

Re Delcourt & Stewart

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

James Darren Delcourt and James Alexander Stewart

2011 IIROC 69

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

Hearing: December 6, 2011
Decision: December 22, 2011
(15 paras.)

Hearing Panel:

J.D. Brian Foster, Q.C., Peter McWilliams, Kelly D. Trout

Appearances:

Natalija Popovic, Senior Enforcement Counsel for the Investment Industry Regulatory Organization of Canada
The Respondents

DECISION

I. INTRODUCTION

¶ 1 This Hearing Panel (the "Panel") was constituted to conduct a Settlement Hearing pursuant to By-law 20, Section 20.36. The Settlement Hearing proceeded on December 6, 2011. At the Settlement Hearing the Panel was provided with a settlement agreement executed by the Respondents (the "Settlement Agreement").

¶ 2 At the conclusion of the Hearing and after hearing submissions by IIROC's counsel and the Respondents and after reviewing the terms of the Settlement Agreement, the Panel accepted the Settlement Agreement.

¶ 3 Below are the reasons for doing so.

II. THE SETTLEMENT AGREEMENT

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

- (a) a statement by the Respondents admitting the following contraventions of IIROC Rules, Guidelines, IDA By-laws, Regulations or Policies:

From or about March to June 2009, the Respondents, while Registered Representatives:

- (i) Engaged in business conduct or practice which is

unbecoming or detrimental to the public interest, in that they conducted their business consistent with registration as Portfolio Managers without being registered as such, contrary to Dealer Member Rule 29.1;

and

- (ii) Failed to use due diligence to ensure that the acceptance of orders was within the bounds of good business practice, contrary to Dealer Member Rule 1300.1 (o).

(b) a statement of the facts agreed to between Staff and the Respondents;

(c) the agreement of Staff and the Respondents to the following terms of settlement:

Staff and the Respondents agree to the following terms of settlement for each of Delcourt and for Stewart:

- o Global fine of \$30,000
- o Disgorgement of commissions of \$14,747.78
- o Re write the CPH
- o Close supervision for 3 months

The Respondents agree to pay costs to IIROC in the sum of \$3,000, each.

¶ 5 The authority granted pursuant to 20.36 of the By-laws allows the Panel to either accept the Settlement Agreement or reject the Settlement Agreement. When considering whether to accept or reject a Settlement Agreement, the Hearing Panel should not interfere lightly in a negotiated settlement. As stated in the decision in *Re: Milewski* [1999] I.D.A.C. No. 17:

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 The *Re: Milewski* decision has been applied in a number of cases, including *Re: Gaudet*, [2010] IIROC No. 29. Further, the Panel accepts the following statement found in *Re: Graydon Elliot Capital Corp.*, [2007] I.D.A.C.D. No. 43:

The Panel accepts that its role under the By-laws in reviewing a Settlement Agreement is not the same as its role considering a penalty following a hearing on the merits. As has been said in a number of cases, in considering a Settlement Agreement, the Panel should not simply substitute its discretion to that of Staff in negotiating the settlement. The Panel must be cognizant of the importance of the settlement process, and it should not interfere lightly in a negotiated settlement. We acknowledge that the settlement process is one of negotiation and compromise and the penalty imposed may be somewhat different than one imposed following a hearing where similar findings are made and the Panel determines the penalty.

¶ 7 The Panel is of the unanimous view that the public interest concerns of IIROC, and the sanction objectives of general and specific deterrent, will be achieved by the agreed penalties which the Panel finds are within a reasonable range of appropriateness.

III. ANALYSIS

¶ 8 The Panel has reviewed the facts agreed to in the Settlement Agreement, and has heard the submissions of IIROC counsel and of the Respondents. We were referred to the IIROC Dealers Member Disciplinary Sanctions Guidelines, General Principles and the specific sanction Guidelines 3.4 (Order not Within Bounds of Good Business Practice - Dealer Member Rule 1300.1(o)) and 3.6 (Discretionary Trading - Dealer Member Rule 1300.4 and 1300.5).

¶ 9 Counsel for IIROC addressed a number of the "Key Considerations When Determining Sanctions" found in the IIROC Sanction Guidelines:

3.1 Harm to Clients, Employer and/or the Securities Market

In this case the admitted client losses occurred in 37 accounts, held by 29 clients and were in the total amount of approximately \$505,000 including commission and foreign exchange costs. The initial investment committed to the "Wave Pool" transactions was \$2,990,000. The losses were approximately 15%, on average, of the investments (including costs) between March and June, 2009. The TSX Composite Index gained in excess of 39% over the same period. The Panel was advised that there was no issue with respect to suitability of the investments and that the losses did not flow from a lack of suitability.

3.2 Blameworthiness

The failure in this case was a failure to conduct independent due diligence by the Respondents and their reliance on another registrant. There was no manipulative, fraudulent or deceptive conduct.

3.4 Enrichment

The Respondents benefitted from commissions in the amount of \$14,747.78 and the Settlement Agreement provides that those commissions be disgorged.

3.5 Prior Disciplinary Record

There is no prior disciplinary history for either Respondent.

3.6 Acceptance of Responsibilities, Acknowledgment of Misconduct and Remorse

IIROC's counsel advised that by entering into the Settlement Agreement the Respondents accepted and recognized their responsibility.

3.7 Credit for Cooperation

The Respondents complied with all requests of IIROC, including production of records and attendance at interviews.

3.9 Reliance on the Expertise of Others

As is stated in the Sanction Guidelines, there may be times when an Approved Person's relative culpability may be tempered by his or her reliance on the expertise of others. In this case the Respondents relied on BC and his expertise in relation to the Wave Pool program. IIROC counsel referred the panel to the decision in *Re: Gareau*, [2005] I.D.A.C.D. No. 25 where the respondent in that case was accused of failing to carry out due diligence to learn the essential facts relative to orders accepted when he did not adequately inform himself as to the nature or details of a Bell Canada International Inc. 6.75% Convertible Subordinated Debenture ("BCI Deb"). The respondent in *Gareau* claimed reliance on comments made by Graham, a supervisor. Graham had advised Gareau that "it's Bell, so it should be fine." Gareau had not taken steps to adequately review the BCI Deb prospectus or the AIF. Nor did he have any knowledge of any financial information for BCI. The Hearing Panel in *Re: Gareau* concluded:

The question for us is whether or not Mr. Gareau took reasonable steps to ensure that the investment was a low risk investment as

requested by his clients. It is our conclusion that he failed to use due diligence to learn the essential facts relevant to the BCI Debenture. While in some circumstances reliance upon a person in the position of Mr. Graham might meet the requirements of due diligence notwithstanding that a registered representative has a responsibility to his clients to ensure a reasonable amount of independent due diligence, we find that the reliance upon Mr. Graham in this case did not absolve the Respondent of his responsibility. Our conclusion might be different had the Respondent not received indications that the BCI Debenture might not be the solid investment he perceived it to be....

¶ 10 At paragraph 22 of the *Re Gareau* decision, the panel addressed squarely the question of the primary responsibility of the Registered Representative ("RR"). The panel stated:

... To put it in question form, can an RR avoid the responsibility to carry out steps of due diligence, such as investigating the characteristics of an investment, by relying upon the advice of a superior or someone held out to be an expert by the Employer? This issue was discussed in some detail in a decision of the Pacific District Council of the IDA in a disciplinary action brought against Allan Bruce Alexander Thomson (Re: Thomson, dated August 3, 2004). In Thomson, the Respondent's position was that he did rely on his employer and third parties to ensure that all was in order. While the facts of the Thomson case were drastically different from the facts before us, the Panel in *the Thomson* case noted that Thomson's "defence questions the very role of the Registered Representative in the investment industry." At p. 8 of the decision the Panel stated:

We firmly believe that a Registered Representative is required to take responsible precautions to ensure that the security in which he or she is trading complies fully with all applicable securities laws. We firmly believe that a Registered Representative is required to take reasonable steps to ensure that the security he or she is selling has had a reasonable level of due diligence performed on it. And we firmly believe that a registered representative is required to take reasonable precautions to ensure that any transaction in which he or she is involved is transacted to the benefit of and best interests of his or her client.

What is reasonable in each instance will depend upon the fact situation.

The above quotes from *Re: Gareau* have application to this case. While reliance on BC may, as is stated in the Sanction Guidelines, have some tempering effect on culpability, the reliance on this case does not absolve the Respondents of their responsibilities.

¶ 11 On the facts, the Wave Pool clients of the Respondents agreed to invest a specific dollar amount to be used for trading using the Elliott Wave Theory (EWT), but were not consulted in any detail about the individual transactions that the Respondents completed.

¶ 12 The Respondents allege that BC provided to them, on at least a daily basis, lists of securities that he was recommending for purchases and sales, with corresponding target price points for each. The Respondents allege that they contacted their Wave Pool clients to discuss every list, and that the clients agreed to purchase any or all of the securities on the list if and when the securities hit the suggested purchase and/or sale price parameters. However, as is stated in paragraph 23 of the Settlement Agreement, there is no documentary or corroborating evidence to reflect that these lists were in fact generated, that the Respondents discussed every list

with their clients or that they obtained their clients' instructions in respect of the specific details of each of the orders. In paragraph 24 of the Settlement Agreement the Respondents admit that their clients "did not specifically authorize the specific details of each order; instead the Respondents exercised discretion in relation to the above noted specifics for the Wave Pool transactions and effected the trades on a discretionary basis as though they were Portfolio Managers."

¶ 13 A Portfolio Manager is a partner, director, officer or sales person of a member who has been designated and approved to manage managed accounts. There are proficiency and experience requirements for a person to be qualified as a Portfolio Manager. The Respondents were not Portfolio Managers. Further, the client accounts were not discretionary accounts.

IV. CONCLUSION

¶ 14 Having heard the submissions of IIROC counsel and of the Respondents, and having reviewed the decisions referred to in Appendix "A" to this Decision, and having reviewed the IIROC Sanction Guidelines, this Panel finds that the terms of the Settlement Agreement are consistent with the Guidelines. The penalties will address the public interest concerns that are to be considered when setting penalties. The penalties also provide a significant general deterrent and specific deterrent to the individual Respondents that address prevention of a repetition of the conduct of the type under consideration. The penalty provisions of the Settlement Agreement do not fall outside a reasonable range of appropriateness.

¶ 15 These are the reasons for our Decision of December 6, 2011 to accept the Settlement Agreement.

DATED at the City of Calgary, in the Province of Alberta, this 22nd day of December, 2011

Chair - D. Brian Foster, Q.C.

Industry Member - Mr. Peter McWilliams

Industry Member - Ms. Kelly D. Trout

APPENDIX "A" - List of Cases Referred to at the Hearing

- A. Bardsley [2010] IIROC, No. 15
- B. Osman [2007] I.D.A.C.D. No. 3
- C. Tobin [2006] I.D.A.C.D. No. 8
- D. Leung [2005] I.D.A.C.D. No. 45
- E. Gareau [2005] I.D.A.C.D. No. 25
- F. Gaudet [2010] IIROC No. 29
- G. Graydon [2007] I.D.A.C.D. No. 43

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondents, James Darren Delcourt and James Alexander Stewart 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 James Darren Delcourt (Delcourt) and James Alexander Stewart (Stewart).

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 Respondents consent to be subject to the jurisdiction of IIROC.
5. The Investigation discloses matters for which the Respondents 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 Respondents jointly recommend that the Hearing Panel accept this Settlement Agreement.
7. The Respondents admit to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

From or about March to June 2009, the Respondents, while Registered Representatives:

- (i) Engaged in business conduct or practice which is unbecoming or detrimental to the public interest, in that they conducted their business consistent with registration as Portfolio Managers without being registered as such, contrary to Dealer Member Rule 29.1;
and
 - (ii) Failed to use due diligence to ensure that the acceptance of orders was within the bounds of good business practice, contrary to Dealer Member Rule 1300.1(o).
8. Staff and the Respondents agree to the following terms of settlement for each of Delcourt and for Stewart:
 - o Global fine of \$30,000
 - o Disgorgement of commissions of \$14,747.78
 - o Re write the CPH
 - o Close supervision for 3 months
 9. The Respondents agree to pay costs to IIROC in the sum of \$3,000, each.

III. STATEMENT OF FACTS

(i) Acknowledgment

10. Staff and the Respondents 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

A. Overview

11. The Respondents, together with another registrant, formed an investment team known as the “Wave Pool” with the objective of investing for a group of their clients according to a technical analysis model. Certain of the Respondents’ existing clients agreed to make investments according to the Wave Pool. Never the less, they exercised discretion in placing the actual trades as the clients were not consulted before individual transactions were completed. Therefore, the Respondents conducted themselves as a Portfolio Managers without being duly registered as such.
12. Further, the Respondents relied upon the other registrant’s recommendations, and made investments for their clients on that basis without conducting their own due diligence in respect of the securities. When the commissions and foreign exchange costs were factored in, in many cases there was no clear economic benefit to the clients as a result of the transactions. Overall, the clients sustained significant losses in their Wave Pool accounts.

B. Registration History

13. Throughout the relevant time, March to June 2009, the Respondent Delcourt was a registrant at Mackie Research Capital Corporation [Mackie], where he continues to be registered. The Respondent has been a registrant since 1989, and at Mackie since 2002. The Respondent was not registered as a Portfolio Manager at any point during the relevant time.
14. Throughout the relevant time, March to June 2009, the Respondent Stewart was a registrant at Mackie Research Capital Corporation [Mackie], where he continues to be registered. The Respondent has been a registrant since 2004, and at Mackie throughout. The Respondent was not registered as a Portfolio Manager at any point during the relevant time.

C. The Wave Pool

15. In or about March 2009, the Respondents, together with another registrant, BC, formed an investment team called the Wave Pool and worked together under a single broker code dedicated to the Wave Pool. The team's objective was to invest for clients according to a technical analysis model known as the Elliott Wave Theory (EWT). All commissions for the Wave Pool code were split equally among the three team members.
16. The Respondents transferred several of their existing client accounts from their individual code to the new code; no new accounts were opened for the Wave Pool. None of the client accounts transferred were approved as discretionary or managed accounts either before or after they were under the Wave Pool code.
17. The client accounts that were transferred were standard full-service retail accounts. The only distinction was the application of the EWT to the investment strategy. Clients did not have to complete additional forms or written acknowledgements to participate in the Wave Pool and the accounts were treated in the same manner as any other retail account.
18. In total 37 accounts, held by 29 clients, participated in the Wave Pool. The total initial investment committed to the Wave Pool by these clients was approximately \$2,990,000.
19. BC did not transfer any of his own client accounts to the new code as his role was solely to provide technical analysis; and he had no client contact with the Respondents' Wave Pool clients. It was agreed among the three team members that BC's recommendations would be strictly followed. The Respondents' clients were advised that they could opt out of the Wave Pool at any time, but they could not opt out of the individual trades.

D. Respondents' Conduct in Relation to Wave Pool Clients

I. Respondents Acted as a Portfolio Managers and Exercised Discretion

20. The Wave Pool clients agreed to invest a specific dollar amount to be used for trading using the EWT, but they were not consulted in any detail about the individual transactions that the Respondents completed.
21. The Wave Pool trades were of Exchange Traded Funds [ETFs] and were executed in bulk as "average-price" trades in one of the firm's house account. Purchases of ETFs, or proceeds of sales, were later ticketed and disbursed to the Wave Pool clients' accounts on a pro-rata basis.
22. The Respondents allege in their evidence that the mechanism used for the Wave Pool trades was as follows:
 - The Respondents had taken technical analysis courses in the past.
 - BC provided the Respondents, on at least a daily basis, with lists of the securities that he was recommending for purchases and sales, and the corresponding target price points for each, based upon his technical analysis.
 - The Respondents contacted their Wave Pool clients to discuss every list.
 - The clients agreed to purchase any or all of the securities on the list if and when the securities hit

the suggested purchase and or sale price parameters.

- At the same time, the clients agreed that if the securities were purchased, they could be sold at the suggested exit points or at a 10% stop loss, whichever came first.
 - The clients would receive their pro-rata allocation of securities, or proceeds from the sale thereof, if the purchase price or exit price was hit, respectively.
23. However, there is no documentary or corroborating evidence to reflect that these lists were in fact generated, that the Respondents discussed every list with their clients or that they obtained the clients' instructions in respect of the specific details of each of the orders; namely the quantity, the specific ETF on any such list and the timing of the purchase and or sale of a given ETF.
24. The Respondents' clients did not specifically authorize the specific details of each order; instead the Respondents exercised discretion in relation to the above noted specifics for the Wave Pool transactions and effected the trades on a discretionary basis as though they were Portfolio Managers.

II. Respondent's Conduct Not Within the Bounds of Good Business Practice

Reliance on BC

25. The Respondents relied on BC's technical analysis and recommendations for the purchase and sale of securities. The Respondents then completed trades for their Wave Pool clients on the basis of BC's recommendations.
26. There is no evidence to show that the Respondents conducted any review of BC's technical analysis, or that they conducted their own independent due diligence or suitability assessments of BC's recommended securities before completing trades for their clients.
27. When BC resigned from the Wave Pool team in April 2009, the Respondents consulted with another technical analysis expert in order to wind down the Wave Pool. There is no evidence that the Respondents conducted their own independent due diligence or suitability assessments of any of the securities subsequently traded for their Wave Pool clients.
28. The new technical analysis expert did not have any contact with the existing Wave Pool clients, receive a share of any of the commissions generated in the Wave Pool code or add any new clients to the Wave Pool.

No Economic Benefit

29. None of the Respondents' Wave Pool clients ultimately made money on these transactions. In the case of many Wave Pool transactions, the clients did not profit from the trades, after costs. The costs to the clients associated with the Wave Pool transactions consisted of commissions and foreign exchange fees.

(i) Commissions Generated

30. The Respondents told their clients that the standard commission for the Wave Pool transactions was 1%. However, this commission was subject to a minimum charge of \$100 and a ticket fee of \$20, per trade.
31. Therefore, when the trade value was less than \$10,000, the commission often exceeded 1%. In fact, in excess of 75% of the Wave Pool trades were for amounts of less than \$10,000.
32. Although in some cases, commissions were abridged if clients traded the same security in multiple accounts, taking into account only those trades where commission was in fact charged, the average commission was 1.27%, with approximately 39% of those trades generating commissions in excess of 3%. The annualized commission rate was in excess of 12%.
33. There is no evidence to show that the clients were made aware that the commission amounts they were paying were often in excess of the 1% amount they were told about upon agreeing to participate in the Wave Pool.

(ii) Foreign Exchange Costs

34. All of the Wave Pool trades were executed in CDN dollar accounts; any USD based transactions were subject to foreign exchange fees. Wave Pool clients transacted approximately \$4,700,000 in USD securities over the course of March to June 2009, all of which were converted to CDN dollars. On a buy and sell of a security, the client would therefore lose 2.3% in foreign exchange costs.
35. As many of the Wave Pool accounts were registered accounts foreign exchange could not be avoided on the USD trades as there was no option for a USD currency for these accounts. However, approximately 13 of the Wave Pool accounts were cash/margin accounts, and clients could have avoided foreign exchange costs by using a USD currency account.
36. There is no evidence to show that the clients agreed to or were told of the foreign exchange costs imbedded in the Wave Pool transactions or that some of these costs could have been avoided.

(iii) Losses Sustained in Wave Pool Client Accounts

37. In total, Wave Pool clients lost in excess of \$505,000 or approximately 15%, on average, of their investment [including costs] between March and June, 2009. The TSX Composite index gained in excess of 39% over the same period.
38. Of the approximately \$505,000 in losses sustained by the Wave Pool accounts from March to June 2009, the following is a breakdown of the allocation;
 - Total commissions were in excess of \$92,000; of which the Respondents' proportionate share of commissions was \$ 14,747.78 each;
 - Foreign exchange costs totaled in excess of \$54,000; and
 - The clients' capital losses were approximately \$359,000.

IV. TERMS OF SETTLEMENT

39. 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.
40. The Settlement Agreement is subject to acceptance by the Hearing Panel.
41. The Settlement Agreement shall become effective and binding upon the Respondents and Staff as of the date of its acceptance by the Hearing Panel.
42. 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.
43. If the Hearing Panel accepts the Settlement Agreement, the Respondents waive their rights under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
44. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondents may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.
45. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
46. Staff and the Respondents 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.
47. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondents are payable immediately upon the effective date of the Settlement Agreement.
48. 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 Calgary, in the Province of Alberta, this 11th day of October, 2011.

“Witness signature”

Witness

“James Delcourt”

Respondent: Delcourt

“Witness signature”

Witness

“James Stewart”

Respondent: Stewart

AGREED TO by Staff at the City of Toronto, in the Province of Ontario this 20th day of October, 2011.

“Witness signature”

Witness

“Natalija Popovic”

Natalija Popovic

Enforcement Counsel on behalf of Staff of the
Investment Industry Regulatory Organization of
Canada

ACCEPTED at the City of Calgary, in the Province of Alberta, this 6th day of December, 2011, by the following Hearing Panel:

Per: **“Brian Foster”**

Panel Chair

Per: **“Peter McWilliams”**

Panel Member

Per: **“Kelly Trout”**

Panel Member

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