



INVESTMENT DEALERS
ASSOCIATION OF CANADA

bulletin



ASSOCIATION CANADIENNE DES
COURTIERS EN VALEURS MOBILIÈRES

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For distribution to relevant parties within your firm

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Discipline

Discipline Penalties Imposed on Zona Paulette Armstrong – Violations of Regulation 1300.1(c), 1300.1(a), By-law 29.1 and By-law 19.5

Person Disciplined The Alberta District Council of the Investment Dealers Association of Canada (the “Association”) has imposed discipline penalties on Zona Paulette Armstrong, (“Armstrong”), formerly a Registered Representative, Registered Options Representative and Senior Vice-President-Trading with Burns Fry Limited (subsequently BMO Nesbitt Burns Inc.- “Nesbitt”).

By-laws, Regulations, Policies Violated On November 18, 2002 and March 6, 2003, the Alberta District Council conducted a hearing into allegations of professional misconduct against Ms. Armstrong. By a written decision dated May 6, 2003, the Alberta District Council found Ms. Armstrong to have:

- (a) failed to exercise due diligence to ensure that the recommendations made for numerous client accounts were appropriate for the clients and in keeping with the clients investment objectives, contrary to Association Regulation 1300.1(c);
- (b) failed to learn the essential facts or failed to update the essential information in client account documentation relative to two client accounts, contrary to Association Regulation 1300.1(a);
- (c) prepared price lists used by Nesbitt for the purposes of pricing certain U.S. corporate debt securities for clients’ month end statements, and on at least three occasions, the prices of at least three of the securities appearing on the price lists were inflated, and therefore, materially, incorrect. This was deemed to be business conduct or practice unbecoming a registered representative or detrimental to the public interest, contrary to Association By-law 29.1; and

- (d) failed to fully cooperate with the investigation conducted by the Association's Enforcement Department in relation to the above-mentioned contraventions of the Association's Regulations and By-laws, contrary to Association By-law 19.5.

Penalty
Assessed

The discipline penalties assessed against Ms. Armstrong were:

- a lifetime prohibition from approval in any capacity with a Member of the Association;
- a fine in the amount of \$120,000.00 for 11 counts of unsuitable investment recommendations;
- a fine in the amount of \$20,000.00 for two counts of failing to learn the essential facts relative to client accounts;
- a fine in the amount of \$50,000.00 for one count of engaging in business conduct or practice which was unbecoming or detrimental to the public interest;
- a fine in the amount of \$15,000.00 for failing or refusing to comply with requests from the Association to attend and give information in relation to its investigation;
- disgorgement of commissions in the amount of \$241,000; and
- costs of the Association's investigation and prosecution of this matter, fixed at \$50,000.

Summary
of Facts

From June 1990 to April 1999, Ms. Armstrong was employed as a Registered Representative, Registered Options Representative and Senior Vice-President – Trading by Burns Fry Ltd. (subsequently BMO Nesbitt Burns Inc.- "Nesbitt"). While employed by Nesbitt, Ms. Armstrong was particularly active in the trading of U.S. corporate convertible debentures. In 1998 and 1999, the Association received 10 complaints from Ms. Armstrong's clients. Upon investigation, Association Staff determined that the source of all of the complaints involved Ms. Armstrong's purchases of certain U.S. corporate debt securities, primarily corporate convertible debentures. With one exception, all of the complainant clients were unsophisticated investors, and while expressing some acceptance of risk in a small portion of their portfolios, they were generally risk adverse and generally more concerned with capital preservation and income generation as investment objectives. The U.S. corporate convertible debentures traded in these clients' accounts generally fell into a category of speculative investments suitable for aggressive investors with a high tolerance for risk. In fact, they could be generally characterized as "junk bonds". The end result for the complainants was cumulative losses of approximately \$2,000,000.00. It was found that the securities in question were inappropriate for these clients.

It was also found that Ms. Armstrong failed to learn the essential facts relative to at least two of her clients, contrary to Regulatory 1300.1(a). In the case of one client, the New Client Application Forms were signed by Ms. Armstrong without her ever

meeting with the client or discussing his investment objectives or risk tolerance to confirm the information set out in the New Client Application Form, as it had been prepared by another registered representative. With respect to the other client, it was found that Ms. Armstrong failed to update the client's investment objectives so as to properly reflect the actual asset allocation in the client's account.

Sometime between 1996 and 1998, Ms. Armstrong began to provide to Nesbitt's Risk Management Department lists of what she claimed were the fair market values of certain U.S. corporate convertible debentures for the purposes of client month end statements. At the time, Nesbitt had no written policies dealing with the verification of the prices of U.S. corporate convertible debentures for the purposes of month end statements. However, Nesbitt's general policy was that all prices for month end statements had to be obtained through or verified by an external source, either electronically or through Nesbitt's trading desk, with sources in New York. At the material time, the market for the U.S. corporate convertible debentures that Ms. Armstrong traded in deteriorated. Consequently, the Ms. Armstrong took issue with the prices Nesbitt was attributing to these securities. As a result of her complaints, Nesbitt's Risk Management Department began to accept the Respondent's lists of month end prices for these securities without confirming them with their own trading desk. However, the prices submitted by Ms. Armstrong to Nesbitt for a number of U.S. corporate convertible debentures for the months ending September, October and November 1998 were materially incorrect, as there was a substantial gap between the prices listed by Ms. Armstrong and the fair market value of the securities at the material time, according to readily obtainable, independent public sources. This resulted in discrepancies on her clients' month end statements to the extent that the gaps between the prices submitted by Ms. Armstrong to Nesbitt and the actual fair market value of the securities were, in some cases, well in excess of 100 % of the actual fair market value. Ms. Armstrong's failure to exercise due diligence in verifying the accuracy of her submissions either through Nesbitt's trading desk or through external sources amounted to conduct unbecoming a registered representative and was found to be detrimental to the public interest, contrary to Association By-law 29.1.

It should be noted that in a Settlement Agreement between Association Staff and Nesbitt (approved by the Association's Ontario District Council on July 23, 2002), Nesbitt admitted that it failed to ensure that its Risk Management Department followed internal procedures for verifying prices of certain U.S. convertible debentures, in contravention of Association Regulation 1300.2, Policy No. 2, Section I, and Policy 3, Statement I, and that it failed to verify that Ms. Armstrong was complying with internal firm procedures regarding the pricing of the U.S. convertible debentures. For this and other related breaches of the Association's Regulations, By-law and Policies, Nesbitt was fined \$450,000 plus \$50,000 in costs (*see* Association Bulletin #3020).

It was also found that Ms. Armstrong failed to fully cooperate with the Association's investigation into her clients' complaints, contrary to Association By-law 19.5.. While Ms. Armstrong did initially provide the Association with a compelled statement with respect to some of the complaints against her, she refused to subsequently attend any further interviews "because of pending litigation". She did however offer to provide a written response to any queries from the Associations investigators. In finding that Ms. Armstrong had violated By-law 19.5, the Alberta District Council found that while written interrogatories from Association investigators and replies were permitted pursuant to the By-law, their use is entirely at the discretion of Association Staff. The

By-law makes it clear that the personal attendance of the industry member under investigation for interviews is entirely at the discretion of Staff , and if that discretion is exercised, the member must comply.

Ms. Armstrong provided a Reply upon being served with a Notice of Hearing and Particulars in this matter. However, Ms. Armstrong declined to attend the actual hearing before Alberta District Council.

In determining the penalty imposed, the Alberta District Council took into account the scope of the Respondent's misconduct, in that it involved a large number of clients, hundreds of transactions and it extended over a period of years. In addition to the complaints received by the Association, over 150 complaints were received by Nesbitt itself with respect to Ms. Armstrong's conduct, and as a result, Nesbitt had settled the vast majority of these complaints for a total cost to the firm of over \$10,000,000.00 CDN. While the disciplinary panel found it difficult to "extend the characterization of [Ms. Armstrong's] activities from a level of gross negligence to that involving deception or fraud, it is difficult to characterize [her] activities with respect to the mispricing of the securities in question on client statements as anything but deliberately deceptive." The panel also found it significant that Mss. Armstrong benefited considerably from the misconduct in question, in that her commissions earned from the transactions that were the subject of this prosecution involving the ten complainants alone amounted to approximately \$241,000.00. Further, the Alberta District Council took into account that Ms. Armstrong continued to deny any wrongdoing or any responsibility for the very significant losses suffered by her clients and then by her employer. She did not appear on either hearing date nor provided any expression or remorse for her conduct. Lastly, the panel did not consider Nesbitt's "regrettable lack of supervision" over Ms. Armstrong as either a mitigating or aggravating circumstance. The panel stated that "while it was clear that there was a failure to supervise by her employer, there was no evidence that [Ms. Armstrong] ever relied on her employer for supervision and, in fact, vigorously objected on those occasions when any supervision was attempted".

Ms. Armstrong left the industry in April 1999, and has not been registered in any capacity with a Member firm since that time.

Kenneth A. Nason
Association Secretary