Re Watts

IN THE MATTER OF:

The Dealer Member Rules of the Investment Industry Regulatory Organization of Canada

and

John Phillip Watts

2016 IIROC 28

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

Heard: April 13, 2016 in Charlottetown, PEI
Oral Decision: April 13, 2016
Written Reasons: August 9, 2016

Hearing Panel:
Edward W. Keyes (Chair), Mr. Brian Gibbons and Mr. Thomas Purves
Appearances:
Natalija Popovic, Enforcement Counsel
Mr. Kevin J. Kiley, Counsel for John Phillip Watts

DECISION AND REASONS

Introduction

¶ 1 This Hearing Panel was constituted, pursuant to Part 10 of Dealer Member Rule 20.36 of the Investment Industry Regulatory Organization of Canada ("IIROC").

¶ 2 The purpose of this hearing was to determine whether the Hearing Panel was prepared to accept or reject the terms of a Settlement Agreement which had been entered into between IIROC and the Respondent, John Phillip Watts (the "Respondent"), pursuant to a written Settlement Agreement.

¶ 3 At the conclusion of the Settlement Hearing, and after hearing from counsel for IIROC and the Respondent, and upon receiving the Settlement Agreement and considering its terms, the Hearing Panel satisfied itself that the terms of the Settlement Agreement were satisfactory to it and it was thereafter accepted by the Hearing Panel. These are our written reasons for doing so.

The Settlement Agreement

¶ 4 A copy of the Settlement Agreement is attached hereto as Schedule "A" to these Reasons for Decision. Pursuant to the terms of the Settlement Agreement, the Respondent admits the following contraventions of the IIROC Rules, Bylaws, Regulations or Policies, that:

(1) from on or about July 2007 until December 2010, the Respondent failed to use sufficient due diligence to ensure that his recommendations were suitable for four clients contrary to IIROC

Dealer Member Rule 1300.1(q) [IDA Regulation 1300.1Q prior to June 1, 2008]; and

(2) from about May 2008 until June 2008, the Respondent engaged in trading in the accounts of one estate client with instructions from only one of three executors contrary to IIROC Dealer Member Rule 1300.4 [IDA Regulation Rule 1300.4 prior to June 1, 2008].

¶ 5 The Respondent has agreed to the following sanctions as set out in paragraph 6 of the Settlement Agreement:

a. a global fine of $115,000.00 inclusive of disgorgement;

b. a prohibition from applying for re-registration until June 30, 2017;

c. in the event the Respondent seeks re-registration, strict supervision for six (6) months; and

d. further, the Respondent agrees to pay costs to IIROC in the sum of $20,000.00.

General Considerations

¶ 6 In considering the terms of the Settlement Agreement, this Hearing Panel must decide whether the sanctions proposed to be imposed strike a reasonable balance between fairness to the Respondent under the circumstances while also considering the need to protect the investing public, the industry membership, the integrity of the disciplinary process, the integrity of the securities markets and the prevention of repetition of the offense.

¶ 7 The facts in the present matter can be summarized as follows:

a. The Respondent was a registrant with Berkshire Securities Inc. ("BSI") from 2001 until 2007. He was then a registrant with Wellington West Capital Inc. ("WWCI") from 2007 until the end of 2011 and was at WWCI throughout the relevant period for which this Settlement Agreement covers. Subsequently, WWCI was acquired by National Bank Financial Ltd. where the Respondent continues to be registered. The Respondent has not worked as an investment advisor and has been on leave since November 2011.

b. The Respondent became a regulated person of IIROC on June 1, 2008. On August 15, 2007, the Respondent and Sean Thomas Hickey ("Mr. Hickey") registered Watts Hickey Investment Partners.

c. The Respondent and Mr. Hickey shared a joint code pursuant to which they split all revenues from Watts Hickey Investment Partners evenly. The Respondent and Mr. Hickey charged clients a management a fee ranging from 1-1.5% on all assets invested.

d. Mr. Hickey was not the primary advisor in relation to the clients that are subject to this Settlement Agreement. He relied on the Respondent to make suitable recommendations to those clients.

Unsuitable Investments

e. Over an approximate three year period, the Respondent engaged in an investment strategy for a number of clients. The investment strategy used by the Respondent focused primarily on a number of high risk securities in companies based in China which included small cap and/or start-up companies.

f. The Respondent's investment strategy was unsuitable for four of those clients.

g. Client DC was unable to work and had a limited annual income. The securities recommended by the Respondent for this particular client were unsuitable for that client's particular personal and

financial circumstances.

h. Client MC was retired with a limited annual income and was primarily dependent on investments with the Respondent. Again the securities recommended by the Respondent were unsuitable for this client based on his particular personal and financial circumstances.

i. Client LM was employed as a dental assistant, with a limited annual income and investments and who also had limited investment knowledge. The securities recommended by the Respondent for this client were also unsuitable based on client LM's personal and financial circumstances.

j. Client HJ had limited investment knowledge and was unemployed and, again, the securities recommended were unsuitable for client HJ's personal and financial circumstances.

k. The panel heard that the Respondent conducted extensive research on the securities that he recommended to the clients, however, these securities were unsuitable for client's DC, MC, LM and HJ and significantly decreased in value in amounts ranging from $30,150.00 to $122,363.00.

Unauthorized Trading

l. In the case of the Estate Client, the Respondent was aware as early as March 2008 that there were three executors of the Estate. Notwithstanding, the Respondent communicated with only one of the executors, who had a high risk tolerance, before executing trades in the Estate account in May and June 2008.

m. In May of 2008, the Respondent executed three purchases of shares with a book value of over $220,000 in the account of the estate client without receiving instructions from all three of the executors. Shares of at least two of these companies purchased along with other similar shares had previously been purchased by the Estate Client, on the directions of the same executor, at another dealer and transferred in kind to the Respondent while he was at WWCI.

n. In June of 2008, the Respondent executed an additional three purchases of shares with a book value of approximately $54,000, in the account of the Estate Client without the prior instructions from all three executors.

o. The evidence presented also established that the Respondent has a discipline history with IIROC in relation to a previous settlement entered into in 2008.

Analysis and Decision

¶ 8 It is the Hearing Panel's duty to reject the penalties set out in the Settlement Agreement if we determine that they clearly fall outside the range of appropriateness, given the conduct of the Respondent. This principle was stated in the Decision of *Milewski (Re)* [1999] IDACD No. 17, August 5, 1999 at page 11; see also *Clark (Re)* [1999] IDACD No. 40, Bulletin No. 2674 (December 14, 1999):

> "... a District Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness."

¶ 9 This Hearing Panel must also give serious consideration to the fact that the parties made a joint submission with respect to the appropriateness of the sanctions. This principle, as it applies to administrative tribunals, has been cited with approval by the Saskatchewan Court of Appeal in the decision of *Rault v. Law Society of Saskatchewan*, 2009 SKCA 81 (CanLII) where the Court considered and followed the decision of the Alberta Court of Appeal in *NR (Re) v. GWC*, 2000 ABCA 333 (CanLII). The Court of Appeal held that there is an obligation on a tribunal to give serious consideration to a joint submission on sentencing that was agreed

upon by counsel unless the sentence is unfit or unreasonable, or contrary to the public interest, and that it should not be departed from unless there are good and sufficient reasons for doing so.

¶ 10 In evaluating the terms of the Settlement Agreement, the Hearing Panel has considered the IIROC Dealer Member Disciplinary Sanction Guidelines (the "Guidelines") that identify a number of key considerations to be considered when determining the appropriate disciplinary sanction. These include the following:

(1) the number, size and character of the transactions at issue;

(2) whether the respondent engaged in numerous acts and/or a pattern of misconduct;

(3) whether the Respondent engaged in the misconduct over an extended period of time;

(4) whether the misconduct was intentional, wilfully blind or reckless with respect to regulatory requirements;

(5) the extent of harm to clients or other market participants;

(6) the extent of harm to market integrity or the reputation of the market place, or both;

(7) the level of vulnerability of the injured or affected client(s);

(8) the respondent's relevant disciplinary hearing;

(9) the extent to which the respondent obtained or attempted to obtain a financial benefit from the misconduct;

(10) whether the respondent accepted responsibility for and acknowledged the misconduct to his or her employer or the regulator prior to detection and intervention by the Dealer Member or the regulator;

(11) whether the respondent provided proactive and exceptional assistance to IIROC in the investigation of the misconduct;

(12) whether the Respondent attempted to delay IIROC's investigation to conceal information from IIROC or intentionally providing inaccurate or misleading testimony or documentary information to IIROC;

(13) whether the Respondent failed to adhere to regulatory guidelines with respect to the misconduct at issue; and

(14) whether the Respondent engaged in the misconduct at issue notwithstanding warnings from IIROC, another regulator or a supervisor (in the case of an individual Respondent) that the conduct contravened firm policies, IIROC rules or applicable securities, laws or regulations where it was not in the best interest of the client or public.

¶ 11 Not all of the key considerations are relevant to the facts in the case at bar and those that are must be considered in light of the principles set out in *Milewski (Re) (supra)*.

¶ 12 The purpose of sanctions in a regulatory proceeding is to protect the public interest by restraining future conduct that may harm the capital markets. In order to achieve this, sanctions should be significant enough to prevent and discourage future misconduct by a Respondent, characterized as specific deterrence to the member, and also to deter others from engaging in similar misconduct, known as the principle of general deterrence.

¶ 13 General deterrence can usually be achieved if a sanction strikes an appropriate balance by addressing a regulated person's specific misconduct while at the same time being in line with the industry's expectations. Ultimately the sanction imposed must be proportionate to the conduct at issue and should be similar to sanctions

previously imposed on Respondents for similar contraventions under similar circumstances.

¶ 14 It is of note that the Respondent's prior disciplinary record is an aggravating factor here and could warrant a harsher sanction than would be required had this been the Respondent's first disciplinary contravention. The Guidelines state that a suspension should be considered where:

- there has been more than one or more serious contraventions;
- there has been a pattern of misconduct;
- the Respondent has a prior disciplinary history;
- the contraventions involve fraudulent, wilful or reckless misconduct; or
- the misconduct in question has caused some measure of harm to investors, the integrity of the market place or the securities industry as a whole.

¶ 15 In reviewing the Guidelines, the Hearing Panel is cognisant of the circumstances where a suspension should be considered, as has effectively been agreed to under the terms of the Settlement Agreement negotiated between the parties in the within matter as the Respondent is prohibited from applying for re-registration until June 30, 2017. When there are multiple violations, the Guidelines state that the overall sanctions imposed should not be excessive or disproportionate to the gravity of the misconduct at hand and that a global approach to sanctioning may be appropriate where the imposition of a sanction for each contravention would have the effect of imposing on the Respondent a cumulative sanction that is excessive.

¶ 16 Enforcement Counsel referred the Hearing Panel to the following decisions dealing with the penalties imposed by other Panels in circumstances where similar types of misconduct as alleged in this case had occurred: *Gareau (Re)*, 2011 LNIIROC 72; *Jones (Re)*, 2012 LNIIROC 48; *Phillips (Re)*, 2011 LNIIROC 60; *Leigh (Re)*, 2010 LNIIROC 1; *Grieve (Re)*, [2003] I.D.A.C.D. No.8 and *Blanko (Re)*, [2007] I.D.A.C.D. No. 10. These decisions were of assistance to the Hearing Panel in evaluating the appropriateness of the penalties as set out in the Settlement Agreement entered into by the parties in the within matter taking into consideration the facts of the matter before us.

¶ 17 It is often cited that registered representatives hold privileged positions in the securities industry and accordingly are required to observe high standards of ethics and conduct and not engage in business conduct and practise that is detrimental to the public and/or their clients. They have a responsibility to protect clients from inappropriate investment policies and to exercise due diligence in their dealings on behalf of clients. The Respondent clearly breached IIROC Dealer Member Rules 1300.1(q) and 1300.4 (previously IDA Regulation 1300.1(q) and 1300.4 prior to June 1, 2008) when he engaged in unauthorized trading in the account of his Estate Client and by making unsuitable investment recommendations for client's DC, MC, LM and HJ.

CONCLUSION

¶ 18 Upon considering the relevant Guidelines, the submissions of counsel and upon reviewing the sanctions levied in the cases referred to above, we believe that the penalties as set out in the Settlement Agreement strike a reasonable balance between fairness to the Respondent under the circumstances while considering the need to protect the investing public, the industry membership, the integrity of the discipline process, the integrity of the securities markets and the prevention of a repetition of the offense.

¶ 19 In our opinion, and upon considering that the Respondent had been subject to disciplinary proceedings in the past, we believe that the provisions of the within Settlement Agreement regarding the sanctions agreed to between the parties fall within a reasonable range of appropriateness under the circumstances. The penalties agreed to provide for both specific and general deterrence and serve to protect the integrity of the capital markets and the general public. For all of these reasons we find it is in the public interest to accept the Settlement Agreement as negotiated and entered into by the Respondent John Phillip Watts and IIROC.

¶20 For the record, upon the Hearing Panel advising at the Settlement Hearing that it accepted the Settlement Agreement entered into by IIROC and the Respondent John Phillip Watts, IIROC Enforcement Counsel advised that the matter against Sean Thomas Hickey was withdrawn.

Dated this 9th day of August, 2016.

Edward W. Keyes, Chair

Brian Gibbons

Thomas Purves

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondent, John Phillip Watts ("the Respondent"), consent and agree to the settlement of this matter by way of this settlement agreement ("the Settlement Agreement").

2. The Enforcement Department of IIROC has conducted an investigation ("the Investigation") into the conduct of the Respondent.

3. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C ("the Hearing Panel").

II. JOINT SETTLEMENT RECOMMENDATION

4. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

5. The Respondent admits to the following contraventions *of IIROC Dealer Member Rules:*

   (a) From or about July of 2007 until December of 2010 (the "Relevant Period"), the Respondent failed to use sufficient due diligence to ensure that his recommendations were suitable for four clients, contrary to IIROC Dealer Member Rule 1300.1(q) [IDA Regulation 1300.1(q) prior to June 1, 2008].

   (b) From or about May 2008 until June 2008, the Respondent engaged in trading in the accounts of one Estate client with instructions from only one of the three executors, contrary to IIROC Dealer Member Rule -1300.4 (IDA Regulation 1300.4 prior to June 1, 2008).

6. Staff and the Respondent agree to the following terms of settlement:

   (a) A global fine of $ 115,000, inclusive of disgorgement;

   (b) A prohibition from applying for re-registration until June 30, 2017; and

   (c) In the event that the Respondent seeks re-registration, strict supervision for six months.

7. The Respondent agrees to pay costs to IIROC in the sum of $ 20,000.

III. STATEMENT OF FACTS

(i) Acknowledgment

8. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

A. Overview

9. In the case of four clients, the Respondent failed to use sufficient due diligence to ensure that his recommendations were suitable for them.

10. In the case of one client, the Respondent engaged in unauthorized trading for the client's account in that he executed trades when he did not have instructions from all relevant parties.

11. This client was an estate (the "Estate Client") for which the Respondent executed trades without having obtained prior instructions from all three of the executors. Trading instructions were obtained from only one of the executors for a period of time. All of the executors and beneficiaries of the estate were adult family members.

B. Registration History

12. The Respondent was a registrant with Berkshire Securities Inc. ("BSI") from 2001 until 2007. He was a registrant with Wellington West Capital Inc. ("WWCI") from 2007 through to the end of October 2011 and was at WWCI throughout the Relevant Period. Subsequently, WWCI was acquired by National Bank Financial Ltd., where he continues to be registered.

13. The Respondent has not worked as an investment advisor, and has been on leave, since November 2011. The Respondent has no intention of returning to the securities industry.

14. On June 1, 2008, the Respondent became a regulated person of IIROC.

15. Sean Thomas Hickey ("Hickey") has been registered with IIROC, and its predecessor the IDA, since 2002. He worked at RBC Dominion Securities from 2002 to 2006, and BSI from 2006 until 2007. He worked at WWCI from 2007 through to the end of October, 2011 when WWCI was acquired by NBF, where he continues to be registered.

C. Watts Hickey Investment Partners

16. On August 15, 2007 the Respondent and Hickey registered Watts Hickey Investment Partners. The Respondent and Hickey shared a joint code pursuant to which they split all revenues from Watts Hickey Investment Partners evenly. The Respondent and Hickey charged clients a management fee ranging from 1 to 1.5 percent of all assets invested.

17. Hickey was not the primary advisor in relation to the clients discussed herein. He relied on the Respondent to make suitable recommendations to those clients.

D. Unsuitable Investments

18. Over an approximate three-year period the Respondent engaged in an investment strategy for a number of clients, including DC, MC, LM, and HJ. The investment strategy primarily focused on a number of high risk securities in companies based in China, which included small cap and or start-up companies. The Respondent's investment strategy was unsuitable for DC, MC, LM, and HJ.

19. Client DC was unable to work, and had a limited annual income. The securities recommended by the Respondent were unsuitable for Client DC's particular personal and financial circumstances.

20. Client MC was born in 1940. Client MC was retired with a limited annual income and primarily dependent upon investments with the Respondent. The securities recommended by the Respondent were unsuitable for Client MC's particular personal and financial circumstances.

21. Client LM was employed as a Dental Assistant with a limited annual income and investments along with limited investment knowledge. The securities recommended by the Respondent were unsuitable for

Client LM's particular personal and financial circumstances.

22. Client HJ had limited investment knowledge and was unemployed. The securities recommended by the Respondent were unsuitable for Client HJ's particular personal and financial circumstances.

23. The Respondent conducted extensive research on the securities that he recommended to clients. Nevertheless, the securities recommended by the Respondent were unsuitable for DC, MC, LM, and HJ, and significantly decreased in value in amounts ranging from $30,150 to $122, 363.

24. The Respondent has a discipline history with IIROC in relation to a settlement entered into in 2008.

E. Unauthorized Trading

25. In the case of the Estate Client, the Respondent was aware as early as March 2008 that there were three executors of the estate. However, the Respondent communicated with only one of the executors, who had a high risk tolerance, before executing trades in the account in May and June 2008.

26. In particular, in May 2008, the Respondent executed three purchases of shares with a book value of over $220,000 in the account of the Estate Client without receiving the instructions of all three of the executors. Shares of at least two of these companies along with other similar shares had been previously purchased by the Estate Client, on the directions of the same executor, at another dealer and transferred in kind to the Respondent at WWCI.

27. In June 2008, the Respondent executed an additional three purchases of shares with a book value of approximately $54,000 in the account of the Estate Client without the prior instructions of all three of the executors. Shares of these companies were also similar to shares that had been previously purchased by the Estate Client, on the directions of the same executor, at another dealer and transferred in kind to the Respondent at WWCI.

28. Subsequent to June 16, 2008, all of the executors and beneficiaries reviewed all of the holdings in the account and provided instructions for the preparation of an investment policy statement for the Estate Client.

29. Ultimately, due to the different investment objectives and risk tolerances of the three executors and the four beneficiaries of the Estate Client, the assets in the account were distributed into four separate accounts for each of the beneficiaries.

IV. TERMS OF SETTLEMENT

30. This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.

31. The Settlement Agreement is subject to acceptance by the Hearing Panel.

32. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

33. The Settlement Agreement will be presented to the Hearing Panel at a hearing ("the Settlement Hearing") for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.

34. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives his right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

35. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed

in the Investigation.

36. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.

37. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.

38. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

39. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Charlottetown, in the Province of Prince Edward Island, this 23 day of March, 2016.

"Witness"
Witness

"John Watts"
JOHN PHILLIP WATTS

AGREED TO by Staff at the City of Toronto, in the Province of Ontario, this 4 day of April, 2016.

"Witness"
Witness

"Natalija Popovic"
NATALIJA POPOVIC
Enforcement Counsel on behalf
of Staff of the Investment
Industry Regulatory
Organization of Canada

ACCEPTED at the City of Charlottetown, in the Province of PEI, this 13 day of April, 2016, by the following Hearing Panel:

Per: "Edward Keyes"
Edward Keyes, Panel Chair

Per: "Brian Gibbons"
Brian Gibbons, Panel Member

Per: "Tom Purves"
Tom Purves, Panel Member