

Re BMO Nesbitt Burns

IN THE MATTER OF:

**The Rules of the Investment Industry Regulatory Organization of
Canada**

and

BMO Nesbitt Burns Inc.

2019 IIROC 28

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

Heard: October 4, 2019 in Toronto, Ontario

Decision: October 4, 2019

Reasons for Decision: November 15, 2019

Hearing Panel:

Emily Cole, Chair, Steve Garmaise and Emily Jelich

Appearance:

Charles Corlett, for Staff of IIROC

Laura Paglia, for BMO Nesbitt Burns

Bruce Ferman, Head, Investment Management, BMO Private Wealth, present

Mandi Epstein, Senior Counsel, BMO Financial Group, present

REASONS FOR ACCEPTING SETTLEMENT

¶ 1 This was a hearing pursuant to Section 8215 of the IIROC Consolidated Enforcement, Examination and Approval Rules to consider a settlement agreement between Staff of IIROC and the Respondent, BMO Nesbitt Burns Inc. (BMO Nesbitt).

¶ 2 After reviewing the proposed Settlement Agreement and the material filed by Staff and listening to the submissions of counsel for Staff and the Respondent the hearing panel accepted the settlement agreement attached. Here are the reasons for our decision:

The Contraventions

¶ 3 Staff alleged, and the Respondent admitted it contravened IIROC's Rules as follows:

Between September 2014 and March 2016, the Respondent permitted a Registered Representative to use an order execution procedure that was contrary to the Universal Market Integrity Rules (UMIR) Policy 6.3 – Exposure of Client Orders.

The Sanctions

¶ 4 The Respondent agrees to the following sanctions and costs

- A fine of \$50,000; and;

- Costs of \$5,000.

Issues

¶ 5 The issues to be determined by this panel before it can accept the proposed settlement are whether the agreed sanctions are within an acceptable range, are fair and reasonable and will serve as a deterrent to the Respondent and to the industry.

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The Circumstances

¶ 6 A summary of the agreed facts follows:

Background

¶ 7 BMO Nesbitt is a Dealer Member and Participant under UMIR.

¶ 8 Among the different account types offered by BMO Nesbitt for retail investors, there are:

- Managed Portfolio Account ("MPA")
- Non-Managed account ("Non-Managed Account")

¶ 9 The key difference between these two account types is that an MPA is managed for a client by an accredited Portfolio Manager who makes investment decisions in the portfolio without requiring the client to approve each transaction. Registered Representatives responsible for Non-Managed Accounts must confirm the specifics of each transaction with each client before it is made.

¶ 10 The circumstances of this case relate to a Registered Representative who worked at a BMO Nesbitt branch in Calgary, Alberta (the "RR"). The RR was not a Portfolio Manager. The client accounts in question were Non-Managed Accounts.

The Special Handling Desk

¶ 11 BMO Nesbitt's Special Handling Desk provides expertise in the execution of large volume trades. The Special Handling Desk also generally facilitates trades of thinly traded securities or trades greater than 5,000 shares (50 standard trading units) or greater than \$100,000.

The Average Price Trading Policy

¶ 12 BMO Nesbitt had developed a specific policy for circumstances under which the Special Handling Desk could be used by Registered Representatives to execute orders at an average price (the "Average Price Trading Policy") for Non-Managed Accounts.

¶ 13 The Average Price Trading Policy provided that:

- a) a Registered Representative must have firm, specific instructions from a client prior to entering an order with the Special Handling Desk;
- b) client orders could be accumulated over a maximum one-hour period, beginning from the time the first client agreed to average pricing;
- c) clients could receive fills at an average price in certain circumstances, including where the fills were completed through multiple trades (possibly over several days). In this instance, the order is held in the Accumulation Account until the order has been completed, after which the order is ticketed to the client's account at an average price;
- d) average price orders for multiple clients that were grouped together and entered through the Special Handling Desk as a single order could only be executed if each client had specifically

- agreed to participate in a block order at an average price;
- e) clients must be made aware that trades may not be entered immediately in order to participate in the block purchase or sale; and
 - f) investment advisors should be familiar with the Order Exposure Rule as it pertains to average pricing.

The RR's use of the Special Handling Desk

¶ 14 In accordance with the Average Price Trading Policy, the RR used the Special Handling Desk to execute average price trades for multiple Non-Managed Accounts for orders of less than 50 standard units that were grouped together in tranches and entered as a single order. This included requesting client consent to withhold orders at a specified limit price for up to one hour so they could be accumulated with other Non-Managed Account orders for the same security. At the end of the hour, the orders from multiple Non-Managed Accounts were entered as a block order, which would be filled and distributed to the clients at an average price.

¶ 15 The RR was the only person at the Calgary branch who regularly used the Special Handling Desk to execute average price trades for multiple Non-Managed Accounts.

RR suspended from using the Special Handling Desk

¶ 16 In 2014, the RR's branch supervisor became concerned about the RR's use of the Special Handling Desk for average price trades because the RR was not keeping a detailed list of the clients who were participating in the orders, including the dates and times the clients were spoken to.

¶ 17 In July 2014, after a written warning and subsequent verbal warnings, the RR was prohibited from using the Special Handling Desk for 60 days for failing to maintain a detailed list (including date and time) of the clients the RR had spoken to.

The Spreadsheet

¶ 18 In September 2014, after the RR's use of the Special Handling Desk was reinstated, the RR's branch supervisor required him to keep a record, in the form of an electronic spreadsheet with a detailed list of the clients he had spoken to, any time he used the Special Handling Desk for average price trades.

The One-Hour Tranches

¶ 19 Between September 2014 and March 2016, the RR routinely used the Special Handling Desk to accumulate orders over a one-hour period in accordance with the Average Price Trading Policy, and with the knowledge and approval of the clients and BMO Nesbitt supervisors, including his branch supervisor. In some instances, there were up to 7 tranches of orders that were submitted in one-hour increments to the Special Handling Desk at a limit price and held in the Accumulation Account over a period of multiple days, as permitted under the Average Price Trading Policy.

¶ 20 After the last tranche of orders was submitted, the orders could be distributed to clients at an average price for each of the fills the Special Handling Desk had achieved for the day rather than multiple average prices for each one hour.

¶ 21 The trade confirmations that were sent to clients after their orders were filled included a disclosure that their order was filled at an average price.

Seriousness of the Contravention

¶ 22 UMIR Policy 6.3 requires that all client orders for 50 standard trading units or less be immediately entered on a marketplace that displays information regarding orders in a consolidated market display. The Order Exposure Rule is intended to support the price discovery mechanism in the Canadian market by adding

liquidity in the displayed markets.

¶ 23 Exceptions to the requirement to immediately enter a client order, include orders of \$100,000 or more. In addition, UMIR 6.3.1(a) provides that an order need not be immediately entered if the client has specifically instructed the Participant to deal otherwise with the order.

¶ 24 The Respondent's Average Price Trading Policy was not consistent with UMIR 6.3(1)(a), as client requests to withhold orders could be solicited.

¶ 25 One of the Respondent's RR's in Calgary used the Respondent's Special Handling Desk to bundle orders and then solicited instructions from his clients to withhold orders contrary to Part 3 of UMIR Policy 6.3. Staff submitted that the RR misconduct was likely a well-intentioned practice that contravened the UMIR Rule.

¶ 26 Staff stated that this case was a straightforward and relatively modest case. Counsel submitted it was more akin to a discrete failure to supervise. Staff described the Respondent's contravention of UMIR Policy 6.3 as a technical breach and stated that the RR's misconduct was a work around.

¶ 27 The Respondent, BMO Nesbitt, is a sophisticated institution. BMO Nesbitt should have exercised more care and given more forethought as to how its Average Price Trading Policy could be misused. Further, when the Respondent discovered the misconduct, it should have stopped it rather than accommodate it.

¶ 28 The Respondent's Branch manager identified the audit issue but did not appear to recognize the contravention of UMIR Rule 6.3.

¶ 29 Therefore, rather than address the breach of the UMIR Rule, the Branch Manager accommodated the RR's misconduct by simply requesting that the RR keep a spreadsheet of the clients spoken to and the date he received instructions from them to withhold the order.

¶ 30 As a result, the breach of the Rule and the misconduct continued for a prolonged period of at least eighteen months.

Mitigating factors

¶ 31 The misconduct was not a systemic problem. The Respondent's contravention of UMIR was limited to one RR.

¶ 32 In addition, although the misconduct related to many client accounts and continued for two years, there was no investor harm.

¶ 33 We also considered that the Respondent amended its policy but noted that it was not amended until nearly four years after the contravention.

Specific and General Deterrence

¶ 34 The primary purpose of IIROC disciplinary proceedings is to maintain high standards of conduct in the securities industry and to protect market integrity. Our task is to consider whether the agreed sanctions provide specific and general deterrence.

¶ 35 Settlements negotiated by competent counsel are to be encouraged and supported as they save time, expense and institutional resources.

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¶ 36 The Sanction Guidelines for IIROC Disciplinary Proceedings state that when considering specific and general deterrence we are to consider the size of the Dealer Member, including the firm's financial resources, the nature of the firm's business and the number of individuals associated with the firm.

¶ 37 We considered this information in our determination that the \$50,000 fine is, as Staff suggested, significant for this Dealer Member. The penalty is appropriate for this misconduct and this Respondent, and

the sanctions will therefore be a specific deterrent to the Respondent. Disclosing detailed information about the Dealer Member increases transparency. It allows the industry to see that the sanctions are in line with expectations and sends a strong message of general deterrence to all Dealer Members.

¶ 38 We accept Staff's submission that the penalty together with the time, effort and expense that the Respondent has committed to improve their supervision of fee-based accounts will act as specific deterrence to BMO Nesbitt.

¶ 39 We find the agreed sanctions are within a reasonable range, are fair and reasonable and will deter the Respondent and other Dealer Members. We see no reason not to accept the proposed settlement agreement.

¶ 40 The Respondent is ordered to pay \$50,000 fine and \$5000 costs within 30 days of the date of these reasons.

¶ 41

Dated at Toronto, Ontario this 15 day of November, 2019.

Emily Cole

Steve Garmaise

Emily Jelich, Member

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

1. The Investment Industry Regulatory Organization of Canada ("IIROC") will issue a Notice of Application to announce that it will hold a settlement hearing to consider whether, pursuant to Section 8215 of the Consolidated Enforcement, Examination and Approval Rules of IIROC, a hearing panel ("Hearing Panel") should accept the settlement agreement ("Settlement Agreement") entered into between the staff of IIROC ("Staff") and BMO Nesbitt Burns Inc. ("BMO Nesbitt" or "Respondent").

PART II – JOINT SETTLEMENT RECOMMENDATION

2. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

PART III – AGREED FACTS

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement.

Overview

4. Between September 2014 and March 2016, BMO Nesbitt approved and permitted an order execution procedure for a Registered Representative (the "RR") which resulted in some retail client orders that were less than 50 standard trading units (5,000 units for securities priced \$1.00 or more) being accumulated over a one hour period before they were entered on a marketplace. This was contrary to Rule 6.3 of the Universal Market Integrity Rules ("UMIR"), commonly known as the "Order Exposure Rule."

Background

5. BMO Nesbitt is a Dealer Member and Participant under UMIR.
6. Among the different account types offered by BMO Nesbitt for retail investors, there are:
 - Managed Portfolio Account ("MPA")

- Non-Managed account (“Non-Managed Account”)
7. The key difference between these two account types is that an MPA is managed for a client by an accredited Portfolio Manager who makes investment decisions in the portfolio without requiring the client to approve each and every transaction. Registered Representatives responsible for Non-Managed Accounts must confirm the specifics of each transaction with each client before it is made.
 8. The circumstances of this case relate to a Registered Representative who worked at a BMO Nesbitt branch in Calgary, Alberta (the “RR”). The RR was not a Portfolio Manager. The client accounts in question were Non-Managed Accounts.

The Special Handling Desk

9. BMO Nesbitt’s Special Handling Desk provides expertise in the execution of large volume trades. The Special Handling Desk also generally facilitates trades of thinly traded securities or trades greater than 5,000 shares (50 standard trading units) or greater than \$100,000.

The Average Price Trading Policy

10. BMO Nesbitt had developed a specific policy for circumstances under which the Special Handling Desk could be used by Registered Representatives to execute orders at an average price (the “Average Price Trading Policy”) for Non-Managed Accounts.
11. The Average Price Trading Policy provided that:
 - a) a Registered Representative must have firm, specific instructions from a client prior to entering an order with the Special Handling Desk;
 - b) client orders could be accumulated over a maximum one hour period, beginning from the time the first client agreed to average pricing);
 - c) clients could receive fills at an average price in certain circumstances, including where the fills were completed through multiple trades (possibly over several days). In this instance, the order is held in the Accumulation Account until the order has been completed, after which the order is ticketed to the client’s account at an average price;
 - d) average price orders for multiple clients that were grouped together and entered through the Special Handling Desk as a single order could only be executed if each client had specifically agreed to participate in a block order at an average price;
 - e) clients must be made aware that trades may not be entered immediately in order to participate in the block purchase or sale; and
 - f) investment advisors should be familiar with the Order Exposure Rule as it pertains to average pricing.
12. UMIR 6.3 requires that all client orders for 50 standard trading units or less be immediately entered on a marketplace that displays information regarding orders in a consolidated market display. This “Order Exposure Rule” is intended to support the price discovery mechanism in the Canadian market by adding liquidity in the displayed markets.
13. UMIR 6.3 also lists a number of exceptions to the requirement to immediately enter a client order. One exception is for orders that have a value of \$100,000 or more. Another exception (UMIR 6.3(1)(a)) provides that an order need not be immediately entered if the client has specifically instructed the Participant to deal otherwise with the particular order.
14. The Average Price Trading Policy was not consistent with UMIR 6.3(1)(a), as the client requests to withhold orders could be solicited. The solicitation to withhold orders was contrary to Part 3 of UMIR

The RR's use of the Special Handling Desk

15. In accordance with the Average Price Trading Policy, the RR used the Special Handling Desk to execute average price trades for multiple Non-Managed Accounts for orders of less than 50 standard units that were grouped together in tranches and entered as a single order. This included requesting client consent to withhold orders at a specified limit price for up to one hour so they could be accumulated with other Non-Managed Account orders for the same security. At the end of the hour, the orders from multiple Non-Managed Accounts were entered as a block order, which would be filled and distributed to the clients at an average price.
16. The RR was the only person at the Calgary branch who regularly used the Special Handling Desk to execute average price trades for multiple Non-Managed Accounts.

RR suspended from using the Special Handling Desk

17. In 2014, the RR's branch supervisor became concerned about the RR's use of the Special Handling Desk for average price trades because the RR was not keeping a detailed list of the clients who were participating in the orders, including the dates and times the clients were spoken to.
18. In July 2014, after a written warning and subsequent verbal warnings, the RR was prohibited from using the Special Handling Desk for 60 days for failing to maintain a detailed list (including date and time) of the clients the RR had spoken to.

The Spreadsheet

19. In September 2014, after the RR's use of the Special Handling Desk was reinstated, the RR's branch supervisor required him to keep a record, in the form of an electronic spreadsheet with a detailed list of the clients he had spoken to, any time he used the Special Handling Desk for average price trades.

The One-Hour Tranches

20. Between September 2014 and March 2016, the RR routinely used the Special Handling Desk to accumulate orders over a one-hour period in accordance with the Average Price Trading Policy, and with the knowledge and approval of the clients and BMO Nesbitt supervisors, including his branch supervisor. In some instances there were up to 7 tranches of orders that were submitted in one-hour increments to the Special Handling Desk at a limit price and held in the Accumulation Account over a period of multiple days, as permitted under the Average Price Trading Policy.
21. After the last tranche of orders was submitted, the orders could be distributed to clients at an average price for each of the fills the Special Handling Desk had achieved for the day rather than multiple average prices for each one hour.
22. The trade confirmations that were sent to clients after their orders were filled included a disclosure that their order was filled at an average price.

Other Factors

23. The Respondent allowed the RR to use its Average Price Trading Policy in the manner outlined herein in an effort to treat clients of the RR equally with respect to security price and in an attempt to achieve a better fill for them. . In pursuit of these objectives, the Respondent inadvertently failed to comply with UMIR 6.3.
24. Staff is not alleging investor harm. In each example where IIROC Staff found that an order was not immediately entered, the average price fills that each client ultimately received after participating in a block order, were potentially better than the price each client could have received if their order was

immediately entered and filled.

25. BMO Nesbitt has agreed to amend its use of the Average Price Trading Policy to ensure compliance with UMIR.

PART IV – CONTRAVENTIONS

26. By engaging in the conduct described above, the Respondent committed the following contravention of IIROC's Rules:
- (i) Between September 2014 and March 2016, the Respondent permitted an RR to use an order execution procedure that was contrary to UMIR 6.3.

PART V – TERMS OF SETTLEMENT

27. The Respondent agrees to the following sanction and costs:
- a) A fine in the amount of \$50,000, and
- b) Costs in the amount of \$5,000.
28. If this Settlement Agreement is accepted by the Hearing Panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

PART VI – STAFF COMMITMENT

29. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.
30. If the Hearing Panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

31. This Settlement Agreement is conditional on acceptance by the Hearing Panel.
32. This Settlement Agreement shall be presented to a Hearing Panel at a settlement hearing in accordance with the procedures described in Sections 8215 and 8428, in addition to any other procedures that may be agreed upon between the parties.
33. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the Hearing Panel.
34. If the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to waive all rights under the IIROC Rules and any applicable legislation to any further hearing, appeal and review.
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 based on the same or related allegations.
36. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.
37. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel

and IIROC will post a full of copy of this Settlement Agreement on the IIROC website. IIROC will also publish a summary of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement.

- 38. If this Settlement Agreement is accepted, the Respondent agrees that neither it nor anyone on its behalf, will make a public statement inconsistent with this Settlement Agreement.
- 39. The Settlement Agreement is effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

- 40. This Settlement Agreement may be signed in one or more counterparts, which together will constitute a binding agreement.
- 41. A fax or electronic copy of any signature will be treated as an original signature.

DATED this "4th" day of ~~September~~ "October", 2019.

"Witness"

Witness

"BMO Nesbitt Burns Inc."

BMO Nesbitt Burns Inc.

PER:

DATED this "4th" day of ~~September~~ "October", 2019.

"Witness"

Witness

"Charles Corlett"

Charles Corlett

Director, Enforcement Litigation on behalf of Enforcement Staff of the Investment Industry Regulatory Organization of Canada

The Settlement Agreement is hereby accepted this 4th day of October, 2019 by the following Hearing Panel:

Per: "Emily Cole"

Panel Chair

Per: "Emily Jelich"

Panel Member

Per: "Steve Garmaise"

Panel Member

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