

Re TD Waterhouse Canada Inc

IN THE MATTER OF:

**THE DEALER MEMBER RULES OF THE
INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA**

AND

THE BY-LAWS OF THE INVESTMENT DEALERS ASSOCIATION OF CANADA

AND

TD WATERHOUSE CANADA INC

2008 IIROC 7

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

Heard: July 31, 2008 in Toronto, ON

Decision: July 31, 2008

(8 paras.)

Hearing Panel:

Mr. Frederick Webber (chair), Mr. Hugh McNabney and Mr. Guenther Kleberg

Appearances:

Ms Kathryn Andrews, Enforcement Counsel

Ms. Laura Paglia, Respondent's Counsel

DECISION

1. As a result of a Settlement agreement entered into between IIROC and the Respondent, a Settlement Hearing was conducted on July 31 in Toronto pursuant to the rules of IIROC and By-laws of the IDA. In addition to the Settlement Agreement, a copy of which is attached to this decision, the Hearing Panel received and considered oral submissions from both counsel for IIROC and the Respondent together with IIROC's Book of Documents containing relevant by-laws, regulations, policies, guidelines regarding sanctions and previous decisions of Hearing Panels
2. The contraventions alleged by IIROC and admitted by the Respondent are set out at page 9 of the Settlement Agreement and are as follows;

Count 1: From 2001 to early 2005, the Respondent facilitated purchases of Olympus funds in client accounts without ensuring that clients were in fact accredited investors pursuant to the relevant prospectus exemption rules, contrary to IDA Regulations 1300.1(a), 1300.2 and Policy 2.

Count 2: From 2001 to the fall of 2004, the Respondent failed to establish and maintain alternative investment review or approval procedures and from 2001 to 2005 failed to establish and maintain sufficient training and guidance to its approved persons, to ensure that the purchase of hedge funds were appropriate for its clients contrary to IDA By-law 29.27, Regulations 1300.1(q), 1300.2 and Policy 2.

3. The issue for the panel was whether to accept or reject the proposed settlement. This panel accepts as applicable in this case, the statement in the decision *Re Milewski*, [1999] I.D.A.C.D. No.17:

“ A district Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness.”

and the statement in the *Clark* decision [1999] I.D.A.C.D. No. 40:

“ In considering a settlement... the panel should not simply substitute its discretion for that of the staff who negotiated the settlement. The panel must be cognizant of the importance of the settlement process and should not interfere lightly in a negotiated settlement. In our view, as a result, panels must also be careful in using previous settlements as precedent. The settlement process is one of negotiation and compromise and the penalty imposed following a settlement will often be less onerous than one imposed following a hearing where similar findings are made.”
4. Both cases were referred to in the Book of Documents and orally by IIROC Counsel.
5. Given the standard of ‘reasonableness’, it is the responsibility of this panel to determine whether the penalties set forth in the Settlement Agreement reasonably address the primary purposes of disciplinary sanctions which are:
 - protection of: the investing public, IIROC’s membership, the integrity of IIROC’s process, the integrity of the securities markets, and
 - prevention of a repetition of conduct of the type under consideration.
6. The facts which give rise to the breach of the by-laws and regulations are set forth in the Settlement agreement and involve three main issues:
 1. Clients who were non-accredited investors purchased Olympus funds;
 2. Lack of review/ approval for alternative investments and lack of training/guidance regarding hedge funds; and
 3. Lack of supervision.
7. There is no doubt that the actions of the Respondent constituted serious breaches of the by-laws and regulations. In considering the appropriateness of the sanctions agreed to in the Settlement Agreement, the panel was referred to the applicable IDA Disciplinary Sanction Guidelines and various cases set out in the Book of Documents. The panel also considered mitigating factors noted by both counsel:
 1. The Respondent implemented product due diligence processes, starting in the fall of 2004;
 2. The Respondent has implemented training and guidance requirements for its RRs regarding hedge funds and other alternative investments;
 3. The Respondent developed a guideline to help its Investment Risk Committee decide whether or not the Respondent should offer a new alternative investment for sale;

4. The Respondent implemented practices and procedures to ensure that new alternative investments are reviewed and approved by the Respondent, and has a procedure for exempt market securities. The Respondent now requires the branch manager to sign a pre-trade approval form for hedge funds and the client and branch manager must sign a market risk disclosure form;
 5. The Respondent voluntarily compensated all clients who purchased Olympus funds who were non-accredited investors and where no other prospectus exemption applied;
 6. The Respondent disciplined 3 of its RRs who sold Olympus funds to clients who were non-accredited investors; and
 7. The Respondent cooperated in the investigation of all these matters.
8. The panel agreed that the terms of the Settlement Agreement reasonably address the purpose of disciplinary sanctions taking into account both the seriousness of the breaches by the Respondent and the offsetting mitigating factors. Consequently, the panel accepted the Settlement Agreement.

Dated as of the 31st day of July 2008.

Frederick Webber- Chair
Hugh McNabney-Member
Guenther Kleberg- Member

* * * * *

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. The Enforcement Department Staff (“Staff”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) has conducted an investigation (“the Investigation”) into the conduct of TD Waterhouse Canada Inc. (“TDW” or “the Respondent”).
2. The Investigation was commenced by Enforcement Department Staff (“IDA Staff”) of the Investment Dealers Association of Canada (“IDA”) prior to May 30, 2008. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. With respect to conduct of IDA registrants occurring before June 1, 2008, the IDA has retained IIROC to provide services necessary for the IDA to carry out its regulatory functions pursuant to the *Administrative and Regulatory Services Agreement* between the IDA and IIROC.
3. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No. 1, Schedule C.1, Part C (“the Hearing Panel”).

II. Joint Settlement Recommendation

4. The Respondent consents to be subject to the jurisdiction of IIROC.
5. Staff and the Respondent consent and agree to the settlement of these matters by way of this settlement agreement (“the Settlement Agreement”) in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.
6. The Settlement Agreement is subject to acceptance by the Hearing Panel.

7. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
8. The Settlement Agreement will be presented to the Hearing Panel at a hearing (“the Settlement Hearing”) for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.
9. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its right under the IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
10. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.
11. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
12. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement. Nothing in this section is intended to restrict the Respondent from making full answer and defence to any civil proceedings against it.
13. Staff and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement.

III. Statement of Facts

14. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts for the purposes of this Settlement Agreement only and further agree that this agreement of facts is without prejudice to the Respondent or Staff in any other proceeding of any kind including, but without limiting the generality of the foregoing, any proceedings brought by IIROC or any civil or other proceedings which may be brought by any other person or agency. No other person or agency may raise or rely upon the terms of this Settlement Agreement or any agreement to the facts stated herein whether or not this Settlement Agreement is approved by the Hearing Panel.
15. This Settlement Agreement involves the actions of the Private Investment Advice Division of TDW.

Three main issues:

16. There are three main issues which make up this Settlement Agreement:
 - (A) Clients who were non-accredited investors purchased Olympus funds;
 - (B) Lack of review/approval for alternative investments and lack of training/guidance regarding hedge funds; and
 - (C) Lack of supervision.

Norshield and Olympus:

17. Norshield Asset Management (Canada) Ltd. (“NAM”) is a Canadian corporation which was registered with the Ontario Securities Commission (“OSC”) as an Investment Counsel and Portfolio Manager, amongst other registration categories.

18. Olympus United Group Inc. (“Olympus”) is a Canadian corporation which was registered under Ontario securities law as a Limited Market Dealer and Mutual Fund Dealer.
19. Olympus United Funds Corporation (“Olympus United”) is a Canadian corporation which raised capital for investment in asset pools owned and managed by Olympus Bank and Trust Company with NAM as the portfolio manager.

Horizons becomes Olympus:

20. First Horizon Holdings Ltd. had issued various hedge funds to Canadian retail investors in 2001 and 2002. Effective early 2003, an aggregation of various Norshield entities (including NAM) assumed operating and management control of all of the exempt funds of First Horizon Group. These exempt funds were then subject to a name change. Thus Horizons Uninvest II hedge fund became Olympus United Uninvest II hedge fund etc.

Receivership:

21. On or about May 2, 2005, Olympus announced the deferral of redemptions in a number of its funds. In late May 2005, the OSC suspended the registrations of NAM and Olympus. NAM and other related entities were placed into receivership on June 29, 2005.
22. RSM Richter Inc., in its capacity as the court appointed receiver, indicates in its sixth report dated March 6, 2007, (“Richter’s sixth report”) that its task of identifying and realizing on the assets of the Norshield Companies has been made more difficult due to, amongst other things, competing claims, the absence of complete accounting records and incomplete documentation as well as the need to seek relief from the courts of other jurisdictions. Olympus United and NAM are two of the many companies included in the Norshield Companies referred to in Richter’s sixth report.
23. Richter’s sixth report indicates that there is evidence of possible fraudulent and/or wrongful activities within the Norshield investment structure. These possibly wrongful activities include false reporting through over statement of the net asset values in the Norshield investment structure together with transactions which had the effect of inflating the value of assets and transactions which had the effect of diverting assets to the detriment of investors.

OSC statement of allegations against Norshield and Olympus:

24. In October 2006, the OSC issued a statement of allegations against NAM, Olympus and various principals of those companies, alleging amongst other things; fraud, misleading the OSC, failure to safeguard documents and failure to maintain proper books and records.

IDA Investigation:

25. The Respondent is an IIROC Member firm with its head office located in Toronto, Ontario. This investigation commenced as a result of Comset reports filed by the Respondent. Various TDW clients had complained regarding their investments in Olympus hedge funds.
26. Most of the Comset reports were received at the IDA during 2006. Thirty one client complaints were received in total from Ontario TDW clients. Of the 31 complaints, 9 were clients of one TDW RR who told the IDA that he had suggested to his clients that they should complain. He also advised them on the points that he thought should be mentioned in their complaint letters to the Member firm.

27. The 31 client complaints relate to investments in Olympus hedge funds, most of which involved purchases of Horizon Uninvest II or Olympus United Uninvest II funds in 2003 and 2004. Most of the client complaints were that the Olympus funds had been portrayed by TDW as a low risk, and/or safe and/or conservative investment.

ISSUE A : Non-accredited investors:

TDW clients purchased Olympus funds:

28. In 2001 and 2002, TDW clients bought hedge funds pursuant to Offering Memoranda issued by First Horizon Holdings Ltd. dated September 14, 2001 and two Offering Memoranda dated July 30, 2002 (“Horizon Funds”). Some of the Horizon funds were Horizon Uninvest II funds. The client account statements continued to reflect the Horizon name until April 2003.
29. During 2003 and subsequently, Olympus United also offered a number of hedge fund products for sale to retail investors, being mainly Olympus United Uninvest II Fund and others. TDW clients purchased Olympus funds during 2003 to early 2005. These purchases were made pursuant to Offering Memoranda dated March 29, 2003 and February 26, 2004. The Horizon and Olympus funds are collectively referred to as the Olympus funds.

Accredited investor exemption:

30. The Olympus funds were purchased by TDW clients pursuant to various prospectus exemptions. To buy the hedge funds, the clients had to be either accredited investors (as set out in National Instrument 45-106 Prospectus and Registration Exemptions) or invest a minimum initial subscription of \$150,000. The primary exemptions relied upon by TDW in Ontario were the definitions set out in Section 1.1 (j), (k) of National Instrument 45-106, which state that an “accredited investor” includes:
- (j) An individual who, either alone or with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes but net of any related liabilities, exceeds \$1,000,000.
- (k) An individual whose net income before taxes exceeded \$200,000 in each of the two most recent calendar years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year,

“financial assets” means

- (a) cash,
- (b) securities, or
- (c) a contract of insurance, a deposit or an evidence of a deposit that is not a security for the purposes of securities legislation.
- (d)

Amount of Olympus funds purchased at TDW:

31. Based on data provided by TDW, there was approximately \$15,953,694 worth of gross retail purchases made in Horizon and Olympus funds by TDW clients from 2001 to the end of March 2005. During this time period, there were retail redemptions of approximately \$8,194,330. There were also various switches from one fund to another during this time.
32. As of May 2005, TDW clients held approximately \$7,759,364 in net retail purchases. This amount does not include transfers.

33. Given the subsequent events mentioned above, the current market value of Olympus funds is unknown. Univest II funds, whether sold under the Horizons name or the Olympus name, made up the majority of the Olympus funds bought by TDW clients.

Amount of Norshield Companies funds purchased in Canada by retail investors in general:

34. Richter's sixth report indicates that there were approximately 1,900 Retail Investors in Canada. Richter's sixth report also indicates that there was approximately \$265 million raised from Retail Investors by Olympus United Corporation from 2001 to 2005.

Purchases of Olympus funds contrary to the various *Securities Acts*:

35. Some of TDW's Registered Representatives ("RRs") included real property in financial assets, when it should not have been included. These RRs sold Olympus funds to clients if they held \$1 million dollars in net worth, whether the assets were fixed or liquid.
36. At their interviews by the Association, three RRs admitted that at the time they thought that real property could properly be included in financial assets, and that they had misunderstood the accredited investor rule and had sold Olympus funds to clients who in actual fact were not accredited investors.
37. Thus during 2001 to early 2005, the Respondent executed purchases of Olympus funds on behalf of some clients who did not qualify as accredited investors as defined by the relevant provincial legislation where no other prospectus exemption was available, contrary to the relevant Securities Acts.
38. The Respondent failed to maintain accurate and complete information and documentation in respect of those clients and otherwise failed to know the financial circumstances of those clients. As a result, many non accredited investors purchased Olympus funds in their accounts because it was not clear whether they came within the exemption.

Compensation to clients:

39. As discussed below, as of November 30, 2007, TDW has compensated its non accredited investor clients who purchased Olympus funds, in the amount of \$1,970,441.

ISSUE (B): Lack of new product review/approval and lack of training/guidance re: hedge funds:

Product review/approval:

40. From 2001 to the fall of 2004, there was no review or approval process for new alternative investments by the Respondent. For example, there were no procedures or practices specific to the selection and approval of the Olympus funds when purchased by TDW clients from 2001 until the fall of 2004. Any due diligence that was done was left up to the individual RRs.
41. In the summer of 2004, TDW's Research Marketing Group ("RMG") proposed a future product approval process. After the RMG's draft proposal, it was decided that product due diligence would precede new alternative investments. This proposal was informally implemented by the fall of 2004, and was formalized in early 2005.

Lack of training/guidance re: hedge funds:

42. The IDA investigation to date did not reveal any formal training or guidance given by TDW regarding hedge funds during 2001 to 2005 to its RRs. For example, the RRs interviewed by IDA staff did not receive specific training on hedge funds until they were advised to take the CSI course on hedge funds in 2005.
43. Currently, TDW requires its RRs to take the hedge funds course. In addition, TDW has put various measures in place to ensure that adequate training and guidance are provided to its RRs with respect to hedge funds and other alternative investment products.

ISSUE (C): Lack of supervision:

44. Supervision documentation reviewed during the investigation revealed that there were inadequate inquiries made by TDW regarding Olympus funds with respect to accredited investor eligibility at both branch and head office levels. At the Windsor and Whitby branches (two of the three branches reviewed by IDA Staff), there were inadequate inquiries regarding Olympus funds made by TDW with respect to suitability including risk, contrary to Policy 2. Policy 2 inquiries in general were made at head office level.
45. Risk Assessments with respect to Olympus funds were left to the individual RRs during 2001 to 2005. TDW did not provide sufficient training or guidance to the RRs in doing so. Notwithstanding, various RRs interviewed by the IDA had uniformly assessed the Univest II fund as having medium risk and some other Olympus funds as being higher risk.

Further post 2005 events:

46. After May 2005 TDW developed an Alternative Investment Risk Rating Matrix (AIRRM) which is a guideline to help TDW's Investment Risk Committee decide as to whether or not TDW should offer a new alternative investment for sale, [which in turn includes a review and analysis of any new alternative investments.](#) AIRRM was not in existence prior to the suspension of redemptions on Olympus.

New Firm Wide Policies resulting from Issues A through C:

New product review and approval:

47. TDW currently has put in place detailed practices and procedures to ensure that new alternative investments are reviewed and approved by the Member firm, and has a pre-approval procedure for exempt market securities. TDW now requires the branch manager to sign a pre trade approval form for hedge funds and the client and branch manager are required to sign a market risk disclosure form.
48. TDW current practices and procedures are aimed at amongst other things, identifying, addressing and preventing the sale of prospectus exempt products to non accredited investors. In addition, TDW is in the process of creating a course for RRs specific to alternative investments.

Training Programs:

49. As discussed above in more detail, TDW has agreed to establish and maintain a training program to ensure that sufficient training and guidance is provided by TDW to its approved persons with respect to alternative investments.

Compensation to clients:

50. TDW has proactively investigated its sale of Olympus funds to investors independently of the Investigation and has voluntarily compensated all clients who purchased Olympus funds during this time period who were non-accredited investors and where no other prospectus exemption applied. As of November 30, 2007, this amount was \$1,970,441.

TDW internal discipline:

51. In August 2007 TDW internally disciplined three of its RRs who had sold Olympus funds to clients who were non accredited investors. The penalties assessed ranged from a fine of \$15,000 to \$25,000, to rewrite the CPH, close supervision for 6 to 12 months and contribution of 40% or 50% of all client settlements.

Co-operation with the Investigation

52. TDW has co-operated with Staff in the investigation of all of these matters.

IV. Contraventions

53. The Respondent admits to the following contraventions of IIROC Rules, Guidance, IDA By-laws, Regulations, or Policies:

Count 1: From 2001 to early 2005, the Respondent facilitated purchases of Olympus funds in client accounts without ensuring that clients were in fact accredited investors pursuant to the relevant prospectus exemption rules, contrary to IDA Regulations 1300.1(a), 1300.2 and Policy 2.

Count 2: From 2001 to the fall of 2004, the Respondent failed to establish and maintain alternative investment review or approval procedures and from 2001 to 2005 failed to establish and maintain sufficient training and guidance to its approved persons, to ensure that the purchase of hedge funds were appropriate for its clients contrary to IDA By-law 29.27, Regulations 1300.1(q), 1300.2 and Policy 2.

V. Terms of Settlement

54. The Respondent agrees to payment of a fine in the amount of \$2,000,000 broken down as follows:

- Count 1: \$1,500,000
- Count 2: \$500,000

55. The Respondent agrees to pay a portion of Staff's costs of the investigation in the amount of \$50,000.

56. Unless otherwise stated, any restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Toronto, in the Province of Ontario, this ____ day of July 2008.

Witness

TD Waterhouse Canada Inc.

AGREED TO by Staff at the City of Toronto, in the Province of Ontario, this _____ day of July, 2008.

Witness

Kathryn Andrews

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

ACCEPTED at the City of Toronto in the Province of Ontario, this _ day of _____2008, by the following
Hearing Panel:

Per: _____

Panel Chair

Per: _____

Panel Member

Per: _____

Panel Member

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