Re Lambert

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 (IIROC)

and

James Dale Lambert

2013 IIROC 16

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

Heard: March 18, 2013
Decision: April 5, 2013

Hearing Panel:
P.N. McDonald, Q.C. Chair, William Welton, Eric Wray
Appearances:
David McLellan, Enforcement Counsel and Mark Pallas, Investigator for Investment Industry Regulatory Organization of Canada
Grant Scharfstein, Counsel for the Respondent

DECISION

Introduction

¶ 1 The panel conducted a hearing on March 18, 2013 in relation to the allegation of IIROC that the Respondent, James Dale Lambert, committed the following contravention:

> From approximately June, 2005 to January, 2011, the Respondent, while a Registered Representative:
>
> (i) failed to use due diligence to learn and remain informed of the essential facts relative to every order accepted, contrary to IIROC Dealer Member Rule 1300.1(a) [IDA Regulation 1300.1(a) prior to June 1, 2008];
>
> (ii) failed to use due diligence to ensure that recommendations were suitable for his clients, contrary to IIROC Dealer Member Rule 1300.1(q) [IDA Regulation 1300.1(q) prior to June 1, 2008].

¶ 2 Prior to the hearing IIROC and the Respondent executed an Agreed Statement of Facts, stating *inter alia* that "the Investigation discloses matters for which the Respondent may be disciplined by a hearing panel" and "the parties are not able to agree on appropriate sanction and therefore agree to refer this matter to a penalty hearing." Hence, the hearing on March 18 was concerned only with penalty.

¶ 3 The Respondent was represented at the hearing by his counsel Grant Scharfstein, but did not appear himself. The panel was told Lambert suffered from depression and could not face the proceedings. With the consent of IIROC, Lambert's counsel filed a letter dated March 15, 2013 from a psychologist to whom Lambert had been referred for therapy by his family physician some time prior to October, 2010. His working diagnosis was Major Depression, with symptoms of an Anxiety Disorder. Lambert has not worked in the industry since July of 2010.

¶ 4 Neither party called any witness. The evidence before the panel consisted of the Agreed Statement of Facts, an affidavit of IIROC staff member speaking to costs of their investigation, and the psychologist's letter.

Facts

¶ 5 The Agreed Statement of Facts is appended to our Decision. In summary, Lambert was a registered representative with Edward Jones in Saskatoon. He learned of a product called Streams, which was originally sold to the public in units, consisting of Equity Dividend Shares (EDS) and Capital Yield Shares (CYS). Subsequently, EDS and CYS were separately traded. The asset base of Streams was a portfolio of securities of publically traded financial sector companies. The EDS shareholders received a fixed dividend out of earnings and the CYS shareholders received dividends equal to the balance of earnings, if any. At the ten-year maturity date of the investment the shares were to be redeemed, with EDS shareholders receiving an amount based on the net asset value of the portfolio up to a cap of $25.00 per share (the original issue price). The CYS shareholders, by contrast, had the $25.00 capital repayment guaranteed by TD Global Finance.

¶ 6 The Streams investment was not included on the Edward Jones recommended securities list and was not covered by the firm's research department. As a result, Lambert provided documentation concerning Streams to the Edward Jones research group in Toronto for their review. The research group told Lambert it did not recommend the investment but did not prohibit him from purchasing it for his clients. Lambert believed the principal of the Streams investment was protected and he therefore recommended it, and in particular EDS, to clients as a safe, low risk investment. He did not understand that the principal in an EDS investment was not protected. Forty-two clients bought the product. When the market declined significantly in 2008, EDS declined substantially in value. At maturity, EDS shareholders received only $9.78 per share. Ten clients, who suffered net losses of $250,000 after dividends, complained to IIROC. They were compensated by Edward Jones in the amount of about $240,000, of which Lambert repaid $15,000 to the firm.

Submissions

¶ 7 IIROC submitted a written Staff Submission. The Submission refers to the Disciplinary Sanction Guidelines approved by IIROC. In addition to addressing in a general way the considerations to be taken into account in fixing sanctions, the Guidelines provide for specific recommended sanctions, which include the following for both unsuitable recommendations and failure to know your client:

- Fine: Minimum of $10,000;
- Re-write of CPH;
- Period of close and/or strict supervision;
- Period of suspension (in most egregious cases).

¶ 8 In oral argument counsel for IIROC submitted there were aggravating factors in Lambert's case, including:

- his clients were not seeking out this investment, rather Lambert recommended it
- his recommendation resulted in a substantial loss to a large number of clients
- the investment was "off the grid"

¶ 9 IIROC also acknowledged a number of mitigating factors, including:

- Lambert was not motivated by self interest, he was not in it for the money

- he had no prior record and there was no pattern of carelessness
- he accepted responsibility for his actions and was forthright in responding to the investigation
- his clients were compensated by Edward Jones and Lambert (to a small extent) up to 95% of their loss
- Lambert suffered personally, financially and professionally apart from any sanctions

¶ 10 The penalty suggested as appropriate by IIROC consisted of:

a. A global fine in the amount of $40,000 for both contraventions;

b. A ninety (90) days suspension from working in any registered capacity with an IIROC member firm;

c. Successful re-write of the Conduct and Practices Examination within 6 months of returning to industry;

d. Costs in the amount of $10,000.

¶ 11 Mr. Scharfstein submitted there were two additional mitigating factors in his client's favour. The first was the fact that thirty-two of the forty-two clients to whom Lambert sold the EDS product did not complain. He submitted these thirty-two clients should not be considered in assessing penalty. The second factor was that Lambert's violation was in the nature of an honest mistake, such that visiting any penalty has no deterrent value either in terms of Lambert personally or investment dealers generally.

¶ 12 Mr. Scharfstein recommended a penalty consisting of a re-write of the CPH, should Lambert ever return to the industry, a period of close supervision in that event, and costs of $10,000.

Analysis

¶ 13 Although two contraventions were alleged by IIROC, their counsel allowed that this was essentially a "know your product" case. We agree. In fact, the panel would take it one step further: Lambert ought to be sanctioned, if at all, for one contravention only. In the circumstances of this case, there is no element of blameworthiness in one violation that is not part of the other. That is, if Lambert failed to make suitable recommendations to his clients, it was solely because he did not understand his product. He *did* understand what was suitable for his clients and he recommended only what he thought was suitable. It is true that Rule 1300.1(q) involves the element of recommendation to clients, which is not part of Rule 1300.1(a). However, if in the case of a particular client the purchase of a product has been recommended, it would not be right to sanction the dealer both for accepting an order and making a recommendation, without knowledge of the product. The dealer might be found in contravention of one or the other, but not both. The lesser offence of accepting an order is subsumed in the greater offence of recommending a product of which the dealer is ignorant. In our opinion, to sanction Lambert for two violations does not advance the purpose of the Rules. He should be sanctioned, if at all, for one contravention.

¶ 14 There is no question in the panel's mind that a penalty is appropriate. Lambert did not understand the product he was selling. We cannot accept the argument of his counsel that this was in the nature of an honest mistake and nothing more. The Agreed Facts include the statement: "He failed to undertake a careful analysis of the information available to him and therefore failed to know his product." Thus, failure to use due diligence is admitted and cannot be contradicted at this point, unless that conclusion is patently unreasonable in the circumstances.

¶ 15 We accept that conclusion as a reasonable one on the facts as stated: that is, Lambert did not understand his product *because* he was not as careful or diligent as he should have been.

¶ 16 The Streams offering is not a simple or straightforward product. It involves an interplay of rights to income and capital of EDS and CYS that has some complexity. As it appears from the facts, Lambert needed

assistance in understanding the product.

¶ 17 Lambert did ask the Edward Jones research group for assistance, but the fact is he didn't get it. The research group told him only that it was not a recommended investment, which we can assume Lambert knew going in. They didn't tell him anything else except that he was not prohibited from buying it for his clients. If Lambert was out of his depth, as it would seem, his approach to the research group did not change that. Clearly, he should have avoided an investment that was complex and off the grid if he could not gain an understanding of it through the firm's research group or otherwise. No other due diligence was undertaken.

¶ 18 Lambert therefore did fail to use due diligence to learn and understand the essential facts pertaining to EDS. However, the lack of due diligence was of the least offensive variety. It was not a product of laziness, indifference or greed. Everything in the facts, both in what is stated and what is not stated, suggests Lambert cared about his clients, wanted very much to fill their investment needs, and went to some trouble to try to accomplish that. We note, for example, there is no allegation that Lambert failed in any aspect of his "know your client" responsibilities. Had he done so, these would clearly have come to light in the course of the IIROC investigation. We have to assume that his new account application forms were accurate and in good order. If Lambert was less than fully diligent with respect to EDS, this was not part of any pattern of carelessness.

¶ 19 All we have in this case is the bare conclusion that Lambert, for reasons apparently selfless, was not diligent enough. In the opinion of the panel, this case is one that calls for penalty at the low end of the range, even apart from the mitigating factors extraneous to the offence itself, which in our judgment also weigh heavily in Lambert's favour.

¶ 20 We have been referred to a number of earlier IDA and IIROC cases. Two of these, *Re Beechey* and *Re Dyck* involve sanctions agreed between the regulatory authority and the respondent. In *Re Beechey*, fines of $20,000, $15,000 and $15,000 were imposed for "know your product" and "know your client" violations under 1300.1(a) and unsuitable recommendations under 1300.1(q), respectively. There is not a great deal to distinguish the circumstances of *Re Beechey* from this case, except that Beechey clearly did fail to understand both his products and his clients, exhibiting thereby a pattern carelessness, and the product he sold was high risk structured derivative product, not one based in publically traded shares of large financial institutions. Beechey, like Lambert, sought information from others in relation to the product. Beechey did not suffer the personal, financial and professional loss Lambert has.

¶ 21 In *Re Dyck* a fine of $20,000 was imposed for a "know your product" violation that resulted in unsuitable recommendations, as in this case. Dyck did not understand at all that the product he was selling was complicated and risky. He was not diligent in any way. The penalty also included a seven year registration prohibition, but we think that may have reflected circumstances peculiar to the respondent. There is no mention in the case of mitigating factors favouring the respondent.

¶ 22 Finally, *Re Gareau* is also similar to this case. A fine of $10,000 for each violation, that is "know your product" and unsuitable recommendations, was imposed. Gareau was essentially ignorant about the product he was selling. He relied on the advice of his superior that "it's Bell, so it should be fine." In our view his culpability was at a higher level than Lambert's. In addition, he continued to make recommendations causing greater losses, even after information was brought to his attention which might cause a reasonable person to reconsider his initial advice.

Decision

¶ 23 Having considered carefully all the circumstances of Lambert's case and with the guidance provided by the Disciplinary Sanction Guidelines and the earlier cases, the panel imposes the following sanctions:

a. A global fine of $10,000;

b. Successful re-right of the Conduct and Practices Examination within six months of returning to industry;

c. Six months of close supervision upon return to the industry;

d. Costs in the amount of $3,000.

¶ 24 We have not imposed any suspension. Mr. Lambert is out of the industry and unlikely to return at least in the short run. As such a suspension would be gratuitous and meaningless. On the other hand, were Lambert ready and willing to return, we think a suspension of any duration would be more penalty than the circumstances warrant.

DATED at Regina, Saskatchewan the 5 day of April, 2013.

P.N. McDonald, Q.C. Chair

William Welton

Eric Wray

AGREED STATEMENT OF FACTS

I. INTRODUCTION

1. The Enforcement Department of IIROC has conducted an investigation ("the Investigation") into the conduct of the Respondent, James Lambert.

2. 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.

3. The Respondent consents to be subject to the jurisdiction of IIROC.

4. 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").

5. IIROC and the Respondent agree to the facts outlined below.

6. The parties are not able to agree on an appropriate sanction and therefore agree to refer this matter to a penalty hearing. Both parties consent and acknowledge that the other shall be permitted to introduce evidence at the penalty hearing, including calling witnesses, relevant to any of the matters at issue at the penalty hearing.

II. CONTRAVENTIONS

7. From approximately June 2005 to January 2011, while a Registered Representative with Edward Jones, Lambert:

   (i) failed to use due diligence to learn and remain informed of the essential facts relative to every order accepted, contrary to IIROC Dealer Member Rule 1300.1(a) [IDA Regulation 1300.1(a) prior to June 1, 2008];

   (ii) failed to use due diligence to ensure that recommendations were suitable for his clients, contrary to IIROC Dealer Member Rule 1300.1(q) [IDA Regulation 1300.1(q) prior to June 1, 2008].

III. STATEMENT OF FACTS

Overview

8. The Respondent, James Dale Lambert ("Lambert"), recommended an investment in a financial product to forty two of his clients as a low risk investment. He believed that the investment would repay the principal invested to holders at maturity. However, this was not the case.

9. He failed to undertake a careful analysis of the information available to him and therefore failed to know

his product. As a result, he recommended an investment to clients based on incorrect information and they suffered significant losses.

10. Lambert recommended the investment to clients in circumstances where it was not suitable as these clients were seeking safe investments.

Registration History

11. At all material times, Lambert was employed as a Registered Representative ("RR") with Edward Jones in Saskatoon, Saskatchewan.

12. Lambert has been an RR since 1999, all with Edward Jones.

13. He has not worked as an RR since July, 2010.

FSIS Investment

14. In early 2005, Lambert learned from a colleague at another firm about a financial product called Streams (Structured Target Repayment And Managed Securities),which was a Financial Services Income Streams Corporation ("FSIS") offering.

15. Two Streams products offered by FSIS were Equity Dividend Shares ("EDS") and Capital Yield Shares ("CYS"). EDS and CYS were each individually traded on the TSX, having been listed pursuant to initial public offerings in 2000 whereby investors could purchase a unit comprised of one EDS share and one CYS share.

16. Both EDS and CYS held securities in large, publicly traded financial sector companies. In addition, the objective was to provide holders of EDS and CYS with payment of dividends, as well as repayment of the original subscription amount of $25 per share on a fixed termination date of February 1, 2011 ("Maturity Date").

17. However, an important characteristic of CYS was that it provided a holder with principal protection of the original subscription amount on the Maturity Date. Principal protection was not available to holders of EDS, and this was a crucial differentiating feature between EDS and CYS.

18. The particulars of the characteristics of both CYS and EDS were outlined in the initial public offering prospectus, as well as additional filing documentation, all of which was available on SEDAR.

Recommendation to Clients

19. Lambert believed a Streams investment was an attractive alternative for clients seeking a safe, low risk investment in a low interest rate environment.

20. However, the Streams investment was not included on the Edward Jones recommended securities list, nor was it covered by the firm's research department. As a result, Lambert provided documentation concerning Streams to the Edward Jones' research group in Toronto for their review.

21. The research group advised Lambert that it did not recommend the investment, but it did not prohibit him from purchasing it for his clients.

22. Lambert then recommended Streams, and in particular EDS, to clients as an attractive alternative for those seeking a safe, low risk investment. His belief that the investment was low risk was primarily based on his belief that the principal was protected, and the underlying securities were held in established financial issuers.

23. A number of Lambert's clients were interested and Lambert proceeded to complete the investment in EDS on their behalf.

24. In total, forty two clients invested and held a total of $1,264,780 to maturity.

25. As the market declined significantly in 2008, EDS declined substantially in value.

26. At the Maturity Date, CYS holders were paid their principal amount of $25 per share. However, EDS holders were paid just $9.78 per share, reflecting 39% of their principal investment in EDS.

27. Clients who had expected the repayment of principal were surprised to learn that they had suffered capital losses when they had understood the investment principal to be protected.

28. In total, ten of Lambert's clients complained. These ten clients suffered total capital losses of approximately $492,000. The capital losses do not include dividends received by the clients.

29. When factoring in dividends, the ten clients' losses were mitigated, resulting in total losses of approximately $251,714.

30. These clients have been compensated by the firm in the amount of approximately $240,614 of which Lambert has repaid $15,000 to the firm.

31. Lambert did not fully understand the structure and particulars of EDS. In particular, he failed to understand that unlike CYS, the principal in an investment in EDS was not protected.

32. By failing to understand the product, Lambert was not in a position to adequately explain the nature and risks of the investment in order to recommend the securities to his clients. As a result, the clients did not fully understand the complexities or risks inherent in the investment.

33. By failing to understand the product, Lambert was unable to engage in a proper suitability assessment for his clients. As a result, he recommended an investment to clients seeking a low risk investment which was not suitable for them.

AGREED TO by the Respondent at the City of Saskatoon, in the Province of Saskatchewan,

this 6 day of March, 2013.

"Witness" **"James Lambert"**

Witness **James Dale Lambert**

AGREED TO by Staff at the City of Calgary in the Province of Alberta,

this 8 day of March, 2013.

"Witness" **"David McLellan"**

Witness **David McLellan**

Senior Enforcement Counsel on behalf of
the Staff of the Investment Industry
Regulatory Organization of Canada