Chapter 3

Reasons: Decisions, Orders and Rulings

3.1 OSC Decisions, Orders and Rulings

3.1.1 optionsXpress, Inc.

ALBERTA SECURITIES COMMISSION (ASC)
MANITOBA SECURITIES COMMISSION (MSC)
ONTARIO SECURITIES COMMISSION (OSC)
BUREAU DE DÉCISION ET DE REVISION EN VALEURS MOBILIÈRES (BDVM)
NEW BRUNSWICK SECURITIES COMMISSION (NBSC)
NOVA SCOTIA SECURITIES COMMISSION (NSSC)

JOINT HEARING

IN THE MATTER OF
OPTIONSXPRESS, INC.

ALBERTA SECURITIES ACT, R.S.A. 2000, C. S-4, S.198
MANITOBA SECURITIES COMMISSION ACT, C.C.S.M. C. S50, S.148
ONTARIO SECURITIES ACT, R.S.O. 1990, C.S.5, AS AMENDED, S.127
QUÉBEC SECURITIES ACT, L.R.Q., C. V-1.1, S.269.2
NEW BRUNSWICK SECURITIES ACT, S.N.B. 2004, C. S-5.5, S.184
NOVA SCOTIA SECURITIES ACT, R.S.N.S. 1989, C.481, AS AMENDED, S.134

Hearing:	**Wednesday, August 31, 2005**		
Panels:			
In Ontario:	**Paul M. Moore, Q.C.**	**-**	**Vice Chair (Coordinating Chair of the hearing)**
	Robert Davis	**-**	**Commissioner**
	David Knight	**-**	**Commissioner**
In Alberta:	**Glenda A. Campbell, Q.C.**	**-**	**Vice Chair (Chair of Alberta Panel)**
	David Betts	**-**	**Commissioner**
In Manitoba:	**Lynne McCarthy**	**-**	**Commissioner (Chair of Manitoba Panel)**
	Bob McEwan	**-**	**Commissioner**
In Quebec:	**Jean-Pierre Major**	**-**	**Member (Chair of Quebec Panel)**
	Alain Gélinas	**-**	**Member**
	Marc Rosenstein	**-**	**Member**
In New Brunswick:	**Donne Smith**	**-**	**Chair (Chair of New Brunswick Panel)**
	David Hashey, Q.C.	**-**	**Commissioner**
In Nova Scotia:	**Les O'Brien, Q.C.**	**-**	**Chair (Chair of Nova Scotia Panel)**
	Daren Baxter	**-**	**Vice Chair**
Appearances:			
In Ontario:	**Gregory MacKenzie**	**-**	**For the OSC Staff**
	Martha Rafuse		

	Peter Dunne **Christine Vogelsang**	**-**	**For optionsXpress, Inc.**
In Alberta:	**Terry Hutcheon**	**-**	**For the ASC Staff**
In Manitoba:	**Kimberly Laycock**	**-**	**For the MSC Staff**
In Quebec:	**Richard Proulx**	**-**	**For the AMF Staff**
In New Brunswick:	**Suzanne Ball** **Jake van der Laan** **Lucie Mathurin-Ring**	**-**	**For the NBSC Staff**
In Nova Scotia:	**Scott Peacock**	**-**	**For the NSSC Staff**
Also Present in Ontario:	**Benjamin Morof**	**-**	**For optionsXpress**

DECISION AND REASONS

The following text has been prepared for purposes of publication in the Ontario Securities Commission Bulletin and is based on excerpts from the English version of the transcript of the hearing. The excerpts have been edited and supplemented and the text has been approved by the coordinating chair of the panel (Paul M. Moore) for the purpose of providing a public record of the decision.

A. Introduction

Vice-Chair Moore:

[1] This is a joint hearing of the Alberta Securities Commission, Manitoba Securities Commission, Ontario Securities Commission, the bureau de décision et de revision en valeurs mobilières in Quebec, the New Brunswick Securities Commission, and the Nova Scotia Securities Commission.

[2] Each jurisdiction has its own panel participating in the hearing, and each jurisdiction will issue its own order or ruling disposing of the matter before it in the joint hearing.

[3] Each panel is assembled in its own forum and is connected with the others through telephone- or video-conferencing facilities. Each panel has its own chair for this joint hearing, and I will be acting as chair of the Ontario panel and as coordinating chair for the joint hearing.

[4] The purpose of the hearing is to consider and, if appropriate, to approve a settlement agreement among optionsXpress, Inc., optionsXpress Canada Corp., the autorité des marchés financiers of Quebec and staff of the British Columbia Securities Commission, the Alberta Securities Commission, the Saskatchewan Securities Commission, the Manitoba Securities Commission, the Ontario Securities Commission, the New Brunswick Securities Commission, the Nova Scotia Securities Commission, the Prince Edward Island Securities Commission, and the Securities Commission of Newfoundland and Labrador.

[5] I'm going to now call upon the Ontario staff to introduce this matter and make its submission. I will then give an opportunity for staff of the other jurisdictions to make any submissions if they desire.

[6] When that is concluded, I will give an opportunity to the panel members across the country to ask any questions. We'll do it geographically, beginning with Alberta. And after that, I will ask the respondents or the respondents' counsel if they wish to say anything, and then each of the jurisdictions can ask questions of respondents' counsel if so desired.

[7] Then we will adjourn to allow each panel to confer separately. After about ten minutes, if that proves sufficient, the jurisdictions will get together by calling in to the Ontario Securities Commission. We will be in our boardroom, and we will have a joint conference of all the panels to see if we can come up with a unanimous decision.

[8] We will then reconvene, and if all the jurisdictions agree on the matter, I will then announce the decision and give brief reasons, and if any jurisdiction hasn't agreed, they will speak at that time.

[9] I will also give all the panelists across the country an opportunity to concur or add anything. At the end of the matter, when we have concluded, we will terminate the hearing. If the settlement agreement is approved, Ontario, as the principal jurisdiction under the mutual reliance relief system, will then consider an application to grant an exemption to optionsXpress.

. . .

Mr. MacKenzie:

[10] This is quite an extraordinary process. We are at the final stage of the approval process, but much has occurred up to now. There are actually ten jurisdictions involved, and this will be obvious from a review of the settlement agreement, but perhaps I could just update things.

[11] Since the settlement agreement was executed beginning on August 17th, we've had four jurisdictions approve the settlement agreement already. BC has approved the settlement agreement by way of an executive director order. Saskatchewan, Newfoundland and Labrador, and PEI each has approved the settlement agreement by way of no action letter.

[12] The six remaining jurisdictions are convening today. So we hope today to complete the approval process and to obtain approval.

[13] Approving the settlement agreement would be a great demonstration of the capacity of Canadian securities regulators to cooperate and coordinate on matters of common interest.

[14] I do wish just to point out, though, Mr. Chair, that the way that the settlement agreement is set up, it is of an all-or-nothing nature. If all jurisdictions are not able to approve it, then the settlement agreement is of no force and effect, essentially, and we will have to go back to the drawing board.

. . .

B. Decision

Vice Chair Moore:

[15] We are now re-assembled. All of the panels have deliberated separately, and we have conferred together. We have all agreed separately that we will approve the settlement agreement as being in the public interest.

[16] The purpose of the hearing today was for the participating securities commissions and the bureau de décision et de revision et en valeurs mobilières in Quebec, to consider the settlement agreement dated August 11, 2005, among optionsXpress Inc., which I will refer to as Options, and its newly incorporated Canadian affiliate, which I will refer to as Options Canada, and the ten provincial securities authorities in Canada.

[17] This case involves trading of U.S. securities by Options on behalf of residents in ten Canadian jurisdictions. Options traded without registration, contrary to the applicable provincial securities legislation.

[18] Between early January 2001 and May 6, 2004, Options traded U.S. securities on behalf of 1,467 accounts in Canada and earned gross commissions in excess of $2million Canadian.

[19] Options has delivered to the Commission $550,000 Canadian, supposedly representing an estimate in very rough figures of profits on its behalf that were earned in the above-noted period.

[20] The panels of the various jurisdictions are not relying on the accuracy of the calculation of this figure. It doesn't cover profits that would have been earned subsequent to May 6, 2004.

[21] We do not consider the method of determining this payment to be a precedent for any future matters.

[22] We consider the payment to be a sufficiently significant sum in the circumstances of this case.

[23] This settlement payment will be divided among the ten jurisdictions based on the number of accounts per jurisdiction, as outlined in materials submitted to the commissions.

[24] Options Canada has undertaken to diligently seek membership with the Investment Dealers Association ("IDA") and to obtain from the Commission and the nine other provincial securities regulators registration in the category of investment dealer or equivalent. It is expected that Options Canada will obtain IDA membership and the required registration with all provincial securities regulators by December 31, 2005.

[25] Prior to the registration of Options Canada, Options and Options Canada have undertaken to provide information and to cooperate fully with the Commission and the other provincial securities regulators in a manner equivalent to that required of a registrant in the category of investment dealer or equivalent.

[26] The settlement agreement sets out agreed facts, and I would like to briefly refer to them.

[27] Options acknowledges that it is a corporation organized under the laws of Delaware and is registered as a broker/dealer with the United States Securities and Exchange Commission in each of the U.S. states.

[28] In late 2000, Options began operations as a web-based Internet securities firm from its principal office in Chicago, Illinois. In early 2001, Options started to trade U.S. securities on behalf of residents in the jurisdictions in Canada without being registered. Residents in the jurisdictions could log-on to the Options web site and open an Options account to execute on-line trades of securities listed or traded in the U.S.

[29] Securities legislation in each of the jurisdictions of Canada require a securities firm trading for residents of that jurisdiction to be registered as a dealer in the category of investment dealer or equivalent in that jurisdiction. Options was not registered and is not registered in any capacity in any of the jurisdictions.

[30] All Options accounts are self-directed, as Options employees do not offer advice or make recommendations regarding the purchase or sale of securities.

[31] Options has no offices or employees in the jurisdictions and does not advertise for or otherwise solicit customers in the jurisdictions.

[32] In May 2004, as a result of inquiries by the authorities in the various jurisdictions, Options stopped opening accounts for residents in the Canadian jurisdictions. Options has subsequently continued to preclude the opening of accounts by residents in the various jurisdictions, pending resolution of this matter, and has otherwise cooperated with the Canadian provincial securities authorities.

[33] Options represents that in 2001, as a startup Internet securities firm focused on its U.S. operations, Options had limited knowledge and experience regarding the regulatory requirements of the Canadian jurisdictions. According to representations from Options, Options erroneously believed, in good faith, that its non-solicitation of residents in the jurisdictions exempted Options from registration requirements in the jurisdictions.

[34] The staff of the various Canadian jurisdictions are not aware of any complaints by Options customers in the Canadian jurisdictions. Options represents that it has not received complaints from any Options customers in the Canadian jurisdictions.

[35] Finally, Options admits that it breached section 25 of the Ontario Act in Ontario by reason of the facts set out in part 2 of the settlement agreement, and similar sections in the securities legislation of the other Canadian jurisdictions.

Public Interest

[36] The mandate of the Commission is set out in the Ontario Act, and it is,

(1) to provide protection to investors from unfair, improper, or fraudulent practices, and

(2) to foster fair and efficient capital markets and confidence in capital markets.

[37] In pursuing the purposes of the Ontario Act, the Commission's mandate includes the "maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants." (See section 2.1(2)(3) of the Ontario Act.)

[38] Our jurisdiction is not punitive or remedial. It is preventative and prospective with respect to possible future harm. See: *Re Mithras Management Ltd.,* (1990), 13 O.S.C.B. 1600, and *Committee for the Equal Treatment of Asbestos Minority Shareholders* v. *Ontario (Securities Commission)* [2001] 2 S.C.R. 132.

[39] With respect to the appropriate sanctions, Options has admitted that it broke the law, but no investors have suffered because of the breach. No investment advice has been given, and no solicitation or advertising aimed at Canadians was made. Although access in Canada was through the Internet, Options had no physical presence in Canada.

[40] Nevertheless, as I stated, the law was broken. This may have been inadvertent, but it was not excusable.

[41] We note also that Options is subject to substantial regulation in the U.S. and has agreed to become regulated through registration in Canada.

[42] In *Belteco Holdings Inc. et al.,* (1998), 21 O.S.C.B. 7743 and in *M.C.J.C. Holdings and Michael Cowpland* (2002), O.S.C.B. 1133, the Commission enumerated a number of factors to consider when imposing sanctions on a respondent, which may be summarized as follows:

(a) the seriousness of the allegations proved,

(b) the respondent's experience in the marketplace,

(c) the level of a respondent's activities in the marketplace,

(d) whether or not there has been a recognition of the seriousness of the improprieties,

(e) the restraint of future conduct that is likely to be prejudicial to the public interest (with reference to past conduct),

(f) whether or not the sanctions imposed may serve to deter not only those involved in the case being considered, but any like-minded people from engaging in similar abuses of the capital markets,

(g) any mitigating factors,

(h) the size of any profit or loss avoided from the illegal conduct,

(i) the reputation and prestige of the respondent, and

(j) the remorse of the respondent.

[43] Not all of these factors need be applicable in every case, and there may be other factors not enumerated that are relevant. I will refer in a minute to the principal factors that we have relied on.

[44] Appropriate sanctions should be determined by taking into account the specific circumstances of each case. As stated in *Cowpland*,

> We have a duty to consider what is in the public interest. To do that, we have to take into account what sanctions are appropriate to protect the integrity of the marketplace . . .
>
> In doing this, we have to take into account circumstances that are appropriate to the particular respondents. This requires us to be satisfied that proposed sanctions are proportionately appropriate with respect to the circumstances facing the particular respondents. We should not just look at absolute values, for example, what has been paid voluntarily in other settlements or what has been found to be appropriate sanctions by way of cease-trade orders in other cases.

[45] The role of a Commission panel reviewing a settlement agreement is not to substitute the sanctions it would impose for what is proposed in the settlement agreement. Rather, the Commission should ensure that the agreed sanctions are within acceptable parameters. *Re Sohan Singh Koonar* (2002), 25 O.S.C.B. 2691, and *Re Pollitt* (2004), 27 O.S.C.B. 9643.

[46] The Commission has previously considered the issue of Internet-based trading for Canadian residents by foreign dealers. In June 2001, the Commission and certain other provincial securities regulators approved settlement agreements with three U.S. Internet-based securities firms that traded U.S. securities for Canadian residents without registration.

[47] Under those settlement agreements, the three U.S. securities firms, Ameritrade Inc., Datek Online Brokerage Services LLC, and TD Waterhouse Investor Services, Inc. were each required to pay $800,000 Canadian. *See: Re Ameritrade Inc.* (2001), 24 O.S.C.B. 3782, *Re TD Waterhouse Investor Services, Inc.* (2001), 24 O.S.C.B. 3787, and *Re Datek Online Brokerage Services LLC* (2001), 24 O.S.C.B. 3785.

[48] As I mentioned earlier, not all of the factors outlined in the cases are necessary to be taken into account when determining whether sanctions in a settlement agreement are appropriate or fall within acceptable parameters. In this particular case, we wish to note the following as being particularly relevant.

[49] First, the proposed sanctions signal to market participants, particularly those using the Internet to reach investors, the importance of the registration obligations for effective securities regulation by the Commission. The registration requirements

under the Ontario Act enable the Commission to protect investors and to maintain high standards of honest and responsible conduct by market participants. By circumventing the registration obligations, market participants frustrate the purposes of the Ontario Act and the mandate of the Commission.

[50] Secondly, Options' failure to seek registration resulted in part from its erroneous belief regarding its registration obligations with the Commission and other provincial securities regulators. Options believed in good faith, albeit erroneously, that registration in Ontario was unnecessary because Options traded only U.S. securities, had no offices or employees in Canada, and did not solicit clients in Canada.

[51] Thirdly, without putting any degree of comfort in the calculation of the figure of $550,000 Canadian, we note that on the basis of proportionality, it is roughly equivalent to the settlement payment of $800,000 Canadian which each respondent in *Ameritrade* paid, and it does take into account Options' relative inexperience as a start-up securities firm when it began trading in Canada.

[52] But as noted earlier in these reasons, we do not consider the particular formula or the amount and the methodology purportedly followed in arriving at $550,000 as a precedent for future cases.

[53] Fourthly, Options represented that it did not receive any complaints from its Canadian clients, and staff indicated that it is not aware of any such complaints.

[54] Fifthly, Options accepted responsibility for its misconduct and acknowledged the seriousness and importance of meeting its registration obligations. Options has been cooperative with all of the provincial securities regulators, and Options Canada is diligently seeking registration.

[55] Finally, the way this matter has been handled and this settlement agreement protect and minimize inconvenience to the existing clients of Options in the Canadian jurisdictions. This is important because our mandate is not only to protect future investors, but to minimize harm to existing investors.

Conclusion

[56] In conclusion, let me say that we are very pleased with the manner in which all parties have handled this matter. Having one settlement agreement with a respondent carrying on business in more than one of the Canadian jurisdictions and having one settlement hearing, where a settlement hearing is required, has avoided the need for separate settlement agreements and multiple proceedings.

[57] The coordination that has been shown in this case should be an example to others that the Canadian securities system, made up of ten provincial securities regulators and three territorial securities regulators, regardless of its faults and regardless of the criticism made by others, can and does operate in an efficient manner.

[58] So congratulations to staff of the Ontario Securities Commission, which managed this matter, and congratulations to staff in the other jurisdictions who have cooperated in this matter.

[59] That concludes my remarks. I'm going to ask each of the jurisdictions and panel members if they wish to make any comments or further remarks. I'm going to start with my fellow panelists in Ontario, and I'll start with Mr. Davis.

Mr. Davis:

[60] I have nothing to add to your comments.

Mr. Knight:

[61] Nothing to add.

Mr. Betts:

[62] No comment, thank you.

Ms Campbell:

[63] I have one comment. On behalf of the panel, I would like to express as well the fact that we are very pleased with the manner in which these proceedings have been coordinated and conducted. This procedure today has resulted in an effective hearing: one hearing which is beneficial for securities regulation in Canada.

[64] We would also like to compliment staff on their oral presentations. They were very good. I compliment you all.

Ms McCarthy:

[65] We have no comments to add, other than to echo Alberta's comments. Compliments to all parties who were involved in this matter.

Mr. Major:

[66] No comment.

Mr. Smith:

[67] Mr. Chair, we have no further comments other than to join in with our colleagues in the other jurisdictions to express our appreciation to staff of the Ontario Securities Commission for its leadership and staff of the other jurisdictions for the excellent job that they have done. We trust that this will, as you have highlighted, be the first of many similar activities in the future. Thank you.

Mr. O'Brien:

[68] Mr. Chair, we have no further comment on the substance of your decision, and we would echo Ms Campbell's comment with respect to the presentation.

Approved by the coordinating chair of the hearing on September 16, 2005.

"Paul M. Moore"
Coordinating Chair