Re Harding

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

Randal William Harding

2011 IIROC 65

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

Hearing: December 5, 2011
Decision: December 16, 2011
(45 paras.)

Hearing Panel:
Hon. Patrick T. Galligan (Chair), Brigitte J. Geisler, Peter A. Bailey
Appearances:
Andrew P. Werbowski, IIROC Enforcement Counsel
Randal William Harding did not appear

REASONS FOR DECISION

¶ 1 By Notice of Hearing dated September 9, 2011, Randal William Harding, (the Respondent) was accused of the following two contraventions:

> Count 1:
>
> From February 2004 to December 2007 the Respondent, while a Registered Representative failed to use due diligence to ensure that recommendations were suitable for his client NB, contrary to IDA Regulation 1300.1(q) (formerly IDA Regulation 1300.1(d); and
>
> Count 2:
>
> From February 2004 to December 2007 the Respondent, while a Registered Representative, made unauthorized transactions in the account of NB, and thereby engaged in conduct unbecoming contrary to IDA By-law 29.1

¶ 2 At a hearing on December 5, 2011 which the Respondent failed to attend, this Hearing Panel found that the foregoing contraventions were proven to the requisite degree of proof. We stated that our reasons for our decision would follow. After the conclusion of the hearing the members of the Hearing Panel met and decided upon the appropriate penalties. On December 8, 2011 the National Hearing Coordinator was advised of that decision and was told that reasons for the decision on penalty would follow.

¶ 3 These are the reasons for both decisions.

PROCEDURAL MATTERS

¶ 4 Before setting out those reasons a short outline of the history of the proceedings is in order. The Respondent was served with the Notice of Hearing and appeared before the Hearing Panel at the set date hearing on September 22, 2011. He advised that he was no longer in the investment industry and that he may not participate in the hearing. He, nevertheless, consented to the hearing being fixed to proceed on December 5 and 6, 2011, commencing at 10:00 a.m. on December 5, 2011. The Hearing Panel directed that IIROC make full disclosure of documents generated during its investigation. That disclosure was made shortly after September 22, 2011.

¶ 5 At the opening of the hearing, on December 5, 2011, the Respondent did not appear. The Hearing Panel waited for a half hour in case his failure to appear was due to misadventure. When he had not appeared, nor sent any message explaining his absence, the Hearing Panel directed that the hearing proceed in his absence.

¶ 6 Enforcement counsel called two witnesses. The first witness was the investigator, Michael Arthur. The other witness was the complainant, NB. Upon the completion of their testimony enforcement counsel made submissions respecting the evidence and the charges which the Respondent was facing. The Hearing Panel ruled that the charges had been proven to the requisite degree of proof. It stated that reasons for the decision would follow.

¶ 7 The Hearing Panel then heard submissions from enforcement counsel in respect to penalty and costs. At the conclusion of those submissions the Hearing Panel reserved its decision and terminated the hearing. After the hearing the members of the Hearing Panel met and made their decision respecting penalty and costs. As noted, that decision was communicated to the National Hearing Coordinator on December 8, 2011. She was advised that reasons for the decision would follow.

THE CHARGES

¶ 8 Before turning to the charges against the Respondent it is appropriate to make certain observations about him and about the two persons who testified before us.

¶ 9 The Respondent first became a registrant in 1989. He was employed by Dominic and Dominic from January 2001 to January 2004. It was during that time when he became acquainted with NB and when she became his client. He moved to Octagon Capital Corporation ("Octagon") in February 2004. He took NB and her portfolio with him. He left Octagon in January 2008 and is no longer registered in the securities industry. The Respondent was in charge of NB's portfolio from February 2004 until the end of 2007. That is the timeframe of the charges against him.

¶ 10 The issues between the Respondent and NB are matters particularly within his knowledge. He has chosen not to testify about them. There is a principle of the law of evidence that where a matter in dispute is within the knowledge of a party, and that party declines to testify about it, a tribunal is entitled to infer that the reason he did not testify is because his testimony would not have been helpful to his case. We think it is appropriate to draw that inference in this case.

¶ 11 Michael Arthur is a very senior and experienced investigator who has been with IDA/IIROC for many years. He gave his evidence in a professional and competent manner. We accord full credence to his testimony.

¶ 12 NB is a 70-year-old widow. She went to high school but did not finish. She did waitressing and clerical work until her marriage when she was 27. After her marriage she did not work out of her home. She and her husband had one daughter. NB's husband had a truck and a backhoe which he operated as his own business. Evidently he was a hard worker and careful with his money because when he died, in 1997, their home was mortgage-free and he had accumulated savings of over $300,000.

¶ 13 NB testified that her husband looked after all financial matters. Everything was in his hands. She understood that he put their money in Ontario and Canada Savings Bonds and in some mutual funds, the details of which she is unaware, except that she knew them to be not risky. Her husband died suddenly, leaving her to

try to deal with financial issues which she had difficulty understanding.

¶ 14 She testified that since her husband's death she has had an income of approximately $20,000 per annum. That is made up of survivor benefits from her husband's Canada Pension and Old Age Security together with some income from her securities. She had a $200 per month pension from her husband's service in the Dutch Navy, but that ended when she turned 65.

¶ 15 NB's testimony was uncertain about some details of her dealings with the Respondent, however, on the two crucial aspects of her relationship with the Respondent she was firm and clear. Both aspects will be specifically referred to when we deal with the charges. We have no reason not to accept her testimony about them. She was a credible witness. Having drawn the inference that the Respondent's silence means that his testimony would not have been able to help his case, we are confident that she told us the substantial truth. We accept her testimony.

¶ 16 We now turn to consider the two charges.

(a) Suitability of Recommendations

¶ 17 Count 1 of the Notice of Hearing reads as follows:

> From February 2004 to December 2007 the Respondent, while a Registered Representative failed to use due diligence to ensure that recommendations were suitable for his client NB, contrary to IDA Regulation 1300.1(q), (formerly IDA Regulation 1300.1(d)).

¶ 18 Regulation 1300.1(q) reads as follows:

> (q) Each Member, when recommending to a customer the purchase, sale, 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.

¶ 19 The essence of this charge is that the Respondent made investments on NB's behalf which were unsuitable for her. NB's testimony was that she was very unsophisticated about securities. She did not have "a clue" about common shares or equities. She knew nothing about margin accounts or short sales. She said that the Respondent never explained these things to her. Doubtless she wanted some income from her portfolio, but what was consistent throughout was that she would not accept any risk. She was determined that her money be kept safe and she relied upon the Respondent to keep it so.

¶ 20 During the time that the Respondent was with Dominic and Dominic he generated New Client Application Forms ("NCAF"). The NCAFs were not signed by NB. The NCAFs suggested that NB had agreed to a portfolio which included 20% high-risk securities. We accept her testimony that she did not agree to that risk. The NCAF also overstated her investment knowledge, her income and her financial assets.

¶ 21 When the Respondent moved to Octagon, in February 2004, he had NB sign seven documents. One of them was a new NCAF which has a section Investment Objectives and Risk Tolerance. It shows a securities allocation as follows:

> 0% - Lower-risk, income-producing securities
>
> 45% - Moderate to higher-risk, income-producing securities
>
> 30% - Moderate-risk, growth-oriented securities
>
> 25% - Higher-risk, speculative securities and trading strategies

¶ 22 NB admitted that she signed that document, along with all of the others, without reading them because she trusted the Respondent to invest her funds as she had directed him. Accepting her testimony that she did not want any risk, the risk allocation recommended in the NCAF would clearly be unsuitable for someone with low risk tolerance. It was certainly unsuitable for NB. Again, NB's investment knowledge, income and financial assets were overstated.

¶ 23 It is illuminating to read the description of lower risk income-producing securities, which is beside the risk allocation in the NCAF:

> - I agree to allocate the following (approximate) percentage of my assets held in my accounts with your firm to relatively low risk, income-producing securities which may include, but are not limited to, government Treasury Bills, Canada Savings Bonds, Money Market Mutual Funds, and other higher quality, income-producing securities, with little or no reliance on margin...

¶ 24 That describes almost exactly what NB told the Respondent she wanted done with her portfolio. It seems to us to be suitable for a risk adverse, unsophisticated elderly widow living on a modest fixed income. It is quite surprising that the Respondent did not recommend that any of her assets be allocated to that category of securities. The NCAF demonstrates that the Respondent's recommendations to NB were unsuitable for his client. It clearly establishes a breach of Regulation 1300.1(q).

¶ 25 In addition, the Hearing Panel heard evidence that NB's margin account had over 350 transactions in the four-year period, 27 short transactions in under four years, the shorting of a government bond, and excessive investments in highly speculative penny stocks, all of which resulted in a trading loss of over $150,000 during the time of a rising market. These transactions were clearly unsuitable for a client whose personal situation required conservative investments and who had specified low risk investments.

¶ 26 It should be noted that the trading which took place in NB's accounts was somewhat in line with the investment objectives which were stated on the NCAF. However, it is not an acceptable response to serious allegations of unsuitable trading to observe that the trading aligned with the investment objectives. If that were to be the case, it would become common practice to overstate investment objectives to ensure that trading (inappropriate by reference to the client's financial situation) would be considered to be "suitable". By doing so, the registered representative is attempting to transfer the responsibility of suitability to the client who has signed the NCAF which sets out the investment objectives. Regardless of that acknowledgement by the client, it is the responsibility of a registered representative to ensure that appropriate investment objectives are set out for the client. The decision of *Re Daubney*, OSC (2008)31 OSCB 4817; 2008 LNONOSC 338, clearly stated that the duty of care with respect to the recommendation of suitable investments is placed upon "the registrant who is better placed to understand the risks and benefits of any particular investment product. That duty cannot be transferred to the client. (at paragraph 210). A similar conclusion was reached in the *Re Lamoureux*, Alta. S.C. 2001 LNABASC 433; [2001] A.S.C.D. No. 613, decision which stated that "this responsibility cannot be substituted, avoided or transferred to the client, even by obtaining from the client an acknowledgement that they are aware of the negative material factors or risks associated with the particular investment".

¶ 27 We find that Count 1 is proven by clear and convincing evidence.

(b) Unauthorized Trading

¶ 28 Count 2 of the Notice of Hearing reads as follows:

> From February 2004 to December 2007 the Respondent, while a Registered Representative, made unauthorized transactions in the account of NB, and thereby engaged in conduct unbecoming contrary to IDA By-law 29.1.

¶ 29 By-law 29.1 reads as follows:

> 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.

¶ 30 IIROC panel jurisprudence makes it clear that unauthorized trading in a client's account amounts to a violation of By-law 29.1. We refer to the recent decision of the Hearing Panel in *Re Wilson* 2011 IIROC 47. At paragraph 21 the facts are outlined:

> 21 The NOH states that GM learned of trading in her account only after the fact, usually from reading the trade confirmations; she did not instruct the Respondent to buy or sell any securities and he rarely, if ever contacted GM prior to executing a purchase or sale of securities. GM relied solely and completely on the Respondent's judgment and knowledge and did not question the activities in her account. The Respondent completed the transactions in GM's account without her knowledge or consent.

¶ 31 The decision of the Hearing Panel appears at paragraph 25:

> 25 It is the decision of this Panel that it was the responsibility of the Respondent to get the consent of GM prior to making any purchases or sales in her account but he did not do so. Consequently he is breach of IDA By-law 29.1 and IIROC Rule 29.1 as alleged by IIROC.

¶ 32 NB testified that the Respondent never consulted her or advised her about any of the trades. Her evidence is remarkably similar to that of the client in *Re Wilson*. NB did receive trade confirmations, which she hardly understood. She did not question the Respondent about them because she trusted him completely.

¶ 33 Mr. Arthur's evidence establishes that there were hundreds of trades made by the Respondent in her account over the four-year period. Our acceptance of NB's testimony that she was not consulted about them and did not authorize them is sufficient to find that the Respondent violated By-law 29.1. However there is strong corroboration of her evidence about a significant number of those trades.

¶ 34 That corroboration is found in Exhibit 2, tab 17. It shows that, on seven specific occasions, NB was away from Toronto for periods of several days when any communication with her by the Respondent would have had to have taken place by long distance telephone calls. The periods were:

1. August 2 - 22, 2004
2. September 29 - October 15, 2005
3. January 26 - February 2, 2006
4. July 3 - 15, 2006
5. October 6 - 21, 2006
6. August 4 - 11, 2007
7. August 21 - 31, 2007

¶ 35 NB testified that the Respondent did not call her during any of those times. An examination of Octagon's telephone records shows that the Respondent did not make one long distance call to NB during any one of those seven periods when she was away from Toronto.

¶ 36 We will not set out all of the trades made by the Respondent in her account during those times. Exhibit 2, tab 17 records 27 of them. By way of example, during the first period, August 2 - 22, 2004, the Respondent made trades in the account on August 3, August 17 and two trades on August 20. It was impossible for him to have had authorization for the making of those trades.

¶ 37 The evidence to which we have just referred clearly supports and confirms NB's testimony that the Respondent traded in her account without her authorization. We accept and agree with the opinion expressed in *Re Wilson* that unauthorized trading in a client's account amounts to a violation of By-law 29.1

¶ 38 Accordingly we find that Count 2 has been proven by clear and convincing evidence.

PENALTY

¶ 39 Dealer Member Disciplinary Sanction Guidelines issued by IIROC are not binding upon a hearing panel

when it exercises its jurisdiction to impose a penalty. Nevertheless they are helpful by calling to mind the appropriate principles which should be applied in a particular case. We again refer to *Re Wilson* where the Hearing Panel, at paragraph 26, helpfully summarizes the import of those guidelines:

> 26 … This panel agrees with the statement in the guidelines that the main concerns when determining an appropriate penalty are protection of the investing public, the IIROC membership, the integrity of the IIROC process, the integrity of the securities markets and prevention of a repetition of conduct of the type under consideration. As stated in the Guidelines, sanctions should be based on the particular misconduct of the respondent with an aim of general deterrence which will be achieved if a sanction strikes an appropriate balance by addressing a registrant's specific misconduct, but also being in line with industry expectations.

¶ 40 We have looked at the penalties imposed in certain other decisions. While that is a helpful exercise, it must be remembered that even though cases may have similarities, no two cases are the same. We think that while it is useful to look at the penalties imposed in other cases, it is our duty to consider the factors appropriate to this case and decide what is an appropriate penalty for this Respondent. Penalties in other cases can help to establish a range of reasonable penalties in cases of this kind. The main factors which we have considered are the following.

Harm to Client

NB suffered serious financial harm. Her losses, in what should have been a low risk portfolio, were upwards of $150,000 during the period of a rising market.

Repetition

There were hundreds of trades in a portfolio which should have been relatively stable.

Deliberation

Against his client's strong wishes to the contrary, the Respondent put some of her assets into very risky investments.

Benefit to the Respondent

While some trading is to be expected even in a low risk account, the hundreds of trades which took place in this one lead us to be concerned whether he was motivated by a desire to earn commission. Over the period he earned $17,861 in commissions for transactions in NB's account.

The Victim

NB was unsophisticated, vulnerable and trusting. The loss of over $150,000 was a very significant one for her.

Disciplinary Record

The Respondent has no previous disciplinary record. That is a mitigating factor.

¶ 41 After considering those factors, and others in the guidelines, we have concluded that the most important purpose of the penalty in this case must be general deterrence. Members of the financial industry must realize that failure to make recommendations which are suitable to the particular client and unauthorized trading will be treated very seriously.

¶ 42 We did attempt to assess separate penalties for each of the violations. The reality is that the unauthorized trades were made in relation to the unsuitable recommendation. Thus we found that the two offences were so interrelated that it was impracticable to assign different penalties to each of them. Accordingly the penalties which we imposed subsume both of the charges which we have found to have been proved.

¶ 43 Accordingly, as we advised the National Hearing Officer on December 8, 2011 we impose the following penalties:

1. A fine of $125,000 covering both charges.
2. Disgorgement of commissions in the amount of $17,861.
3. A suspension of approval for a period of five years.

COSTS

¶ 44 We reviewed the affidavit of Ricki Ann Newmarch, sworn December 2, 2011. That affidavit sets out the bill of costs and how it was calculated. We find that the costs claimed by IIROC are fair and reasonable and we allow them in the amount of $25,000.

¶ 45 Accordingly Randal William Harding is ordered to pay to IIROC the sum of $25,000 on account of its costs.

Dated at Toronto this 16th day of December 2011.

P. T. Galligan, Chair

Brigitte J. Geisler

Peter A. Bailey