Re McErlean

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

Shaun Gerard McErlean

2011 IIROC 59

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

Heard: May 2, 3, 4 and September 28 and 29, 2011
Decision: October 31, 2011
(47 paras.)

Hearing Panel:
Hon. Patrick T. Galligan, Q.C. (Chair), David Lang, Stuart Livingston
Appearances:
Milton Chan and Natalija Popovic, IIROC Enforcement Counsel
Shaun Gerard McErlean, the Respondent appearing personally without counsel

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DECISION AND REASONS

¶ 1 This Hearing Panel was convened to hear three charges against the Respondent, Shaun Gerard McErlean. The charges are set out in the Notice of Hearing dated December 8, 2010. The charges read as follows:

1. From January 2008 to January 2009 the Respondent engaged in business conduct that is unbecoming or detrimental to the public interest, contrary to IIROC Dealer Member Rule 29.1 and its predecessor IDA by-law 29.1 in that he:
   (i) provided falsified account documents to two clients; and
   (ii) misrepresented investment information to two clients about their accounts.
2. From July 2005 to January 2009 the Respondent made discretionary trades in the account of his client MR without first having the client's written authorization or having the account approved as discretionary by his firm, contrary to IIROC Dealer Member Rule 1300.4 and its predecessor IDA Regulation 1300.4.
3. Between December 2008 and January 2009, the Respondent personally compensated two of his clients for losses in their accounts without the knowledge or approval of his Member firm, contrary to IIROC Dealer Member Rule 29.1.

¶ 2 The Respondent became employed by CIBC in October 2002. In October 2004 he was registered as an investment representative. Between January 2005 and January 2009, he was employed by CIBC Wood Gundy and, later, by CIBC World Markets as a registered representative (retail).

¶ 3 After hearing the evidence provided by IIROC's Staff, on May 3, 2011, it became apparent to us that there would likely be a serious credibility issue in respect to Count #2. At the request of the Respondent, we made an extensive disclosure Order. The essential part of the Order reads as follows:

> (1) IIROC Staff shall obtain the following information from CIBC World Markets Inc. and shall disclose the same to the Respondent by no later than June 30, 2011
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> a) the Respondent's trade log for all transactions pertaining to client MR for the period between July 2005 and January 2009;
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> b) the Respondent's telephone log for the period between July 2005 and January 2009;
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> c) the physical client file of client MR;
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> d) all notes and documents stored on the Respondent's work desktop hard drive, network folders, and remote access folder, including Maximizer, pertaining to client MR;
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> e) all emails between the Respondent and client MR, all emails between the Respondent's assistants and client MR, and all emails between the Respondent and his assistant pertaining to client MR from the period between July 2005 and January 2009; and
>
> f) all web-forms and other submissions by the Respondent to CIBC World Markets Inc' TOPS department from the period between November 2008 and January 2009;

¶ 4 The efforts of Staff to comply with that Order and the results obtained by them are set out in the affidavits of Steve Bujan and Katie Trotman, which were filed as Exhibits #4 and #5 respectively. When we discuss the charge contained in Count #2, we will again refer to the disclosure issue.

COUNT #1

¶ 5 For ease of reference we again set out that count:

> 1. From January 2008 to January 2009 the Respondent engaged in business conduct that is unbecoming or detrimental to the public interest, contrary to IIROC Dealer Member Rule 29.1 and its predecessor IDA by-law 29.1 in that he:
>
> (i) provided falsified account documents to two clients; and
>
> (ii) misrepresented investment information to two clients about their accounts.

¶ 6 That count makes two separate allegations in respect to two specific clients. The two clients are MK and MR. The clients are not connected with one another in any way. It is convenient, therefore, to consider the allegations respecting each client separately.

Client MK

¶ 7 MK was a sophisticated client who had extensive trading experience and watched his account very carefully. He opened his account with the Respondent in the summer of 2007.

¶ 8 Providing falsified documents – On November 12, 2008 the Respondent purchased 100 shares of Quadra Mining for the account of MK. The shares remained in MK's account until January of 2009. Nevertheless, on December 19, 2008, the Respondent provided his client with a Portfolio Evaluation which did not report the Quadra holding. The evaluation was false because it did not contain that holding.

¶ 9 The Respondent testified that he purchased the Quadra shares for another client but in error the purchase

was credited to MK's account. The Respondent said that by mistake he failed to make the appropriate correction. In December MK asked for the evaluation. The Respondent gave him what he calls a "hypothetical" document to show MK what his account would have been if the correction had been made. During November and December 2008, the Respondent had cut off MK's online access to his account. MK first learned of the Quadra purchase in January 2009.

¶ 10 We are unable to accept that MK had asked for or accepted a hypothetical statement. It is clear, from part of an answer given in cross-examination, that MK (May 3, 2011, page 88):

> … was most frustrated because I had no confidence that the information that was provided to me was accurate or that the trades that should have been executed were.

¶ 11 In the light of his lack of confidence in the information he was getting, it is highly unlikely that MK would have agreed to accept a hypothetical statement. We are unable to accept the Respondent's explanation and are satisfied that he did provide a falsified account document to his client MK.

¶ 12 Misrepresented investment information – Paragraph 16 of the Notice of Hearing sets out the particulars of this charge which are alleged against the Respondent.

> 16. Between September and November 2008, the Respondent did not execute certain trades in MK's account according to the MK's instructions. The Respondent sent MK various e-mails misrepresenting the fact that the trades had been completed. When MK complained that his account statements did not reflect the transactions, the Respondent advised him that the discrepancy was due to technical problems at CIBC WM.

¶ 13 In his written Response, delivered before the hearing, the Respondent replied to those particulars.

> Response: Half true, half not true. There were multiple trades that were not executed in MK's account and many were due to the fact that I did not have an assistant who could execute trades. Why wouldn't I if I was in a place to do it? This was an argument that I had with CIBC Wood Gundy on a regular basis. MK also regularly wanted to give instructions through email and I would take those orders. There was a 'technical issue' with the selling of one mutual fund in MK's account. There will be a detailed history about it. I experienced a family tragedy in December of 2008 and MK grew increasingly tired of waiting but I did not have the support system to back me up. I defended CIBC Wood Gundy through it all but not anymore. MK was a problem client who was removed from CIBC Imperial Service due to being a constant pain and I requested that he be sent to the investment centre in the latter half of 2008. This was never followed through on by CIBC and I incurred some losses after the fact.

¶ 14 There was much testimony from MK, and a number of emails, dealing with conversations and communications between him and the Respondent about trade instructions. In some of the exchanges it is not at all clear whether specific instructions were given to make a trade or whether they amounted to raising a question of whether a particular trade should or should not be made. It is not necessary to examine those exchanges, in any detail, because there is one incident which is very clear.

¶ 15 In September and October 2008, MK held units of Templeton Growth and Chou in his account. In late September he instructed the Respondent to sell them. The Respondent did not execute the trades. On October 6, 2008, MK sent an email to the Respondent which said:

> Please tell me you sold Templeton Growth and Chou last week as instructed.

¶ 16 On October 8, 2008, the Respondent replied in an email:

> Everything was executed as instructed.

¶ 17 When the Respondent said that he had executed trades, when he had not, he misrepresented investment information to his client. The Respondent's broad and unsubstantiated blaming of others for his giving of false information to his client cannot amount to a defence. He was the person who was specifically asked to provide

the information and he was the one who, without qualification, gave it.

¶ 18 We are satisfied, on the appropriate burden of proof, that the Respondent provided a false account document and misrepresented investment information to his client MK.

Client MR

¶ 19 MR is a fitness coordinator. She became a client of the Respondent because she was a friend of his girlfriend with whom she worked at a previous employment. We find as a fact that MR was an unsophisticated, conservative investor who "can't handle a lot of risk". Initially, MR was investing to save money for her retirement. She then decided to purchase a condominium and wanted to be able to draw down money from the account to pay for it. She knew that she needed to have a secure and relatively certain amount of money when she would be required to close the purchase transaction.

¶ 20 MR became a client of the Respondent in July of 2005. At that time she had approximately $40,000 at RBC invested in very secure securities. Those securities were transferred into the account which she opened with the Respondent. Her opening statement with CIBC Wood Gundy shows that, on July 29, 2005, the total value of her investments was $39,921.64.

¶ 21 Providing falsified documents – By December 2008 the value of the investments in her account was approximately $6,200. In August of 2008 she had moved into her condominium under an interim occupancy agreement. Closing had been set for December 23, 2008. Upon closing she would be required to have her mortgage financing in place and she would need approximately $20,000 to pay the balance due on closing.

¶ 22 MR had considered getting her mortgage from a number of different lenders. By December 10, 2008 she had pretty well settled on taking a mortgage with RBC. On that date she sent an email to the Respondent which indicated that its subject was "Investment Confirmation" and contained this message:

> I need a copy of my investment ASP. I'm considering going to RBC for mortgage and have to send the info to them by tomorrow.

¶ 23 She received no reply. On December 12, 2008, she sent the Respondent an email marked "Statement URGENT" containing this message:

> Can you please send me the investment statement by 2 pm this afternoon. I have to sent [sic] it to RBC Monday, they have approved my mortgage pending the statement.

¶ 24 That afternoon the Respondent sent to her the statement found at pages 61 and 62 of Exhibit #1. That statement showed that her account contained a portfolio with a total market value on that day of $39,212. The statement was false. The investments in her account had a value of approximately $6,200.

¶ 25 In his Response, the Respondent admitted that "an incorrect document" was emailed to MR. His explanation is difficult to comprehend and impossible to accept. The document was created by adding to MR's securities some securities in a portfolio belonging to another, but unrelated, client of the Respondent. We heard the testimony of Steve Bujan, a senior compliance officer at CIBC. Based upon his testimony, we are satisfied that it is virtually impossible to create such a document accidentally or inadvertently. Even if by some mysterious computer malfunction the document had been inadvertently created, with his knowledge of MR's account and personal circumstances, the Respondent could not have failed to know that it was not correct when he sent it out to her.

¶ 26 Misrepresented investment information – MR became concerned, in February 2008, about the decline in the value of her investments. She testified that she spoke to the Respondent about it and that he told her that she had $12,000 in a cash protected account which would not show up on her statement. The Respondent denied telling her that she had an investment of $12,000 in a cash protected account which would not show up on her statement.

¶ 27 It is not necessary to resolve this conflict in their testimony. There can be no doubt that MR thought that the Respondent had invested $12,000 for her in a cash protected account. Her understanding is confirmed in emails which she sent to him on July 10, 2008 and on December 4, 2008. During his cross-examination at the

hearing, the Respondent admitted that MR was under a misapprehension that she had $12,000 which was not shown in her statements. He knew that she thought that she had that investment but he did not correct her.

¶ 28 A financial adviser is under a duty to be completely frank and truthful with a client. We can see no difference between a financial adviser telling a client that she has $12,000 when she does not, and failing to correct her of a misapprehension under which he knows she was suffering. By his silence, in the circumstances of this case, he misrepresented investment information to his client.

¶ 29 We are satisfied, on the appropriate burden of proof, that the Respondent provided a false account document and misrepresented investment information to his client MR.

¶ 30 IIROC Dealer Member Rule 29.1 and its predecessor IDA By-law 29.1 provide:

> 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.

¶ 31 It is our opinion that the provision of falsified account documents and the misrepresentation of account information to two clients constitute conduct which is in breach of the high standards of ethics required of a registered representative. Moreover, it is conduct detrimental to the public interest in having open and transparent conduct by persons employed in the financial industry.

¶ 32 We find that the allegations contained in Count #1 are established.

COUNT #2

¶ 33 This count reads as follows:

> 2. From July 2005 to January 2009 the Respondent made discretionary trades in the account of his client MR without first having the client's written authorization or having the account approved as discretionary by his firm, contrary to IIROC Dealer Member Rule 1300.4 and its predecessor IDA Regulation 1300.4.

¶ 34 The dispute about this allegation can be briefly stated. MR testified that after opening her account with the Respondent, and putting her securities in his control, she was not consulted about any individual trades. Her contention is that she left everything to his discretion. Over the years trades were made in her account but, according to her, she was not consulted about any of them. The Respondent admitted that MR's account was not a managed account and that she did not execute a discretionary trading agreement. However, he testified that MR's evidence was not true. He said that he consulted her before every trade was entered. The conflict in their evidence could hardly be more stark.

¶ 35 Before addressing that conflict, we refer again to the Order which we made on May 3, 2011. The Order was made as a result of our becoming aware that there would be that conflict in the evidence. The Respondent had argued that in the material, which he sought to have produced to him, there would be found corroboration for his position that he communicated with his client before every trade. He made particular reference to the hard drive of his computer where, he said, he noted every call he made to her.

¶ 36 Staff and CIBC made exceptional efforts to comply with the Order. Those efforts and the results are described in Exhibits #4 and #5. A great deal of material was obtained and produced to the Respondent. However, diligent search and inquiries have failed to locate the hard drive. The Respondent does not, through no fault of his own, have that hard drive or access to it.

¶ 37 The productions made pursuant to the Order have not been put in evidence before us. We understand the production was voluminous. If among it all there was something which would tend to corroborate the Respondent's evidence, it is reasonable to assume that he would have presented it to us. The fact that he has not

done so leads us to infer that nothing was found in all of that material which would tend to support his testimony. It is impossible for us to know whether, if located, the hard drive would or would not have supported his testimony.

¶ 38 After careful consideration we have reached the conclusion that, where conflicts exist between the testimony of MR and that of the Respondent, we should accept that of MR. We have considered a number of factors in arriving at that conclusion:

1. MR has no interest in the outcome of this case. Any claim which she could have had for losses has long since been settled by CIBC. The Respondent has a very obvious interest in the outcome. While a witness' interest in the outcome may not be conclusive, it is something which a tribunal of fact can take into account when weighing his credibility as against that of a disinterested witness.

2. Our findings on Count #1, that the Respondent provided false documents and gave misleading investment information, have led us to worry about what reliance we could safely put on what he told us about his dealings with MR. We saw nothing in her testimony which would raise similar concerns about the reliability of what she told us.

3. MR's testimony has a ring of probability about it. It is the sort of thing that an unsophisticated investor would do – let a trusted adviser manage her affairs without question.

4. In June and August 2007, there was a dramatic change in the investment pattern in MR's account. In those months a $30,000 investment in Manulife Bank Investment Savings Account was liquidated and the proceeds were used to purchase what seem to us to be quite speculative stocks. (It was the virtual collapse of some of those stocks, in 2008, which almost wiped out her account.)

Even though she is unsophisticated, we think that it is probable that if she had been consulted about moving from a safe investment to a speculative one it is something that she would have remembered. The fact that she does not remember such a dramatic shift in investment policy, from conservative to speculative, suggests to us that she probably was not consulted about it. Indeed, if she had been consulted, it is highly likely that she would have at least questioned if not objected to it.

5. It is documented and admitted that MR believed, until the end of 2008, that she had $12,000 in a cash protected account. That belief strongly suggests that she did not know that her entire Manulife investment had been sold. If the Respondent had consulted her about the liquidation of Manulife, there would have been no reason for MR to believe that she still had $12,000 in cash. That liquidation removed virtually all of the cash from her account and placed it in other securities which were less secure.

¶ 39 We have accepted MR's evidence and based upon it we find that the Respondent made discretionary trades of great significance in her account without authority.

¶ 40 Even if we had been unable to resolve the credibility issue we would, nevertheless, have been driven to find that the allegations in Count #2 had been established. In its decision, *Re Shamseer* [2011] IIROC No. 5, an IIROC hearing panel held, at paragraph 26, that where a registered representative effects a securities transaction without first obtaining from the client specifics of quantity, security, price and timing he/she is engaged in discretionary trading. The Respondent's evidence about his consultations with MR was so vague and general that we are unable to say that he fulfilled his obligation to show that he had obtained his client's authorization of the four elements of the transactions. While a registered representative cannot be expected to have a perfect memory of all trades he/she may have effected, where as here, there is a game change in a client's investment policy, it is not too much to expect that he will be able to say more than just "I consulted her" without some detail of when, where and in what circumstances.

¶ 41 The Respondent argued that the absence of his hard drive has compromised his ability to support the credibility of his testimony. As noted above, we have no way of knowing whether the hard drive would or would not have supported his testimony. Because of the factors set out above, when we accepted the testimony of MR, we are unable to rely upon the Respondent's assertion that the hard drive would have supported his

testimony.

¶ 42 We have concluded that the allegations of discretionary trading as set out in Count #2 have been established.

COUNT #3

¶ 43 This count reads as follows:

> 3. Between December 2008 and January 2009, the Respondent personally compensated two of his clients for losses in their accounts without the knowledge or approval of his Member firm, contrary to IIROC Dealer Member Rule 29.1.

¶ 44 The particulars upon which IIROC relies in support of the allegations in this count read as follows:

> On January 15, 2009 the Respondent arranged to have $7,000 transferred from his cousin's account into MK's account. The Respondent did so without CIBC WM's knowledge or approval.

¶ 45 In his response, the Respondent acknowledged that those particulars were true. In his testimony at the hearing the Respondent stated that on December 22 or 23, 2008, he paid $10,000 into the account of his client MR. He acknowledged that those payments were made without the knowledge or approval of his employer. He did advise his employer about the payments after they were made and after he had resigned from his employment.

¶ 46 Based on the Respondent's admissions, we find that the allegations contained in Count #3 are established.

¶ 47 In view of our determination that the allegations contained in the three counts have been established, it is necessary to convene a hearing for the purpose of determining penalty. Therefore, the National Hearing Coordinator will arrange for the convening of such a hearing.

Dated at Toronto, this 31st day of October 2011.

Hon. Patrick T. Galligan, Chair

David Lang

Stuart Livingston