Re All Group Financial Services Inc

IN THE MATTER OF:

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

and

All Group Financial Services Inc

2011 IIROC 4

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

Heard: December 21, 2010
Decision: January 25, 2011
(46 paras.)

Hearing Panel:
Paul M. Moore, Q.C (Chair), Nick Savona, Hugh McNabney
Appearance:
Kathryn Andrews, IIROC Enforcement Counsel
Nigel Campbell and James Alexander, Respondent's Counsel

DECISION AND REASONS FOR ACCEPTANCE OF SETTLEMENT AGREEMENT

Overview

¶ 1 These are the decision and reasons in writing further to our oral decision and reasons given at the hearing.

¶ 2 The respondent is a small retail brokerage firm in Toronto. At all material times the respondent was capital deficient contrary to IIROC Rules. IIROC Financial Operations Compliance Department ("FINOPS") determined that the respondent was having capital, profitability and liquidity problems throughout 2009 and placed the firm in early warning designation.

¶ 3 In the summer of 2009, while still in the early warning designation, the respondent reduced its capital further when it redeemed shares in the firm in the amount of $25,000, without prior consent of IIROC, contrary to the dealer member rules.

¶ 4 IIROC and the respondent entered into a settlement agreement and have recommended that the panel approve the settlement agreement as being in the public interest.

¶ 5 In the settlement agreement, the respondent agrees to pay to IIROC a fine of $35,000 and costs of $2,000.

¶ 6 In the settlement agreement, the respondent admits to the following contraventions of IIROC rules, guidelines, IDA by-laws, regulations or policies:

COUNT 1: Between April 22, 2009 and May 19, 2009 and during December 2009, All Group Financial Services Inc. failed to maintain its Risk Adjusted Capital at a level greater than zero, contrary to IIROC dealer member Rule 17.1;

COUNT 2: During July and August 2009, while in an early warning Category, All Group Financial Services Inc. reduced its capital by redeeming shares without obtaining prior consent from IIROC, contrary to IIROC dealer member Rule 30.3(iv)(1).

¶ 7 The respondent has been a dealer member firm of IIROC (and the former IDA) since January 2008. The respondent employed GC as a part time chief financial officer during 2009. At all material times, James Moon was respondent's president, chief executive officer and a director.

¶ 8 IIROC commenced it investigation in June, 2009, by way of a referral to the enforcement department from FINOPS.

December 2008 early warning Levels 1 and 2:

¶ 9 FINIP's early warning system measures the capital, profitability and liquidity position of a firm to monitor their financial health. As of December 5, 2008, the respondent was designated in early warning ("EW") Level 1. This designation was due to profitability test 2, based on the firm's interim risk adjusted capital ("RAC") as of November 30, 2008. The respondent indicated that this result was due to low commission revenue for the month.

¶ 10 At this time the respondent acknowledged that the firm was in EW Level 1 and that the EW restrictions applied to the firm.

¶ 11 Later that month, GC advised FINOPS that in fact the respondent's RAC was even lower than was previously estimated, due to an under estimation of expenses.

¶ 12 As of December 23, 2008, the respondent was designated as being in EW Level 2 due to profitability test 2, based on the filing of the November 30, 2008 monthly financial report ("MFR").

2009 early warning Level 2:

¶ 13 On January 22, 2009, the respondent triggered EW Level 1, based on its December 31, 2008 MFR; however, the firm was kept in EW Level 2 due to its low level of RAC ($59,000) as of December 31, 2008 and then RAC of $51,000 as of January 16, 2009.

¶ 14 On January 22, 2009 FINOPS wrote to the respondent advising them of the above and reminding the firm that the EW restrictions and reporting requirements continued to apply.

The respondent's loan to broker MJ:

¶ 15 In February 2009, unknown to IIROC and GC, the respondent entered into a written agreement with a newly employed registered representative MJ. The agreement dealt with payments to be made to MJ by the respondent after his license had been transferred from his former firm. The agreement specified (in part) as follows:

> 7.1 To assist the Registered Representative in making the transition to the Company the Company shall, upon execution of this Agreement by the Registered Representative:
>
> (a) lend the Registered Representative within the first 60 days after the successful transfer of his license … to the Company, $100,000 to ease the transition to the Company;

¶ 16 The loan was to be forgiven by the respondent over a 5 year period.

¶ 17 The respondent did not obtain IIROC's consent, written or otherwise, to the agreement.

Letter from FINOPS:

¶ 18 On April 16, 2009, and not knowing about the agreement at the time, FINOPS wrote to the respondent

advising that based on their review of the past 12 MFR's, the respondent's RAC had fallen from $172,000 to $48,000 as at March 31, 2009. FINOPS also advised that the respondent was considered to be in the high risk category and remained in EW Level 2. FINOPS recommended that the firm inject additional capital.

FINOPS is advised of the Agreement:

¶ 19 On May 19, 2009, GC contacted FINOPS and advised them that the respondent was likely capital deficient. GC advised FINOPS that he had discovered the capital deficiency when he was finalizing an April 2009 bank reconciliation, and noticed a cheque payable to MJ which Moon then explained was a cheque in reference to the agreement.

Capital Deficiency:

¶ 20 The agreement became effective on April 22nd the day that IIROC approved MJ's license transfer. On this date, a commitment to advance a forgivable loan to MJ commenced and was recorded by GC on May 19, 2009 and back-dated to April 22, 2009 as a loan receivable (non-allowable asset) with an offsetting liability to commit to pay the funds to MJ.

¶ 21 The recorded loan receivable would remain a non-allowable asset of the respondent and would decrease (be forgiven) in equal fixed amounts of over the term of the agreement. The regulatory accounting effect of the agreement on April 22, 2009 caused the firm's RAC to fall below zero and caused the respondent to be capital deficient on that day.

¶ 22 On May 20, 2009, FINOPS wrote to the respondent advising that the firm was capital deficient in the amount of $56,000 from April 22, 2009 to May 19, 2009, due to the agreement entered into between the respondent and MJ.

¶ 23 IIROC's capital requirements are clear that a dealer member must maintain RAC greater than zero. Once the respondent's part time CFO became aware of the agreement and the impact on capital, he notified IIROC and the firm took steps to eliminate the capital deficiency.

Injection of Capital:

¶ 24 By May 19, 2009, the respondent arranged for and obtained the injection of $275,000 worth of capital into the firm.

Second Capital Deficiency:

¶ 25 The respondent was also capital deficient during the month of December 2009, in the amount of $13,000. This second capital deficiency was a result of additional year end accruals recorded as expenses.

¶ 26 The interim RAC calculation filed by the firm after the second capital deficiency reported a RAC of $74,000 as of January 8, 2010. In addition there was a $115,000 subordinated loan injected on January 14, 2010. The second capital deficiency was reported to IIROC on March 5, 2010. As of that date the early warning restrictions that had been in place since December 23, 2008 continued to apply.

Count 2: Redemption of preferred shares:

¶ 27 GM was an investor in the respondent. In the summer of 2009 he asked the respondent to redeem his preferred shares and the respondent agreed to pay him $25,000. At this point in time the respondent continued to be designated in EW Level 2. The respondent was aware of this designation.

¶ 28 The respondent made two payments totaling $25,000 to GM – one payment of $15,000 on July 2, 2009 and one payment for $10,000 on August 12, 2009. These payments were made without obtaining IIROC's prior consent, contrary to IIROC dealer member Rule 30.3(iv)(1). These payments also had the effect of reducing the respondent's capital.

Other Considerations:

¶ 29 The respondent has no previous disciplinary history.

¶ 30 The respondent has co-operated with the investigation and prosecution of this matter.

Decision and Reasons:

¶ 31 We approve the settlement agreement as being in the public interest.

¶ 32 This was not an easy decision on our part.

¶ 33 The fine of $35,000 was a bundled amount for the two separate accounts. We accept staff's submission that the minimum fines suggested by the IIROC penalty guidelines are suggestions and not legislation. We have a discretion to accept whatever we consider appropriate and since this is a settlement hearing we do not have the option to set the level of this fine, but must, instead, decide whether or not the sanctions are reasonable and appropriate and, more importantly, within the range of acceptability.

¶ 34 We find that in this particular case the fine and the costs awarded were within the range of acceptability.

¶ 35 We suggest that a bundling of fines for all the counts is not generally a good practice.

¶ 36 First of all, intellectually, it is wise for everybody to go through the process of figuring out what fine is appropriate for each infraction.

¶ 37 Secondly, it may be helpful to the panel in assessing whether a settlement is in the public interest, to weigh factors including a proposed fine is on a per offence basis. That does not mean that in the last analysis bundling should be prohibited, but that it may not be all that helpful for the reasoning that the panel has to go through.

¶ 38 Finally, from a deterrence point of view, identifying a fine on a per offence basis can be helpful in that it sends the appropriate message to the industry and to others as to the possible consequences of infractions on a specific basis.

¶ 39 We accept what counsel has advised about our ability to accept bundling in this case, and to determine, on a global basis, whether this settlement is appropriate or not, and we have done that. But we do not want this case to be a precedent that bundling is a preferred practice.

¶ 40 The question of whether or not the sanctions provided for in the settlemtnt are appropriate is determined, to some extent, by whether or not the respondent was reckless or inadvertent or timely in reporting matters. We accept that the respondent did report on an immediate basis. We accept counsel's advice that the infraction dealing with the agreement for a loan was subject to interpretation as to when it took effect and what its effect was, and when the liability created by the agreement should be taken into account. We also accept that the reporting of the failure to get consent for the redemption of capital was addressed immediately.

¶ 41 The most troubling aspect of the facts was the redemption of capital. The redemption of capital was done when the firm was under close watch, and early warning requirements.

¶ 42 While we accept that the breach of the rules through the redemption of capital was inadvertent, we asked the question of ourselves, "Is there a pattern of non-compliance here or a pattern of inadvertence that causes concern?"

¶ 43 We note that the respondent had no permanent CFO at the time. Also, we recognize that the respondent has been in business just for two or three years.

¶ 44 We don't accept the argument that it's a mitigating factor that the respondent is new. Any new entrant should gear up and comply with the requirements from day one.

¶ 45 These were mistakes that shouldn't have been made, and we accept them as that. On the other hand, we conclude that the respondent's breaches of the requirements were not part of a pattern and this conclusion is an important factor in our decision that this settlement was reasonable within the range of acceptability.

¶ 46 It is important going forward that the respondent gets its act together and makes sure that something like this doesn't happen again, because if there are more infractions of this nature, a subsequent panel may find it

more difficult to conclude that there is not a pattern of non-compliance that causes greater concern.

DATED at Toronto this 25th day of January, 2011.

Paul M. Moore, Q.C.

Nick Savona

Hugh McNabney

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondent All Group Financial Services Inc. consent and agree to the settlement of this matter by way of this settlement agreement ("the Settlement Agreement").

2. The Enforcement Department of IIROC has conducted an investigation ("the Investigation") into the conduct of All Group Financial Services Inc. (the "Respondent").

3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the IDA and Market Regulation Services Inc. Pursuant to the Administrative and Regulatory Services Agreement between the IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for the IDA to carry out its regulatory functions.

4. The Respondent consents to be subject to the jurisdiction of IIROC.

5. 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

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

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

   COUNT 1: Between April 22, 2009 and May 19, 2009 and during December 2009, All Group Financial Services Inc. failed to maintain its Risk Adjusted Capital at a level greater than zero, contrary to IIROC Dealer Member Rule 17.1;

   COUNT 2: During July and August 2009, while in an Early Warning Category, All Group Financial Services Inc. reduced its capital by redeeming shares without obtaining prior consent from IIROC, contrary to IIROC Dealer Member Rule 30.3 (iv) (1).

Terms of Settlement:

8. Staff and the Respondent agree that the Respondent will pay a fine of $35,000 to IIROC.

9. The Respondent agrees to pay costs to IIROC in the sum of $2,000.

III. STATEMENT OF FACTS

Acknowledgment:

10. 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.

Overview:

11. The Respondent is a small retail brokerage firm in Toronto. At all material times the Respondent was

capital deficient contrary to IIROC Rules. IIROC Financial Operations Compliance Department ("FINOPS") determined that the Respondent was having capital, profitability and liquidity problems throughout 2009 and placed the firm in Early Warning designation.

12. In the summer of 2009, while still in the Early Warning designation, the Respondent reduced its capital further when it redeemed shares in the firm in the amount of $25,000, without the prior consent of IIROC, contrary to the Dealer Member Rules.

Background:

13. The Respondent has been a Dealer Member firm of IIROC (and the former IDA) since January 2008. The Respondent employed GC as a part time Chief Financial Officer ("CFO") during 2009. At all material times, James Moon ("Moon") was The Respondent's President, CEO and a Director.

14. IIROC commenced its investigation in June 2009, by way of a referral to the enforcement department from FINOPS.

December 2008 Early Warning Levels 1 and 2:

15. FINOP's Early Warning system measures the capital, profitability and liquidity position of a firm to monitor their financial health. As of December 5, 2008, the Respondent was designated in Early Warning ("EW") Level 1. This designation was due to profitability test 2, based on the firm's interim Risk Adjusted Capital ("RAC") as of November 30, 2008. The Respondent indicated that this result was due to low commission revenue for the month.

16. At this time the Respondent acknowledged that the firm was in EW Level 1 and that the EW restrictions applied to the firm.

17. Later that month GC advised FINOPS that in fact its RAC was even lower than was previously estimated, due to an under estimation of expenses.

18. As of December 23, 2008, the Respondent was designated as being in EW Level 2 due to profitability test 2, based on the filing of the November 30, 2008 Monthly Financial Report ("MFR").

2009 Early Warning Level 2:

19. On January 22, 2009, the Respondent triggered EW Level 1, based on its December 31, 2008 MFR, however, the firm was kept in EW Level 2 due to its low level of RAC $59,000 as of December 31, 2008 and then RAC of $51,000 as of January 16, 2009.

20. On January 22, 2009 FINOPS wrote to the Respondent advising them of the above and reminding the firm that the EW restrictions and reporting requirements continued to apply.

The Respondent's loan to broker MJ:

21. In February 2009, unknown to IIROC and GC, the Respondent entered into a written agreement with a newly employed Registered Representative MJ ("the Agreement"). The Agreement dealt with payments to be made to MJ by the Respondent after his license had been transferred from his former firm. The Agreement specifies (in part) as follows in Article 7 Financial Assistance:

> 7.1 To assist the Registered Representative in making the transition to the Company the Company shall, upon execution of this Agreement by the Registered Representative:
>
> (a) lend the Registered Representative within the first 60 days after the successful transfer of his license … to the Company, $100,000 to ease the transition to the Company;

22. The loan was to be forgiven by the Respondent over a 5 year period (Article 7.2).

23. The Respondent did not obtain IIROC's consent, written or otherwise, to the Agreement.

Letter from FINOPS:

24. On April 16, 2009, and not knowing about the Agreement at the time, FINOPS wrote to the Respondent advising that based on their review of the past 12 MFR's, that the Respondent's RAC had fallen from $172, 000 to $48,000 as at March 31, 2009. FINOPS also advised that the Respondent was considered to be in the high risk category and remained in EW Level 2. FINOPS recommended that the firm inject additional capital.

FINOPS is advised of the Agreement:

25. On May 19, 2009, GC contacted FINOPS and advised them that the Respondent was likely capital deficient. GC advised FINOPS that he had discovered the capital deficiency when he was finalizing an April 2009 bank reconciliation, and noticed a cheque payable to MJ which Moon then explained was a cheque in reference to the Agreement.

Capital Deficiency:

26. The Agreement became effective on April 22nd the day that IIROC approved MJ's license transfer. On this date, a commitment to advance a forgivable loan to MJ commenced and was recorded by GC on May 19, 2009 and back-dated to April 22, 2009 as a loan receivable (non-allowable asset) with an offsetting liability to commit to pay the funds to MJ.

27. The recorded loan receivable would remain a non-allowable asset of the Respondent and would decrease (be forgiven) in equal fixed amounts over the term of the Agreement. The regulatory accounting effect of the Agreement on April 22, 2009 caused the firm's RAC to fall below zero and caused the Respondent to be capital deficient on that day.

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29. IIROC's capital requirements are clear that a Dealer Member must maintain RAC greater than zero. Once the Respondent's part time CFO became aware of the Agreement and the impact on capital, he notified IIROC and the firm took steps to eliminate the capital deficiency.

Injection of Capital:

30. By May 19, 2009, the Respondent had injected $275,000 worth of capital into the firm.

Second Capital Deficiency:

31. The Respondent was also capital deficient during the month of December 2009, in the amount of $13,000. This second capital deficiency was as a result of additional year end accruals recorded as expenses.

32. The interim RAC calculation filed by the firm after the second capital deficiency reported a RAC of $74,000 as of January 8, 2010. In addition there was a $115,000 subordinated loan injected on January 14, 2010. The second capital deficiency was reported to IIROC on March 5, 2010. As of that date the early warning restrictions that had been in place since December 23, 2008 continued to apply.

Count 2: Redemption of preferred shares:

33. GM was an investor in the Respondent. In the summer of 2009 he asked the Respondent to redeem his preferred shares and the Respondent agreed to pay him $25,000. At this point in time the Respondent continued to be designated in Early Warning Level 2. The Respondent was aware of this designation.

34. The Respondent made two payments totaling $25,000 to GM-one payment of $15,000 on July 2, 2009 and one payment for $10,000 on August 12, 2009. These payments were made without obtaining IIROC's prior consent, contrary to IIROC Dealer Member Rule 30.3 (iv) (1). These payments also had the effect of reducing the Respondent's capital.

Other:

35. The Respondent has no previous disciplinary history.

36. The Respondent co-operated with the investigation and prosecution of this matter.

IV. TERMS OF SETTLEMENT

37. This settlement is agreed upon 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.

38. The Settlement Agreement is subject to acceptance by the Hearing Panel.

39. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

40. 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.

41. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

42. 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.

43. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.

44. 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.

AGREED TO by the Respondent at the City of Toronto in the Province of Ontario this 30th day of November, 2010.

"Witness signature"
Witness

"Respondent's signature"
The Respondent

AGREED TO by Staff at the City of Toronto in the Province of Ontario, this 1st day of December, 2010.

"Witness signature"
Witness

"Kathryn Andrews"
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 21st day of December 2010, by the following Hearing Panel:

Per: "Paul Moore"
Panel Chair
Per: "Nick Savona"
Panel Member
Per: "Hugh McNabney"
Panel Member