Re Blackmont Capital Inc & Duke

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

Blackmont Capital Inc.

And

Dean Shannon Duke

2010 IIROC 40

Investment Industry Regulatory Organization of Canada
Hearing Panel (Pacific District Council)

Heard: June 21 to 24, 2010 in Vancouver BC
Decision: September 1, 2010
(117 paras.)

Hearing Panel:
John Rogers, Chair, Brian Field and Bob Sutherland

Appearance:
Barbara Lohmann, Enforcement Counsel for the Investment Industry Regulatory Organization of Canada
Nigel M. Campbell, Blake, Cassels & Graydon LLP, for Blackmont Capital Inc.
Ronald N. Pelletier and Brigeeta C. Richdale, Harper Grey LLP, for Dean Shannon Duke.

DECISION AND REASONS

¶ 1 This disciplinary hearing was held pursuant to Part 10 of Dealer Member Rule 20; Section 1.9 of Schedule C.1 to Transition Rule No. 1 of the Transitional Rules dated June 1, 2008; and Rule 13 of the Rules of Practice and Procedure of the Investment Industry Regulatory Organization of Canada ("IIROC").

Allegations

¶ 2 The Enforcement Division of IIROC ("IIROC Staff") alleges that the respondent, Blackmont Capital Inc. ("Blackmont"), and the respondent, Dean Shannon Duke ("Duke"), (collectively the "Respondents"), acted contrary to IIROC Dealer Member Rules (the "Rules") in the following circumstances:

Count 1

Between January 2003 and March 2007, Blackmont, at all material times a Member Firm of IIROC or its predecessor, the Investment Industry Association of Canada ("IDA"), and Mr. Duke, a registered representative with Blackmont, entered into and participated in an arrangement which involved the payment of commissions to a third party who placed orders in the accounts of seven clients without disclosing the details and the existence of the arrangement to these clients, contrary to Rule 29.6 (then IDA By-law 29.6) and/or Rule 29.1 (then IDA By-law 29.1);

Count 2

Between January 2003 and October 2007, the Respondents effected trades in the accounts of clients based on the instructions of a third party without the existence of a duly executed trading authorization, contrary to Rule 200.1(i)(3) (then IDA Regulation 200.1(i)(3)); and

Count 3

Between January 2003 and October 2007, Blackmont failed to obtain:

- Corporate records which indicated the power to bind a corporate client;
- Signature documentation regarding trading authorization; and/or
- Identity verification for authorized trading individuals

required pursuant to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* in respect of certain client accounts and thereby engaged in conduct that is detrimental to the public interest contrary to Rule 29.1 (then IDA By-law 29.1).

Summary of the Facts

The Respondents

Mr. Duke

¶ 3 Mr. Duke was employed in the securities industry as a registered representative from 1987 to January 6, 2010. The transactions referred to in the three counts occurred between January 2003 and October 2007 (the "Relevant Period") during which time Mr. Duke was an employee of Blackmont. Mr. Duke continued his employment with Blackmont until December 2008. Mr. Duke is not presently employed in the securities industry.

¶ 4 While working as a registered representative in the securities industry, Mr. Duke was twice disciplined. He was first disciplined by the Vancouver Stock Exchange in 1997. The allegations against him at that time were that he exercised trading discretion in four client accounts without the required authorization from either the client or his firm. In addition, it was alleged that he arranged to have securities deposited in or transferred to client accounts and then to sell these securities to offset debits in these client accounts. Mr. Duke entered into a settlement agreement with the Vancouver Stock Exchange whereby he admitted to these allegations; agreed to pay a fine of $10,000; agreed to disgorge $3,000 in profits; agreed to successfully re-write the examination based upon the *Conduct and Practices Handbook;* and agreed to pay costs in the amount of $1,500.

¶ 5 Mr. Duke's subsequent disciplinary involvement occurred in 2003 and was with the TSX Venture Exchange. At that time the allegations against him were that he effected or participated in the trades of a particular company when either his clients did not have the intention to properly settle such trades or the trades were made for the purpose of deferring payment of the securities traded. Additional allegations with respect to this trading were that he failed to discharge his obligation as gatekeeper to use due diligence to learn the essential facts relative to each of the clients and about every order accepted by him. Mr. Duke entered into a settlement agreement with the TSX Venture Exchange admitting to these allegations; agreeing to pay a fine of $20,000; agreeing to disgorge the sum of $3,633.57; and agreeing to pay $3,000 in costs.

Blackmont

¶ 6 In 2003, First Associates Investments Inc. (“First Associates”) purchased from Yorkton Securities Inc. ("Yorkton") the assets constituting Yorkton’s retail client division (the “Yorkton Sale”). In 2005, First Associates changed its name to Blackmont Capital Inc. As a result of the Yorkton Sale, Mr. Duke became an employee of Blackmont.

The Commission Arrangement

Civelli, Clarion and PTS

¶ 7 Mr. Carlos Civelli (“Civelli”) is a portfolio manager, who was a resident of Switzerland during the Relevant Period. Through his company, Clarion Finanz AG ("Clarion"), Mr. Civelli acted as what was described as "an important conduit of European funds to North American stock exchanges".

¶ 8 Professional Trading Services S.A. (“PTS") is an investment management corporation of which Mr. Civelli was a director during the Relevant Period.

¶ 9 Neither Clarion nor PTS were registered securities dealers with the Swiss Federal Banking Commission ("SFBC"). However, Clarion was registered as a portfolio manager with the VQF, the relevant Swiss self-regulatory organization.

The Banks

¶ 10 During the Relevant Period, Clarion acted as an “external asset manager” for the following European banks (the "Banks") which were resident in either Switzerland or Liechtenstein:

1. Centrum Bank ("CB");
2. Bank Sal Oppenheim Jr. & Cie (Schweiz) AG ("BSO");
3. Bank Sarasin & Cie AG ("BS");
4. Maerki Bauman & Co. AG ("MB");
5. VP Bank (Schweiz) AG ("VPB");
6. ABM Amro Bank (Schweiz) ("ABN"); and
7. Hypo Alpe-Adria Bank ("HB").

¶ 11 All of the Banks, save and except for CB and HB, were registered as authorized banks and securities dealers with the Swiss Federal Banking Commission ("SFBC"). CB was registered with the SFBC as an authorized representative office of a foreign bank.

The Banks and Clarion

¶ 12 The relationship between the Banks and Clarion was governed by a series of three sets of agreements.

¶ 13 The first set of agreements was between each of the Banks and Clarion whereby Clarion was authorized to act as agent to manage accounts and portfolios on behalf of the Banks' customers.

¶ 14 The second set of agreements was between the Banks’ customers and the Banks. By virtue of these agreements, the Banks’ customers authorized Clarion to act as their external asset manager to manage the portfolio of securities owned by the Banks’ customers and held on their behalf by the Banks. Clarion co-signed these agreements. These agreements purportedly entitled Clarion to commission “retrocessions” or rebates.

¶ 15 And the third set of agreements were entered into directly between the Banks' customers and Clarion and included, among other terms, the investment strategy, the fees payable and the commission arrangement agreed to between the parties. The Banks were not a party to this third set of agreements.

The Accounts

In accordance with the authorization granted to the Banks from the Banks’ customers, on the instructions of Mr. Civelli the Banks opened certain accounts with Yorkton (the “Accounts”) and, within certain broad limitations,

authorized Clarion to issue trading instructions for the Accounts. Although each of the Accounts was in the name of one of the Banks, the beneficial owners of the securities in this account were not the bank in whose name the account was opened, but rather the customers of that bank.

All of the Accounts, except the accounts for HB, were opened prior to the Yorkton Sale. The HB account was initially opened by an advisor at Blackmont other than Mr. Duke and was transferred to Mr. Duke when this advisor left Blackmont. Following the processing of a few trades in this account, Mr. Duke was advised by Blackmont compliance staff that further documentation was required and, when this documentation was not forthcoming, Mr. Duke took steps to close the account

Therefore, following the Yorkton Sale and during the Relevant Period, the Respondents accepted trading instructions on the Accounts from Clarion as agent for each of the Banks for the purpose of trading securities beneficially owned by the Banks' customers.

During the Relevant Period, all of the Accounts were located in Blackmont's office in British Columbia and Mr. Duke worked from this office.

Clarion's Relationship with the Respondents

¶ 16 In 1999, Mr. Duke was introduced to Mr. Civelli. Mr. Duke offered his trade execution services to Mr. Civelli and Clarion, and a commission arrangement was subsequently agreed upon between Clarion, Yorkton and Mr. Duke. This commission arrangement ("Commission Arrangement") provided that of the gross commissions generated by orders placed by Clarion in respect of the Accounts, 50% would be paid to Yorkton, 20% would be paid to Mr. Duke, and 30% would be paid to PTS. The Commission Arrangement was continued by Blackmont and Mr. Duke following the Yorkton Sale.

Commission Payments

¶ 17 To keep track of the agreed to entitlement for commissions generated by the Commission Arrangement, a special RR code was established. Trades placed for the Accounts by Clarion were booked into Blackmont's inventory account at a zero commission under Mr. Duke's usual RR code. A trailer code was entered onto the trade tickets to identify that the orders were placed by Clarion and therefore subject to the Commission Arrangement. These trades were then re-booked under the specially created RR code to the appropriate account with 30% of the commission reflected as being payable to PTS.

¶ 18 During the Relevant Period, over $2.8 million in gross commissions were generated from trading in the Accounts based upon trading instructions from Clarion. Of this amount, PTS received $697,739.42, paid in the form of 17 invoices rendered by PTS to Blackmont. These invoices were generated approximately quarterly by PTS following advice from Mr. Duke to Mr. Civelli as to what the amount of the invoice should be.

¶ 19 PTS was owed an additional $166,060.42 for the period April 2007 to October 2007. However, rather than paying this amount directly to PTS, this amount was paid to Mr. Duke through Blackmont's usual payroll process.

Termination of the Commission Arrangement

¶ 20 In November of 2007, Blackmont terminated the trading arrangement with respect to the Accounts after Mr. Civelli refused to complete, sign and return certain "Referral Agreement and Client Disclosure Forms" created by Blackmont following the 2007 Sales Compliance Review conducted by staff of the IDA. Following termination of this trading arrangement, Mr. Duke subsequently advised IIROC Staff that the trading volume in the Accounts dropped by 50%-80%.

Trading Instructions

¶ 21 For those of the Accounts in the names of BS, HB and MB, there was no written documentation authorizing Clarion to place orders in these accounts. For the Accounts in the name of BSO, there was a written trading authorization for Clarion, but this authorization was dated June 30, 1997, was between BSO and Yorkton, and was not updated following the Yorkton Sale in 2003.

PCMLTF Documentation

¶ 22 Section 23(1) of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* ("PCMLTF Regulations") enacted pursuant to subsection 73(1) of the federal *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* S.C.2001 c. 41 ("PCMLTF Act"), requires a securities dealer when opening an account for a corporation to retain a copy of that part of the official corporate records of the corporation that contains any provisions relating to the power to bind the corporation in respect of that account. This section of the PCMLFT Regulations also requires that for each such newly opened account there be on file with the securities dealer a signature card, an account operating agreement, or an account application form that bears the signature of the person who is authorized to give instructions in respect of that account.

¶ 23 Section 57 of the PCMLTF Regulations requires securities dealers to ascertain the identity of every person who is authorized to give instructions in respect of an account for which a record must be kept by the securities dealer.

¶ 24 There was conflicting evidence before us as to whether or not for certain of the Banks and for Clarion that Blackmont had in its records the necessary copies of the official corporate records, that Blackmont had in its records the necessary copies of documentation bearing the signature of the person authorized to give instructions in respect of the account, and that Blackmont had in its records confirmation that it had verified the identity of each individual with trading authorization on the account, all as required by the PCMLTF Regulations.

Decision

¶ 25 The Hearing Panel finds as follows:

1. With respect to Count 1, the Hearing Panel finds that the Respondents acted contrary to Rules 29.1 and 29.6 in participating in an arrangement which involved the payment of commissions to a third party who placed orders in the accounts of seven clients without disclosing the details and the existence of the arrangement to these clients;
2. With respect to Count 2, the Hearing Panel finds that the Respondents acted contrary to Rule 200.1(i)(3) by effecting trades in the accounts of their clients based upon the instructions of a third party without the existence of a duly executed trading authorization enabling them to take trading instructions from such third party; and
3. With respect to Count 3, the Hearing Panel finds that Blackmont acted contrary to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* in not having on hand documentation required by these regulations with respect to certain client accounts.

¶ 26 The National Hearing Coordinator will be asked to set a date for the parties to make submissions on penalties.

Reasons

The Commission Arrangement – Count 1

¶ 27 Rule 29.6 of the Rules states:

> No Dealer Member or any Director, Executive or employee or shareholder of a Dealer Member shall give, offer or agree to give or offer, directly or indirectly, to any partner, director, officer, employee, shareholder or agent of a customer, or any associate of such persons, a gratuity, advantage, benefit or any other consideration in relation to any business of the customer with the Dealer Member, unless the prior written consent of the customer has first been obtained.

¶ 28 During the majority of the Relevant Period, Section 53 of the Securities Rules made pursuant to the *Securities Act* of British Columbia ("Section 53") contained disclosure requirements similar to Rule 29.6. The applicable provisions of Section 53 might be summarized as:

1. if a registrant receives from, or pays to, another person a commission or other compensation related to the purchase or sale of a security on behalf of a client, the registrant must disclose in writing to the client on whose behalf the purchase or sale is made and at the time the purchase or sale is made or as soon as practicable after that time, the amount of commission that was paid, to whom it was paid, and the services for which the fee was payable;
2. If the payment of this commission is part of a continuing arrangement between a registrant and another party, this disclosure is not required for each transaction for which the fee is payable, provided that the registrant has made such disclosure to the client prior to the first purchase or sale under the arrangement, and provided that the registrant discloses in similar fashion any material changes in the arrangement; and
3. There is no requirement to make such a disclosure if the commission is paid to a person registered in the capacity of a dealer in another jurisdiction.

¶ 29 Following the Relevant Period, and having effect as and from March 28, 2010, Section 53 was repealed by British Columbia Regulation 226/2009 and replaced with National Instrument 31-103. Division 3 of National Instrument 31-103 entitled "Referral arrangements" contains client disclosure provisions with respect to referral arrangements similar to those included in Section 53, including the obligation for written disclosure to the client of the terms of the referral agreement. This new regulation imposes upon the registrant the additional obligation to disclose to the client any possible conflicts of interest that might result from such a referral arrangement.

Response of Blackmont

¶ 30 Blackmont's response to the allegations of IIROC Staff contained in Count 1 focus on four arguments. The first is that the actions complained of by IIROC Staff are more a case of inadvertent documentary deficiencies rather than matters of deliberate or deceptive conduct on Blackmont's part. The second is that as IIROC Staff has a limited jurisdiction within which they are able to conduct their investigations, they are not able to properly compel documents and witnesses to provide the necessary evidence to meet the standard of proof of the breaches of the Rules alleged in Count 1. The third is that as Clarion was the Banks' agent and as Clarion was fully aware of the Commission Arrangement, the Banks as Clarion's principals must in law be taken to be aware of the Commission Arrangement and, if this is the case, there was no further disclosure obligation required of Blackmont. And the fourth is that Section 53 does not apply to the Commission Arrangement due to its replacement with National Instrument 31-103.

¶ 31 To deal with these responses in more detail.

Inadvertent Documentary Deficiencies

¶ 32 Blackmont acknowledges that there were indeed documentary deficiencies with respect to the disclosure of the Commission Arrangement but claims that these deficiencies have now been remedied. It points out that there is no evidence of unresolved client complaints, financial loss, or harm to the integrity of capital markets. Rather Blackmont submits that the trading in the Accounts was ordinary course dealings between established international financial institutions, none of which has complained of any loss or improper conduct.

Jurisdiction of IIROC Staff

¶ 33 Blackmont submits that the fact that IIROC Staff was provided with signed acknowledgements of the Commission Arrangement from at least two of the Banks suggests that additional such documentation might exist. However, given the limited jurisdiction of IIROC Staff to compel further documents or to interview additional witnesses at the Banks' offices in Switzerland and Liechtenstein, IIROC Staff are not able to meet the requisite standard of proof with respect to the allegation contained in Count 1 and to prove that such signed acknowledgements do not exist.

Clarion as Agent

¶ 34 The agreements among Clarion, the Banks, and the Banks' customers clearly designate Clarion as the

Banks' authorized trading agent for all matters dealing with the Accounts. As the Banks' agent, anything that Clarion was familiar with, such as the Commission Arrangement, means either that the Banks actually knew about the Commission Arrangement, or that by law they are imputed with this knowledge through their agent Clarion. And even if the precise details of the Commission Arrangement were not conveyed to the Banks, Blackmont submits, the commissions paid on the trading in the Accounts were well within industry standards and were the same as the Banks would have paid were the Commission Arrangement not in place.

Section 53 Inapplicable

¶ 35 Section 53 is inapplicable to the relationship between Clarion, the Banks and the Banks' customers as created by the sets of agreements outlined above as Section 53 requires disclosure of commissions paid to persons unrelated to the account holder. In this relationship, Clarion is not an unrelated party.

¶ 36 In addition, Section 53 was repealed effective March 28, 2010 and its replacement regulation does not speak to commissions as does Section 53. The current regulatory framework is not, therefore, designed to target the Commission Arrangement.

Response of Duke

¶ 37 Mr. Duke supports the arguments put forward by Blackmont, especially the agency relationship among Clarion, the Banks and the Banks' customers, observing that Clarion was his client and that Clarion's knowledge was that of the Banks and, therefore, the knowledge of the Banks' customers. He observes that over the term of the Commission Arrangement, he and his staff processed thousands of trades in the Accounts with a combined value of millions of dollars in a wide range of securities which traded on the Vancouver Stock Exchange and elsewhere. He submits that in processing these trades at no time did he receive a client complaint nor was there a trade cancellation or a trade which didn't settle.

¶ 38 Mr. Duke also points out that during the entire time that the Commission Arrangement was operative, he kept his managers and supervisors fully informed of the details of the Commission Arrangement and that he obtained whatever documents and information he was asked to obtain by such managers and supervisors when he was asked to do so.

Prior Written Consent

¶ 39 Rule 29.6 is clear and unequivocal. Rule 29.6 requires that the Respondents obtained from the Banks prior to the payment of any of the commissions under the Commission Arrangement the Banks' written consent to such payment. Without this prior written consent, neither Blackmont nor Mr. Duke should have made or authorized any payments under the Commission Arrangement.

¶ 40 Indeed, Rule 29.6 requires that Yorkton and Mr. Duke prior to agreeing to the Commission Arrangement should have obtained this written consent.

¶ 41 Further, Rule 29.6 requires the consent of the "customer". In the matter at hand, the question is begged as to whether the customer is each of the Banks in whose names the Accounts were registered, or the Banks' customers, the acknowledged beneficial owners of the securities in the Accounts and the parties who bore the cost of the commission payments to PTS.

¶ 42 Section 53 expands upon the provisions of Rule 29.6 by requiring that the written disclosure that the Respondents were to provide to their clients prior to the payment of any share of the commissions to PTS under the Commission Arrangement should include details of the amount of commission that was to be paid to PTS and the services for which this commission was to be paid.

¶ 43 That this prior written consent of the Banks to the payment of commissions under the Commission Arrangement was not in place was first brought to the Respondents' attention during the IDA's staff 2007 Sales Compliance Review. Blackmont attempted to remedy this deficiency in documentation by seeking Mr. Civelli's assistance in having the Banks sign and return certain forms. Mr. Civelli refused to co-operate with this request, Blackmont terminated the Commission Arrangement, and the trading volume in the Accounts dropped by 50%-80%.

¶ 44 This is not a case of "inadvertence documentary deficiencies". If such were the case, surely Mr. Civelli and the Banks would have signed the necessary documentation to satisfy the provisions of Rule 29.6 and Section 53 and continue the trading in the Accounts.

¶ 45 And the fact that there were no client complaints does not for a minute suggest that the Banks and the Banks' customers were content with the Commission Arrangement. Indeed, unless the Banks and the Banks' customers were aware that 30% of the commissions generated by trades in the Accounts at the direction of Mr. Civelli were paid to PTS, how would they be in a position to complain?

¶ 46 Nor is the fact that the commission charged to the Banks on the Accounts is in keeping with industry standards sufficient answer on the part of the Respondents. The disclosure requirement is not restricted to the amount of commission involved or the method of calculating that commission. The disclosure envisaged by Section 53 requires disclosure of the party to whom the payment is to made. If the requisite disclosure identifying PTS had been made, it might have been the case that one of the Banks or one of the Banks' customers objected to the payment of such commissions to PTS.

¶ 47 The fact that Clarion was the Banks' agent for the purpose of the Accounts and the argument that Clarion's knowledge was the Banks' knowledge misses the entire point and what is likely one of the principle reasons for the existence of Rule 29.6 and Section 53, namely the obligation on the Respondents to have obtained the prior written consent of the Banks before any payment is made to or on the direction of Clarion as the Banks' agent. The Respondents' obligation is to the Banks as their customers and if Clarion as the agent of the Banks is to benefit from any business dealing with the Respondents, the Respondents are required to secure the Banks' prior written consent to the payment of such benefit before conferring it on Clarion or on PTS as the party designated by Clarion to receive this benefit. In other words, the consent of the Banks' agent, Clarion, does not satisfy the Respondents' obligations under Rule 29.6 and Section 53 to secure the prior written consent of the Banks as Clarion's principals.

¶ 48 Section 53 is indeed applicable to the matter at hand. Although it was repealed effective March 28, 2010, its terms reflected the standard of disclosure expected of the Respondents during the Relevant Period. As well, its replacement, as outlined above, although using the broader concept of referral fees rather than commissions, does deal with the requirement for written client disclosure in referral arrangements, the essence of what the Commission Arrangement is all about. Therefore, the replacement of Section 53 with Division 3 of National Instrument 31-103 does not assist the Respondents' case.

¶ 49 IIROC Staff clearly have an obligation to present clear and convincing proof based upon cogent evidence of the alleged contraventions of Rule 29.6 and Section 53. The Respondents argue that to meet this obligation IIROC Staff must demonstrate that the prior written consents from the Banks required by Rule 29.6 and Section 53 do not exist. The Respondents submit that IIROC Staff is not able to demonstrate this fact largely because of IIROC's limited jurisdiction. This limited jurisdiction renders IIROC Staff unable to go to the Banks' offices in Europe, to interview witnesses to ascertain whether or not such document exists, and if such documentation does exist, to secure copies of it.

¶ 50 However, the obligation on IIROC Staff is not to prove that such documentation does not exist. Rather the obligation on IIROC Staff is to present clear and convincing evidence that during the 2007 Sales Compliance Review copies of the required prior written consents from the Banks as required by Rule 29.6 and Section 53 were not on file at the Respondents' offices or available to the Respondents for production at the request of IDA staff. There is no question in the evidence before us that such documentation was not available for production to either IDA staff or IIROC Staff either during or following the 2007 Sales Compliance Review. Indeed, the acknowledged attempt by the Respondents to secure Mr. Civelli's assistance in obtaining the necessary consents would appear to further confirm this fact.

¶ 51 The subsequent production of documentation by two of the Banks, which documentation purports to authorize Clarion to trade in those of the Accounts in the names of these institutions, certainly does not satisfy the obligation imposed upon the Respondents by Rule 29.6 and Section 53. Rather, it begs the question as to why such documentation was not available during the 2007 Sales Compliance Review.

¶ 52 The fact that Mr. Duke kept his managers and supervisors fully informed of his dealings with Mr. Civelli, Clarion, the Banks and the Accounts does not in any manner relieve him of his responsibilities as a registered representative to comply with the Rules. This obligation on an employee was canvassed by the Ontario District Council in the matters of *Re Ng* [2007] I.D.A.C.D. No. 47, Panel Decision July 27, 2007, Penalty Decision December 20.2007; and *Re Kasman* 2009 LNONOSC 502, (2009) 32 OSCB 5729, Ontario Securities Commission July 14, 2009, a decision of the Ontario Securities Commission on an appeal of a decision rendered by the Ontario District Council of the IDA,

¶ 53 In *Ng*, the registered representative submitted that as an employee of a Dealer Member he was subject to the direction of his employer's branch manager and supervising compliance officer. As both of these representatives of his employer had knowledge of his trading activities and as they did nothing to alert him to the possibility of stock manipulation, his liability for a breach of the Rules was thereby reduced. In rejecting this assertion as a mitigating factor with respect to Mr. Ng's culpability, the Hearing Panel observed that the conduct of Mr. Ng's branch manager and his supervising compliance officer was totally irrelevant to the Hearing Panel's determination of an appropriate sanction for Mr. Ng. The Hearing Panel determined that it must judge the action of an employed registered representative based on his or her conduct, and not upon that of others.

¶ 54 In *Kasman*, the Ontario District Council observed as reported at pg. 4

> ….. while a good compliance culture and a decent compliance infrastructure can be of great assistance and comfort to a registered representative and may permit reasonable reliance by the registered representative on the firm in appropriate circumstances, the lack of a decent compliance infrastructure does not obviate the primary responsibilities and duties of a registered representative to his clients, his firm and the market.

¶ 55 We agree with and adopt the sentiments expressed by the Hearing Panels in these two decisions. Mr. Duke cannot satisfy his obligation to comply with the Rules merely by reporting details of his activities with respect to the Commission Arrangement to representatives of Blackmont. Mr. Duke as a registered representative is responsible for ensuring that in carrying on his professional duties, he does so in full compliance with the Rules.

¶ 56 Therefore, we find that both Blackmont and Mr. Duke breached Rule 29.6 as alleged by IIROC Staff in Count 1 by not securing the prior written consent of the Banks to the Commission Arrangement prior to making any payments to PTS thereunder. In a similar vein, both of the Respondents breached Rule 29.1 by not complying with the provisions of Section 53 with respect to the Commission Arrangement.

Clarion's Trading Authorization – Count 2

¶ 57 Dealer Member Rule 200 is entitled "Minimum Records" and requires every Dealer Member to make and to keep current certain records.

¶ 58 Rule 200.1(i)(3)requires to be included in these records the name and address of the beneficial owner of each cash and margin account for each of a Dealer Member's clients. Rule 200.1(i)(3) further specifies that where trading instructions for such accounts are accepted from a person or corporation other than the customer, every Dealer Member must keep written authorization or ratification from this customer naming the person or corporation so authorized to trade these accounts.

¶ 59 Of the Accounts, those in the name of BS, HB and MB did not contain written authorization for Clarion to issue trading instructions for these Accounts.

¶ 60 There was an authorization for the account in the name of BSO, but this was dated June 30, 1997 and this authorization was between BSO and Yorkton. Following the Yorkton Sale, IIROC Staff alleges that this authorization was not updated in accordance with Dealer Rule 200.1(i)(3) by replacing Yorkton with Blackmont as a party to the authorization.

¶ 61 As well, Clarion had an account with Blackmont during the Relevant Period for which account Mr.

Duke was the responsible registered representative. IIROC Staff alleges that trading instructions were given on this account by Rolf Kessler when there was no written authorization in the account documentation which permitted Rolf Kessler to provide such trading instructions.

Response of Blackmont

¶ 62 Blackmont's response to the allegations made by IIROC Staff in Count 2 are threefold.

SFBC Confirmation

¶ 63 It is Blackmont's position that the three missing sets of written trading authorizations for MB, BS and HB as required by Dealer Member Rule 200.1(3)(i) are contained in the agreements among Clarion, the Banks, and the Banks' customers referred to above whereby the Banks and the Banks' customers purportedly authorized Clarion to issue trading instructions with respect to those of the Accounts in the name of these Banks.

¶ 64 That this was the case was confirmed in letters to IIROC Staff dated September 24, 2008 and September 30, 2008, wherein the SFBC advised IIROC Staff that MB and BS, respectively, had confirmed to the SFBC that they had granted trading authority to Clarion for those of the Accounts in the names of these Banks.

¶ 65 As for HB, the third missing trading authorization, Blackmont submits that when IIROC Staff sought the assistance from SFBC for MB and BS, they should have requested similar assistance from SFBC for the trading authority for HB. In a similar vein, IIROC Staff should have canvassed the Liechtenstein authorities to seek their assistance with respect to this trading authorization. As they took neither of these actions, Blackmont submits, IIROC Staff is precluded from denying the existence of the trading authorization. In effect, this failure to ask for assistance and IIROC's Staff's lack of jurisdiction to compel evidence from HB prevents IIROC Staff from presenting clear and convincing proof that HB operates any differently than the other Banks and from being in a position to prove that HB did not grant trading authority to Clarion in a manner similar to the trading authorization granted to Clarion by the other Banks.

Ratification

¶ 66 Trades in the Accounts were settled as Delivery Against Payment and were duly ratified by the Banks' deemed receipt and acceptance of trade confirmations. It was proper for Blackmont to rely on the verbal confirmation from all of the Banks that Clarion, a registered portfolio manager in its resident jurisdiction, was authorized to trade on the Banks' behalf. The integrity of Clarion's authority to enter and execute trades on behalf of the Banks was never raised with Mr. Duke, Yorkton or Blackmont, nor was the integrity of the Respondents' authority to enter and execute trades questioned by any of the Banks or by any of the Banks' customers.

The Clarion Account

¶ 67 IIROC Staff has not adduced any evidence to contradict the Respondents' evidence that Rolf Kessler did not, in fact, give any trading instructions on the Clarion account.

Response of Mr. Duke

¶ 68 Mr. Duke's response to IIROC Staff's allegations under this Count 2 mirror those of Blackmont, with the additional observation similar to that contained in his response to the allegations contained in Count 1, that Mr. Duke at all times obtained whatever documents and information required of him by his managers, supervisors and compliance staff at Blackmont.

Dealer Member Obligation

¶ 69 Rule 200.1(i)(3) clearly states that every Dealer Member is required to keep in the situation:

> Where trading instructions are accepted from a person or corporation other than the customer, written authorization or ratification from the customer naming the person or company.

¶ 70 It is to be noted in passing that verbal authorization from the Banks confirming that Clarion had trading

authorization for the Accounts as alleged by the Respondents is not sufficient. Dealer Member Rule 200.1(i)(3) requires that such authorization must be in writing.

¶ 71 The fact that such a written authorization may exist in a geographical location outside of IIROC's jurisdiction is not sufficient to satisfy the requirements of this Rule. This Rule requires that in situations such as the matter at hand, where the Respondents accepted trading instructions in the Accounts from a party other than the Banks in whose names the Accounts were registered, that the Respondents have on file the written authorization from the Banks naming Clarion as a party having trading authorization for the Accounts.

¶ 72 Letters obtained by IIROC Staff following the Relevant Period confirming that SFBC was advised by some of the Banks that Clarion had such trading authorization does not constitute compliance with the Rule. Nor is there an obligation on IIROC Staff to prove that such written authorization does not exist. Dealer Member Rule 200.1(3)(i) clearly places on the Respondents the obligation to have written copies of the trading authorizations purportedly issued by the Banks authorizing Clarion to deliver trading instructions to the Respondents for the Accounts.

¶ 73 Moreover, Rule 200.1(3)(i) imposes on a Dealer Member the obligation to "keep current" such written trading authorizations. A trading authorization executed prior to the Yorkton Sale, to which Yorkton was a party rather than Blackmont, and dated 5 years prior to the commencement of the Relevant Period certainly does not meet this currency test.

¶ 74 Similar to the observation made above when dealing with the Respondents' arguments with respect to Count 1, the obligation of proof imposed upon the IIROC Staff is not to prove that the required trading authorizations did not exist. Rather the obligation upon IIROC Staff is to adduce clear, cogent, admissible evidence that the required trading authorizations were not in the possession of the Respondents during the 2007 Sales Compliance Review. We find that IIROC Staff has met this onus. Evidence that such trading authorizations were not in the possession of the Respondents at the time of the 2007 Sales Compliance Review is readily apparent from the evidence presented at the hearing.

¶ 75 Rule 200.1(i)(3) requires that "written authorization or ratification from the customer" be kept. The fact that none of the Banks nor the Banks' customers objected to the trading activity in the Accounts and could therefore be taken to have ratified this activity as argued by the Respondents does not satisfy the requirement of Rule 200.1(i)(3). Deemed ratification does not meet the test. This Rule requires that such ratification must be in writing, it must be from the customer, and it must name the person or company whose trade requires such ratification. There is no evidence of such written ratification from any of the Banks or the Banks' customers.

¶ 76 As referred to above in our reasons dealing with Count 1, it is not sufficient for Mr. Duke to rely completely on his employer's instructions and directions to ensure that he is operating within the Rules. As a registered representative, Mr. Duke has the responsibility to be aware of the Rules and to ensure that he is acting in compliance with them in carrying out his professional duties during the course of his employment.

¶ 77 We find that the Respondents are in breach of Dealer Member Rule 200.1(i)(3) by effecting trades in those of the Accounts in the name of BS, HB, MB and BSO without the existence of a duly executed trading authorization.

¶ 78 However, we find that IIROC Staff did not meet the required standard of proof with respect to the allegations of the trading activities of Rolf Kessler and, therefore, do not find that the Respondents breached Rule 200.1(i)(3) with respect to the Clarion account as alleged by IIROC Staff.

PCMLTF Regulations - Count 3

¶ 79 On May 14, 2002, the PCMLTF Regulations were promulgated under the PCMLTF Act making changes to the then existing client identification and verification requirements expected of all Dealer Members. These changes were brought to the attention of Dealer Members in Member Regulation Bulletin MR0143 published by the IDA and distributed to all Dealer Members ("MR0143").

¶ 80 Section 23(1)(b) of the PCMLTF Regulations deals with the situation where the client is a corporation.

This section requires a Dealer Member when opening an account for a corporate client to "obtain a copy of the part of the official corporate records that contains any provision relating to the power to bind the corporation in respect of that account". MR0143 observed that there were no exceptions to this provision, even for financial entities or other securities dealers.

¶ 81 Of the Accounts, IIROC Staff alleges that Blackmont did not have the documentation or records required under Section 23(1)(b) of the PCMLTF Regulations for those Accounts in the name of ABN, BSO, BS, MB and VPB.

¶ 82 Section 23(1)(a) of the PCMLTF Regulations requires a Dealer Member to obtain a signature card, account operating agreement, or account application bearing the signature of everyone authorized to give instructions for a corporate account. This provision does not apply in respect of an account for which instructions are authorized to be given by a financial entity or other securities dealer. The relevant definition of "financial entity" in the PCMLTF Regulations is an authorized foreign bank under section 2 of the Bank Act and a "securities dealer" is an entity authorized under provincial legislation to engage in the business of dealing in securities, including portfolio management and investment counselling.

¶ 83 Of the Accounts, IIROC Staff alleges that Blackmont did not have the documentation or records required under Section 23(1)(a) of the PCMLTF Regulations for those Accounts in the name of BSO, BS, CB, MB and VPB.

¶ 84 Section 57 of the PCMLTF Regulations is specifically directed at securities dealers. This section requires every securities dealer to ascertain the identity of every person who is authorized to give instructions in respect of an account to which Section 23 of the PCMLTF Regulations applies.

¶ 85 For the Accounts in the name of CB and MB, and for the account that Clarion operated at Blackmont, IIROC Staff alleges that Blackmont did not obtain the records required under Section 57 of the PCMLTF Regulations to verify the identify of each individual purportedly authorized to give instructions on these Accounts.

¶ 86 The allegations contained in Count 3 are made only against Blackmont and allege a breach of Rule 29.1 by Blackmont due to its failure to comply with the provisions of Sections 23(1)(a), 23(1)(b) and Section 57 of the PCMLTF Regulations as above outlined.

Response of Blackmont

Dealing with the Banks

¶ 87 Blackmont submits that the principle underlying the PCMLTF Regulations is that well established international financial institutions such as the Banks do not require the same degree of verification as individual investors or other types of business corporations. It points out that the Banks are subject to the regulatory regimes in their legal domiciles of Switzerland and Liechtenstein and publish detailed annual reports containing audited financial statements. There is, therefore, little or no danger to the public interest in transacting business with the Banks and in not having the paperwork for certain of the Accounts of the Banks as required by the PCMLTF Regulations.

Accounts Opened Prior to Regulations

¶ 88 Blackmont further submits that the PCMLTF Regulations apply only to the opening of new accounts. Blackmont argues that as all of the Accounts were opened prior to the promulgation of the PCMLTF Regulations, it has complied with their requirements.

Previous Reviews

¶ 89 Prior to the Sales Compliance Review conducted by the staff of the IDA in 2007, previous sales compliance reviews did not raise any issues with respect to possible deficiencies in records of the Accounts causing non-compliance with the provisions of the PCMLTF Regulations.

¶ 90 Following the 2007 Sales Compliance Review, Blackmont attempted in good faith to remedy the

technical deficiencies in Blackmont's documentation. In any event, at no time were these technical deficiencies detrimental to the public interest nor did they constitute anything more than delayed compliance with requirements introduced after the Accounts had been opened and operating satisfactorily for some time.

Meeting PCMLTF Regulations

¶ 91 The relevant portions of Section 23 of the PCMLTF Regulations state:

> 23. (1) Subject to subsection (2), every securities dealer shall keep the following records:
>
> (a) in respect of every account that the securities dealer opens, a signature card, an account operating agreement or an account application that
>
> (i) bears the signature of the person who is authorized to give instructions in respect of the account , and
>
> (ii) sets out the account number of a financial entity account, if any, that is in the name of that person or in respect of which that person is authorized to give instructions;
>
> (b) where the securities dealer opens an account in respect of a corporation, a copy of the part of official corporate records that contains any provision relating to the power to bind the corporation in respect of that account;
>
> (2) Paragraph (1)(a) does not apply in respect of an account in the name of, or in respect of which instructions are authorized to be given by, a financial entity or another securities dealer.

¶ 92 The relevant portions of the definition of a "financial entity" in the PCMLTF Regulations state:

> "financial entity" means an authorized foreign bank within the meaning of Section 2 of the *Bank Act* in respect of its business in Canada or a bank to which that Act applies, …..

¶ 93 And the definition of "securities dealer" in the PCMLTF Regulations states:

> "securities dealer" means a person or entity that is authorized under provincial legislation to engage in the business of dealing in securities, including portfolio management and investment counseling.

¶ 94 There is no evidence before us that any of the Banks or Clarion qualify as either a financial entity or a securities dealer, as these terms are defined in the PCMLTF Regulations. However, Blackmont does fall within the definition of a securities dealer under the PCMLTF Regulations.

¶ 95 Therefore, the provisions of Section 23 (1) of the PCMLTF Regulations referred to above apply to the Accounts and to Clarion issuing trading instructions with respect to the Accounts. In addition, the obligations contained in Section 23(1), paragraphs (a) and (b) apply to Blackmont requiring it to keep the records referred to therein.

Accounts Previously Opened

¶ 96 Blackmont submits that if the provisions of Section 23(1) of the PCMLTF Regulations do apply with respect to Blackmont's dealing with the Banks, that these provisions do not apply to the Accounts as the Accounts were opened prior to the coming into force of the PCMLTF Regulations. As the requirements of Section 57 only apply to accounts to which the provisions of Section 23(1) apply and as Blackmont argues that Section 23(1) doesn't apply, Blackmont submits that it has not breached Section 57 as alleged by IIROC Staff.

¶ 97 Blackmont's argument is based upon the interpretation of the word "opens" on the two occasions it appears in Section 23(1) as forward looking and therefore not applicable to previously opened accounts.

¶ 98 The interpretation of the word "opens" put forward by Blackmont is the correct interpretation. Section 23(1) is indeed forward looking from the date of its promulgation in May of 2002 and therefore did not apply to any accounts existing at the date of its promulgation.

¶ 99 However, the Yorkton Sale occurred in 2003 following the coming into force of the PCMLTF

Regulations. The Yorkton Sale was a sale of the retail assets owned by Yorkton to First Associates, which legal entity eventually changed its name to Blackmont. As the Yorkton Sale was an asset sale, new account agreements had to be entered into between the retail clients the subject of the sale and First Associates. This meant that new accounts had to be opened between First Associates and the Banks, and such new accounts being opened after the date of the promulgation of the PCMLTF Regulations would be subject to the provisions of Section 23(1). Therefore, Blackmont is required to keep the records referred to in paragraphs (a) and (b) of Section 23(1) of the PCMLTF Regulations with respect to the Accounts.

Section 57

¶ 100 The relevant portion of Section 57 of the PCMLTF Regulations provides that:

> 57. (1) ….. every securities dealer shall ascertain, in accordance with paragraph 64(1)(*c*), the identity of every person who is authorized to give instructions in respect of an account for which a record must be kept by the securities dealer under subsection 23(1).

and the relevant portions of Section 64 of the PCMLTF Regulations provide that:

> 64. (1) The identity of a person shall be ascertained, at the time referred to in subsection (2) and in accordance with subsection (3), ……..
>
> (*c*) in a case referred to in section 57,
>
> (i) by referring to the person's birth certificate, driver's licence, provincial health insurance card (if such use of the card is not prohibited by the applicable provincial law), passport or any similar record,
>
> (ii) where the person is not physically present when the account is opened, by confirming that
>
> (A) a cheque drawn by the person on an account of a financial entity has been cleared, or
>
> (B) the person holds an account in the person's name with a financial entity;
>
> (2) The identity shall be ascertained …….
>
> (*e)* in the case referred to in section 57, within six months after the account is opened.

¶ 101 As discussed above, Section 23(1) of the PCMLTF Regulations applies to the Accounts. Therefore, in accordance with the provisions of Section 57, Blackmont is required to have established within six months following the Yorkton Sale the identity of the person giving instructions with respect to the trading in the Accounts in accordance with the identification criteria set forth in Section 64(1)(*c*) of the PCMLTF Regulations.

Previous Reviews

¶ 102 Sales compliance reviews conducted by IIROC's compliance staff are intended to assist Dealer Members to comply with the Rules. They are not intended to nor do they serve as a form of confirmation by IIROC that a Dealer Member is complying with the Rules. Nor do they prevent IIROC Staff from pursuing disciplinary sanctions against a Dealer Member with respect to an alleged breach of the Rules, evidence of which comes to light at a time subsequent to a sales compliance review and which at the time of this sales compliance review might have been missed by IIROC compliance staff.

¶ 103 Therefore, the fact that previous sales compliance reviews by IDA compliance staff might not have uncovered those issues raised in the 2007 Sales Compliance Review and subsequently by IIROC Staff does not diminish Blackmont's responsibility to ensure that it is in full compliance with the Rules.

¶ 104 The evidence before us is clear that Blackmont failed to obtain the records required under Section 23(1)(a) of the PCMLTF Regulations for those Accounts in the names of BS and MB; that Blackmont failed to

obtain the records required under Section 23(1)(b) of the PCMLTF Regulations for those Accounts in the names of ABN, BS and MB; and that Blackmont failed to obtain the documentation required under Section 57 of the PCMLTF Regulations for those Accounts in the names of CB and MB. In failing to obtain these records, Blackmont engaged in conduct that is detrimental to the public interest contrary to Rule 29.1.

¶ 105 However, similar clear and convincing evidence was not provided by IIROC Staff with respect to the Accounts in the names of VPB, BSO and CB and the Clarion account and we, therefore, do not find that Blackmont breached Rule 29.1 as alleged by IIROC Staff with respect to the provisions of the PCMLTF Regulations as they relate to these accounts.

Inadvertent Documentary Deficiencies

¶ 106 One of the main principles underlying the Respondents' submissions in responding to the allegations of IIROC Staff in this matter is that the allegations put forward by IIROC Staff focus upon what are referred to in the Respondents' submissions as "inadvertent documentary deficiencies". The Respondents vigorously assert that the relationships created by the agreements between Clarion, the Banks and the Banks' customers were perfectly legal in the Banks' regulating jurisdiction of either Switzerland or Liechtenstein and that these relationships were beneficial to the Canadian securities industry as being responsible for funneling a great deal of investment capital from Europe into the Canadian securities markets. As there is no history of unresolved client complaints, financial loss, or harm to the integrity of capital markets resulting from these relationships, the Respondents assert, it is not in the public interest to pursue disciplinary proceedings against the Respondents for inadvertent documentary deficiencies which occurred during the course of these international dealings between established financial institutions. In effect, the Respondents submit that the deficiencies complained of by IIROC Staff do not constitute a business practice detrimental to the public interest nor detrimental to the interest of the Respondents' clients.

¶ 107 To deal firstly with the legality of the relationships between Clarion, the Banks and the Banks' customers in the Banks' resident jurisdictions. The legality of these relationships was at no time questioned by IIROC Staff. Indeed, it appears from the evidence before us that although IIROC Staff might have been aware of the possible existence of the relationships behind the Accounts, IIROC Staff was not aware of many of the details of these relationships that came forth in the responses provided by Blackmont and Mr. Duke to the allegations of IIROC Staff.

¶ 108 However, the legality of these relationships is irrelevant to the matter at hand. The Accounts were established in British Columbia. Trading instructions were given to Mr. Duke who managed the trading in the Accounts from Blackmont's office in British Columbia. Therefore, British Columbia law and practices applied to the trading in the Accounts and, if Clarion, the Banks and the Banks' customers wished to carry on such activities within British Columbia, they were subject to and were required to comply with the law and practices of British Columbia. And the Respondents as the gatekeepers to the Canadian securities market were responsible to ensure that these established financial institutions were acting in full compliance with this law and these practices.

¶ 109 The second aspect of the Respondents' submissions which needs to be highlighted is their attempt to trivialize the fact that certain documentation required to be included in the records kept by Blackmont with respect to the Accounts was missing. The matter before us involves more than merely a case of missing paper work or mere administrative error on the Respondents' behalf.

¶ 110 It is trite to observe that the capital markets depend upon disclosure. This disclosure extends to more than the issuers of securities which trade in these capital markets. It also extends to the traders of these securities. Without such disclosure it will be extremely difficult to accomplish the goal of maintaining fair, efficient and competitive capital markets in which the public has confidence;

¶ 111 Disclosure of the identity these market participants, their trading authority and their means of compensation is achieved through the creation and retention of various forms of records. And the principles behind these records focus upon the identity of the parties issuing trading instructions, the authority of these

parties given to them by the beneficial owners of the securities being traded, and the nature of the compensation being paid to these parties as a result of issuing these trading instructions. Dealer Members and registered representatives as gatekeepers of the Canadian capital markets are required to keep such records. The contents of such records and how there are to be kept is spelled out in the rules and regulations governing all parties who so participate as gatekeepers.

¶ 112 As these disclosure requirements expected from the parties trading in the capital markets go to the integrity of the capital markets, so too does a disregard for the creation and maintenance of records encompassing these disclosure requirements. Therefore, we disagree completely with the submissions of the Respondents in this respect. Obvious and un-remedied deficiencies in these record keeping obligations, no matter what the national or financial stature of the parties involved, do in fact cause harm to the integrity of the Canadian capital markets.

¶ 113 In the matter at hand, this principle of disclosure of market participants, their trading authority, and their compensation lies behind the Rules that the Respondents are alleged by IIROC Staff to have breached. Provided that this principle of disclosure of the market participants is met, technical difficulties with record keeping can be identified and remedied.

¶ 114 However, from the evidence before us, it appears that there is more than missing or incomplete records that is at issue. It appears that this principle of disclosure was not met. Not only was there no disclosure of the Commission Arrangement to the possible detriment of the beneficial owners of the securities in the Accounts, but there was limited disclosure of the details of the authority and identities of some of the parties involved in the trading activities carried on in the Accounts. Indeed, the evidence before us is that when the deficiencies in the records which would lead to the required disclosure was attempted to be remedied and the documentation deficiency sought to be corrected by Blackmont in its request to Mr. Civelli to have additional disclosure forms completed and signed, he refused to comply with this request, and the trading in the Accounts decreased markedly.

¶ 115 One would have thought that the payment of $682,725.62 to PTS on Mr. Civelli's instructions over the Relevant Period, an expanse of a little over 4 years, would have encouraged Mr. Civelli to remedy the claimed inadvertent documentary deficiency in order for the parties to continue what would appear to have been a rather lucrative financial arrangement for PTS.

¶ 116 In a similar vein, in excess of $2.8 million in gross commissions were generated from the orders entered in the Accounts by Clarion. Of these gross commissions, the Respondents received 70%. With this amount of money involved, one would have thought that the Respondents would pay more attention to the Accounts to ensure that any inadvertent documentary deficiencies were quickly dealt with.

¶ 117 IIROC Staff has proven the allegations made against the Respondents on a balance of probabilities with clear, convincing and cogent evidence that the Respondents failed in their duties as gatekeepers to ensure that this disclosure principle was met with respect to the trading in the Accounts. This failure was more than the claimed inadvertent documentary deficiency. It was clearly business conduct detrimental to the public interest and in breach of Rule 29.1.

Dated at Vancouver, British Columbia this 1st day of September, 2010.

John Rogers, Chair

Brian Field

Bob Sutherland