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Discipline

Discipline Penalties Imposed on Spencer Edward Graham; Violation of Regulation 1300.2

Person Disciplined	A Hearing Panel appointed pursuant to IDA By-law 20 has imposed discipline penalties on Spencer Edward Graham (“Graham”) at all material times a Co-Branch Manager with the Regina, Saskatchewan Branch Office of Credential Securities Inc. (“Credential”), a Member of the Association. Graham also had supervisory responsibility for Credential’s Prince Albert, Saskatchewan Sub-Branch (the “Sub-Branch”).
By-laws, Regulations, Policies Violated	<p>In a written decision released on June 14, 2005, which followed a disciplinary hearing held on April 18, 2005 in Regina, Saskatchewan a Hearing Panel found that Spencer Edward Graham violated Regulation 1300.2 in that he failed to adequately supervise Richard Reynaud Gareau (“Gareau”), over whom Graham had supervisory responsibility, to ensure that Gareau performed sufficient due diligence with respect to a security and that Graham further failed to take steps to remain sufficiently informed of the essential facts with respect to that security, which actions led to unsuitable concentrations of the security in four client accounts.</p> <p>The panel dismissed the other allegation against Graham which alleged that he permitted Gareau to update a client account with risk tolerance recorded for that account which was unsuitable for that client, contrary to Regulation 1300.2.</p>
Penalty Assessed	The Hearing Panel imposed a fine of \$50,000 against Graham. Further, as a condition of Graham’s continued approval as a Branch Manager, he must successfully re-write the CSC, CPH and PDO examinations by March 31, 2006. Failure to successfully complete these examinations within the prescribed period will result in Graham’s suspension from his approval as a Branch Manager, which suspension shall remain in effect until successful completion of these exams. The Hearing Panel also ordered that Graham pay \$15,000 towards the Association’s costs. The fine and costs must be paid by September 30, 2005.

Summary
of Facts

The facts, which were agreed upon by both the Association and Graham were that Gareau was employed at the Sub-Branch as a Registered Representative from May 23, 2000 to July 2, 2002. Graham had supervisory responsibility for the Sub-Branch.

BCI Deb

On February 10, 1999, Bell Canada International (“BCI”) issued a prospectus (the “Prospectus”) for the issuance of a BCI Convertible Subordinated Debenture due February 15, 2002 (the “BCI Deb”). The Prospectus stated that on the maturity date, BCI may, at its option, elect to satisfy its obligation to repay the principal amount by delivery of common shares of BCI. The Prospectus contained a risk section that is eight pages in length.

On March 13, 2001, BCI filed an Annual Information Form (“AIF”) for the year ended December 31, 2000. The AIF stated that BCI’s parent company is a wholly owned subsidiary of Bell Canada Enterprises (“BCE”). The AIF stated further that the BCI Deb is unsecured and convertible on the maturity date into common shares of BCI. As a risk factor, the AIF stated that BCI experienced losses in the past and may incur additional losses in the foreseeable future.

Both the Prospectus and the AIF were available on the System for Electronic Document Analysis and Retrieval (“SEDAR”).

Gareau recommended the BCI Deb to 14 of his clients. At the material time, there was less than a year to maturity of the BCI Deb. With a 6.75% coupon rate and trading below par, the BCI Deb had a significantly higher yield than the six-month T-Bill rate of 4.10% or the one-year GIC rate of 3.18% that were available on July 31, 2001. Further, BCI common shares dropped over 99% in value in the period from January 2001 to January 2003. From January 2001 to July 2001 the BCI common share value had dropped by about 50%. Moody’s Investors Service assigned a B3 rating to the BCI Deb. A B3 rating from Moody’s is described as highly speculative.

Due Diligence

On July 25, 2001, Gareau telephoned Graham to ask him about his thoughts regarding the BCI Deb. During that conversation, Graham looked at the Merrill Lynch screen information regarding the security, which provided only basic information regarding the quality of the BCI Deb. In that conversation with Gareau, Graham advised him that the BCI Deb was trading off the conversion price. Graham assumed that Gareau knew what he meant by this comment based on the fact that Gareau had been in the industry for seven years. However, Gareau had only been registered as an RR since May 23, 2000. Graham also advised Gareau that BCI was a subsidiary of BCE and that he was not terribly worried about the BCI Deb as BCE had never let one of its companies “go down”.

Graham did not review any further literature or research with respect to the BCI Deb, including the information on SEDAR.

On July 27, 2001, Gareau began purchasing the BCI Deb for his clients almost on a weekly basis. Even after BCI announced its intention to pay out the BCI Deb in shares, Graham conducted no further research into the security.

Gareau continued to recommend the purchase of the BCI Deb even as the price of that security continued to fall. While Graham was concerned, he was reassured by Gareau that the clients were okay with that and that he had clearly explained the terms of the security to the clients. Accordingly, as Graham had had no previous complaints about Gareau, he “did not lose any sleep over the issue.”

Between August 2001 and January 2002, Graham did not have any contact with any of Gareau’s clients in respect of the BCI Deb. While Graham considered contacting at least some of the clients, he did not do so since that had never been done at Credential and he did not want to put Gareau in an awkward position. The extent of Graham’s follow up with respect to the BCI Deb consisted of following the price of the security and speaking with Gareau.

The BCI Deb accounted for approximately 15% of Gareau’s entire book. The losses incurred by 14 of Gareau’s clients as a result of his recommendation of the BCI Deb to them was \$724,803.46.

Graham was not a producing Branch Manager, and he was not remunerated based on commissions generated by his Branch or the Sub-Branch. He was a salaried employee and, as such, stood to gain nothing financially from Gareau recommending the BCI Deb rather than another investment.

Concentration

Gareau was the registered representative for the account of a numbered company. The net worth of this company was \$480,000 and the initial deposit into the company was \$478,000, representing the entire net worth of the company. Gareau recommended the purchase of \$493,490.52 of the BCI Deb for this account. This purchase was made in several stages as the result of an error at prices ranging from \$90.50 to \$98.00. Graham was aware of this purchase and while he asked Gareau if this was a concentration problem, Gareau advised him that the client was happy as long as the order was filled at the right price. Graham considered contacting the client, but did not do so since he did not want to put Gareau in an awkward position.

Gareau also recommended the total purchase of \$95,061.11 worth of the BCI Deb for the account of AK (@ \$91.00 and \$91.50) just after the account was opened, which represented 50% of the value of that account. Graham was concerned that this purchase was close to the \$100,000 threshold that required prior management approval prior to the purchase. However, notwithstanding this concern, Graham stated that he would likely have approved the purchase in any event. Graham was not concerned regarding the concentration since BCE owned a significant portion of BCI.

Gareau recommended the total purchase of \$108,904.61 worth of the BCI Deb for the account of EL and LL on the two days immediately after that account was opened. This purchase represented 87% of the value of this account. With respect to concentration, Graham stated that this purchase would not have required prior management approval since each of the two purchases was less than the \$100,000 threshold.

Gareau recommended the purchase of \$72,275.38 of the BCI Deb for the account of KET @ \$93.50 the day after the account was opened. This purchase represented the entire value of this account. Graham did not make any inquiries of Gareau regarding this purchase based on the fact that his concerns over BCI at the time were not high.

With respect to all of the foregoing, the Hearing Panel stated that Graham had serious supervisory responsibilities and he failed. The result of his failure was the loss of a significant amount of money. While the Hearing Panel agreed that there was really only one error, that error was seminal and grave and was repeated over and over. Graham was presented with many “red flags” and he chose to ignore them. The Hearing Panel pointed to the concentration of the BCI Deb in the accounts generally as well as its concentration, beyond NCAF objectives in particular accounts, the falling price of the BCI Deb, the continued purchases of the BCI Deb, the purchases of the BCI Deb for brand new accounts and in sizable amounts and the purchases of the BCI Deb made at levels close to but just below those requiring management approval. As well as being “red flags” regarding the conduct of Gareau, many of these were “red flags” with respect to the security itself. Graham had many occasions to revisit that first decision and he chose not to. In short, the Hearing Panel found there were aggravating factors that placed this matter well above the minimum fine level.

Graham’s initial error caused the Hearing Panel concern. While Graham was negligent and not deceitful, the Hearing Panel questioned his initial judgment. While Graham said that he really did not know what the BCI Deb was, it was abundantly clear that he knew what it was not – he knew that it was not a debenture of BCE and that BCE and BCI were separate companies and he took no steps to further research the issue, despite Gareau having come to him for advice on the issue.

The Hearing Panel did not feel that a suspension of Graham’s Branch Manager’s registration was warranted in this case. Had there been a hint that this was done for personal gain, they would have found otherwise. While the Hearing Panel found there was some validity in the point of view that a suspension should be considered for general deterrence purposes, they nevertheless believed that on balance, a suspension should not be imposed only to address matters of general deterrence, particularly in a matter related to supervision where no personal gain or deceit was involved.

Count 2 Not Made Out

The account of KM was opened in 1997 at which time he was 56. Gareau was not responsible for this account at the time. At that time, KM’s risk tolerance was noted as 100% speculative. In 2001, after KM turned 60, the NCAF was updated by Gareau who was now the RR for the account. The risk tolerance was recorded as 50% speculative. Graham agreed that in hindsight, 50% speculative was high for a person that was 60 years old and that he made no inquires in this regard. Graham’s counsel argued that Graham acknowledged that 50% speculative was high but he did not acknowledge that it was high for this client. The Hearing Panel agreed with Graham’s counsel on this point, and accordingly dismissed the allegation.

Graham continues to be employed as a Branch Manager with Credential.

Kenneth A. Nason
Association Secretary