

# Re Cornacchia

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**

**Rocco Tony Cornacchia**

**and**

**Northern Securities Inc**

2011 IIROC 25

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

Heard: March 8 and 9, 2011

Decision: May 5, 2011

(45 paras.)

## **Hearing Panel:**

Wade Nesmith (Chair), Elizabeth Petticrew, Chris Lay

## **Appearances:**

Barbara Lohmann, for IIROC Staff

H. Roderick Anderson, for Rocco Tony Cornacchia

David Hausman, for Northern Securities Inc.

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## **DECISION**

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### **BACKGROUND**

¶ 1 By virtue of Notices of Hearing dated October 20, 2010, the Investment Industry Regulatory Organization of Canada (“IIROC”) commenced proceedings pursuant to Part 10 of Dealer Member Rule 20 and Section 1.9 of Schedule C.1 to Transition Rule No.1 against Rocco Tony Cornacchia (“Cornacchia”) and Northern Securities Inc. (“Northern”) (together, the “Respondents”).

¶ 2 The allegations against Cornacchia are as follows:

#### **“COUNT 1**

Between June 2007 and July 2007, the Respondent, while employed as a Registered Representative (“RR”) at Northern Securities Inc. (“Northern”), a Member firm, failed to use due

diligence to ensure that clients qualified as accredited investors in accordance with the provisions of the British Columbia *Securities Act*, before facilitating the purchase of securities offered pursuant to prospectus exemptions, contrary to Dealer Member Rule 1300.1(a) (then Association Regulation 1300.1(a)).

## **COUNT 2**

Between 2003 – 2007 inclusive, the Respondent, while an RR at Northern, failed to use due diligence to remain informed of the essential facts relative to as many as twelve clients by failing to update the New Client Application Forms (“NCAF”) for these clients, contrary to Dealer Member Rule 1300.1(a) (then Association Regulation 1300.1(a)) and/or Dealer Member Rule 29.1 (then Association By-law 29.1).”

¶ 3 The allegations against Northern are as follows:

### **“COUNT 1**

Between June 2007 and July 2007, the Respondent facilitated purchases of a private placement in client accounts pursuant to accredited investor exemptions set out in the BC *Securities Act* without ensuring that the clients were in fact accredited investors pursuant to the relevant prospectus exemption rules, contrary to Dealer Member Rules 1300.1 (a) (formerly Regulation 1300.1(a)), 1300.2 (formerly Regulation 1300.2 (a)) and 2500 (formerly Policy 2).

### **COUNT 2**

Between June 2007 and July 2007, the Respondent failed to establish and maintain investment review or approval procedures with respect to the purchases of private placements pursuant to accredited investor exemptions and between June 2007 and July 2007 failed to establish and maintain sufficient training and guidance to its approved persons, to ensure that purchasers of these investments properly qualified for the investments, contrary to Dealer Member Rule 29.27 (formerly by-law 29.7), 1300.2 (formerly Regulation 1300.2) and 2500 (formerly Policy 2).”

¶ 4 The factual background to both sets of allegations was identical and by implicit consent, the hearings were held together on March 8 and 9, 2011. The hearing proceeded on the basis of agreed statements of fact (appended hereto). Cornacchia admitted both the facts and liability. Northern admitted only the facts and accordingly the first part of the hearing dealt with Northern’s liability.

## **SUMMARY OF AGREED FACTS**

¶ 5 Cornacchia first became registered as a Registered Representative (“RR”) in January 1990 and joined Northern as a result of its purchase of Georgia Pacific Securities Corp. in 2003. He has no disciplinary history.

¶ 6 Northern is an IIROC Member with offices in Toronto and Vancouver. Cornacchia worked in the Vancouver office.

¶ 7 The matters in question came to the attention of IIROC Staff (“Staff”) as a result of a referral from the British Columbia Securities Commission (“BCSC”) on March 17, 2008. The referral advised Staff that the Respondents may have had some clients participate in a private placement in circumstances where the clients were not qualified participants pursuant to the British Columbia *Securities Act* (the “Act”).

¶ 8 In July 2007 Russell Breweries Inc. (“Russell”), a TSX Venture Exchange issuer, completed a private placement to residents in British Columbia (the “Private Placement”). For all the distributions, Russell relied upon the Accredited Investor Exemption from the registration and prospectus requirements of the Act.

¶ 9 Section 61 of the Act provides:

(1) Unless exempted under this Act or the regulations, a person must not distribute a security unless

(a) a preliminary prospectus and a prospectus respecting the security have been filed with the executive director, and

(b) the executive director has issued receipts for the preliminary prospectus and prospectus.

¶ 10 National Instrument 45-106 – Prospectus and Registration Exemptions, section 2.3 Accredited Investor provides:

- (a) The dealer registration requirement does not apply in respect of a trade in a security if the purchaser purchases the security as principal and is an accredited investor.
- (b) The prospectus requirement does not apply to a distribution of a security in the circumstances referred to in subsection (1).

¶ 11 National Instrument 45-106 defines accredited investor to mean, *inter alia*:

- (j) an individual who, either alone or with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000 (“Item J”).
- (k) an individual whose net income before taxes exceeded \$200,000 in each of the 2 most recent calendar years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the 2 most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year.

¶ 12 National Instrument 45-106 defines financial assets to mean:

- (a) cash,
- (b) securities, or
- (c) contract of insurance, a deposit or an evidence of a deposit that is not a security for the purposes of securities legislation.

¶ 13 It should be noted that the definition of “financial assets” excludes real estate in any form.

¶ 14 The Conduct and Practices Handbook (“CPH”) provides that:

Registrants must ensure that their conduct is in accordance with the Securities Acts of the province or provinces in which registration is held.

¶ 15 Northern’s Policy and Procedures Manual at the time stated the following regarding exemptions from prospectus requirements:

**Distributions Exempt from Prospectus Requirements**

Securities laws specify a number of circumstances in which securities may be distributed without a prospectus. The Compliance Department should be consulted for such transactions. (emphasis added)

¶ 16 Twelve of the Cornacchia’s clients participated in the Private Placement for a total investment of \$47,400 and the commission of \$3,528 was split between Cornacchia (\$1,768) and Northern (\$1,760). It is agreed that 3 of those clients were not “accredited investors” and that the majority of the New Account Application Forms (“NCAF”) in respect of those clients were out of date by more than 10 years.

¶ 17 Cornacchia believed that the term “financial assets” included real estate and advised his clients that was the case.

¶ 18 Cornacchia took no steps to verify or ensure that completed accredited investor documentation was accurate, supported or confirmed by information on the NCAFs or otherwise and did not consult Northern’s Compliance Department with respect to these transactions.

¶ 19 By failing to update the NCAFs with respect to 12 clients, Cornacchia did not discharge his “know your client obligations”.

¶ 20 Cornacchia confirmed to Northern, in 2006, that he had reviewed and understood Northern’s Policy and Procedure Manual. Northern requires that employees remain familiar with the Conduct and Practices Handbook (“CPH”) which reminds registrants of the requirement to comply with Securities Acts across the country.

¶ 21 During the relevant period, Northern’s Syndication Department was responsible for oversight of private

placement transactions, but the company did not have a procedure in place whereby any of the Branch Manager, Syndication Department or Compliance Department reviewed a client's accredited investor eligibility against the client's NCAF.

¶ 22 Subsequent to the initiation of the investigation regarding this matter, Northern notified all Registered Representatives that on an ongoing basis, with respect to private placement transactions, accredited investor information would be compared to NCAFs and that the NCAFs, if out of date, would need to be updated. Further, they provided clarity with respect to the term "financial assets".

¶ 23 Each of Cornacchia and Northern cooperated with IIROC Staff.

¶ 24 To date, none of the 12 clients referenced above has expressed any concerns or made any complaints with respect to either Respondent in respect of the private placement.

### **LIABILITY OF CORNACCHIA**

¶ 25 As a result of the facts agreed to by Cornacchia, and his admission of liability, the Panel finds that liability with respect to Counts 1 and 2 has been proved against Cornacchia.

### **LIABILITY OF NORTHERN**

¶ 26 While admitting to the facts noted above, Northern disputed liability in respect of both counts.

¶ 27 The essence of the IIROC Staff position regarding both Counts 1 and 2, as they relate to Northern, is that Northern's procedures were inadequate to ensure, as best as possible, that each of the clients was an accredited investor and that they provided little guidance to their RR's with respect to how these transactions should be handled.

¶ 28 The essence of Northern's position is that its procedures were adequate for a registrant of their size, especially given that private placements were a small part of their business, that comparing NCAF's with private placement questionnaires would be comparing "apples and oranges" and would not achieve the desired result, and that to put additional compliance measures on small firms with respect to private placements would create a climate where compliance was avoided.

¶ 29 We agree with IIROC Staff that Northern's procedures were inadequate. While we are of the view that compliance is a matter that must be tailored to an individual firm, our view is that if a firm makes a decision to participate in a particular type of market transaction, it must have procedures in place that, to the greatest extent possible, ensure that it and its employees participate in such activity in a manner that is consistent with the Act. Northern's requirement that RR's "should" consult with Compliance with respect to private placement was a suggestion, not a directive. While we agree that a simple comparison of NCAFs with private placement questionnaires would not necessarily ensure compliance with the Act, we are of the view that it would be a step in the right direction. The systems and RR education in place at the time (but now remedied) were inadequate.

¶ 30 The challenge for Northern was exacerbated by the fact that the private placement questionnaire is an issuer generated document. In other words, these forms are not mandated by a securities commission. There was no definition of what comprises "financial assets" included on the form in question. An ordinary reader would be well justified in assuming that such a definition included all of the assets of the potential investor. This situation puts an even higher burden on any dealer or registrant proposing to conduct activities in this exempt market and is one of many examples of the care that must be taken when dealing in the exempt market or, for that matter, any market with which a dealer is unfamiliar.

¶ 31 Accordingly, we find that IIROC Staff has proved the elements necessary to prove Northern liable in respect of counts 1 and 2 against it.

### **PENALTY**

¶ 32 While the parties agreed upon the facts, there was a wide discrepancy in terms of the penalties proposed. The principles involved in penalties are agreed, in the sense that the parties submit that the Panel should be guided, although not bound, by the Discipline Sanction Guidelines (the "Guidelines"). However, each of the

parties submitted cases as precedent that were completely at odds with the cases submitted by the other party.

¶ 33 In general, we have found the precedents to be of little value and, in particular, the precedents provided by IIROC Staff to involve cases and settlements where the facts are vastly different than the instant matter. In the result, we believe that we should review this matter more in the context of Guidelines rather than attempting to force these facts into line with one or more of the precedents provided to us.

¶ 34 With respect to Cornacchia, IIROC Staff submitted that the appropriate penalty was a total fine of \$20,000, disgorgement of \$1,768 and a re-write of the CPH. Mr. Anderson, on behalf of Mr. Cornacchia, argued that a total fine of \$7,500 plus a re-write of the CPH would be appropriate.

¶ 35 With respect to Northern, IIROC Staff submitted that the appropriate penalty was a total fine of \$125,000 and disgorgement of \$1,760. Mr. Hausman, on behalf of Northern, argued that a total fine of \$25,000 would be appropriate.

¶ 36 It is important to keep in mind the key mitigating facts in this matter that apply to both respondents. First, only 3 investors were demonstrated not to be accredited. Second, only 12 accounts were found to have NACF's that were deficient. Third, the amounts of money involved are very small. Fourth, none of the clients in questions has complained.

¶ 37 With respect to Cornacchia, he has no disciplinary history, he acted on a firmly held but mistaken belief that "financial assets" included real estate assets, there was clearly no attempt to defraud, and he has limited means.

¶ 38 With respect to Northern, there is no evidence of disciplinary history, and while we have found their procedures to be inadequate, they have moved quickly to correct the situation and they also have relatively limited means.

¶ 39 Following a review of the authorities, we are of the view that "ability to pay" in respect of the imposition of a fine on a respondent is a principle of which we need to take notice.

¶ 40 Despite the mitigating factors noted above, two key market protection principles cannot be discounted. First, it is fundamentally important that RR's know their clients and understand the rules of the regulatory regime within which they work. This is key to the integrity of the markets. Updating NCAF's, while potentially tedious and often annoying for clients, is an important tool in that "know your client" process. RRs must do this on a regular basis and dealers must be vigilant in ensuring that their employees comply. In addition, RRs must stay current on the rules and regulations and their employers must do everything reasonably possible to assist them and ensure that they do so.

¶ 41 The second important issue is the necessity for all dealers to have clear compliance procedures in place for all business that they transact. A dealer cannot excuse its lack of procedure in a certain area of business on the basis that it forms only a small piece of the dealer's overall business. In a regulated industry, the integrity of the markets demand that any business conducted by a registrant, no matter how small, must be conducted in a manner that, to the greatest extent possible, protects the dealer, its clients, and the market. If the cost of that compliance is too great, the route forward for the dealer is to avoid that business.

¶ 42 In the absence of the mitigating factors noted above, these last two principles would have caused us to impose penalties twice the size of the penalties outlined below.

## **FINDINGS AND ORDERS**

¶ 43 With respect to Cornacchia, we find that he breached Dealer Member Rule 1300.1(a), is liable under counts 1 and 2 above, and order that he:

- pay a fine of \$5,000 with respect to each count;
- disgorge profits of \$1,768;
- pay such amounts within 12 months of the date of this order; and

- re-write and successfully pass the CPH during that 12 month period and that until completion of that term, he be under Close Supervision.

¶ 44 With respect to Northern, we find that it breached Dealer Member Rules 1300.1(a), 1300.2, 2500, and 29.27 , and is liable under counts 1 and 2 above, and order that it:

- pay a fine of \$12,500 with respect to each count;
- disgorge profits of \$1,768; and
- pay such amounts within 45 days of this order.

#### **COSTS**

¶ 45 We invite the parties to review liability with respect to costs. Certain issues arose as the costs issue was argued and we suggest that the parties attempt to reach agreement with respect to appropriate apportionment of costs. In the event they are unable to do so, we remain ready to adjudicate that matter, as well as to make any order that may be agreed upon.

**DATED** at Vancouver, British Columbia this 5<sup>th</sup> day of May, 2011.

Wade Nesmith, Chair

Elizabeth Petticrew

Chris Lay

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