

# INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

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

**AND**

**JOHN DONNELLY**

## NOTICE OF HEARING

**TAKE NOTICE** that pursuant to Part 10 of Dealer Member Rule 20 of the Investment Industry Regulatory Organization of Canada (“IIROC”), a hearing will be held before a hearing panel of IIROC (“Hearing Panel”) on November 10, 2015 at 121 King Street West, at 10 am, or as soon thereafter as the hearing can be heard.

**TAKE FURTHER NOTICE** that pursuant to Rule 6.2 of IIROC’s Dealer Member Rules of Practice and Procedure (“Rules of Practice and Procedure”), that the hearing shall be designated on the:

- The Standard Track
- The Complex Track

**THE PURPOSE OF THE HEARING** is to determine whether John Donnelly (“Donnelly” or “the Respondent”) has committed the following contravention that is alleged by the Staff of IIROC (“Staff”):

From May to November 2010, the Respondent as Branch Manager failed to adequately supervise a Registered Representative and the accounts of a client, contrary to IIROC Dealer Member Rules 1300.2 and 2500.

## **PARTICULARS**

**TAKE FURTHER NOTICE** that the following is a summary of the facts alleged and to be relied upon by Staff at the hearing:

### **A. Overview**

1. The Respondent as Branch Manager was responsible for the supervision of the activity in the client accounts of Registered Representative Prohash Mondal (“Mondal”) including the period from February 2009 to November 2010, at which time Mondal left the firm.
2. Between February and April 2009 Mondal opened five margin accounts for his client AM. At that time, AM was approximately 51 years of age, unemployed, and recently widowed. AM invested approximately \$2 million, representing the majority of her net worth and consisting of proceeds of a life insurance policy. The Respondent approved the opening of all accounts for this client.
3. From May to November 2010, the Respondent failed to adequately supervise Mondal and the activity in this client’s accounts by failing to make inquiries to ensure that the activity was suitable for the client. The suitability issues included a single stock concentration, the significant use of margin, large debit balances, frequent short term trading, and short selling.
4. In addition, the Respondent failed to make inquiries of Mondal when on numerous occasions Mondal placed unsolicited trades for the same securities on the same day for several of his clients, including AM.

### **B. Registration History**

5. At all material times, the Respondent was employed as a Branch Manager at Raymond James Ltd. (“RJ”) and started working there in 2005. The Respondent has been a registrant of the Investment Dealers’ Association, the predecessor to IIROC, in various capacities since 1979. The Respondent is currently Senior Vice President and a Registered Representative at RJ, but has not acted as a Branch Manager since approximately 2012 on a voluntary basis.

### **C. Donnelly Approves Opening of Multiple Margin Accounts**

6. Between February 23rd and April 2nd, 2009 five accounts were opened for AM, all of which were margin accounts (the “Accounts”).
7. The Respondent approved the opening of all of the Accounts. The New Client Application (“NCAF”) relating to the Accounts reflected that AM was approximately 51 years of age, unemployed, and recently widowed. AM placed approximately \$2 million into the Accounts, representing the majority of her net worth and consisting of proceeds

of a life insurance policy. No additional funds were subsequently deposited into the Accounts.

8. The NCAFs for AM's Accounts characterized her financial situation as follows:
  - She had liquid assets valued at \$2.4 million
  - She had fixed assets valued at \$600K
  - Her investment knowledge was "limited"
  - Her investment objective was "growth"; and
  - Her risk tolerance was characterized as 80% low risk, 10% medium risk, and 10% high risk.
9. On May 21, 2009, AM wrote a letter to the Respondent complimenting Mondal on his handling of her Accounts.

#### **D. Donnelly Approves Updates to Risk Tolerance and Account Objectives**

10. A few days after the first four accounts were opened in February 2009, and after trading in the accounts had already commenced, Mondal sent an email to the Respondent proposing a corporate bond portfolio for AM.
11. The Respondent provided the firm's head office with the email inquiring as to what risk profile would be necessary to support the portfolio Mondal had proposed. In response compliance staff indicated the risk level should be "*no less than medium risk*".
12. The Respondent then directed Mondal to update AM's risk tolerance from the original 80% low risk, 10% medium risk, and 10% high risk, to 5% low risk, 60% medium risk, and 35% high risk in order to reflect the proposed bond purchases. He also asked Mondal to ensure that AM was given the "*...option to stay with or rebalance to her original objectives.*"
13. On or about March 11, 2009, Mondal updated the NCAF for one of the four margin accounts by changing the risk tolerance to 5% low risk, 60% medium risk and 35% high risk, and made a notation on the update that: "*Client understands & is aware of the risks inherent in purchasing & holding corporate bonds & further understands the current risk categorization does not apply.*" The Respondent's notation on the update indicated that: "*Client declined the option to rebalance.*"
14. In April 2009, the firm's head office compliance staff advised Mondal to update the NCAFs of the remaining four margin accounts to reflect the new risk tolerance and investment objectives. According to compliance staff these changes were required as short term trading was taking place in the Accounts which was not in keeping with AMs original investment objectives or "*...the client's documented 80% low risk investment objective....[and] 'limited' investment knowledge.*"

15. On or about May 5, 2009 Mondal again updated the NCAFs for all five Accounts to reflect risk tolerance of 100% high risk, good investment knowledge and investment objectives of 50% growth and 50% speculative. AM signed all of the update forms.
16. Mondal made a notation on the update form indicating: *“All accounts are being updated in order to reflect the clients’ true objectives. The client does not wish to re-balance to the original objectives. Client is also comfortable with speculative trading. I have also explained all risks related to trading.”*
17. Further, while the February 23, 2009 NCAF reflected that AM had investment experience with only T-Bills and GICs; the update dated May 5, 2009 for the NCAFs for all of the Accounts reflected that this client had investment experience in strip bonds; income trusts; common shares; preferred shares, new issues and venture investments.
18. However there is no evidence that the Respondent questioned the significant change in investment experience for this client over the intervening approximately two month period of time. These changes did not reflect the client’s true investor profile.
19. A summary of the NCAF information and updates is found at Appendix A to this Notice of Hearing.

**E. Trading Activity in the Accounts**

**i. Increase in Equities Holdings**

20. Notwithstanding Mondal’s original February 2009 proposal for a 90% bond portfolio for AM, by May 2010 the Accounts held approximately 5% bonds. By November 2010 there were no bonds remaining in the Accounts.
21. In tandem with the decrease in bond holdings, AM’s equities holdings, increased to 100% of the holdings in the Accounts in November 2010.

**ii. Single Stock Concentration and Large Debit Balance**

22. In addition, from May to November 2010 the activity in AM’s Accounts reflected a significant increase in concentration of Bank of America (“BAC”) shares, a significant use of margin, and a large debit balance, as reflected below:

<b>2010</b>	<b>Market value</b>	<b>Debit balance (000s)</b>	<b>Equity (cash + securities) (millions)</b>	<b>Concentration of BAC as %</b>	<b>Number of shares of BAC</b>	<b>BAC Share price</b>	<b>Market value of BAC (000s)</b>
April	1.9	93	2.0	18	20,000	17.83	360
May	2.4M	-517	1.8	35	40,000	15.74	650
June	2.6M	-1.02M	1.6	65	70,000	14.37	1.0M
July	2.5M	-833	1.7	67	80,000	14.04	1.1M
August	2.1M	-737	1.4	73	80,000	12.45	1.0M

September	1.9M	-355	1.5	70	80,000	13.11	1.0M
October	2.1M	-693	1.4	65	80,000	11.44	930
November	2.0M	-607	1.4	64	80,000	10.95	900

23. Throughout June to November 2010 the concentration of BAC shares in the Accounts was at least 64%, with a high of 73% in August 2010.
24. The significant use of margin together with a decline in BAC's share value contributed to a large debit balance in the Accounts which hit a high of \$2.2 million in mid-August, 2010.
25. In response to a head office query, the Respondent wrote to Mondal on August 16, 2010 noting that the "...debit increased by \$1.2 million last week. It must be reduced immediately below its previous level."
26. Further, in or about August 2010 the Respondent made a notation on the daily commission run for Mondal indicating that following a meeting with him he had directed Mondal to "...have the margin exposure reduced significantly from the \$1.8MM - \$2.4MM level down to a maximum of 1/3 to 1/2 of equity."
27. By September 2010 the debit was reduced to \$355,000. Even with this reduction in the debit, for several weeks in September and October 2010, AM's debit was the highest among all of the clients in the Respondent's branch.
28. Other than these two inquiries in August 2010, there is no evidence that the Respondent specifically queried Mondal about the concentration in BAC shares, the debit balance or the margin exposure in the Accounts.

### **iii. Frequent Short Term Trading**

29. Mondal used the proceeds from the sale of bonds in the Accounts to engage in frequent short term trading of equities.
30. There were over 115 transactions in August 2010, and over 165 transactions in September 2010. The majority of these trades were marked "unsolicited".
31. During the material time, in at least 80% of the transactions in AM's Accounts equity securities were held for fewer than 10 days and approximately half of those were bought and sold on the same day.
32. The frequent short term trading in AM's Accounts was identified by the firm's head office compliance staff on or about June 3, 2010 when a compliance officer questioned why AM's account had a "...pattern of buying large concentrated positions...only a few days before selling...".

33. Approximately two months later, in a response dated August 3, 2010, Mondal advised RJ compliance that AM was an active trader, that she held significant assets outside the firm, and that the account in question held her risk capital.
34. There is no evidence that the Respondent queried Mondal about the short term trading or whether AM was willing to take on the risks associated with short term trading.
35. The frequent short term trading resulted in an annualized turnover ratio of at least 13 in the Accounts, and was not consistent with this client's true investor profile.

**iv. Short Selling**

36. In addition to the frequent short term trading detailed above, by May 2010 Mondal was short selling securities in the Accounts.
37. By November 2010 he had executed approximately 45 short sales, approximately 20 of which occurred in September 2010 alone.
38. There is no evidence that the Respondent queried Mondal about the short selling in the Accounts. This activity was not consistent with this client's true investor profile.

**v. Numerous Trades for Several Client Accounts Marked Unsolicited**

39. From February 2009 to November 2010, the Respondent initialed and dated the branch daily commission reports for Mondal. The commission reports included the trading activity in the Accounts, Mondal's other clients' accounts and his personal accounts.
40. On numerous days for the time period May to November 2010, these commission reports indicated buys and sells on the same day for many of the same securities for several of Mondal's clients, including AM, all marked unsolicited.
41. Other than one inquiry of Mondal in July 2009, there is otherwise no evidence that the Respondent queried Mondal about any of the trading marked unsolicited on the commission reports that he reviewed.
42. On or about November 26, 2010 the Respondent agreed to meet with Mondal and AM; however the meeting did not take place as Mondal and AM did not attend as scheduled.

**F. The Respondent's Failure to Adequately Supervise**

43. For the period from May to November 2010, the Respondent failed to supervise the Accounts in that there is no evidence of any inquiries regarding the activity in the Accounts, as detailed above. At a minimum the following red flags relating to the Accounts should have prompted inquiries by the Respondent:

- Concentration of a single security, namely BAC shares, which doubled in a two month period from May to July, 2010 resulting in a 67% concentration in July; and concentration of 73% in August of 2010;
- Frequent short term trading, including 165 short term trades in September 2010 alone;
- Short selling that included over 20 short sales in September 2010 alone; and
- Mondal's marking of trades as "unsolicited" across several client accounts on the same days that he traded the same securities in other clients' accounts as well as in his personal account.

### **G. Losses and Commissions**

44. For the period May to November, 2010 unrealized and realized losses in the Accounts totaled approximately \$600,000. Of the total losses approximately \$400,000 was attributable to the concentrated position in BAC shares, as at November 30, 2010.
45. During this time period, Mondal earned approximately \$40,000 in commissions as a result of the activity in the Accounts.
46. The dollar value of purchases for the Accounts during this time period was in excess of \$30 million.
47. As a consequence of the large debit balances, in the period from May and November 2010 AM was charged approximately \$37,000 in interest.

### **GENERAL PROCEDURAL MATTERS**

**TAKE FURTHER NOTICE** that the hearing and related proceedings shall be subject to the Rules of Practice and Procedure.

**TAKE FURTHER NOTICE** that pursuant to Rule 13.1 of the Rules of Practice and Procedure, the Respondent is entitled to attend and be heard, be represented by counsel or an agent, call, examine and cross-examine witnesses, and make submissions to the Hearing Panel at the hearing.

### **RESPONSE TO NOTICE OF HEARING**

**TAKE FURTHER NOTICE** that the Respondent must serve upon the Staff of IIROC a Response to the Notice of Hearing in accordance with Rule 7 of the Rules of Practice and Procedure within twenty (20) days (for a Standard Track disciplinary proceeding) or within thirty

(30) days (for a Complex Track disciplinary proceeding) from the effective date of service of the Notice of Hearing.

### **FAILURE TO RESPOND OR ATTEND HEARING**

**TAKE FURTHER NOTICE** that if the Respondent fails to serve a Response or attend the hearing, the Hearing Panel may, pursuant to Rules 7.2 and 13.5 of the Rules of Practice and Procedure:

- (a) proceed with the hearing as set out in the Notice of Hearing, without further notice to the Respondent;
- (b) accept as proven the facts and contraventions alleged by Staff in the Notice of Hearing; and
- (c) order penalties and costs against the Respondent pursuant to Dealer Member Rules 20.33, 20.34 and 20.49.

### **PENALTIES & COSTS**

**TAKE FURTHER NOTICE** that if the Hearing Panel concludes that the Respondent did commit any or all of the contraventions alleged by Staff in the Notice of Hearing, the Hearing Panel may, pursuant to Dealer Member Rules 20.33 and 20.34, impose any one or more of the following penalties:

#### **Where the Respondent is/was an Approved Person:**

- (a) a reprimand;
- (b) a fine not exceeding the greater of:
  - (i) \$1,000,000 per contravention; and
  - (ii) an amount equal to three times the profit made or loss avoided by such Approved Person by reason of the contravention.
- (c) suspension of approval for any period of time and upon any conditions or terms;
- (d) terms and conditions of continued approval;
- (e) prohibition of approval in any capacity for any period of time;
- (f) termination of the rights and privileges of approval;



- (g) revocation of approval;
- (h) a permanent bar from approval with the IIROC; or
- (i) any other fit remedy or penalty.

**Where the Respondent is/was a Dealer Member:**

- (a) a reprimand;
- (b) a fine not exceeding the greater of:
  - (i) \$5,000,000 per contravention; and
  - (ii) an amount equal to three times the profit made or loss avoided by the Dealer Member by reason of the contravention;
- (c) suspension of the rights and privileges of the Dealer Member (and such suspension may include a direction to the Dealer Member to cease dealing with the public) for any period of time and upon any conditions or terms;
- (d) terms and conditions of continued Membership;
- (e) termination of the rights and privileges of Membership;
- (f) expulsion of the Dealer Member from membership in the IIROC; or
- (g) any other fit remedy or penalty.

**TAKE FURTHER NOTICE** that if the Hearing Panel concludes that the Respondent did commit any or all of the contraventions alleged by the Staff in the Notice of Hearing, the Hearing Panel may pursuant to Dealer Member Rule 20.49 assess and order any investigation and prosecution costs determined to be appropriate and reasonable in the circumstances.

**DATED** at Toronto, this 6th day of November, 2015.

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ELSA RENZELLA  
VICE-PRESIDENT, ENFORCEMENT  
INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA  
Suite 2000, 121 King Street West  
Toronto, Ontario M5H 3T9

Appendix A to Notice of Hearing for John Donnelly

Summary of NCAF Information and Updates

<b>NCAF Information</b>	<b>Date 2009</b>	<b>Employment</b>	<b>Annual Income</b>	<b>Net Worth</b>	<b>Risk Tolerance</b>	<b>Account Objectives</b>	<b>Investment Knowledge</b>
<b>First</b> Margin Account in CDN\$	Feb.23	Homemaker	\$100,000 From investments	\$3 million	80% low 10% med 10% high	100% Growth	Limited
<b>Update</b> to First Account in CDN\$	Mar.12	Not indicated	Not indicated	Not indicated	5% low 60% med 35% high	Not indicated	Not indicated

<b>Second</b> Margin Account in US\$	Feb. 23	Homemaker	\$100,000 From investments	\$3 million	80% low 10% med 10% high	100% Growth	Limited
<b>Third</b> Margin Account in CDN\$	Feb. 24	Not Employed Student or Homemaker	\$100,000 From investments	\$3 million	80% low 10% med 10% high	100% Growth	Limited
<b>Fourth</b> Margin Account in US\$	Feb. 24	Not Employed Student or Homemaker	\$100,000 From investments	\$3 million	80% low 10% med 10% high	100% Growth	Limited
<b>Fifth</b> Margin Account in CDN\$	Apr. 2	Not Employed Student or Homemaker	\$100,000 From investments	\$3 million	80% low 10% med 10% high	100% Growth	Limited

<b>Update</b> To all Five Margin Accounts	May 5	Homemaker	\$100,000 From investments	\$2.7million	100% high	50% Growth 50% Speculative	Good
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