

# INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

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

RAYMOND JAMES LTD.

## SETTLEMENT AGREEMENT

### I. INTRODUCTION

1. IIROC Enforcement Staff and Raymond James Ltd. (the “Respondent”), consent and agree to the settlement of this matter by way of this settlement agreement (“the Settlement Agreement”).
2. The Enforcement Department of IIROC has conducted an investigation (“the Investigation”) into the conduct of the Respondent.
3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. Pursuant to the *Administrative and Regulatory Services Agreement* between IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for IDA to carry out its regulatory functions.
4. The Respondent consents to be subject to the jurisdiction of IIROC.
5. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (“the Hearing Panel”).

### II. JOINT SETTLEMENT RECOMMENDATION

6. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

7. The Respondent admits to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

Between May 14, 2008 and October 31, 2008, the Respondent failed to ensure adequate supervision of the option trading in twenty three (23) client accounts of Kostas Arapis (“Arapis”), an Approved Person of the Respondent, contrary to IDA Regulations 1300.1 (o), 1300.2 and IDA Policy No. 2 and Dealer Member Rules 1300.1 (o), 1300.2 and 2500.

8. Staff and the Respondent agree to the following terms of settlement:

- a) A fine in the amount of \$50,000

9. The Respondent agrees to pay costs to IIROC in the sum of \$10,000.

### **III. STATEMENT OF FACTS**

#### **(i) Acknowledgment**

10. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

#### **(ii) Factual Background**

##### **A. Overview**

11. The Respondent failed in its supervisory responsibilities over Arapis. Arapis effected numerous level 3 and level 4 option trades in 23 client accounts. None of these trades were identified by the Respondent’s tier 1 supervisors as being outside the accounts’ approved option levels.
12. The supervisors responsible for supervising Arapis’ trading mistakenly believed that the Respondent’s trading platform automatically prevented trades from being processed which were outside of the accounts’ approved option levels. As such, although all of these option transactions were reviewed, the supervisor conducting the review did not take any steps to identify whether the trades were outside the accounts’ approved option levels.
13. The Respondent failed to take adequate measures to ensure that its supervisors undertook reviews to confirm that the transactions were within the accounts’ approved option levels. The Respondent failed initially to fully appreciate and then to properly inform its supervisors that the trading platform did not automatically prevent trades which were outside the accounts’ approved option levels. The Respondent has subsequently done

considerable work with the service provider of the trading platform to improve the system for options supervisory purposes

14. This supervisory failure resulted in some clients being exposed to potentially greater risk as a result of these transactions.

### **B. Registration History**

15. The Respondent is an IIROC Member firm with its head office located in Vancouver, British Columbia and branch offices located across the country.
16. On June 1, 2008, the Respondent became a Dealer Member of IIROC.

### **C. MacKay Delegated Supervisory Responsibilities Over Arapis**

17. Between December 20, 2005 and November 28, 2009, Arapis was registered as a Registered Representative (Retail) at a Saskatoon, Saskatchewan branch of the Respondent. On June 6, 2007, Arapis completed the Options Supervisors Course. He subsequently became registered as a Branch Manager from June 22, 2007 until November 28, 2009.
18. Since Arapis was a Branch Manager, his trading activities were supervised off-site by John Whyte (“Whyte”) a Branch Manager located at a Toronto, Ontario branch of the Respondent. Pursuant to a memo dated October 13, 2006, Whyte delegated to Daniel MacKay (“MacKay”), his assistant Branch Manager, the supervisory tasks over Arapis’s Saskatoon branch, among others.
19. As a result, MacKay was responsible for performing various supervisory tasks, including the daily and monthly review of Arapis’ trading activity and account opening approvals.

### **D. The Respondent’s Option Trading Policies**

20. In accordance with the Respondent’s policies and procedures, when option trading is added to an account, the account is assigned a level that identifies the allowable option activity. The level is based on the client’s intended strategy, his/her investment experience, risk tolerance, and financial capabilities. The various levels of option trades in place at the Respondent at the time were:

<b>Level 1</b>	Purchase options
<b>Level 2</b>	Purchase and sell covered options
<b>Level 3</b>	Purchase and sell covered/spread options
<b>Level 4</b>	Purchase and sell covered/spread/uncovered options

21. These option levels are substantially similar to the option levels set out in the Options Supervisors Course prepared and published by the Canadian Securities Institute.

22. On May 9, 2008, the Respondent's Senior Vice-President and Chief Compliance Officer distributed a Compliance Bulletin to all Branch Managers, regarding the firm's option levels policies. Specifically, the changes were made to better define the Respondent's level 4 options approval and oversight practices.
23. The Compliance Bulletin states that "Level 4 options trading represents the highest risk/reward client trading possible at RJL." As such, all Level 4 accounts must be approved by both the Branch Manager and the Designated Registered Options Principal ("DROP") or Alternate Registered Options Principal ("AROP"). Level 1, 2 or 3 option accounts could be approved by the Branch Manager, without DROP or AROP approval.

#### **E. MacKay's Supervision of Arapis**

24. On May 9, 2008, Arapis became licensed to advise and trade in options and subsequently solicited several clients to add options trading to their accounts.
25. MacKay was responsible for approving Arapis' client accounts for option trading. MacKay approved most of Arapis' client accounts to trade in Level 2 options. Four accounts were approved to trade in Level 3 options. None of the accounts were approved either by MacKay or subsequently by the DROP or AROP to trade in Level 4 options.
26. Between May 14, 2008 and October 31, 2008, Arapis effected one hundred and eleven (111) option transactions in twenty three (23) client accounts which were outside of the accounts' approved option level. Specifically, Arapis effected ninety four (94) uncovered puts, ten (10) uncovered calls and seven (7) spread trades.
27. The 94 uncovered puts and the 10 uncovered calls trades represented level 4 option trades and were not approved for any of the 23 client accounts in which the trades took place.
28. The 7 spread trades represented level 3 option trades and were not approved for any of the 7 client accounts in which the trades took place.
29. There was no automated supervision processes in place at the Respondent to recognize that these trades were taking place in accounts that were not approved for this trading.
30. MacKay reviewed all of these transactions as part of his daily review. It was his understanding that the Respondent's trading platform contained a "hard edit" whereby the system would automatically prevent a trade from being processed in an account if the trade was outside the approved option level for the account. This understanding was consistent with Whyte's. As such, his daily trade review did not include a review for the account approval level, but instead focused on the suitability of the transactions in light of the client's KYC information.
31. In fact, the Respondent's trading platform did not contain a "hard edit" feature to automatically prevent this type of trading. Instead, the trading platform had a "soft edit" which could be bypassed by the Approved Person upon order entry.

32. Between June 3 and June 8, 2008, Arapis processed put trades in the RRSP accounts of two clients (the “RRSP Trades”). The RRSP Trades were level four options transactions that were not allowed in RRSP accounts pursuant to the *Income Tax Act*. In addition to being prohibited pursuant to the *Income Tax Act*, the RRSP Trades were also outside the accounts’ approved option level.
33. During his daily trade review, MacKay identified RRSP Trades as being prohibited pursuant to the *Income Tax Act*. He advised Whyte and his superiors at the Respondent of his findings. MacKay and Whyte reviewed Arapis’ other RRSP client accounts to ensure that no level 4 option positions were held in violation of the *Income Tax Act*. However, their review did not include a review of all of Arapis’ client accounts with option positions to ensure that the accounts did not hold positions which exceeded the accounts approved option levels.
34. As a result, neither MacKay nor Whyte, nor anyone else at the Respondent detected that, in June 2008, seven of Arapis’ non-registered client accounts held 19 level 4 option positions which exceeded the accounts’ approved option levels.
35. In reviewing the RRSP Trades, MacKay, Whyte or the Respondent ought to have realized that the transactions were also outside of the accounts’ approved option levels.
36. The Respondent ought to have realized that Arapis was bypassing the “soft edit” feature and the supervisors were not identifying and prohibiting trades outside the accounts approved option levels. Nonetheless, MacKay continued his supervisory obligations based on his assumption that the system was preventing trades that exceeded approved options levels, although he took no steps to confirm this. In fact, when Arapis bypassed the trading platform’s “soft edit” feature warning that the trade exceeded approved options levels, the system allowed Arapis to continue option transactions which were outside of the accounts’ approved option levels.
37. Between June 12, 2008 and October 31, 2008 (i.e. after discovery of the RRSP Trades), Arapis effected 89 option transactions in 18 client accounts which were outside of the accounts’ approved option level. Specifically, Arapis effected seventy one (71) uncovered puts, ten (10) uncovered calls and eight (8) spread trades.
38. At no time during this period did anyone at the Respondent identify these trades as being outside of the accounts’ approved option level.
39. On November 18, 2008, Peter Matter, the Respondent’s DROP, identified three client accounts that held options which were outside the accounts’ approved option level. He advised Whyte and MacKay of his concerns.
40. As a result of these concerns, the Respondent suspended Arapis’ option trading privileges on November 22, 2008.

41. Shortly thereafter, the Respondent worked with the provider of the trading system to identify to the provider the flawed logic in the system preventing a viable solution to automatically block options transactions that are outside the accounts' approved option levels.
42. On November 25 and 26, 2008, the Respondent received complaints from two of Arapis' clients regarding the trading in their accounts and the Respondent revoked Arapis' option trading privileges.
43. In May and June 2009, the Respondent and Arapis reached settlement agreements with the two clients who filed formal complaints.
44. In October 2009, the Respondent updated its Policy & Procedures Manual. Following the update, the Policy & Procedures Manual now expressly requires that the Branch Manager's daily supervision include a review to detect options transactions that are outside the accounts' approved option levels.
45. In May 2011, Arapis entered into a settlement agreement with IIROC as a result of his conduct as outlined above.

#### **IV. TERMS OF SETTLEMENT**

46. This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.
47. The Settlement Agreement is subject to acceptance by the Hearing Panel.
48. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
49. The Settlement Agreement will be presented to the Hearing Panel at a hearing ("the Settlement Hearing") for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.
50. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
51. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.
52. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.

- 53. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.
- 54. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
- 55. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

**AGREED TO** by the Respondent at the City of Vancouver, in the Province of British Columbia,  
this 16th day of November, 2012.

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Witness  
**WITNESS**  
NAME:

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**RESPONDENT**

**AGREED TO** by Staff at the City of Vancouver in the Province of British Columbia,  
this 22 day of November, 2012.

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Witness  
**WITNESS**  
Name

Rob DelFrate\_\_\_\_\_  
**ROB DELFRATE**  
Enforcement Counsel on behalf of  
Staff of the Investment Industry  
Regulatory Organization of Canada

**ACCEPTED** at the City of Vancouver, in the Province of British Columbia,  
this 22<sup>nd</sup> day of November, 2012 , by the following Hearing Panel:

Per: Mr. John Rogers  
Panel Chair

Per: Mr. Bob Sutherland  
Panel Member

Per: Mr. James Harkness  
Panel Member