Re TD Waterhouse Canada

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

TD Waterhouse Canada Inc.

2020 IIROC 09

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

Heard: December 11 and 13, 2019
Decision: March 17, 2020

Hearing Panel:
John Lorn McDougall QC, Chair, Richard E. Austin and Neil Murphy
Appearance:
Charles Corlett, Director, Enforcement Litigation
Andrew Werbowski, Senior Enforcement Counsel
Jeremy Devereux, Respondent Counsel

DECISION AND REASONS

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I. INTRODUCTION

¶ 1 On April 11, 2019, the Investment Industry Regulatory Organization of Canada ("IIROC") issued a Notice of Hearing and a Statement of Allegations ("Statement of Allegations") also dated April 11, 2019 addressed to TD Waterhouse Canada Inc. ("Respondent" or "TDW").

¶ 2 In the Statement of Allegations, the following allegation is made against the Respondent:

> Since December 31, 2015, the Respondent has failed to include position cost information within the quarterly account statement for certain securities positions, contrary to the position cost calculations and disclosure requirements set out in clauses 200.2(d)(ii)(F) of Rule 200.

¶ 3 Under Rule 200.2(d)(ii)(F) the Respondent was obliged to do the following:

> (F) Where the client is a Retail Customer and the statement is a quarterly statement, the statement must also include:
>
> (I) For each security position in the account:
>
> (a) Where the cost is determinable, either the cost or the total cost; and
>
> (b) Where the cost is not determinable, the notification required pursuant to clause 200.1(b)(iii).
>
> And
>
> (II) A notation setting out the definitions of the calculation methodologies used to calculate the individual position cost information included in the statement, provided that where the individual position cost information included in the statement is calculated using:
>
> (a) The "book cost" calculation methodology, the definition language set out in subsection 200.1(a) or language that is substantially similar must be used as the notation; and
>
> (b) The "original cost" calculation methodology, the definition language set out in subsection 200.1(e) or language that is substantially similar must be used as the notation.

¶ 4 Rule 200.1 contains definitions of the terms "book cost" and "original cost" used in subsection 200.2(d)(ii)F above quoted as follows:

> 200.1 For the purposes of this Rule 200:
>
> (a) "book cost" means:
>
> (i) In the case a long security position, the total amount paid for the security, including any transaction charges related to the purchase, adjusted for reinvested distributions, returns of capital and corporate actions; or
>
> (ii) In the case of a short security position, the total amount received for the security, net of any transaction charges related to the sale, adjusted for any distributions (other than dividends), returns of capital and corporate actions.
>
> …
>
> (e) "original cost" means:
>
> (i) In the case of a long security position, the total amount paid for the security, including any transaction charges related to the purchase; or
>
> (ii) In the case of a short security position, the total amount received for the security, net of any transaction charges related to the sale.

II. BACKGROUND

Procedural Background

¶ 5 The Respondent responded to the Notice of Hearing and Statement of Allegations by delivering and filing a response ("Response"), as required by Rule 8415 of the IIROC Consolidated Enforcement, Examination and Approval Rules ("Consolidated Rules"). That Rule requires that:

> (2) A response must contain a statement of:

(i) the facts alleged in the statement of allegations that the respondent admits,

(ii) the facts alleged that the respondent denies and the grounds for the denial, and

(iii) all other facts on which the respondent relies.

Consolidated Rules, Rules of Practice and Procedure, Rule 8415. Response to a Notice of Hearing

¶ 6 In responding, the Respondent employed a system of admitting paragraphs in the Statement of Allegations, but subject to the amendments it proposed for each paragraph being adopted. This was done for paragraphs 5, 7, 10, 20, 22, 24, 26, 27, 28, 30, 31, 33, 34, 35, 49, 51 and 55 of the Statement of Allegations. The Hearing Panel was not advised that any of the proposed amendments were accepted by Staff.

¶ 7 The Respondent denied paragraphs 3, 16 and 58 of the Statement of Allegations and admitted all other facts contained in it.

¶ 8 Faced with the difficulty in discerning exactly what facts were not in controversy, the Hearing Panel carefully reviewed the pleadings and identified those facts, which were not related to the Respondent's proposed amendments to the Statement of Allegations.

¶ 9 In performing this determination of agreed facts, the Hearing Panel was assisted by the powers confirmed by Rule 8415(3):

(3) A hearing panel may accept as proven any facts alleged in a statement of allegations that are not specifically denied or for which grounds for the denial are not provided in a response.

Consolidated Rules, Rules of Practice and Procedure, Rule 8415(3)

¶ 10 The Respondent, in paragraph 4 of the Response, set out additional facts upon which it indicated it proposed to rely. These additional facts relate primarily to the selection of the appropriate penalty and will be dealt with in the Sanction portion of our Reasons, which follows below.

¶ 11 Paragraph 1 of the Response reads as follows:

1. The Respondent, TD Waterhouse Canada Inc. admits for the purpose of this proceeding the requirements contravened as stated in Part I of the Statement of Allegations.

¶ 12 It was not entirely clear to us what was meant by the words "…the requirements contravened…". However, any uncertainty was removed by paragraph 2 of the Closing Submissions filed by TDW where counsel stated: "In the Response to the Notice of Hearing and Statement of Allegations, TD Waterhouse substantially admitted all of the facts alleged by IIROC staff, including the allegation of a breach of IIROC Rule 200." That statement was repeated in oral submissions, with the result there can be no doubt about the Respondent's admission that it was in breach of Rule 200 as alleged.

¶ 13 The allegation set out in paragraph 2 above having been admitted, the sole objective of the hearing was to determine what the appropriate sanction was for the failure to provide the position cost information as alleged.

¶ 14 In Staff's submission, the breach by the Respondent of Rule 200 was a wilful business decision, done without the knowledge of IIROC, and which was in direct contravention of its obligations as a member of a self-regulated industry. It therefore requested the maximum permissible fine, $5,000,000, and costs of $28,497. The Respondent's position is that while it was in breach of the position cost rule as alleged, it always intended to comply. Therefore, it argues, a fine in the range of $500,000 would be more than adequate to accomplish all of IIROC's benchmark regulatory goals. It was the task of the Hearing Panel to determine what the appropriate fine was within that range.

Consolidated Rule 8209. Sanctions for Dealer Members

Consolidated Rule 8214. Costs

¶ 15 On February 29, 2008, IIROC, at the time known as the Investment Dealers Association, first notified the industry that significant amendments to regulatory requirements regarding client reporting obligations, including the requirement to provide clients with individual position cost information, would be made. These proposed amendments, collectively known as the Client Relationship Model ("CRM"), were to be phased in over time. The requirement to provide clients with individual position cost information was part of the second phase of CRM ("CRM2") which was to be implemented in 2015.

¶ 16 The CRM2 was far more than a simple change in a regulation. It imposed new reporting obligations on members of IIROC, which involved major changes to their reporting systems and in many cases entailed significant implementation costs, particularly for the larger institutions such as the Respondent.

¶ 17 The CRM2 amendments were part of an important regulatory initiative undertaken by the Canadian Securities Administrators ("CSA") and the self-regulatory organizations, IIROC and the Mutual Fund Dealers Association.

¶ 18 Specifically, effective December 31, 2015, IIROC directed the implementation of requirements to provide Retail Customers with cost information on a quarterly basis for all account positions held at the quarter end (the "Position Cost Requirements").These are described in paragraphs 3 and 4 above, but in summary, Dealer Members were required to disclose for each account position held:

(a) The actual amount paid by the client for the position (position cost);

(b) For positions added to the account prior to the effective date of the rule, one of:

(i) Position cost;

(ii) An estimate of position cost using the market value of the position at December 31, 2015 (2015 estimated position cost);

(iii) Where neither position cost nor estimated position cost could be determined, a notation within the account statement informing the client of this (not determinable notation).

¶ 19 The fixing of the implementation date of the CRM2 position cost amendments followed several years of discussions between participants in the securities industry, including IIROC, Dealer Members and the other regulators. That process culminated in a directive from the CSA to the industry dated January 28, 2015. The relevant portion which responds to requests for changes from the industry is as follows:

> I am writing to you on behalf of the CSA Chairs to let you know that after careful consideration of your letter, we have reached these decisions:
>
> 1. The coming into force date of the requirement for registered dealers and registered advisers to deliver reports on charges to clients and on investment performance will remain July 15, 2016. However, firms that report for the calendar year 2016 will not be required to include comparative data from 2015 in their investment performance reports. They will be able to base their first investment performance reports on 2016 information alone.
> 2. The CRM2 Amendments applicable to registered dealers and registered advisers that are currently scheduled to come into force as of July 15, 2015 will instead come into force as of December 31, 2015.
> 3. The definition of "book cost" will not change. Registered firms that wish to provide tax-adjusted cost information to their clients can do so as supplementary information.
>
> Letter from B. Rice, CSA Chair, to B. Amsden, Managing Director, IIAC, Exhibit 2, Volume 3, Tab 77, p.

IIROC-1189

¶ 20 At a February 10, 2015 meeting of the CRM2 Executive Steering Committee ("ESC"), the TDW committee charged with oversight of the implementation of CRM2, it was noted that the sought after change to the position cost was refused, as follows:

…

CRM2 2015:

…

- **Position Cost:**

  …

  o Key changes – client experience – 2 key changes expected in the regulations did not materialize:

  - Grandfathering of existing book values including client directed adjustments for tax elections.
  - Clarification that reset of a security for one client impacts all clients holding the same security.
    - Large client impact.
      - Need to address how to handle these communications to these clients – 400,000 DI clients.
      - How to report back to these clients, including tax reporting needs to be resolved.
      - Question from Arnie Hochman – regarding approach to position cost reset
        - Dave: examine all suspect positions. Options: Do we capture snap shot in point of time and provide that to clients, OR, stand up into a data store (with point of time).
        - Arnie Hochman recommended that tax be included in the discussion, in order for us to maintain current good relationship with CRA. Dave confirmed they are included.
    - Regarding two columns on ISM – Business Architecture reviewed previous project that examined this and impact was $10mm spend over 2 years. Even if project can compress this, we would not meet regulatory timelines

  …

Email from M. Smith Subject: Meeting Minutes: CRM2 Executive Steering Committee – February 10, Exhibit 2, Volume 1, Tab 4, p. IIROC-0047

¶ 21 As of January 16, 2015, the Respondent had 10,645,940 security positions on its books. The Respondent believed at that time that (approximately) the following positions would need to be addressed in order to be compliant with the Position Cost Requirements:

(a) 343,088 or 3.2% were Adjusted Positions

(b) 100,415 or 0.9% were Invalid Positions

(c) 414,578 or 3.9% were Zero Positions

¶ 22 While all members of IIROC were equally subject to the changes embodied in CRM2, members of the size and scale of the Respondent were expected to show leadership in their implementation. Performing such obligations voluntarily is fundamental to being allowed to self-regulate in the securities industry.

Evidence and Hearing

¶ 23 As presented, this case was almost totally based on documentary evidence. Only one witness was called. He was Richard J. Corner, Vice President and Chief Policy Advisor of the Member Regulation Division at IIROC, who was called by Staff. He was and remains a very senior member of IIROC who, at the relevant times, was directly responsible for the CRM on behalf of IIROC. He had no personal involvement with the present case until 2017 when the complaint which led to these proceedings was filed and no direct involvement thereafter except in respect of the Respondent's application for an exemption briefly described below in paragraph 35.

¶ 24 Mr. Corner was called primarily to explain the background of the CRM2 amendments to the Panel (Hearing Transcript, December 11, 2019 at pages 10 and 16). His evidence was most helpful, particularly as it was given in a non-partisan manner.

¶ 25 The only other witness was indicated by the Respondent at the opening of the hearing to be Atanaska Novakova, a senior member of TDW management. She ultimately assumed responsibility for CRM2 implementation at TDW. TDW later decided not to call her as a witness.

¶ 26 However, the transcript of Ms. Novakova's interview by IIROC Enforcement Staff dated February 27, 2019 was filed as an exhibit. In it, she testified that she had very little personal involvement in the process leading to the complaint, and as a result her evidence was only of marginal help to the Hearing Panel. Her most lasting contribution was to characterize the events leading up to the proceedings as constituting a "slip-up", which should not have happened. In addition, several other parts of her evidence will be briefly referred to in what follows.

Transcript of Interview of Atanaska Novakova, February 27, 2019, Exhibit 4

¶ 27 Thus, as stated, the case was decided based almost entirely on the documentary record. That record consisted, primarily, of a five volume compendium of documents prepared by Staff largely from material produced by the Respondent during the investigation. The Respondent also filed a relatively small compendium. These volumes together contain more than 1,500 pages of documentation, some of which was heavily redacted.

¶ 28 As no witness was called by either side to explain any of the documents or the circumstances in which they were written, it was difficult for the members of the Hearing Panel to understand the context and significance of some of the material before us. However, Staff and Counsel for the Respondent opened their respective cases by taking the Hearing Panel through the most significant of the documents, which was helpful.

III. THE FACTS: (Admitted and derived from Admitted Documents)

¶ 29 The Respondent is a Dealer Member of IIROC and operates as a full service retail brokerage. The Respondent also offers order execution only services to retail customers through TD Direct Investing, a separate division of TD Waterhouse Canada Inc.

¶ 30 The Respondent admitted that it had the capability of becoming fully compliant with the Position Cost Requirements by December 31, 2015. However, in the spring of 2015, the Respondent identified what it considered to be potential litigation risks and client experience issues that might have resulted from its proposed manner of implementing compliance with the Position Cost Requirements.

¶ 31 An alternative solution to avoid the problem was proposed and internally approved by the Respondent

in May 2015. This alternative solution included the acceptance of the business risk inherent in having a significant percentage (then believed to be approximately 8%) of client positions non-compliant with the Position Cost Requirements of Rule 200. The evidence was that the 8% represented approximately 175,301 client accounts.

¶ 32 On May 11, 2015, the ESC considered and approved the following decision which was reported in the meeting minutes which were widely distributed internally by email as follows:

> …
>
> **CRM2 2015:**
>
> ➢ **Key Messages:**
>
> **IIROC: Book Value/Original Cost**
>
> ▪ **ACTION**: Revise Original Cost proposal and recirculate to a broader audience – Dave/Nadia.
>
> ▪ Richard informed that there may be a period of time during which tax elections are not allowed.
>
> ➢ **Key Issues and Risks:**
>
> **Book Value/Original Cost**- For implementation by December 31 2015
>
> ▪ Repurpose Book Value as Book Cost
>
> - Continue to allow agent book value adjustments with documentation, REMOVE self-service client book value adjustments
>
> - Do NOT reset positions with previously adjusted, invalid and/or zero book values
>
> - Do NOT allow personal tax elections on Book Value
>
> ▪ During 2016 – Build capability to house and maintain an Original Cost value and starting 2017 allow Book Value to be a Tax reporting field. Apply withheld tax elections to it in time for tax reporting cycle.
>
> ▪ Deliver in 2 stages:
>
> - Stage 1 – Results in us being materially compliant by December of this year
>
> - Stage 2 – Changes during 2016 to be compliant from CRM2 perspective and CSA perspective
>
> o Using internal development (not IBM)
>
> - Not intending to update/correct past history for original cost where it doesn't exist or is incorrect
>
> - Have polled industry for what is being done for similar challenges
>
> ▪ **DECISION**- Proposal approved
>
> Email from D. George Subject: Meeting Minutes: CRM2 Executive Steering Committee – May 11, Exhibit 2, Volume 1, Tab 20, pp. IIOC-0293 and 0294

¶ 33 In approving the proposal, the Respondent expressly recognized the risk in being intentionally non-compliant with the position cost requirements, as follows:

> **CRM2 2015 Project**
>
> **IIROC Original Cost**
>
> **May 6, 2015**

…

Implementation Plan Recommendation

- Recommendation – Proceed with Option 4a for December 31 2015
- How?

  - Repurpose Book Value as Book Cost

    - Continue to allow agent book value adjustments with documentation; book value adjustments will centralized (sic); REMOVE self service client book value adjustments

    - Do NOT reset positions with previously adjusted, invalid and/or zero book values

- Considerations:

  - Client Reporting:

    - Will be materially onside with IIROC regulations

    - Will be in line with stated industry approach (Big 5 peers) for position

      Cost

    - TD will incur some risk as Book Values reported for approximately 8% of positions will be previously adjusted – these are not in line with the IIROC Book Cost definition

    - This approach is not compliant based on the finalized IIROC written regulation, however, it is in line with IIROC's verbally stated expectations

  …

Strategic Solution Recommendation

- Recommendation: Proceed with Option 4b

…

Next Steps

- Approval obtained to move forward on recommendation by ESC May 11 2015

Presentation: CRM2 2015 Project IIROC Original Cost – May 6, 2015, Exhibit 2, Volume 1, Tab 21, pp. IIROC-0297ff

¶ 34 There was no evidence of any kind regarding IIROC's "verbally stated expectations" referred to above, and there is nothing in the evidence indicating that anything was done until 2017. Mr. Corner was not asked about the subject during his testimony.

¶ 35 In order to mitigate the business risk, the TDW project team responsible for the implementation of CRM2 was to develop, using internal resources, updated information technology that would bring the non-compliant account position information into compliance in mid-2016. The completion date for the proposed project was then delayed until 2017, and nothing further appears to have been done until 2017. The 2015 account position data has still not been supplied. An exemption application to permit the use of 2018 account position data had been filed by TDW with IIROC and is presently pending.

Reporting to the Wealth Risk Committee ("WRC")

¶ 36 The ESC reported to the WRC including on the subject of CRM2. Ms. Novakova explained that it was a committee for reporting to people at the senior vice president level and above on risk matters. She described it as follows:

There is no vote. It's a risk committee. It's really an executive committee for awareness and just making sure that everyone is really made aware – it's not necessarily a decision committee of any way. It's a forum at a monthly level for all control functions to update everyone else and the business heads of all issues that are relevant to the business. So it's strictly risk-focused.

Transcript of Interview of Atanaska Novakova, *supra*, page 14, lines 14 – 21

¶ 37 The Minutes of the WRC meeting of May 21, 2015 contain the following entry:

CRM2 (Client Relationship Model 2)

- The pricing team is continuing to examine the new market value pricing methodology and work towards implementation.
- The Executive Steering Committee has accepted the project team recommendation to use current book value as the "position cost" value to address the December 31, 2015 CRM2 requirements.
- By doing so, the business has accepted the risk that approximately 8% of the book values reported will not initially comply with the CRM2 position cost requirements, because the values have been subject to client-initiated tax elections.
- To address that risk going forward, the project team will be building an original cost field in ISM (expected to be completed mid-2016) and, in the meantime, clients will not be permitted to make any further tax elections.

TD Wealth Risk Committee Meeting Package, May 21, 2015, Exhibit 2, Volume 1, Tab 22, p. IIROC-0318

¶ 38 Similarly, the material before the WRC meeting of September 17, 2015 contained the following entry relating to CRM2:

Governance Control Group Update – Wealth Compliance

SIGNIFICANT REGULATORY UPDATES/CHANGES, continued

…

CRM2 (Client Relationship Model 2)

- The CRM2 initiative sets out new requirements for cost disclosure, performance reporting and client statements. It applies to all registered dealers and advisers (TDW, TDIS and PCG) and contains a reporting obligation applicable to investment funds (TDAM). The new requirements are being phased-in over three years.
- The pricing team continues to examine the new market value pricing methodology to work towards a successful implementation.
- Effective December 31, 2015, Dealers are required to include "position cost" on client statements, however, due to client-initiated tax elections, the book value displayed may not be consistent with CRM2 requirements for some business lines.
- A decision has been made that TDW will continue to use current data as the CRM2 position cost and accept the risk that 8% of the values in TDW are potentially offside the CRM2 requirements. When enhanced client reporting is developed in 2016/2017, the expectation is that the current data will be restored and an additional CRM2 compliant field for position cost will be added to the client statements.

TD Wealth Risk Committee Meeting Package, September 17, 2015, Exhibit 2, Volume 1, Tab 38, pp. IIROC-0479 and 0481

¶ 39 Following the WRC's consideration of the CRM2 position cost issue in September 2015, the status of the matter was again reviewed in the following emails:

> **From:** Vickers, Kelly
>
> **To:** Inderlall, Sohana
>
> **Subject:** FW: CRM2 2015 – IIROC Position Cost Information
>
> **Date:** Thu, 19 Nov 2015 16:04:40
>
> **Importance:** Normal
>
> **Attachments:** …
>
> I think this is the information that you are looking for.
>
> The key difference between position cost and what TD has historically allowed in its various "cost" fields is the ability for clients and advisors to manipulate the data upon request. This manipulation would impact the data integrity. Some industry participants have not allowed any change in that data so they would not have any issues with their data integrity.
>
> …
>
> The conservative approach, and probably the most expensive approach, would have been to add a new field for position cost and leave any existing "cost" data in place as this has most likely been modified to meet client needs for tax reporting. The new field for position cost could be populated with the market value of all securities on the earlier of December 31st 2015 or the date we initialize the column. PIC took this approach. TDW did not as they were relying heavily on industry lobbying which did not yield the desired result. As such TDW has landed on an interim solution which may compromise the ability of the tax department to fulfill their obligations under CRA regulations. What the plan is with respect to the ultimate solution and how they get there, I am not completely clear on but really have no choice because there was insufficient time to build an additional field to house position cost data.
>
> …
>
> Kelly
>
> Email dated November 19, 2015 from K. Vickers to S. Indersall, Subject: FW: CRM2 2015 – Position Cost Information, Exhibit 2, Volume 1, Tab 44

¶ 40 The next and final step in the reporting of the CRM2/Rule 200 issue was to the meeting of the Board of Directors of TD Waterhouse Canada Inc. ("Board") held on December 16, 2015. The Compliance Report to the Board dated December 7, 2015 contained the following:

> AGENDA ITEM NO. 10
>
> **COMPLIANCE REPORT**
>
> **TO**
>
> **BOARD OF DIRECTORS**
>
> **TD WATERHOUSE CANADA INC.**
>
> | | |
> |---|---|
> | Date of Report: | December 7, 2015 |
> | Date of Board Meeting: | December 16, 2015 |
> | Prepared by: | Louise Hamel |
> | | AVP, Wealth Compliance |

COMPLIANCE STATUS

In my opinion, TD Waterhouse Canada Inc. (TDWCI) has adequate and effective processes and controls in place to manage and monitor material compliance risks. Compliance has reported to senior management and the Board of Directors all material or significant instances of non-compliance with regulatory requirements that have been identified through monitoring & testing, Internal Audit, Regulatory Examinations or self-identified by the Business.

OFSI Guideline E-13; Regulatory Compliance Management (RCM)

The Global Chief Compliance Officer (CCO) is responsible for assessing the adequacy of, adherence to and effectiveness of TD Bank Group's day-to-day (RCM) controls, and for providing an opinion to the Board whether, based on the independent monitoring and testing conducted, the RCM controls are sufficiently robust to achieve compliance with the applicable regulatory requirements enterprise-wide. This assessment is completed using inputs from a variety of data sources and Key Control Environment Indicators (KCEIs) to arrive at a conclusion of ineffective, Moderately Effective or Effective.

The TDWCI (for the Quarter ending Oct 31, 2015) was rated Moderately Effective, with the following comments:

Business Oversight Programs

(redacted)

Monitoring and Testing

Through monitoring and testing, Compliance has identified some control weaknesses related to:

(redacted)

2) Regulatory non-compliance

-CRM2 definition of Book Cost for approximately 8% of positions

(redacted)

All Compliance issues noted are receiving full management attention and remediation is being investigated or underway.

…

AGENDA ITEM NO. 14

TD Waterhouse Canada Inc. Risk Management Report

Presentation to TD Waterhouse

Canada Inc. Board of Directors

December 16, 2015

Current Risk Conditions and Trend – Business Indicators

(redacted)

Tier 1/2/3 projects:

- **October:**

(redacted)

- Projects in Yellow status: CRM2 – 2015

TD WATERHOUSE CANADA INC

DIRECTORS' MEETING

Wednesday, December 16, 2015 – 2:00 pm

Main Board Room, 35th Floor, Canada Trust Tower, 161 Bay Street, Toronto

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Directors: Leovigildo (Leo) Salom (Chair)	**Invitees:** Sayward Whiteley (Secretary)
Lee Bennett	Jennifer Soward (Assistant Secretary)
Sandra Cimoroni	Michael Arthur
David Kelly	Jennifer dela Cruz
Atanaska Novakova	Mike Donovan
Minal Upadhyaya	Robert Leggett
	Sandra Gortana
	Louise Hamel
	Jenny Heibein
Quorum = 4 (50%)	Marlo Kravetsky
	Evan Mamas
	John See
	Bola Sholubi
	Colin Small
	Fraser Whale (E&Y)
Copy:	Effie Biros
	Rachel Zhou

Compliance Report to Board of Directors, TD Waterhouse Canada Inc., dated December 7, 2015, Exhibit 2, Volume 2, Tab 47, p. IIROC-0582

¶ 41 There are no further reports in the evidence following the December 16, 2015 Board of Directors meeting which deal with the CRM2 position cost non-compliance until 2017.

¶ 42 The Respondent did not, at the time of making its decision to be non-compliant, or at any other time thereafter, advise IIROC Staff or any other securities regulatory authority that a certain percentage of its clients' positions would be non-compliant with the Position Cost Requirements. Further, there is no reference anywhere in the documents before us that there ever was any consideration given to involving IIROC in the then pending non-compliance.

¶ 43 IIROC Staff only became aware of the non-compliance in April 2017 when it received a written complaint from a TD Direct Investing retail client alleging that the Respondent was not complying with the requirement to provide position cost information for all positions within his account.

Re: Complaint

To Whom It May Concern:

I hereby notify Investment Industry Regulatory Organization of Canada of TD Direct Investing's non-compliance with the IIROC Rule – sub-clause 200.1(b)(ii)(B) (see attached rules) which became effective December 31, 2015 (as part of the rules known as CRM2).

…

Every one of these securities is on listed market where market values for each of these securities is available. I'm sure that TD Direct Investing has numerous feeds from a variety of sources which are provide either real-time or end of day market values for these securities. This is further evidenced on the statement itself for the reporting period ending December 31, 2015 as a market value is provided for the each security as of December 31, 2015 valuation.

TD Direct Investing did not follow Rule – sub-clause 200.1(b)(ii)(B) as set out by IIROC (and the Ontario Securities Commission) in adjusting the cost position using the Market Value as of December 31, 2015, and it appears TD Direct Investing defaulted the cost position form Not Available to Not Determinable.

Complaint Letter from PS to IIROC dated April 13, 2017, Exhibit 2, Volume 2, Tab 65

¶ 44 Prior to sending the written complaint to IIROC, the complainant had complained directly to TDW on a number of occasions, the details of which are set out in his letter to IIROC as follows:

TD Direct Investing has insisted that they are following the rules, which I disagree with as there are no exemptions that I know of or clarification through IIROC CRM FAW published (see Question 14).

Please find attached and (sic) timeline of correspondence with TD Direct Investing:

…

- **Item 2:** Initial Complaint to TD Direct Investing – February 4, 2017

➢ February 10th at 2:55 pm spoke to Janine id 40842. She was going to follow up with an email to the individual as he was in a meeting and unavailable.

I indicated that I have not received acknowledgment and I believe that under IIROC rule there is a 5-business day turn around.

➢ February 14th at 12:36 pm spoke to Phillip McCrae. Spoke to Phillip and emailed to him. X 41938

- **Item 3:** Follow up on Complaint to TD Direct Investing – February 14, 2017

➢ February 14th Romeo Javellana called to clarify the complaint and would forward the material on internally.

➢ February 23rd call received from Deepa Vaswani phone 905 474 7120. Deepa indicated that I could adjust the cost value of the securities – if I provided evidence. I indicated that I understood that, but under the rule TD Direct Investing was mandated to assign a book value if the market value could be determined.

She will send info (look at page 6.)

- **Item 4:** email from Deepa Vaswani – February 23, 2017
- **Item 5:** email from (redacted) to Deepa Vaswani – February 27, 2017
- **Item 6:** email from Deepa Vaswani to (redacted) – February 28, 2o017
- **Item 7:** email from (redacted) to Deepa Vaswani – February 28, 2017
- **Item 8:** email from Deepa Vaswani to (redacted) – February 28, 2o017

- February 28, 2017 Called IIROC complaint line and spoke to Bert Nogura to determine complaint process.

  Complaint Letter from PS to IIROC dated April 13, 2017, *ibid*

¶ 45 IIROC Staff reviewed the complaint and concluded that the Respondent was not complying with the position cost calculation and disclosure requirements for all positions in the complainant client's account and that the non-compliance was not limited to the complainant's account.

¶ 46 The issue raised in the client complaint was referred to IIROC Financial and Operations Compliance Staff ("FinOps Staff") who were in the process of performing a routine Financial and Operations Compliance Field Examination on the Respondent.

¶ 47 In early June 2017, FinOps Staff first discussed the book cost issue with staff members of the Respondent. FinOps Staff was advised that there had been recent turnover in the employees responsible for position cost reporting and the person responsible for the book cost issue during CRM2 implementation was no longer employed by the Respondent. Members of the Respondent's compliance department, some of whom were new to their role, agreed to address the issue.

IV. ANALYSIS AND FINDINGS

¶ 48 To begin, the Hearing Panel is unpersuaded by the Respondent's argument that it did not refuse to comply with the new Rule. The uncontroverted fact is that on May 16, 2015, the ESC of the Respondent approved the recommendation to proceed with the implementation of the position cost estimate even though that meant it would be non-compliant with the IIROC Book Cost Definition for 8% of TDW clients. This decision was approved by and reported to the senior management and the Board of Directors of TDW. It constituted a direct refusal to comply of which IIROC was unaware until the complaint was received in 2017.

¶ 49 The Respondent goes on to argue that it fully intended to comply with Rule 200. However, it could have complied fully on December 15, 2015, but chose not to do so. It says it had a better solution, one which obviated a perceived risk of interfering with tax reporting of some clients. That may or may not be correct, but TDW did not tell IIROC about it nor anybody else and it is clear that the "business risk" they decided to take was the risk that the deliberate non-compliance with Rule 200 would be discovered. It was, nearly two years later, and TDW was then obliged to confront the realities and consequences of its non-compliance.

¶ 50 Further, as it turned out, the better way, the so called "two column" method, was never approved or even further considered. We are told it was simply forgotten and TDW continued thereafter to be non-compliant. It is difficult to accept this argument by the Respondent that all of the 60 or 70 people working on the CRM2 changes had together forgotten about the continuing non-compliance or that the senior management and that the Board members were equally unaware of the continued non-compliance.

¶ 51 Whether or not it was a "slip-up" by all concerned as it was characterized by Ms. Novakova, in the Hearing Panel's view it was a failure of governance that is equally as serious a misstep as the deliberate decision to be non-compliant. In both cases, the failures should give rise to concerns about possible systemic weakness in the governance systems of TDW. Obviously, matters relating to regulatory compliance are of the highest importance for a member of a self-regulatory organization and it should be impossible for them to have been simply forgotten.

¶ 52 It is for that reason, among others, that the Respondent's failure to consult or advise its regulator about the non-compliance is deeply concerning. Consultation with IIROC should have been the first step for TDW. Its failure to do so is damaging to the integrity of the regulatory regime. The fact that a premier financial institution acted in such a manner provides extremely poor leadership for the other members of IIROC.

¶ 53 As the Respondent correctly submits, there appear to have been no complaints of harm from those deprived of the book cost information they were entitled to as at December 15, 2015. That is not to say

however that that deprivation was without effect. Cost information is obviously important for investors, and CRM2 was intended to provide it to all investors, not just a majority of them.

¶ 54 It is not as if the deprivation was limited to a few TDW investors; TDW is a very large Dealer Member and small percentages can involve large numbers of investors. In this case, as TDW informed Mr. Corner in 2018, an estimated 175,301 clients held positions which were incorrectly reported ND, "not determinable", when the information was available. A failure of such magnitude is not, by any measure, a minor transgression.

Sanction Principles

¶ 55 In opening the case, Staff made three general submissions, each of which the Hearing Panel fully accepted:

1) The sanction imposed on TD Waterhouse Canada Inc. ("TDW") must be significant enough that TDW, industry participants and the public, will not view it simply as a cost of doing business. The sanction should be more than a cost of doing business and be of a magnitude sufficient to ensure effective deterrence of TDW and other Dealer Members that might see a benefit in non-compliance.

2) The sufficiency of the monetary sanction does not depend on establishing whether the deliberate non-compliance was the result of "moral turpitude" or whether it was well intentioned. The central fact is that TDW, as an experienced investment dealer, made a deliberate decision that not complying with a regulatory requirement for a material number of client positions was an acceptable business risk and then failed to rectify the non-compliance, apparently lacking any recognition that it was non-compliant for an extended period.

3) The integrity of the securities industry depends on Dealer Members maintaining high business standards and practices. Those who comply have a right to expect that those who do not will be sanctioned so as to make compliant behavior the only reasonable and practical option.

¶ 56 We recognize that setting the quantum of any fine is an important part of achieving the objectives of specific deterrence directed at the transgressor and perhaps more importantly in cases like this one involving large financial institutions, of providing general deterrence for all those within IIROC's jurisdiction tempted to flaunt the rules governing their participation in the securities industry.

¶ 57 In the modern world where news is distributed almost instantaneously and widely by all forms of media, the reputational aspect has to be taken into account in fixing a sanction. Major financial institutions such as TDW invest large amounts of time and money in promoting their brands. While they may be able to easily afford large fines as a cost of doing business, bad publicity is very bad for business and that in itself provides a strong specific deterrence.

¶ 58 The Hearing Panel's task then is to fix on an amount that will attract sufficient adverse attention that it will cause sufficient publicity that it is less likely to be repeated, either by the transgressor or any other member of the securities industry which might be similarly inclined to repeat the conduct in future.

¶ 59 The Ontario Securities Commission in *Re Rowan* emphasized that "the Commission should consider general deterrence as an important factor when determining the appropriate sanction." In *Re Cartaway,* the Supreme Court of Canada stated that "…it is reasonable to view general deterrence as an appropriate, and perhaps necessary, consideration in making orders that are both protective and preventative". The Commission added that the sanction imposed must be sufficient "to respond to the specific misconduct of the Respondent(s) and to send a message to other registrants about the importance of fulfilling their statutory duties".

Re Rowan, 2009 LNONOSC 941, aff'd *Rowan v. Ontario (Securities Commission)*, [2012] O.J. No. 1375

(C.A.)

Cartaway Resources Corp (Re), [2004] 1 S.C.R. 672, 2004 SCC 26

¶ 60 The IIROC Sanction Guidelines ("Sanction Guidelines") summarize sanction principles that have been endorsed by IIROC hearing panels and the Ontario Securities Commission. Sanction Principle #1 of the Sanction Guidelines states that specific and general deterrence can be achieved if a sanction strikes an appropriate balance by addressing a respondent's specific misconduct but is also in line with industry expectations. The sanction should be designed to "improve overall business standards and practices".

IIROC Sanction Guidelines, February 2, 2015

The Relevant Factors

¶ 61 The Sanction Guidelines list the key factors commonly taken into consideration by IIROC hearing panels when making a determination as to an appropriate sanction. The ones which are most applicable to this case are those which the Respondent, in its closing argument, has chosen to rely on. Those which have not been previously discussed are considered in what follows.

Respondent's Key Factor No 3: Whether the respondent engaged in the misconduct over an extended period of time

¶ 62 Submission: The non-compliance extended from January 2016 to mid-2017, when the Respondent began discussions with IIROC as to how to remediate the non-compliance with respect to the subset of security positions. However, during that time, the WRC and the Board of the Respondent were not aware that there was continuing non-compliance.

¶ 63 Finding: The non-compliance extended from January 2016 to mid-2017. On the evidence, as summarized at paragraphs 37 – 40 of this decision, the Board, the WRC and the ESC were aware, or should have been aware, that there was continued non-compliance.

Respondent's Key Factor No 4: Whether the misconduct was intentional, willfully blind, or reckless with respect to regulatory requirements

¶ 64 Submission: The failure to implement Position Cost Requirements with respect to a subset of security positions was not intentional, willfully blind or reckless with respect to regulatory requirements.

¶ 65 Finding: As evidence demonstrates, the failure to implement Position Cost Requirements with respect to a "subset of security positions" was intentional.

Respondent's Key Factor No 5: Extent of harm to clients or other market participants

¶ 66 Submission: The failure to implement the Position Cost Requirements with respect to a subset of security positions did not result in any client losses and did not deprive clients of the actual cost information for those security positions.

¶ 67 IIROC described the fact that clients have position costs for those positions based on market values as at December 31, 2018 instead of December 31, 2015 as "not optimal" but not "overly burdensome on clients as they already have a similar obligation to calculate and maintain records of the "adjusted cost base" amount for individual tax reporting purposes.

Memorandum from Richard Corner to Board of Directors, November 16, 2018, Exhibit 2, Tab 100.

¶ 68 Finding: The failure of the Respondent to comply with Rule 200 does not appear to have caused any harm save and except the deprivation of a large number of security holders of important information they were entitled to receive. Any effect of such deprivation is unknown.

Respondent's Key Factor No 6: Extent of harm to market integrity or the reputation of the marketplace,

or both

¶ 69 Submission: Not applicable. The facts here are not analogous to *Re Sutton,* 2018 ONSEC 42 (CanLII) relied upon by Staff. That case involved a failure to provide clients with accurate current market values – an obligation that registrants have always had which is crucial to client decision-making. That type of failure clearly can affect market integrity.

¶ 70 Finding: We do not agree that the facts here are not analogous to those in *Re Sutton.* The information was important for informed investment decisions in both cases, albeit on a far larger scale in the present case.

Respondent's Key Factor No 8: The Respondent's relevant disciplinary history

¶ 71 Submission: The Respondent has no disciplinary history relevant to the issues here.

¶ 72 Finding: The Respondent has a disciplinary history with IIROC. See *TD Waterhouse Canada Inc. (Re)* 2008 IIROC 7 (CanLII). Relevance to the issue in the present case is not part of the test to determine previous disciplinary history.

Respondent's Key Factor No 11: In the case of a Dealer Member, whether the respondent accepted responsibility for and acknowledged the misconduct to the regulator prior to detection and intervention by the regulator

¶ 73 Submission: While the Respondent did not report the non-compliance with respect to a subset of security positions prior to detection by IIROC Staff, the Respondent accepted responsibility for, and acknowledged, the non-compliance when it learned of it from Staff.

¶ 74 Finding: Contrary to TDW's submission, it did not, as we have found, learn of the non-compliance with respect to "a subset of security positions" from Staff.

¶ 75 While the Hearing Panel considered each of the factors set out above, and in fact reviewed all the factors listed in the Sanction Guidelines in order to select the ones most applicable to this case, with one exception these factors had only a marginal effect on our selection of the appropriate fine.

¶ 76 The Ontario Securities Commission in *Re Sutton* explained the situation we found ourselves in this case. Staff quoted from *Re Sutton* in its Closing Submissions as follows:

> It is rare that substantially similar precedents can be found to assist in determining appropriate sanctions. That is particularly true here, given the unusual facts of this case.
>
> *Re Sutton, ibid*, page 30

¶ 77 Here as well, the basic facts are unique. There are no cases which come close to being comparable to the Respondent's wilful decision not to follow Rule 200 and to ignore the regulator until the misconduct was discovered and a complaint was made. We had to fashion a sanction that is appropriate for such an act of fundamental disobedience to the applicable rules. That focus meant that all the other factors merely provided guidance for the Hearing Panel. The overwhelming objective was to fix a sanction, which would provide specific and general deterrence for the failure to follow rules such as Rule 200.

¶ 78 The one exception was the consideration of harm. As we have stated, there was deprivation attendant on the breach but there were no complaints about harm. That fact is something that we took into consideration, particularly when considering Staff's request for the maximum fine of $5,000,000.

¶ 79 The Hearing Panel was not attracted to the submission that it should order a fine in the maximum amount permitted as an appropriate reaction to egregious facts. Such a response is too similar to punishment as opposed to being aimed at deterrence. We agree that the fine should be significantly larger than previous fines, the largest of which was $1,500,000 in 2008. It needs to be seen as a severe sanction but also seen as reasonable in all the circumstances. It also needs to leave room for cases that, for example, involve facts,

which are equally egregious but have a significant harm component.

¶ 80 After deliberation, the Hearing Panel unanimously concluded that a fine of $4,000,000 would be appropriate in this case as it would send a strong message to all those concerned. In short, we believe such a fine will provide both general and specific deterrence to all those inclined not to respect their obligations to obey the regulatory rules.

V. CONCLUSION

¶ 81 In summary, the Hearing Panel orders that:

i) The Respondent shall pay a fine in the amount of $4,000,000;

ii) The Respondent shall pay costs in the amount of $28,497.00 to IIROC.

¶ 82 The Hearing Panel is grateful for the assistance it received from all counsel.

DATED this 17 day of March 2020.

Lorn McDougall

Richard E. Austin

Neil Murphy