Re Smith

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

Kenneth Edward Smith

2018 IIROC 18

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

Heard: May 10, 2018
Decision: June 4, 2018

Hearing Panel:
The Honourable Thomas R. Braidwood, Q.C., Chair and Nigel Potts
Appearance:
Lorne Herlin, Enforcement Counsel for IIROC

REASONS FOR DECISION

¶ 1 This hearing was commenced to consider the appropriate penalty to be rendered to the Respondent, Kenneth Edward Smith, as a result of findings made on February 23, 2018 when the following allegations were found to be proven.

A. CONTRAVENTIONS

Count 1

Between May 2014 and August 2016, Kenneth Edward Smith (the "Respondent"), engaged in an outside business activity without obtaining the approval of his Dealer Member, contrary to Dealer Member Rules 18.14 and 29.1.

Count 2

In or about February 2016, the Respondent engaged in personal financial dealings with his client, RF, contrary to Dealer Member Rule 43.1.

Count 3

Between June 2013 and November 2014, the Respondent placed off-book investments for his client, RF, without the knowledge or consent of his Dealer Member, contrary to Dealer Member Rule 29.1.

Count 4

In or around June 2015, the Respondent took $10,000 from a former client CB in order to invest the funds on her behalf, without the knowledge or consent of his Dealer Member, contrary to Dealer Member Rule 29.1.

Count 5

On May 3, 2017, the Respondent failed to cooperate with IIROC Staff who were conducting an investigation, contrary to Rule 8100, section 8104 of the Consolidated Rules.

¶ 2 IIROC Staff submits that pursuant to Dealer Member Rule 20.33 and Section 8210 of Consolidated Rule 8200, the Hearing Panel should impose the following penalties on the Respondent:

(a) a fine of $125,000;

(b) a permanent bar to approval in any capacity; and

(c) costs in the amount of $20,000.

Contravention 1

¶ 3 Contravention 1 states:

> Between May 2014 and August 2016, the Respondent, engaged in an outside business activity without obtain the approval of his Dealer Member, contrary to Dealer Member Rules 18.14 and 29.1.

Unapproved Outside Business Activity

¶ 4 In May 2014, Shine-On Chrome & Graphic Finishes Inc. (Shine-On) was incorporated pursuant to the laws of British Columbia.

¶ 5 At all material times, the Respondent was a director of Shine-On and owned a portion of the company.

¶ 6 TC was also a director of Shine-On and she owned a portion of the company. At all material times, the Respondent was the Registered Representative responsible for TC's investment accounts at Queensbury.

¶ 7 Shine-On purported to be in the business of applying chrome and graphic finishes on automobiles, motorcycles, and other surfaces.

¶ 8 Shine-On was located in the same building as the Respondent's Queensbury business location.

¶ 9 At all material times, the Respondent did not inform Queensbury of his ownership interest in and involvement with Shine-On.

¶ 10 In fact, in his 2014 and 2015 Annual Advisor Updates he indicated that:

(a) he was not involved in any investment or business partnership with one of his clients; and

(b) he was not engaged in any business activity other than for which he was licensed through Queensbury.

¶ 11 The Hearing Panel in *Re Bortolin*, 2012 IIROC 13 emphasized that both "knowledge and approval are required" from the Dealer Member before a registrant can engage in an outside business activity. The Hearing Panel explained the rationale for these requirements at para. 34:

> Disclosure and approval are necessary in such circumstances in order to allow the Member to supervise and control a Registered Representative's activities. Not to do so can create conflicts of interest for the Registered Representative… The policy also helps protect the integrity of the securities market as well as the reputation of the Member.
>
> IIROC Brief of Authorities, Volume I, Tab 10

Contravention 2

¶ 12 Contravention 2 states:

> In or about February 2016, the Respondent engaged in personal financial dealings with his client, RF, contrary to Dealer Member Rule 43.1.

¶ 13 Dealer Member Rule 43.1 states that:

> An employee or Approved Person of a Dealer Member must not, directly or indirectly, engage in any personal financial dealings with clients.
>
> IIROC Brief of Authorities, Volume I, Tab 4

¶ 14 Dealer Member Rule 43.2 clarifies that:

> Personal financial dealings include, but are not limited to, the following types of dealings: […]
>
> (3) Borrowing from clients
>
> (i) Borrowing money or receiving a guarantee in relation to borrowing money, securities or any other assets from a client…

Undisclosed Personal Financial Dealings - RF

¶ 15 RF is a business manager who lives in Nanaimo. He has known the Respondent since they were both children.

¶ 16 In or around July 2011, RF transferred his investment accounts from First Financial to Queensbury.

¶ 17 The New Client Document for Individual Accounts form which RF completed in order to transfer his investment accounts to Queensbury indicated that he was 64 years old and his:

(a) annual income was $90,000.00;

(b) estimated net liquid assets were $400,000.00; and

(c) estimated net fixed assets were $700,000.00.

¶ 18 At all material times, the Respondent was the Registered Representative responsible for RF's accounts at Queensbury.

¶ 19 The Respondent asked RF if he would be interested in loaning Shine-On money in order to purchase equipment and that in return Shine-On would pay him interest on the loan.

¶ 20 As a result, in February 2016 Shine-On entered into a written agreement with RF (the "Agreement").

¶ 21 Pursuant to the Agreement, RF gave Shine-On $7,500 and in return Shine-On agreed to pay RF $1,750 per month for six months ($10,500 in total). The first payment of$1,750 was due on April 2, 2016.

¶ 22 The Respondent and another individual signed the Agreement on behalf of Shine-On.

¶ 23 In total, Shine-On paid RF:

(a) $1,500 in April 2016; and

(b) $1,000 in May 2016.

¶ 24 Shine-On then stopped making payments pursuant to the Agreement. As a result, RF made several attempts to collect the outstanding payments.

¶ 25 To date, Shine-On has not made any additional payments.

¶ 26 In late August 2016, RF informed Queensbury about the Respondent's involvement with Shine-On and the fact that RF had loaned money to Shine-On.

¶ 27 In September 2016, Queensbury terminated the Respondent for cause.

¶ 28 The policy rationale for this rule is explained in *Re Gebert* 2016 IIROC 44 at paras. 23 - 25:

> … There is always a conflict of interest between the borrower and the lender. A

> Registered Representative and client are in a relationship in which the Registered Representative has an obligation of trust towards the client. Where a person is in conflict of interest with a person to whom a duty of trust is owed, that person is acting unethically. It follows that when the Respondent borrowed money from his client, he became involved in a conflict of interest with his client. He acted unethically towards his client […].
>
> Moreover, the obligation of trust to one's client is fundamental to the public interest and to the reputation of the investment industry. When the Respondent, unethically, borrowed money from his client, his conduct was both unbecoming and detrimental to the public interest.
>
> The proper functioning of the investment industry and the public interest in the protection of investors demand that all Registered Representatives have trustworthy relationships with their clients.
>
> IIROC Brief of Authorities, Volume I, Tab 12.

Contravention 3

¶ 29 Contravention 3 states:

> Between June 2013 and November 2014, the Respondent placed off-book investments for his client, RF, without the knowledge or consent of his Dealer Member, contrary to Dealer Member Rule 29.1.

¶ 30 Dealer Member Rule 29.1 states that:

> Dealer Members and each... Registered 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.
>
> IIROC Brief of Authorities, Volume I, Tab 3

Offbook Transactions - RF

¶ 31 The Respondent and RF agreed that RF would provide the Respondent with funds in order to primarily buy and sell futures on behalf of RF. In return, RF agreed to pay the Respondent a portion of any profits which the trading generated.

¶ 32 The Respondent was not registered to trade futures.

¶ 33 As a result in or around June 2013, the Respondent opened an order execution-only investment account at another Dealer Member in the name of RF (the "RF Account").

¶ 34 Between June 2013 and May 2014, RF deposited $36,100 into the RF Account as follows:

(a) $50 on June 21, 2013;

(b) $50 on June 25, 2013;

(c) $15,000 on June 27, 2013;

(d) $14,000 on January 30, 2014; and

(e) $7,000 on May 29, 2014.

¶ 35 Unbeknownst to Queensbury, between June 2013 and November 2014, the Respondent placed orders for the RF Account. The Respondent did not consult with RF before placing any of these orders.

¶ 36 No funds were withdrawn from the RF Account until RF closed the RF Account in November 2015. By that time, the value of the holdings in the account had diminished to approximately $1,074.

¶ 37 In *Re Dubois*, 2014 IIROC 18, the Registered Representative, among other things, placed off-book investments for five of his clients. The Hearing Panel in that case detailed the risks of this type of misconduct at paras 39-40:

> In respect of the standards of ethics and business conduct recognized within the industry, these activities exposed the five clients concerned and the dealer who employed him to real risks, since not disclosing them made it impossible for the dealer to ensure appropriate oversight and supervision.
>
> By failing to disclose these activities, the Respondent was hindering the dealer who employed him in its duty to protect the public. What's more, he exposed the latter to potential liability in regard to the clients concerned, by depriving it of the ability to mitigate the risk through the normal application of its policies and supervision procedures. Indeed, the clients could have demanded that the dealer indemnify them for any alleged losses that its representative's undisclosed business activities might have caused them.

Contravention 4

¶ 38 Contravention 4 states:

> In or around June 2015, the Respondent took $10,000 from CB in order to invest the funds on her behalf, without the knowledge or consent of his Dealer Member, contrary to Dealer Member Rule 29.1.

¶ 39 At times, the Respondent was also licensed to sell insurance products.

¶ 40 CB had been one of the Respondent's insurance clients.

¶ 41 The Respondent approached CB about day trading on her behalf. He informed CB that he could make her $10 a day by trading futures.

¶ 42 CB assumed that her funds would be invested in an account at Queensbury.

¶ 43 In June 2015, CB agreed and she gave the Respondent $10,000 to invest on her behalf.

¶ 44 Pursuant to the Respondent's instructions, CB made her cheque for $10,000 payable to BC1009062.

¶ 45 10090662 B.C. Ltd. (Incorporation Number: BC1009062) is a company that was incorporated pursuant to the laws of British Columbia. The Respondent is the sole director of 10090662 B.C. Ltd.

¶ 46 Respondent provided CB with account statements dated March 31, 2016, June 2016, August 19, 2016, December 1, 2016, January 31, 2017, and March 1, 2017 which each indicated that CB's investment had increased in value.

¶ 47 In particular, the March 1, 2017 statement indicated that her investment was worth $13,764.

¶ 48 In January 2017, CB asked the Respondent to return her funds, but he claimed that in December 2016 he had invested the funds in a one year locked-in investment.

¶ 49 In May 2017, CB contacted Queensbury to complain about the Respondent's conduct and she learned that she did not have an account with Queensbury.

¶ 50 In *Re Melville*, 2014 IIROC 51, the Registered Representative misappropriated client funds and provided false account statements to some of his clients. The Hearing Panel stated at para. 27 that:

> ... these are both extremely serious offences which demand a significant response. Such actions are injurious to the investing public and threaten the integrity of the Capital

Markets...

IIROC Brief of Authorities, Volume I, Tab 15

Contravention 5

¶ 51 Contravention 5 states:

> On May3, 2017, the Respondent failed to cooperate with IIROC Staff who were conducting an investigation, contrary to Consolidated Rule 8100, section 8104.

¶ 52 Consolidated Rule 8100 imposes an obligation on a registrant to comply with any request by IIROC Enforcement Staff to attend an investigatory interview.

Failure To Attend IIROC Interview

¶ 53 By way of a January 6, 2017 letter which was delivered to the Respondent on January 13, 2017, IIROC Staff advised the Respondent that it had begun an investigation into his conduct (the "Investigation").

¶ 54 By way of a February 16, 2017 voice mail message and email, IIROC Staff asked the Respondent to contact IIROC Staff to discuss the January 6, 2017 letter.

¶ 55 By way of a February 23, 2017 voice mail message, IIROC Staff asked the Respondent to contact IIROC Staff.

¶ 56 Later on February 23, 2017, IIROC Staff and the Respondent spoke by telephone. During the telephone conversation, IIROC Staff informed the Respondent that IIROC Staff wished to interview him. In response, the Respondent stated "that's not going to happen".

¶ 57 By way of a March 7, 2017 letter, IIROC Staff asked the Respondent to contact IIROC Staff by March 20, 2017 in order to arrange a mutually convenient time for the interview.

¶ 58 The Respondent did not respond to the March 7, 2017 letter.

¶ 59 On April 15, 2017, the Respondent was personally served with a letter dated March 29, 2017 which indicated that he was required to attend an interview on May 3, 2017 in order to answer questions regarding the Investigation.

¶ 60 The Respondent did not respond to the March 29, 2017 letter and he failed to attend the interview on May 3, 2017.

¶ 61 By failing to attend the interview, the Respondent failed to cooperate with IIROC Staff's Investigation.

¶ 62 Section 8103(1)(iv) of Consolidated Rule 8100 states that:

> In connection with an investigation, Enforcement Staff may, by written or electronic request, require a Regulated Person, an employee, partner, director or officer of a Regulated Person, an approved investor, or, where authorized by law, another person to:
>
> …
>
> (iv) attend and answer questions under oath or otherwise, and any such attendance may be transcribed, recorded electronically, audio-recorded or video-recorded, as Enforcement Staff determines.

¶ 63 Section 8104(3) of Consolidated Rule 8100 states that:

> (3) A person must cooperate with Enforcement Staff who are conducting an investigation, and a Regulated Person must require its employees, partners, directors and officers to cooperate with Enforcement Staff conducting an investigation and to comply with a request made under section 8103.

¶ 64 A registrant's duty to cooperate with Enforcement Staff conducting an investigation is fundamental to

maintaining the integrity of the securities system. As the Hearing Panel in *Re Morrison*, 2009 IIROC 4 stated at para. 51:

> The securities industry is a business of trust and confidence. Approved Persons must above all conduct themselves with trustworthiness and integrity, and act in an honest and fair manner in all their dealings with the public, their clients, and the securities industry as a whole. Approved Persons have agreed to abide by and comply with the Association's By-laws, and that includes the duty to cooperate in any investigation. As was said in *Re Stewart,* there is a general principle that the requirement to cooperate in any investigation is fundamental to maintaining an efficient, competitive market environment, and also to maintain the integrity of the securities system and protect the public interest.
>
> IIROC Brief of Authorities, Volume II, Tab 11

¶ 65 Further as the Hearing Panel in *Re Gottfred*, 2016 IIROC 2 noted, the obligation to cooperate does not end when an approved person ceases to be registered and the seriousness of the underlying misconduct is not a relevant factor in sanctioning. The Hearing Panel stated at paras. 73-75:

> One of the cases provided by Counsel, Trites (Re) 2010 IIROC 48 (CanLII), is highly instructive in its analysis of the significance of an approved person's failure to cooperate with an IIROC investigation.
>
> In Trites, the respondent came under investigation for engaging in unauthorized discretionary trading, recommending unsuitable investments, and misrepresenting the risks of certain investments in respect of four different clients. He failed to cooperate with the investigation and resigned from the industry. IIROC issued a Notice of Hearing that was limited to alleging a breach of Rule 19.5, whereupon the respondent's failure to attend the hearing the Hearing Panel, relying on affidavit evidence, found him to have violated. In its reasons, the Panel noted that the respondent had intentionally failed to attend an interview without offering any excuse or explanation and after IIROC had made reasonable attempts to accommodate him. The Panel observed:
>
> > It is of vital importance to the system for regulating approved persons that approved persons cooperate with reasonable demands made on them during investigation of their conduct. This obligation does not end when an approved person ceases to be registered. (at para. 12)
>
> The Panel did not consider the seriousness of the underlying allegations to be a relevant factor in sanctioning. On the contrary, in that regard the more relevant consideration was the inherent seriousness of failing to cooperate:
>
> We do not consider that it is generally worse to fail to attend an interview in an investigation involving serious allegations than in an investigation involving less serious allegations. The gravamen of the misconduct is not respecting that, as a participant or former participant in a regulated industry, one must comply with the obligation to cooperate with the regulator's investigation, regardless of how one regards the allegations. (at para. 16)
>
> IIROC Brief of Authorities, Volume II, Tab 20

¶ 66 We were referred to a number of authorities, including:

(a) Re Blackmore, 2014 IIROC 43;

(b) Re Hodge, 2013 IIROC 31;

(c) Re Lee, 2013 IIROC 10;

(d) Re Mendelman, 2016 IIROC 14.

¶ 67 Further cases concerning the failure to attend investigatory interview precedents are *Re Robb*, [2002] I.D.A.C.D. No. 1, *Re Stauffer*, [2002] I.D.A.C.D. No. 40, and *Re Loewen*, [2004] I.D.A.C.D. No. 45, to name only a few.

¶ 68 Once again, the Respondent elected not to attend these proceedings and accordingly, after proper service and notice, these proceedings were continued in his absence. As noted, he was given a considerable time after the original hearing to prepare himself but chose not to make any type of submission to the Hearing Panel. Accordingly, we are in agreement with the submissions of IIROC counsel.

¶ 69 The Hearing Panel is unanimously of the view that given the circumstances that the penalty that should be imposed on this Respondent is that as suggested by counsel for IIROC, namely we impose the following penalty:

(a) a permanent bar to approval in any capacity;

(b) a $125,000.00 fine; and

(c) $20,000.00 in costs**.**

Dated: June 4, 2018

Thomas R. Braidwood

Nigel Potts