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For distribution to relevant parties within your firm

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Discipline Discipline Penalties Imposed on Hong Xiao – Violations of By-law 29.1

Person Disciplined The Ontario District Council has imposed penalties on Hong Xiao, at the relevant time a Registered Representative at Gorinsen Capital Inc. (subsequently Westminster Securities Inc., currently Argosy Securities Inc.)

By-laws, Regulations, Policies Violated On July 19, 2004, the Ontario District Council considered, reviewed and accepted a Settlement Agreement that had been negotiated between Hong Xiao and Association Staff.

Pursuant to the Settlement Agreement Ms Xiao acknowledged that:

- (1) Between February and October 1999 inclusive she engaged in conduct unbecoming or detrimental to the public interest by churning the account of her client YZ in that she employed a strategy of excessive trading which she knew or ought to have known was contrary to, or which was in willful or reckless disregard of, her client's best interests and/or instructions, contrary to By-law 29.1; and
- (2) In October 1999 she engaged in conduct unbecoming or detrimental to the public interest by agreeing to compensate her client YZ in an amount equal to YZ's initial investment, and by delivering an amount in partial satisfaction of that agreement, which agreement and payment were made without the knowledge, consent or authorization of the Respondent's Member firm, contrary to By-law 29.1.

Penalty Assessed Discipline penalties assessed against Ms Xiao are:

1. For violation (1), a fine in the amount of \$35,000
2. For violation (1), disgorgement of commissions in the amount of \$5, 051.50
3. For violation (2), a fine in the amount of \$10,000;
4. A prohibition on receiving registration approval with any Member Firm of the

Association for a period of ten (10) years, commencing on the effective date of this Settlement Agreement;

5. Strict supervision for a period of two years upon any subsequent registration approval with a Member Firm of the Association;
6. As a condition of re-approval, write and pass the examination based on the Conduct and Practices Handbook for Securities Industry Professionals; and
7. As a condition of any subsequent term of re-approval by the Association in any capacity, that the Respondent does not work directly, indirectly, or in conjunction with WT (see Facts) in any manner whatsoever within the securities industry.

Ms Xiao is also required to pay \$25,000 toward the costs of the investigation.

Summary
of Facts

In late February 1999, while a registered representative at Gorinsen Capital Inc, the Respondent opened an account for her client YZ. YZ deposited \$50,000 for investment on March 1. At that time she was 42 years old, employed as a hotel housekeeper with an annual income of \$20,000. The Respondent had known YZ for a few years, during which time YZ had been a client of the Respondent's husband, WT.

YZ signed three documents when she opened her Gorinsen account: a *New Client Application Form*, a *Trading Authorization* and a *Margin Agreement*. All the forms were in English. Her investment knowledge was rated as sophisticated, her investment objectives were shown as 80% short term, 20% medium term and risk factors were shown as 50% medium and 50% high. Although not approved for registration with the Association, WT was given trading authorization over the account; however, unbeknownst to YZ this authorization was revoked in May at the direction of the Member firm. Throughout the period her account was active, YZ relied on both the Respondent and WT to provide advice and conduct appropriate trading on her behalf.

YZ signed the documents without fully understanding them because her ability to function in English - either verbally or in written form - was extremely limited. She and the Respondent only ever communicated in Chinese. Due to the language barrier and except for the personal information section, the Respondent filled out all the forms without YZ's assistance. YZ indicated that the Respondent never discussed or explained objectives or risk factors to her. Moreover, YZ's only investment experience had been in mutual funds at banking institutions as a client of WT.

Over the next eight months the following activity took place in the client's account:

- 356 trades (178 purchases and 178 sales);
- Purchases of approximately \$8.2 million;
- Commissions charged of \$25,258, this being more than half the client's original investment;

- Account losses of approximately \$39,000;
- Turnover ratio of over 247, where a ratio of 6 is normally indicative of

- excessive trading;
- Cost equity ratio of 83% this being the return required just to break even;
- Holding periods for most securities of 5 days or less with 80 securities being sold the same day as they were purchased.

At various times throughout this period the client indicated that the trading in her account was excessive and that she could not afford the commissions being charged. However, the trading pattern continued unchanged and losses rapidly continued to accumulate. Consequently, in October 1999 the client had the Respondent removed as registered representative over the account.

Around this time the Respondent agreed to compensate YZ for an amount which would restore the account to its original balance of \$50,000. To this end the Respondent delivered a cheque for \$10,000 to YZ in partial satisfaction of this agreement but did not deliver any further amounts.

Staff determined that the short-term holding strategy coupled with the excessive number of trades and accompanying commissions made it impossible for YZ to procure a profit. The activities were furthermore conducted in willful and/or reckless disregard of YZ's best interests and/or instructions in relation to the account over which the Respondent bore responsibility.

In addition, the Respondent's role in arranging compensation for YZ and delivering an amount in partial satisfaction of this agreement, without the knowledge or consent of her Member firm was conduct unbecoming a registered representative and detrimental to the public interest.

Kenneth A. Nason
Association Secretary