Unofficial English Translation

Re Industrial Alliance Securities Inc.

IN THE MATTER OF:

The By-Laws of the Investment Dealers Association of Canada

and

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

and

Industrial Alliance Securities Inc. Respondent

2015 IIROC 42

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

Hearing held on: October 29, 2015
Decision rendered on: October 29, 2015
Decision published on: November 23, 2015

Hearing Panel
Robert Monette (Chair), Normand Durette, and Michel Duchesne
Appearances
Me Pascale Dionne-Bourassa, Counsel for IIROC
Me Marc-André Chartrand, Counsel for the Respondent

REASONS FOR DECISION ON SETTLEMENT

¶ 1 At a Hearing held on October 29, 2015, the parties, namely Staff of IIROC (IIROC) and the Respondent Industrial Alliance Securities Inc. (IAS) presented the Hearing Panel (Hearing Panel) with a Settlement Agreement (the Agreement)[1].

¶ 2 After hearing the parties' representations, the Hearing Panel accepted the Settlement Agreement and rendered it enforceable effective the date of the Settlement Hearing, while reserving its Reasons to a later date.

¶ 3 This decision sets out the grounds for the acceptance of the Settlement Agreement.

¶ 4 The Agreement dated September 11, 2015 is further to the discussions between the parties; pursuant to Rule 14 of IIROC's *Rules of Practice and Procedure*. It contains an outline of the relevant facts, as well as a description of the contraventions and the proposed sanctions.

SUMMARY OF THE AGREEMENT

[1] The Agreement is appended to this decision, so as to form an integral part thereof.

¶ 5 According to the allegations contained in the Agreement, the misconduct occurred over the period of September 2007 to April 2011 and concerns two types of violations of IIROC Dealer Member Rules, Guidelines, Regulations or Policies.

¶ 6 The first violation concerns allegations that IAS Inc. failed to take reasonable measures to ensure that two of its representatives, RL and PM, as well as certain of its supervisors, possessed the required knowledge and understood the features and risks inherent in leveraged Exchange-Traded Funds (ETF).

¶ 7 It appears that as of 2009, specific information was available regarding the complexity and the risk of volatility of the products concerned. Yet, IAS did not immediately institute an appropriate policy respecting leveraged ETFs and delayed the transmission of adequate knowledge to its two representatives and to its supervisors.

¶ 8 This negligence resulted in the two representatives recommending the purchase and holding of these products to two clients for whom the products were unsuited.

¶ 9 The second violation is that IAS failed to intervene in respect of one of its representatives, RL, to ensure that trades executed by the latter in the accounts of two clients were within the bounds of good business practice.

¶ 10 Thus, between March 2009 and April 2011, RL executed a large number of trades in two client accounts and the analyzed asset turnover rate in these accounts was questionable. IAS itself recognized that this practice was not within the bounds of good business practice.

¶ 11 Despite certain interventions by IAS branch managers in 2009, the situation could not be totally remedied until April 2011.

¶ 12 IAS admits to the contraventions described above.

¶ 13 Consequently to the facts outlined in the Settlement Agreement, the parties recommend the following terms of settlement:

- a fine of $75,000 payable by the Respondent
- costs in the amount of $15,000 payable to IIROC by the Respondent.

DISCUSSION

¶ 14 The principles are well established concerning the role of the hearing panel in a settlement hearing.

¶ 15 Thus, the hearing panel may not simply substitute its opinion for the joint recommendation of the parties, by determining that it could render a more suitable decision; that is not its role.

¶ 16 The hearing panel may only set aside a joint recommendation in cases where the suggestion appears to it to be unreasonable, contrary to the public interest or would tend to bring the administration of justice into disrepute.[2]

¶ 17 To determine the reasonable nature of a penalty proposed in a settlement agreement, the hearing panel must ensure that the key factors cited in the *Dealer Member Disciplinary Sanction Guidelines* (Guidelines) have been taken into consideration.

¶ 18 Furthermore, it must verify that the proposed penalty falls within a reasonable range of the appropriateness.[3]

¶ 19 As regards the key considerations discussed in the Guidelines, the Hearing Panel retains the following mitigating factors:

- the contraventions concern isolated incidents that are in no way indicative of a systemic problem

[2] *Poulin c R*. J.E. 2010-1891, 2010 QCCA 1854 (CanLII) at par. 10

[3] *Re Rao* 2011 IIROC 12

- the Respondent has no prior disciplinary record relating to breaches in training or supervision
- not all clients filed an official complaint and compensation was paid
- the Respondent cooperated with the disciplinary investigation.

¶ 20 Counsel for IIROC submitted a book of authorities to demonstrate that the Agreement falls within a reasonable range of appropriateness for disciplinary sanctions in similar matters.

¶ 21 In two of the matters cited, the imposed fine is higher than in the present Agreement, but the violations involved a far greater number of clients and, in one case, the respondent had a disciplinary record of similar contraventions.[4]

¶ 22 Taking into account the particularities of each matter, the Hearing Panel is satisfied with the demonstration.

¶ 23 Counsel for both parties have argued that the negotiated settlement is consistent with the public interest and falls within a range of appropriate sanctions; the Hearing Panel agrees with this argument.

CONCLUSION

¶ 24 The Agreement entered into between the parties is not unreasonable. The objectives of safeguarding the public interest and the integrity of the investment industry are not jeopardized by the Agreement's acceptance.

¶ 25 For the reasons given here, and as was decided at the Hearing, the Hearing Panel considers the Agreement reasonable and accepts it, effective the date of the Hearing, namely October 29, 2015.

Montréal, this November 23, 2015

Robert Monette, Chair

Normand Durette, Member

Michel Duchesne, Member

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. The Enforcement Staff of IIROC and the Respondent, Industrial Alliance Securities Inc., consent and agree to the settlement of these matters 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 Industrial Alliance Securities Inc.;

3. The Investigation disclosed matters for which the Respondent may be disciplined by a Hearing Panel appointed pursuant to Part C of Schedule C.1 to Transition Rule No. 1 of IIROC (the Hearing Panel).

II. JOINT SETTLEMENT RECOMMENDATION

4. Staff and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement;

5. The Respondent admits to the following contraventions of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:

    1) Between September 2007 and January 2010, IAS failed to take reasonable measures to ensure that its representatives RL and Paul Milot, and some of its supervisors, possessed the required knowledge and understood the features and risks inherent in leveraged Exchange-Traded Funds

[4] *Re Laurentian Bank Securities* 2012 IIROC 49; *Re Wellington West Capital* 2013 IIROC 46

(ETF), contrary to IIROC Rule 18.3b) (IDA By-law 18 prior to June 1, 2008) and to Part III A(1) and Part III A(5) of IIROC Dealer Member Rule 2500 (IDA Policy 2 prior to June 1, 2008);

2) Between March 2009 and April 2011, IAS failed to intervene and to take the necessary measures in respect of its representative RL to ensure that the trades executed in the accounts of two clients were within the bounds of good business practice, contrary to IIROC Dealer Member Rule 1300.1(o) and IIROC Dealer Member Rule 2500;

6. Staff of IIROC and the Respondent accept the following terms of settlement, namely a fine of $75,000.

7. The Respondent agrees to pay IIROC costs in the amount of $15,000.

III. STATEMENT OF FACTS

(i) Acknowledgment

8. Staff and the Respondent agree with the facts set out in this section and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

Summary of the Respondent's alleged misconduct

9. The Respondent, Industrial Alliance Securities Inc. (IAS), is an IIROC-regulated firm;

10. Prior to the adoption of its policy in August 2009, IAS allowed certain of its registered representatives to recommend the purchase and holding of leveraged ETFs (LETFs) to certain of their clients, without ascertaining that these representatives possessed an adequate understanding of the nature of these investment products;

11. Moreover, some of the IAS supervisors failed to intervene in a timely fashion with these representatives, concerning the recommendations to purchase LETFs made to certain of the firm's clients, because they did not have sufficient knowledge of how these products worked, as well as their associated risks;

12. IAS failed to take the necessary measures with respect to its representative RL, whereas it knew, or should have known, that the trades that the latter was executing on behalf of two of the firm's clients were not within the bounds of good business practice;

Inadequate measures regarding LETFs concerning the representatives RL and Paul Milot

13. LETFs are high risk and highly speculative financial products and are not for investors whose main objective is a regular income or the preservation of capital;

14. Investors must be prepared to lose a large portion or even all of the money that they invest in an ETF;

15. LETFs are subject to increased volatility as they seek to achieve the multiple or inverse (opposite) multiple of the daily performance of an underlying index;

16. As an IIROC-regulated firm, IAS had a duty to take reasonable measures to ensure that its representatives possessed the required knowledge and adequately understood the trading and functioning of LETFs in the accounts of certain of its clients;

17. IAS allowed at least two of its representatives, RL and Paul Milot, to recommend the purchase and holding of these products to three (3) clients for whom these products were unsuited;

18. IAS also failed to take reasonable measures to ensure that its supervisors fully understood the features and risks inherent in LETFs;

19. Until spring 2009, LETFs were little-known and the perception of the IAS supervisors was that LETFs worked pretty much like a mutual fund;

20. Reading the prospectuses of the LETFs in question should have raised some questions on the part of the representatives and the supervisors as to the risk of these products;

21. Indeed, the prospectuses of some of these products stated notably that the securities were "speculative", that they involved "a high degree of risk" and that they were only for "persons who are able to assume the risk of losing their entire investment";

22. On June 11, 2009, IIROC issued a Guidance Note concerning the sale of LETFs, stating that these were complex products with daily performance objectives that are unsuitable for investors seeking a long-term investment;

23. Among other things, IIROC's Guidance Note mentioned the following regarding the supervision that dealer members should exercise if they wish to promote ETFs:

    a. complete an appropriate product suitability analysis;

    b. perform a customer-specific suitability analysis;

    c. provide balanced and accurate sales materials;

    d. follow all IIROC rules and applicable securities laws;

    e. offer the firm's representatives adequate training on the risks, terms and features of the ETFs.

24. The June 11, 2009 guidance note was generally known to the supervisors who were interviewed during the investigation;

25. Indeed, it was following this Guidance Note that IAS adopted, in August 2009, an internal policy respecting the trading of ETFs; this policy was only implemented in January 2010 after the IAS representatives had received their training;

26. The policy stated, among other things, that the branch manager must monitor trades involving an ETF daily;

27. The policy also stated that the manager must ensure that representatives who trade ETFs have had the necessary training to do so, while ascertaining the suitability of the trade, failing which the trade was to be canceled;

28. At the time, IAS, by omitting to implement an adequate policy respecting LETFs, opened the door to unsuitable transactions for three (3) of its clients;

The matter of Paul Milot

29. Paul Milot joined IAS as a registered representative in June 2007;

30. In a decision rendered by IIROC on November 13, 2014, ratifying a settlement agreement, Paul Milot was found guilty of the following violations:

> *"1) Between September 2007 and December 2009, Respondent failed to use due diligence to obtain sufficient knowledge of the features and risks inherent in leveraged Exchange-Traded Funds (ETFs) before recommending their purchase to his client, contrary to IIROC Dealer Member Rule 1300.1(a) (Regulation 1300.1(a) of the IDA prior to June 1, 2008);*
>
> *"2) Between September 2007 and December 2009, Respondent failed to use due diligence to ensure that his recommendations to buy, sell and/or hold securities were suitable for his client, contrary to IIROC Dealer Member Rule 1300.1(q) (Regulation 1300.1(q) of the IDA prior to June 1, 2008);"*

31. As part of that settlement agreement, it was admitted that Paul Milot did not properly understand the features and risks inherent in LETFs, among others, which had the effect of causing an excessive concentration of speculative securities in the account of his client CJ.

32. This excessive concentration of LETFs in CJ's case was not detected by the IAS supervisors, due to their own lack of knowledge of the functioning of these products and their associated risk level;

The matter of RL

33. RL worked as a registered representative with IAS from June 2008 to April 2011;

34. During an investigation that concerned him, the trades executed in the accounts of two (2) of his clients, HM and GM, were analyzed for the period of July 2008 to April 2011;

35. From March 2009 to November 2010, RL executed 51 trades involving LETFs in the account of GM, for a loss of $20,364;

36. As for HM's account, RL executed 41 trades involving LETFs, namely the Direxion and Horizon Beta Pro securities, from March 2009 to July 2010, for a loss of $9313;

37. Effective August 2009, IAS adopted a policy respecting ETFs;

38. Effective January 2010, IAS dispensed mandatory training for representatives wishing to recommend leveraged ETFs to their clients;

39. RL completed his ETF training on June 15, 2010 and traded a few LETFs without receiving any mandatory training between January 2010 and June 2010;

Trades not within the bounds of good business practice concerning the representative RL

40. From March 2009 to April 2011, approximately 386 trades were executed in the accounts of HM and GM for a combined purchase volume of $1,833,714, which represented approximately one (1) trade every day and a half of trading, on average;

41. The annualized turnover rate in HM's account was 5.2, while GM's was 9.3;

42. The breakeven points for HM's and GM's accounts' were respectively, 14% and 25%;

43. As for the holding of securities in the accounts, the average was 45 days in HM's account and 29 days in GM's account;

44. Here is a table summarizing the analysis of the turnover rate in HM's and GM's accounts:

Asset Turnover Rate Analysis (IAS)

HM / GM

March-09 to April-11

Complainant	Period	Number of trades	Average Net Assets	Purchase Volume	Turnover Rate	Total Commission	Total Int. Exp	Breakeven Point
HM	Mar-09 /Apr-11	162	64,615	722,542	5.2	20,142	N/A	14%
GM	Mar-09 /Apr-11	224	55,223	1,111,172	9.3	30,038	N/A	25%
TOTAL / AVERAGE		386	119,838	1,833,714	7.06	50,180		19%

45. The trades executed by RL generated losses of $8,066.92 in HM's account and $23,890.50 in GM's account;

46. IAS, through its supervisors, observed in March 2009 that the investment strategy practiced by RL was risky in the accounts of HM and GM, especially with respect to the security Direxion, which was a triple leveraged ETF;

47. Nevertheless, in spite of the interventions made by IAS' various branch managers as of March 2009, the

firm took no measure to remedy the problem until April 2011;

IV. TERMS OF SETTLEMENT

48. 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.

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

50. The Settlement Agreement shall become effective and binding upon the Respondent and Staff from the date of its acceptance by the Hearing Panel.

51. 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.

52. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives his right, under IIROC rules and any applicable legislation, to a disciplinary hearing, review or appeal.

53. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or staff may proceed to a disciplinary hearing in relation to the matters disclosed in the investigation.

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

55. Staff and the Respondent 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.

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

57. 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 Québec (Québec), this September 4, 2015.

Industrial Alliance Securities Inc.

RESPONDENT

« Witness »

WITNESS

Per: « Richard Legault »

Name: Richard Legault

Title: President

AGREED TO by Staff, at Montréal, Québec, this September 11, 2015.

« Witness »

WITNESS

« Pascale Dionne-Bourassa »

Enforcement Counsel, for Staff of IIROC