Re Questrade 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

QUESTRADE INC

2008 IIROC 12

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

Heard: September 4, 2008 in Toronto, ON
Decision: September 30, 2008
(6 paras.)

Hearing Panel:
Hon. Patrick T. Galligan, Q.C. (Chair)
Mr. Robert J. Guilday
Mr. Donald W. (Sandy) Grant

Appearances:
Mr. Andrew P. Werbowski, Enforcement Counsel
Ms. Inna Kholodenko, for the Respondent

DECISION AND REASONS

1. At the hearing counsel outlined the circumstances of the case and advised the panel that a settlement had been reached. The circumstances are set out in a settlement agreement which was presented to the panel. After considering the circumstances and the representations made by counsel, the panel approved the settlement. We now set out, in full, the settlement agreement.

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 Questrade Inc., ("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 his/her/its right under 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.

13. Staff and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement.

III. Statement of Facts

(i) Acknowledgment

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.

(ii) Factual Background

A. Registration History and Nature of Business

15. Questrade, Inc ("Questrade") became an IDA member on April 12, 2001 under the name Quest Capital Group Ltd. The firm subsequently changed its name to Questrade Inc.

16. Questrade carries on business as a Type 4 introducing broker, offering three main lines of business:
    a) Proprietary trading;
    b) On-line discount trading; and
    c) On-line FX trading.

B. The Regulatory Framework – Minimum Capital Requirements

17. Association By-Law No. 17 describes the requirement to maintain minimum risk adjusted capital ("RAC"). The calculation of RAC is the primary means by which the financial status of a Member is prescribed and monitored.

18. In particular, By-Law No. 17.1 provides:

> Every Member shall have and maintain at all times risk adjusted capital greater than zero calculated in accordance with Form 1 and with such requirements as the Board of Directors may from time to time prescribe. If at any time the risk adjusted capital of a Member is, to the knowledge of such Member, less than zero, such Member shall immediately notify the Association and the District Association Auditors of the District in which the Member has its principal office.

C. The Capital Deficiencies

19. In May 2007, a client at Questrade purchased 750,000 shares of a private placement in a company, CGR, for $2,260,000. The client paid for the private placement by utilizing the available margin capital in its account. As a result of this purchase, the debit balance in the client's account increased to approximately $2,843,297 at the end of the month.

20. On May 31, 2007, Questrade discovered that the client's debit position was substantially secured by a position in IM Corp. The combination of the debit balance and equity concentration (which occurs when a large debit position is being secured by a position in one security, in this case, IM Corp) impacted Questrade's RAC calculation.

21. IDA Financial Compliance regulations require Questrade to take a securities concentration capital charge against its RAC due to the concentration issue in the client's account. The resultant concentration charge was estimated to be approximately $1.5 million. This charge against RAC caused Questrade to be capital deficient on May 31, 2007 and June 1, 2007 by $431,000 and $133,000 respectively.

22. IDA by-laws allow a firm 5 business days to correct any capital deficiencies. In this case, the capital deficiency would need to have been corrected by June 7, 2007. Questrade attempted various ways of eliminating the concentration charge which would thereby correct the capital deficiency. The steps initially taken by Questrade to correct the capital deficiency did not come to fruition. On June 6, 2007 Questrade sold enough shares in IM Corp to eliminate the concentration. Due to regular settlement day practices (T+3), the capital deficiency was not corrected on June 6, but rather on June 11, 2007. As result, the firm was capital deficient on May 31st and June 1st.

D. Aggravating and Mitigating Factors

23. Questrade was previously disciplined by the Association for a capital deficiency in December 2002. The circumstances giving rise to the capital deficiency were somewhat similar in that they arose from a securities concentration charge. A Settlement Agreement was entered into at that time pursuant to which Questrade paid a fine of $20,000 and costs of $4,500.

24. Questrade cooperated with IDA Staff throughout the investigation and no client accounts were affected as a result of the capital deficiency. Questrade was pro-active in attempting to correct the deficiency and notified FC Staff promptly as to the possibility of the capital deficiency.

IV. Contraventions

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

    1) On or about May 31 and June 1, 2007, Questrade Inc. failed to maintain risk adjusted capital at a level greater than zero as calculated in accordance with Association Form 1 and was capital deficient in the sums of $431,000 and $133,000 respectively and thereby contravened IDA By-law 17.1.

VI. Terms of Settlement

26. The Respondent agrees to the following terms of settlement:

    a) A fine in the amount of $30,000.

27. The Respondent shall pay a portion of Staff's costs of this proceeding in the amount of $2,500.00.

28. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

29. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Toronto in the Province of Ont, this 21st day of August, 2008.

Questrade Inc.

"Illegible"	**"Dean Percy"**
Witness	**Per: Dean Percy, CFO** I have authority to bind the Corporation

AGREED TO by Staff at the City of Toronto in the Province of Ont, this 21st day of August, 2008.

"Illegible"	**"Andrew P. Werbowski"**
Witness	**Andrew P. Werbowski** Enforcement Counsel on behalf of Staff of the Investment Industry Regulatory Organization of Canada

ACCEPTED at the City of Toronto in the Province of Ont, this 4th day of September, 2008, by the following Hearing Panel:

Per: "Patrick T. Galligan"
Panel Chair
Per: "Robert J. Guilday"
Panel Member
Per: "Donald W. (Sandy) Grant"
Panel Member

2. This case bears a striking resemblance to the decision of a different panel in *I.D.A. v. Peregrine Financial Group Canada Inc.*, [2007] I.D.A.C.D. No. 49. We think it appropriate to quote that decision in full.

> We have considered the circumstances disclosed in the Settlement Agreement. We accept the statements made by counsel, during the hearing, that the breach of By-law 17.1 by the Respondent was inadvertent and that, from a practical perspective, no client accounts or client funds were ever at risk. The sanction is within the range of sanctions imposed in other cases of this type. It is within the range of sanctions suggested by the Association's guidelines. In all of the circumstances of this case, we think that the settlement is a reasonable one and we accept it.
>
> Before leaving the case, there are two observations we wish to make. The record disclosed that the Respondent has previously found itself with a capital deficiency. In 2003, it was disciplined for a capital deficiency and fined $25,000 including costs. The agreed fine in this case is greater than that and represents a greater sanction because the Respondent is a repeat offender. We think that it is imperative that the Respondent put in place controls which will prevent a recurrence of such problems. It might be difficult to accept that a further deficiency could be the result of mitigating inadvertence.
>
> Our second observation relates to the fact that the fine is "inclusive of the Association's costs". We were advised by counsel that the costs in this case are minimal because as soon as the deficiency was recognized, the parties entered into settlement negotiations. That eliminated the need for an extensive investigation or significant legal proceedings. Therefore, it seemed to the parties that it was convenient to include the fine and costs in the one amount.

We are not critical of that being done in this particular case. However, one of the purposes of discipline proceedings is to deter others from violating the Association's by-laws. A fine is an important and significant element of deterrence. If it is blended with costs, it is difficult for a Member or an approved person, to determine exactly what was the penalty imposed for a particular infraction. We suggest that the better practice is to show exactly what part of a sanction is fine or penalty and what part of it is made up of costs.

3. We note that the suggestion made in the panel's second observation has been followed in this case.

4. In this case, the capital deficiency was inadvertent and the respondent acted diligently in its attempts to correct it. Moreover, it cooperated with IDA Staff throughout the investigations. No client accounts were affected by the capital deficiency.

5. In respect to the respondent's history of a previous similar contravention, we note that the fine recommended in this case is greater than the one imposed previously. In our view, that increase in the fine adequately represents a greater sanction because the respondent is a repeat offender.

6. We think that the settlement is a reasonable one and serves the interests of justice. For those reasons, we accepted the settlement when it was placed before us.

Dated this 30th day of September 2008.

Hon. Patrick T. Galligan, Q.C., Chair
Robert J. Guilday, Member
Donald W. (Sandy) Grant, Member