

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

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

AND

JOHN PHILLIP WATTS AND SEAN THOMAS HICKEY

NOTICE OF HEARING

TAKE NOTICE that pursuant to Part 10 of Dealer Member Rule 20 of the Investment Industry Regulatory Organization of Canada (“IIROC”), a hearing will be held before a hearing panel of IIROC (“Hearing Panel”) to set a date for a discipline hearing on September 30, 2014 at 150 Euston Street, Charlottetown, PEI, at 10 am or as soon thereafter as the hearing can be heard.

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

- The Standard Track
- The Complex Track

THE PURPOSE OF THE HEARING is to determine whether John Phillip Watts (“Watts”) and Sean Thomas Hickey (“Hickey”) (collectively “the Respondents”) have committed the following contraventions that are alleged by the Staff of IIROC (“Staff”):

Count 1 From July 2007 to December 2010 the Respondents failed to use due diligence to ensure that recommendations were suitable for their clients, contrary to IIROC Dealer Member Rule 1300.1(q) (IDA Regulation 1300.1(q) prior to June 1, 2008).

Count 2 From May to June 2008, the Respondent Watts engaged in unauthorized trading in a client account, contrary to IIROC Dealer Member Rule 29.1 (IDA By-law 29.1 prior to June 1, 2008).

Count 3 From July 2007 to December 2010 the Respondent Watts failed to use due diligence to learn the essential facts relative to his clients, contrary to IROC Dealer Member Rule 1300.1(a)(IDA Regulation 1300.1(a) prior to June 1, 2008).

PARTICULARS

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

A. Overview

1. Starting in or about July 2007 Watts opened accounts at Wellington West Capital Inc. (“WWCI”) for 11 clients, (the “Clients”) many of whom were formerly his clients at Berkshire Securities Inc. (“BSI”).
2. From October 2007 through to December 2010 Watts and Hickey worked in a partnership (the “Partnership”). The partners shared all revenues of the Partnership equally.
3. Pursuant to internal firm compliance requirements, Hickey was required to review and sign all know your client (“KYC”) documentation for the Clients brought into the Partnership by Watts.
4. Watts subsequently updated several of the Clients’ KYC documents to indicate progressively higher risk tolerances, ultimately indicating in many cases a 100% high risk allocation. Hickey initialed all of the updated KYC forms for these Clients. These updates, however, did not accurately reflect the Clients’ risk profiles.
5. Watts recommended and purchased shares of several companies operating in China (the “China Companies”) for the Clients’ accounts. Hickey was aware of the recommendations and purchases. Eventually, the holdings in several of these accounts migrated to an overall high risk profile with shares of the China Companies comprising in many cases over 90% and up to 100% of holdings.
6. The recommendation and purchase of the China Companies’ shares were unsuitable for these Clients due to the high risk nature of the shares and the level of concentration of the shares in their accounts. Several of the Clients sustained significant losses.
7. In the case of one additional client that was an estate account, Watts engaged in unauthorized trading in that he executed trades when he had not obtained trading authority from all of the co-executors of the estate.
8. In the case of five of the Clients when opening the accounts at WWCI Watts failed to know these Clients in that their net worth and/ or income, as set out in the KYC documents, was incorrect and overstated their true values.

B. Registration History

9. Watts has been registered with IIROC, and its predecessor the IDA, since 2001. He worked at BSI from 2001 until 2007. He worked at WWCI from 2007 through to the end of October 2011, when WWCI was acquired by National Bank Financial Ltd., (“NBF”) where he continues to be registered. However, Watts has been on medical leave from NBF since November 2011.
10. Hickey has been registered with IIROC, and its predecessor the IDA, since 2002. He worked at RBC Dominion Securities from 2002 to 2006, and BSI from 2006 until 2007. He worked at WWCI from 2007 through to the end of October 2011 when WWCI was acquired by NBF, where he continues to be registered.

C. Watts / Hickey Partnership

11. In October of 2007 while employed at WWCI, Watts entered into the Partnership with Hickey and filed formal notice of the Partnership with IIROC.
12. Prior to October 2007, as Watts had a larger book of business, Hickey was given an opportunity to buy into the former’s business. Hickey paid Watts approximately \$300,000 to do so and the Partnership was created. During the relevant time the Partnership’s assets under administration were approximately \$110-135M.
13. Watts and Hickey shared the business revenues of the Partnership on a 50/50 basis, in the form of a management fee charged to client accounts. The management fee was equal to between one and two percent of the value of the assets in the accounts. In addition, a flat commission charge was applied to each trade conducted in the accounts. Watts and Hickey shared a joint RR code and used a joint email address at WWCI such that any communications would go to both Watts and Hickey.
14. All clients were considered clients of the Partnership. Watts spent the majority of his time implementing a high risk investment strategy that focused on the China Companies. Hickey focused on a more conventional investment strategy, including a pension business and the management of an institutional bond business. At times he also made recommendations to clients for investments in the shares of the China Companies.
15. When Watts took medical leave in November 2011, Hickey continued to manage all of the Partnership accounts.

D. The China Companies

2006 – BSI

16. Starting in mid-2006, while still employed at BSI, Watts started recommending significant purchases of the shares of Hanfeng Evergreen Inc. (“Hanfeng”) to several of his BSI clients. Hanfeng is a fertilizer company based in China.
17. Due to a dramatic increase in the price of Hanfeng shares between 2006 and 2007, several of his BSI clients experienced gains that ranged from 100% to over 200%. As a result, many BSI clients’ portfolios were concentrated in Hanfeng shares when their accounts were transferred to WWCI in mid-2007. In some cases, these shares represented over 50% of the market value of their portfolios.

2007 - WWCI

18. Starting in July 2007, while employed at WWCI, and over the course of approximately the next two years, Watts sold the Hanfeng shares as well as most or all other securities held in the Clients’ accounts and purchased shares of a variety of other China Companies.
19. Watts also recommended shares of the China Companies to several new clients at WWCI.
20. Hickey was aware that Watts recommended and purchased the shares of a number of the following China Companies in the Clients’ accounts, all of which were small cap and/or start-up companies, including:
 - Hanfeng Evergreen Inc.
 - Migao Corporation
 - Hanwei Energy Services Corp.
 - Sino Clean Energy Inc.
 - Asia Bio-Chem Group Corp.
 - Changfeng Energy Inc.
 - Cantronic Systems Inc.
 - Zongshen Pem Power Systems
 - Grand Power Logistics Group
 - Zungui Haixi Corp
 - China XD Plastics Co. Ltd.
 - Cathay Forest Products Corp.

E. Unsuitable Investments in the China Companies for Certain Clients

21. Beginning in early 2012, in excess of 100 clients initiated civil actions against Watts and in some cases the Partnership, alleging, among other things, that the investments in the China Companies in their portfolios were unsuitable.

22. In most of the 11 Clients' accounts, as detailed in Appendix A below, the New Client Application Forms ("NCAFs") indicated progressively increased risk tolerance, ultimately reaching in many cases a 100% high risk allocation.
23. Hickey was aware of, and initialed, the updates to the Clients' KYC information, including the allocation to 100% high risk.
24. Watts' recommendations and purchases of the shares of several of the China Companies eventually resulted in the holdings in these Clients' accounts migrating to an overall high risk profile. The accounts had a high concentration of shares of the China Companies. By December 2010, the shares comprised in many cases over 90% and up to 100% of the holdings in the accounts.
25. However, this increase in risk tolerance did not accurately reflect the Clients' true risk profiles. Further, the holdings of the China Companies' shares were unsuitable for the Clients due to the high risk nature of the securities and the level of concentration in the accounts. Watts and Hickey failed to explain, or to adequately explain, the risks of investing in the China Companies to the Clients.

F. Hickey's Benefits and Responsibilities in Relation to the Clients

26. Hickey and Watts received benefits in that they were drawing fees on the accounts of the Clients on an equal basis.
27. As a member of the Partnership, Hickey had responsibilities toward the Clients, including ensuring that all recommendations made were suitable. He in fact undertook certain positive responsibilities and/or actions generally in relation to the Clients in the Partnership and the investments in the China Companies, as set out below.

With regard to the Clients, Hickey:

- a. reviewed investment objectives and risk tolerances, assessed reasonableness of information, and signed the Clients' KYC documentation;
- b. signed off on the Clients' KYC update forms;
- c. became familiar over time with each Client that Watts brought to the Partnership;
- d. attended Client meetings with Watts; and
- e. recommended investments in the China Companies to some Clients as well as to some of his own primary relationship clients.

With regard to the assessment of investment risk, Hickey:

- a. understood the investments in the China Companies to be a high risk, unconventional strategy; and
- b. understood that the Clients had a high risk of loss from the investment and that the China Companies were highly volatile securities.

28. However, Hickey ultimately failed to ensure that the recommendations made to invest in the China Companies were suitable for the Clients. Instead, he:
- a. relied on Watts for the contents of KYC documents;
 - b. generally did not question the advice that Watts gave to the Clients; and
 - c. trusted Watts as his business partner without question.

G. Watts Engaged in Unauthorized Trading

29. In the case of one additional client, Watts conducted trading without proper authorization. Specifically, in an account established for the estate of client DR, Watts was aware as early as March 2008 that there were three co-executors for the estate. Watts, however, only communicated with one of the co-executors before executing trades in the account in May and June 2008.
30. In particular, in May 2008 he executed three purchases of shares of two of the China Companies, with a book value of over \$220,000, in this account without the authorization of all three co-executors.
31. In June 2008 Watts executed an additional two purchases of shares of two China Companies, with a book value of over \$54,000, in this account without the authorization of all three co-executors.
32. Ultimately, due to the differing investment objectives and risk tolerances of the three co-executors and the four beneficiaries of the estate, the assets in the estate account were redistributed into four separate accounts.

H. Watts' Failure to Know Your Client—Overstated Client Financial Information

33. In the case of five of the Clients, the NCAF documentation indicated overstated financial information as follows:

Client	Net Worth		Income	
	NCAF	Actual	NCAF	Actual
HM	\$838K	\$550K	-	-
KB	\$100K	\$35K	\$60K	\$35K
GM	-	-	\$200K	\$70K
MM	\$4M	\$3M	-	-
AM	\$4M	\$3M	-	-

In the case of these Clients, Watts failed in his ongoing obligation to know his client.

I. Client Losses / Partnership Fees Earned

34. Between July 2007 and December 2010, total losses in the accounts of the 11 Clients amounted to in excess of \$2.2 million excluding management and redemption fees. Individual Client losses ranged from approximately \$24,000 to \$560,000. Six of the 11 Clients lost in excess of \$175,000.
35. The weighted average loss for the 11 Clients' accounts was approximately 67% of the value of the assets brought into the accounts.
36. During the same time period, the management fees earned by the Partnership from these 11 Clients' accounts alone were approximately \$74,000. Each of Watts and Hickey received approximately \$18,500 of these fees.

GENERAL PROCEDURAL MATTERS

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

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

RESPONSE TO NOTICE OF HEARING

TAKE FURTHER NOTICE that the Respondent must serve upon the Staff of IIROC a Response to the Notice of Hearing in accordance with Rule 7 of the Rules of Practice and Procedure within twenty (20) days (for a Standard Track disciplinary proceeding) or within thirty (30) days (for a Complex Track disciplinary proceeding) from the effective date of service of the Notice of Hearing.

FAILURE TO RESPOND OR ATTEND HEARING

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

- (a) proceed with the hearing as set out in the Notice of Hearing, without further notice to the Respondent;

- (b) accept as proven the facts and contraventions alleged by Staff in the Notice of Hearing; and
- (c) order penalties and costs against the Respondent pursuant to Dealer Member Rules 20.33, 20.34 and 20.49.

PENALTIES & COSTS

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

Where the Respondent is/was an Approved Person:

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

Where the Respondent is/was a Dealer Member:

- (a) a reprimand;
- (b) a fine not exceeding the greater of:
 - (i) \$5,000,000 per contravention; and

- (ii) an amount equal to three times the profit made or loss avoided by the Dealer Member by reason of the contravention;
- (c) suspension of the rights and privileges of the Dealer Member (and such suspension may include a direction to the Dealer Member to cease dealing with the public) for any period of time and upon any conditions or terms;
- (d) terms and conditions of continued Membership;
- (e) termination of the rights and privileges of Membership;
- (f) expulsion of the Dealer Member from membership in the IIROC; or
- (g) any other fit remedy or penalty.

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

DATED at Toronto, this 19th day of September, 2014.

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

Appendix A to Notice of Hearing for John Phillip Watts and Sean Thomas Hickey

Clients	% High Risk Tolerance on NCAF and Updates	% High Risk Holdings as at December 2010*	Client's Circumstances
HM	July 2007 10% Dec. 2007 50% Aug. 2009 100%	98%	-DOB 1956 -purpose of account was for retirement -no private pension -held all assets in accounts with Watts
LM	April 2008 60% July 2008 100%	91.2%	-DOB 1970 -account was from spouse's severance package - no prior investment holdings
GM	July 2007 10% Sep. 2007 20% Nov 2007 60% July 2009 85% June 2010 100%	99%	-DOB 1956 -purpose of account was for retirement -company pension account also managed by Watts Hickey Partners [G&P T account]
JM	July 2007 10% July 2009 40% Feb. 2010 75% June 2010 70%	97.6%	-DOB 1959 - purpose of account was for retirement -company pension account also managed by Watts Hickey Partners [G&P T account]
G&P T	A/C 1: Aug. 2007 30% April 2008 45% Feb. 2010 60% A/C 2: Jul. 2007 30% Aug. 70% May 2010 100% Jun. 2010 100%	A/C 1: 39.6% A/C 2: 94.7%	- purpose of account was for retirement i.e. Pension Plan for Clients GM and JM
GP	July 2007 10% Sept. 2007 27% July 2009 35% April 2010 80%	80.5%*[*as at July 2010]	-DOB 1948 -purpose of account was for retirement -no private pension
MM	July 2007 0% Sept 2007 50% Feb. 2008 70% Nov. 2009 78% Jan. 2010 100%	99%	-DOB 1949 -retired -purpose of account was for retirement -held all assets in accounts with Watts
AM	July 2007 10% Sept. 2007 50% Feb. 2008 70% Nov. 2009 78% April 2010 100%	100%	-DOB 1949 -purpose of account was for retirement -no private pension -held all assets in accounts with Watts
DC	Aug. 2007 25% April 2008 60% April 2010 100%	71.6%	-DOB 1955 -retired - purpose of account was for retirement
HJ	May 2008 50%	24%	-DOB 1952 --purpose of account was for retirement --no private pension --did not want any high risk
MC	A/C 1: Aug. 2007 15% A/C 2: July 2007 10%	A/C 1: 12% A/C 2: 27.5%	-DOB 1940 -retired