to show that the losses incurred by Mrs. ... account during that period were not that much alarming since the market as a whole, represented by the value of the index, had also lost value. By doing so, he makes complete abstraction of the fact that the market as a whole recuperated its losses within a few days while Mrs. Account was continuing to lose value.

The relevance of referring to the TSX Composite Index is also questionable considering the fact that during the period of July 25, 2011 to September 14, 2011 the account held securities being part of the Composite Index only for very short period of time. All others securities purchased and sold during this period were junior or high risk securities and this type of securities rarely fluctuates in tandem with the TSX Index.

....

Between July 31, 2011 and December 31, 2011, the account lost some 23 % of its value while during the same period the TSX Index benchmark lost 7.4 % of its value. Mrs.... account was therefore significantly underperforming when compared to the TSX Composite Index.

(Tanguay report, pp. 14 and 15)

¶ 183 For these reasons, regarding Count 1, the Hearing Panel is of the opinion that the Respondent failed to adequately supervise activities in a client's account by a registered representative under her responsibility, pursuant to the supervision conditions imposed on this registered representative by the Approval Committee of the Québec District Council, contrary to Rule 38.4 (a) and Rule 2500 of the IIROC Dealer Member Rules.

¶ 184 With regard to Count 2, the Hearing Panel is also of the opinion that the Respondent failed to adequately supervise registered representative Dubois, who was under her responsibility, pursuant to the supervision conditions imposed on this registered representative by the Approval Committee of the Québec District Council, contrary to Rule 38.4 (a) and Rule 2500 of the IIROC Dealer Member Rules.

¶ 185 Yet, the decision mentioned that the representative "Daniel Dubois must work from an approved business location where a qualified on-site supervisor is located" (Exhibit P-1, p. 7.30, our emphasis).

¶ 186 The Hearing Panel reminds that the Respondent, in her interview with the IIROC investigator, admitted that she did not supervise trades between July 2013 and Dubois' departure in March 2014. She was present on site but everyone's trades, including representative Dubois', were reviewed by DL from the Toronto office. If there was no problem, the Respondent signed the report (notes of December 10, 2018, p. 200).

¶ 187 However, the Respondent was listed in the NRD as the "supervisor designated to be responsible for the business activities of Daniel Dubois..."

¶ 188 There is no evidence to show that this designation was withdrawn following the approval of DL who, in any case, was not in charge of the on-site supervision of the representative Dubois.

¶ 189 The Respondent made no effort to withdraw her registration as an on-site supervisor of representative Dubois's activities from the NRD, or to inform IIROC.

¶ 190 The changing standards concerning the supervision of establishments outside the head office is not relevant in the present matter. A general standard cannot have the effect of countermanding a specific decision aimed at protecting investors. A general email from IIROC does not alter the Hearing Panel's position in this regard.

¶ 191 The Approval Committee of the Québec District Council, on November 29, 2011, handed down a decision to impose close supervision conditions on representative Dubois at his place of work (on site). This specific decision was rendered in the context of the reactivation and approval of Daniel Dubois as a registered representative with Mackie. The Respondent was the person designated to conduct the close on-site supervision of representative Dubois.

¶ 192 The Hearing Panel disagrees with the assertion that a supervisor having been specifically designated to effect on-site supervision may, at his/her discretion, delegate his/her important role to an outside person.

¶ 193 The fact of signing a monthly supervision report which attested that the Respondent had effected close on-site supervision of the representative Dubois was of a nature to mislead IIROC.

¶ 194 Transparency of the Dealer Members, supervisors and representatives is at the heart of self-regulation. Transparency is essential to an effective supervision and compliance system.

¶ 195 Such an action by the Respondent respected neither the letter of the decision nor its spirit which was intended to protect the investors and the public.

Decision

¶ 196 After analysis of the exhibits, expert reports and testimony, the Hearing Panel renders the following decision:

FINDS the Respondent guilty on both counts;

SUMMONS the parties to a penalty hearing, on a date to be determined by the National Hearing Coordinator, in order to hear their submissions regarding penalties.

Dated at Montréal, Québec, this 2nd day of February, 2020

Alain Gélinas

François Gervais

Yves Julien

Copyright © 2020 Investment Industry Regulatory Organization of Canada. All Rights Reserved.