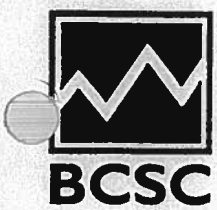

British Columbia Securities Commission

COR#00/165

IN THE MATTER OF THE SECURITIES ACT, R.S.B.C. 1996, c. 418

AND

IN THE MATTER OF JEAN-CLAUDE HAUCHECORNE

HEARING

PANEL
Brent W. Aitken, Member
Joan L. Brockman, Member
John K. Graf, Member

DATE OF HEARING
July 24, 2000

DATE OF DECISION
August 1, 2000

APPEARING FOR COMMISSION STAFF
Patricia A. A. Taylor
Lorne Herlin

APPEARING FOR A COMMITTEE OF INDUSTRY PARTICIPANTS
Catharine M. Esson

DECISION

This is a hearing under section 161(1) of the *Securities Act*, R.S.B.C. 1996, c. 418 pursuant to a notice of hearing dated February 3, 2000. Commission staff is seeking orders in the public interest that Jean-Claude Hauchecorne:

(a) be denied the use of the exemptions under the Act,
(b) be prohibited from acting as a director or officer of any issuer,
(c) be prohibited from engaging in investor relations activities,
(d) pay an administrative penalty, and
(e) pay the costs of the hearing.

BACKGROUND

This matter relates to Hauchecorne's conduct while employed in 1995 and 1996 by Yorkton Securities Ltd. and Pacific International Securities Inc., both members of the Vancouver Stock Exchange (now merged with the Alberta Stock Exchange to form the Canadian Venture Exchange).

The notice of hearing alleges that Hauchecorne contravened section 43 of the *Securities Regulation*, B.C. Reg. 270/86 (now section 48 of the *Securities Rules*, B.C. Reg. 194/97) and the related Exchange Rules F.1.01 and F.1.04. These provisions are commonly known as the "Know Your Client" rule.

The notice of hearing also alleges that Hauchecorne contravened Exchange Rule F.1.02 by executing trades on the instructions of persons not authorized to trade in the accounts in which the trades were made and that Hauchecorne contravened Exchange By-law 5.01(2), which prohibits conduct "unbecoming or inconsistent with just and equitable principles of trade or detrimental to the interests of the Exchange or the public".

Hauchecorne was given notice of this hearing in accordance with section 180 of the Act but was not present in person or represented by counsel.

Previous Proceedings

In July 1998 the Exchange issued a citation against Hauchecorne alleging 25 infractions of Rules F.1.01, F.1.02, and F.1.04 and By-law 5.01(2). The allegations were that Hauchecorne had:

- breached the Know Your Client rule by accepting orders to trade from individuals that he knew or ought to have known had histories of securities violations and associations with organized crime and by failing to identify the beneficial owners of the accounts in issue;
- traded the accounts on the directions of persons not properly authorized to give instructions;

- improperly disclosed confidential information about the accounts; and
- assisted in the unauthorized transfer of funds from the accounts.

The Exchange held a hearing in August and September 1998 at which Hauchecorne appeared and was represented by counsel. In February 1999 on the issue of liability the Exchange found against Hauchecorne on all but four of the alleged infractions. The four allegations dismissed by the Exchange were those alleging that Hauchecorne contravened Rule F.1.04 and By-law 5.01(2) by failing to identify the beneficial owners of four accounts opened in the names of two offshore corporations, one incorporated in the British Virgin Islands and one incorporated in the Bahamas.

In June 1999 on the issue of penalty the Exchange fined Hauchecorne $200,000, ordered him to disgorge commissions in the amount of $95,000 and permanently withdrew its approval of Hauchecorne as a registrant. Hauchecorne was also ordered to pay the costs of the Exchange hearing.

Both Hauchecorne and the Executive Director applied for a hearing and review of the Exchange decisions. Hauchecorne applied to have the liability decision set aside or alternatively to have the penalty reduced. The Executive Director applied to have the Exchange's dismissal of the four allegations reversed.

In December 1999[1] the Commission dismissed Hauchecorne's application and confirmed the Exchange's decisions, other than its decision to dismiss the four allegations. As to those allegations, the Commission granted the Executive Director's application by finding Hauchecorne liable for failing to identify the beneficial owners of the accounts in the names of the offshore corporations.

The evidence in support of the allegations contained in the notice of hearing consisted of the Exchange decisions and the decision of the Commission on the hearing and review. The following summary is based on the facts as found in those decisions.

Hauchecorne's Conduct

In about 1987 Hauchecorne met Eric Wynn, a resident of the United States. Wynn helped Hauchecorne find market makers in the United States and provided him with information on NASDAQ stocks. Over time, Hauchecorne and Wynn became close friends. In 1988 Wynn was charged in the U.S. with conspiracy, intent to transfer stolen money and tax evasion and was indicted for defrauding investors. In 1989 he was sentenced to jail for three years. The Exchange found that various publications between 1989 and 1993 contained allegations that Wynn was involved in market manipulation,

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[1] *In the Matter of Jean-Claude Hauchecorne*, [1999] 51 BCSC Weekly Summary 69.

broker intimidation and organized crime. In 1995 Wynn was convicted in New Jersey for conspiracy, securities fraud and wire fraud and sentenced to 52 months in jail. Hauchecorne knew Wynn was imprisoned and frequently accepted Wynn's collect calls from jail.

Hauchecorne said he knew of Wynn's incarceration but that he thought it was for tax evasion and he "left it at that". Hauchecorne never made any inquiries about Wynn's background or reputation.

Hauchecorne said Wynn was not a client but the Exchange found his staff took trading instructions from Wynn. Hauchecorne misrepresented Wynn's identity to his staff by referring to Wynn as "George". Hauchecorne represented to his staff that "George" was his brother.

In 1994 Wynn introduced Hauchecorne to Philip Gurian, also a U. S. resident. Gurian told Hauchecorne that he was interested in short selling stocks through a Canadian broker because the rules were less stringent in Canada than in the U.S. Gurian asked Hauchecorne to open eight accounts in the names of four clients, including the two offshore corporations referred to above. We refer to the eight accounts as the Gurian accounts, although Gurian was not formally authorized to trade in them. It is Hauchecorne's handling of the Gurian accounts that is in issue.

Shortly after opening the Gurian accounts Hauchecorne's employer informed him that Gurian may have been involved in a short selling scheme that resulted in the bankruptcy of two U.S. brokerage firms. Hauchecorne was also aware that Gurian was involved in substantial litigation with another Vancouver-based dealer.

Nevertheless, Hauchecorne made no inquiries as to Gurian's background or reputation. Gurian had been subject to sanctions by U.S. securities regulators and the Exchange found he was connected to organized crime in the United States.

Hauchecorne took most if not all of his trading instructions in the Gurian accounts from Gurian and, to a lesser extent, Wynn. Neither was authorized to trade in the accounts.

Hauchecorne said that by early 1996 he had heard that Gurian was involved with the intimidation of certain brokers in New York and was perhaps connected to organized crime. He said he wanted to close the Gurian accounts and asked Wynn to help. However, the Exchange found that Hauchecorne's conduct was inconsistent with a desire to close the accounts because he continued to accept and carry out Gurian's instructions. The Exchange also noted that if Hauchecorne was serious about closing the Gurian accounts, he could easily have reported the matter to his employer and had it take the necessary steps.

In April 1996 Hauchecorne participated in a scheme arranged by Wynn whereby $1.7 million was improperly transferred from one of the Gurian accounts to Hans-Joerg Schneeberger, a Swiss national in Hong Kong. Hauchecorne provided Schneeberger with confidential information about the account, including the account name and the balance in the account. This information was used to forge faxed instructions to transfer funds. Hauchecorne accepted and acted on the faxed instructions without verification, which the Exchange found "to say the least, extremely careless".

In May 1996 Hauchecorne traveled to New York, where he was physically threatened by associates of Gurian over the money removed from the account. In a later settlement, Schneeberger returned $1.6 million to the account. Schneeberger was prosecuted and acquitted in Hong Kong for theft of the money. The Hong Kong judge described the dealings as a "classic laundering scheme".

The Interveners

Four of the allegations in the Exchange citation alleged that Hauchecorne failed to "establish the identity of the beneficial owner" of the accounts of the offshore corporations, contrary to Rule F.1.04 and By-law 5.01(2). The Exchange dismissed these allegations, saying:

"It is our view that Rule F.104 [*sic*] does not specifically preclude the use of offshore companies when the beneficial owner is protected by secrecy legislation as is the case here and there are circumstances when such accounts are appropriate and thus failing to learn the name of the beneficial owner is not contrary to Bylaw [*sic*] 5.01(2)."

On the hearing and review, the Commission reversed this portion of the Exchange decision. The Commission reviewed the Know Your Client rule and its importance. The Commission then said:

"Whatever the reasons for the hearing panel's conclusions, we are of the view that they are not tenable given the broader regulatory framework described above. The 'know your client rule' requires the broker to learn the identity of the client and the discussion in the handbook makes clear that the broker must look behind any corporate veil to determine who has a financial interest in the account. As the Handbook says, one of the purposes of gathering this information is to 'judge the risk involved in accepting the account.' The events of this case demonstrate very clearly the risks that can be encountered by a broker and his firm when the broker fails to learn the identity of his client."

This aspect of the Commission's decision created some consternation among investment dealers and in April 2000 a committee of nine investment dealers styling themselves the Committee of Industry Participants successfully applied for standing in this hearing.[2]

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[2] *In the Matter of Jean-Claude Hauchecorne*, [2000] 17 BCSC Weekly Summary 12.

The dealers are: Canaccord Capital Corporation, Goepel McDermid Inc., Georgia Pacific Securities Corporation, Global Securities Corporation, Haywood Securities Inc., Pacific International Securities Inc., Union Securities Ltd., Wolverton Securities Ltd., and Yorkton Securities Ltd. All are members of both CDNX and the Toronto Stock Exchange. Several are also engaged in the securities business in jurisdictions outside British Columbia.

The concern of the Committee members is that the Commission's statement in the hearing and review decision has created uncertainty among registrants because it appears to be a statement of general principle that would have the effect of substantially altering the application of the Know Your Client rule to corporate accounts, compared to current industry practice.

The Committee is also preparing submissions on the subject of the application of the Know Your Client rule to corporate accounts for the consideration of the Commission and the Investment Dealers Association (IDA). The IDA is in the process of developing its position on the issue. The IDA intends to use established processes within the IDA to facilitate consultation among industry participants and regulators with a view to formulating a national consensus on the appropriate approach to the issue.

The Committee's concerns are that:

- the Commission's statement quoted above appears to be a statement of general principle not restricted to the particular facts of the case;
- the allegations contained in the notice of hearing in this matter raise the same issue addressed by the Commission in its decision on the hearing and review; and
- therefore the Commission, in the course of its findings and decision in this matter may effectively establish a standard of conduct relating to that issue.

ISSUES AND FINDINGS

Know Your Client

Commission staff alleges that Hauchecorne "failed to make the necessary inquiries and perform the required due diligence to learn the essential facts relative to the clients, contrary to section 43 of the Regulation". In particular, staff alleges that Hauchecorne failed to use due diligence to learn the essential facts relative to the Gurian accounts, contrary to Rule F.1.01 and By-law 5.01(2), and that he failed to make any inquiry as to the identity and financial reputation of the beneficial owners and the directors of the offshore corporations, contrary to Rule F.1.04 and By-Law 5.01(2).

The Exchange found that Hauchecorne failed to make proper inquiry as to the reputation of Gurian and Wynn, contrary to Rule F.1.01 and By-law 5.01(2). These findings were confirmed by the Commission on the hearing and review. We adopt those findings for the purposes of this decision.

The Exchange dismissed the findings with respect to the allegation that Hauchecorne failed to "establish the identity of the beneficial owner" of the accounts of the offshore corporations, contrary to Rule F.1.04 and By-law 5.01(2). The Commission on the hearing and review reversed that decision and found that Hauchecorne committed those infractions as alleged in the Exchange citation. We adopt this finding of the Commission for the purposes of this decision.

Section 43 of the Regulation read as follows:

"43. (1) . . . every dealer, investment counsel and portfolio manager shall make enquiries concerning each client

(a) to establish the identity and, where applicable, creditworthiness of the client and the reputation of the client if information known to the dealer, investment counsel or portfolio manager causes doubt as to whether the client is of good reputation . . . ."

In light of the findings we have adopted, we also find that Hauchecorne contravened section 43 of the Regulation.

Trading Without Proper Authority

Commission staff alleges that Hauchecorne executed trades on the instructions of persons not authorized to trade in the Gurian accounts, contrary to Rule F.1.02. The Exchange found the identical allegation in the Exchange citation to be true. This finding was confirmed by the Commission on the hearing and review. We adopt those findings for the purposes of this decision.

Participation in Improper Transactions

Commission staff alleges that Hauchecorne acted contrary to By-law 5.01(2) in connection with his participation in the transfer of the $1.7 million from one of the Gurian accounts to Schneeberger. The Exchange found the identical allegation in the Exchange citation to be true. This finding was confirmed by the Commission on the hearing and review. We adopt those findings for the purposes of this decision.

Concerns of the Committee

The Committee argues that this decision ought not establish a standard of conduct that represents a significant change to the procedures for opening corporate accounts. In particular, the Committee believes that the standard it perceives the Commission adopted in the hearing and review decision is not an appropriate one. The Committee argues that treating corporate accounts as nominee accounts or requiring corporate clients in all cases to disclose their beneficial shareholders:

- would be impractical and would not advance the interests of the client, the dealer or British Columbia's capital markets,
- could significantly affect the credibility and accessibility of our capital markets to international investors, and
- could impose a substantial and unwarranted barrier to legitimate international investors participating in our capital markets in the future.

At its application for standing, the Committee argued that its members have a tangible interest in standards that the Commission may find applied in the past or are to be applied in the future because:

- with respect to past conduct, the imposition of a standard that differs from actual industry practice may expose them to legal risks, both civil and regulatory, and
- with respect to future conduct, they would be adversely affected by a standard that was unrealistic, too vague to allow proper compliance, or that discouraged legitimate investors from participating in our capital markets.

In granting standing to the Committee, we said:

"This application arises primarily because the Commission, in dealing with the matter before it on the hearing and review, appeared to the members of the Committee to establish a principle of general application with respect to the opening of corporate accounts. It should be borne in mind by those reading Commission decisions that the primary purpose of its decisions with respect to the allegations in a notice of hearing or with respect to the conduct of a registrant on a hearing and review is to reach a determination on the facts before it. In interpreting the Commission's interpretations and observations on the applicable regulatory provisions, the reader must also consider the facts of the case before the Commission at the time."

We have adopted the finding of the Commission on the hearing and review that Hauchecorne contravened Rule F.1.04 and By-law 5.01(2) by failing to make proper inquiry about the offshore corporations.

The Committee made various technical arguments regarding the interpretation and effect of Rule F.1.04. These arguments have some merit. However, the Commission did not confine its finding on that issue to the narrow language of Rule F.1.04. Rather, it considered the requirements of Rule F.1.04 in the context of what was expected of Hauchecorne under the Know Your Client rule as embodied in section 48 of the Rules (formerly section 43 of the Regulation), Rule F.1.04 and the Conduct and Practices Handbook for Securities Industry Professionals. In that context, the Commission concluded that Hauchecorne ought to have made inquiries with respect to the offshore corporations. Given what the Exchange found Hauchecorne ought to have known about Gurian and Wynn, the Commission could hardly have concluded otherwise.

The Commission's purpose on the hearing and review was to assess the Exchange's decisions in light of the evidence before it. In this decision, it is our purpose to assess Hauchecorne's conduct as found by the Exchange and the Commission in the previous decisions and to determine what, if any, orders ought to be made in the public interest in light of that conduct.

Neither of the Commission hearings was for the purpose of establishing general standards for registrants when opening corporate accounts. This is particularly so given that the industry is now undertaking a consultation involving registrants and regulators on a national basis. It is far preferable that the ultimate policy determination flow out of that process, which will afford all interested parties the opportunity to participate in a full debate on the issue.

DECISION

In its penalty decision, the Exchange said that Hauchecorne's contraventions of the Exchange Rules and By-laws were deliberate. The Exchange also noted that Hauchecorne was deceitful by denying that he executed trades on Wynn's instructions when the evidence showed otherwise, by misrepresenting Wynn's identity and by participating in what the Hong Kong judge referred to as a "classic laundering scheme".

The Exchange concluded that:

"It is clear to us that this is not a case of negligence or bad judgement but rather a case of a willing participant in questionable activity entered into for the purpose of earning rich commissions. The Rules and Bylaws [*sic*] were deliberately ignored . . . ."

The following factors are relevant to our consideration of the orders we ought to make in this matter in the public interest:

- Hauchecorne's conduct was dishonest;
- his conduct represented an utter failure to meet his responsibility as a "gatekeeper" for the market;
- his conduct damaged the integrity of the capital markets of British Columbia; and
- he was an experienced broker yet failed to discharge his responsibilities under the Know Your Client rule, one of the most fundamental and important obligations of a registrant.

The Know Your Client rule is described in the Conduct and Practices Handbook as the "Cardinal Rule". Compliance by registrants with both the letter and the spirit of the rule is essential to their responsibility to act in the best interests of their clients and to uphold the integrity of the market. Hauchecorne has been found to have deliberately ignored this fundamental principle.

Accordingly, considering it to be in the public interest, we order:

1. under section 161(1)(c) of the Act, that the exemptions contained in sections 44 to 47, 74, 75, 98 and 99 of the Act do not apply to Hauchecorne for 20 years from the date of this decision;

2. under section 161(1)(d) of the Act, that Hauchecorne resign any position he holds as a director or officer of any issuer;

3. under section 161(1)(d) of the Act, that Hauchecorne is prohibited from acting as a director or officer of any issuer and is prohibited from engaging in investor relations activities, both for 20 years from the date of this decision; and

4. under section 174 of the Act, that Hauchecorne pay the costs of or related to the hearing.

It would have been appropriate to make an order that Hauchecorne pay an administrative penalty under section 162 for his contravention of section 43 of the Regulation. However, the Exchange fined Hauchecorne $200,000 and ordered him to disgorge commissions totalling $95,000. In these circumstances we make no order under section 162.

Dated August 1, 2000.

FOR THE COMMISSION

Brent W. Aitken, Member

Joan L. Brockman, Member

John K. Graf, Member