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 60

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

Hearing: September 16, 2011
Decision: November 16, 2011
(46 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 - PENALTY

INTRODUCTION

¶ 1 In its Decision and Reasons issued on June 8, 2011, this Panel found that all four allegations contained in a Notice of Hearing issued by IIROC on January 24, 2011 were proven to the required standard.

¶ 2 The Panel asked that IIROC counsel prepare calculations as to the losses incurred by SF and DW and provide this information to the Respondent prior to the penalty hearing. At the outset of the penalty hearing, IIROC counsel advised that this information had been delivered to the Respondent, that she had been given notice of the date for the penalty hearing, and that she had told IIROC that she would not attend or participate in the hearing.

¶ 3 IIROC counsel took the position that the appropriate disposition was a fine of $100,000.00, a ten year suspension or a permanent ban, disgorgement of profits of $6475.00, a requirement that before the Respondent is re-registered, she successfully rewrite the Conduct and Practices Handbook ("CPH") examination, that if she is re-registered, she is to be subject to strict supervision in the first year of re-entry to the securities industry, and the payment of costs of $22,717.41. IIROC counsel referred the Panel to the "Dealer Member Disciplinary Sanction Guidelines" (the "Guidelines") and to case authorities.

SUMMARY OF FINDINGS

¶ 4 This case concerns misconduct summarized as follows:

Count 1 – Unsuitable purchases

- Between January 2007 and August 2007 the Respondent purchased securities in the accounts of two clients, SF and DW, which were not suitable for them.
- At the relevant time, SF was an 82 year old retired longshoreman. By the middle of 2007, the Respondent was responsible for all of SF's assets of approximately $668,000. In 30 purchases on 17 different days, 70% of SF's holdings were placed by the Respondent in high risk speculative junior mining stocks and small cap income trusts. As a result of the unsuitable trades, SF's accounts lost in excess of $169,000.
- DW, SF's daughter, was 57 years old and divorced. At the time DW's account was opened, DW had a total net worth of $475,000.00 and an annual income of $20,000. DW deposited in total $138,000 with Canaccord in the care of the Respondent, which represented all of DW's assets other than the value of her home. In 13 purchases on 7 different days, 90% of these assets were invested by the Respondent in high risk speculative securities. DW's account lost in excess of 50% of its value.
- By reason of their age, limited net worth and lack of investment knowledge, SF and DW were particularly vulnerable clients, and the Respondent knew this. The securities were totally inconsistent with the clients' investment objectives and low tolerance for risk. Thus, these investments failed to meet the safeguards of the clients' NCAF, which in themselves did not prudently meet the clients' needs and circumstances. The Panel found that the Respondent knew at the time she made the purchases that the securities were unsuitable, and contrary to the best interests of these clients.

Count 2 – Unauthorized discretionary trades

- Thirteen purchases made in DW's account on 7 different days were unauthorized discretionary purchases. These were the purchases of unsuitable securities for DW in Count 1.
- The Respondent denied the allegation in Count 2 of IIROC's Notice of Hearing and in her Response to the Notice of Hearing dated January 27, 2011 (the "Response") wrote that the she has "never made a discretionary purchase in [her] career". The Panel rejected the Respondent's claim. We accepted DW's evidence that she only knew about trades "after-the-fact".

Count 3 – Tax returns

- The Panel found that the Respondent acted contrary to the IDA By-laws by preparing tax returns for SF (2006 and 2007) and DW (2007) and charging a fee for same, without prior approval from her firm and without any formal training or designation.

Count 4 – Sale to LK from the Respondent's personal account

- On July 13, 2007, the Respondent purchased shares in Redcliffe in the account of a client (LK) which were acquired directly from the Respondent's own personal sell order without advising the client of her interest in the transaction or taking reasonable steps to ensure the client obtained the shares for the best available price, contrary to the By-laws and UMIR 8.1.
- The Panel found that 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 Respondent's sell order was filled in subsequent days at lower prices.
- The Panel rejected the Respondent's defence as not credible. The Respondent's various explanations are not supported by the evidence.

SANCTION GUIDELINES

¶ 5 The Guidelines state that the main concerns in the determination of an appropriate penalty are the

protection of the investing public and IIROC's membership, protection of the integrity of the IIROC process, protection of the integrity of the securities markets and prevention of repetition of the conduct at issue. Sanctions are to be based on the particular misconduct, "with an aim at general deterrence".

¶ 6 The Panel also considered the Guidelines pertaining to the types of misconduct at issue and the following "key considerations when determining sanctions".

Harm to Clients, Employer and/or the Securities Market

¶ 7 The Respondent's conduct caused significant harm to her clients SF and DW. The Respondent purchased unsuitable securities which were totally inconsistent with the clients' investment objectives and tolerance for risk, exposing the clients' assets to substantial risk. The unauthorized discretionary trades facilitated the purchase of unsuitable securities.

¶ 8 These offences go to the core of the duties and functions of an investment advisor. A registrant's most basic duty is to make suitable recommendations in accordance with the client's objectives and risk factors and to properly obtain instructions before implementing trades.

¶ 9 The fourth count related to the sale of a security to a client on a single occasion, without declaring the Respondent's personal interest, on which the client did not receive a better price than the market. This is in breach of the duty owed by the registrant to the client to use the registrant's specialized knowledge for the client's benefit. The Respondent benefited by (a) a partial (first) fill of her sell order, (b) an earned commission, and (c) a modest capital gain.

¶ 10 The Respondent's breach of these fundamental duties diminishes confidence in the registrant, the firm and the securities industry.

¶ 11 The third offence, while on its own less serious than the others which are the subject of this hearing, demonstrates a lax pattern of conduct and disregard for the IIROC rules and regulations which govern the Respondent's activities.

Blameworthiness

¶ 12 A high degree of blameworthiness must be attached to the Respondent's conduct. The Respondent knew that the trades were unsuitable and contrary to the best interests of her clients SF and DW.

¶ 13 The Respondent failed to meet her obligations for the client/principal trade with LK.

Degree of Participation

¶ 14 The Respondent is solely responsible for her misconduct.

Extent to which the Respondent was Enriched by the Misconduct

¶ 15 The Respondent was enriched by commissions (Counts 1 and 2), by the payment of fees for the preparation of the tax returns (Count 3) and by an earned commission and receipt of a modest capital gain concerning the Redcliffe trade (Count 4).

Prior Disciplinary Record

¶ 16 The Respondent has no disciplinary record. She had been a registrant for ten years at the time the conduct occurred and had served as a qualified branch manager at a different firm for two years immediately before she joined Canaccord.

Acceptance of Responsibility

¶ 17 In her Response, the Respondent admitted that she prepared tax returns (Count 3), but denied the other allegations.

¶ 18 The Respondent, in her IIROC interview of July 14, 2009 (the "IIROC Interview"), conceded that in hindsight, the securities purchased were too risky for her clients as to Count 1; denied ever making a discretionary trade as to Count 2; claimed her member firm was aware that she prepared tax returns for some of

her clients as to Count 3; and claimed the client/principal trade was an inadvertent error as to Count 4. There was no other form of acknowledgement of her misconduct and absolutely no acceptance for responsibilities in the IIROC Interview and the Response.

Credit of Cooperation/Voluntary Rehabilitative Efforts

¶ 19 The Respondent receives no credit for cooperation. She submitted to the IIROC Interview as required. She has left the industry.

Reliance on the Expertise of Others

¶ 20 According to the IIROC Interview, for her security selection of investments for her clients, the Respondent (a) subscribed to a research service, (b) attended investor relations presentations, and (c) received her member firm's research and recommendations. However, the Respondent failed to ensure such investments were suitable for her clients given their investment objectives and low risk tolerance.

Planning and Organization

¶ 21 The Respondent's actions were a total disregard of the clients' financial well-being and the rules and regulations governing her activities. Her conduct was not an accident or negligence but willful disregard of her obligations as a registrant and member of the securities industry.

Multiple Incidents of Misconduct Over an Extended Period of Time

¶ 22 The misconduct relating to trading took place over a period of 8 months. During that time there were multiple purchases of unsuitable securities for SF (30 trades on 17 different days) and DW (13 trades on 7 different days), and for DW the same trades were also unauthorized discretionary trades, plus the client (LK)/principal trade in Redcliffe shares.

¶ 23 The tax returns were prepared in 2007 (SF-2006) and 2008 (SF-2007, DW-2007).

Vulnerability of the Victim

¶ 24 The principal victims, SF and DW, were unsophisticated investors. They were very trusting and completely reliant upon the Respondent's advice. Given the financial circumstances of each, they required conservative investment strategies and objectives consistent with low risk. In the result, and to the knowledge of the Respondent, they were particularly vulnerable. Such clients most need the skilled and careful advice of a professional Investment Advisor.

¶ 25 The vulnerability of SF and DW aggravates the penalty in this case.

¶ 26 No evidence is before the Panel regarding the circumstances of LK.

Failure to Cooperate with the Investigation

¶ 27 The Respondent submitted to the IIROC Interview as required. Otherwise the evidence on this point is neutral.

Significant Economic Loss to the Client and/or Firm

¶ 28 SF and DW suffered substantial losses, in excess of $169,000 for SF and $69,000 for DW. These amounts were especially significant as a percentage of their assets. They could ill afford the losses which they suffered as a consequence of the Respondent's conduct.

Summary - Concerns as to the Respondent's Misconduct

¶ 29 Unsuitable trades are the gravamen of the Respondent's misconduct in that the Respondent did not fulfill her fiduciary duty to her clients. She was aware of their circumstances, that they were unsophisticated investors, developed their investment objectives for them, and knew that they had a low risk tolerance. Although she did some research as to securities purchased, the Respondent failed to ensure that these investments were suitable for her clients, given their investment objectives and low risk tolerance. Whether the investments realized gains or losses (while being a contributing factor) is not the issue; the real problem is the

Respondent's security purchases for her clients exposed their investments to greater risk contrary to the safeguards in their conservative investment objectives, and their low risk tolerance.

¶ 30 In the IIROC Interview and her Response, the Respondent alludes to a lax member firm's supervisory environment, in which she chose to interpret "silence" as tacit approval or acquiescence of her conduct. In effect, if none of the Respondent's activities were questioned or challenged by her member firm, then "a green-light". This is unacceptable: as an Investment Advisor, the Respondent is on the front-line of the client relationship and is expected to conduct herself with trustworthiness and integrity, and act in an honest, fair, and efficient manner in all dealings with the public, her clients, and the securities industry as a whole.

¶ 31 The Respondent also indicated that she used research from a number of sources (a research firm, investor relations from listed companies, and research from her member firm) to identify potential securities for investing by her clients. In her Response, the Respondent asserted "How can a buy or strong buy rating from your own Firm's research department translate into an inappropriate recommendation?" Such logic is flawed. The Respondent appears to not recognize that she is still required to ensure that such securities are suitable for her clients based on their circumstances, investment objectives, and risk tolerance.

CASE AUTHORITIES

¶ 32 The case authorities referred to were as follows:

¶ 33 *Re Janiewicz* [2006] I.D.A.C.D. No. 3, *Re Balanko* [2007] I.D.A.C.D. No. 10 and *Re Wilson* [2011] IIROC No. 47 concerned unsuitable and unauthorized trades. In *Re Janiewicz* the panel noted the seriousness of the offence, but noted that only one client was affected and over a short time period. The exposure to loss and actual loss was lower than in the present case. The panel ordered a six month suspension, a fine of $50,000, disgorgement of $8300 and costs of $20,000.

¶ 34 In *Re Balanko,* there were two clients affected by the registrant's conduct. The panel ordered that Balanko could not reapply for registration for two years, must successfully write the CPH and CSC examinations before re-registration and thereafter be subject to supervision for one year. It also imposed a fine of $60,000, disgorgement of $2500 and costs of $25,000.

¶ 35 *Re Wilson*, a more recent decision, concerned unsuitable and unauthorized trades for one client, over a period of 3.5 years, which nearly depleted the assets of the client that he knew to be vulnerable. The misconduct was aggravated by leveraging the risk by the use of "margin" and failing to properly advise the client as to the potential impact of the client's monthly cash withdrawals. The panel ordered a 5 year suspension, a requirement that Wilson successfully rewrite the appropriate examinations before re-registration, disgorgement of $26,000 and costs of $10,000.

¶ 36 In *Re Leigh* [2010] IIROC No. 1, the key misconduct was primarily improperly borrowed monies from a set of clients, and improper use of monies in those clients' accounts to purportedly pay back the loans to them, plus, with another set of clients, unsuitable trades and unauthorized discretionary trading. The disposition was a ten year suspension, a $70,000 fine, $36,000 in costs and a requirement that he rewrite the CPH exam, and, if reinstated, be subject to supervision for 12 months. This case is more serious than that before us.

ORDER

¶ 37 The Guidelines list situations in which a suspension is appropriate, which include where there have been numerous serious transgressions or a pattern of misconduct. Both are present in this case.

¶ 38 Based upon the above, the Panel orders that the following sanctions be imposed upon the Respondent:

a. a fine of $290,000;
b. disgorgement of profits of $10,350;
c. an order that the Respondent may not seek registration for 3 years from the date of the decision as to sanctions;
d. a requirement for full payment of fine, disgorgement, & costs prior to re-registration;
e. the Respondent must successfully re-take and complete all appropriate courses successfully prior

to re-registration, which will include the Canadian Securities Course, the CPH and others, depending upon the class of registration sought and the courses required at the time of application;

f. in the event the Respondent is re-registered, she must thereafter be subject to strict supervision for first 2 years of re-entry to the securities industry; and
g. payment of costs of $15,000.

¶ 39 The Panel was troubled by the disconnect between the guidance provided in IIROC's Guidelines, which surely must convey the securities industry's expectations and the relative gravity of various forms of misconduct, and IIROC's recommended sanction of a 10 year suspension with conditions and the suggestion that the Panel consider setting a new precedent in this case by imposing a permanent ban from approval instead. The Panel is of the view that IIROC's recommendations were not consistent with the Guidelines.

¶ 40 The evidence before the Panel suggested more widespread problems in the Respondent's book of business, but such problems were not part of the allegations before the Panel and therefore have not been considered by this Panel in determining guilt or penalty.

¶ 41 The Panel considered carefully whether the circumstances justified a permanent ban. The misconduct is both serious and wide-ranging. However, we note that in no prior similar case was the registrant prohibited from seeking re-registration. We are of the view that the penalties and conditions upon re-registration that we have imposed are sufficient to protect the public and consistent with the case precedents.

Jean Whittow, Q.C. (Chair)

Brian R. Worth

Michael E. Johnson

ADDENDUM

¶ 42 I am in agreement with the majority of the Panel with respect to the sanctions to be imposed upon the Respondent. However, I wanted to separately express my additional concerns.

¶ 43 The Respondent's conduct was egregious. The securities purchased by the Respondent for SF and DW were, as the Panel has found, completely unsuitable. As well, I note there were virtually no suitable securities purchased by the Respondent. To take a client's limited funds, disregard their needs and ability to tolerate risk is a total disregard for the client's financial well-being.

¶ 44 The unsuitable purchases in this case were in part accomplished by unauthorized discretionary trading. It is a fundamental requirement, and known to every registrant, that trades be specifically authorized by the client, unless specialized licensing is in place. Unauthorized discretionary trading and its use in facilitating the purchase of unsuitable securities cannot be tolerated by the industry.

¶ 45 In all, the Respondent had good knowledge of SF and DW and their requirements and ignored them, repeatedly. She has shown disregard for the regulatory boundaries governing her registration. In my view the Respondent has demonstrated she is entirely unsuitable for the securities industry.

¶ 46 Were it not for the limits imposed by the precedents provided, I would have favoured a permanent bar on re-registration.

Brian R. Worth