

# Re Klemke

IN THE MATTER OF:

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

**and**

**The By-Laws of the Investment Dealers Association of Canada (IDA)**

**and**

**Paul Ryan Klemke**

2011 IIROC 14

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

Heard: December 15, 2010 at Calgary, Alberta  
Decision: March 15, 2011  
(18 paras.)

**Hearing Panel:**

Alan V.M. Beattie, Q.C. (Chair), David Duquette (Industry Representative), Philip Heimbecker (Industry Representative)

**Appearances:**

The Respondent  
Faye Emmanuel, For the Association  
James Shea, For the Respondent

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## **REASONS FOR DECISION (SETTLEMENT AGREEMENT)**

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### **INTRODUCTION**

¶ 1 A Settlement agreement was entered into dated December 3, 2010 between Paul Ryan Klemke (“the Respondent”) and the Investment Industry Regulatory Organization of Canada (“IIROC”) 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.

¶ 2 The Settlement Agreement contains a complete Statement of Facts, a description of the Contraventions and the Terms of Settlement (all below). In the Settlement Agreement the Respondent admits to the contraventions. It is stated that the Settlement Agreement is subject to acceptance by the Hearing Panel and if the Panel accepts the Settlement Agreement, the Respondent waives his right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal. IIROC and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement.

¶ 3 A Settlement Hearing Book was provided in advance of the Hearing by IIROC to the Respondent and his Counsel, and members of the Hearing Panel.

## **STATEMENT OF FACTS**

¶ 4 The Statement of Facts in the Settlement Agreement includes:

### **Acknowledgment**

14. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

### **Overview**

15. Between late March and early April 2008, the Respondent ticketed forty-two clients in a capital pool company offering on an unauthorized basis. The Respondent also redeemed the mutual funds of approximately thirty-five of these clients on a unauthorized basis to fund the unauthorized purchases.
16. The investment in the offering was not within the then filed Know Your Client parameters for forty of the aforementioned clients.
17. Further, the Respondent sold the offering to forty-nine residents of the Province of Saskatchewan, where the distribution was not approved for sale.

### **Background**

18. At all material times the Respondent was employed with Jennings Capital Inc. (Jennings).
19. On April 16, 2008 the Respondent tendered his resignation as an employee of Jennings. According to the Notice of Termination the Respondent resigned for cause.
20. After receiving client complaints, Jennings conducted an investigation into the Respondent's conduct.
21. Staff initiated an investigation into the Respondent's conduct on May 15, 2008.
22. The Respondent has not been registered with any IIROC Dealer Member firm since April 16, 2008.
23. On June 1, 2008, the Respondent became a regulated person of IIROC.

### **Royal Capital Corporation (Royal CPC)**

24. Royal CPC, a capital pool company, was incorporated in November 2007; its head office was in Calgary, Alberta.
25. In March and April 2008, Jennings was involved in a syndicated initial offering of the shares of the Royal CPC. The offering was for 4,000,000 common shares at a price of \$0.20 per share (\$800,000 total).
26. According to the prospectus, the net proceeds of the Offering "will be used to provide the Royal CPC with a minimum of funds with which to identify and evaluate assets or businesses, for acquisition with a view of completing a Qualifying Transaction".

### **Unauthorized Transactions**

27. In March and through to April 4, 2008, the Respondent purchased the Royal CPC for clients.
28. The Respondent was advised of client complaints between April 11 and 13, 2008 regarding the purchase of the Royal CPC.
29. According to the Respondent, he resigned from Jennings on April 16, 2008 to take an offer at another retail brokerage firm in the City of Calgary.
30. After the Respondent's resignation from Jennings, and during the course of the Jennings

compliance group's investigation, eight further complaints were confirmed that supported the admitted events of unauthorized purchases and the corresponding mutual fund redemptions.

31. As a result, Jennings began an internal investigation in which they discovered other unauthorized purchases of the Royal CPC and mutual fund redemptions in client accounts.
32. Staff determined that the Respondent purchased the Royal CPC for approximately forty-two clients without having their prior approval and/or instructions. The cumulative amount invested in the Royal CPC by these clients was approximately thirty-one thousand and two hundred dollars (\$31,200.00).
33. The subject transaction for the clients represented approximately two percent of the then market value of their collective holdings.
34. Of the forty-two clients, the Respondent redeemed the mutual funds of approximately thirty-five clients to fund the purchase of the Royal CPC without seeking their prior approval and/or instructions.
35. Ultimately the Royal CPC purchases in the aforementioned client accounts and the corresponding mutual fund redemptions were cancelled and client accounts were restored to their original holdings.

#### **Unsuitable Investment Recommendations**

36. The Royal CPC Prospectus of March 27, 2008 states that investment in the common shares is highly speculative and that the offering is only suitable for those investors who are prepared to risk the loss of their entire investment.
37. The Respondent purchased the Royal CPC for as many as forty of his clients who had a documented risk tolerance of 0% high risk and 0% speculative objectives. For the majority of these clients, the Royal CPC purchase was their first equity transaction.
38. Many of these clients were also clients for whom the Respondent made unauthorized purchases as described above.

#### **Selling the Royal CPC to Saskatchewan residents**

39. The Royal CPC was qualified for sale in Alberta and British Columbia; it was not approved for sale in Saskatchewan.
40. Between late March 2008 and early April 2008 the Respondent sold the Royal CPC to as many as forty-nine Saskatchewan residents.
41. Some of the Saskatchewan residents also had the Royal CPC purchased for them on an unauthorized basis and/or had unauthorized redemptions of their mutual funds and/or the purchases of the Royal CPC were unsuitable for them.

#### **Mitigating Factors**

42. None of the Respondent's clients suffered a financial loss as a result of the aforementioned conduct. Ultimately, the Royal CPC purchases and mutual fund redemptions were cancelled/reversed and client accounts were restored to their original holdings.
43. According to the Respondent, the Respondent has suffered ongoing financial hardship since leaving his employment at Jennings.

#### **CONTRAVENTIONS**

The Settlement Agreement includes:

44. The Respondent admits to the following contraventions of IIROC Rules, IDA By-Laws,

Regulations or Policies:

- i. During March and/or April 2008 the Respondent engaged in unauthorized trading with respect to approximately forty-two clients and thereby engaged in conduct unbecoming or detrimental to the public interest, contrary to IDA By-Law 29.1.
- ii. During March and/or April 2008 the Respondent failed to use due diligence to ensure trades conducted in approximately forty client accounts were suitable, contrary to IDA Regulation 1300.1(q).
- iii. During March and/or April 2008 the Respondent sold and/or attempted to sell a security to approximately forty-nine residents of Saskatchewan when it was not eligible for distribution in that Province thereby engaging in conduct unbecoming or detrimental to the public interest, contrary to IDA By-Law 29.1.

**TERMS OF SETTLEMENT**

45. The Respondent agrees to the following terms of settlement:
- a) A fine in the amount of thirty-five thousand dollars (\$35,000.00);
  - b) The Respondent shall be prohibited from reapplying for registration with IIROC until one (1) year from the date the Settlement Agreement has been approved by the Hearing Panel, at which time he may reapply for registration with IIROC;
  - c) As a condition of re-approval in any capacity, the Respondent shall successfully complete the Conduct and Practices Handbook examination; and
  - d) As a condition of re-approval in any capacity, the Respondent shall be subject to a period of one (1) year of strict supervision with reports to be filed with IIROC.
46. The Respondent shall pay a portion of Staff's costs of this proceeding in the amount of five thousand dollars (\$5,000.00).
47. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
48. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

**SUBMISSIONS OF IIROC**

¶ 5 The foregoing Agreed Statement of Facts, Contraventions and Terms of Settlement were reviewed by Ms. Emmanuel.

¶ 6 Ms. Emmanuel referred to pertinent parts of the Settlement Hearing Book, including IDA By-Laws 29.1 and 1300.1(q). IIROC Dealer Member Disciplinary Sanction Guidelines (including "Considerations in Addition to General Principles" and "Recommended Sanctions"). Ms. Emmanuel made the following further submissions:

1. The Respondent has no prior disciplinary record.
2. The unauthorized trades were over a short period of time and there were no client losses; on the other hand numerous clients were involved.
3. The Respondent has cooperated in the investigation and in entering into the Settlement Agreement.
4. The following decisions provide assistance in determining the reasonable range of penalties, this case falling into the lower range:

*Milewski* (1999) I.D.A.C.A. No. 17; Bulletin No. 2605, August 5, 1999 (Ontario District Council) – failed to use due diligence to ensure recommendations for an RRSP account were appropriate; failed to ascertain directly from a client her investment objectives, and failed to make or keep a written authorization naming the client’s husband - \$20,000 fine for three contraventions, disgorge \$1,650 in commissions, pay costs of \$1,500, strict supervision for six months, and pass the CPH exam.

*Shamseer* (2007) I.D.A.C.A. No. 2 (Ontario District Council) – conducted discretionary trades in a client account (husband and wife age 67 and 62) without the account being specifically approved and accepted in writing as a discretionary account; failed to use due diligence to ensure that trades conducted were suitable based on factors such as the clients’ financial situation, investment knowledge, investment objectives and risk tolerance; total loss to the account, net of any withdrawals, was \$47,251.82, representing 50.1% of the clients’ net investment in the account; clients were partially compensated for their losses – fine \$40,000, disgorge commissions of \$2,100, strict supervision for a period of twelve months and pass the CPH exam.

*Balanko* (2007) I.D.A.C.D. No. 10 (Pacific District Council) – made unsuitable investment recommendations for an RRIF account; effected fifteen discretionary transactions without the prior written authorization of the client and without those accounts being specifically approved and accepted as discretionary by the Member; made unsuitable investment recommendations for an RRSP account; effected ten unauthorized transactions in the RRSP account; in the RRSP account low risk and medium risk securities decreased, and high risk securities increased, significantly – fine total of \$60,000 on four counts, disgorge commissions of \$2,500, costs, \$25,000, no application by the Respondent for registration as an approved person for two years, pass the CSC and CPH exams, and if again registered as an approved person to be subject to a period of strict supervision for twelve months.

*Husky* (2006) I.D.A.C.D. No. 14 (Alberta District Council) – failed to use due diligence to learn and remain informed of the essential facts relative to every customer; executed one trade in each of a client’s two accounts without the knowledge and the consent of the client – total fines of \$25,000 (less fine levied by Member of \$5,000), disgorge commissions of \$1,227, costs of \$4,000, pass the CPH exam and close supervision for six months.

## **SUBMISSIONS OF THE RESPONDENT**

¶ 7 Mr. Shea, Counsel for the Respondent, reiterated that the Respondent agrees with and supports the Settlement Agreement. He said the Respondent has an explanation, not justification, for the contraventions. The Respondent had not realized that the Royal CPC was not approved for sale in Saskatchewan and as soon as that was discovered the client accounts were restored to their original holdings.

## **DECISION**

¶ 8 In the Settlement Agreement the Respondent admits to the contraventions of IIROC Rules, IDA By-Laws, Regulations or Policies set out above.

¶ 9 The Hearing Panel accepts that the contraventions have been established.

¶ 10 **IDA By-Law No. 29.1** provides:

### **BUSINESS CONDUCT**

29.1 Members and each partner, director, officer, sales manager, branch manager, assistant or co-branch manager, registered representative, investment representative and employee of a 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 of

Directors.

....

¶ 11 IDA By-Law No. 1300.1(q) provides:

### **Suitability Determination Required When Recommendation Provided**

(q) Each Dealer Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.

¶ 12 The **IDA Disciplinary Sanction Guidelines**, under the heading "General Principles", include the following:

#### **1. Main Concerns When Determining An appropriate Penalty**

As set out in *Re Derivative Services Inc.*, [2000] I,D,A,C,D, No. 26, at page 3, a Hearing Panel's main concerns in determining an appropriate penalty are:

1. Protection of the investing public;
2. Protection of the Investment Industry Regulatory Organization's membership;
3. Protection of the integrity of the Investment Industry Regulatory Organization's process;
4. Protection of the integrity of the securities markets, and
5. Prevention of a repetition of conduct of the type under consideration.

The penalty imposed in a specific proceeding should reflect the Hearing Panel's assessment of the measures necessary in the specific case to accomplish these goals, ranging from a reprimand to an absolute bar, and may take into account the seriousness of the respondent's conduct and specific and general deterrence.

#### **2. Disciplinary Sanctions as Deterrence**

Registrants and Dealers Members firms have significant responsibilities that they must meet if investors are to be protected and market integrity maintained. Registrants who choose to act in ways that threaten the integrity of the capital markets must have the expectation that they will be held accountable through enforcement action by regulators. Sanctions should be based on the circumstances of the particular misconduct by a respondent with an aim at general deterrence.

General deterrence will follow from an appropriate decision and deter others from engaging in similar misconduct and improve overall business standards in the securities industry. This can be achieved if a sanction strikes an appropriate balance by addressing a registrant's specific misconduct, but also being in line with industry expectations. As was observed by the Hearing Panel in *Re Mills*, [2001] I.D.A.C.D. No. 7, April 17, 2001, at p. 3:

*Industry expectations and understandings are particularly relevant to general deterrence. If a penalty is less than industry understandings would lead its Members to expect for the conduct under consideration, it may undermine the goals of the Association's disciplinary process; similarly, excessive penalties may reduce respect for the process and concomitantly diminish its deterrent effect. Thus the responsibility of the District Council in a penalty hearing is to determine a penalty appropriate to the conduct and respondent before it, reflecting that its primary purpose is prevention rather than punishment.*

However, an important objective of the disciplinary process is to deter future misconduct by imposing progressively escalating sanctions on "repeat offenders". For this reason, when appropriate, a District

Council should consider a respondent’s relevant disciplinary history in determining sanctions. Relevant disciplinary history may include (a) past misconduct similar to that at issue; or (b) past misconduct that, while unrelated to the misconduct at issue, evidences prior disregard for regulatory requirements, investor protection, or commercial integrity. Even if a respondent has no history of relevant misconduct, however, the misconduct at issue may be so serious as to justify a higher penalty.

### 3. Key Considerations When Determining Sanctions

The following list of factors should be considered in conjunction with the imposition of sanctions. Individual guidelines may list additional factors. This list is illustrative, not exhaustive, and the Hearing Panel should consider case-specific factors in addition to those listed here and in the guidelines. Since sanctions should be tailored to address the misconduct involved in a particular case, a penalty must be proportionate to the gravity of the misconduct and the relative degree of responsibility of a respondent. To properly assess the gravity of specific misconduct, the decision-maker should look to a number of factors, including, but not restricted to the following:

*[Hearing Panel note: There are fourteen factors listed. The following are the factors which are pertinent in the present case. The extensive explanatory comment is not included except for factor 3.1]*

#### 3.1 Harm To Clients, Employer and/or the Securities Market

Actual harm can sometimes be quantified by considering the type of transactions, the number of transactions, the size of the transactions, the number of clients affected by the misconduct, the length of time over which the misconduct took place, and the size of the loss suffered by the client(s) or the Dealer Member firm. Harm can also be measured using less empirical, but more subjective factors, such as the impact of a specific misconduct on a client’s life (from an emotional, physical and/or mental perspective), or the impact on the reputation of the Dealer Member firm, or the reputation of the Canadian securities industry as a whole.

#### 3.2 Blameworthiness

#### 3.3 Degree of Participation

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#### 3.5 Prior Disciplinary Record

#### 3.6 Acceptance of Responsibilities, Acknowledgement of Misconduct and Remorse

#### 3.7 Credit for Cooperation

¶ 13 The IIROC Dealer Member Disciplinary Sanction Guidelines contain the following Guideline:

#### **Guideline 3.7 Unauthorized Trading - Dealer Member Rule 29.1**

One of the five primary values set out in the Code of Ethics states that “Registrants must conduct themselves with trustworthiness and integrity, and act in an honest and fair manner in all dealings with the public, clients, employers and colleagues.” There is a relationship of trust and confidence that exists between a registrant and client. When a registrant executes trades without the knowledge or consent of his/her client, the registrant has breached his/her ethical obligations to his client.

#### Considerations In Addition to General

#### Recommended Sanctions

#### Principles

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|--|--|
| <ol style="list-style-type: none"> <li>1. Number of unauthorized trades</li> <li>2. Underlying reason for executing unauthorized trades. (e.g. for personal financial gain)</li> </ol> | <ul style="list-style-type: none"> <li>• Fine: Minimum fine of \$15,000</li> <li>• Disgorgement of profits</li> <li>• Period of Close and/or strict</li> </ul> |
|--|--|

- |   |   |
|---|---|
|   | supervision   |
| 3. The number of clients affected                 | • Re-write of CPH   |
| 4. Period of time unauthorized trading took place | • Period of suspension (in most egregious cases involving large number of large value trades) |
| 5. Suitability of unauthorized trades             |   |
| 6. Magnitude of client losses, if any             |   |

¶ 14 In applying the general principles set out above, the protection of the investing public, protection of the integrity of the IIROC process, protection of the integrity of the securities market, prevention of a repetition of conduct of the type under consideration, and general deterrence, lead us to the conclusion that the penalties agreed upon between IIROC and the Respondent in the Settlement Agreement fall within the reasonable range established in the decisions, are appropriate and should be accepted. We adopt the reasoning of the Hearing Panel in *Milewski*, at p. 12:

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

¶ 15 We have taken into consideration the factors in favour of the Respondent including that he has no prior disciplinary record, there were no client losses and he has cooperated in the investigation and entering into the Settlement Agreement. We are also mindful of the potential for losses to a considerable number of clients, and numerous complaints from clients.

¶ 16 The Hearing Panel advised, at the conclusion of the Hearing, that we accepted, and we signed, the Settlement Agreement. We confirm that decision.

¶ 17 The Respondent, in the Settlement Agreement, agreed to the following terms of settlement, which we have accepted as appropriate:

- (a) a fine of \$35,000;
- (b) the Respondent is prohibited from reapplying for registration with IIROC until December 15, 2011, being one year from the date the Settlement Agreement was approved by the Hearing Panel, at which time he may reapply for registration with IIROC;
- (c) as a condition of re-approval in any capacity, the Respondent shall successfully complete the Conduct and Practices Handbook examination; and
- (d) as a condition of re-approval in any capacity, the Respondent shall be subject to a period of one (1) year of strict supervision with reports to be filed with IIROC.

The Respondent has agreed to pay costs to IIROC in the sum of \$5,000.

¶ 18 We consider the amount of the costs to be within the reasonable range and although they will not fully cover IIROC's costs, they reflect the reduced involvement and cost for IIROC resulting from the Respondent's cooperation.

March 15, 2011

Alan V.M. Beattie, Chair

David Duquette

Philip Heimbecker

