Re Matthews

IN THE MATTER OF:

The By-laws of the Investment Dealers Association of Canada

and

The Dealer Member Rules of the Investment Industry Regulatory Organization of Canada

and

Grant Patrick Matthews

2014 IIROC 56

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

Heard: September 22-24, 2014 in Calgary, Alberta
Decision: November 21, 2014

Hearing Panel:
Eric Spink, QC, Chair, Martin Davies and Don Milligan
Appearances:
David McLellan, Enforcement Counsel
No one appearing for Grant Patrick Matthews

REASONS FOR DECISION

INTRODUCTION

¶ 1 The purpose of this hearing is to determine whether Mr. Matthews (the Respondent) committed the following contraventions alleged in the Notice of Hearing dated February 27, 2014:

1. Between approximately March 2004 and May 2012, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to four (4) clients contrary to Dealer Member Rule 1300.1(a) [IDA Regulation 1300.1(a) prior to June 1, 2008];
2. Between approximately January 2009 and May 2012, the Respondent failed to use due diligence to ensure that recommendations were suitable for four (4) clients, based on factors including the client's financial situation, investment knowledge, investment objectives and risk tolerance contrary to IIROC Dealer Member Rule 1300.1(q);
3. Between approximately June 2009 and May 2012, the Respondent engaged in discretionary trading with respect to the accounts of three (3) clients, without being authorized and approved as having discretionary authority contrary to Dealer Member Rule 1300.4;
4. From January 2009 and March 2011, the Respondent engaged in improper practices by excessively trading in (churning) the accounts of three (3) clients, for the sole purpose of generating additional commissions contrary to Dealer Member Rules 1300.1(o) and 29.1.

¶ 2 The Notice of Hearing included Particulars of the alleged contraventions, set out in 93 paragraphs.

¶ 3 The Respondent was temporarily represented by counsel, who filed a Response to Notice of Hearing dated March 19, 2014 (the Response) in accordance with Rule 7.1 of the IIROC Rules of Practice and Procedure. The Response admitted some facts but denied all the allegations and suggested an alternative version of events that generally contradicted the Notice of Hearing and Particulars.

¶ 4 The Respondent did not appear at the hearing on September 24, 2014. The evidence established proper service and showed that the Respondent's former counsel ceased to act for him in July 2014, and that the Respondent was well aware of these proceedings.

¶ 5 IIROC's counsel invited the panel to rely upon Rule 13.5 of the IIROC Rules of Practice and Procedure which says:

> Where a Respondent, having been served with a Notice of Hearing, fails to attend a disciplinary hearing, the Hearing Panel may proceed in the absence of the Respondent and may accept as proven the facts and violations alleged by the Organization in the Notice of Hearing.

¶ 6 The panel decided to hear the evidence before making any decision on the alleged violations.

SUMMARY OF ALLEGATIONS

¶ 7 The Notice of Hearing alleges that the Respondent violated the following IIROC Dealer Member Rules:

> 1300.1(a) 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.
>
> 1300.1(q) 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.
>
> 1300.4 A Registered Representative may not exercise discretionary authority over a customer account unless:
>
> (a) the Dealer Member has designated a Supervisor or Supervisors to be responsible for discretionary accounts;
> (b) the customer has given prior written authorization in compliance with in compliance with Rule 1300.5;
> (c) a Supervisor designated under subsection (a) has approved the account as a discretionary account and recorded that approval;
> (d) the Registered Representative authorized to effect discretionary trades for the account has actively dealt in, advised on or performed analysis for a period of two years with respect to all types of products which are to be traded on a discretionary basis; and
> (e) the account is maintained at the Dealer Member of the Registered Representative.
>
> 1300.1(o) Each Dealer Member shall use due diligence to ensure that the acceptance of any order for any account is within the bounds of good business practice.
>
> 29.1 Dealer Members and each partner, Director, Officer, Supervisor, Registered Representative, Investment Representative and employee of a Dealer Member (i) shall observe high standards of ethics and conduct in the transaction of their business, (ii) shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest, and (iii) shall be of such character and business repute and have such experience and training as is consistent with the standards described in clauses (i) and (ii) or as may be prescribed by the Board.

¶ 8 For convenience we refer to: Rule 1300.1(a) as the "know your client" or KYC rule or obligation; Rule 1300.1(q) as the "suitability" rule or obligation; Rule 1300.4 as the rule against "discretionary trading"; and

Rules 1300.1 and 29.1 as the rules against "churning".

¶ 9 The allegations involve four clients – EF, LZ, JS and DS – and amount to fourteen separate Counts:

- with respect to client EF:
    - Count 1: KYC;
    - Count 2: suitability;
    - Count 3: discretionary trading;
- with respect to client LZ:
    - Count 4: KYC;
    - Count 5: suitability;
    - Count 6: churning;
- with respect to client JS:
    - Count 7: KYC;
    - Count 8: suitability;
    - Count 9: discretionary trading;
    - Count 10: churning;
- with respect to client DS:
    - Count 11: KYC;
    - Count 12: suitability;
    - Count 13: discretionary trading; and
    - Count 14: churning.

SUMMARY OF APPLICABLE LAW

The "Know Your Client" (KYC) and "Suitability" Obligations

¶ 10 The leading authority on these obligations is *Re Lamoureux* [2001] A.S.C.D. No. 613, where the Alberta Securities Commission said at Part IV(B)(2):

> Determining whether a registrant has satisfied their regulatory obligations in relation to an individual client depends upon the particular circumstances of each case. It requires close analysis of the client's situation and the relationship between the registrant and the client. Both the fiduciary and the regulatory obligations of a registrant may be more or less onerous depending upon the extent of the client's reliance upon the registrant.
>
> The Supreme Court of Canada discussed the issue in *Hodgkinson v. Simms et al* (1995) 117 D.L.R. (4th) 161 saying [at p. 183]:
>
> > ... in *Varcoe v. Sterling* (1992), 7 O.R. (3d) 204, ... in an effort to demarcate the boundaries of the fiduciary principle in the broker-client relationship. Keenan J. stated, at pp 234-36:
> >
> > > The relationship of broker and client is not *per se* a fiduciary relationship... Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. On the other hand, if those elements are not present, the fiduciary relationship does not exist ... The circumstances can cover the whole spectrum from total reliance to total independence. An example of total reliance is found in the case of *Ryder v. Osler, Wills,*

> *Bickle Ltd*. (1985), 49 O.R. (2d) 609, 16 D.L.R. (4th) 80 (H.C.J.). A $400,000 trust for the benefit of an elderly widow was deposited with the broker. An investment plan was prepared and approved and authority given to operate a discretionary account... At the other end of the spectrum is the unreported case of *Merit Investment Corp. v. Mogil*, Ont. H.C.J., Anderson J., March 23, 1989 [summarized at 14 A.C.W.S. (3d) 378], in which the client used the brokerage firm for processing orders. He referred to the account executive as an "order-taker", whose advice was not sought and whose warnings were ignored.
>
> …
>
> The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker's advice in making business decisions. When the broker seeks or accepts the client's trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith. ... It is the trust and reliance placed by the client which gives the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and has given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly.

In my view, this passage represents an accurate statement of fiduciary law in the context of independent professional advisory relationships, whether the advisers be accountants, stockbrokers, bankers, or investment counselors. Moreover, it states a principled and workable doctrinal approach. Thus, where a fiduciary duty is claimed in the context of a financial advisory relationship, it is at all events a question of fact as to whether the parties' relationship was such as to give rise to a fiduciary duty on the part of the advisor.

and at Part IV(B)(3)(a):

> The "know your client" and "suitability" obligations are conceptually distinct but, in practice, they are so closely connected and interwoven that the terms are sometimes used interchangeably.
>
> The "know your client" obligation is the obligation to learn about the client, their personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance.
>
> The "suitability" obligation is the obligation on a registrant to determine whether an investment is appropriate for a particular client. Assessment of suitability requires both that the registrant understands the investment product and knows enough about the client to assess whether the product and client are a match.

and at Part IV(B)(3)(b):

> Neither the "know your client" obligation nor the "suitability" obligation can be fulfilled merely by completing poorly-constructed forms or by following a procedure in a perfunctory fashion. Forms and procedures are merely tools that can assist in performing a task and that may provide reminders or evidence of efforts undertaken or not undertaken.
>
> …
>
> Whatever forms or procedures may be used, the essential test for determining whether a registrant has satisfied their obligations is whether the registrant used due diligence…. A knowledge of the forms and procedures applied can help in assessing whether the test has been satisfied but completion of a form by itself is not determinative of whether a registrant "knew his client".

and at Part IV(B)(3)(c):

> Suitability is to be assessed prior to any investment recommendation by the registrant to a client. The process that culminates in a registrant's investment recommendation to a client has three component phases or stages that must occur in sequence.

> The first stage involves the "due diligence" steps undertaken by the registrant to "know the client" and to "know the product". Knowing the product involves carefully reviewing and understanding the attributes, including associated risks, of the securities that they are considering recommending to their clients. Knowing the client was discussed above.
>
> Only after the "due diligence" of the first stage is completed, can the registrant move to the second stage in which they fulfill their obligation to determine whether specific trades or investments, solicited or unsolicited, are suitable for that client.
>
> Suitability determinations, discussed in section IV (B) (d), will always be fact specific. A proper assessment of suitability will generally require consideration of such factors as a client's income, net worth, risk tolerance, liquid assets and investment objectives, as well as an understanding of particular investment products. The registrant must apply sound professional judgement to the information elicited from "know your client" inquiries. If, based on the due diligence and professional assessment the registrant reasonably concludes that an investment in a particular security in a particular amount would be suitable for a particular client, it is then appropriate to the registrant to recommend the investment to that client.
>
> By recommending a securities transaction to a client, a registrant enters the third stage of the process. Whether a particular transaction has in fact been "recommended" is to be determined objectively, taking into consideration the content, context and manner of communication from a registrant to the client, to assess whether it could reasonably be understood as a suggestion that the customer engage in a securities transaction. At this stage, when making the client aware of a potential investment, the registrant is obligated to make the client aware of the negative material factors involved in the transaction, as well as positive factors.
>
> The disclosure of material negative factors in the third stage of the process is intended to assist the client in making an informed investment decision. It should be emphasized that such disclosure cannot ameliorate deficiencies in either of the first two stages of the process. If a registrant recommends securities that are not suitable for a particular client, then disclosure by the registrant during the third stage is irrelevant to their suitability obligation in stage two. The registrant's failure may have been the result of not knowing the client, or not knowing the securities, or an error in the suitability determination but, once the improper recommendation has been made, it does not matter whether or how the registrant discloses the material negative factors, or whether the client claims to understand and accept the risks involved in the investment. The registrant has failed to fulfill their obligations.

and at Part IV(B)(3)(d):

> The obligation to ensure that recommendations are suitable or appropriate for the client rests solely with the registrants. This responsibility cannot be substituted, avoided or transferred to the client, even by obtaining from the client an acknowledgement that they are aware of the negative material factors or risks associated with the particular investment.
>
> The obligation on a registrant to ensure that each investment recommended to a client is suitable is a particularly important protection for those clients whose investment experience and sophistication may be insufficient to enable them to fully recognize or assess the risks inherent in an investment. As noted below, disclosure to the client of the negative material factors of an investment, however important, is not necessarily relevant to a suitability determination and cannot replace a registrant's obligation to assess suitability. Acknowledgement on the part of an investor of awareness of the material negative factors or risk does not convert an unsuitable investment into a suitable one.

Discretionary Trading

¶ 11 The Alberta Securities Commission summarized "discretionary trading" in Re Wenzel [2005] A.S.C.D. No. 153, saying: "When a person effects a securities transaction for a client without obtaining from the client, in advance, specifics as to four elements of the transaction – quantity, security, price and timing – that person is

exercising ‘discretion’.”

Churning

¶ 12 In *Re D.M. Graydon Osler, Wills, Bickle Ltd.* [1987] T.S.E.D.D. No. 20 (*Re Graydon*) the panel said that “the word ‘churning’ is little more than a shorthand way of describing improper conduct of the kind specified in the complaint”. The panel accepted the description that: “churning is a practice whereby a registered representative, exercising control of the volume and frequency of trades, trades that account excessively in view of the character of the account and the customer’s objectives”.

¶ 13 The panel in *Re Graydon* observed that a registered representative may control an account by exercising discretionary authority over the account, or by exercising de facto control, which “may be inferred from the fact that the client reposed confidence in the registered representative because, for example, of the disparity of their knowledge and experience of the market, the existence of some pre-existing family or social relationship, and the age of the client”.

¶ 14 The panel in *Re Graydon* described the following considerations as relevant to determining “whether trading was so excessive as to constitute a breach of the principles of just and equitable trading”:

a. Character of the account and the client’s investment objectives

> As a matter of common sense, a volume of trading that may be appropriate in an account that contains a modest part of the capital of a wealthy person and is to be used for speculation, may be totally inappropriate in an account that contains almost the entire capital of an elderly person of limited means who intends the account to supplement her present income and to provide her with a source of financial support in her retirement. …

b. Volume and frequency of trading

> There are several widely used indicators of the extent of the trading activity in an account. One is the annualized rate at which an account is turned over: this is calculated by dividing the total value of the purchases in a year by the average value of the equity [turnover rate]. …
>
> Another measure is the frequency with which securities are bought and sold (“in and out trading”), especially when the same or similar investments are involved. …

c. Client loss v. broker profit

> …It may be inferred from the size of the increase in the client’s equity that would be needed to offset the commissions and interest paid to the broker, that the high volume of trading was excessive in the light of the nature of the account and the client’s objectives, and supports a conclusion that the profit of the broker, not the interest of the client, was the dominant motivation for the transactions.

¶ 15 The panel in *Re Graydon* also described the mental element of churning, saying:

> This offence certainly involves more than an error of judgment, or negligence: as indicated earlier, its gist is an allegation that the broker has abused the confidence of the client by trading in the account with the intention of generating commissions, wilfully disregarding the client’s interests. Direct evidence of a person’s state of mind is often unavailable: nonetheless, a tribunal may infer the requisite mens rea from other facts. Indeed, the rationale of many of the elements of the offence is that they point to the broker’s intention to enrich himself, rather than to protect the client.

¶ 16 In *Re Shanks* [2002] I.D.A.C.D. No. 27 the panel said:

> The preliminary issue for the Committee relating to this charge was whether excessive trading, as opposed to churning, constituted a separate offense of conduct unbecoming. Mr. Abells argued that "excessive trading" was not an offence in and of itself but constituted either one element of a churning offence or it related to suitability in that the trading was excessive due to

> the investment objectives, risk tolerance and sophistication of the client. Based upon the decision of the Toronto Stock Exchange in *Re: D.M. Graydon Osler, Wills, Bickle* Ltd. [1987] T.S.E. D.D. NO. 20 and an article entitled "Use of Statistical Evidence in Proving Churning of Securities Accounts" by Nancy E. Reich, 27 AJPF 3d at p. 213, the Committee confirms that in order to establish a churning allegation, three elements must be present: (i) the trading must be excessive in light of the nature of the account and the customer's investment objectives, (ii) the broker must exercise control over trading in the account, and (iii) the broker must act with some sort of "guilty purpose" such as an intent to defraud the customer or with wilful or reckless disregard for the customer's best interests.

STANDARD OF PROOF

¶ 17 The standard of proof in this case is the same as that applied in enforcement proceedings before the Alberta Securities Commission, as described in *Re Stan*, 2013 ABASC 148, at paras. 203-5:

> The standard of proof applied in Commission enforcement hearings is the balance-of-probabilities civil standard (*Re Arbour Energy Inc.*, 2012 ABASC 131 at para. 36).
>
> The balance-of-probabilities civil standard requires the trier of fact to decide "whether it is more likely than not that an alleged event occurred" (*F.H. v. McDougall*, 2008 SCC 53 at para. 49). In *F.H.*, the Supreme Court of Canada stated (at paras. 40, 45-46):
>
> > . . . I think it is time to say, once and for all in Canada, that there is only one civil standard of proof at common law and that is proof on a balance of probabilities. Of course, context is all important and a judge should not be unmindful, where appropriate, of inherent probabilities or improbabilities or the seriousness of the allegations or consequences. . . .
> >
> > . . .
> >
> > To suggest that depending upon the seriousness, the evidence in the civil case must be scrutinized with greater care implies that in less serious cases the evidence need not be scrutinized with such care. I think it is inappropriate to say that there are legally recognized different levels of scrutiny of the evidence depending upon the seriousness of the case. There is only one legal rule and that is that in all cases, evidence must be scrutinized with care by the trial judge.
> >
> > . . . evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test. . . .
>
> Therefore, in applying the balance-of-probabilities civil standard, "we must be satisfied that there is sufficiently clear, convincing and cogent evidence that the existence or occurrence of any alleged fact required to be proved is more likely than its non-existence or non-occurrence" (*Arbour* at para. 38).

EVIDENCE, CREDIBILITY AND FINDINGS

¶ 18 It was not disputed that the Respondent has been a Registered Representative since 1997 and employed with Leede Financial Markets Inc. in Calgary since 1999. The Respondent acknowledged being responsible for the accounts of the four clients and did not dispute the accuracy of certain documents relevant to each account. The Respondent also acknowledged that he did not have the authority to conduct discretionary trades in any client accounts.

¶ 19 The Respondent’s Response however denied all the alleged violations and many of the detailed facts alleged in IIROC’s Particulars. The Response suggested alternate facts that contradicted many of IIROC’s alleged facts and most of the evidence presented at the hearing.

¶ 20 At the hearing, the panel heard evidence from three witnesses – the IIROC investigator and two clients, EF and JS. Extensive documentary evidence was introduced in relation to all of the accounts, including

documents produced by the Respondent's employer and transcripts of IIROC's interviews with the Respondent, EF, and JS.

¶ 21 The contradictions between the Respondent's version of events (as described in the Response and the Respondent's interviews with IIROC) and the evidence presented by the witnesses at the hearing required the panel to assess credibility.

¶ 22 Assessing credibility is a multi-stage process. We first ask whether the witness is trying to tell the truth, and not trying to deceive. If we are satisfied that the witness is trying to tell the truth, we must then assess the witness' reliability – their capacity to accurately observe, remember and describe the facts. We consider each witness' particular human characteristics and circumstances, their demeanor in giving evidence, and whether their evidence fits reasonably with other evidence. We were mindful of the fact that both clients who testified (EF and JS) were seeking compensation for their losses from the Respondent's employer, and the statement by the BC Court of Appeal in *Faryna v. Chorny*, [1952] 2 D.L.R. 354 at 357:

> The credibility of interested witnesses, particularly in cases of conflict of evidence, cannot be gauged solely by the test of whether the personal demeanor of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions.

¶ 23 With both EF and JS, the panel had the opportunity to see them give evidence and to ask direct questions. We were also able to compare their evidence at the hearing with transcripts of their previous interviews with IIROC. The panel found the EF and JS were both truthful, and generally reliable witnesses. Their memories were imperfect, and some of their evidence was imprecise or included minor inconsistencies, but the panel was satisfied that their description of events was generally accurate.

¶ 24 The panel was also satisfied that the IIROC investigator's evidence regarding all the accounts in question was credible. There were inconsistencies in some of the data and calculations presented in the various analyses, some of which were the result of using different sets of data for each analysis. The panel was satisfied that the inconsistencies were not material and that the data and calculations presented by the IIROC investigator were generally accurate and reliable.

¶ 25 It follows that the panel rejected the Respondent's version of events, as reflected in his Response and in the transcripts of his interviews with IIROC, and find it not credible. Our finding is based upon: the Respondent's failure to appear at the hearing to present any evidence supporting his version of the facts, such as notes of his interactions with the clients; the Respondent's failure to challenge the evidence presented by the witnesses at the hearing; and the credibility of the other evidence contradicting the Respondent's version. The panel therefore preferred the evidence of the witnesses over the Respondent's version wherever there was any conflict. Specific examples of our credibility findings are discussed below in the context of particular facts.

¶ 26 In summary, the panel finds most of the allegations to be proven. The panel did not find that the Respondent failed to know any of the clients because we agreed with IIROC's counsel's submission that this "wasn't so much a know-your-client as an ignore-your-client situation". We found that: the Respondent knew all four clients; each client reposed their trust and confidence in the Respondent, enabling him to exercise control over their accounts; the Respondent used that control to execute a trading strategy involving frequent trading in high-risk securities, which was unsuitable for all four clients; some of the trading was not authorized by the clients; and the trading was so excessive as to constitute churning in the accounts of three customers. These findings are described in detail below.

CLIENT EF

¶ 27 Counts 1-3 allege that, with respect to client EF, the Respondent violated the KYC, suitability and discretionary trading rules. Count 1 was not proven as the panel found that the Respondent knew the essential

facts regarding EF. Counts 2 and 3 – suitability and discretionary trading – have been proven.

¶ 28 EF is currently 72 years of age. She was a homemaker who also did the books for her husband's business and later ran a lottery booth franchise for 13 years, retiring in 2007. She and her husband had several accounts with the Respondent commencing in 2001. EF was widowed in May 2010, after which her husband's assets were transferred to her accounts.

¶ 29 All of the New Client Application Forms (NCAFs) for EF and her husband were in evidence. They are summarized in the chart below.

Date (d/m/y)	**Account Type**	**Investment Experience**	**Objectives**	**Risk Tolerance**	**Assets (thousands)**	**Income (thousands) Occupation**
11/05/01	EF Spousal RRSP	fair	50% long term growth 50% short term speculative	50% medium 50% high	$100 liquid $300 fixed $400 total	$0 – EF homemaker $32 – Mr. F custodian
11/08/01	EF/Mr. F Joint Cash	fair	50% short term speculative 50% venture speculative	50% medium 50% high	$100 liquid $300 fixed $400 total	$0 – EF Homemaker $32 – Mr. F custodian
04/11/02	Mr. F RRSP	Fair	50% long term growth 50% short term speculative	50% medium 50% high	$100 liquid $300 fixed $400 total	$0 – EF homemaker $32 – Mr. F custodian
04/19/02	Mr. F Cash	Fair	50% short term speculative 50% venture speculative	50% medium 50% high	$100 liquid $300 fixed $400 total	$0 – EF homemaker $32 – Mr. F custodian
03/30/04	EF RRSP	Fair	50% long term growth 50% short term speculative	50% medium 50% high	$100 liquid $300 fixed $400 total	$40 – EF lottery booth $32 – Mr. F custodian
04/05/04	Mr. F Cash	Fair	50% long term growth 50% short term speculative	50% medium 50% high	$100 liquid $300 fixed $400 total	$35 – EF lottery booth $35 – Mr. F custodian
06/24/10	EF TFSA & Cash	Fair	25% income 50% long term growth 25% short term speculative	33% low 33% medium 34% high	$100 liquid $300K fixed $400K total	$32 – EF retired

¶ 30 The allegations focus on the period after EF's husband passed away in May 2010, when various accounts were consolidated into two accounts: EF's RRSP account; and her tax-free savings account (TFSA).

¶ 31 The IIROC investigator testified that there were 113 trades in EF's accounts during the period from June 2010 until May 2012, when the assets were transferred out of the accounts. The IIROC investigator presented lists of all the securities held in each of EF's accounts, categorized by risk level, and calculations of the risk levels of each account at various points in time, as summarized in the charts below.

EF's RRSP Account – Risk Levels By Quarter

QUARTER	LOW	MEDIUM	HIGH
May-10	26.7	51.6	21.8
Aug-10	8.9	57.8	33.3
Nov-10	29.1	43.9	29.1
Feb-11	33.1	11.1	55.9
May-11	3.7	34.1	62.1
Aug-11	8.8	41.8	49.4
Nov-11	9.3	41.9	48.8
Feb-12	25.9	41.5	32.6
Apr-12	30.9	41.5	27.7
AVERAGE	**19.6**	**40.6**	**40.0**

TFSA Account – Risk Levels By Quarter

QUARTER	LOW	MEDIUM	HIGH
Feb-11	9	0	91
May-11	8.9	0	91.1
Aug-11	11.6	0	88.4
Nov-11	16.9	0	83.1
Feb-12	14.4	0	85.6
Apr-12	18	0	82
AVERAGE	**13.1**	**0**	**86.9**

¶ 32 The IIROC investigator testified that neither of EF's accounts ever contained any securities that could be categorized as low-risk, and the low-risk percentages in the charts above reflect cash positions in the accounts. The high-risk securities included leveraged and inverse exchange-traded funds.

¶ 33 EF testified that, while her husband was alive, she left all investment matters to him and he was the only one who dealt with the Respondent and their accounts. Her late husband and the Respondent were friends and had frequent, often daily, contact regarding the accounts.

¶ 34 EF also considered the Respondent a family friend so that, when she met with the Respondent in June 2010 after her husband's death, she trusted the Respondent enough to ask him to "handle everything". EF described this in the following excerpt from her IIROC interview:

> EF: … I actually asked him to just handle everything for me at that point.
>
> Q: Okay. What does that mean to you, handle everything for me?
>
> EF: Well, I just – I asked him to take care of the account for me.
>
> Q: Right. But, by saying that do you mean you wanted him to buy and sell as necessary or was there any more specific discussion about that?
>
> EF: Well, I just – exactly, to just take care of it for me. To see that, you know, if the stock was making money to get out of it and buy whatever him and my husband did because I wasn't in any frame of mind to do anything.

Q: Do you remember if that was discussed in any kind of detail or – what I'm trying to understand is what his understanding of the situation might've been. Did you ever specifically say to him, just take care of it for me, those were the words?

EF: That's exactly what I did, yeah.

Q: Okay. There was no further discussion about what that meant?

EF: Not really, no.

Q: Okay. All right. Now, in terms of authorizing investments going forward, did he tell you how he'd be making investments for you in the future; how he planned to get in touch with you; how often he'd contact you?

EF: No.

Q: There was no discussion about that?

EF: No.

Q: Okay. Typically, when [the Respondent] wanted to make a purchase or sale in your account how did that play out, did he call you?

EF: No. … I would call him periodically just to see how things were going and then we talked as friends. He'd ask me how I was doing, blah, blah, blah. No.

Q: No, okay. Did he ever call you with an investment idea to get your authorization for it?

EF: No.

¶ 35 EF was emphatic that the only time the Respondent ever called her about an investment in her account was when he called to inform her, after the fact, of the sale of Osisko Mining shares at a loss – an event which upset EF. EF consistently said that the Respondent did not seek her prior authorization for trades, except for the following statement she made during her interview:

> The only stock that I gave him permission to buy was in February of 2012 and that was Eldorado Gold. … Because I actually phoned him at one point and I told him not to buy any stock without calling me first. … And that was in February of 2012. At that point I was getting really upset with my portfolio.

¶ 36 EF began to take an interest in her accounts about a year after her husband died, when she noticed that the account had lost $7,000 in one month. In her interview EF said:

EF: Yes, I called him after I got my statement [in June 2011] and my portfolio had dropped by about $7,900. I called him with a concern and he did say to me that the markets were volatile and I had nothing to worry about. That I didn't need to worry and we left it at that. …

That was the first time. No, I kept calling him and then there were certain stocks, there as East Asia and HNU and Crocodile Gold that I was just watching my statements and I would go on the internet and look to see what the stocks were at. I phoned him – I remember calling him when East Asia fell down to $5.60 a share and I said to him, I'm really concerned about that. I said, Do you think we should pull out? He said, No, he said, I don't think so. He said, Because I checked the company policy and there's no policy changes there. I said to him, Well, it's never gone below $6.00. He said, There's nothing to worry about, nothing to panic about, and we left it at that. Then the stock just bottomed out.

Q: All right. … How many times would you say you called [the Respondent] and expressed concerns about your accounts from June, 2011 until this year?

EF: Oh, gosh, a lot. I was really concerned because as the – I said to him at one point I didn't want to lose everything that Ray had made. And he still told me there was nothing to worry about and nothing to panic about. …

I just said to him at one point when he said to me, We're in it for the long term. I said, Given my age, should we be going down that path. And he still told me not to panic and not to worry.

¶ 37 At the hearing, EF said:

Well, I recall calling [the Respondent] several times on different stocks that were declining, and he would always tell me that I had nothing to worry about, nothing to panic about it and that we're in it for a long term. And I said to him, Well, with my age, should we be in there for a long term? And he said, Don't worry about anything. Everything will be fine. And as the time went on, the stocks were falling and falling, and he did nothing.

¶ 38 EF's evidence was that she did not provide any of the information contained in any of the NCAFs regarding investment experience, objectives, risk tolerance, assets or income. She said that, at the time the NCAFs were completed, she did not understand what the "objectives" or "risk tolerance" percentages actually meant in terms of different types of securities or trading in the account and that all these percentages were suggested by the Respondent. With respect to the 2010 NCAF, EF said (in her interview):

Q: Now, the investment objectives on this form are different that on your previous forms. So, it's this section here and, again, it's out of 100%, lists income as 25%; long term growth as 50% and short term speculative as 25%. Do you recall having a conversation with [the Respondent] about those numbers?

E: No, I think that was what he suggested I do.

Q: Okay. What do those numbers mean to you?

EF: Very little.

Q: Okay. Would they say that they accurately reflected what you wanted to do with the account or what your personal objectives were?

EF: At that point, I just left everything up to him.

Q: Okay.

EF: I wasn't thinking. …

Q: It was very soon after your husband's passing. For your risk factors, that had also changed from the previous forms. It now lists 33% low, 33% medium, and 34% high. Whereas, on the previous form it had been 50% medium, 50% high. So, this is slightly more conservative than the objectives on your previous forms. Do you recall having any kind of discussion about making that change?

EF: No.

Q: Okay. Now, would you say those fairly accurately represented your risk tolerance at the time?

EF: Well, given my age, I believe, that that would've been better than 50/50 medium and high.

Q: Okay. But, you don't recall discussing it with him?

EF: Not particularly, no.

Q: We discussed this briefly a moment ago but, again, I just want to confirm for the record because this relates specifically to your complaint. At any time, did [the Respondent] go over the existing investments with you in any kind of detail?

EF: Not the ones that I inherited from my husband.

Q: Okay.

EF: Well, not even the ones that I had that my husband controlled.

¶ 39 EF said that her income and employment were inaccurately described in the 2001 NCAFs (because she was then earning income from the lottery booth) and the 2010 NCAF (because she then had only her CPP pension which was less than $32,000 per year).

¶ 40 EF said that her investment experience and knowledge at the time of all the NCAFs would have been more accurately described as "none". It was as a result of her becoming concerned with her accounts and getting more involved since June 2011 that her knowledge increased to the point where it could now be described as "fair".

¶ 41 The Respondent's version of events differed significantly from EF's descriptions. The Respondent's Response said:

> EF was a knowledgeable investor who took a keen interest in her holdings and was in frequent, often daily, contact with [the Respondent] after [her husband's] death. She … frequently proposed speculative investment ideas to [the Respondent] based on her own independent research. The Notice of Hearing's characterization [of] EF as penniless, unsophisticated, and vulnerable is inaccurate and is denied. [The Respondent] specifically denies that EF had "limited investment knowledge" as claimed [in] the Notice of Hearing.
>
> In 2010 after the passing of [her husband], EF advised [the Respondent] that her goal was to double the value in her RSP account to $200,000. [The Respondent] informed EF that this goal could not be achieved with the typical, conservative RSP investments. EF understood and agreed that higher risk trading and an aggressive trading strategy would be needed in order for her to meet her stated goal. Such trading was consistent with the investment objectives, risk tolerance, and investment knowledge.

¶ 42 When interviewed by IIROC, the Respondent said that:

a. the NCAFs accurately recorded information provided by EF and her husband, after the Respondent discussed with them their investment objectives and risk tolerances;

b. the Respondent dealt regularly with EF regarding her accounts prior to her husband's death, and always obtained her authorization prior to executing trades in her accounts;

c. the Respondent had no notes of any discussions with EF or her husband;

d. her husband's death did nothing to change the objectives or risk tolerance for EF's RRSP account;

e. the investment experience recorded in the NCAFs was not the Respondent's assessment of their investment experience, but the clients' own assessment; and

f. he would not have suggested the risk tolerances recorded in the NCAF's but would have explained risk tolerance and then recorded "what came back to me".

FINDINGS RE CLIENT EF

¶ 43 It is convenient to start with the allegation of discretionary trading in Count 3 because it illustrates the magnitude of the contradiction between the Respondent's version and the evidence of EF. The Respondent's version is that EF authorized every one of the 113 trades in her accounts during the period from June 2010 to May 2012. EF's evidence is that she authorized only one (the purchase of Eldorado Gold). The panel accepts EF's evidence and rejects the Respondent's version. Count 3 is proven.

¶ 44 The panel finds that, when EF met with the Respondent in June 2010, she instructed him to "handle everything" and the Respondent did exactly that.

¶ 45 Count 2, with respect to suitability, is also proven.

¶ 46 The panel accepts EF's evidence describing her passive role in the completion of the NCAF forms for her accounts. We find that the Respondent completed the sections concerning investment experience, objectives and risk tolerance without significant input from EF, and that the NCAFs should have recorded EF's level of

investment experience and knowledge as "none". The inaccurate descriptions of EF's income in the 2001 and 2010 NCAFs, and the Respondent's failure to update the 2004 NCAF for EF's RRSP account despite two major events in her life (her retirement in 2007 and the death of her husband in 2010), demonstrate the Respondent's perfunctory approach to the NCAFs. The panel need not determine exactly what objectives and risk tolerances should have been recorded on the NCAFs for EF's accounts. We find that, since May of 2010, EF's actual risk tolerance was significantly lower, and her investment objectives were significantly more conservative, than shown by the NCAFs for her accounts. We find that the NCAFs actually recorded objectives and risk tolerances chosen by the Respondent to support the trading he wanted to do, which was significantly more aggressive and risky than EF would have agreed to had she been properly consulted and advised.

¶ 47 The panel found that the defects in the NCAFs were not the result of the Respondent failing to know the essential facts relative to EF. We find that the Respondent knew EF's essential facts but ignored them, and that the defects in the NCAFs illustrate the Respondent's wilful failure to meet the suitability requirement by recording what the Respondent thought would permit the type of trading he wanted to do.

¶ 48 EF's TFSA account only ever contained one security, which was a high-risk security. The trading in that account was therefore unsuitable according to the NCAF, which already overstated EF's tolerance for risk.

¶ 49 The trading in EF's other accounts was roughly consistent with the objectives and risk tolerances recorded in the 2004 NCAF, which overstated EF's tolerance for risk. The panel finds that the trading in EF's other accounts was also unsuitable because it was too risky and aggressive. This is most clearly illustrated by considering the Respondent's trading in leveraged and inverse exchange-traded funds (LETFs).

¶ 50 LETFs were discussed in IIROC Notice 09-0172 dated June 11, 2009, which said:

> Exchange-traded funds (ETFs) that offer leverage or that are designed to perform inversely to the index or benchmark they track, or both, are growing in number and popularity. While such products may be useful in some sophisticated trading strategies, they are highly complex financial instruments that are typically designed to achieve their stated objectives on a daily basis. Due to the effects of compounding, their performance over longer periods of time can differ significantly from their stated daily objective. Therefore, leveraged and inverse ETFs that are reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets.
>
> This Notice reminds Dealer Members of their sales practice obligations in connection with leveraged and inverse ETFs. In particular, recommendations to customers must be suitable and based on a full understanding of the terms and features of the product recommended….
>
> Suitability
>
> IIROC Dealer Member Rules 1300.1(p) and (q) require that, before recommending or accepting a customer order to purchase or sell a security, a firm must determine that the transaction is suitable for the customer. This analysis has two components. The first in determining whether the product is suitable for any customer, an analysis that requires Dealer Members and its registered persons to fully understand the products and transactions they recommend. With respect to leveraged or inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective, and the impact that market volatility, the ETF's use of leverage and the customer's intended holding period will have on their performance. Dealer Members may find it helpful to refer to IIROC Guidance Note 09-0087, which provides further guidance on best practices for product due diligence.
>
> Once a determination is made that a product is generally suitable for at least some investors, a firm must also determine that the product is suitable for specific customers. This analysis includes making reasonable efforts to obtain information concerning the customer's financial situation, investment knowledge, investment objectives, risk tolerance and any other relevant customer specific information. While the customer-specific suitability analysis depends on the investor's particular circumstances, leveraged and inverse ETFs typically are not suitable for retail investors who plan to hold them for more

than one trading session, particularly in volatile markets.

¶ 51 The Respondent was asked about this Notice in one of his interviews with IIROC. He said, "I don't remember seeing this specific notice, no".

¶ 52 The IIROC investigator's evidence showed that, although most of the LETFs in EF's accounts were held for short periods, several were held for months or years. The 6 longest-held LETF positions produced losses of $17,485 or 37.1% (including commissions). The longest-held LETF position was purchased September 29, 2010 and remained until the account was closed in May 2012, a period of 580 days, producing a loss of $5,931 or 91.9%. The subsequent performance of an investment is not necessarily relevant to a suitability assessment but here it is indicative of the level of risk associated with LETFs.

¶ 53 We find that, with respect to the LETF trades, the Respondent failed at all three stages of the suitability assessment described in *Re Lamoureux*. At the first stage, the Respondent's failure to adequately know or understand the product is evident from his decisions to hold LETF positions for extended periods. At the second stage, the Respondent must consider whether these trades were appropriate in light of the client's particular circumstances. We find that the Respondent knew these trades were too risky and unsuitable for a person in EF's circumstances: retired; recently widowed; of limited means; and with no real investment knowledge, experience or interest. The final stage of the suitability assessment process required the Respondent to make EF aware of the material negative and positive factors pertaining to the recommended transaction, so that EF could make an informed investment decision. The Respondent's failure is complete at this stage, since he did not communicate at all with EF regarding the LETF trades.

¶ 54 The Respondent claimed that the objectives, risk tolerances and trading strategy after her husband's death were dictated by EF's express desire to increase the value of her RRSP account from just over $100,000 to $200,000 in 5 years. The Respondent claimed that he informed EF that such an objective entailed higher risk and an aggressive trading strategy, which EF understood and agreed with. The Respondent's claims are not credible and we reject them. We accept EF's evidence that she mentioned the $200,000 objective to the Respondent as a joke, which they both laughed about, and that there was no follow-up discussion about what kind of risks or trading strategy might be necessary to achieve such an objective.

¶ 55 When EF told the Respondent to "handle everything", she reposed her trust and confidence in him, triggering the highest level of fiduciary and regulatory obligations upon the Respondent. The panel notes that, if the Respondent actually understood EF to have been serious about wanting to double the value of the account in five years, the Respondent's fiduciary and regulatory obligations were to advise EF against such a risky plan and, if she had insisted on proceeding, to document the fact that it was contrary to his advice. Instead, the Respondent used the opportunity to exercise complete control over the account to execute his own risky and aggressive strategy and, when the Respondent began to express concern about her accounts, he repeatedly brushed her off by telling her there was "nothing to worry about". The panel finds that the Respondent's actions ignored EF's interests to such an extent that they were an egregious breach of the Respondent's fiduciary and regulatory obligations to EF regarding suitability.

CLIENT LZ

¶ 56 Counts 4-6 allege that, with respect to client LZ, the Respondent violated the KYC, suitability and churning rules. Count 4 was not proven as the panel found that the Respondent knew the essential facts regarding LZ. Counts 5 and 6 (suitability and churning) have been proven.

¶ 57 The IIROC investigator testified that she first contacted LZ in April 2013 because, in the course of reviewing the Respondent's accounts, she noticed that the bulk of trading commissions were generated by a few accounts, including LZ's. The IIROC investigator subsequently had several telephone conversations with LZ, which she described in her testimony, and her notes of those conversations were in evidence. The IIROC investigator also introduced extensive documentary evidence regarding LZ's accounts, including several analyses of the trading in those accounts during the period from January 2009 until June/July 2010.

¶ 58 LZ is an oilfield worker who took early retirement in 2003 (at age 52) and had his pension paid as a

lump sum into a LIRA account with the Respondent. Since then LZ has worked as a self-employed oilfield consultant. The New Client Application Forms (NCAFs) for LZ were in evidence and are summarized in the chart below.

Date (d/m/y)	**Account Type**	**Investment Experience**	**Objectives**	**Risk Tolerance**	**Assets (thousands)**	**Income (thousands) Occupation**
01/08/03	RRSP new	Fair	15% income 30% long term growth 25% short term speculative 30% venture speculative	50% medium 50% high	blank	blank
11/12/03	LIRA new	Fair	50% income 50% long term growth	"Low" checked-off (percentages blank)	$250 liquid $175 fixed $425 total	$30 – LZ consultant $30 – spouse bookkeeper
08/11/06	RRSP update	Good	20% income 10% long term growth 70% short term speculative	20% low 50% medium 30% high	$300 liquid $200 fixed $500 total	$30 – LZ consultant $30 - spouse homemaker
08/20/10	RRSP & LIRA update	Good	50% income 40% long term growth 10% venture speculative	50% low 50% medium	$300 liquid $200 fixed $500 total	$30 – LZ consultant $30 - spouse homemaker

¶ 59 The most recent NCAF shown in the chart above was completed with the Respondent's branch manager who took over the handling of LZ's accounts in August 2010. The previous NCAFs were all completed with the Respondent. The allegations focus on the period prior to the transfer, from January 2009 to July 2010.

¶ 60 LZ expressed concerns about his accounts to the Respondent in an email dated July 5, 2010, which LZ later forwarded to the Respondent's branch manager. The email included several calculations and a graph prepared by LZ showing the poor performance of his accounts, and said [sic]:

> I have paid $17213 for the expertise to trade and lose a total of $30638.00 out of my account in the past year, if this was your account would you find this acceptable ???!!! …
>
> I have paid $49945 for the expertise to trade and lose a total of $86026.00 out of my account in the past 15 months, if this was your account would you find this acceptable !!!???
>
> I hope this puts things into better prospective with actual numbers and you can understand why I will not tolerate further losses, I maybe should not say this but to be honest I feel like nothing more than a cash cow used to line Leeds pockets because of the if we did nothing scenarios I have gave you when we talked where I would be much farther head if we had did no trading, but that is hind sight and it always 20/20.

¶ 61 The IIROC investigator said that she did not perform a traditional suitability analysis – comparing the holdings in LZ's accounts with LZ's objectives and risk tolerances – because the positions in the accounts changed too frequently. The IIROC investigator presented several other analyses of LZ's accounts showing the

following (referring to the period from January 2009 to June/July 2010, except where noted).

1. There were 519 trades in LZ's accounts.
2. The value of LZ's accounts declined from $294,613 to $212,851. The loss of $81,762 (27.75% using the net gain/loss ratio; 31.75 % using the average equity method) is composed of trading losses of $14,379 and commissions of $67,384.
3. The trading was similar in both of LZ's accounts, showing a pattern of frequent trades in medium to high risk securities. The medium risk securities were primarily resource issuers trading on the TSX, and the high risk securities were primarily commodity-based LETFs. The average hold period for securities in the accounts was 12.35 days.
4. In both accounts there were minimal low-risk holdings other than small cash positions. Nearly all of the securities traded in the account were medium or high risk securities. The accounts included some medium-risk, income-paying securities that were often not held long enough to generate any income.
5. There were 212 LETF transactions in LZ's accounts resulting in losses of $45,671 composed of trading losses of $18,718 and commissions of $26,953.
6. Unprofitable trades were held on average for 20.22 days and produced an average loss of 12.24 %. Profitable trades were held on average for 9.03 days for an average gain of 2.73%.
7. LETFs were held on average for 7.23 days. There were 5 LETF trades which were held for a longer term, an average of 70 days, and resulted in losses of $25,627.
8. The commission-to-equity ratio was 16.56% (trading profits of 16.56% were needed to break even).
9. The commission-to-profit ratio was 52.96 (on profitable trades, 52.96% of profit went to commissions).
10. The turnover rate was 14.74 (assets in the accounts were turned over 14.74 times per year).
11. The Respondent's total commissions for all of his client accounts for 2009 and 2010 were $182,917.

¶ 62 It was evident from the IIROC investigator's conversations with LZ that, although LZ authorized all the trades, LZ also relied upon and followed the Respondent's recommendations with respect to the accounts. LZ advised the IIROC investigator that he didn't watch the markets or follow particular stocks – the Respondent would make a suggestion and LZ would consent, relying upon the Respondent to ensure that the trade was suitable. When the IIROC investigator asked LZ about LETFs, LZ indicated that he didn't know what she was talking about.

FINDINGS RE CLIENT LZ

¶ 63 The panel finds that the Respondent knew LZ's essential facts, but ignored them, and that the Respondent violated his fiduciary and regulatory obligations to LZ by recommending trades that were unsuitable for LZ and so excessive as to constitute churning of LZ's accounts. Counts 5 and 6 are proven.

¶ 64 It follows that we reject the Respondent's version, which denied the allegations and claimed that that the trades "met LZ's stated goals and risk profile" and that the "timing of the trades was based on a reasonable assessment of the market and on LZ's investment strategy of short term gain, and was in keeping with LZ's stated investment objectives, risk tolerance, and investment knowledge".

¶ 65 The panel finds that the trading in LZ's accounts was unsuitable because it was significantly more aggressive and risky than reflected by the NCAFs for those accounts, especially the LIRA account. The panel finds that the objectives and risk tolerances recorded in the 2006 NCAF for LZ's RRSP account are irrational – 70% short term speculative cannot be reconciled with only 30% tolerance for high risk. The panel finds that the

NCAFs signed by the Respondent reflect his perfunctory approach to such documents, and we were satisfied that LZ's actual objectives and risk tolerances during the period in question were more similar to those stated in the 2010 NCAF signed by the Respondent's manager. The panel specifically rejects the Respondent's claim that his short term trading strategy reduced the risk associated with the securities traded in LZ's accounts.

¶ 66 The suitability and churning rules overlap in this context. The core elements of a churning violation – excessive trading in light of the nature of the account and the customer's investment objectives, and the "intention to generate commissions in wilful disregard of the interests of the client" (*Re D.M. Graydon*) – may also be seen as violations of the suitability requirement. As noted in *Re D.M. Graydon*:

> Direct evidence of a person's state of mind is often unavailable: nonetheless, a tribunal may infer the requisite mens reas from other facts. Indeed, the rationale of many of the elements of the offence is that they point to the broker's intention to enrich himself, rather than to protect the client.

¶ 67 We agree with the following observations by the panel in *Re D.M. Graydon*:

> A crucial aspect of the broker-client relationship is that it is one of confidence and trust: because of the broker's often superior knowledge and understanding of the market, the client must be able to rely upon the broker's integrity and competence when giving investment advice and exercising discretion over the client's account. When there is an obvious disparity between the market experience and sophistication of the broker and the client, and when the client reposes trust and confidence in the broker to act in the client's interest, it may be appropriate to characterize the relationship as fiduciary.
>
> …
>
> The scope and intensity of the obligations owed by a registered representative to a client depend very much upon the nature of the relationship between the particular individuals concerned. A client who is a sophisticated investor, and takes an active and informed role in the management of his account, will rarely be able to complain about the conduct of the registered representative when carrying out the client's instructions. At the other extreme, if an elderly and inexperienced client of modest means effectively leaves the account in the hands of the registered representative, it will generally be appropriate to scrutinize the management of the account closely to ensure that the registered representative has not taken advantage of the extensive opportunities for self-enrichment at the expense of the client.

¶ 68 The panel finds that the Respondent exercised de facto control over LZ's accounts even though he was not given, and did not exercise, discretionary authority to trade in the account. The panel finds that LZ reposed trust and confidence in the Respondent by authorizing all the trades recommended by the Respondent, effectively yielding control over the accounts to the Respondent.

¶ 69 With respect to excessive trading, the panel agrees with these statements in *Re D.M. Graydon*:

> We should emphasize that there is no magic turn-over rate, above which an inference of churning will be made automatically, and below which a registered representative cannot be found guilty of churning. The ultimate question is whether the trades were made to generate commissions, without regard to the client's interest: how this is answered will depend upon all the circumstance[s] of the particular case.

¶ 70 The panel finds the fact that the trading in LZ's accounts was unprofitable to be evidence of both the suitability and churning violations. As the panel in *Re Graydon* observed:

> A client whose account has been churned will generally be worse off than he would have been if his broker had handled his account properly. The client will have had to pay heavy commissions and…[i]n addition, since the trades will have been made without regard to the client's best interests, it may normally be presumed that had the broker acted from legitimate motives, the investments would have been more profitable. Even when a churned account shows a profit, it may often be assumed that, had the account not been churned, the profit would have been much greater. It may be inferred from the size of the increase in the client's equity that would have been needed to offset the commissions and interest

paid to the broker, that the high volume of trading was excessive in the light of the nature of the account and the client's objectives, and supports a conclusion that the profit of the broker, not the interest of the client, was the dominant motivation for the transactions.

¶ 71 In this case, the turnover rate, the commission-to-profit ratio and the commission-to-equity ratio were all remarkably high. Profitable trades were held for a much shorter period than unprofitable trades, particularly with respect to LETFs. The commissions charged to LZ's accounts from January 2009 to July 2010 were approximately 37% of the total commissions charged by the Respondent for all his clients during 2009 and 2010, even though LZ's accounts represented only about 6% of the total of all the Respondent's customer's assets. These facts must be considered together with our finding that the trading in LZ's accounts was otherwise unsuitable because it was too risky and aggressive for LZ. In light of all the circumstances, the panel finds that the level of trading in LZ's accounts was excessive, primarily intended to generate commissions for the Respondent, and not in the interests of LZ. Counts 5 and 6 are therefore proven.

CLIENTS JS AND DS

¶ 72 Counts 7-14 allege that, with respect to each client JS and DS, the Respondent violated the KYC, suitability, discretionary trading and churning rules. Counts 7 and 11 (KYC) were not proven as the panel found that the Respondent knew the essential facts regarding JS/DS. Count 9 (discretionary trading with respect to JS) was not proven, but Count 13 (discretionary trading with respect to DS) was proven. Counts 8, 10, 12 and 14 (suitability and churning with respect to JS and DS) have been proven.

¶ 73 JS and DS are a married couple. JS is currently 59 years of age, DS is currently 61. JS was a homemaker and also worked part-time as a babysitter, house cleaner, and waitress. DS was a city planner who took early retirement in 2003. JS and DS opened several accounts with the Respondent in 2004 and maintained those accounts until April 2011, when the assets were transferred elsewhere. The allegations focus upon the period from December 1, 2008 – the date on which until DS experienced a severe medical emergency – until the accounts were transferred out in April, 2011.

¶ 74 The New Client Application Forms for JS and DS were in evidence, and are summarized in the chart below.

Date (d/m/y)	**Account Type**	**Investment Experience**	**Objectives**	**Risk Tolerance**	**Assets (thousands)**	**Income (thousands) Occupation**
08/03/04	JS/DS Joint Cash	good	25% income 50% long term growth 25% short term speculative	25% low 50% medium 25% high	$300 liquid $250 fixed $550 total	$0 – JS Blank $36 – DS retired
08/30/04	DS RRSP	good	75% income 15% long term growth 10% short term speculative	50% low 30% medium 20% high	$450 liquid $300 fixed $750 total	$0 – JS homemaker $36 – DS retired
08/30/04	DS RRIF	good	75% income 15% long term growth 10% short term speculative	50% low 30% medium 20% high	$450 liquid $300 fixed $750 total	$0 – JS Homemaker $36 – DS retired
08/30/04	DS LIRA	good	75% income 15% long term growth 10% short term speculative	50% low 30% medium 20% high	$450 liquid $300 fixed $750 total	$0 – JS Homemaker $36 – DS retired

08/30/04	DS Cash	good	75% income 15% long term growth 10% short term speculative	50% low 30% medium 20% high	$450 liquid $300 fixed $750 total	$0 – JS homemaker $36 – DS retired
02/21/05	DS LIF	good	50% income 35% long term growth 15% short term speculative	50% low 40% medium 10% high	$300 liquid $250 fixed $550 total	$25 – JS homemaker $36 – DS retired
02/21/05	JS Spousal RRIF	fair	50% income 35% long term growth 15% short term speculative	50% low 50% medium	$300 liquid $250 fixed $550 total	$25 – JS homemaker $36 – DS retired

¶ 75 Although JS sometimes described her investment experience as “fair” she readily acknowledged that it was closer to “none”. She said, “I have no interest. I just would say to my husband, If I can spend it, let me know, and if not, don't tell me.” JS acknowledged that she signed the NCAFs without knowing what they were, but she was able to testify about the circumstances that existed at the time.

¶ 76 JS testified that, at her first meeting with the Respondent in early August of 2004, her husband told the Respondent that he had been advised to obtain a line of credit to invest more and the Respondent said “that’s a really good idea”. JS and DS then took out a $100,000 loan against their fully-paid home and invested $90,000 of that with the Respondent, which is reflected in the increased liquid assets shown in the subsequent NCAFs for DS dated August 30, 2004.

¶ 77 JS testified that the main topic of conversation at that first meeting was whether they had enough money for her husband to retire. Her husband had a disability pension of about $1,000 per month and the key question was whether the investment accounts could generate additional income of $2,000 per month, which was the amount they needed to live. JS testified that the Respondent assured them that the accounts could generate that amount of income until DS reached age 72 at least.

¶ 78 JS was asked about the two NCAFs dated in 2005 which showed her having income of $25,000. She said she was not working in 2005 and, “I don’t think I’ve ever made that in my life….So I don’t know where that’s coming from.”

¶ 79 DS had trading authorization over JS’ Spousal RRIF account and JS left all dealings with the accounts to her husband until December 2008. DS and the Respondent were friendly, and spoke to each other often by telephone, sometimes for over an hour at a time. Prior to December 2008, JS had never spoken to the Respondent on the phone except to call her husband to the phone.

¶ 80 On December 1, 2008 DS experienced a severe medical emergency which kept him in hospital for approximately 6 weeks. JS testified that her husband’s heart stopped several times that first night. JS said at the hearing:

> JS: Well, [DS] was in there for a month and a half, and I don't know if it was two, three weeks in. He was sneaking -- he was sneaking away from the nurses and using the phone. And he only knew three phone numbers, and [the Respondent]'s was one. And he was telling him to invest in German helmets and the hospital, so [the Respondent] phoned me to ask me what was going on.
>
> Q: Did he say -- what did he say?
>
> JS: He just said, Well, what is going on with [DS]? He's -- he's sounding off his rocker, he's not making sense, and he's whispering in the phone saying invest in German helmets and the hospital.

Q: What did you tell [the Respondent]?

JS: And I told him that he was in the hospital, that he had had brain damage, and not to do any more investments with [DS], that he would have to go through me.

Q: This was when?

JS: When [DS] was in the hospital.

Q: What did [the Respondent] say to that?

JS: He just said, Okay, no, I totally understand.

Q: Did [the Respondent] discuss with you at about that time -- did you just -- when was the next time you spoke to [the Respondent] after that phone call?

JS: I'm not sure, but I'm sure he just phoned a few times, and I just said -- would say, you know, Do what you think is best, you know.

Q: What do you mean by that?

JS: Well, he would be, like, Do you want to invest in this? And I'm, like, I don't know. And he's -- you know, as long as it's, you know, low risk or, you know -- but I think I only talked to him two or three times, and then, you know, he must have been talking to [DS] too, you know.

¶ 81 The IIROC investigator presented several analyses of JS/DS' accounts, which are summarized below. Each analysis used different data so some of the calculated figures vary. All calculations refer to the period from January 2009 until March/April 2011.

1. There were 593 trades in JS/DS' accounts.
2. The value of the accounts declined from $279,668 to $87,099, including withdrawals by JS/DS of 113,946, for a net loss of $78,622. That was a loss of 28.11% (calculated using the net gain/loss ratio) or a loss of 44.5% using the average equity method.
3. The accounts were relatively conservative until the spring of 2009 and then became increasingly speculative, showing a pattern of frequent, short-term trading with high concentrations in certain securities. There were many trades in LETFs. The accounts also contained a number of junior, higher-risk securities, no low-risk securities (except for cash) and few income-producing securities.
4. The average hold period for securities in the accounts was 18.34 days.
5. There were 200 LETF transactions resulting in losses of $56,637, composed of trading losses of $32,163 and commissions of $24,474.
6. Unprofitable trades were held on average for 33.77 days and produced an average loss of 13.74 %. Profitable trades were held on average for 12.18 days for an average gain of 2.77%.
7. LETFs were held on average for 10.36 days. There were 7 LETF trades which were held for a longer term, an average of 89 days, resulting in losses of $36,326.
8. The commission-to-equity ratio was 17.38% (trading profits of 17.38% were needed to break even).
9. The commission-to-profit ratio was 53.99 (on profitable trades, 53.99% of profit went to commissions).
10. The turnover rate was 14.99 (assets in the accounts were turned over 14.99 times per year).
11. The Respondent charged over $71,000 in commissions to JS/DS' accounts, which was roughly 37% of the Respondent's total commissions for all of his client accounts for 2009 and 2010. JS/DS' accounts then represented roughly 4% of the Respondent's total book of business.

¶ 82 JS testified that her husband's medical emergency changed him significantly. She described the situation the hearing:

Q: Were you told what would be the long-term effect on [DS] from a medical perspective?

JS: Not -- they -- they couldn't give you a definite answer. My sister came with me to meet with the doctor, and that was after, and they said he might get a little better. They didn't know. But there was brain damage from the lack of oxygen with his heart stopping four times.

Q: And is that -- so would it be accurate to say -- and I know you probably have talked to lots of doctors --

JS: M-hm.

Q: -- over time, and it's --

JS: No. It's surprising. They're not really forthcoming, but ...

Q: Okay. Is there a lasting cognitive difficulty that he would have? Is that a fair –

JS: They didn't really fully diagnose what -- what the overall outcome was, but they -- like, at one point, they said he wasn't even able to take care of himself and he would have to go in a home.

Q: That was --

JS: And it was two weeks later that they phoned and said, you know, he's going home, you know. So none of the doctors seemed to agree --

Q: Okay.

JS: -- is what we kind of got, you know.

¶ 83 JS' interview with the IIROC investigator includes the following description of her husband:

Q: Now, I just want to touch on something you said to me in that phone call back in May or June. The exact words you said to me were that, if someone met your husband, they would know within a few minutes that he wasn't normal.

JS: Yes.

Q: Okay. Is -- is it fair to say, then, that even – even if you hadn't told [the Respondent] that your husband was unwell, that he probably would have been able to perceive that?

JS: Oh, my gosh, yeah. My husband -- when we -- when he started dealing with [the Respondent], he weighed 200 pounds, was very self-assured, very loud. And now, he's very soft spoken; he's, I think, 160 pounds; and he shakes.

Q: Okay.

JS: And he's aged. He looks like he's 69, 70 years old, and he's, you know, 60.

Q: And you know, if he was only speaking to him on the phone, do you think he would have been able to perceive that there was anything wrong?

JS: I would think so. His voice has totally changed. He's gone from a very loud man to a very soft-spoken, very hesitant -- where he would, you know, be quite loud, and -- you know? There's a definite -- definite -- it's like you're dealing with a different person.

Q: Okay.

JS: My husband used to be very opinionated and talk current events. He now doesn't even watch the news or read a newspaper.

Q: Okay. The reason I'm asking this is, if [the Respondent] said he had no idea --

JS: Oh, he would definitely know.

Q: You -- you feel that strongly that he --

JS: Oh, totally. …Oh, because they used to talk current events. … So they would talk about everything under the sun, all politics. I mean -- you know? And my husband had definite opinions on everything, and he no longer has an opinion on any of it.

¶ 84 JS remained uninvolved and uninterested in the accounts until the first of two withdrawals from DS' LIF that required applications to the Alberta Superintendent of Pensions "for access to funds held in a [LIF] due to a situation of financial hardship", which JS referred to as "hardship letters". The first such withdrawal occurred on July 22, 2010, when $18,615.63 ($13,030.94 net after withholding taxes) was released. The second occurred on March 1, 2011, when $13,133.39 was released. At the hearing, JS described how these withdrawals caused her to become concerned about the accounts:

Q: How many hardship letters were there?

JS: Two. … The first one we just had to fill out forms. He just phoned me and said, I'm sending you this out. It's just a formality. You need to fill it out.

Q: Did he expand on that at all?

JS: I just said, I don't like the name of that. That doesn't sound good. And he said, This is just a standard form. It allows me to keep trading while you're --

Q: And at this time, [DS] is --

JS: He's still not taking an interest in it, yeah.

Q: Okay. So [the Respondent] sent you the form in the mail, or ...

JS: M-hm. I think it was -- yeah. Yeah, it was in the mail, yeah.

Q: Okay. What did you do with it?

JS: Filled it out and sent it back to [the Respondent], and then he sent it on.

Q: Did he talk about the contents of the form?

JS: I think he walked me through some of it. He did, yeah. He said to fill it out this way, or, you know ...

Q: Do you remember what he said?

JS: No, no, not the particulars. I don't remember what the hardship letter form was. That's when I started wondering.

Q: It was a red flag for you?

JS: It was, yeah.

Q: Okay. And then there was -- so what happened after that, that you sent the form in?

JS: I think it was less than six months or six months later that we got another one or [the Respondent] phoned me and said that we were going to have to fill out another one and I would have to do a detailed letter. And that's when I phoned my son and informed him that we had had to fill out a hardship letter, and he said that's not normal.

¶ 85 JS's son insisted upon a meeting with the Respondent and his parents to review the accounts, which were then valued at approximately $100,000. At that meeting, in March 2011, the Respondent advised JS that she would need to go back to work, but DS would not. In her interview, JS described the meeting as follows:

JS: My son just said, You seem to have lost a lot of money. … And it seems really suspicious that all of a sudden there's a hardship, and you haven't explained it to my mom's, you know, satisfaction.

And my husband just sat there and didn't say a word. My son said, You know, you keep telling my mom it's okay, but it's not. And [the Respondent] said, Oh, well. I can double the money. I can get it back no problem. I can double it. And my son just said, Well, if you can double it, how come you haven't? And my son said -- you know, [the Respondent] said, I can do it in a week. So my son said, Well, you've got two weeks. Two weeks, and my parents are taking all their money out of here. So if you double their money in two weeks, you can keep their account. And that's how we left it.

Q: Okay. So I presume he didn't double your money in two weeks?

JS: No. No. No.

…

Q: Okay. And so -- was your husband at that meeting, too?

JS: Yes. He didn't say a word. … Not one word.

Q: [W]hat kind of health condition was your husband in at that point?

JS: You'd have to meet him. He was -- he's -- he's -- he's the way he is now, but he's shaky. And he was – he was kind of staring off into space. He does that a lot. … So he didn't really understand. He just -- when we left there, he just looked at my son and said, Well, [the Respondent] says he can double our money. And … my son -- he said, But he can't. And [DS]'s like, No, no. [the Respondent] says that he can, so yeah, we're fine. And that's all he took from the whole meeting, was that [the Respondent] told him that he could double the money.

THE RESPONDENT'S VERSION AND CREDIBILITY

¶ 86 The Respondent's Response denied all the allegations with respect to the accounts of JS/DS and said:

1. The Respondent "was aware that DS/JS wished to withdraw a monthly amount from their investments but was not aware of the purpose of such withdrawals".

2. The Respondent "has no knowledge … that DS/JS took out a home equity line of credit in order to provide investment funds or that the investment funds were borrowed".

3. The Respondent "spoke weekly to DS/JS during the material period".

¶ 87 The Respondent said in a written response to JS's complaint letter of September 2013:

"I was not advised of the nature of [DS'] medical emergency nor any impact it may have had upon his ability to continue to competently make decisions regarding his accounts with me. I also do not recall any change in the demeanor of [DS] over this time.

¶ 88 In his interview, the Respondent was asked about DS' medical emergency:

Resp: I knew he was in the hospital for a -- for a period of time. I'm not sure what happened.

Q: Do you know the nature of his illness?

Resp: No. I don't know.

Q: Okay. Do you recall if [JS] contacted you to notify you of that?

Resp: I can't recall that, no.

Q: Okay. Do you recall speaking directly to [DS] at any time when he was in the hospital?

Resp: Yes.

Q: Okay. How frequently?

Resp: I -- I -- I don't know. I know he had -- I do remember him calling from the hospital. I can't speak to how often it was, but -- but there was communication there, yes.

Q: And, in your estimation, did he appear fit to make decisions about his investments?

Resp: I didn't -- I didn't hear anything in his voice that would lead me to believe he was mentally enfeeble or anything.

Q: Okay. Now, did -- at any point in time, while he was in the hospital or thereafter, did [JS] ever contact you to say that [DS] was incapacitated or unfit to make financial decisions, either temporarily or permanently?

Resp: I don't recall that, no.

¶ 89 The panel notes that the Respondent's version, if it was credible, would amount to an admission of failure to know these clients. The Respondent pleads ignorance of: DS' health condition; the fact that some of the investment funds were borrowed; and the purpose of JS/DS' monthly withdrawals from the accounts. The panel finds that claim preposterous and rejects it. We find that the Respondent was aware of these essential facts regarding JS/DS.

¶ 90 The panel accepts JS' evidence describing DS' capacity to deal with the accounts as having been practically non-existent during the 6 weeks he was in hospital starting December 1, 2008 and significantly diminished after that. We find that the Respondent called her while DS was in hospital to discuss the bizarre instructions the Respondent had received from DS, and that JS advised the Respondent not to deal with DS due to his incapacity. We accept JS' evidence that the change in her husband was obvious to anyone who knew him. We note that the Respondent chose to contact JS, not DS, when it became necessary to obtain the hardship letters, and find that the Respondent was aware of DS' diminished capacity. The panel also finds that the Respondent knew that JS/DS had augmented their accounts with the proceeds of a home-equity loan, and that the primary purpose of the accounts was to provide retirement income to JS/DS.

FINDINGS RE CLIENTS JS/DS

¶ 91 The panel finds that the Respondent knew JS/DS' essential facts, but ignored them, and that the Respondent violated his fiduciary and regulatory obligations to JS/DS by recommending trades that were unsuitable for JS/DS and so excessive as to constitute churning of their accounts. The panel also found discretionary trading to have occurred with respect to DS' accounts during December 2008. Counts 8, 10, 12, 13 and 14 are proven.

¶ 92 We deal first with the allegations of discretionary trading. With respect to some trades, the panel found the evidence of discretionary trading to be conclusive. In December 2008 the Respondent executed 31 trades in DS' LIF account, including 13 trades in the first five days of December, while DS was experiencing the most serious phase of his medical emergency. We accept JS' evidence and find that: DS was incapacitated during this period; the Respondent called JS to report receiving bizarre instructions from DS; JS advised the Respondent of DS' incapacity and told the Respondent not to take any instructions from DS. We reject the Respondent's claim that he obtained authorization for these trades, which is not credible. We find that the trades in DS' accounts in December 2008 were unauthorized, in violation of Rule 1300.4. Count 13 is therefore proven.

¶ 93 The evidence of discretionary trading at other times was less conclusive. On one hand, the fact that the Respondent exercised discretion during the most acute phase of DS' medical situation is circumstantial evidence suggesting he exercised similar discretion at other times. On the other hand, we accept JS' evidence that the Respondent phoned her "a few times" regarding trades and that she would say "do what you think is best", so the panel is satisfied that some of the trades in the accounts were authorized by her. JS also said that the Respondent was in regular contact with DS after he came out of the hospital, and that she did not know whether the Respondent was discussing finances with DS. The panel therefore recognizes the possibility that DS authorized all the trades similar to the way LZ did, by approving every recommendation made by the Respondent without necessarily understanding those recommendations. Bearing in mind the requirement that the degree of proof must be nothing short of clear and convincing and based upon cogent evidence, the panel did not find discretionary trading in JS/DS' accounts except with respect to Count 13 as described above. Count 9 (relating to JS) is therefore not proven.

¶ 94 With respect to suitability and churning, the panel applies the principles and considerations discussed above in the context of the clients EF and LZ. The panel finds that, like EF and LZ, JS and DS reposed trust and confidence in the Respondent. The panel finds that, since December 2008, JS and DS accepted every recommendation made by the Respondent, effectively yielding control over their accounts to the Respondent.

¶ 95 We find the defects in the NCAFs reflect the Respondent's perfunctory approach to such documents. The most recent NCAFs of JS/DS are dated 2005. They contain inaccurate information about JS' income, which was zero at the time. All the NCAFs contain inaccurate information about DS' income, which was actually his disability pension of about $1,000 per month. We find that, despite those defects, the NCAFs accurately reflected the fact that JS/DS needed an income-producing and relatively low-risk portfolio, which need continued and increased after DS' medical emergency.

¶ 96 We find that the trading in JS/DS' accounts from December 1, 2008 onwards was unsuitable, both in relation to the outdated NCAFs and the clients' actual situation. JS/DS' portfolio included predominantly high-risk securities and almost no low-risk securities (except cash). Although the portfolio included some medium-risk, income-paying securities, they were not held long enough to generate a consistent stream of income, and the total annual income generated by DS' accounts was $8,771 in 2008, $4,160 in 2009, and $1,663 in 2010. Such wide discrepancies between the NCAFs and the portfolio are compelling evidence of the Respondent's failure to ensure that his recommendations for these accounts were suitable for JS/DS.

¶ 97 The panel finds the LETF trades in JS/DS' accounts to have been particularly unsuitable for JS/DS' accounts for essentially the same reasons discussed above in the context of clients EF and LZ. The Respondent's failure to adequately know or understand LETFs is again evident from his decisions to hold LETF positions for long periods. The panel finds that the Respondent knew that LETFs were too risky and volatile to be suitable for JS/DS, whose primary objective was income.

¶ 98 The panel finds that all the essential elements of churning have been proven. We find that the trading in JS/DS' accounts was excessive in light of the nature of the accounts and JS/DS' investment objectives. The level of trading activity was extremely high by any measurement: the number of trades (593 trades in 15 months); the commission-to-equity ratio of 17.385; the commission-to-profit ratio of 53.99, and the turnover rate of 15. The panel finds that level of activity to be excessive for accounts like these, which were primarily intended to generate income.

¶ 99 The commissions charged to JS/DS' accounts were roughly 37% of the Respondent's total Commissions for all his client accounts for 2009 and 2010, despite the fact that JS/DS' accounts then represented only about 4% of the Respondent's total book of business. The panel finds that the trading in JS/DS accounts was intended to generate commissions for the Respondent, and was not in the interests of JS/DS. The suitability and churning violations (Counts 8, 10, 12 and 14) are therefore proven.

CONCLUSION

¶ 100 The panel finds that Counts 1, 4, 7 and 9 – the allegations that the respondent failed to use due diligence to learn and remain informed of the essential facts relative to four clients contrary to Dealer Member Rule 1300.1(a) – are not proven.

¶ 101 The panel finds that Counts 2, 5, 8 and 12 – the allegations that the Respondent failed to use due diligence to ensure that recommendations were suitable for four clients, based on factors including the client's financial situation, investment knowledge, investment objectives and risk tolerance contrary to IIROC Dealer Member Rule 1300.1(q) – are proven.

¶ 102 With respect to Counts 3, 9 and 13 – the allegations that the Respondent engaged in discretionary trading with respect to the accounts of three clients, without being authorized and approved as having discretionary authority contrary to Dealer Member Rule 1300.4 – the panel finds that Count 9 (regarding client JS) is not proven and that Counts 3 and 13 (regarding clients EF and DS) are proven.

¶ 103 The panel finds that Counts 6, 10 and 14 – the allegations that the Respondent engaged in improper practices by excessively trading in (churning) the accounts of three clients, for the sole purpose of generating

additional commissions contrary to Dealer Member Rules 1300.1(o) and 29.1 – are proven.

¶ 104 The panel directs that a penalty hearing be scheduled.

Dated at Calgary, Alberta this 21 day of Nov., 2014.

Eric Spink, QC, Chair

Martin Davies

Don Milligan