

# Re Jory Capital Inc & Cooney

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**

**Patrick Cooney**

**and**

**Jory Capital Inc**

[2010] IIROC No. 52

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

Heard: November 2, 3 and 4, 2010 at Winnipeg, Manitoba  
Decision: November 12, 2010  
(34 paras.)

## **Hearing Panel:**

Mr. Robert Hucal, Chair, Mr. William J. Welton, Mr. Eric M. Wray

## **Appearances:**

Ms Wietzke Gerber & Ms Faye Emmanuel, for Investment Industry Regulatory Organization of Canada  
Mr. Art Stacey, for Patrick Cooney and Jory Capital Inc

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## **REASONS FOR DECISION**

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- ¶ 1 This is a disciplinary hearing brought pursuant to Part 10 of IIROC Dealer Member Rule 20.
- ¶ 2 The hearing concerns a series of allegations as set out in the Notice of Hearing and dealt with hereafter.
- ¶ 3 Counsel for the Respondents appeared before us prior to commencement of the hearing and indicated that the Respondents would not participate in the liability phase of the hearing, would not contest the allegations and, should liability be found by the Hearing Panel, would accept that finding and expect to participate in the hearing only with respect to representations relating to penalty.
- ¶ 4 Counsel for IIROC indicated a desire to lead evidence to establish the allegations. Counsel for the Respondents confirmed that he would not present or submit evidence and would withdraw from the hearing, indicating that the allegations would not be contested. Counsel indicated that three witnesses would be called, Robert DeGoeij, Manager Financial & Operation Compliance, Investigator Edwin Wang and Warren Funt,

### **Systemic Failure and Risk Adjusted Capital (RAC) Deficiencies**

¶ 5 It is alleged that Cooney, the Chief Executive Officer, President and sole director of Jory, failed to ensure that Jory design, establish, oversee and implement an effective financial compliance program to ensure proper compliance with regulatory requirements regarding maintenance of adequate risk adjusted capital (RAC), monitoring of regulatory capital and reliability of financial reporting, contrary to Rules 29 and 2600.

¶ 6 Rule 17.2A states “every Dealer Member shall establish and maintain adequate internal controls in accordance with the internal control policy statements in Rule 2600”. The latter Rule lists a number of minimum required firm policies and procedures including, but not limited to:

- responsibility for continuous monitoring of its capital position of the firm to ensure that at all times RAC is maintained above zero;
- a planning process which recognizes that the projected capital requirements result from current and planned business activities;
- designed activity limits for the major functional areas of the firm to ensure that the combined operations of the firm maintain at least the minimum required amount of RAC;

¶ 7 Dealer Member Rule 30 describes the early warning system, which measures the capital, profitability and liquidity position of Members to monitor their financial health. Each Member is required to file monthly financial reports and a yearly audited Joint Regulatory Financial Report and Questionnaire. This material permits a calculation of capital based on a capital formula. The early warning system measures the Member’s “Risk Adjusted Capital” against certain arithmetical benchmark tests designed to detect the risk of insolvency of the Member. If a Member fails any of the arithmetical early warning tests, or if a Member’s condition is unsatisfactory, the Member may be designated in the Early Warning Level 1 or Level 2. Level 2 reflects a more serious risk of insolvency than Level 1. Rule 30 imposes standard restrictions on Members designated at each level.

¶ 8 Evidence was presented by DeGoeij to the effect that Jory’s internal controls were inadequate between October/07 and April/10. His evidence, inter alia, indicated that:

- Jory’s accounting system produced late and/or erroneous information;
- Jory operated near or at its early warning levels, almost continuously;
- Jory experienced significant and/or unexpected changes in its capital position;
- Jory’s RAC position was continually inadequate given its historical operating requirements;
- Jory’s budgeted projections for promotion and administrative salary were frequently exceeded;
- Jory’s RAC, at times, was insufficient to fund its planned operating requirements without significant risk of incurring a capital deficiency;
- Jory continued to operate at a level of RAC that would ensure it would incur a capital deficiency despite their designation of being in Early Warning, IIROC’s imposition of enhanced business restrictions and IIROC’s advice to Jory that they needed to improve their RAC position;
- Jory’s failure to adhere to its business plans contributed to the cycle of Jory becoming repeatedly RAC deficient;
- Jory failed to identify errors it made in calculating its estimated RAC. Many of the errors IIROC detected Jory knew, or ought to have known, occurred. Jory did not use generally accepted accounting principles or standard industry practice in its RAC calculation; and
- If Jory had an internal policy that worked, Jory would have been able to correctly estimate its RAC,

thereby preventing any period of capital deficiency.

¶ 9 DeGoeij also presented evidence specific to the capital deficiencies. He stated:

- On the estimated RAC filing of January 22, 2008, Jory erroneously reported a RAC of \$126,000; Jory included corporate advisory fees received after January 22, 2008 and included revenue from net commission related to the sale of a security issued by prospectus. After recalculating RAC, IIROC determined that Jory was RAC deficient in the amount of \$7,000 on January 22, 2008;
- Jory incorrectly recorded a commission difference of \$40,000 received in July 2009 on the sale of Manitoba Builder Bonds as revenue when it was unable to substantiate entitlement, subsequent deduction of the overpayment resulted in a capital deficiency 44 of 66 business days between July 8, 2009 and October 14, 2009;
- On April 14, 2010 Jory recorded a RAC of \$3,000 due to a trading error. On refiling, a RAC of \$3,000 was reported as a result of unrecorded expenses. IIROC determined that Jory was RAC deficient an amount of \$14,000 on April 14, 2010.

¶ 10 In all instances aforesaid, Jory was advised of or was aware in detail of the problems delineated.

¶ 11 It is clear that Jory failed to maintain a RAC position of greater than zero on January 22, 2008, between June 2009 and October 2009 and on April 14, 2010.

¶ 12 We are of the opinion that Cooney failed to ensure the existence of a proper financial compliance system to ensure maintenance of adequate risk adjusted capital and that the allegation is proven.

### **Deteriorating Sales Compliance Reviews**

¶ 13 It is alleged that Cooney failed to ensure that Jory establish, maintain and enforce a supervisory system, contrary to Rule 38.

¶ 14 From 2005 to 2010, the evidence showed that Cooney failed to ensure that Jory establish, maintain and enforce a supervisory system, contrary to Rule 38. The Rule requires that each Dealer Member must establish and maintain a system to supervise the activities of each partner, Director, Officer, Registered Representative, Investment Representative, employee and agent of the Dealer Member that is reasonably designed to achieve compliance with the Rules of the Corporation and all other laws, regulations and policies applicable to the Dealer Member's securities and commodities futures business.

¶ 15 Wang interviewed the five Chief Compliance Officers (CCO) responsible for compliance from 2005 to 2009. The common trend for all of the CCOs, except for Allen Hosey, is that they were current employees of Jory, either portfolio Managers, operations assistant or brokers. They did not apply for the CCO position, but were appointed by Cooney "out of necessity".

¶ 16 More specifically, Barry McCort was asked to become CCO and VDP without any experience and no compliance training. He was terminated as a cost cutting measure. Rayleen Vickery was appointed CCO, without compliance experience, received no training and when asked to become UDP (Ultimate Designated Person), resigned. Hanna Giesbrecht was a portfolio manager when appointed as temporary CCO. She was told not to spend more than 30 minutes daily on compliance, received no training and when it became apparent to her that required compliance changes were not going to be made by Cooney, she resigned. Dave Derwin was a broker. When appointed CCO he was advised that the position was short term. He received no training and had no compliance experience. When it became apparent that Cooney was looking for a permanent CCO, he left Jory. Allan Hosey, hired in May 2009, had compliance experience as a branch manager with Credential Securities and remains with Jory in 2010.

¶ 17 Wang interviewed Cooney and Cooney explained that Jory's business is straight-forward. Only 10 to 15 trades executed per day means the CCO should spend at most 1 hour per day performing trade reviews. The other 7 hours in the day he expected the CCO to be productive and contributing to improving RAC.

¶ 18 Jory's Rule 38 violations severity stems from the repeated nature of the deficiencies. Jory repeatedly acknowledged and undertook to correct deficiencies but failed to do so, notwithstanding the ease by which many of these deficiencies could have been corrected. For example, some account document deficiencies were simple yet fundamental Know-Your-Client (KYC) deficiencies. Although these were easy to correct and Jory agreed to correct them, year after year the same deficiencies were repeated and the number of deficiencies increased. The failure to correct these deficiencies resulted in Jory's inability to properly supervise trading activities and consider suitability issued without New Client Application Forms (NCAFs) that contained up-to-date, accurate and complete information.

¶ 19 We are of the opinion that the allegation has been proven.

### **Trading Conduct Compliance**

¶ 20 It is alleged that Cooney failed to ensure that Jory develop and implement a trade supervision policy as required by Universal Market Integrity Rules (UMIR) 7.1.

¶ 21 Rule 7.1 states that "(1) Each participant shall adopt written policies and procedures to be followed by directors, officers, partners and employees of the Participant that are adequate, taking into account the business and affairs of the Participant, to ensure compliance with UMIR and each policy".

¶ 22 The initial Trading Conduct and Compliance Exam Findings was conducted in February 2006 at which time it was determined that Jory had not developed and implemented trading supervision policies and procedures as required under UMIR 7.1. In addition, Jory was not conducting any of the tests required under UMIR 7.1. Market Regulation Services staff communicated with Jory during the remainder of 2006 and provided input into Jory's drafting of a trading supervision policy manual.

¶ 23 When examiners returned to conduct the 2009 Trading Conduct and Compliance exam in September 2009 they found that Jory had not progressed beyond the drafting stage and had failed to implement the policies and procedures required by UMIR 7.1.

¶ 24 Wang questioned Hosey on the UMIR requirements and he stated that he was not aware of any UMIR trading supervision policy at Jory and was only able to locate a draft policy by searching through the firm's computer system after examiners had concluded their exam. He said he consulted with Cooney and confirmed that Cooney also did not know about the trading supervision policy manual.

¶ 25 Warren Funt, in his evidence, stated that Chief Financial Officers (CFOs) at Jory during 2008 and 2009 viewed their roles as analyzing and reporting to Cooney and although attempts were made to implement internal controls to reduce expenses and establish clear control systems, those attempts never came to fruition.

¶ 26 Mr. Funt's evidence also indicated that, in his opinion, Jory did not meet minimum requirements of IIROC membership and that Jory was in a constant state of low regulatory capital.

¶ 27 Due to capital issues, as the evidence showed, compliance became affected as a proper compliance structure was never put in place. Issues as a result include suitability of investments, failure to comply with regulations and controls relating to unqualified investors. We heard from Mr. Funt that Jory's business structure is not unique and that RAC deficiencies were most often identified by the Dealer Member and corrected immediately. The latter was not the case with Jory.

¶ 28 Mr. Funt also stated that UMIR Rules are structured such that firms are required to have policies and procedures in place in order to perform an internal audit on their trading system. In his opinion Funt felt that a violation of UMIR rules posed a risk to the integrity of the market.

¶ 29 In our opinion, the evidence shows that Cooney failed to ensure that Jory develop and implement a trade supervision policy as required by Universal Market Integrity Rules (UMIR) 2.1.

### **Failure to Fulfill Representations to IIROC**

¶ 30 It is alleged that Cooney engaged in conduct unbecoming his positions by failing to ensure that Jory fulfill representations provided to IIROC, contrary to Rule 29.1.

¶ 31 The evidence showed that Jory's representations, which were primarily written responses to IIROC findings, acknowledging deficiencies and agreeing to address those deficiencies. The findings over a 5-year period were followed with repeated assurances and undertakings by Jory to improve its compliance structure. The undertakings were never met.

¶ 32 We are of the opinion that the evidence provided indicated clearly that the representations made by Cooney in respect of sales compliance reviews and Business Conduct Reviews for a 5-year period, which were never fulfilled, is conduct unbecoming contrary to Rule 29.1.

### **Conclusion**

¶ 33 Considering all of the evidence before us, we believe that IIROC has met the test of establishing the allegations in the Hearing Notice of June 7, 2010 and we find Patrick Cooney and Jory Capital Inc. liable for all the alleged contraventions contained in said Hearing Notice.

¶ 34 In the light of our conclusions, upon consultation with counsel, we will fix a date on which the parties can speak to the penalty.

Robert Hucal, Chair

William J. Welton, Industry Member

Eric M. Wray, Industry Member