Re Wood

IN THE MATTER OF:

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

and

James Wood ("the respondent")

2016 IIROC 49

Investment Industry Regulatory Organization of Canada
Hearing Panel (Atlantic District)

Heard: October 18 & 19, 2016
Decision: November 29, 2016

Hearing Panel:
Gerard Mitchell, Chair, Roland Coffill and Nancy Ross
Appearances:
Kathryn Andrews, Senior Enforcement Counsel IIROC
The respondent for himself

DECISION

¶ 1 The Panel conducted a hearing on October 18th and 19th, 2016 in relation to allegations by IIROC that the respondent had committed the following contraventions of IIROC Dealer Member Rules:

1. During 2010 and 2011 the respondent while a registered representative failed to use due diligence to learn and remain informed of the essential facts relative to the client, contrary to IIROC Dealer Member Rule 1300.1(a);
2. Between 2010 and 2013, the respondent failed to ensure that recommendations made for the client's accounts were suitable for him, contrary to IIROC Dealer Member Rule 1300.1(q)
3. In 2010 the respondent failed to use due diligence to ensure that the client qualified as an accredited investor in accordance with the provisions of National Instrument 45-106 before facilitating the purchase of securities offered pursuant to prospectus exemptions, contrary to IIROC Dealer Member Rule 1300.1(a).

¶ 2 IIROC Dealer Member Rule 1300.1(a) provides that:

> Each Dealer Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.

¶ 3 IIROC Dealer Member Rule 1300.1(q) provides that:

> Each Dealer Member, when recommending to a client the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such client based on factors including the client's current financial situation, Investment knowledge, investment objectives and time horizon, risk tolerance and the account or accounts current

investment portfolio composition and risk level.

¶ 4 The "Know Your Client" obligation contained in Rule 1300.1(a) requires, among other things, that a person in the position of the respondent exercise due diligence to learn and keep informed about a client's current financial situation.

¶ 5 The "suitability" obligation contained in Rule 1000.1(q) requires a person in the position of the respondent to determine whether a particular investment is appropriate for a particular client. This means a person in the position of the respondent must know both the client and the product well enough to determine if they would be an appropriate match.

¶ 6 The obligations of due diligence under Rules 1300.1(a) and (q) are not fulfilled by merely filling in blanks or ticking boxes on an application form in a perfunctory manner. The two rules are separate but closely related because if the Know Your Client obligation is not fulfilled it is impossible to fulfill the Suitability obligation.

¶ 7 The respondent was at all material times a Registered Representative employed at the Charlottetown, Prince Edward Island branch of Aston Hill Securities Inc. (formerly known as Citadel Securities Inc.). In this capacity he was an investment advisor to TK ("the client") between May of 2010 and June 2013. The respondent is no longer registered with IIROC.

¶ 8 At the hearing the panel heard evidence from the client, IIROC investigator Pat Gerada, the respondent and his spouse. The panel also received eight exhibits all which were entered with consent.

¶ 9 There is considerable conflict in the evidence as to what was said and understood by the respondent and the client during discussions between them. Both the respondent and the client present some creditability challenges. When however, all of the oral and documented evidence is considered, it is abundantly clear, that the respondent did not comply with IIROC Dealer Member Rules 1300.1 (a) or (q). He did not use due diligence to get to know his client or to determine whether the investments that he recommended to the client were suitable for his circumstances.

¶ 10 The client opened a cash account, a locked in RSP account, and an RSP account with the respondent at Aston Hill Securities Inc. on May 27th, 2010. At that time the New Client Application Form ("NCAF") indicated that the client, a government employed civil engineer, was 55 years old, and married with one dependent. He had estimated net liquid assets of $150K, estimated net fixed assets of $600K and, an estimated net worth of $750K. The client's income was listed at $80K but his spouse's income was left blank although the form indicated she was employed as an office manager. The bank reference on the application form was the Morell branch of the Bank of Nova Scotia.

¶ 11 A week later, on June 3rd, 2010, a second NCAF was signed by the client. This time his estimated liquid assets were increased to $450K and his net worth was increased to $1.05 million. The portion of the form dedicated to spousal profile was not completed. The bank reference on this form was the Charlottetown branch of the TD Canada Trust at Queen and Kent Streets. No reasonable explanation was given for the significant change in assets in such a short time.

¶ 12 About nine months later, on March 17th, 2011, a third NCAF was completed. This time the form indicates that the client's net liquid assets had increased from $450K to $1.1M. His fixed assets were reduced from $600K to 200K. His net worth was stated as $1.3M. Again no reasonable explanation was given for the changes other than the respondent saying the client was going to sell his cottage property. Such a sale would have reduced his fixed assets but there is no evidence it would enhance his liquid assets from $450K to $1.1M. According to the evidence that property for real estate tax purposes was valued at only about $110K. In any event it was not sold.

¶ 13 On the third NCAF the spousal profile was completed and indicated his wife had income of $40K. The client's own income was again shown as $80K. This time the Bank Reference was shown as ScotiaBank 0XXX Transit 6XXXX. It is notable that each of the three NCAFs listed a different financial institution as a bank

reference.

¶ 14 On all 3 of the NCAF forms the box for "good" investment knowledge was checked. Each of the forms also indicated the client wanted to allocate 100% of the assets in his accounts to high risk speculative securities and trading strategies. In fact the client's prior investment experience was limited to GICs and money market products. He had no experience with high risk products.

¶ 15 Between May 2010 and June 2013, on the recommendation of the respondent, the client purchased the following securities on one or another of his three accounts:

Kent Exploration Inc. ("Kent")

ROI Fund ("ROI")

ROI Strategic Fund ("ROI Strategic")

Paragon Minerals Corporation Private Placement ("Paragon Units")

Horizons BetaPro S&P 500 Bear Plus ETF ("Horizons ETF")

Horizons BetaPro S&P 500 VIX Short-term Futures Bull Plus ETF ("Horizons Futures ETF")

Sentry Select Precious Metals Growth Class Fund ("Sentry Class Fund")

Orbite Aluminae Inc. Class A ("Orbite")

Kent Private Placement ("Kent Units")

All of these, with the possible exception of the ROI funds, were high risk investments.

¶ 16 Furthermore, the Kent, ROI, ROI Strategic and Paragon Units could only be purchased by an "accredited investor" as defined in National Instrument 45-106. The respondent in 2010 recommended that the client purchase these four securities pursuant to prospectus exemptions in reliance on the accredited investor exemption set out in s.2.3 of National Instrument 45-106.

¶ 17 Section 2.3 of National Instrument 45-106 provides that a dealer registration does not apply with respect to a trade of a security if the purchaser purchases the security as principal and is an "accredited investor".

¶ 18 According to National Instrument 45-106 1.1 (j) through (l) an individual, such as the client in this case, qualifies as an "accredited investor" if he: (j) either alone or with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, in excess of $1M (k) has net income before taxes exceeding $200K; or (l) either alone or with a spouse, has net assets of at least $5M. National Instrument 45-106 defines "financial assets" to mean cash and securities but not real estate. The client in this case did not qualify under any of these categories and if the respondent had exercised any due diligence he would have known that.

¶ 19 If the respondent had properly carried out his Know Your Client and suitability obligations under IIROC Rules 1300.1 (a) and (q) he would easily have recognized these investments were all out of the client's league. He had no experience in dealing with high risk products. His previous experience was limited to GICs and money market products.

¶ 20 During the time between May 2010 and June 2013 the client sustained losses on the three accounts totalling a little more than 124K.

¶ 21 It may be that the client too was careless or even complicit in signing off on documents containing misinformation. That does not however absolve the respondent. The responsibility to know his client and to recommend only suitable investments rested solely on the respondent. The respondent had to scratch below the surface of such wildly different information. He cannot pass his duty on to the client.

¶ 22 It is inescapable that the changes to the NCAFs were not the result of real material changes but were designed to justify the suitability of investments that would otherwise be unsuitable to the client. It was not

reasonable for the respondent to believe the client's liquid net assets ballooned from $150K to $450K in one week and then to $1.1M in just nine or ten months. There is nothing to account for such dramatic changes. The client did not sell anything and there is nothing to indicate he acquired any additional assets of his own other than what he had at the time of signing the first NCAF. The only assets that might have been added were his wife's RRSP and money that his mother had given him to invest for her. However, neither his wife's RRSP nor his mother's money were his own.

¶ 23 The first two NCAFs indicated the client had net fixed assets of $600K. The third showed his fixed net assets of only $200K. However, he never disposed of any fixed assets. If the respondent had exercised Know Your Client due diligence he would have realized the client did not have $600K in fixed assets in the first place. According to the evidence he owned or had an interest in four pieces of real estate that together, for tax purposes, were valued at about $325K. There is no indication he had any other fixed assets.

¶ 24 The evidence also shows that the client did not have net income of much more than 80K before taxes much less the $200K needed to qualify as an accredited investor under National Instrument 45-106 1.1(j).

¶ 25 As a result of all the forgoing we have concluded that the respondent did commit the three contraventions alleged by IIROC staff in the Notice of Hearing. It will now be necessary to convene a sanctions hearing.

Gerard Mitchell

Panel Chair

Roland Coffill

Panel Member

Nancy Ross

Panel Member