

Re Pollitt & Co

IN THE MATTER OF:

The Investment Dealer and Partially Consolidated Rules

and

Pollitt & Co. Inc.

2023 CIRO 23

Canadian Investment Regulatory Organization
Hearing Panel (Ontario District)

Heard: October 24, 2023 in Toronto, Ontario via videoconference

Decision: October 24, 2023

Reasons for Decision: November 23, 2023

Hearing Panel:

Barry Bresner, Chair, Charles Macfarlane and Vanessa Gardiner

Appearances:

Sylvia Samuel, Senior Enforcement Counsel

Kevin Richard, for Pollitt & Co. Inc.

REASONS FOR DECISION

INTRODUCTION

¶ 1 This hearing was held pursuant to sections 8215 (Settlements and Settlement Hearings) and 8428 (Settlement Hearings) of the Investment Dealer and Partially Consolidated Rules (the “IDPC Rules”) to consider whether to accept a settlement agreement negotiated between Staff of the Enforcement Department of CIRO (“Enforcement Staff”) and Pollitt & Co. Inc. (the “Respondent”), dated October 11, 2023 (the “Settlement Agreement”). A copy of the Settlement Agreement is attached as Appendix A to these Reasons. Part III of the Settlement Agreement recites the facts agreed to by the parties. Pursuant to subsection 8428(6), the agreed facts in the Settlement Agreement were the only facts disclosed to the panel.

¶ 2 In the Settlement Agreement, the Respondent admitted to the following contraventions of CIRO requirements:

- Dealer Member Rule 17.1, by having failed to have and maintain risk adjusted capital (“RAC”) at greater than zero between January and December 2020 and having failed to immediately notify CIRO when its RAC was less than zero;
- Dealer Member Rule 17.2A and the internal control policy statements in Dealer Member Rule 2600, by having failed to establish and maintain adequate internal controls between January and December 2020;
- Dealer Member Rules 17.2 and 200.2, by failing to keep and maintain a proper system of books and records between January and December 2020;
- Dealer Member Rule 2800C and Investment Dealer Rule 7200 (in effect January 1, 2022), by failing to report information about all transactions in debt securities between September 2018 and November 2022; and

- Dealer Member Rule 30.3 and section 4135 of the Investment Dealer Rules (in effect January 1, 2022), by making payments to an affiliate without obtaining CIRO's written consent, between May 2021 and January 2022, while designated in early warning level 2.

¶ 3 The sanctions provided in the Settlement Agreement were a fine of \$175,000 and costs of \$15,000.

¶ 4 At the conclusion of the hearing, after due consideration of the agreed facts, the submissions of the parties, prior disciplinary decisions and the Sanction Guidelines, the Panel concluded that the Settlement Agreement was in the public interest and accepted it, with reasons to follow. These are those reasons.

OVERVIEW

¶ 5 The Respondent is a CIRO Dealer Member operating as a Type 2 introducing broker.

¶ 6 During a field examination of the Respondent's operations by CIRO's Financial & Operations Compliance department ("FinOps") in 2020, a number of concerns were identified. Those concerns are described in detail in the agreed facts of the Settlement Agreement but, for present purposes, can be summarized as follows:

- There were capital deficiencies related to two bought deal underwriting commitments. Dealer Member Rule 17.2 requires all Dealer Members to maintain Risk Adjusted Capital ("RAC") greater than zero and to immediately inform CIRO if it has a negative RAC. On May 7, 2020, the Respondent committed to a bought deal underwriting with GR Silver Mining Ltd. At that time, the Respondent had a capital deficiency of \$212,000. On July 14, 2020, the Respondent committed to a bought deal underwriting with Royal Road Minerals Limited. Through the distribution period, the Respondent had a capital deficiency in excess of \$1 million.
- In addition, there was a RAC deficiency of approximately \$51,000 as of June 30, 2020, due to insufficient margin on bond positions.
- Due to a lack of sufficient internal controls, the Respondent's RAC estimate did not correctly include all material items affecting the Respondent's capital position. The lack of controls included a failure to investigate discrepancies in non-allowable asset balances, operating expenses and financial statement capital amounts, which were identified in the reconciliation of the December 31, 2020 monthly financial report ("MFR") and the December 31, 2020 weekly RAC estimate.
- There were significant reporting issues, including the Respondent's failure to have adequate policies and procedures for identifying business activities between the Respondent and its' affiliates, reporting transactions and shared expenses, or month-end reconciliations with affiliates and a failure to maintain appropriate books and records for related party transactions.

¶ 7 Several of the findings made during the field examination in 2020 were repeat findings that the Respondent, contrary to its representations to FinOps, had failed to correct. The most recent field examination in January 2022 indicated that a number of the deficiencies noted in 2020 were ongoing or had been repeated.

¶ 8 As of June 30, 2020, the Respondent had been designated in early warning level 2 as a result of a capital deficiency and it remains in discretionary early warning level 2. Dealer Members in early warning are required to file their MFRs earlier than other Dealer Members and those in early warning level 2 must also file weekly capital reports to enable FinOps to monitor their financial status. Notwithstanding that designation, the Respondent repeatedly failed to file its MFRs within the prescribed deadline. The MFRs were filed late every month from July 2020 to December 2021. The Respondent was also repeatedly late in filing its weekly capital reports.

¶ 9 Dealer Members in early warning level 2 are prohibited from making any payments to a director, officer, partner, shareholder, related company or affiliate without the written consent of CIRO. Notwithstanding that restriction, the Respondent made four payments to an affiliate without CIRO's consent. Three of those payments were made between May and June 2021, and one was made in January 2022.

¶ 10 Further, from the inception of its bond trading desk in September 2018 until November 15, 2022, the Respondent failed to report its bond trades on the Market Trade Reporting System as required.

¶ 11 In light of the multiple issues identified during the field examination, on February 3, 2023, CIRO imposed a number of terms and conditions on the Respondent's membership (the "Terms and Conditions"), including a requirement that a Financial Monitor be appointed, at the Respondent's expense, to review the accuracy and completeness of the Respondent's financial reporting and other provisions relating to the Respondent's internal controls and reporting on debt transactions.

ANALYSIS

¶ 12 The role of a hearing panel on a settlement hearing, as defined in subrule 8215(5) of the IDPC Rules, is to either accept or reject a proposed settlement. The principles applicable to that determination are well-established. As stated in the oft-cited decision of *Milewski (Re)*¹, the hearing panel must be satisfied that the sanctions agreed to in a settlement agreement are "within a reasonable range of appropriateness", and a settlement should not be rejected unless the panel views the penalty as clearly falling outside of that range.

¶ 13 It is also well-established that reasonable settlements serve the public interest by resolving disputes more quickly and less expensively and by freeing up system resources for other matters.² Settlements are the result of negotiation and compromise between the parties who are in the best position to address the issues, and it is not the role of the hearing panel to second guess the parties. As stated in *Donnelly (Re)*:

It is usually in the public interest that matters be settled where possible rather than be determined through contested hearings. The reasons for this are often that an earlier determination of a dispute is better than a later determination. Settlements are usually less expensive than contested litigation, and there is less congestion in the dispute settling system when matters are taken out of the system through settlements. Finally, where both parties agree, the result is often more palatable to the parties and society than in a contested hearing where the winner takes all.

For these reasons, a panel considering the acceptance of a settlement agreement will try to reach a determination of acceptance. It will recognize that settlements are often hotly debated with much compromise and give-and-take between the parties in order to reach an acceptable position agreeable to both parties. Furthermore, the panel will recognize that it is not privy to all the facts and the motivation and considerations that each of the parties have in coming to a solution of the dispute that is agreeable to them.³

¶ 14 In considering the reasonableness of the sanctions agreed to in the Settlement Agreement, the Panel has considered the IIROC Sanction Guidelines (the "Guidelines"), which provide the general principles applicable to all disciplinary and settlement proceedings (Part I) and the key factors commonly taken into consideration (Part II). The Guidelines are designed to promote consistency, fairness and transparency in the disposition of such proceedings, but recognize that the determination of a sanction in a given case is both discretionary and fact-specific.

¶ 15 A general principle of particular relevance to this settlement hearing is the need to protect the public interest by restraining future conduct that might harm the capital markets by providing sanctions, which are significant enough to deter future misconduct by the Respondent (specific deterrence) and others (general deterrence). The sanction should be proportionate to the conduct at issue and similar to sanctions imposed in similar circumstances for similar contraventions, subject to adjustment for mitigating and aggravating factors.

¶ 16 It is also a general principle that, in the case of multiple violations, the overall sanction imposed should not be excessive or disproportionate to the gravity of the totality of the misconduct. Accordingly, a global approach to sanctioning is appropriate where the imposition of a sanction for each contravention would result in a cumulative sanction that is excessive.

¶ 17 The formulation of an appropriate sanction turns on a balancing of the mitigating and aggravating

¹ [1999] I.D.A.C.D. No.17

² *Donnelly (Re)*, 2016 IIROC 23

³ *Ibid*, paras. 7, 8

factors in a given matter and a consideration of the sanctions imposed in relevant prior decisions. In the present matter, those factors are as follows:

Mitigating Factors

- The Respondent does not have a prior disciplinary record;
- There was no financial harm to the public or financial gain to the Respondent;
- Most of the contraventions occurred in a single year;
- The Terms and Conditions, importantly including the appointment of a Financial Monitor, have reduced the prospects of future violations;
- The Respondent has admitted and accepted responsibility for the contraventions.

Aggravating Factors

- There were multiple serious contraventions, including three RAC deficiencies, which the Respondent failed to report and breaches of the early warning restrictions;
- The Respondent engaged in multiple other breaches of regulatory requirements, including reporting issues relating to dealings between the Respondent and its parent company, a lack of sufficient internal controls and failures to maintain accurate books and records;
- Several of the breaches involved repeat occurrences, which the Respondent had failed to correct notwithstanding its prior representations to FinOps that it would correct those deficiencies;
- The failure to report transactions in debt securities extended over a period of four years.

¶ 18 As indicated above, the Guidelines require the Panel to consider the sanctions imposed in similar circumstances in other cases. While there are prior decisions which have considered the appropriate sanction for various contraventions committed by the Respondent, there does not appear to be a prior decision which addresses the appropriate cumulative sanction for all of the various contraventions by the Respondent in this case. Nonetheless, it is instructive to consider those cases in assessing the reasonableness of the proposed settlement terms.

¶ 19 The circumstances in *Jory Capital Inc. & Cooney (Re)*⁴ have some parallels to those in the present matter. The majority owner and sole director of Jory Capital was found to have failed to take measures to ensure that Jory Capital met compliance standards regarding the maintenance and monitoring of regulatory capital and the reliability of financial reporting. More particularly, he had failed to ensure there was an effective financial compliance program from 2007 to 2010, that there was a supervisory system from 2005 to 2009 and a trade supervision policy from 2006 to 2009, and he had engaged in conduct unbecoming by failing to fulfill representations made to IIROC from 2005 to 2009. Further, the panel concluded that Jory Capital's internal controls were inadequate and that it had failed to maintain a RAC greater than zero on four occasions.

¶ 20 The sanction imposed on Jory Capital was a fine of \$120,000, representing \$40,000 for each RAC deficiency, and the retention of a Monitor for one year. The panel declined to order a suspension in light of the appointment of a Monitor.

¶ 21 In *Re Interactive Brokers Canada Inc.*⁵, the firm had failed to establish or maintain adequate internal controls and to maintain accurate books and records over a period of years. There was also a failure to accurately report financial information and to adequately calculate and report the RAC. In accepting a settlement which provided for a global fine of \$40,000 plus costs of \$10,000, the hearing panel considered a number of other decisions involving internal control or RAC violations in which the fines ranged from \$20,000 to \$60,000.

⁴ 2011 IIROC 7; 2010 IIROC 52

⁵ 2009 IIROC 30

¶ 22 In *Re Northern Securities Inc.*⁶, the Ontario Securities Commission imposed a fine of \$50,000 for the firm having filed inaccurate MFRs that misstated the RAC. As the firm had a prior disciplinary record, which included three settlement agreements, one of which dealt with the firm's failure to maintain a RAC level of greater than zero, the OSC concluded that a substantial sanction was required in order to achieve specific and general deterrence.

¶ 23 Enforcement Staff submitted that the proposed sanction in this matter takes account of the multiple violations and addresses the totality of the Respondent's misconduct in a manner which is both proportionate and consistent with the sanctions imposed in similar circumstances for similar contraventions. Enforcement Staff also submitted that the agreed fine takes into account the size of the Respondent and the fact that the Terms and Conditions, including the appointment of a Financial Monitor at the Respondent's expense, provide a tailored response to the misconduct at issue. The Panel accepts and agrees with those submissions.

¶ 24 The Panel agrees that the proposed sanction is within the reasonable range of appropriateness. The misconduct was serious, particularly as it relates to the RAC violations and the Respondent's failure to fulfill its prior representations to CIRO. There were mitigating factors, but the sheer number and nature of the breaches warrants a substantial penalty in the interests of general deterrence. Compliance with the reporting, record-keeping and capital requirements is of obvious importance to the integrity of the regulatory regime. It is also noted that specific deterrence has already been addressed through the Terms and Conditions, including the appointment of the Financial Monitor.

¶ 25 While the sanction is at the higher end of the range of the sanctions reflected in prior decisions, in the particular circumstances of this case, a global fine of \$175,000 plus costs of \$15,000 is justified by the totality of the contraventions and is clearly within the reasonable range of appropriateness.

CONCLUSION

¶ 26 Taking into account the Guidelines, the prior decisions and the particular facts of this matter, for the reasons stated above, the Panel accepted the Settlement Agreement.

Dated at Toronto, Ontario this 23 day of November 2023.

Barry Bresner, Chair

Charles MacFarlane

Vanessa Gardiner

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⁶ 2014 LNONOSC 581