

IN THE MATTER OF:

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY  
ORGANIZATION OF CANADA**

**AND**

**SCOTIA CAPITAL INC.**

**SETTLEMENT AGREEMENT**

**PART I – INTRODUCTION**

1. The Investment Industry Regulatory Organization of Canada (“IIROC”) will issue a Notice of Application to announce that it will hold a settlement hearing to consider whether, pursuant to Section 8215 of the Consolidated Enforcement, Examination and Approval Rules of IIROC, a hearing panel (“Hearing Panel”) should accept the settlement agreement (“Settlement Agreement”) entered into between the staff of IIROC (“Staff”) and Scotia Capital Inc. (“Scotia” or the “Respondent”).

**PART II – JOINT SETTLEMENT RECOMMENDATION**

2. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

**PART III – AGREED FACTS**

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement

**Overview**

4. Between January 2010 and October 2014, two Registered Representatives with Scotia, an IIROC Dealer Member firm, implemented an investment strategy for many of their clients which attempted to take advantage of the difference between the price of new issues and initial public offerings of securities (“New Issues”) and the price on the secondary market (the “New Issue Strategy”).

5. Scotia was aware of concerns raised by its compliance officers and the relevant supervisor about the risks associated with the New Issue Strategy. However, Scotia approved numerous clients for high risk short term trading without adequately considering whether that was suitable for them, failed to fully investigate concerns about the New Issue Strategy, and failed to take effective action.
6. Overall, Scotia failed to adequately supervise the two Registered Representatives and failed to prevent trading for at least three clients that was unsuitable and not consistent with good business practice.

### **The New Issue Strategy**

7. Scotia employed David Chabassol (“Chabassol”) and David Bugden (“Bugden”) as Registered Representatives. They worked in a partnership called the Chabassol Bugden Group (“CBG”) from a satellite location of Scotia’s Halifax branch in New Glasgow, Nova Scotia.
8. As of at least 2010, CBG implemented the New Issue Strategy for many of their clients. The New Issue Strategy seeks returns from high-volume short-term trading and thus is only suitable for clients with high risk tolerance and whose objectives include short-term trading. The use of leveraged funds for the New Issue Strategy by some of CBG’s clients further increased their risks.
9. In each of 2010, 2011, 2012, 2013 and 2014, the value of purchases that CBG made in all of its accounts was approximately double the value of their total assets under management. New Issues accounted for a significant majority of CBG purchases made in each of those years.
10. When CBG purchased New Issues for their clients, the issuers paid a commission to Scotia, which was shared by Scotia and CBG. Due to the commissions paid by issuers and high turnover, the New Issue Strategy was more profitable than a conventional investment approach.

### **Concerns about CBG and the New Issue Strategy**

11. In late 2009 and early 2010, Scotia compliance officers issued multiple queries related to suitability, high turnover, and concentration in a number of CBG accounts. Significant queries were escalated to CBG’s supervisor (the “Supervisor”) and senior management for Scotia’s compliance department (“Scotia Compliance”).
12. In response, Chabassol proposed a so-called “Risk Management Program” specific to certain CBG clients who were involved in the New Issue Strategy. The Risk Management Program defined risk conservatively in order to highlight the high risk nature of the trading strategy. However, this increased the likelihood that for those clients who wished to engage in the strategy, the client risk tolerance and objectives would be set for high risk active trading. It also encouraged risk tolerance and objectives

to be set based on the type of trading the clients wished to engage in. Clients received customized risk disclosure packages and more frequent reporting due to the short-term trading.

13. CBG's Supervisor sought guidance from Scotia Compliance about the proposed Risk Management Program. Senior management and the Supervisor expressed concerns that the Risk Management Program did not adequately account for clients' personal and financial circumstances and would result in a significant number of CBG clients with 100% high risk tolerance and objectives of 100% short-term capital appreciation ("STCA").
14. Although these concerns were not addressed, Scotia permitted CBG to implement the Risk Management Program. Thereafter, Scotia approved numerous account documents that recorded high risk tolerance of 100% and an objective of 100% STCA.
15. In or about July 2010, a compliance officer noted "*an overall concern with regards to the margin use and the suitability of trading*" in CBG's accounts and undertook a special project on CBG's highest revenue generating households for review by Compliance senior management.
16. Throughout the relevant period, Scotia compliance officers issued numerous queries to CBG relating to the New Issue Strategy. They expressed concerns about suitability, high turnaround, high commissions, conflict of interest, concentration, and use of margin.
17. CBG represented that their clients were comfortable with the New Issue Strategy and frequently responded to queries by increasing high risk tolerance.
18. Scotia relied on CBG's assurances, the updated risk tolerance and the additional reporting clients received under the Risk Management Program.
19. In late 2012, the Supervisor became concerned about the activity in CBG's accounts and undertook a review, which ultimately focused on CBG's top 8 revenue producing clients. Scotia Compliance assisted with the review, but there were delays and it took over a year to complete.
20. In April 2014, Scotia Compliance recommended that the Supervisor contact the 8 clients whose accounts were reviewed to determine whether there were concerns with account activity or performance. This was the first time that Scotia took steps independent of CBG to confirm that clients were comfortable with their account activity and it was limited to the top 8 clients. One client declined to participate further in the New Issue Strategy and made a formal complaint to Scotia.
21. In April 2014, Scotia Compliance also suggested account restrictions that limited New Issue trading by CBG, but none were implemented.

22. In October 2014, Chabassol commenced a medical leave of absence. In the 11 months following, Scotia received 13 complaints from clients of CBG alleging a variety of issues including unsuitable recommendations and discretionary trading.
23. In April 2017, Bugden entered into a Settlement Agreement with IIROC in which he admitted to making unsuitable recommendations to Client A referred to below and to approving account documentation for Clients B and C without adequate due diligence.
24. Scotia has paid compensation to the complainants in the total amount of \$2,501,729.

### **Unsuitable Trading**

25. The New Issue Strategy was not suitable for at least three CBG clients, having regard to their personal and financial circumstances. The trading in their accounts was not consistent with good business practice due to the significant commissions generated as compared to the unsuitable risk undertaken.

### ***Client A***

26. Client A became a client of CBG in 2008. Her Know Your Client (“KYC”) information reflected the following circumstances:
  - a) born in 1939;
  - b) retired and widowed;
  - c) “low” investment knowledge;
  - d) income in the range of \$51,000-\$74,000 per year; and
  - e) entire net worth of \$700,000, all of which was liquid and invested with Scotia.
27. As of October 2010, the risk tolerance for Client A’s RRIF was set at 30% low, 60% medium and 10% high and her investment objectives were 30% income, 60% Long Term Capital Appreciation (“LTCA”), and 10% STCA. In June 2013, the high risk tolerance was increased to 35% and STCA allocation was increased to 45% STCA.
28. As of March 2010, the risk tolerance for Client A’s cash account was set at 25% low, 40% medium and 35% high and her investment objectives were 50% LTCA and 50% STCA. In August 2014, Client A’s risk tolerance was slightly increased to 20% low, 45% medium and 35% high.
29. The risk increases in Client A’s accounts were made in response to suitability queries.
30. Between 2012 and 2014, CBG implemented the New Issue Strategy in Client A’s accounts. During these two years, CBG purchased a total of 97 New Issues in her portfolio.
31. In 2012, the value of the New Issues purchased in both of Client A’s accounts was more than double the account holdings.

32. The New Issues traded in Client A's accounts from 2012-2014 generated approximately \$47,000 in gross commissions for Scotia and CBG, in addition to regular account fees.
33. The trading in Client A's account exceeded her stated risk tolerance and was unsuitable as well as inconsistent with good business practice due to the commissions generated.

***Client B***

34. Client B became a client of CBG in 2010 when she opened an RRSP and margin account. The KYC information reflected the following circumstances:
  - a) born in 1971;
  - b) widowed with two dependent children;
  - c) "low" investment knowledge;
  - d) income of less than \$25,000 per year;
  - e) fixed assets of \$200,000 and liquid assets of \$400,000, all of which was invested with Scotia; and
  - f) risk tolerance 100% high and investment objectives 100% STCA.
35. In May 2011, Client B opened an RESP account. The KYC form reflected the same circumstances, risk tolerance and objectives.
36. Scotia approved the account opening forms for Client B without query, even though the risk tolerance, investment objectives and use of margin did not appear suitable for someone with Client B's personal and financial circumstances.
37. Client B was added to the Risk Management Program, even though she had low investment knowledge, and relatively modest financial means.
38. CBG implemented the New Issue Strategy in Client B's account. From January 2010 until November 2014, CBG effected 280 purchases in Client B's accounts, including 70 New Issues.
39. In 2012, Client B's entire portfolio was turned over more than 3 times and in 2013, her entire portfolio was turned over more than 5 times.
40. The trading in Client B's accounts generated approximately \$60,000 in gross commissions for Scotia and CBG. Approximately \$31,000 of this amount related to New Issues.
41. Client B's risk tolerance and investment objectives were overstated and permitted too much risk for her personal and financial circumstances. The trading in Client B's accounts exceeded her actual risk tolerance and was unsuitable and inconsistent with good business practice due to the commissions generated.

42. Client B was in a transaction-based account and she paid commissions to Scotia on purchases of non-New Issue securities and sales of all securities in her account. Due to the active trading in Client B's account, a fee-based account would have been more suitable.
43. Client B suffered significant losses in the approximate amount of \$190,000. Scotia proactively reached out to client B in order to facilitate the compensation process despite the fact that Client B had not complained. Scotia offered her full compensation.

### *Client C*

44. Client C had been a client of CBG since 2004 with a single cash trading account. In June 2012, Chabassol submitted an Account Agreement Modification Form which reflected the following circumstances:
  - a) born in 1919;
  - b) homemaker;
  - c) "moderate" investment knowledge;
  - d) income in the range of \$25,000-\$50,000 per year;
  - e) fixed assets of \$80,000 and liquid assets of \$210,000, all of which was invested with Scotia; and
  - f) risk tolerance increased from 100% medium, to 70% medium and 30% high, and investment objectives changed from 90% LTCA and 10% STCA to 70% LTCA and 30% STCA.
45. Scotia approved the Account Agreement Modification Form without query, even though the high risk tolerance and investment objectives did not appear suitable for someone with Client C's personal and financial circumstances.
46. CBG implemented the New Issue Strategy in Client C's account. From January 2010 until November 2014, CBG effected 117 purchases for Client C, including 80 New Issues.
47. In 2012 Client C's account was turned over approximately 4.8 times and in 2013 her account was turned over approximately 2.9 times.
48. The New Issues traded in Client C's accounts generated approximately \$31,000 in gross commissions for Scotia and CBG, in addition to regular account fees.
49. Between 2010 and 2014, Client C experienced modest returns. However, Client C's risk tolerance and investment objectives were overstated and permitted too much risk for her personal and financial circumstances. The trading in Client C's account exceeded her actual risk tolerance and was unsuitable and inconsistent with good business practice due to the commissions generated.

### **Inadequate Supervision**

50. Scotia's approval of the Risk Management Program facilitated mischaracterization of client risk tolerance and objectives by CBG and impeded effective supervision.
51. Scotia routinely approved CBG clients for high risk short-term trading. As of November 2015, approximately half of CBG clients had a high risk tolerance of 100% and an investment objective of 100% STCA.
52. The risk tolerance and objectives for many CBG clients was not consistent with their age, investment knowledge, financial and other circumstances. In approving the risk tolerance and investment objectives, Scotia did not take adequate steps to confirm whether they were suitable for the clients and placed undue reliance on the Risk Management Program.
53. Given the high volume of trading associated with the New Issue Strategy, Scotia had many opportunities to detect and query unsuitable risk tolerance, objectives, and trading on daily and monthly reviews. For example, the accounts of Clients A, B and C exceeded the threshold for monthly review by Tier 1 as follows:
  - a) for Client B, 11 times between January 2010 and November 2014;
  - b) for Client C, 6 times between January 2010 and November 2014; and
  - c) for Client A, 4 times in 2012.
54. Client B's accounts also exceeded the commission threshold for monthly review by Tier 2 in September 2012.
55. The daily and monthly reports include summaries of KYC information. Compliance officers queried CBG about potentially unsuitable trading and, in some cases, risk tolerance and objectives. Many queries were escalated to senior management, however Scotia did not take effective action and CBG was permitted to continue the New Issue Strategy for Clients A, B, and C and others for whom it was potentially unsuitable.
56. Since Clients A, B, and C were not among CBG's top 8 revenue producing clients, their accounts were not examined by Scotia in the 2010 or 2012 reviews. Scotia's reviews were inadequate in that they did not include clients with smaller accounts who were vulnerable, despite documented concerns.

### **Mitigating Factors**

57. Individual Scotia compliance officers and the Supervisor took proactive and persistent steps to address suitability and other issues associated with CBG's use of the New Issue Strategy. There were numerous queries and several attempts to analyze the impact of the New Issue Strategy on client accounts.
58. Scotia required the Supervisor to contribute \$100,000 to client remediation by way of salary disgorgement.

59. Scotia has paid \$2,501,729 in compensation to clients of CBG.

#### **PART IV – CONTRAVENTIONS**

60. By engaging in the conduct described above, the Respondent committed the following contravention of IIROC's Rules:

From January 2010 to October 2014, the Respondent Scotia Capital Inc. failed to adequately supervise two Registered Representatives when they recommended securities transactions that were not suitable for their clients and were not in keeping with good business practice, contrary to IIROC Dealer Member Rules 38.1 and 2500.

#### **PART V – TERMS OF SETTLEMENT**

61. The Respondent agrees to the following sanctions and costs:
- a) A fine of \$200,000; and
  - b) The amounts disgorged from the Supervisor in the amount of \$100,000 will be donated by the Respondent to charity.
62. The Respondent will also pay costs to IIROC in the amount of \$20,000.
63. If this Settlement Agreement is accepted by the Hearing Panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

#### **PART VI – STAFF COMMITMENT**

64. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the following paragraph.
65. If the Hearing Panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out Part III of this Settlement Agreement.



**PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT**

66. This Settlement Agreement is conditional on acceptance by the Hearing Panel.
67. This Settlement Agreement shall be presented to a Hearing Panel at a settlement hearing in accordance with the procedures described in Sections 8215 and 8428, in addition to any other procedures that may be agreed upon between the parties.
68. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the Hearing Panel.
69. If the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to waive all rights under the IIROC Rules and any applicable legislation to any further hearing, appeal and review.
70. 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 based on the same or related allegations.
71. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.
72. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel and IIROC will post a full of copy of this Settlement Agreement on the IIROC website. IIROC will also publish a summary of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement.
73. If this Settlement Agreement is accepted, the Respondent agrees that neither it nor anyone on its behalf, will make a public statement inconsistent with this Settlement Agreement.
74. The Settlement Agreement is effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

**PART VIII – EXECUTION OF SETTLEMENT AGREEMENT**

- 75. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.
- 76. A fax or electronic copy of any signature will be treated as an original signature.

**DATED** this “19” day of June, 2017.

“Witness”  
Witness

“Scotia Capital Inc.”  
Scotia Capital Inc.

“Rob Delfrate”  
Witness

“Elissa Sinha”  
Elissa Sinha  
Enforcement Counsel on behalf of  
Enforcement Staff of the Investment  
Industry Regulatory Organization of  
Canada

The Settlement Agreement is hereby accepted this “5” day of “July”, 2017 by the following Hearing Panel:

Per: “John L McDougall, Q.C.”  
Panel Chair

Per: “Daniel Iggers”  
Panel Member

Per: “Richard E. Austin”  
Panel Member