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Contact:

For distribution to relevant parties within your firm

Paul Smith
Enforcement Counsel
604-331-4764
psmith@ida.ca

BULLETIN #3589
December 4, 2006

Barbara Lohmann
Enforcement Counsel
604-331-4795
blohmann@ida.ca

Discipline

Discipline Penalties Imposed on Canaccord Capital Corporation, Donald Grant MacDonald, and Paul Peter DiPasquale; Violations of By-law 29.1, Regulation 1300.2 and Policy 2

Person Disciplined A Hearing Panel of the Investment Dealers Association of Canada (IDA) appointed pursuant to Association By-law 20 has imposed discipline penalties on Canaccord Capital Corporation (Canaccord), an IDA Member whose head office is in Vancouver, British Columbia and Donald Grant Macdonald (Macdonald), and Paul Peter DiPasquale (DiPasquale), co-branch managers at a Canaccord branch located at 1200 - 595 Burrard Street in Vancouver.

By-laws, Regulations, Policies Violated After a Settlement Hearing on November 23, 2006 in Vancouver, British Columbia, a Hearing Panel considered, reviewed, and accepted a Settlement Agreement negotiated between Canaccord, Macdonald, DiPasquale and Staff of the Enforcement Department of the IDA (Staff).

Pursuant to the Settlement Agreement, Macdonald and DiPasquale admitted that between July 1998 and June 2001, while registered in supervisory positions at Brink Hudson & Lefever Ltd. (Brink) and subsequently Canaccord, they failed to effectively supervise the activities of John Frederick Pryde (Pryde) and failed to ensure that effective supervision of Pryde was achieved, contrary to Association

By-Law 29.1, Association Regulation 1300.2 and Association Policy 2.

Canaccord admitted that between November 1998 and June 2001, it failed to have proper systems procedures and personnel in place to ensure that effective supervision of the activities of its Burrard Branch was achieved, and failed to properly supervise the activities of Pryde and failed to ensure that effective or adequate supervision of Pryde was achieved, all of which is contrary to Association By-Law 29.1, Association Regulation 1300.2 and Association Policy 2.

Penalty Assessed The penalties imposed against the Respondents are as follows:

- a) The Respondents will pay a total fine of \$750,000, attributable as follows:
 - \$500,000 to Canaccord;
 - \$125,000 to Macdonald;
 - \$100,000 to DiPasquale; and
 - \$25,000 to the Association's investigation and prosecution costs.
- b) Macdonald has undertaken to never apply for registration in any capacity, with any Member firm.
- c) DiPasquale is suspended from acting as a Branch Manager for a period of six months and must successfully re-complete the Branch Manager's Course before re-registering as a Branch Manager. He is permanently prohibited from acting in any higher supervisory position, with any Member firm.

Staff and the Respondents acknowledged and agreed that the following factors mitigate the circumstances of this case:

- a) After suspending Pryde, Canaccord conducted a complete review of all of Pryde's accounts and contacted Pryde's clients to inquire about the trading in their accounts. Canaccord initiated contact with some clients who had not complained to Canaccord. There were also a number of Pryde's clients who complained to Canaccord about losses in their accounts which resulted from Pryde's pattern of trading. In total, Canaccord has paid approximately \$12 million to compensate most of the approximately 160 clients who complained;
- b) Brink was one of three Member firms experiencing financial or operational difficulties that Canaccord took over at or about the end of 1998 and early 1999. Canaccord made a strategic decision to focus its compliance and supervisory resources on the other two firms because it was generally agreed that those two firms were a higher risk from a compliance and supervision perspective. Canaccord therefore decided to

integrate its financial supervisory and compliance staff, with this office, after the other newly acquired firms;

- c) On March 30, 2001 Macdonald started a six-week vacation which was to be his transition into retirement. When Macdonald returned from vacation, Pryde's activities were being investigated. Instead of fully retiring, Macdonald remained in full time employment with Canaccord for an additional two years with the exclusive task of assisting Canaccord's internal investigation and helping to settle client complaints. Now 73 years old and fully retired, Macdonald has not been registered in any capacity since 2005;
- d) DiPasquale has continued to act as a Branch Manager at Canaccord for the past five years, during which time the Association has had no cause to investigate any supervisory deficiencies by him;
- e) Neither Macdonald, first registered in 1983, nor DiPasquale, first registered in 1982, have any prior disciplinary history.

Summary of Facts **Background**

The contraventions occurred during the period from July 1998 – June 2001 (the Relevant Period).

In November 1998 Canaccord took over Brink's business (the Takeover) and Brink's head office continued to operate as a Canaccord branch office (the Burrard Branch).

Macdonald, first registered in 1983, was the President and Chief Executive Officer of Brink, who, after the Takeover, continued to work at the Burrard Branch as the Co-Branch Manager, primarily responsible for administrative functions. He has not been in an approved position since he left Canaccord on March 31, 2005.

DiPasquale, first registered in 1982, was the Executive Vice-President of Brink. After the Takeover he continued to work at the Burrard Branch as Co-Branch Manager and Executive Vice-President, primarily responsible for sales functions. As of the date of the Settlement Agreement, he was registered as a Branch Manager at Canaccord.

Ann Olson (Olson), not registered until after the Relevant Period, was the Manager of Client Accounts at Canaccord during the Relevant Period.

Pryde was a Registered Representative (RR) first registered in 1987. He joined Brink in October 1995 after having served as a Branch Manager at BZW Canada Limited. During his time at Brink, Pryde was consistently one of the top three RRs in terms of gross

commissions. His client base which consisted almost exclusively of family, friends and referrals placed a high degree of trust in him. Prior to the Relevant Period, Pryde had no disciplinary history.

Throughout the early stages of his career and prior to Macdonald and DiPasquale joining Brink in the fall of 1997, Pryde had made a number of recommendations for his clients to invest in smaller capitalization (Small Cap) companies. By the summer of 1998, Pryde was becoming more focused on certain Small Cap companies (collectively Pryde's Small Cap Stocks) as the primary investment vehicle for many of his clients.

Breakdown / First admitted to hospital

On or about July 30, 1998 during a business discussion, Pryde had a significant breakdown in Macdonald's office in the presence of Macdonald. Pryde subsequently left the Brink Office and went home.

That same day Pryde was admitted to hospital where he remained in the Inpatient Unit until he was discharged on or about September 1, 1998.

While in hospital, Pryde was diagnosed with Bipolar Disorder. Pryde's wife (Esther) had telephone conversations with DiPasquale, and advised him that Pryde suffered from a chemical imbalance.

Macdonald and DiPasquale denied they were aware Pryde was in hospital for the entire month of August, but acknowledge they were aware he was away from the office being treated for a chemical imbalance and failed to make sufficient inquiry to determine the extent of his condition.

Trading from hospital

Trading occurred under Pryde's broker code when Macdonald and DiPasquale knew or ought to have known that Pryde was out of the office and being treated for a mental health related issue. Macdonald and DiPasquale therefore knew, or ought to have known, that Pryde was not in a position to be recommending trades to clients. Neither Macdonald or DiPasquale made any inquiries of Pryde, his trader or any of his clients to ensure that the trading conducted while he was in the hospital was authorized and in the best interests of his clients.

No increased supervision after Pryde's breakdown

When Pryde returned to work, Macdonald and DiPasquale failed to take any appropriate measures to effectively supervise Pryde despite the fact that they ought to have known, that Pryde, one of their top producing RRs:

- a) had just returned from a month in hospital where he was being treated for mental health related illness;
- b) had increasingly been trading in Pryde's Small Cap Stocks; and
- c) had conducted a significant volume of trading while he was in hospital being treated for mental health related illness.

Indiscriminate purchasing / Re-aging debits

After the Takeover was completed in November 1998, Pryde continued to work at the Burrard Branch and continued to be supervised by Macdonald and DiPasquale. Pryde appeared to perform as an RR without incident throughout 1999, but by 2000, he was using his own discretion when purchasing Small Cap Stocks in client accounts. He routinely made transactions in client accounts without authorization and without regard to whether the transaction was in the best interests of the client or whether there were any funds available in the client account to pay for the purchases. As a result, a significant number of debits began accumulating in client accounts for trades that were not authorized in the first place.

The number of debits accumulating in client accounts should have been noticed by Macdonald and DiPasquale. The debits were consistently outstanding. Most were also consistently outstanding for under 10 days and consistently recurring which should have been notice to Macdonald and DiPasquale that Pryde was re-aging the outstanding debit balances.

Pryde admitted to hospital in 2000

By February 25, 2000, Pryde's debits had reached \$3,489,565.96.

Pryde was admitted to hospital a second time on February 23, 2000 for 9 days. Pryde again returned to work without any change in the manner, quality or effectiveness of supervision.

Supervisors were aware of client complaints and allegations of false price support

On or about May 8, 2000, Macdonald and DiPasquale became aware of a complaint by one of Pryde's clients who, in a written complaint letter, alleged that he was told "in no uncertain terms" that he could not sell shares because Pryde "was trying to get the price back up." In the course of investigating SD's complaint, Macdonald and DiPasquale were advised by Pryde's trader, that she did not tell SD that Pryde was "trying to get the price back up." Beyond this, Macdonald and DiPasquale conducted no further independent investigation of the possibility that Pryde was in any way attempting to "get the price back up."

Failure to effectively supervise enables Pryde to continue erratic trading

From at least January 2000 until he was suspended by Canaccord on or about May 25, 2001 and eventually dismissed, there were numerous indicators which would have caused a reasonably diligent supervisor to make inquiries of Pryde and/or his clients to ensure that Pryde's handling of client business was ethical and not detrimental to the interests of the securities industry and/or his clients.

Throughout this period the daily and monthly reviews showed transactions and trading patterns which would have caused a reasonably diligent supervisor to question whether Pryde's clients' accounts were subject to:

- a) over concentration in the Pryde Small Cap Stocks;
- b) continual re-aging and running debit balances in cash accounts;
and
- c) unauthorized or discretionary trading.

The daily reviews and aged debit reports also showed transactions and trading patterns which would have caused a reasonably diligent supervisor to question whether Pryde was re-aging debits for the Pryde Small Cap Stocks by arranging for some of his clients to purchase one of the Pryde Small Cap Stocks from some of his other clients.

All of the information which would have caused a reasonably diligent supervisor to make and document inquiries of Pryde or his clients and to receive satisfactory assurances that the trading in the client accounts was ethical and in the best interests of the client were more compelling in this particular situation because of the May 8, 2000 complaint and because of Pryde's mental health issues.

Cash accounts converted to margin

On or about January 13, 2001, a number of Pryde's clients' cash accounts were converted to margin accounts, notwithstanding that the holdings in these accounts, primarily the Pryde Small Cap Stocks, were not margin eligible.

Olson only considered credit issues before deciding whether to authorize the conversion from cash to margin account. She did not contact any person in Canaccord's head office compliance department, to inquire whether it was appropriate to make a universal switch from cash to margin for accounts that had a lengthy history of outstanding debits. She gave no consideration to whether a margin account was in the best interests of the client at all.

When she authorized the opening of the margin accounts, Olson knew, or ought to have known, the purpose of opening the margin accounts was to reduce the outstanding debit balances but did not consider whether the client was aware that the margin account was

being opened or the reason for opening the margin account.

Special margin rate applied to Voxcom

Following a discussion with Macdonald, Olson also authorized a special exception to Canaccord's margin rules to make Voxcom margin eligible. At the time Voxcom, one of the Pryde Small Cap Stocks, was trading at a level which made it margin eligible pursuant to TSX rules but not margin eligible pursuant to Canaccord's more restrictive requirements.

The primary purpose for the conversion of accounts from cash to margin and the special margin eligibility for Voxcom was to eliminate the outstanding debit balances which Pryde had improperly accumulated in client accounts.

Failure of Canaccord's supervisory structure

The formal divide between Canaccord's compliance and credit departments contributed to the failure to properly supervise Pryde. Olson approved the conversion of cash accounts to margin accounts, on a credit basis only. Similarly, when dealing with debit balances, any issues which came to Olson's attention were dealt with only from a credit perspective. There was no combined analysis into the client accounts that were accumulating and running these debit balances to determine why the debit balances existed and what implications these had for the client.

Head Office Compliance only became involved in debit issues if a problem was referred from the credit department. At no point did Olson consult Head Office Compliance about this matter. Canaccord's failure to integrate a reporting structure between credit and compliance resulted in Canaccord's Head Office Compliance department having no knowledge of the huge problem of outstanding debits in Pryde's client accounts.

The failure to effectively integrate the Burrard Branch into Canaccord's Head Office supervisory structure also contributed to Canaccord's failure to supervise Pryde. Head Office did not do daily or monthly reviews. Head Office did not oversee the Burrard Branch in any meaningful way to ensure that effective supervision of the activity at the Burrard Branch was achieved.

Supervision at the Burrard Branch was not only ineffective but also disorderly. Supervisors did not have a clear understanding of their responsibilities or reporting procedures. The Canaccord supervisory structure enabled this unsatisfactory level of supervision which existed at the Branch level to go undetected at the Head Office.

Pryde dismissed from Canaccord

In May 2001, Pryde informed Canaccord's Chairman and Chief Executive Officer that he had problems with debit balances in client accounts. On May 25, 2001, he was suspended and his employment was subsequently terminated by Canaccord on June 26, 2001.

A number of Pryde's clients complained to Canaccord about losses in their accounts which resulted from Pryde's pattern of trading. Canaccord has paid a total of approximately \$12 million to compensate almost all of the approximately 160 clients who complained.

In September 2005, Pryde entered into a Settlement Agreement with the Association which permanently prohibited him from acting in any registered capacity with any Member of the Association. Pryde was also ordered to pay \$20,000 toward the Association's investigation and prosecution costs.

In the Settlement Agreement, Pryde admitted that he did not resign as an RR despite the fact that he posed a significant threat of loss to his clients, Canaccord, the capital markets, and the public interest.

The Hearing Panel's written reasons will be posted on the Association's website when they become available.

Kenneth A. Nason
Association Secretary