Re Dariotis and Fiumidinisi

IN THE MATTER OF:

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

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

and

Konstantine Dariotis and Alfonso Fiumidinisi

2011 IIROC 75

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

Hearing held on October 21, 2011
Decision rendered on Janurary 25, 2012
(40 paragraphs)

Hearing Panel :
Me Jean Martel, Ad. E. (Chair), John Ballard, Élaine C. Phénix
Appearances:
Me Sébastien Tisserand and Me Elsa Renzella, for IIROC
Me Pierre V. LaTraverse (LaTraverse, independent lawyers), Counsel for the Respondents

DECISION ON SETTLEMENT AGREEMENT

(Decision - Unofficial English Translation)

¶ 1 This Settlement Hearing is governed by IIROC Dealer Member Rules 20.35 to 20.40, *Hearing Processes*.

¶ 2 Both Respondents have been registered securities representatives since 1988. Until September 2006, they were in the employ of RBC Dominion Securities (RBC), an Investment Industry Regulatory Organization of Canada (IIROC)-regulated firm. At the material time, RBC was a Member firm of the Investment Dealers Association of Canada (IDA).

¶ 3 At the close of an investigation into the Respondents' conduct, Staff of IIROC concluded that, between 1991 and 2005, Respondents repeatedly violated the provisions of IDA By-law 29.1, *Business Conduct* (the "**Rules"**).

¶ 4 The IDA Rules, in their various iterations in force at the material time,[1] required that registered representatives of the member firms of this Association observe high standards of ethics and professional conduct. To this principle was added, effective 1992, the principle requiring representatives to abstain from engaging in conduct or business practices that are unbecoming or detrimental to the interests of the public.

¶ 5 Since June 1, 2008, the IDA's self-regulatory activities within the securities industry have been taken

[1] The different texts of the IDA Rules that were applicable from 1991 to 2005 can be found under tab 6 of the Book of Regulations and Authorities that was submitted to us.

over by IIROC. *Transition Rule No. 1 of the Investment Industry Regulatory Organization of Canada ("IIROC")* permits it, among other things, to hold a settlement hearing on behalf of the IDA, relative to facts that occurred prior to this takeover, when the Respondent in the matter was governed by the Rules of the Association.[2] That is the case here.

Settlement Agreement

¶ 6 Based on a discussion of the facts admitted by the parties, and an acknowledgment by the Respondents that they had consequently committed certain violations of these rules, Staff of IIROC negotiated and concluded with them a settlement agreement dated September 19, 2011 ("Settlement Agreement" or "the Agreement"), pursuant to IIROC Rule 20.35, *Hearing Processes*, and Rule 14 of our *Rules of Practice and Procedure*.

¶ 7 In this Settlement Agreement, the Respondents acknowledge in the following terms that they violated the Rules on numerous occasions by repeatedly carrying out undisclosed outside business activities without their employer's formal authorization:

> *"During the approximate period between 1991 and 2005, the Respondents engaged in outside business activities without proper disclosure and authorization from their Dealer Member employer by:*
>
> *a) referring individuals including clients of its Member Dealer employer to offshore banks;*
>
> *b) obtaining and acting upon trading authority over most of these offshore accounts; and*
>
> *c) facilitating these individuals to invest in offshore funds for which the Respondents had an interest to earn fees and commissions; […]"* [3]

¶ 8 Conditionally on its acceptance by a Hearing Panel pursuant to Rule 14 of the IIROC *Rules of Practice and Procedure*, the parties have agreed that the violations committed by the Respondents are liable for the following penalties:

(i) an aggregate fine of $350,000;

(ii) for each of them, suspension of approval in any capacity with an IIROC-regulated firm for a period of two months, such suspension periods to be discharged consecutively.[4]

¶ 9 Respondents have also agreed to pay costs in the amount of $50,000 in connection with this matter.

Essential facts admitted

¶ 10 The activities undisclosed by the Respondents to their employer consisted in:

(i) opening and, in most cases, operating with authorization, on behalf of 31 persons, the majority of whom were RBC clients (the "**offshore clients"**), accounts that were held with RBC Suisse or Pictet & Cie (the "**offshore banks**") through which investments were made;

(ii) facilitating, for the offshore clients and nine (9) other individuals, equity investments in an offshore hedge fund by the name of Globe-X International Inc. (**GXI**).

¶ 11 These activities indirectly earned the Respondents compensation in the form of client referral fees and commissions, which were paid by the offshore banks (approximately $230,000) and by GXI (approximately $20,000).

¶ 12 Practically speaking, the Respondents were paid these amounts through companies based in the Bahamas, in which their parents were shareholders and officers, and two of whom also acted as sales agents of GXI while at the same time holding securities in the latter, which entitled them to share in the revenues

[2] In this case, according to *Schedule C.1 to Transition Rule No. 1, the Hearing Committee and Hearing Panels Rule* (s. 1.9(2)), the IDA Rules that were in force at the material time are the ones that must apply, to the extent that they are not incompatible with IIROC's Rules of Practice and Procedure on the date the enforcement proceeding was initiated.

[3] Settlement Agreement, Part II, art. 8, on p. 2.

[4] Settlement Agreement, Part II, on p. 2.

(including the revenues from managing the investments in the fund's own equity). In these last instances, the companies – and in turn, the Respondents – therefore benefited both directly and indirectly from the trading effected on behalf of the offshore clients or other individuals referred as investors to GXI.

¶ 13 On September 27, 2006, the Respondents were fired by RBC, their employer at the time.

¶ 14 Shortly afterwards, they were hired as registered representatives by CIBC World Market (sic) Inc. (**CIBC**), another IDA Member firm, which subsequently became an IIROC-regulated firm. They are still employed with this firm, where their activity has been subject to strict supervision for several years.

The proceeding

¶ 15 At a hearing held on October 21, 2011, the text of the Settlement Agreement attached hereto was recommended to us for acceptance, and our Hearing Panel was invited consequently to exercise the powers conferred on it by IIROC Dealer Member Rule 20.36 (1) (a).

¶ 16 After considering the terms and conditions of this Agreement and taking into account the representations by the legal counsel of both parties, we stated our intention to accept the Agreement on the effective date of this decision, for the reasons outlined below.

The analysis

¶ 17 IIROC Dealer Member rules 20.35 to 20.40 provide that, in the context of a settlement hearing, the Hearing Panel may only accept or reject the Settlement Agreement that is submitted for its consideration.

¶ 18 To take a position on this subject, the principles that must guide us are those laid out in *Re Clark* [1999] I.D.A.C.D. No. 40 and *Re Milewski* [1999] I.D.A.C.D. No. 17, as more recently applied in *Re Reynolds and Chang* [2009] IIROC No. 50.

¶ 19 In *Clark,* it was decided that when a hearing panel examines a settlement agreement by virtue of By-law 20.26, it has a duty to keep in mind the importance of the settlement process and avoid blithely interfering in a settlement that was negotiated between the parties.[5] Thus, only on serious grounds should we interfere with the terms and conditions of the Agreement.

¶ 20 *Milewski*, for its part, established that a hearing panel invited to consider a settlement agreement should accept it if, after consideration of the facts in admission in the settlement agreement, the disciplinary measures that the agreement proposes in the matter of the respondent appear to it to fall within a "reasonable range of appropriateness" with respect to the misconduct in question.[6]

¶ 21 Applying these principles here, we come to the conclusion that, in the circumstances, the penalties set forth in the Settlement Agreement appear to us to comply in all respects with the reasonable criteria of fairness and adequacy which are necessary to the acceptance thereof.

¶ 22 To conclude in this direction, we notably considered the *IIROC Dealer Members' Disciplinary Sanction Guidelines* (March 2009 version), as well as borrowed the key considerations stated in *Re Stefiuk* [2011] IIROC No. 24, which followed a settlement hearing where the misconduct acknowledged by the respondent in that case was analogous to the misconduct that is the subject of the Agreement now before us.

¶ 23 We also based ourselves on the factors described more specifically below.

Mitigating Factors

¶ 24 Since their respective entry into the securities industry in 1988, the respondents have incurred no disciplinary history other than the present matter, be it with the IDA or IIROC.

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[5] *Re Clark*, op. cit., p. 3.
[6] *Re Milewsky* [1999] I.D.A.C. No. 17, August 5, 1999, p. 11.

¶ 25 Since their hiring by CIBC in 2006 and until recently,[7] the Respondents' conduct has been subject to strict supervision by this broker and has proven beyond reproach. This treatment was imposed upon them for a much longer period – 4 years – than one would normally expect (see, for instance, *Stefiuk*, op. cit., one-year period, and *Re Michaels* [2007] I. D.A.C.D. No. 8, six-month period). It is therefore understandable that the penalties agreed to in the Settlement Agreement say nothing about imposing any supervision of this type on the Respondents.

¶ 26 Finally, the Respondents have not been the object of any client complaint during this time.

¶ 27 It follows that, in the employ of CIBC, the Respondents have shown a real commitment to reforming themselves, to being more rigorous in their observance of the ethical standards that govern their professional conduct, and to following the good business practices dictated by the Rules of the IDA and IIROC for the protection of the public. The lengthy period of strict supervision imposed on them by this broker doubtless had something to do with restoring things.

¶ 28 Our Hearing Panel also took into account that even though the Respondents neglected to disclose outside business activities to their former employer and to obtain the latter's authorization to pursue them, the Settlement Agreement recognizes that in the course of these activities:

(i) the offshore clients to whom the Respondents provided advice or services were duly informed of the trades being made in the offshore bank accounts held in their names;

(ii) the investments effected for the offshore clients and for other individuals who were not clients of RBC were well suited to their needs and objectives;

(iii) these clients and persons suffered no loss whatsoever from these investments;

(iv) these activities were moreover lawful and in compliance with the applicable legislation.

¶ 29 Finally, we noted that the Respondents cooperated with Staff of IIROC throughout the investigation, an attitude for which due credit must be given.

Aggravating Factors

¶ 30 These mitigating factors notwithstanding, the fact remains that, with respect to the standards of ethics and professional conduct generally accepted within the industry, the Respondents' undisclosed outside business activities exposed the public and their employer to very real risks of suffering some prejudice or damage to their reputation.

¶ 31 Here is what the *Conduct and Practices Handbook for Securities Industry Professionals,* published by the Canadian Securities Institute for the period covered by the Settlement Agreement, has to say:

> *"Dealings in securities outside of the normal business of the firm, sometimes referred to as selling away or outside deals may expose clients to unknown risks and expose registrants and firms to civil liability. Such activity done without the knowledge of the firm also prevents effective supervision of the handling of client accounts, which is a requirement placed upon firms by the SROs* [i.e. self-regulatory organizations like the IDA and, today, IIROC]. *Firms may be exposed to liability for the actions of their employees in the effecting of such trades, even though the firm is unaware of the activities."*[8]

¶ 32 The fact that the Respondents did not inform RBC of their outside professional activities, nor of the benefit that they derived as a result, accordingly prevented the broker from supervising this activity and the

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[7] The prosecutor at IIROC argues that this period of strict supervision lasted 4 years: n.s. October 21, 2011, page 28.

[8] *Conduct and Practices Handbook for Securities Industry Professionals, Standard C – Public Respect and Confidence – 3. Financial Integrity and Moral Responsibility,* originally published in April 1971, in the 1993 edition, on pp. 20 and 21. This principle is still valid: see commentary to Standard C of the CPH handbook, *IIROC Disciplinary Sanction Guidelines,* section 3.10 *Outside Business Activities – By-law 29.1,* p. 35.

Respondents' role in it, whereas their efforts were devoted to clients of the broker or to other individuals. The Respondents thus deprived the broker of the ability to fulfill its duty to protect the public that is incumbent on it.[9]

¶ 33 Our Hearing Panel also assigned great importance to the fact that, far from simply being undisclosed by the Respondents to RBC, which is already tantamount to concealing them (*Re Michaels*, op. cit., par. 14, which based itself in this regard on *Re Pandelidis* [2005] I.D.A.C.D. No. 16), the outside business activities were carried out through companies that had some relationship with the Respondents, over which they likely had some influence, and whose involvement had the effect of concealing the aforesaid activities or, at the very least, making them more difficult to detect. As we see it, this more or less opaque set-up was no coincidence.

¶ 34 What's more, these activities spanned several years and were substantial, involving some 40 people to whom the Respondents provided services, including 31 offshore clients who were in the majority clients of RBC. These people might have been misled to believe that these activities were conducted with the knowledge and authorization of the broker, which was not the case. The Respondents thus exposed their firm to liability in regard to clients in good faith, and to potential financial losses.

¶ 35 Moreover, these undisclosed outside business activities generated referral fees and commissions for the Respondents without the clients concerned being informed of the Respondents' financial interest in this regard. It is clear that such financial interest could potentially conflict with the clients' interest and that the latter had the right to be informed. In the Respondents' defense however, we find that they were transparent with the offshore clients and other individuals they referred to GXI regarding the fact that their parents shared in the profits from this hedge fund.

¶ 36 Under these circumstances, the fact of not disclosing international activities of substantial scope that were conducted through an elaborate set-up, as well as in secret and with potential risk for RBC, did indeed constitute a serious violation of the Rules on the Respondents' part. It is therefore appropriate that the provisions of the Settlement Agreement impose a fairly severe financial penalty on them.

¶ 37 We agree with the fact that the amount of the fine agreed between the parties should reflect a will to deprive the Respondents of the enjoyment of the compensation – in the amount of about $250,000 – that they derived as a team from their undisclosed outside business activities. This is certainly not unreasonable.

¶ 38 Excluding the portion of the agreed fine that essentially corresponds to the above-mentioned compensation, the other portion is equal to imposing a $50,000 fine per individual Respondent, which here again does not unreasonably depart from the precedents (in particular, the recent *Stefiuk* and *Dennis* decisions) invoked before us on this point.

¶ 39 For all these reasons, we think it is appropriate to grant the parties' joint recommendation and accept the Settlement Agreement before us.

Conclusions

¶ 40 **FOR THESE REASONS, THE HEARING PANEL:**

ACCEPTS the Settlement Agreement dated September 19, 2011, the text of which is appended hereto, and notably the following terms and conditions against the Respondents:

1) for each Respondent, suspension of approval from IIROC in any capacity for a two-month period, the two suspension periods to be discharged consecutively;

2) an aggregate fine of $350,000 imposed on the Respondents together; and

3) payment of an amount of $50,000, imposed on the Respondents on account of the costs incurred by IIROC.

[9] *Re Dennis* [2011] IIROC No. 39, par. 10.

Montréal, January 25, 2012.

Jean Martel, Chair

John Ballard, Member, Hearing Panel

Élaine C. Phenix, Member, Hearing Panel

APPENDIX - SETTLEMENT AGREEMENT

(Original Document – English)

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondents, Konstantine Dariotis ("**Respondent Dariotis**") and Alfonso Fiumidinisi ("**Respondent Fiumidinisi**"), consent and agree to the settlement of this matter by way of this settlement agreement ("**the Settlement Agreement**");

2. The Enforcement Department of IIROC has conducted an investigation ("**the Investigation**") into the conduct of the Respondents;

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. IIROC represents that it has the requisite statutory and regulatory power to enter into this Settlement Agreement and to impose a fine and a suspension;

5. The Respondents consent to be subject to the jurisdiction of IIROC;

6. 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

7. Staff and the Respondents jointly recommend that the Hearing Panel accept this Settlement Agreement.

8. The Respondents admit to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

   During the approximate period between 1991 and 2005, the Respondents engaged in outside business activities without proper disclosure and authorization from their Dealer Member employer by:

   a) referring individuals including clients of its Dealer Member employer to offshore banks ;

   b) obtaining and acting upon trading authority over most of these offshore accounts; and

   c) facilitating these individuals to invest in offshore funds for which the Respondents had an interest to earn fees and commissions.

   all of which is business conduct that is unbecoming or detrimental to the public interest, contrary to IDA By-law 29.1 (now Dealer Member Rule 29.1).

9. Staff and the Respondents agree to the following terms of settlement:

   a) The Respondents will pay a total fine in the amount of $350,000;

   b) The Respondents will each be suspended from any registered capacity with IIROC for a period of

two months, the two periods of suspension to be served consecutively;

10. The Respondents agree to pay costs to IIROC in the amount of $50,000.

III. STATEMENT OF FACTS

(i) Acknowledgment

11. 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

Overview

12. For many years, the Respondents referred certain individuals including their clients at RBC Dominion Securities (RBC DS) to two offshore banking institutions and continued to transact in these accounts on behalf of these individuals by virtue of trading authorizations. During this same period of time, the Respondents also directly referred individuals including RBC DS clients to an offshore fund known as Globe-X International. The Respondents had an interest to transact in these accounts or to refer these investors to this fund to earn fees and commissions through off-shore corporations. The Respondents did not take the appropriate steps to ensure RBC DS properly knew and consented to these offshore activities.

13. As a result of this offshore activity, the Respondents earned approximately $250,000 in referral fees and commissions.

Registration of Respondents

14. At all material times, the Respondents were registered representatives and employed as Investment Advisors at a Montreal branch of RBC DS.

15. The Respondents were terminated from RBCDS on September 27, 2006.

16. The Respondents currently are employed with CIBC World Markets Inc.

17. The Respondents have been under close supervision since 2006.

18. The Respondents have no prior disciplinary history.

Off-shore Bank Referrals

19. Starting in 1991, the Respondents began to refer RBC DS clients and other individuals to RBC Suisse. A few years later, they referred RBC DS clients and others to Pictet & Cie, a private bank based in Switzerland.

20. In total, the Respondents referred approximately 31 individuals, the majority of which were RBC DS clients (collectively referred to as the "offshore clients').

21. For many of the offshore clients, the Respondents obtained trading authority over their accounts. With this authority, the Respondents provided the offshore banks with trading instructions on behalf of the offshore clients and at times provided investment advice to the offshore clients with respect to the holdings held in their accounts.

22. The Respondents did not provide the details of these referrals including the names of the offshore clients or any of the related account documentation to the firm. No proper approval was obtained from RBC DS.

23. All trades conducted in the offshore accounts were done with the offshore clients' knowledge. The investment recommendations made to the clients were not unsuitable; and the clients did not suffer any losses from the offshore investment activity.

24. The Respondents directly/indirectly received referrals fees from the offshore banks through a Bahamian

company called Kodaf Investment Management inc. ("Kodaf"). The company was set up in 1991 with the Respondents' relatives named as registered shareholders and officers of Kodaf.

25. In total, the Respondents earned approximately $230,000 in referral fees.

Off-shore Fund

26. In or about 1992, the Respondents set up two other Bahamian companies called Cap Dragon ("**Cap**") & Vir Dragon ("**Vir**") for and in the name of their parents.

27. On or about June 1, 1993, Cap & Vir signed a Sales Agent Agreement with an offshore hedge fund called Globe-X International Inc. ("**GXI**"). Cap & Vir were appointed as non-exclusive agents for the referral of subscription to GXI shares. In exchange, Cap & Vir was to receive a payment of 1% of the subscription amount obtained from their referrals.

28. Cap & Vir also acquired non-voting participating shares of GXI, entitling them to benefit from the fund's revenues in fees.

29. From approximately June 1993 to early 2000, the Respondents facilitated investments in GXI by the offshore clients and 9 others. The investment recommendations were not unsuitable and the investors did not suffer any losses from investing in GXI.

30. The Respondents, through Cap & Vir, obtained referral commissions based on the agreement signed with GXI. Total commissions earned were approximately $20,000.

31. The clients referred to GXI were not advised about the Respondents' interest to earn commissions from these referrals but were advised of their parents' investment in GXI.

32. RBC DS was not properly made aware of these direct referrals to GXI or of the commissions earned by the Respondents.

IV. TERMS OF SETTLEMENT

33. 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.

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

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

36. 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.

37. 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.

38. 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.

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

40. 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.

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

42. 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.

Signatures to follow on the next page

AGREED TO by the Respondents at the City of Montreal in the Province of Quebec, this 19th day of September, 2011.

"Respondent's signature"
Respondent Dariotis

"Respondent's signature"
Respondent Fiumidinisi

« Pierre LaTraverse »
Me Pierre LaTraverse, Counsel for the Respondents

AGREED TO by Staff at the City of Montreal in the Province of Quebec, this 22nd day of September, 2011.

"Witness signature"
Witness

"Carmen Crépin"
Carmen Crépin
Vice President, Québec
Investment Industry Regulatory Organization of Canada