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COR#03/066

Decision

Patrick Yao

Section 165 of the *Securities Act*, RSBC 1996, c. 418

Hearing and Review

Panel	Joyce C. Maykut, Q.C. Robert J. Milbourne	Vice Chair Commissioner
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Date of Hearing March 24, 2003

Date of Decision April 10, 2003

Appearing

Patrick Yao For himself

Sean K. Boyle For Commission staff

Introduction

- ¶ 1 This is a hearing and review of the November 20, 2002 decision of the Director of Capital Markets Regulation, refusing Patrick Yao's application for registration as compliance officer of Aspen Futures & Options Inc.

Background

- ¶ 2 Aspen has been registered as an exchange contract dealer under the Act since March 19, 2002. Aspen's business office is in Vancouver, British Columbia. Yao is a principal, managing director and a registered representative of Aspen.
- ¶ 3 Yao has been registered under the Act to sell exchange contracts almost continuously since 1992. Yao received a Bachelor of Arts in 1974 from the University of Toronto and a Bachelor of Commerce (Honours Business Administration) in 1975 from the University of Windsor. In 1982 Yao became registered with the US Commodity Futures Trading Commission and in 1985 he became a registered commodity representative of the Chicago Board of Trade while with Shearson Lehman Brothers Inc.'s Hong Kong office. In 1997, Yao successfully completed the Ethics Course for Futures Professionals under the rules and regulations of the US Commodity Futures Trading Commission, the National

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Futures Association and commodity exchanges. In 2001, Yao successfully completed the Canadian commodity supervisor's exam.

- ¶ 4 Commission staff acknowledge that Yao has the experience and educational courses required by the Act to be recognized as a compliance officer of an exchange contracts dealer.
- ¶ 5 Despite Yao's experience and education, staff say that Yao is not suitable to be registered as Aspen's compliance officer. Relying on staff's recommendation, the Director of Capital Markets Regulation refused Yao's application for the following reasons:
1. While at FSG International Futures, Inc., Yao did not exercise the level of care and diligence expected of a compliance officer.
 2. Staff's compliance examination of Aspen identified a number of deficiencies in its compliance system. As Aspen's managing director and temporary compliance officer, Yao failed to implement adequate procedures for review of trades and supervision of representatives.

Yao's conduct at FSG

- ¶ 6 FSG was registered with the Alberta Securities Commission and had an office in Vancouver, British Columbia. Yao was registered as FSG's trading partner, director and officer. FSG's registration with the ASC expired in June 2001. The ASC extended FSG's registration until September 30, 2001, subject to it becoming an IDA member. FSG failed to become a member of the IDA so the ASC suspended FSG's registration on September 30, 2001.
- ¶ 7 On October 1, 2001, the ASC sent a fax to FSG's Vancouver office addressed to Carlos Mormeneo, a non-trading director of FSG, stating that FSG's registration was suspended as of September 30, 2001. On October 10, 2001, the ASC sent another letter to FSG's Vancouver office confirming that FSG's registration was suspended as of September 30, 2001. Yao became FSG's compliance officer on October 1 and continued in that position until November 9, 2001. Yao said that he took on the compliance officer function because FSG did not have anyone else who was qualified to do it. He said that no one, including Mormeneo, the corporate lawyer or the previous compliance officer told him of FSG's registration problems with the ASC.
- ¶ 8 Yao said that he did not see the ASC's October 1 letter, but acknowledged seeing the October 10, 2001 letter. He said that he did not pay particular attention to it because it was not addressed to him. However another FSG broker read the October 10, 2001 letter and telephoned the ASC to find out the status of FSG's registration in Alberta. The broker was told that FSG's registration had been

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suspended on September 30, 2001. The broker taped his conversation with the ASC and played it for others in the office including Yao.

- ¶ 9 Yao then did two things, which staff acknowledge. He contacted Mormeneo and FSG's corporate lawyer for advice. Yao said they told him that since the ASC terminated FSG's registration in June, the ASC had been renewing it on a month-to-month basis and they expected that to continue. According to Yao, the lawyer said he would take care of it and get back to Yao immediately. Mormeneo agreed that FSG's lawyer, who practiced in Alberta, should deal with the ASC. Mormeneo told Yao to continue business as usual but not to initiate client contact. Yao passed this advice along to FSG representatives in the Vancouver office. As a consequence, they continued to liquidate client positions until October 18, 2001.
- ¶ 10 Yao said FSG's corporate lawyer finally called him back on October 18, 2001 and told Yao that the ASC reinstated FSG's registration for two weeks to permit it to wind down the company and liquidate client positions. FSG's registration in BC was extended to November 9, 2001 to allow it to liquidate client positions in its Vancouver office.
- ¶ 11 Commission staff argue that Yao is unsuitable to be a compliance officer because he continued to trade between September 30 and October 18, 2001 when he knew, or ought to have known, FSG's registration was suspended.
- ¶ 12 Yao disagrees. He argues that it was reasonable for him to assume from discussions with Mormeneo and FSG's corporate lawyer that FSG's registration problems with the ASC were being taken care of by FSG's corporate lawyer. Yao also says that while they were waiting for FSG's lawyer to get back to them about his discussions with the ASC, it was reasonable and in the clients' interests for FSG to liquidate existing client positions. In the end, that is what the ASC and BC staff agreed should occur after October 18, 2001 and it proceeded in an orderly fashion in the Vancouver office under Yao's direction.

Yao's conduct as temporary compliance officer at Aspen

- ¶ 13 Aspen's registration was approved subject to a compliance examination within six months and subject to Aspen having a compliance officer other than Yao. Hugh Der was hired as Aspen's compliance officer. On September 1, 2002, Der resigned.
- ¶ 14 On September 6, 2002, staff sent Yao a fax stating that Aspen had to find a replacement for Der immediately and in "[i]n the meantime, as the remaining trading partner/director/officer, [Yao] must ensure that someone performs the compliance officer's duties on a day-to-day basis. We expect that, when our examiners audit Aspen, they will find evidence that Aspen's compliance system

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continue to operate uninterrupted following Mr. Der's departure.” The Executive Director then permitted Yao to act as a temporary compliance officer until Aspen found another compliance officer.

- ¶ 15 On October 8, 2002, staff notified Yao that they completed the compliance examination of Aspen. Their report, which was sent to Aspen, identified a number of deficiencies, including insufficient information on client files and inadequate procedures for review of trades and supervision of representatives. Staff requested Aspen to take immediate corrective action to resolve the deficiencies. Staff required Aspen to provide a response by November 7, 2002, outlining how, and when, Aspen intended to resolve the deficiencies. Yao agreed to implement the recommended changes immediately.
- ¶ 16 On October 31, 2002, Yao applied to change his status to compliance officer. On November 20, 2002, the Director of Capital Markets Regulation denied Yao’s application. However, the Director told Yao that if, in 18 months, Aspen’s compliance system had improved and there were no other concerns with Aspen or Yao, he, the Director, would be willing to reconsider Yao's application. On November 26, 2002, the Director approved Wei Pang as Aspen’s compliance officer.
- ¶ 17 Despite agreeing to implement staff’s recommended changes to Aspen’s compliance system, staff felt that Yao did not understand his obligations as a compliance officer or why the changes were necessary. In particular, staff were concerned that when Yao was acting as Aspen’s temporary compliance officer, he made no changes to its compliance system. Staff believe that a new firm like Aspen, with few established procedures, needs a compliance officer who has a sound grasp of the legislation and the duties of a compliance officer. Staff say Yao’s conduct demonstrates that he does not fit the bill.
- ¶ 18 Yao argues that staff’s position is unjustified. He states that he has been in the futures industry in Hong Kong, the United States and Canada for over 18 years without any problems or complaints.
- ¶ 19 Yao has been acting as Aspen’s compliance officer since September 2002. Under his direction, Aspen agreed to rectify immediately the deficiencies raised in the compliance examination. This resulted in Aspen receiving an overall risk rating of three on a scale of one to five (five being the highest risk and one the lowest) with a follow up to be conducted within eight months.
- ¶ 20 Yao says that staff’s argument that he failed to implement adequate compliance procedures at Aspen while he was acting as temporary compliance officer flies in the face of staff’s direction to him to ensure that “Aspen's compliance system

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continue to operate uninterrupted following Mr. Der's departure". Yao says he understood "uninterrupted" to mean that he should not make any changes until staff had completed their compliance examination. He says to punish him for staff's unclear direction in their letter would be unreasonable and unfair.

- ¶ 21 Yao also argued that although the Executive Director approved Wei Pang as Aspen's new compliance officer, Pang has considerably less experience than Yao and has even less experience than the previous compliance officer, Hugh Der. Wang had been in the industry less than five years when the Executive Director approved his registration as compliance officer. Furthermore Pang has yet to write the Canadian commodity supervisors examination, which Yao has written and has successfully passed. Because of his experience, Yao has ended up teaching Der and Wang how to discharge Aspen's compliance function.
- ¶ 22 With staff's agreement, Yao acted as Aspen's compliance officer from September 2002 until Pang's registration in November 2002. Yao says he wants Aspen to have two compliance officers, him and Pang, so they can cover for each other if either is away. Furthermore, should Pang leave, Yao does not want Aspen to be limbo again with the Executive Director because it does not have a compliance officer.
- ¶ 23 In summary, Yao argues that there is no reasonable foundation for staff's assertion that he is not suitable to be Aspen's compliance officer.

Issue

- ¶ 24 Is Yao suitable to be registered as Aspen's compliance officer?

Analysis and decision

- ¶ 25 This is a hearing and review under section 165(4) of the Act of the decision of the Director of Capital Markets Regulation under delegated authority of the Executive Director.
- ¶ 26 Section 165(4) of the Act provides that on a hearing and review, the Commission may confirm or vary the decision under review or make another decision it considers proper.
- ¶ 27 The Director's decision was made under section 35 of the *Act*, which states:

35 (1) Subject to subsection (2), the executive director must grant an applicant registration, renewal or reinstatement of registration or an amendment to registration, as the case may be, unless

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(a) the executive director considers that the applicant is not suitable for registration in the capacity applied for, or that the proposed registration is objectionable, or

...

- ¶ 28 Commission staff concede that Yao meets the proficiency requirements as a compliance officer for an exchange contract dealer as described in section 9.5 of *BC Policy 31-601 Registration Requirements*.
- ¶ 29 Therefore the only question is whether Yao's conduct as compliance officer at FSG and temporary compliance officer at Aspen demonstrates that he is not suitable for this category of registration.
- ¶ 30 In our view it does not. In coming to our conclusion we find that Yao's explanation for his conduct at FSG, while not entirely satisfactory, was understandable in the circumstances. We also find that his explanation for not making changes to Aspen's compliance system until staff's examination was complete was reasonable in light of staff's September 6, 2002 fax.
- ¶ 31 As a result we find that Yao's conduct does not demonstrate that he is unsuitable to be Aspen's compliance officer.
- ¶ 32 We have also taken into account the fact that Pang is registered as a compliance officer with Aspen and that staff will be conducting a follow up examination of Aspen's compliance function within eight months of its earlier examination. If serious deficiencies are revealed, it is open to the Executive Director to re-examine the issue of Aspen's and its compliance officers' registration.
- ¶ 33 This is a review under section 165 of the Act of the decision of the Director of Capital Markets Regulation under delegated authority of the Executive Director.
- ¶ 34 Accordingly, under section 165(4) of the Act we direct the Executive Director to register Yao as compliance officer of Aspen Futures & Options Inc.
- ¶ 35 April 10, 2003
- ¶ 36 **For the Commission**

Joyce C. Maykut, Q.C.

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Vice Chair

Robert J. Milbourne
Commissioner