

Re Northern Securities

IN THE MATTER OF:

**The Dealer Member Rules of the
Investment Industry Regulatory Organization of Canada (IIROC)**

and

Northern Securities Inc.

2013 IIROC 14

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

Heard: March 19, 2013
Decision: March 19, 2013
(29 paras.)

Hearing Panel:

Martin L. Friedland, C.C., Q.C. (Chair), Richard E. Austin, Selwyn B. Kossuth

Appearances:

Susan Kushneryk, Senior Enforcement Counsel, IIROC

Robert W. Staley, for the Respondent

REASONS FOR DECISION

INTRODUCTION

¶ 1 Staff of the Investment Industry Regulatory Organization of Canada (“IIROC”) and the Respondent, Northern Securities Inc. (“Northern Securities” or “Northern”), entered into the attached Settlement Agreement, dated March 19, 2013. The settlement was in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive, and Rule 15 of the IIROC Dealer Member Rules of Practice and Procedure.

¶ 2 The Settlement Agreement was presented to the Hearing Panel for acceptance on March 19, 2013.

¶ 3 After hearing counsel for IIROC and the respondent and considering the material filed, the Hearing Panel issued an order accepting the Settlement Agreement. These are our reasons for making that order.

BACKGROUND

¶ 4 Northern Securities was a member of the Investment Dealers Association for many years and is now a member of IIROC. It is a wholly owned subsidiary of Northern Financial Corporation. Victor Alboini has been the chief executive officer of Northern Securities since 1999.

¶ 5 Northern Securities has been and is in financial difficulty. It has less than zero risk adjusted capital. Its risk adjusted capital deficiency at the end of February 2013 was \$809,000, and it does not expect to receive any new revenue or a capital injection. It does not have a chief financial officer or a chief compliance officer. It has reduced its staff to five employees and expects those remaining employees to be transferred from Northern shortly.

¶ 6 Northern Securities has been the subject of a number of hearings in recent years. After a lengthy hearing, an IIROC Hearing Panel found in November 2012 (see 2012 IIROC 63) that Northern Securities and

others had breached a number of IIROC rules. Significant fines were ordered to be paid by Northern Securities and others, and for two of the respondents suspensions were ordered. An appeal from that decision is now before the Ontario Securities Commission. The IIROC Panel's decision was stayed until 30 days after the release of the OSC decision.

¶ 7 A further problem arose. Northern Securities was an introducing broker and required a carrying broker to perform various transactions and activities on its behalf. Penson Financial Services Canada (Penson), an IIROC member, was its carrying broker. But Penson was in the process of liquidating its Canadian operations.

¶ 8 In December 2012 IIROC Staff applied for an expedited hearing which resulted in a settlement agreement between IIROC and Northern Securities dealing with a number of matters involving Northern's future dealings with clients. This agreement was approved by an IIROC Hearing Panel (order dated December 14, 2012).

¶ 9 Northern Securities was unable to surmount its problems. It was not able to find a new carrying broker and could not raise capital by a public offering or otherwise to correct its capital deficiency.

¶ 10 On February 4, 2013 an IIROC Hearing Panel issued an order concerning the orderly winding down of Penson's membership in IIROC. (See IIROC Notice 13-0036.)

¶ 11 Similarly, the present Settlement Agreement and this hearing deal with the orderly winding down of the membership of Northern Securities in IIROC. (See clause six of the attached Settlement Agreement.) As with Penson, the firm is suspended, rather than being permitted simply to resign. The Settlement Agreement gives clients and others six months to come forward with claims against the firm. (There are apparently none known to IIROC at present.) There is a prohibition against dealing with the public as a dealer member and a requirement that the firm's websites be removed from public view. Weekly reporting to IIROC of risk adjusted capital is also required. The Settlement Agreement controls certain expenditures of funds and requires setting aside until the end of June, 2013, \$100,000 – which are funds now owing to Northern Securities from Penson – for possible client claims. It also deals with the preservation and availability of Northern Securities' books and records for a reasonable period of time (at least seven years).

ALLEGATIONS

¶ 12 A notice of hearing was issued under Part 10 of Dealer Member Rule 20 on January 30, 2013. According to the Notice, the purpose of the hearing was as follows:

“ to determine whether Northern Securities Inc. ('Northern' or the 'Respondent') has committed the following contraventions that are alleged by IIROC staff ('Staff'):

Over the period from November 21, 2012, to January 25, 2013:

- (a) Northern had risk adjusted capital in an amount less than zero on 38 days, contrary to Dealer Member Rules 17.1 and 2600 (Policy Statement 2); and
- (b) Northern failed to have adequate internal controls in that it failed to have an approved Chief Financial Officer in place, other than from January 7 to 22, 2013, contrary to Dealer Member Rules 17.2A and 2600 (Policy Statement 2).”

¶ 13 These are serious allegations. No one in the industry would dispute the importance of having adequate risk adjusted capital and having a chief financial officer.

¶ 14 Rule 17.1 of the IIROC Dealer Member rules states:

“17.1 Every Dealer Member shall have and maintain at all times risk adjusted capital greater than zero calculated in accordance with Form 1 and with such requirements as the Board of Directors [of IIROC] may from time to time prescribe. If at any time the risk adjusted capital of a Dealer Member is, to the knowledge of such Dealer Member, less than zero, such Dealer Member shall immediately notify the Corporation.”

¶ 15 The necessity for adequate capital was explained by an Ontario Securities Commission Panel decision in

1995, chaired by the head of the Commission at the time, E.J. Waitzer, *Re Security Trading Inc.* ([1995] T.S.E.D.D. No. 2):

“The capital requirements are intended to ensure that a broker has sufficient funds in the business so that it is solvent even in the face of market fluctuations and so that the firm’s customers and other brokers can be paid any amounts to which they are entitled without delay. Compliance by all dealers with the capital rules is critical to functioning of the self-regulatory system as well as the capital markets in Ontario. It is the underpinning of the trade execution and settlement system and has served the securities industry well in promoting transactional efficiency and public confidence.”

The regulator in that case was The Toronto Stock Exchange. Capital requirements are now the responsibility of IIROC. The OSC Panel went on to say:

“We agree that it is in the public interest, inasmuch as it is essential to the integrity of the self-regulatory system and indeed the capital markets, for all dealers to comply with the capital rules. We also agree that it is important for the Exchange to vigorously enforce compliance with those rules.”

¶ 16 The Dealer Member rules provide that firms must set up internal control systems to ensure compliance with the minimum capital requirement. Rule 17.2A states:

“Every Dealer Member shall establish and maintain adequate internal controls in accordance with the internal control policy statements in Rule 2600.”

¶ 17 Policy Rule 2600 (Policy Statement 2) expands on Rule 17.2A by stating that the control objective is to “monitor and act upon information produced by the management reporting system so that Risk Adjusted Capital is maintained at all times in an amount at least equal to the minimum required by regulation.”

¶ 18 Rule 2600 assumes that the dealer member has a chief financial officer. The first clause of Rule 2600 states: “The Chief Financial Officer is responsible for continuous monitoring of the capital position of the firm to ensure that at all times Risk Adjusted Capital is maintained as prescribed by Corporation regulation.” Another clause states: “Activity limits for major functional areas of the firm (such as capital markets, principal trading, borrowing/lending, etc.) are designed to ensure that the combined operations of the firm maintain at least the minimum required amount of risk adjusted capital.” Another clause states: “At least weekly, but more frequently if required (e.g. the firm is operating close to early warning levels or volatile market conditions exist), the Chief Financial Officer or designated person assigned the task for monitoring the capital position documents [receive various reports and estimates]”. Further, another clause states, senior management must take “prompt action to avert or remedy any projected or actual capital deficiency” and report “any deficiencies, when required, immediately to the appropriate regulators.”

¶ 19 The requirement to maintain adequate capital levels and to monitor the situation carefully is therefore clear.

SETTLEMENT AGREEMENT

¶ 20 A three day hearing was scheduled to deal with the allegations set out above. On the day before the hearing was to commence, the parties agreed on the terms of settlement.

¶ 21 Most importantly, Northern Securities admitted that it had contravened IIROC’s Rules, Guidelines, Regulations or Policies set out above. It had for a period of time a risk adjusted capital of less than zero, and it did not have a chief financial officer.

¶ 22 The rest of the terms of settlement, some of which are mentioned above, were worked out and can be found in paragraph six of the Settlement Agreement attached.

¶ 23 At the end of six months, paragraph 6(g) provides: “So long as Northern complies with the terms of this Settlement Agreement, and so long as there are no intervening developments that would make termination of Northern’s Membership contrary to the interests of Northern’s clients...either Staff or Northern shall be at liberty to apply to a Hearing Panel to terminate Northern’s Membership.”

¶ 24 IIROC is not seeking a fine. Nor is it asking for costs. Even if it had, the chance of recovering anything from the firm would seem to be nil.

STANDARD FOR REVIEWING A SETTLEMENT AGREEMENT

¶ 25 The standard for reviewing a Settlement Agreement was well-stated in a 2012 Pacific District hearing, *Re Johnson* (2012 IIROC 19) where the Panel stated:

“The test applicable to a decision whether to accept or reject a settlement is well-known. Simply put, a panel should accept such an agreement unless it considers the penalty provided for clearly to fall outside a reasonable range of appropriateness.”

¶ 26 That is just one of many cases stating a similar test: see, e.g., other 2012 cases: *Re Jiwa and Hoffar* (2012 IIROC 9); *Re Rotstein and Zackheim* (2012 IIROC 27), and *Re Ast* (2012 IIROC 38).

¶ 27 A Settlement Agreement cannot be modified by a Hearing Panel. It can only be accepted or rejected.

¶ 28 Not only does the agreement *not* “fall outside a reasonable range of appropriateness”, we had no hesitation in concluding that the Settlement Agreement appears sound and reasonable in this case.

CONCLUSION

¶ 29 For the above reasons, the Panel accepted the Settlement Agreement.

Dated at Toronto this 19th day of March, 2013.

Martin L. Friedland, C.C., Q.C., Chair

Richard E. Austin

Selwyn B. Kossuth

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff (“Staff”) and the Respondent, Northern Securities Inc. (“Northern” or the “Respondent”), consent and agree to the settlement of this matter by way of this agreement (the “Settlement Agreement”).
2. IIROC’s Enforcement Department has conducted an investigation (the “Investigation”) into Northern’s conduct.
3. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (the “Hearing Panel”).

II. JOINT SETTLEMENT RECOMMENDATION

4. Staff and Northern jointly recommend that the Hearing Panel accept this Settlement Agreement.
5. Northern admits to the following contraventions of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:

Over the period from November 21, 2012, to January 25, 2013, Northern:

- (a) had risk adjusted capital in an amount less than zero on 38 days, contrary to Dealer Member Rules 17.1 and 2600 (Policy Statement 2); and
- (b) failed to have adequate internal controls in that it failed to have an approved Chief Financial Officer in place, other than from January 7 to 22, 2013, contrary to Dealer

Member Rules 17.2A and 2600 (Policy Statement 2).

6. Staff and Northern agree to the following terms of settlement:
- (a) Northern's Membership is immediately suspended and Northern remains subject to IIROC Dealer Member Rules as a suspended Member.
 - (b) During the period of the suspension Northern will be required to report weekly to IIROC staff on its risk adjusted capital. Northern will not be required to obtain or provide evidence that it has obtained an audit.
 - (c) Northern is directed to immediately cease dealing with the public as a Dealer Member, including removing any websites from public access.
 - (d) Northern shall preserve \$100,000 of its remaining assets until June 30, 2013, at which time Northern shall be authorized to disburse those funds to its creditors, including any former clients with a valid claim against Northern. For greater certainty, it is agreed that the \$100,000 shall be preserved from receivables owing to Northern from Penson Financial Services Canada Inc. ("Penson").
 - (e) Northern is restricted from undertaking any of the following activities without first obtaining the written consent of IIROC's VP Financial and Operations Compliance:
 - (i) reducing its capital in any manner including redemption, repurchase or cancellation of any of its shares;
 - (ii) reducing or repaying any indebtedness which has been subordinated with the approval of IIROC;
 - (iii) directly or indirectly making any payments by way of loan, advance, bonus, dividend, repayment of capital or other distribution of assets to any director, officer, partner, shareholder, related company or affiliate; and
 - (iv) increasing non-allowable assets, unless a prior binding commitment to do so exists, or entering into any new commitments which would have the effect of materially increasing the non-allowable assets of the firm;
 - (f) Northern shall make arrangements with its parent company, Northern Financial Corporation ("NFC"), to preserve Northern's books and records (the "Records") for a period of no less than seven years from the date on which each record is created, which Records shall be maintained at NFC's head office or an accessible storage location and shall be made available to former clients of Northern and/or to IIROC staff on request.
 - (g) So long as Northern complies with the terms of this Settlement Agreement, and so long as there are no intervening developments that would make the termination of Northern's Membership contrary to the interests of Northern's clients, at any time that is six months after the date of approval of this Settlement Agreement, either Staff or Northern shall be at liberty to apply to a Hearing Panel to terminate Northern's Membership.

III. STATEMENT OF FACTS

(i) Acknowledgment

7. Staff and Northern agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

A. Overview

8. From late 2012 into early 2013, Northern carried on its operations without sufficient capital and without

a Chief Financial Officer to ensure regulatory compliance.

B. Northern

9. At all material times, Northern was an IROC registrant. As described below, Northern has not carried on any client account or other registerable client activities since December 31, 2012.
10. Penson was Northern's carrying broker, starting from December 6, 2002. In 2012, Penson took steps to cease its operations. On September 28, 2012, Penson notified Northern that it would be terminating the Introducing Broker/Carrying Broker Agreement between the two firms. Penson further advised Northern that all client and firm accounts should be transferred out to an alternate carrying broker or otherwise carried by Northern no later than December 31, 2012.
11. Northern was unable to find a new carrying broker and, as a result, transferred and assigned its client accounts to other IROC dealer members.
12. The terms of the transfer of Northern's accounts, among other things, were set out in an Order of an IROC hearing panel made on December 14, 2012, on consent of the parties. That Order also prohibited Northern from carrying on any sales and advisory activity for retail or institutional customers and restricted its activities to mergers and acquisitions, research and corporate finance. The Order required Northern to continue to meet all obligations of IROC membership.
13. On November 10, 2012, as a result of a separate disciplinary matter, Northern was subject to sanctions for breaches of various IROC Dealer Member Rules, including failing to correct compliance deficiencies and failing to have adequate policies, procedures and practices in place. Those sanctions included fines for Northern totaling \$300,000. Northern has sought a review of that decision. As of the date of this agreement, the review decision is pending.

C. Transfer of Northern's Accounts and Notice to Northern Clients

14. Northern transferred its client accounts to new introducing brokers or to Penson by January 15, 2013, and notice of that transfer was provided to Northern's clients in December 2012.
15. Penson became subject to a liquidation and a liquidator was appointed for Penson on February 1, 2013.

D. Northern Has Insufficient Capital and No Chief Financial Officer

16. Northern was in a position of risk adjusted capital deficiency almost continuously over the period from November 21, 2012, to January 25, 2013. At end of day on January 25, 2013, Northern's reported risk adjusted capital deficiency had risen to \$638,000. Without sufficient risk adjusted capital, Northern is at risk of defaulting on its financial obligations and being unable to carry on normal business operations.
17. Northern's Chief Financial Officer resigned on June 18, 2012. Since that date, Northern has met the obligations of the Chief Financial Officer through various means, including having an Acting Chief Financial Officer supported by external consultants, having an outside accounting firm perform various regulatory compliance procedures and retaining a new Chief Financial Officer for two weeks in January 2013.
18. Northern does not intend to continue its operations going forward. Northern reported a risk adjusted capital deficiency of \$809,000 as at the end of day on February 28, 2013, and does not anticipate any new revenue. Northern does not have a Chief Financial Officer or Chief Compliance Officer in place. Northern has reduced its staff to five employees and expects those remaining employees to transfer out of Northern shortly.

IV. TERMS OF SETTLEMENT

19. This settlement is agreed upon in accordance with IROC Dealer Member Rules 20.35 to 20.40, inclusive, and Rule 15 of the Dealer Member Rules of Practice and Procedure.
20. The Settlement Agreement is subject to acceptance by the Hearing Panel.

21. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
22. The Settlement Agreement will be presented to the Hearing Panel at a hearing (the “Settlement Hearing”) for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.
23. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
24. 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 in relation to the matters disclosed in the Investigation.
25. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
26. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.
27. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
28. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Toronto, in the Province of Ontario, this 18th day of March, 2013.

“Wendy Clark”

“Vic Alboini”

Witness – Wendy Clark

Northern Securities Inc.

Per: Vic Alboini

“I am authorized to bind the corporation”

AGREED TO by Staff at the City of Toronto, in the Province of Ontario this 18th day of March, 2013.

“Michael Arthur”

“Susan Kushneryk”

Witness – Michael Arthur

Susan Kushneryk

Senior Enforcement Counsel on behalf of
Staff of the Investment Industry Regulatory
Organization of Canada

ACCEPTED at the City of Toronto, in the Province of Ontario, this 19th day of March, 2013, by the following Hearing Panel:

“Martin Friedland”

Mr. Martin Friedland

“Richard Austin”

Mr. Richard Austin

“Selwyn Kossuth”

Mr. Selwyn Kossuth