

Re Jacob Securities

IN THE MATTER OF:

**An Expedited Hearing Pursuant to Dealer Member Rule 20 of the
Investment Industry Regulatory Organization of Canada**

and

Jacob Securities Inc.

2016 IIROC 03

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

Heard: December 17, 2015 in Toronto, Ontario

Oral Decision: December 17, 2015

Written Reasons: January 14, 2016

Hearing Panel:

The Honourable Susan Lang, Chair; Mary Savona and Peter Dymott

Appearances:

Andrew Werbowski, Natalija Popovic and Elissa Sinha, Senior Enforcement Counsel

Sasha Jacob for Jacob Securities Inc., in person

Walied Soliman, Norton Rose, for Jacob Securities Inc. by teleconference

REASONS FOR ORDER

Introduction

¶ 1 This expedited hearing was initiated by the Investment Industry Regulatory Organization of Canada (IIROC) with notice to Jacob Securities Inc. (JSI). Indeed, Sasha Jacob, JSI's principal, appeared at the beginning of the hearing and requested a brief adjournment so that JSI's counsel, Mr. Soliman, who was out of the province, could represent JSI by teleconference. The panel granted the requested adjournment. When the hearing resumed in the afternoon, Mr. Soliman was ready to proceed. In addition to the material filed, the Panel heard oral evidence from IIROC Staff as well as from Mr. Jacob and the proposed Monitor, Doug Fox of Risk Management Services with respect to a Risk Proposal for JSI.

¶ 2 At the hearing, IIROC sought the immediate suspension of JSI's IIROC membership pursuant to Rule 20.45. While IIROC argued the alternative of the imposition of a Monitor pursuant to Rules 20.45 and 20.46, it took the position that a Monitor would not provide sufficient protection for the investing public. JSI argued against a suspension, which it referred to as a "death sentence" in light of the consequences it would suffer. Instead, JSI argued that the appointment of a Monitor was the appropriate disposition.

¶ 3 At the conclusion of the evidence and submissions, the Panel was satisfied that IIROC had established the requisite risk of imminent harm, a risk that could not reasonably be averted by the appointment of a Monitor. The Panel ordered JSI's immediate suspension with written reasons to follow. These are those reasons.

Background

¶ 4 JSI, a Dealer Member with IIROC since 2009, is a Type 2 Introducing Broker with National Bank

Correspondent Network (NBCN) as its Carrying Broker. Sasha Jacob is JSI's Chairman, Chief Executive Officer and Ultimate Designated Person charged with the primary responsibility for JSI's compliance system. Gurterath Buttar, JSI's Chief Financial Officer, resigned that position effective two days before the hearing of this matter. Christopher Rutledge continued as JSI's Chief Compliance Officer and attended and participated in the hearing.

¶ 5 JSI had been facing difficulties for some time. Since May 2013, it had been continuously designated by IROC in "Early Warning Level 2" due to low risk-adjusted capital (RAC), having failed liquidity and profitability tests. From May 2013 through to November 2015, JSI was unable to remedy its financial deficiencies to the point of potential insolvency.

¶ 6 Historically, JSI's principal business was primarily institutional trading and corporate finance transactions. In March 2014, its business was 90% institutional accounts. That changed significantly. By March 2015, institutional clients were only 20% of JSI's business and the balance of 80% was retail accounts. JSI had opened 225 retail accounts in the preceding year.

¶ 7 IROC undertook an Integrated Compliance Examination (ICE) Report on JSI's business. The Examination was initiated to provide a consolidated picture of JSI's position and included review of JSI by IROC's Financial and Operations Compliance Staff (FINOPS), its Business Conduct Compliance Staff and its Trading Conduct Compliance Staff. The ensuing Report listed 40 deficiencies, seven of which were classified as Repeat Significant Items and 21 of which were classified as Significant Items. The deficiencies identified by Staff were reviewed with JSI's representatives in an "Exit Interview" in October 2015 before the delivery of the Report on November 12, 2015. It was the contents of that Report, and JSI's apparent lack of ability to remedy the deficiencies, that initially led to this application. We provide an overview of those deficiencies, which are listed in detail in the Table of Contents of the ICE Report, which we attach as Appendix A. In addition, we attach Appendix B, which is a further list prepared by IROC describing the categories of deficiency.

¶ 8 As described by IROC, the Financial and Operations Compliance examination demonstrated several deficiencies. In reviewing JSI's Monthly Financial Report as of January 31, 2015, Staff concluded that JSI's RAC was "approximately \$78,000 less than the \$202,000" reported on its Monthly Financial Report. FINOPS identified significant issues, including a serious lack of accounting and reporting controls and risk management resulting in misstatements of RAC, as well as a failure to contain confidential information. The ICE Executive Summary set out these deficiencies:

JSI is engaged in new issue of securities of private placement, best efforts and bought deal prospectus offerings. The report identifies several significant deficiencies in JSI's controlled environment particularly around regulatory reporting, corporate finance reporting, compliance and credit monitoring. In addition, FINOPS discovered that JSI was capital deficient for a week in May 2014. These deficiencies are indicative of Senior Management's lack of commitment to foster a culture of compliance to adhere to regulatory rules, and inadequate resources. There was no backup for the Chief Financial Officer and Chief Compliance Officer's Roles. As a result, our review was significantly delayed due to the failure of JSI to cooperate to provide information on a timely basis.

¶ 9 The Report also described extensive deficiencies in regard to Business Conduct Compliance, including Repeat Significant and Significant Items described in the executive summary as JSI's failure to:

- take adequate steps to rectify deficiencies identified in the 2014, 2012-2013 ("2013") and 2010 Business Conduct Examinations (BCEs).
- comply with its previous undertakings in response to previous BCEs.
- establish an effective supervisory structure with respect to client accounts and employee activities.
- establish adequate written policies and procedures.
- follow its existing written policies and procedures.

¶ 10 In addition, the Report cited deficiencies in supervision of the Grey and Restricted Lists and employee accounts held with other dealer members.

¶ 11 The Report also pointed to other supervisory deficiencies, an undisclosed conflict of interest, failure to meet anti-laundering requirements, failure to supervise or archive or monitor employee email as well as options trading without the required registrations and supervision. In the course of the hearing, Mr. Rutledge, JSI's CCO acknowledged options trading even in the week of the hearing.

¶ 12 The Trading Conduct Compliance deficiencies were described in the Executive Summary as focused on:

... the level and quality of supervision of trading in place at your firm. Continued inattention to these matters will result in further referrals to our Enforcement department for failure to supervise. Our review of trading in certain securities has already been referred for further review.

¶ 13 IIROC's documentary evidence was reinforced by the oral evidence of several Staff who spoke of the absence of or insufficient evidence of retail and institutional account and trade supervision, delayed production of supervision records - at least some of which appeared to have been created after the fact, the failure to put in place a system regarding trading in securities on the Grey and Restricted Lists, failure to comply with basic corporate governance requirements, improper supervision of insiders and order markers as well as deficient written policies and procedures. Apparently, when such deficiencies were reviewed with JSI in the course of the Examination, JSI advised that it did not know how to resolve the deficiencies and looked to IIROC for advice on how to do so.

¶ 14 New concerns arose during and after the ICE Examination. On November 6, 2015, JSI became capital deficient. That deficiency was not remedied by an injection of capital, but by obtaining forgiveness of debt and terminating certain employees. Neither of these provided a long-term solution. Although JSI continued to represent that it would obtain capital, its financial situation remained precarious in that it was without sufficient assets to meet its liabilities.

¶ 15 IIROC alleged that JSI announced a Cannabis Fund on November 10, 2015, without requisite registration approvals and named an auditor who alleged that it had not been engaged for the offering. Meetings ensued between IIROC and JSI. On December 2, JSI notified IIROC that its Chief Financial Officer was resigning as of December 16. On December 14, JSI's Chief Compliance Officer advised IIROC that JSI was locked out of its business premises due to its failure to pay rent of approximately \$110,000. Apparently, unsupervised trading continued by JSI's registered representatives through their mobile phones and by meeting with clients in the lobby of the building. With these additional circumstances, on December 15, IIROC amended its initial application of December 11 that had sought the imposition of a monitor to seek instead JSI's immediate suspension on the basis of the risk of imminent harm. Additional affidavits were filed concerning the risk of imminent harm in the current circumstances, including harm to "the reputation of IIROC and the integrity of the marketplace." Further, the Affidavit material indicated that, if JSI's membership were suspended, NBCN would implement a protocol for business continuity for JSI's client accounts. In the meantime, JSI satisfied the arrears of rent by December 16.

¶ 16 At the hearing, JSI did not take issue with much of the evidence presented by IIROC, but argued forcefully that a suspension was not an appropriate disposition. Mr. Soliman advanced the Risk Proposal that JSI provided to IIROC in discussions. However, in contrast to the magnitude of IIROC's concerns, the Risk Proposal significantly underestimated the amount of intervention needed to protect the investing public. Mr. Soliman recognized this and proposed an expanded scope to the monitoring. The proposed Monitor, Mr. Fox, was out of the country at the time of the hearing but gave evidence by way of teleconference. While optimistic about his ability to fulfill the expanded monitoring role with the addition of other supports, Mr. Fox acknowledged that he would need to re-design the scope of his role once he had an opportunity to review JSI's current operations. After reviewing the evidence, in the Panel's view, the imposition of a Monitor in the circumstances of this case would not have been in the public interest given the nature, significance, magnitude and persistence of JSI's financial and operating difficulties and deficiencies.

¶ 17 The Panel was simply not satisfied that the Monitor would be able to address the myriad imminent difficulties that JSI was confronting in the comprehensive and timely manner that was required in the circumstances of this case.

¶ 18 IIROC also expressed concern about JSI's ability to pay the proposed Monitor. In response, Mr. Soliman relied on Mr. Jacob's statement that he would see to payment as well as the testimony of Mr. Fox, the proposed monitor, to the effect that he felt he would be paid. In addition, Mr. Jacob gave evidence of a term sheet and the potential for significant funding and injection of capital as of January 11, 2016. However, Mr. Jacob conceded that the proposed loan was subject to conditions, including further diligence. While the term sheet was a step forward in moving to resolve its financial difficulties, in all the circumstances, it could provide no reasonable level of confidence that that loan would be forthcoming in a timely manner. In the result, the Panel was not satisfied that the imposition of the Monitor was "in the interests of the public" as required by Rule 20.46(1). Further, the imposition of a Monitor in the circumstances of this case would not have averted the risk of imminent harm referenced in Rule 20.42(1)(d).

¶ 19 That Rule permits the imposition of a suspension where a Dealer Member "is in such financial or operating difficulty that the Hearing Panel determines the Dealer Member cannot be permitted to continue to operate without risk of imminent harm to the public, other Dealer Members" or IIROC. IIROC established that JSI's numerous deficiencies and its prolonged and pervasive inability to meet basic compliance and regulatory standards put the public at risk of imminent harm, specifically JSI's clients whose accounts are not being adequately supervised. In the same vein, JSI continued to demonstrate an inability to appreciate or to remedy its numerous problems and it continued to be in serious financial and operating difficulty.

¶ 20 This risk of harm was exacerbated by particular problems at JSI. JSI's operating expenses in relation to its revenue, suggested that its ability to maintain the required RAC was in serious jeopardy. At the time of the hearing, JSI was without a Chief Financial Officer who had resigned as a result of his concern with JSI's operation and internal communication. A CFO was essential on an immediate basis to monitor JSI's financial situation and compliance. The temporary individual proposed by JSI at the hearing had not applied for registration and did not meet IIROC's registration requirements. Finally, JSI had option positions in client accounts and was without a qualified options supervisor or registrant.

¶ 21 The Panel also observes, that by way of safeguard for investors in the event of JSI's suspension, NBCN, as Carrying Broker, proposed to implement its protocol to permit business continuity for JSI's clients.

Result

¶ 22 In the result, in the terms of the draft order proposed by IIROC and amended by the Panel, the Panel ordered the suspension of JSI's Membership in IIROC and ordered JSI to immediately cease dealing with the public. Other terms require JSI's compliance with certain requirements and allow for IIROC to move with five days notice to JSI to re-attend before this Panel regarding JSI's continued membership.

Dated at Toronto, Ontario this 14th day of January 2016.

Susan Lang, Chair

Mary Savona

Peter Dymott

APPENDIX A

TABLE OF CONTENTS – 2015 ICE REPORT

REPEAT SIGNIFICANT ITEMS

Business Conduct Compliance & Trading Conduct Compliance

1. Supervision of Trading Activity – Controls and Internal Testing*

2. Supervision of the Grey and Restricted Lists*
3. Corporate Governance*

Business Conduct Compliance

4. Conflicts of Interest*
5. Outside Business Activities*
6. Employee Accounts held with Other Dealer Members*
7. Institutional Accounts*

SIGNIFICANT ITEMS

Financial & Operations Compliance, Business Conduct Compliance & Trading Conduct Compliance

8. Corporate Finance Reporting and Compliance (FinOps)
9. Mercator Associates, LLC, FINRA Broker-Dealer (FinOps)
10. Credit Risk Management (FinOps)
11. Reporting and Reconciliation Control Deficiencies (FinOps)
12. Containment of Confidential Information* (BCC/TCC)
13. Supervision of Insiders and Order Markers* (BCC/TCC)
14. Written Policies and Procedures (BCC/TCC)
15. Registration* (BCC)
16. Accredited Investors Concerns* (BCC)
17. Prospectus Distribution and Expressions of Interest* (BCC)
18. Employee Supervision* (BCC)
19. Account Documentation Concerns – Retail* (BCC)
20. Anti-Money Laundering (AML)* (BCC)
21. New Issues/Syndication Practices* (BCC)
22. Electronic Communications* (BCC)
23. Client Relationship Model (BCC)
24. Managed Accounts (BCC)
25. Research (BCC)
26. Statement of Financial Condition (BCC)
27. Reassignment of Client Accounts (BCC)
28. Electronic Trading Rule (TCC)

OTHER ITEMS

Financial & Operations Compliance, Business Conduct Compliance & Trading Conduct Compliance

29. Internal Control Policy Statements (FinOps)
30. Broker Warrants (FinOps)
31. Related Party Agreement (FinOps)
32. Corporate Ownership Chart (FinOps)

33. Incomplete Corporate Finance Deal Listings (FinOps)
34. Delegation of Duties (BCC)
35. Portfolio Summaries (BCC)
36. Retail Suitability Concerns (BCC)
37. Pending Documentation (BCC)
38. Use of Titles and Designations (BCC)
39. Out-of-Jurisdiction accounts (BCC)
40. Audit Trail (TCC)

APPENDIX B

JACOB SECURITIES INC. DEFICIENCY LIST

Prepared by IROC Staff January 6, 2016

REPEAT SIGNIFICANT DEFICIENCIES PERTAINING TO:

1. Supervision of Trading Activity – Controls and Internal Testing (BCC/TCC)
 - *IROC Rules 29.1, 38.1, 1300.1 & 1300.2; 2500 (Introduction), (I), (III), (IV) & (V); 2700 (Introduction) & (IV)*
 - *UMIR 7.1*
2. Supervision of the Grey and Restricted Lists (BCC/TCC)
 - *IROC Rules 38.1 & 2500 III*
 - *IDA Member Regulation Notice MR0377*
 - *OSC Policy 33-601*
 - *UMIR 2.2, 7.1 & 7.7*
3. Corporate Governance (BCC/TCC)
 - *IROC Rules 38.7(h)(iv) & 38.8*
 - *UMIR 7.1 Part 2*
4. Conflicts of Interest (BCC)
 - *IROC Rules 38.1 & 42*
5. Outside Business Activities (BCC)
 - *IROC Rules 18.14, 40.12, 42, National Instrument 31-103 section 13.4 and its Companion Policy*
 - *IROC Notice 13-0163*
6. Employee Accounts held with Other Dealer Members (BCC)
 - *IROC Rules 2500(III) (B) (7), IV (B) (4)*
7. Institutional Accounts (BCC)
 - *IROC Rule 2700 II*

SIGNIFICANT DEFICIENCIES PERTAINING TO:

8. Corporate Finance Reporting and Compliance (FinOps)

- *IIROC Rule 30.5 & 200.2*
 - *Form 1- Notes and Instructions*
 - *Member Regulation Notice MR0481*
9. Mercator Associates, LLC, FINRA Broker-Dealer (FinOps)
 - *IIROC Rule 35*
 10. Credit Risk Management (FinOps)
 - *Form 1*
 11. Reporting and Reconciliation Control Deficiencies (FinOps)
 - *Form 1- General Notes and Instructions and Statements A- E*
 - *IIROC Rules 30.5 & 2600, Internal Control Policy Statements*
 12. Containment of Confidential Information (BCC/TCC)
 - *Ontario Securities Act, s. 76 & Ontario Securities Act Regulations, s.175*
 - *OSC Policy 33-601*
 - *IDA Member Regulation Notice MR-0377*
 13. Supervision of Insiders and Order Markers (BCC/TCC)
 - *IIROC Rules 1300.1 & 2500 (IV)*
 - *UMIR 6.2 & 7.1*
 14. Written Policies and Procedures (BCC/TCC)
 - *IIROC Rule 38.1*
 - *Notice 10-0060*
 - *UMIR 5.1, 6.2, 6.3 & 8.1*
 15. Registration (BCC)
 - *IIROC Rules 18.2, 18.3, 18.16, 40.12, 1900.2(a), 2500 (V) & 2900 Part I*
 - *National Instrument 31-103 Parts 2 & 3 and its Companion Policy*
 16. Accredited Investors Concerns (BCC)
 - *IIROC Rule 1300.1*
 - *National Instrument 45-106 and its Companion Policy*
 17. Prospectus Distribution and Expressions of Interest (BCC)
 - *Ontario Securities Act, ss. 65-67 & 71*
 18. Employee Supervision (BCC)
 - *IIROC Rules 29.1 & 1300.1*
 - *Ontario Securities Act, s. 127*
 19. Account Documentation Concerns – Retail (BCC)
 - *IIROC Rules 1300.1, 1300.2 & 2500 (II)*
 20. Anti-Money Laundering (AML) (BCC)

- IIROC Rules 1300.1, 2500 II & 2700 III
 - Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA)
 - IIROC Notice 10-0273
 - IDA Member Regulation Notice MR-0498 & FINTRAC Guidelines 4 & 6E
21. New Issues/Syndication Practices (BCC)
 - *IIROC Rule 29.1, 29.3 & 1300.1 (o)*
 - *National Instrument 31-103 ss. 11.5 & 11.6*
 22. Electronic Communications (BCC)
 - *IIROC Rules 29.7 & 38.1*
 - *National Instrument 31-103, 11.5(2) and its Companion Policy*
 - *IIROC Notice 11-0349*
 23. Client Relationship Model (BCC)
 - *IIROC Rules 1300.1 & 3500*
 - *IIROC Notices 12-0107, 12-0108 & 12-0109*
 24. Managed Accounts (BCC)
 - *IIROC Rules 38.1, 1300.1, 1300.7, 1300.8, 1300.15, 1300.16 & 2500 III & IV*
 25. Research (BCC)
 - *IIROC Rules 29.7(3), 38.4 & 3400*
 26. Statement of Financial Condition (BCC)
 - *IIROC Rule 1400.1*
 27. Reassignment of Client Accounts (BCC)
 - *IIROC Rules 18.14 & 2500 (II) (A) (6)*
 28. Electronic Trading Rule (TCC)
 - *UMIR 7.1 Parts 7, 8 & 9*

SIGNIFICANT ISSUES ARISING AFTER THE 2015 INTEGRATED COMPLIANCE EXAMINATION WAS COMPLETED:

29. Launch of Cannabis Fund on November 10, 2015
30. Capital Deficiency From November 6-13, 2015
31. Resignation of CFO Effective December 16, 2015
32. Closure of Business Premises by Landlord for Rental Arrears on December 14-15, 2015
33. Failure to Deliver on Promises to Inject New Capital

Copyright © 2016 Investment Industry Regulatory Organization of Canada. All Rights Reserved.