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Discipline

Discipline Penalties Imposed on Research Capital Corporation and Patrick Gerald Walsh; Violations of By-law 29.1

Person Disciplined	A Hearing Panel appointed pursuant to IDA By-law 20 has imposed discipline penalties on Research Capital Corporation (Research Capital), at all material times a Member firm, and on Patrick Gerald Walsh, at all material times, an approved person (CEO, President and Ultimate Designated Person) with the Toronto office of Research Capital.
By-laws, Regulations, Policies Violated	<p>On November 25, 2005, a Hearing Panel considered, reviewed, and accepted a Settlement Agreement negotiated between Staff of the Enforcement Division of the Association (Association Staff), Research Capital Corporation and Patrick Gerald Walsh.</p> <p>Pursuant to the Settlement Agreement, the Respondents admitted to contravening Association By-Law 29.1, in that between September 2001 and September 2004 they failed to ensure effective or adequate supervision by the appropriate officers or employees of the Registered Representative S.T. and that between 2002 and June 2004, they failed to adequately address and correct compliance shortcomings identified by the Investment Dealers Association of Canada and to provide reasonable assurance that Association standards governing compliance and supervision were met.</p>
Penalty Assessed	<p>The following penalties were assessed:</p> <ul style="list-style-type: none">• payment of a \$160,000 fine; and• payment of \$40,000 towards the Association's investigation and prosecution costs in this matter.

Background

Supervision of T.

In September 2001, with the knowledge and approval of the Respondent Walsh, T was hired by RCC to act as a Registered Representative (RR), providing advice and trading services to RCC's retail clients. To the knowledge of senior managers at RCC, T had been fined and suspended in 1997 by the Ontario Securities Commission for improper activities as a RR, and was at the time he was hired by RCC under investigation by the Association.

T's employment at RCC was approved by the Association subject to a request that he be placed under "close supervision" by the firm. Close supervision is a regime in which an individual's activities are monitored and supervised more closely than is normal in the securities industry and monthly reports of that supervision are compiled and kept on file by the employer. In response to the Association's request, and with the knowledge of the Respondent Walsh, RCC agreed to place T under close supervision, and named the individual (T's Branch Manager in the Respondent's Toronto office) who would be responsible for the supervision.

From the time of his arrival at RCC in September 2001, T persistently engaged in a number of activities and practices in the course of his business which the Association alleges were contrary to various Association By-Laws, Regulations and Policies. During the course of his employment, T's overall pattern of business conduct should have raised concerns in RCC's senior management such that his business should have been subject to closer scrutiny and tighter control than actually occurred. In particular, the nature of T's business in the name of the Respondent involved, among other features:

- a high volume of transactions in the Over-The-Counter Bulletin Board ("OTC BB") market;
- frequent filings for, and trades pursuant to, exemptions under Rule 144 of the Securities Exchange Commission of the United States;
- numerous offshore accounts;
- a large number of third-party transfers of stock;
- frequent trading by clients in a small number of low-priced securities;
- the appearance of artificially "re-flagging" accounts into different names or jurisdictions after trading in those accounts had been prevented or limited by the Respondent's compliance department;
- numerous transactions of apparently questionable economic purpose.

Particular failures of supervision of T's activities, for which the Respondents bear responsibility, included the following:

- failure to prevent him from opening accounts for and serving many clients in jurisdictions in which, to the Respondent's knowledge, he was not registered or approved;
- failure to examine the totality of those activities with a view to identifying questionable or improper trading patterns, or clients of a dubious or unsavory nature or background;

- failure to follow up on compliance queries or directives made to T or his assistant;
- failure to share or circulate information among or coordinate the actions of compliance and management staff who were or should have been engaged in supervising T and his accounts;
- failure to maintain adequate evidence of supervision by documenting inquiries made, responses received and action taken when specific concerns were identified; and
- failure to prepare accurate or timely “close supervision” reports relating to his activities.

Although T’s activities were to be under close supervision, the Respondents failed to effectively identify, record, or curtail the misconduct described in the preceding paragraph. These failures of supervision were detrimental to the public interest, and therefore collectively constituted a violation of the Association’s By-Law 29.1.

Compliance at RCC in the Period 2000-2004

In 2002 and again in 2004, Association Sales Compliance Staff carried out Sales Compliance Reviews (“SCR”) at RCC. The procedure generally involved a review of the report(s) of any previous Sales Compliance Review(s), followed by an on-site review, the perusal of related documentation, and interviews with individual officers and employees of the firm. Each SCR resulted in the preparation of a detailed report on the nature and quality of compliance activity observed at RCC.

The draft report of the 2004 SCR described, in detail, instances of problems in many areas of the sales compliance function at RCC. Many of the adverse findings in the report, including some characterized as “significant” (the most serious category in the Association’s lexicon) were repeats of similar findings made in the course of the 2002 Sales Compliance Review at RCC.

In particular, the draft SCR report described instances of problems in the following subject areas:

- Supervision of certain client account activity;
- Adequacy of certain account documentation and classification of accounts;
- Measures to deter money-laundering and potential terrorist activity;
- Supervision of options trading;
- Supervision of certain discretionary and managed accounts;
- Aspects of supervision of branch offices; and
- Controls in the Corporate Finance Department.

The observed failings frequently involved the accounts and activities of T. By January 2003, following the receipt at RCC of the draft report of the 2002 SCR, the firm’s Chief Compliance Officer pointed out to management at RCC that T constituted a “main risk” to RCC and that T’s trading was a “main issue” raised by the Association in its Sales Compliance Review process.

The observed failings in the subject areas noted above related directly to the regulatory requirements in effect at RCC, including various Association By-Laws, Regulations and Policies, requirements of the Ontario Securities Commission, and the Proceeds of Crime (Money-Laundering) and Terrorist Financing Regulations.

In addition to the failings already noted, there had been no annual report from RCC's Chief Compliance Officer to its Board of Directors on the status of compliance at the company for any year from 2001 to 2003 (inclusive), as was required by By-Law 38.8. Since no such report had been made, there was no formal review by the Board during this period of the status of compliance at the company, as was required by By-Law 38.9.

The failure by the Respondents to prevent or correct the sales compliance shortcomings noted in the 2002 and 2004 SCR was detrimental to the public interest, and was therefore a contravention of By-Law 29.1.

Staff and the Respondents acknowledge and agree that the penalty proposed in this Settlement Agreement would have been significantly higher except for the following factors:

- a) By June 2004, RCC had completed an extensive search process and hired an experienced individual as their Chief Compliance Officer. Further, subsequent to the delivery of the report of the 2004 SCR, the Respondent RCC, in consultation with the Association, retained a consulting expert in the field of sales compliance. The consultant evaluated RCC's compliance program and made detailed recommendations to RCC's Board of Directors with a view to addressing the issues identified in the SCR report. Those recommendations, as implemented by RCC, have resulted in substantial improvement in RCC's sales compliance performance. The cost of this initiative, in an amount in excess of \$100,000, was borne by the respondent RCC;
- b) The Respondents cooperated fully with Association Staff in their investigation of the matters giving rise to this Settlement Agreement; and
- c) The Respondent Walsh has no history of previous disciplinary action by the Association.

Kenneth A. Nason
Association Secretary