Re Berkshire Securities

IN THE MATTER OF:

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

and

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

and

Berkshire Securities Inc.

2011 IIROC 57

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

Heard: September 30, 2011
Decision: September 30, 2011
(18 paras.)

Hearing Panel:
Leon Getz, Q.C., Bob Sutherland and Chris Lay
Appearances:
Paul Smith for the Investment Industry Regulatory Organization of Canada
Tracey M. Cohen for Berkshire Securities Inc.

DECISION

Introduction

¶ 1 We were constituted as a panel to consider, pursuant to Rule 20.36 of the Investment Industry Regulatory Organization of Canada ("IIROC"), whether to accept a settlement agreement (the "Settlement Agreement") that has been negotiated between IIROC's Enforcement Department and ("Berkshire") At the conclusion of the hearing held for this purpose in Vancouver, B.C. on September 30, 2011, and after considering the joint submissions of counsel for IIROC and for Berkshire and the terms of the Settlement Agreement, we accepted it.

¶ 2 These are our reasons for doing so.

The Settlement Agreement

¶ 3 The Settlement Agreement is annexed to this Decision. It contains:

(a) a summary of the underlying facts;

(b) an acknowledgement by Berkshire that from May 2007 until early September 2007 (the "Relevant Period"), it failed to effectively supervise one of its Registered Representatives and

recommendations and representations that Registered Representative ("RR") made to clients, contrary to IDA Regulation 1300.2 (now IIROC Dealer Member Rule 1300.2)

(c) Berkshire's agreement to pay a fine of $120,000 and to pay an amount of $10,000 to IIROC on account of its costs in connection with this matter.

The governing principles applicable to a decision to accept or reject a settlement

¶ 4 There are two broad related principles that apply in connection with a decision to accept or reject a settlement.

¶ 5 The first is succinctly stated in the following passage from the decision in *Re Milewski*:[1]

> 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.

¶ 6 Secondly, in *Rault v. Law Society of Saskatchewan*[2], the Saskatchewan Court of Appeal cited with approval and applied to an administrative tribunal the principles applicable to joint submissions on sentencing in criminal cases earlier described by the Alberta Court of Appeal in *R. v. G.W.C.*[3], namely, that there is an obligation on the tribunal to give serious consideration to a joint submission on sentencing agreed upon by counsel unless the sentence is unfit or unreasonable; or contrary to the public interest; and, it should not be departed from unless there are good or cogent reasons for doing so. See also, *Re Higgs,* [2010] IIROC No. 3.

¶ 7 In our view rejection of the Settlement Agreement in this case would not be consistent with these principles.

Discussion

¶ 8 We have been influenced by several considerations.

A. IIROC DEALER MEMBER RULE 1300.2

¶ 9 IIROC Dealer Member Rule 1300.2 provides, in substance, that every Dealer Member must take appropriate steps for the supervision of client accounts so as to ensure that "the handling of client business is within the bounds of ethical conduct, consistent with just and equitable principles of trade and not detrimental to the interests of the securities industry." It is difficult to overstate the importance of substantive compliance with this requirement.

B. IIROC DISCIPLINARY SANCTIONS GUIDELINES

¶ 10 The Disciplinary Sanctions Guidelines promulgated by IIROC suggest that where a Dealer Member has failed in its duty to ensure proper supervision of client accounts, a minimum fine of $50,000 should be imposed and, in particularly egregious cases, the suspension or expulsion of the Dealer Member. Among the other considerations identified in the Guidelines as possibly affecting the selection of an appropriate sanction, reference is made to "the amount of the losses or compensation for which the Dealer Member is liable as a result of the employee's misconduct" and the existence of "red flag" warnings "that should have been caught by a proper system of supervision/failure to follow-up or to conduct periodic reviews". A further consideration is whether the Dealer Member has subsequent to the discovery of the problem taken appropriate corrective measures.

¶ 11 In the Settlement Agreement Berkshire has acknowledged its failure in two respects:

(a) First, in connection with the activities of an employee who, to the knowledge of his supervisors, "commonly recommended leveraged loans to his clients" [paragraph 23] the supervisors failed to review either

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1 [1999] I.D.A.C. No. 17, August 5, 1999 at page 11. See also *Re Clark*, [1999] I.D.A.C.D. No. 40, Bulletin No. 2674, December 14, 1999.
2 2009 SKCA 81 (CanLII)
3 2000 ABCA 333 (CanLII)

the extent of the leveraged loans taken out by the clients or the suitability of such loans for the clients in question [paragraph 24]. In fact, as noted in paragraph 27 of the Settlement Agreement, the amounts borrowed were not suitable having regard to the age, income, net worth and risk tolerance of the clients as set out in their New Client Application Forms. The facts justifying this conclusion are set out in detail in paragraphs 20 and 27 of the Settlement Agreement.

(b) Second, as set out in paragraph 35 of the Settlement Agreement, on August 16, 2007, the employee raised with his Branch Manager the question whether he could properly guarantee a client against losses. Somewhat surprisingly, the Branch Manager, instead of simply saying "no", decided to discuss the matter with a regional compliance manager and then, equally surprisingly, advised the employee that this could not be done "without having involved head office compliance and advising them of their intention and the circumstances leading up to this decision."

¶ 12 In fact, a few days later some evidence was discovered indicating that the employee had not merely purported to guarantee the client against loss but also to share with the client in certain defined gains. See Settlement Agreement [paragraphs 37 to 40].

¶ 13 Berkshire did not contact the client in question to discuss the issue of the guarantee until several months later [Settlement Agreement, paragraph 42].

¶ 14 In our view, the enquiry made by the employee on August 16 was itself a "red flag" and should have been so considered by the Branch Manager. It is somewhat curious, therefore, that the Settlement Agreement asserts only that "more effective supervision of the [guaranteed] account could have been achieved if the Respondent had immediately contacted the client . . . before the account was exposed to any further losses."

¶ 15 As the Settlement Agreement discloses [paragraph 32], Berkshire compensated the clients who had been encouraged to make unsuitable investment loans and [paragraph 44] the client whose account was "guaranteed".

¶ 16 Finally, in this connection, we note that after the Relevant Period Berkshire amended its Sales Compliance Manual to include "guidelines for identifying suitability concerns related to leveraged accounts" [Settlement Agreement, paragraphs 28 to 31].

C. PRIOR DECISIONS OF HEARING PANELS

¶ 17 It is trite to say that no two cases are exactly alike; each depends on its own facts and that the guidance to be derived from prior decisions is limited. We were referred to a decision of an earlier Hearing Panel in *Re Raymond James,* [2007] I.D.A.C.D. No. 53 which also involved admissions of inadequate supervision on the part of the Dealer Member, but on facts in many ways significantly different from those here. In that case, the Dealer Member agreed to pay a fine of $140,000 and a contribution of $10,000 to the regulator's costs.

D. CONCLUSION

¶ 18 Our conclusion, overall, is that taking account of the considerations to which we have referred, the provisions of the Settlement Agreement with respect to sanctions fall "within a reasonable range".

¶ 19 These are the reasons for our decision to accept the Settlement Agreement.

Leon Getz, Panel Chair

Bob Sutherland, Panel Member

Chris Lay, Panel Member

As of September 30, 2011.

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and Berkshire Securities Inc. ("Berkshire" or the "Respondent"), 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 the Respondent.

3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. Pursuant to the Administrative and Regulatory Services Agreement between IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for 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 that from May 2007 until early September 2007, it failed to effectively supervise one of its Registered Representatives and recommendations and representations that Registered Representative ("RR") made to clients, contrary to IDA Regulation 1300.2 (now IIROC Dealer Member Rule 1300.2).

8. Staff and the Respondent agree to the following term of settlement:

   a) the Respondent will pay a fine in the amount of $120,000.

9. The Respondent agrees to pay costs to IIROC in the amount of $10,000.

III. STATEMENT OF FACTS

(i) 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.

(ii) Factual Background

Overview

11. This Settlement Agreement relates to the Respondent's failure to effectively supervise client accounts operated by Syvert Francis Mytting ("Mytting").

12. Mytting worked as an RR at the Respondent's branch office in Abbotsford, British Columbia from October 2002 until December 18, 2007. Since then, he has not worked for any Dealer Member or in the securities industry generally.

13. This Settlement Agreement generally relates to the period of time from May 2007 until early September 2007 (the "Relevant Period").

14. On August 31, 2007 the Respondent was purchased by Manulife Financial Corporation but continued to operate as Berkshire until July 2008 when it changed its name to Manulife Securities Incorporated.

15. This Settlement Agreement generally relates to two supervisory issues.

16. The first is suitability of recommendations made to a group of five clients to use leveraged investment loans to fund their investment accounts. The time period related to these counts includes time before 2007 but is primarily in May and June 2007.

17. The second relates to a guarantee Mytting made to a client and a claim he made in that client's account in August 2007. This client was not one of the five clients noted in the preceding paragraph.

Suitability of Leveraged Loans

18. The following people (the Clients) were clients of Mytting at Berkshire:

    - GM & AM
    - DF
    - IW & LW
    - MA & NS
    - CR & DM

19. The Clients applied for investment loans through AGF Trust Company and B2B Trust, which loaned money on the condition that it was invested in mutual funds which secured the loan.

20. Some of the Clients applied for more than one loan so that total amounts of loans increased over time as follows:

Client	Loan Amounts and Dates	Total Loans
GM & AM	\$300,000 from AGF in April 2006; \$100,000 from AGF in October 2006; \$200,000 from AGF in February 2007; \$150,000 from AGF in June 2007.	\$750,000
DF	\$102,000 from AGF in June 2007 which consolidated an existing investment loan of \$32,000.	\$102,000
IW & LW	\$100,000 from AGF in May 2007.	\$100,000
MA & NS	\$100,000 from AGF in November 2005; \$147,000 from AGF in May 2006 which consolidated an existing \$117,000 loan from CIBC; \$316,000 from AGF in June 2006 which consolidated an existing investment loan; \$300,000 from B2B Trust in August 2006.	\$863,000
CR & DM	\$50,000 from B2B Trust in October 2006; \$30,000 from AGF in October 2006; \$20,000 from AGF in June 2007.	\$100,000

21. All of the monies borrowed from AGF Trust Company and B2B Trust were deposited in their Berkshire client accounts and used to purchase equity based mutual funds on a deferred sales charge (DSC) basis.

22. Each client loan was charged a variable rate of interest which was either .5% or .75% greater than AGF Trust's prime rate. If AGF Trust's prime rate increased the rate of interest would increase. If AGF Trust's

prime rate decreased the rate paid by the client would decrease. At the time of their latest loan each client was paying interest at a rate of 6.5%.

23. The Respondent's supervisors were generally aware that Mytting commonly recommended leveraged loans to his clients.

24. Each Berkshire account that contained leveraged funds was identified to supervisors with the code "LEV".

25. When AGF Trust forwarded the loaned money to the Respondent for deposit the transaction was identified on the daily transaction blotter as "AGF Trust Loan Deposit."

26. The Respondent, however, did not have electronic systems to monitor the extent of leveraged loans used by its clients in each account. The Respondent's supervisory personnel did not sufficiently review the Clients' accounts to determine whether the extent of the leveraged loans used by the Clients was suitable for each Client.

27. The amount of money each of the Clients borrowed to invest was not suitable for the Clients because the loan was higher than it should have been based on their age, income, net worth, and risk tolerance as recorded on the NCAF for each client.

    a) In the case GM & AM:

        (i) their $750,000 investment loan was 114% of their $660,000 net assets as indicated on their June 2007 NCAF;

        (ii) their $750,000 investment loan was 3,750% of their $20,000 liquid net assets as indicated on their June 2007 NCAF; and

        (iii) their combined annual income on their June 2007 NCAF was $99,000.

    b) In the case of DF:

        (i) her June 2007 NCAF indicated that she was 62 years old and not married;

        (ii) her $102,000 investment loan was 54% of her $190,000 net assets as indicated on her June 2007 NCAF;

        (iii) her $102,000 investment loan was 227% of her $45,000 liquid net assets as indicated on her June 2007 NCAF;

    c) In the case of IW & LW:

        (i) their June 2007 NCAF indicated that IW was 57 years old and LW was 55 years old and that their combined annual income was $82,000;

        (ii) their $100,000 investment loan was 29% of their $340,000 net assets as indicated on their June 2007 NCAF;

        (iii) their $100,000 investment loan was 500% of their $20,000 liquid net assets as indicated on her June 2007 NCAF;

    d) In the case of MA & NS:

        (i) their 2005 NCAF indicated that NS was 71 years old and MA was 62 years old when the loans were advanced and that their combined annual income was $62,000.

        (ii) their $863,000 investment loan was 63% of their $1,358,000 net assets as indicated on their 2005 NCAF;

        (iii) their $863,000 investment loan was 81% of their $1,060,000 liquid net assets as indicated on their 2005 NCAF;

    e) In the case of CR & DM:

(i) their October 2006 NCAF indicated that their combined annual income was $73,000;

(ii) their $100,000 investment loan was 56% of their $180,000 net assets as indicated on their October 2006 NCAF;

(iii) their $100,000 investment loan was 152% of their $66,000 liquid net assets as indicated on their October 2006 NCAF;

28. After the Relevant Period, in October 2008 the Respondent amended its Sales Compliance Manual ("SCM") to include guidelines for identifying suitability concerns related to leveraged accounts. The SCM identified the following criteria as "red flags" indicative of leverage being an unsuitable strategy:

- Age: if the client's age is 60 or over.
- Net Worth: if the amount borrowed exceeds 30% of the client's net worth and 50% of the client's liquid net worth.
- Income: if the client has a relatively low income compared to the loan amount. Generally speaking, the debt payments should not exceed 35% of the client's gross income not including income generated from the leverage investments.

29. The SCM indicated that where two or more of these "red flags" were present, the leverage strategy would most likely be deemed unsuitable.

30. The SCM indicated that with respect to servicing the debt, clients should not be relying upon the growth of the securities in the account to make payments on the leverage loan.

31. The SCM indicated that identification of these "red flags" should prompt further review and analysis. This review may include obtaining detailed information on client cash flows, monthly expenses and other debt or lending obligations.

32. After the Relevant Period, the Clients complained to the Respondent. Each of the Clients' complaints were investigated by the Respondent and the Clients were compensated.

The personal guarantee

33. Another client of Mytting's at Berkshire was KFL, which opened an account (the "KFL Account") with Mytting at Berkshire in February 2007. The New Account Application Form (NAAF) for the KFL Account indicated the following:

- Investment Objectives: 100% Long Term
- Risk Tolerance: 100% Medium
- Time Horizon: 10 years or more

34. In February 2007, $1,000,000 was deposited into the KFL Account and used to purchase $1,000,000 worth of equity based mutual funds.

35. On August 16, 2007, Mytting raised the issue of him (Mytting) personally guaranteeing against the losses in the KFL account with the Respondent's Branch Manager (the "BM"). The BM discussed this issue with the Respondent's Regional Compliance Manager ("Regional Compliance") and then on August 21, 2007, advised Mytting by email that:

> …an advisor may not make any commitment to a client in respect of making up any market losses without having involved head office compliance and advising them of their intention and the circumstances leading up to this decision.

36. More effective supervision of the KFL account could have been achieved if the BM had, at the time Mytting raised the issue with him, made in depth and detailed inquiries of Mytting to determine why he would be considering making up losses in the KFL account. The fact that Mytting was considering

making up losses in the KFL account should have alerted the BM that Mytting had possibly made poor or unsuitable recommendations in the account which caused the client unexpected losses.

37. On September 4, 2007 the BM found a Berkshire Client Information Change Form (the "Change Form") related to the KFL Account had been left on his desk.

38. The Change Form, under the heading "Notes" indicated:

> SMCC Management Inc. and/or Sy Mytting guarantee this account against loss as at Dec. 15/07. Value over $1,000,000 pd. to SMCC/Mytting .

39. SMCC Management Inc. is 100% owned by Mytting.

40. The Client Change Form was not dated.

41. Over the next three months the Respondent conducted an investigation into Mytting's offer of a personal guarantee to KFL. That investigation included an audio recorded interview of Mytting which was conducted on October 22, 2007 and led to the termination of his registration with Berkshire on December 18, 2007.

42. However, it was not until December 3, 2007, that the Respondent contacted the client to discuss details of the guarantee Mytting had given KFL. During that three month period the value of the KFL account declined an additional approximately $50,000.

43. More effective supervision of the KFL account could have been achieved if the Respondent had immediately contacted the client. The Respondent could have then dealt with the client's concern before its account was exposed to any further potential losses.

44. The Respondent compensated KFL for the losses in the KFL account in December, 2007.

IV. TERMS OF SETTLEMENT

45. 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.

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

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

48. 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.

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

50. 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.

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

52. 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.

53. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

54. 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.

AGREED TO by the Respondent at the City of Burlington in the Province of Ontario, this 27th day of September, 2011.

"Julie Clarke"	**"Berkshire Securities Inc. per: Rick Annaert"**
Witness	**Respondent**

AGREED TO by Staff at the City of Vancouver in the Province of British Columbia, this 28th day of September, 2011.

"Barbara Lohmann"	**"Paul Smith"**
Witness	**Paul Smith** Senior Enforcement Counsel on behalf of Staff of the Investment Industry Regulatory Organization of Canada

ACCEPTED at the City of Vancouver in the Province of British Columbia, this 30th day of September, 2011 by the following Hearing Panel:

Per: "Leon Getz"

Leon Getz, Q.C., Panel Chair

Per: "Chris Lay"

Chris Lay, Panel Member

Per: "Bob Sutherland"

Bob Sutherland, Panel Member