

Re Dennis

IN THE MATTER OF:

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

and

James Charles Dennis

2011 IIROC 3

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

Heard: November 23 and 24, 2010 in the City of Toronto
Decision: January 21, 2011
(38 paras.)

Hearing Panel:

Edward T. McDermott (Chair), Colleen Wright, Deborah Archer

Appearance:

Mr. Andrew P. Werbowski, Enforcement Counsel

Mr. James Charles Dennis, on his own behalf

DECISION ON THE MERITS

Introduction and Purpose of Hearing

¶ 1 This Hearing Panel was constituted pursuant to Part 10 of Dealer Member Rule 20 and Section 1.9 of Schedule C.1 to Transition Rule No.1 of the Investment Industry Regulatory Organization Canada (“IIROC”). The purpose of the hearing was to determine whether the Respondent, James Charles Dennis, a registrant and employee of IPC Securities Corp. (“IPCSC”) at all relevant times, acted in contravention of IIROC Dealer Member Rule 29.1 between about June 2007 and September 2008 by failing, during that period of time, to disclose to his employer, IPCSC, certain outside business activities as particularized in the Notice of Hearing dated August 5, 2010 which was served on the Respondent and filed in accordance with the IIROC’s Rules of Practice and Procedure governing this proceeding.

S. 29.1 provides as follows:

Business Conduct

“29.1 Dealer Members and each partner, Director, officer, Supervisor, Registered Representative, Investment Representative and employee of a Dealer Member (i) shall observe high standards of ethics and conduct in the transaction of their business, (ii) shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest, and (iii) shall be of such character and business repute and have such experience and training as is consistent with the standards described in clauses (i) and (ii) or as may be prescribed by the Board.

For the purposes of disciplinary proceedings pursuant to the Rules, each Dealer Member shall be responsible for all acts and omissions of each partner, Director, Officer, Supervisor, Registered Representative, Investment Representative and employee of a Dealer Member, and each of the

foregoing individuals shall comply with all Rules required to be complied with by the Dealer Member. ...”

The specific wording of the count with which the Respondent was charged is as follows:

“Count 1

Between about June 2007 and September 2008, the Respondent failed to disclose to his employer, IPC Securities Corp. certain outside business activities, contrary to IIROC Dealer Member Rule 29.1.”

¶ 2 This Hearing Panel was accordingly constituted to hear the evidence and determine the issue as to whether the Respondent had acted in contravention of Dealer Member Rule 29.1 as alleged.

¶ 3 The hearing took place in Toronto on November 23 and 24, 2010 at which time all of the evidence was presented and the parties made submissions as to the findings which this Hearing Panel should reach in light of such evidence.

At the hearing, IIROC was represented by Senior Enforcement Counsel, Andrew P. Werbowski, and the Respondent undertook to represent himself. At the outset of the hearing, the Respondent was fully advised by the Panel of his right to retain and be represented by counsel at the hearing and the Panel offered to provide the Respondent with the co-ordinates of various bodies he could contact for a referral in order to obtain appropriate counsel to represent him in this proceeding. The Respondent, however, declined such offer and indicated that he wished to proceed with the hearing and to represent himself. The hearing proceeded accordingly.

¶ 4 Over the course of the two (2) days of hearings, the Hearing Panel heard evidence from the following witnesses:

<u>Witness:</u>	<u>Position:</u>
GD	Registered Mutual Fund Advisor with IPC Investment Corp. (“IPCIC”)
LB	Senior Compliance Officer IPCSC
SE	Chief Compliance Officer IPC Corp. (“IPCC”)
JN	President and CEO IPCSC
James Charles Dennis	Respondent

During the course of the hearing, all of the witnesses who testified were subject to examination-in-chief, cross-examination and (where requested) re-examination. The Respondent was offered full opportunity to call whatever witnesses he determined would be relevant to his defence.

¶ 5 At the end of the hearing, there was no substantive disagreement between the parties on the facts which gave rise to this charge.

¶ 6 Accordingly, in order to determine whether the charge has been proven against Mr. Dennis, it is necessary for this Hearing Panel to review the evidence in order to decide whether the Respondent contravened IIROC Dealer Member Rule 29.1 by engaging in outside business activities (“OBA’s”) which he failed to disclose to his employer, IPCSC.

The Evidence

The evidence has demonstrated the following:

¶ 7 Mr. Dennis is an experienced investment advisor having been in the industry for some 14 years.

¶ 8 Prior to the summer of 2005, he was engaged as a registered Mutual Fund Representative by IPC Investment Corp. (“IPCIC”), which was registered as a Mutual Fund Dealer and as such, was fundamentally engaged in trading in mutual funds, but not other securities. Both IPCSC and IPCIC are separate companies

which are owned by IPC Corporation (“IPCC”).

¶ 9 As an employee of IPCIC who was investing on behalf of clients, Mr. Dennis was required to be registered by and was subject to the regulatory authority of the Mutual Fund Dealers Association (“MFDA”) and not IIROC.

¶ 10 The Respondent testified that he decided he wanted to deal with more than just mutual funds and accordingly, in 2005, made a decision to switch to IPCSC, a full-service investment company which he joined as a Registered Representative (Retail) in August 2005. His new employer accordingly became IPCSC which was registered as an investment dealer pursuant to the Dealer Member Rules of IIROC and accordingly, as he was no longer employed by IPCIC, he could no longer conduct trades on behalf of clients of IPCIC.

¶ 11 The Respondent had, however, left a book of business at IPCIC which initially was serviced by his former assistant, MK. She, however, had to leave Canada so at the beginning of 2007, Mr. Dennis was in need of someone to service the book at IPCIC until such time as he could sell it.

¶ 12 In addition, and at about the same time, Mr. Dennis had formed a relationship with a mortgage company which was promoting a strategy known as the “Smith Manoeuvre”. In essence, this strategy involved making non-deductible interest on a mortgage used to finance investments, deductible and using the tax savings to finance part or all of the interest payments on the mortgage loan. As part of the Smith Manoeuvre, the customer/investor would acquire investments in order to make the interest payments deductible. These investments would generally be sold in the form of a mutual fund.

¶ 13 Mr. Dennis indicated to IPCSC Compliance his role in this promotion was to serve as an advisor on investments and, in the early stages, a guest speaker. The Compliance personnel at IPCSC did become aware of his involvement in this marketing activity and after various exchanges with Mr. Dennis, had approved it on the understanding he was only acting as a resource to the mortgage company presenting the seminars and that IPCSC’s name would not be used in connection with the programme. Mr. Dennis advised the Compliance Department he hoped he would get referrals from the mortgage company from clients who participated in the Smith Manoeuvre but there was no mention of a referral/compensation arrangement with GD or IPCIC.

¶ 14 The Respondent had become aware that there was no leveraged platform at IPCSC (at least that was acceptable to him) to process the transactions he hoped to obtain out of the Smith Manoeuvre. He also knew that he himself could not process the transactions through IPCIC as he was no longer a registered mutual fund advisor for that company.

¶ 15 In addition, the Respondent was aware that, while there was a written referral agreement in place for business going from IPCIC to IPCSC (a full service firm), there was no referral agreement in place between IPCSC and IPCIC which would allow him to refer any business obtained by him as a Registered Representative of IPCSC to IPCIC. IPCIC was apparently equipped to process the leveraged transactions emanating out of the Smith Manoeuvre in the manner desired by Mr. Dennis.

¶ 16 In or about March 2007, the Respondent met with his friend GD (who, at the time, was out of work), and made an arrangement which resulted in GD joining IPCIC and becoming a registered Mutual Fund Advisor for that company. The Respondent and GD made an arrangement whereby the Respondent would receive the commissions obtained as a result of the transactions generated by the Respondent from the Smith Manoeuvre with the clients being processed by GD through and on the books of IPCIC. GD would also attempt to and try to expand the Respondent’s residual book of business at IPCIC.

¶ 17 In exchange for this, GD would receive \$35,000.00 per year and additional payments if the existing book grew to an agreed-upon level. The Respondent was to pay the expenses associated with developing this new Smith Manoeuvre business.

¶ 18 This arrangement for referring clients to GD and receiving payments back was never disclosed to or known by IPCSC (or for that matter, IPCIC). The Respondent netted almost \$300,000.00 by virtue of this arrangement between June 2007 and October 2008. None of these payments were put through the books of

IPCSC, the Respondent's employer.

¶ 19 As the business from the Smith Manoeuvre continued to increase, the Respondent, in the fall of 2007 and continuing into 2008, continued to press IPCSC to adopt a leveraged platform which was acceptable to him and to create a written referral arrangement going from IPCSC to IPCIC.

¶ 20 Mr. Dennis urged JN, the President of IPCSC, to adopt a leveraged platform which was acceptable to Mr. Dennis. JN knew the Respondent was seeking a different leveraged platform but ultimately declined to change or alter what was already in place and informed the Respondent of this in July 2008.

¶ 21 The Respondent was also informed by the Chief Compliance Officer of both organizations, that there was no formal referral agreement in existence which would permit referral of IPCSC clients to IPCIC and in order to get one, it would have to be approved as a new business project by JN. In addition, the Respondent was informed there that were no referral forms in existence which would permit a referral to IPCIC from IPCSC.

¶ 22 The Respondent was also informed by the Chief Compliance Officer that if such a referral arrangement were to be approved and implemented, the IPCIC representative would have to have total responsibility for dealing with and advising the clients and any compensation remitted for such referrals would have to go through the Dealer Commission Grids and be reported on the books of both companies.

¶ 23 In the result, the Respondent was unsuccessful in his attempts to have IPCSC adopt a structure acceptable to him for clients engaged in the Smith Manoeuvre. He never, however, told anyone at IPCSC that he was actually referring clients obtained as a result of his participation in the project to GD nor that he was receiving compensation for such referrals from GD. These payments were actually made to either the Respondent personally or his personal corporation, J-2 Investments Limited from GD's personal company, Safe Harbour Consulting Ltd.

¶ 24 The evidence also established that in November 2006, the Compliance Staff of IPCSC had provided the Respondent with written notice that all OBA's had to be disclosed to and approved by IPCSC. Such notice also enclosed a Member Regulation Notice from the Independent Dealers Association of Canada to the same effect.

¶ 25 In addition to the foregoing, as a result of certain inquiries being raised with the Compliance Department of IPCSC in connection with his obligation to disclose information relative to his personal corporation, LB (an IPCSC Compliance Officer) had an on-going exchange with the Respondent relative to his requirement to disclose to his employer all OBA's.

¶ 26 These exchanges arose in March 2008 as a result of the Respondent's failure to disclose the existence (and full particulars) of J2 Investments Limited, his personal company.

¶ 27 In the course of these exchanges and as a result of a direct request from the Respondent for a definition of OBA's, LB made it clearly known to the Respondent that OBA included "... outside business activity refers to any business activity (paid or unpaid) outside of IPCSC". LB also made it clear (in writing) to all IPCSC representatives that they were required to disclose all OBA's to both the Compliance and Registration Departments of IPCSC. IPCSC was required to record all OBA's on the National Registration Database ("NRD").

¶ 28 In addition to the direction and advice given by LB with respect to the requirement to report all OBA's, the Respondent was required to and did complete a number of Outside Business Activities Questionnaires and Annual Compliance Questionnaires throughout the period in question including, in particular, in March 2008 and June 2008. In completing these forms, he failed to disclose any mention of the OBA arrangement he had made with GD and, in fact, indicated he had no OBA's and did not receive fees for referrals.

¶ 29 The Respondent accordingly not only failed to disclose this particular OBA but indeed concealed it in circumstances where he knew he was required to report it.

¶ 30 It was only as a result of an internal audit by IPCIC Compliance staff (completed in or about August 2008) that the payments and referral relationship between the Respondent and GD came to light.

¶ 31 During the course of the investigation arising out of the audit, the Respondent initially denied that referrals were being made to GD and also asserted that any monies being paid to him were simply to cover expenses he partially incurred in undertaking this marketing programme (which was proven not to be the case). He asserted that all of the client servicing and investment recommendations were being made by GD which was denied by GD in the course of his evidence.

¶ 32 On the evidence we heard from GD, it was the Respondent who was completing many of the client applications and KYC forms (for the clients generated by him out of the Smith Manoeuvre) and passing them on to GD for processing at IPCIC. GD indicated that he did not even meet or advise many of the clients that were referred to him by the Respondent as a result of the Smith Manoeuvre and that the investment advice was being given by the Respondent.

¶ 33 The Respondent, himself, acknowledged at the hearing that he did, in fact, receive payments for the commissions earned as a result of these referrals and that the figures produced at the hearing showing almost \$300,000.00 flowing to him over a 16-month period (most of which were attributable to the Smith Manoeuvre business) were, indeed, accurate.

¶ 34 He also agreed that he did not disclose either this referral or compensation arrangement between himself and GD to his employer, IPCSC.

The Decision

¶ 35 Based on the foregoing evidence, we are compelled to conclude that the Respondent did engage in outside business activities which he failed to disclose (and, indeed, knowingly concealed) from his employer IPCSC and its Compliance staff. We are further of the view that his actions in referring clients to GD for which he received compensation (in the form of the remittance of a substantial portion of the commissions earned), does in fact constitute an outside business activity which he knew he was required to and failed to disclose to his employer, IPCSC. Such conduct constitutes a contravention of the Respondent's obligations under Dealer Member Rule 29.1.

¶ 36 During the hearing before this Hearing Panel, the Respondent acknowledged that a violation had occurred and that he knew that it was wrong to enter into this type of arrangement and not disclose it to his employer.

¶ 37 Based upon the evidence which we have heard, we find that the count set forth in the Notice of Hearing has been proven and that Mr. Dennis did knowingly contravene Dealer Member Rule 29.1. He is accordingly found guilty as charged.

¶ 38 Much of the evidence and submissions made by Mr. Dennis were more relevant to any penalty to be invoked by this panel as a result of this finding of guilt. Upon the request of IIROC, the parties shall accordingly be summoned to a penalty hearing, on a date to be determined by the National Hearing Co-ordinator, in order to hear the evidence and representations of the parties with respect to an appropriate penalty in the circumstances of this particular case.

DATED at Toronto this 21st day of January, 2011.

Edward T. McDermott, Chair

Colleen Wright

Deborah Archer

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