

Re Phillips

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

Melaney Phillips

2011 IIROC 34

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

Hearing: April 6 & 7, 2011
Decision: June 8, 2011
(79 paras.)

Hearing Panel:

Jean P. Whittow, Q.C. (Chair), Brian R. Worth, Michael E. Johnson

Appearances:

Paul Smith, Counsel for IIROC

No one appearing for the Respondent

DECISION AND REASONS

INTRODUCTION

¶ 1 This case concerns a Notice of Hearing issued January 24, 2011 which set out the following allegations against Melaney Phillips (“the Respondent”):

Count 1

From January 2007 to August 2007 the Respondent acted contrary to IDA Rule 1300.1 (q) (IIROC Dealer Member Rule 1300.1 (q)) by recommending and purchasing securities in the accounts of two clients which were not suitable for them.

Count 2

From April 2007 to June 2007 the Respondent acted contrary to IDA Rule 1300.4 (IIROC Dealer Member Rule 1300.4) by making discretionary purchases in the accounts of DW.

Count 3

Sometime in 2007 and 2008, the Respondent acted contrary to IDA By-law 29.1 (IIROC Dealer Member Rule 29.1) by preparing tax returns for two clients and charging a fee for same, without prior approval from her firm and without any formal training or designation.

Count 4

On or about July 13, 2007, the Respondent acted contrary to IDA By-law 29.1 (IIROC Dealer Member Rule 29.1) and UMIR 8.1 by recommending and purchasing shares in the account of her client [LK], which were acquired directly from her own personal sell order without advising [LK] of her interest in the transaction or taking reasonable steps to ensure LK obtained the shares for the best available price.

¶ 2 The Notice of Hearing provided for a hearing before an IIROC Hearing Panel (the “Panel”) at St. 1010 – 925 West Georgia Street, Vancouver, BC, on April 6, 2011.

¶ 3 The Respondent filed a Notice of Response dated January 27, 2011.

¶ 4 The Respondent did not attend the hearing and no one appeared on her behalf.

¶ 5 At the outset of the hearing, counsel for IIROC submitted that the hearing could proceed in the absence of the Respondent relying upon Rule 13.5 of the IIROC Rules of Practice and Procedure.

¶ 6 Counsel for IIROC submitted that it had been shown that the Respondent had been served with a Notice of Hearing. He relied upon the fact that the Respondent had filed a Response to the Notice of Hearing. Further, he relied upon the fact that the Respondent made an application at a Pre-Hearing Conference on March 18, 2011 for an order that the hearing take place by way of electronic means, which showed that the Respondent had the Notice of Hearing. (The Respondent’s application was denied.)

¶ 7 On the basis of the facts referred to by counsel for IIROC, the Panel was therefore satisfied that the Respondent had been served with the Notice of Hearing and determined to proceed.

¶ 8 Counsel for IIROC submitted that in light of the Respondent’s failure to attend the hearing, the Panel could accept as proven the facts and violations alleged in the Notice of Hearing; pursuant to Rule 13.5.

¶ 9 The Panel determined to hear and consider the relevant admissible evidence.

¶ 10 The Panel heard evidence from Mr. Wes Chan. He is an IIROC investigator and a chartered accountant by training.

¶ 11 The Respondent was interviewed by IIROC investigator Mr. Chan pursuant to IIROC Rule 19. The Panel received into evidence the transcript of the interview of the Respondent conducted by Mr. Chan on July 14, 2009 (the “IIROC Interview”).

¶ 12 By way of general background, in the IIROC Interview, the Respondent stated she was an Investment Advisor (“IA”) from February 1997 to August 2008, when she resigned from Canaccord. Her experience included serving as a Branch Manager in a different firm from January 2004 to December 2005. In the IIROC Interview the Respondent stated that at the relevant time she had 400 clients with assets in the \$10 million range. The Respondent also described outside business interests: she said that she had a business with her sister, in giftware and unrelated to securities, which business she described as “failing” at the time of her resignation, and that following her resignation she pursued a different business in technology.

¶ 13 The Panel also heard the *viva voce* evidence of DW, the daughter of SF.

¶ 14 The Panel also received as exhibits copies of account opening documents for SF and DW, Canaccord monthly statements for SF, DW and LK, evidence concerning the securities purchased in the accounts of SF and DW and trading data regarding the Redcliffe transaction.

¶ 15 The standard of proof in these proceedings is proof on a balance of probabilities, as set out in *F.H. v. McDougall*, 2008 SCC 53. The evidence must be clear, convincing and cogent.

COUNT 1

¶ 16 Count 1 concerns the allegation that the Respondent purchased securities for two clients, SF and his daughter, DW, that were not suitable for them.

¶ 17 IDA Rule 1300.1 provides:

Suitability Determination Required When Recommendation Provided

(q) each Member, when recommending to a customer the purchase, sale, or 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.

¶ 18 "Member" is defined to include a registered representative under Rule 29.1 of Schedule B.1 to Transition Rule No. 1 of the IIROC Dealer Member Rules.

¶ 19 On the basis of the Respondent's statements in the IIROC Interview, SF's and DW's accounts, described in further detail below, formed 8% of the total assets in her book of business.

Recommendation

¶ 20 In the IIROC Interview the Respondent was asked "was there ever a recommendation where [SF] said – where you recommended something, he said no, don't buy it?". The Respondent replied "I don't think so, no."

¶ 21 DW testified that all the securities purchased by her were the Respondent's "idea".

¶ 22 As set out below, neither SF nor DW had the sophistication or knowledge to purchase securities based on anything other than the Respondent's guidance.

¶ 23 The Panel is therefore satisfied that all securities by SF or DW were purchased on the Respondent's initiative.

Suitability - SF

¶ 24 SF had been a client of the Respondent at Canaccord and at her previous firms for approximately ten years. The Panel is satisfied that SF trusted the Respondent and totally depended upon her guidance, as evidenced by their long relationship and other factors described below.

¶ 25 The account opening document ("NCAF") for SF with Canaccord was completed on January 11, 2006. The NCAF indicates that SF had \$260,000.00 in liquid assets and \$172,000.00 in fixed assets for a total net worth stated to be \$412,000 (the total of the two stated amounts was \$432,000). SF's total income from all sources was reported at \$42,000.00. SF was 82 years old at the time the NCAF was completed. The NCAF indicated that SF's investment objectives were 50% income (low risk) and 50% moderate growth (medium risk).

¶ 26 The Panel was provided with a copy of the transcript on an interview of SF conducted on April 7, 2009. IIROC counsel wished to employ the transcript for the purposes of demonstrating that it indicated SF's lack of sophistication rather than for the truth of its contents. The transcript demonstrates that SF was unsophisticated and on more than one occasion was confused or distracted during the interview. The Panel notes that the interview was conducted in 2009, a year or more after the transactions took place. DW testified that her father gradually deteriorated in terms of his level of comprehension and the Panel is somewhat concerned about whether the transcript reflects SF's condition at the time of the transactions. For this reason, the Panel has not relied on the transcript of SF's interview.

¶ 27 In the IIROC Interview the Respondent admitted that SF was an "unsophisticated investor".

¶ 28 DW testified her father was a retired longshoreman with very little education.

¶ 29 The Panel is of the view that even the equal blend of income and moderate growth stated on the NCAF would not have been suitable for an 82 year old, with limited financial resources, little education and little or no understanding of investing.

¶ 30 The securities purchased for SF by the Respondent alleged to be unsuitable are listed in paragraphs 10 and 12 of the Notice of Hearing. While giving testimony, Mr. Chan reviewed extracts from prospectuses and financial statements of the companies in which stocks were purchased by the Respondent in SF's account. Further, Mr. Chan referred the Panel to the definition of "speculative" contained in a Canaccord publication, as "investments with a high risk of loss, including junior stocks, limited partnerships, junk bonds, low grade preferred, and distressed securities". Based upon these publications, Mr. Chan gave evidence that the stocks purchased in SF's account by the Respondent were speculative in nature.

¶ 31 The Panel notes that, of SF's initial investment of \$257,000, in June 2006, the Respondent purchased for SF \$30,000 worth of Small Cap Limited Partnership – which lost \$2820 by the time of the Respondent's resignation from Canaccord. Later, and also from SF's initial investment of \$257,000, in excess of \$90,000 was placed quickly in high risk junior mining companies of a speculative nature.

¶ 32 Several months later, SF sold his home and the proceeds of the sale of the house were also placed in the Respondent's care. At this point, the Respondent held and was responsible for advising on all of the assets of SF.

¶ 33 Out of the additional \$411,000.00 deposited, being the proceeds of the sale of the house, an additional amount in excess of \$380,000 of purchases were made, more specifically, over \$250,000 in high risk, speculative junior mining stocks and over \$130,000 in small cap investment income trusts.

¶ 34 The Panel finds that, of SF's total estate of approximately \$668,000 dollars, in excess of 70% was in high risk, speculative junior mining stocks and small cap income trusts.

¶ 35 Based upon SF's financial situation, investment knowledge, objectives and risk tolerance, SF was a completely unsophisticated investor. The securities purchased by the Respondent for SF's account were totally inconsistent with SF's investment objectives and tolerance for risk.

¶ 36 The Panel finds the investments, specifically the securities listed in paragraphs 10 and 12 of the Notice of Hearing, were not only inconsistent with the objectives and risk parameters laid out in SF's NCAF but were totally unsuitable for SF.

¶ 37 In this case, the high risk materialized and as a result SF's account incurred substantial losses. SF's accounts held these securities beyond the point that the Respondent ceased employment with Canaccord in August of 2008. Mr. Chan calculated the losses on the total portfolio to August 2008 to be in excess of \$143,000.00, of which the purchased unsuitable securities incurred losses in excess of \$169,000.

¶ 38 The Panel recognizes that client complaints often emanate from losses. However, the securities purchased were unsuitable for SF at the time of purchase. Further the Panel notes that there was no evidence that SF's accounts held any fixed income securities, preferred shares or "blue chip" dividend bearing securities, which would have been consistent with SF's NCAF and his financial circumstances.

Suitability - DW

¶ 39 The Panel also heard from DW. She was born in 1950. DW opened up an account with the Respondent in 2007 at which time DW was 57 years old. DW's NCAF indicates a total net worth of \$475,000.00, composed of fixed assets of \$390,000 (which included a mortgage-free house and a partial interest in a rental property), plus the monies deposited with the Respondent. DW deposited over \$47,000.00 in a locked-in RRSP and over \$47,000.00 in a second RRSP with Canaccord under the care of the Respondent.

¶ 40 In addition, DW's NCAF indicated and DW testified that she had an annual income of \$20,000.00, which included her share of rental income and income from casual, part-time work as a recreation facilitator for seniors.

¶ 41 A few months later, when the rental property was sold, DW deposited her share of the equity from the rental property of \$42,540.00 into her cash account with Canaccord. This brought the total investment assets in DW's accounts with the Respondent to slightly in excess of \$138,000. This represents all of DW's assets other than the value of her home.

¶ 42 The NCAF indicates DW had no experience in common shares. In the IIROC Interview the Respondent acknowledged that DW was a novice investor. In spite of this and the fact that DW had low and uncertain income, and that the Respondent held all her financial assets, the NCAF shows that DW's investment objectives was 80% moderate growth/medium risk and 20% short term trading/high medium-high risk.

¶ 43 DW testified that when she sold her home, she put the money in her cash account because she believed that that would enable her to draw on that money for living expenses which would be required given her limited income. For example, the monthly statements show that during the period February to June 2008, DW withdrew in excess of \$14,000.

¶ 44 DW testified she was conservative and had low tolerance for risk, and also testified that she told the Respondent to "make me some money".

¶ 45 DW further testified that, soon after opening her account with the Respondent, she received statements showing a decrease in the value of her account. This prompted her to telephone the Respondent out of concern. DW testified that the Respondent told her not to look at her statements. In the IIROC Interview, the Respondent does not deny this but stated that she might have said this as a sort of quip. The Panel notes that the client's concerns as to losses (risk and volatility) were not addressed by the Respondent.

¶ 46 Many of the securities purchased by the Respondent for DW's account were the same as those purchased for SF's account. Indeed, the Panel notes from the account statements of another investor, apparently the Respondent's mother, that her account held a number of the same securities.

¶ 47 DW's circumstances at the time the account was opened, that is her age, her financial situation (including low income and limited resources), her lack of investment knowledge and low tolerance for risk all dictate that DW was an unsophisticated investor, who, like her father SF, was completely dependent upon the Respondent's guidance and professional skill. In the IIROC Interview, the Respondent admitted that she appreciated that DW was a novice investor and did not understand risk.

¶ 48 Mr. Chan reviewed extracts from prospectuses and financial statements of the companies in which stocks were purchased by the Respondent in DW's account. Based upon these publications, the securities purchased by the Respondent for DW were described by Mr. Chan as 100% high risk. The Panel agrees with this characterization of the securities. In total, in excess of \$130,000 was invested in high risk speculative securities, or over 90% of DW's total liquid assets.

¶ 49 The Respondent made substantial investments for DW in high risk speculative junior mining stocks and small cap income trusts. These securities were totally inconsistent with DW's investment objectives and low tolerance for risk. Thus, these investments failed to meet the safeguards of DW's NCAF, which itself did not prudently meet DW's needs and circumstances. The Respondent exposed DW's accounts to high risk investments and failed to provide appropriate liquidity and income opportunity in DW's cash account.

¶ 50 In this case, the losses materialized. The losses to DW's accounts between the time of purchase and the date upon which the Respondent ceased employment with Canaccord (14 months) totalled in excess of 50% of their value.

¶ 51 The Panel further notes that there is no evidence that the Respondent made investments which would have been appropriate for DW, such as fixed income securities, preferred shares or "blue chip" dividend bearing securities. The Panel was most concerned that the allocation of securities to the clients' accounts seems to have been as a result of IA profile and not investor profile.

¶ 52 As set out above in relation to the evidence concerning SF, the Panel is mindful that complaints arise from losses. However, the Panel is satisfied that the securities purchased for DW were unsuitable at the time of purchase.

¶ 53 In all, the Panel is satisfied that the securities purchased for DW, listed in paragraph 24 of the Notice of Hearing, were not suitable.

¶ 54 The Panel has found that the Respondent was aware of SF's and DW's personal circumstances and was

aware that both were unsophisticated investors who trusted her and relied wholly upon her skill and judgment. The Respondent must also have been aware of the high risk nature of the securities purchased. The Panel therefore finds that the Respondent knew at the time she made the purchases for SF and DW referred to above that the securities were entirely unsuitable, and contrary to the best interests of these clients.

¶ 55 In summary, the Panel finds that Count 1 is proven both as regards SF and his daughter, DW.

COUNT 2

¶ 56 Count 2 concerns unauthorized discretionary trading by the Respondent in DW's account.

¶ 57 IDA Rule 1300.4 provides that no person shall "effect trades for a customer in a discretionary account unless prior written authorization has been given by the customer" and "the account is specifically approved and accepted in writing as a discretionary account".

¶ 58 In the present case, the NCAF concerning DW shows that the account was not discretionary.

¶ 59 The evidence of DW was that she did not know that securities were purchased until she received the transaction confirmation slips and, later, the monthly account statements. DW testified that she only knew about the trades after-the-fact. The Respondent's Response denies the allegation in Count 2 of IIROC's Notice of Hearing and says that the Respondent has "never made a discretionary purchase in [her] career".

¶ 60 The statements for DW show 13 purchases made on 7 different days (April 16, May 10, May 16, May 22, June 6, June 14, and June 15, 2008). IIROC counsel took care to explore with DW while she was giving evidence whether she had any sort of conversation with the Respondent which might amount to instructions. It was clear from DW's evidence that she did not.

¶ 61 In the case of *Re Shamseer* [2011] IIROC No. 5, the panel defined the meaning of discretionary trade:

In *Re Wenzel* [2005] A.S.C.D. No. 153, the Alberta Securities Commission stated that "when a person effects a securities transaction for a client without obtaining from the client, in advance, specifics as to four elements of the transaction – quantity, security, price and timing – that person is exercising "discretion"." (par. 26)

¶ 62 The Panel is satisfied that the Respondent's trades in DW's accounts were discretionary. Further the Panel is satisfied that the exercise of discretion by the Respondent was not authorized by DW. The Panel is therefore satisfied that Count 2 is proven.

¶ 63 The Panel further notes that the unauthorized discretionary trading can facilitate the purchase of unsuitable securities. In DW's account there were 13 purchases on 7 different days of unsuitable securities. Similarly, in SF's account, there were 30 purchases on 17 different days of unsuitable securities.

COUNT 3

¶ 64 Count 3 concerns the preparation of tax returns for SF and DW by the Respondent. IDA By-law 29.1 requires that Members

- (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....

¶ 65 An extract from the Conduct And Practices Handbook, marked as Exhibit 1-19, provides under the heading Personal Financial Dealings that "IAs, should report all of the following situations to the branch manager before entering them". One of the five items listed is "regarding additional services such as acting as a custodian of the client's financial assets, preparation of tax returns, payment of bills, etc. regardless of whether a consideration is paid for such services" (emphasis added).

¶ 66 The evidence of DW was that she paid \$100.00 by cheque to the Respondent and not to Canaccord for

the Respondent's preparation of her tax return.

¶ 67 In the IIROC Interview, the Respondent admitted to preparing tax returns for fees for some clients, which included SF for 2006 and 2007 and DW for 2007. When asked if she ever disclosed this to Canaccord the Respondent said "I never hid the fact". The Respondent did not provide any evidence that she did in fact disclose or obtain the approval from Canaccord with respect to the preparation of the tax returns.

¶ 68 Therefore, the Panel finds that the Respondent prepared tax returns for SF and DW for fees, without prior approval from her branch manager, which was not consistent with the duty to adhere to high standards of conduct and is therefore contrary to IDA By-law 29.1.

¶ 69 The Panel finds that Count 3 is proven.

COUNT 4

¶ 70 This count concerned transactions for a different client. It is alleged that the Respondent acted contrary to IDA By-law 29.1 and UMIR 8.1 by recommending and purchasing shares in the account of her client LK from the Respondent's own account, without advising LK of her interest in the transaction and without taking reasonable steps to ensure LK received a favorable price.

¶ 71 The evidence provided was in the form of copies of the buy and sell tickets concerning the transaction.

¶ 72 The sell order shows that on July 13, 2007 at 6:51 a.m. the Respondent put in an order to sell 50,000 Redcliff Exploration Inc. CLA ("Redcliffe") on her own account at the price of \$0.72. This order was partially filled by the purchase of 8,000 Redcliffe by the client LK's purchase at 11:33 a.m.

¶ 73 The market surveillance record shows that these were the only transactions for Redcliffe on July 13, 2007.

¶ 74 UMIR 8.1 provides that a representative may only sell to a client for the representative's own account if he or she sells to a client at a better price than that which is in the market.

¶ 75 In this case, the client got a worse price than that which was in the market in that there was no activity in the market whatsoever for Redcliffe at any price. The trade ticket shows that the remainder of the sell order was filled in subsequent days at lower prices.

¶ 76 In the Response, the Respondent asserts that she made an error. She states that she had "an open order to sell [her] shares on the books" and that "I received a phone call pertaining to this trade error, to which I apologized for the oversight, and offered to cancel my trade.....[t]he caller said that it was not necessary.....". However, in the IIROC Interview, the Respondent gave several different explanations: she at first said that she did not recall the transaction, secondly said she is very open with clients if selling her stock to them and, thirdly, said that this was the only time that such a transaction had occurred. These statements are inconsistent. As well, in the IIROC Interview, the Respondent said that she had no recall of any supervisor contacting her in this regard.

¶ 77 It is not credible based upon the documents before the Panel regarding the trading in Redcliffe and the trading in the Respondent's account to assert that the sale by the Respondent to LK was an inadvertent error. The Respondent's various explanations are not supported by the evidence.

¶ 78 The Panel finds that Count 4 is proven.

CONCLUSION

¶ 79 In summary, the Panel finds that all four counts are proven to the required standard.

Jean Whittow, Q.C. (Chair)
Brian R. Worth
Michael E. Johnson

