

Re BMO Nesbitt Burns Inc

IN THE MATTER OF:

**THE DEALER MEMBER RULES OF THE
INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA**

AND

THE BY-LAWS OF THE INVESTMENT DEALERS ASSOCIATION OF CANADA

AND

BMO NESBITT BURNS INC

2008 IIROC 15

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

Heard: October 10, 2008 in Toronto ON

Decision: October 21, 2008

(2 paras.)

Hearing Panel:

Mr. Terrance Sweeney

Mr. Michael Walsh

Mr. Robert Guilday

Appearances:

Ms. Kathryn Andrews

Mr. Andrew Pilla

REASONS FOR DECISION

1. This hearing proceeded pursuant to a Settlement Agreement as a joint submission. The Settlement Agreement is reproduced below:

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. The Enforcement Department Staff (“Staff”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) has conducted an investigation (“the Investigation”) into the conduct of BMO Nesbitt Burns Inc. (“the Respondent” or “BMO”).
2. The Investigation was commenced by Enforcement Department Staff (“IDA Staff”) of the Investment Dealers Association of Canada (“IDA”) prior to May 30, 2008. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the IDA and Market Regulation Services Inc. With respect to conduct of IDA registrants occurring

before June 1, 2008, the IDA has retained IIROC to provide services necessary for the IDA to carry out its regulatory functions pursuant to the *Administrative and Regulatory Services Agreement* between the IDA and IIROC.

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”).
4. The Respondent consents to be subject to the jurisdiction of IIROC.

II. JOINT SETTLEMENT RECOMMENDATION

5. Staff and the Respondent consent and agree to the settlement of these matters by way of this settlement agreement (the “Settlement Agreement”) in accordance with IIROC Dealer Member Rule 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.
6. The Settlement Agreement is subject to acceptance by the Hearing Panel.
7. The Settlement Agreement shall become effective and binding upon the Respondents and Staff as of the date of its acceptance by the Hearing Panel.
8. 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.
9. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its rights under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
10. 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.
11. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
12. 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. Nothing in this section is intended to restrict the Respondent from making full answer and defence to any civil proceedings against it.
13. Staff and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement.

III. STATEMENT OF FACTS

14. Staff and the Respondent 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 for the purposes of this Settlement Agreement only and further agree that this agreement of facts is without prejudice to the Respondent or Staff in any other proceeding of any kind including, but without limiting the generality of the foregoing, any proceedings brought by IIROC or any current or future civil or other proceedings which may be brought by any other person or agency. No other person or agency may raise or rely upon the terms of this Settlement Agreement or any agreement to the facts stated herein whether or not this Settlement Agreement is accepted by the Hearing Panel.

The Investigation:

15. In April of 2006 the Staff of the IDA commenced an investigation into the sale of Olympus hedge funds by the Respondent. BMO co-operated fully with the investigation.

The Respondent:

16. At all material times, the Respondent was a Member firm of the IDA with its head office located in Toronto. The Respondent is currently registered with IIROC.

BMO’s Private Client Research Group:

17. PL was registered as a non-trading officer at BMO at all relevant times. In 1999 he joined BMO's Private Client Research Group ("PCRG") in the full service brokerage side as an analyst. From July 19, 2000 until October 15, 2007 PL was registered as Vice President (Non-Trading). As of October 15, 2007 his title at BMO changed to Vice President & Managing Director, Investment Fund Research.
18. PCRG analysts are specialists within specific sectors or asset groups. They provide recommendations to BMO's Registered Representatives ("RRs") as to the best investment choices within their sector. The purpose of the PCRG is to allow RRs to spend less time committed to research and more time servicing their clients.
19. PL was the head of the fund research unit within PCRG. JP was registered as a non-trading officer at BMO at all relevant times, and his title at BMO was Senior Vice President and Managing Director. JP was PL's supervisor. JP left BMO in 2007.
20. PL and the PCRG group provided information to the RRs to assist them in making the appropriate investment recommendations to their clients. Within BMO, the PCRG and the RRs were considered a partnership that allowed for the RRs to spend as much time as possible with clients. PCRG is a separate and distinct group from the BMO Nesbitt Burns Research Department.
21. PL had two primary roles within the PCRG at BMO. His first role was to review third party mutual funds and alternative investments such as hedge funds to ensure that they met certain criteria prior to making them available for sale to BMO's customers.
22. PL's second role involved supporting retail RRs by conducting analysis and making recommendations of mutual funds and various alternative investment products, including hedge funds. His role in reviewing these investment products included choosing the "best" products in their respective sectors and making these choices available to the RRs to recommend to their clients.

Olympus and Norshield background:

23. Norshield Asset Management (Canada) Ltd. ("NAM") is a Canadian corporation which was registered with the Ontario Securities Commission ("OSC") as an Investment Counsel and Portfolio Manager, amongst other registration categories.
24. Olympus United Group Inc. (Olympus") is a Canadian corporation which was registered under Ontario securities law as a Limited Market Dealer and Mutual Fund Dealer.
25. Olympus United Funds Corporation ("Olympus United") is a Canadian corporation which raised capital for investment in asset pools owned and managed by Olympus Bank and Trust Company with NAM as the portfolio manager.

Univest II hedge funds:

26. First Horizon Holdings Ltd. had issued various hedge funds to Canadian retail investors in 2001 and 2002. Effective early 2003, an aggregation of various Norshield entities (including NAM) assumed operating and management control of all of the exempt funds of First Horizon Group. These exempt funds were then subject to a name change. Thus Horizons Univest II hedge fund became Olympus United Univest II hedge fund ("Univest II").

Accredited investor exemption:

27. During 2003 and subsequently, Olympus United offered a number of hedge fund products for sale to retail investors, including Univest II. These funds were offered to retail investors in Canada under specific product exemption rules. In order to purchase the Olympus hedge funds, clients were required to be "accredited investors" as prescribed by section 1.1 of national Instrument 45-106 Prospectus and Registration Exemption, or invest a minimum initial subscription of no less than \$150,000 pursuant to section 2.10 of National Instrument 45-106 Prospectus and Registration Exemption.

Olympus and Nam receivership:

28. On or about May 2, 2005, Olympus announced the deferral of redemptions in a number of its funds. In late May 2005, the OSC suspended the registrations of NAM and Olympus. NAM and other related entities were placed into court ordered receivership on June 29, 2005.
29. RSM Richter Inc., in its capacity as the court appointed receiver, indicated in its sixth report dated March 6, 2007 that there was approximately \$265 million raised from approximately 1,900 retail investors in Canada by Olympus United from 2001 to 2005.

BMO clients purchased Uninvest II:

30. Uninvest II was a hedge “fund of funds” that was recommended by BMO to certain of its retail clients. BMO clients purchased various Olympus United hedge funds during 2003 to early 2005, including Uninvest II. As of March 31, 2005, 130 BMO client accounts held Uninvest II funds in the amount of approximately \$8.6 million.
31. The Olympus United purchases were made by way of prospectus exemptions pursuant to various Offering Memoranda, including those dated March 29, 2003 and February 26, 2004. Some BMO Registered Representatives also discussed various Olympus marketing materials with their clients.
32. The IDA received 37 client complaints on ComSet related to BMO’s sale of Olympus products. During the course of the investigation, IDA Staff spoke to, amongst others, three RRs and various clients.

Offering Memoranda:

33. According to Uninvest II Offering Memoranda, Uninvest II had the following attributes:
 - “An Investment in the Class Shares offered hereby is appropriate only for investors who have the capacity to absorb a loss of all of their investment and for investors who have a significant degree of investment knowledge and sophistication as well as high net worth.”;
 - “While we believe that each Fund’s investment strategies will be successful over the long term, there can be no guarantee that losses will not result from an investment in our funds and there can be no assurances that a Fund’s investment strategies will be successful or that its investment objectives will be attained.”;
 - “The funds could realize substantial losses, rather than gains, from some or all of the investments described herein.”
34. In addition, the Offering Memoranda stated that the fund’s investment objective was to provide a superior yield, while maintaining a low degree of volatility and correlation relative to major global markets.

Sales Literature Issued by BMO:

a) March 2003 Report

35. In early 2003 BMO determined that hedge funds had started to attract considerable attention in the market. It decided that the PCRG would prepare sales literature, which PL and JP also characterized as an educational piece, to assist RRs in recommending certain hedge funds to their clients.
36. In March 2003, BMO published a research report titled “An Introduction to Hedge Funds” (“The Report”). The Report was written by PL, with assistance from PS, who was not a registrant at the time.
37. In March of 2003, the Report was posted on BMO’s internal web site and as such, it was made available to all RRs. The Report was intended both to educate and to recommend the hedge funds that PL’s department believed to be the “best” hedge funds available.
38. The Report provided an overview of the history of hedge funds and a comparison of key differences between hedge funds and traditional investment funds. The Report discussed eleven main hedge fund strategies employed by hedge fund managers. The Report also discussed which investors hedge funds would be most suited to. For example, the Report stated that:

- The fund-of-funds strategy “designs a diversified portfolio of managers with the objective of significantly lowering the risk (volatility) of investing with an individual manager”;
 - “We believe that fund-of-hedge funds represent the best risk/return option for investors. Not only do such funds facilitate a diversified hedge funds investment across multiple strategies, but they also offer the service of constant monitoring and rebalancing as various strategies go in and out of favour.”
 - “While the minimum investment applied to hedge funds may make it impractical for many clients to purchase them, we believe that hedge funds can have a positive impact on almost any portfolio.”
 - “For larger investors, we believe that market neutral hedge fund of funds can form the cornerstone of a portfolio. These funds’ low volatility and attractive return profile generates positive returns irrespective of market gyrations. They are neither economically or cyclically sensitive like stocks or interest rate or credit sensitive like bonds.”
 - “It is quite clear that we believe alternative investment funds offer a tremendous opportunity for our clients; however, as with anything, there are varying degrees of quality.”
 - “we have conducted extensive due diligence to ensure these funds can and will deliver on their stated objectives”.
39. The Report specifically recommended Univest II. It stated:
- “The Fund has created solid absolute returns with bond-like volatility over the current equity bear market ... since the fund’s inception in April 1991 the fund has lost money in only 6 months with the average loss being only 0.42%.”;
 - “The Univest II Fund is a market neutral hedge fund of funds that offers investors the opportunity to participate in strong absolute returns regardless of the movement in equity markets”;
 - “We believe that market neutral fund of funds can form the basis of any portfolio and that this is an excellent choice as a client’s fund of fund allocation.”

b) October 2003 Updated Report

40. In October 2003 BMO published and posted on its internal web site a second research report entitled “Hedge Fund Update” (“The Update”). The Update maintained BMO’s recommendation of the Univest II hedge fund. The Update made the following recommendations:
- “We continue to feel that market neutral fund-of-funds are a tremendous opportunity for almost all clients. Despite a difficult year for many arbitrage strategies, Norshield’s long term track record should inspire confidence.”
 - “We believe that market neutral fund of funds offer a tremendous alternative to bond portfolios and note that the return objective of market neutral fund of funds tend to be positively correlated with interest [sic] rates, as opposed to the opposite for bonds.”

Internal Email Promoting Report and Update

41. On October 20, 2003, the National Sales Office of the Respondent sent an email with the subject line “Hedge Funds for Conservative Investors” (“The Email”). The Email was marked in bold “This information is for internal use only.” The Email was sent to all retail employees at BMO.
42. The Email contained a link to the Report. In addition to continuing to specifically recommend Univest II, the Email stated:
- “While more complex investment strategies and the use of leverage in some cases can increase the risk profile of an investment fund, we recommend two hedge

funds in particular where these strategies greatly reduce risk and provide steady returns for investors”;

- “advisors should consider market neutral fund of funds as an alternative to a bond portfolio.”

Failure to Fairly Present the Potential Risks

43. The Report and the Update did not present a fair and balanced discussion of the risk factors inherent in Uninvest II as part of a portfolio. While each investor who purchased Uninvest II executed a subscription agreement and received an Offering Memorandum, the language from the Report and the Update highlighted above did not fairly present the potential risks to the client. In addition, the Report and the Update did not point out the following:

- that Uninvest II was suitable for investors with a significant level of sophistication;
- that the investor could lose all of their investment in Uninvest II;
- that an investor’s status as “accredited” was not the sole criterion for suitability for investment in Uninvest II.

No Approval Process in Place prior to August 1, 2004:

44. IDA By-law 29.7 was in effect prior to August 1, 2004. This by-law required that all sales literature had to be approved by a designated partner, director, officer or branch manager of the Member prior to it being issued.
45. BMO did not have the appropriate designation or approval process in place when it issued the Report, or when it issued the Update.
46. PL stated that he was solely responsible for the research reports issued from his department and that he did not seek any final approval from any other person prior to the distribution of the Report or the Update.

No Written Policies in Place:

47. Since August 1, 2004, IDA By-law 29.7(2) has required each member to develop written policies and procedures for the review and supervision of sales literature. Additionally, all such policies and procedures are required to be approved by the IDA.
48. While BMO did have certain written policies and procedures for the review of some sales literature, BMO admits that they did not have any written policies or procedures in place with respect to the review and supervision of research reports and sales literature distributed by PCRG.

No approval process after August 1, 2004:

49. Since August 1, 2004, IDA By-law 29.7(3) requires that research reports be approved by a partner, director, officer or branch manager of the Member who is designated to approve such materials prior to their use.
50. After August 1, 2004, RRs at BMO were still relying upon the Report and the Update when advising their clients to purchase Uninvest II. Neither the Report nor the Update was approved by a designated person prior to their use during that time.

IV. CONTRAVENTIONS

51. The Respondent admits to the following contraventions of IIROC Rules, Guidance, IDA By-Laws, Regulations or Policies:
- (i) In or about March 2003 to May 2005, BMO participated in the production of sales literature that failed to fairly present the potential risks of Uninvest II to the client, contrary to IDA By-laws 29.7(e), and 29.7(1)(e).
 - (ii) In or about March 2003 to July 2004, BMO issued and/or used sales literature that was not first approved by a partner, director, officer or branch manager who was designated in writing by the Member, contrary to IDA By-law 29.7.

- (iii) In or about August 2004 to May 2005, BMO, a Member of the IDA at all material times, failed to develop appropriate written policies and procedures for the review and supervision of sales literature, contrary to IDA By-law 29.7(2) and/or (3).

V. TERMS OF SETTLEMENT

52. BMO agrees to pay a fine in the amount of \$ 300,000, broken down as follows:
a) count 1: \$ 200,000
b) count 2: \$ 50,000
c) count 3: \$ 50,000
53. The Respondent agrees to pay costs of \$ 20,000 toward the costs of the investigation and prosecution.
54. Unless otherwise stated, any 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 15th day of September, 2008.

Original Executed by
"Witness Signature"
"WITNESS"

"Respondent's signature"
"BMO NESBITT BURNS INC,
RESPONDENT ."

AGREED TO by Staff at the City of Toronto in the Province of Ontario this 15th day of September, 2008.

"WITNESS"
"Witness signature"

"Kathryn Andrews:
"KATHRYN ANDREWS"

"WITNESS"
"Witness signature"

"Andrew Pilla"
"ANDREW PILLA"
Enforcement Counsel on behalf of Staff
of the Investment Industry Regulatory
Organization of Canada

2. We are of the opinion that the Settlement Agreement is fair to both parties. The Settlement Agreement is, therefore, approved and we accept it.

DATED at Toronto, this 21st day of October, 2008.

Terrance Sweeney, Panel Chair
Michael Walsh, Panel Member
Robert Guilday, Panel Member

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