# Re Credential Securities Inc

**IN THE MATTER OF:**

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

**AND**

**CREDENTIAL SECURITIES INC**

2009 IIROC 55

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

Heard: December 21, 2009 at Vancouver B.C.
Decision: January 15, 2010
(43 paras.)

**Hearing Panel:**
John Rogers, Chair
Brian Field
Chris Lay

**Appearances:**
Tamara Brooks, Enforcement Counsel, for the Investment Industry Regulatory Organization of Canada
Tim McCafferty, McCarthy Tétrault, Barristers & Solicitors, for the Respondent

## REASONS FOR DECISION

¶ 1 A hearing panel of the Investment Industry Regulatory Organization of Canada ("IIROC") was convened on December 21, 2009 in accordance with Rule 15 of the IIROC Dealer Member Rules of Practice and Procedure to review a settlement agreement ("Settlement Agreement") dated December 17, 2010 negotiated between the Enforcement Department of IIROC and Credential Securities Inc. ("Respondent") in accordance with Rule 20.35 of Part 10 of the IIROC Dealer Member Rules (the "Rules") and Rule 15 of the Dealer Member Rules of Practice and Procedure. A copy of the Settlement Agreement is attached to this decision.

### Preliminary Application

¶ 2 At the commencement of the Settlement Agreement Hearing, Enforcement Counsel advised the Hearing Panel that similar proceedings to the matter at hand were being conducted across Canada. She confirmed that these other hearings related to matters referred to in the Settlement Agreement, matters which most likely the Canadian financial press would find of interest. In an attempt to coordinate the release to the public of the decisions resulting from this Hearing and the other hearings, Enforcement Counsel requested that we defer any decision that we might make in this matter until 2:00 PM Vancouver time.

¶ 3 The Respondent consented to this approach.

¶ 4 Therefore, following the submissions of counsel, the Settlement Agreement Hearing was adjourned until

2:15 PM Vancouver time when we delivered the decision below set out.

**Statement of Facts**

¶ 5 The Settlement Agreement contains certain facts agreed to by IIROC and the Respondent for the purpose of the Settlement Agreement. A summary of these facts are set out below.

***The Asset Backed Commercial Paper Market***

The Security

¶ 6 During 2006 and 2007 the Respondent offered for sale to its clients a security known as Asset Backed Commercial Paper ("ABCP"). ABCP is a short-term debt instrument with typical maturities of 30 to 180 days, offering a yield slightly better than the yield offered on short-term government debt, and backed by a pool of long term underlying financial assets. The security offered by the Respondent was issued by a trust which was established by a sponsor. The sponsor of a particular trust selected the underlying assets for the trust, administered these assets, and arranged for the sale of the ABCP securities. The Canadian ABCP market included two categories of ABCP securities: bank-sponsored and non-bank-sponsored ("third party").

¶ 7 The pool of underlying financial assets included traditional financial assets such as consumer loans, credit card receivables and residential mortgages; however the pool might also include non-traditional more complex synthetic assets with a different risk profile such as collateralized debt obligations. There was no disclosure of the specific assets in the pool of assets held by the trust, with, in most cases, the general asset classes being the only information publicly disclosed.

¶ 8 The Respondent mainly traded in third party ABCP securities, which securities by August 2007 had non-traditional underlying assets.

Liquidity Agreements

¶ 9 As the underlying assets supporting the trust had a long term maturity and the maturity of the ABCP securities had a short term maturity, maturing ABCP securities of a particular trust were financed by the issuance of new short term ABCP securities by that trust. To safeguard against difficulty in financing the redemption of the ABCP securities upon their maturity, the issuing trust entered into an agreement with a liquidity provider to provide back up credit lines under certain conditions. These conditions included the requirement that specified "general market disruption events" had occurred and a credit rating affirmation before liquidity would be provided.

¶ 10 These liquidity agreements were subject to confidentiality provisions prohibiting disclosure of many of their terms, including disclosure of the definition of the general market disruption event condition.

Dominion Bond Rating Services Limited

¶ 11 Dominion Bond Rating Services Limited ("DBRS"), an approved credit rating organization, was the sole credit rating organization which rated the ABCP securities sold to the Respondent's clients. These ABCP securities received from DBRS the highest credit rating available, being R-1 (high), and this credit rating remained in place until August 13, 2007.

¶ 12 On January 19, 2007, DBRS announced changes to its rating methodology. These changes included a new set of requirements for liquidity agreements for ABCP securities for which a DBRS rating was being sought. These changes did not apply to the issuance by trusts of new ABCP securities to finance the redemption of DBRS rated ABCP securities issued prior to January 19, 2007.

ABCP Over-the-Counter Market

¶ 13 Third party ABCP securities were distributed to investors through a dealer syndicate. One member of the dealer syndicate was appointed as the lead dealer whose duties included the allocation of the ABCP securities to dealer syndicate members and, in consultation with the sponsor, setting the yield on the securities offered.

¶ 14 The third party ABCP securities traded in an over-the-counter dealer market which was not transparent to investors. Participating investors were, therefore, reliant mainly upon the dealer syndicate for information relating to issues such as pricing, market depth and market volume. The primary information that dealers disclosed to investors was the yield and credit rating of the third party ABCP securities traded in that market.

The Market Freeze

¶ 15 On August 13, 2007, a number of Canadian trusts which had previously issued ABCP securities were unable to sell new ABCP securities to fund the repayment of their previously issued and maturing ABCP securities. In addition, many of the liquidity providers did not agree that the conditions for liquidity funding had occurred and refused to provide liquidity to fund this repayment.

Remedial Action

¶ 16 As a result of this market freeze, on August 16, 2007 a consortium representing banks, asset providers and major holders of ABCP securities agreed to take steps to establish normal operations in the ABCP market (the "Montreal Proposal"). Subsequently, a Pan-Canadian Investors Committee, including parties to the Montreal Proposal and other significant holders of ABCP securities, put forward a Plan of Compromise and Arrangement (the "Plan"). The Plan as eventually implemented on January 21, 2009 led to the exchanging of short term ABCP securities for ABCP securities of a longer term more closely matching the maturity dates of the underlying financial assets securing the ABCP securities.

***The Respondent's Involvement in the ABCP Market***

¶ 17 The Respondent was an introducing broker and had a carrying broker agreement in place with another non-syndicate Member firm that sold third party ABCP securities. While the Respondent's money market activity was handled by the carrying broker's bond desk, the Respondent's decision to make products available to its retail clients remained with it.

¶ 18 During the period that the Respondent was trading in ABCP securities, the Respondent's Product Review Committee, a subcommittee of the Respondent's Investment Risk Committee, established the Respondent's general criteria for the Respondent's retail product offerings. These criteria included the provision that products that were rated by a recognized bond rating agency as investment grade BBB or better were pre-approved by the Product Review Committee for distribution by the Respondent to its clients. Since the third party ABCP securities met this threshold, they automatically became eligible as part of the Respondent's pool of fixed income products available for purchase by the Respondent's clients through the Respondent's approved persons.

***Lack of Adequate Due Diligence***

¶ 19 In the Settlement Agreement, the Respondent acknowledges that it did not perform adequate due diligence on the ABCP securities in which it traded. It relied primarily on the credit rating provided by DBRS and secondarily on corroborating information from its carrying broker.

¶ 20 Specifically, the Respondent acknowledges that:

1. It did not learn and remain informed of the complexities of the ABCP securities and the consequent systemic risks arising from the manner in which the securities were rated by DBRS and the counterparty risks arising from the liquidity agreements;
2. As the third-party ABCP securities met the basic criteria of the BBB rating by DBRS, they automatically became part of the Respondent's pool of fixed income product offerings without further due diligence; and
3. It did not take steps to adequately ensure that its approved persons involved in the sale and distribution of third party ABCP securities to retail clients were trained in and understood the complexities of the ABCP product and the consequent risks related to these securities to make proper decisions involving suitability.

¶ 21 Consequently, without a full understanding of the ABCP securities being offered, certain of the Respondent's approved persons were representing the ABCP securities to their clients as a safe and secure investment that was similar to a Treasury Bill, Guaranteed Investment Certificate or a term deposit.

**The Respondent's Remedial Actions**

¶ 22 Following the market freeze on August 13, 2007, the Respondent made significant efforts to assist its clients. The Settlement Agreement acknowledges that:

1. From the time of the market freeze, under its relief program the Respondent returned to the vast majority of its retail clients full face value plus interest and costs of up to $1 million in exchange for the longer term ABCP securities issued under the Plan;
2. From the time when the issues surrounding the third party ABCP securities became known, the Respondent proactively undertook an examination of and has instituted several changes to its procedures and systems to strengthen the review of complex fixed income securities that are traded by its retail clients;
3. The Respondent has made additions to its risk monitoring personnel; and
4. The Respondent is in the process of instituting additional training modules for its approved persons.

**Contraventions**

¶ 23 The Settlement Agreement contains the Respondent's admission that contrary to IIROC Dealer Member Rule 1300.1(a), in or about 2006 and 2007 it did not take adequate steps to ensure that its sales staff understood the complexities of the third party ABCP securities it offered for sale to retail clients and the consequent risks (including systemic risks and counterparty risks) related to these securities, and, in not taking these steps, it did not ensure that the purchase of third party ABCP securities was properly understood by its clients.

**Terms of Settlement**

¶ 24 In the Settlement Agreement, IIROC and the Respondent agree to the following terms of settlement:

1. That the Respondent will pay a fine in the amount of $200,000 (inclusive of costs); and
2. That the Respondent will have an outside consultant undertake a verification review of the Respondent's due diligence practices, policies and procedures relating to fixed income securities.

¶ 25 The complete terms of reference of the verification review agreed to by the Respondent, together with the consultant's reporting obligations and the terms of the consultant's retainer, are more particularly set out in Schedule A of the Settlement Agreement.

**Staff Commitment**

¶ 26 The Settlement Agreement provides that if this Hearing Panel accepts the Settlement Agreement, that IIROC Enforcement Staff will not commence any proceeding under the Rules against the Respondent or any of its affiliates or their respective present or former directors, officers, employees or agents in relation to the facts set out in the Settlement Agreement.

¶ 27 This provision is also stated in the Settlement Agreement to bind the Ontario Securities Commission and Authorité des marchés financiers to prevent the commencement of any proceeding under their applicable legislation and rules.

¶ 28 The Hearing Panel was advised by Enforcement Counsel that although not referred to in the Settlement Agreement, that the British Columbia Securities Commission has, as well, agreed to be bound by this provision.

**Decision**

¶ 29 The Hearing Panel accepts the Settlement Agreement.

**Reasons**

¶ 30 Rule 20.36 empowers a Hearing Panel upon the conclusion of a settlement agreement hearing to either accept or reject the settlement agreement under consideration. Neither in Rule 20.36 nor elsewhere in the Rules is there guidance for what criteria a Hearing Panel should use in making this decision.

***Appropriateness of Penalty***

¶ 31 Past decisions of Hearing Panels determining whether or not to accept a settlement agreement are of assistance. In *Milewski* [1999] I.D.A.C.D. No. 17, Bulletin No. 2605, August 5, 1999, and *Clark* [1999] I.D.A.C.D. No. 40, Bulletin No. 2674, December 14, 1999 the test for a Hearing Panel to use in determining whether or not to accept a settlement agreement was defined as whether or not the settlement agreement reached between the respondent and IIROC Enforcement Staff includes a penalty which clearly falls outside a "reasonable range of appropriateness". If in the opinion of the Hearing Panel the penalty falls outside this reasonable range, the Hearing Panel should not accept the settlement agreement. Otherwise it should do so. The rationale behind this approach is that a Hearing Panel should be cognizant of the settlement process and should not interfere in a negotiated settlement by attempting to substitute its discretion for that of the parties.

¶ 32 Further assistance as to what factors should be considered by a Hearing Panel in determining whether or not to accept that a settlement agreement contains an appropriate penalty was provided in *Derivative Services Inc.*, [2000] I.D.A.C.D. No. 26 at page 3. The decision lists five considerations of which a Hearing Panel should be cognizant in determining an appropriate penalty. These considerations are:

1. Protection of the investing public;
2. Protection of the IIROC membership;
3. Protection of the integrity of the IIROC hearing process;
4. Protection of the integrity of the securities markets; and
5. Prevention of a repetition of the conduct leading to the penalty.

¶ 33 The terms of settlement in the Settlement Agreement contain two elements – a monetary fine and an agreement to have an outside consultant conduct a verification review. To deal firstly with the verification review.

***Verification Review***

¶ 34 The Respondent did not perform its own due diligence on the ABCP securities it offered to its clients in order to learn and remain informed about the complexities of the security. It did not properly understand the manner in which DBRS had rated the ABCP security or the risks involved if the liquidity providers failed to meet their contractual commitments or, indeed, the possibility of them failing to do so. Although the confidentiality restrictions governing the liquidity agreements might have prevented the Respondent from finding out these and other factors as part of a due diligence program, the Respondent did not attempt such a program. .

¶ 35 For product knowledge, the Respondent relied primarily on the credit rating provided by DBRS and secondarily on the corroborating information from its carrying broker which, in turn, received its information from the broker leading the syndicate. A situation the Respondent acknowledges in the Settlement Agreement was insufficient and which it has since taken steps to remedy.

¶ 36 Nor did the Respondent make an adequate effort to ensure that its approved persons understood and conveyed to their clients the complexities of the ABCP securities, the lack of transparency surrounding these financial products, and the consequent risks from purchasing these products.

¶ 37 The Settlement Agreement acknowledges that after August 2007, the Respondent reviewed its policies and procedures in connection with its fixed income business, particularly in relation to third party ABCP securities, and took the following remedial actions:

1. Reviewed and revised its product review policy, practices and systems;

2. Engaged additional personnel to assist with risk monitoring; and
3. Commenced development of additional training modules for advisors on due diligence practices and fixed income structured products.

¶ 38 These remedial actions and their implementation will be subject to a verification review by an outside consultant insofar as they relate to:

1. The Respondent's compliance and oversight functions concerning its sales with respect to fixed income securities made available to clients;
2. Any committees or other mechanisms established to review and approve new fixed income securities made available to clients and changes to those securities;
3. The training of the Respondent's staff concerning fixed income securities; and
4. The Respondent's procedures regarding staff compliance with the foregoing.

¶ 39 We believe that this verification review will confirm the effectiveness of the remedial actions undertaken by the Respondent and will deal with the concerns in regard to prevention and protection as set out in *Derivative Securities* . It is, therefore, clearly within the range of an appropriate penalty in accordance with *Milewski*.

***Monetary Fine***

¶ 40 In attempting to determine the reasonable range of appropriateness of the monetary fine, we are faced with a paucity of criteria against which to compare the fine negotiated by the parties.

¶ 41 The Settlement Agreement itself does not enumerate the criteria used by the parties in arriving at the fine inclusive of costs of $200,000.

¶ 42 With respect to mitigating circumstances, we note:

1. The Respondent's role in the ABCP securities market was restricted to that of an introducing broker relying for its knowledge of the ABCP securities it traded on another Member firm, which, in turn, relied on another Member firm which acted as lead dealer;
2. From the commencement of the market freeze on August 13, 2007, Respondent made significant efforts to assist its clients and returned to the vast majority of its retail clients the full face value of their investment together with interest and costs;
3. Proactively, the Respondent undertook an examination of and has instituted several remedial changes to its procedures and systems; and
4. The submission by IIROC Enforcement Counsel that the Respondent from the beginning of the market freeze accepted full responsibility and cooperated fully with IIROC officials and Enforcement Staff.

¶ 43 Based upon the above, it is obvious that the Respondent took immediate steps to assist its clients affected by the ABCP market freeze cooperating fully with IIROC officials and Enforcement Staff to work through what became a very difficult and financially challenging process. We see no reason to question the amount of the fine arrived at by the parties and find the amount arrived at by them within a reasonable range of appropriateness.

Dated at Vancouver, British Columbia, this 15th day of January, 2010.
John Rogers, Chair
Brian Field
Chris Lay

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## 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 Credential Securities Inc. ("the Respondent").

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 Investment Dealers Association of Canada and Market Regulation Services Inc. Pursuant to the *Administrative and Regulatory Services Agreement* between IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for IDA to carry out its regulatory functions.

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. The Respondent consents to be subject to the jurisdiction of IIROC.

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 Rules 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 Respondent 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 right 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.

13. Staff and the Respondent jointly recommend that the Hearing Panel accept the Settlement Agreement.

**III. Statement of Facts**

*(i) Acknowledgment*

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.

**(ii) Factual Background**

**ASSET-BACKED COMMERCIAL PAPER ("ABCP")**

15. ABCP is a short-term debt instrument with typical maturities of 30 to 180 days. ABCP is backed by a pool of underlying assets and offers a yield slightly better than the yield offered on short-term government debt.

16. ABCP is issued by a special purpose vehicle (also referred to as a conduit). In Canada, the conduits are trusts established by sponsors. Sponsors generally select underlying assets, administer the assets and arrange for the sale of the ABCP notes. The Canadian ABCP market included two categories: bank-sponsored and non-bank-sponsored (or third party) ABCP.

17. As the underlying assets were long term and the ABCP notes were short term, there was a timing mismatch between the cash flowing from the assets and the cash needed to repay maturing ABCP. For many years, conduits met their obligations by selling newly issued ABCP, the proceeds of which were used to pay maturing ABCP. The liquidity of ABCP was an important characteristic for investors.

18. To safeguard against difficulty meeting maturity obligations, conduits entered into agreements with liquidity providers which provided credit lines under certain conditions. In general, there were two types of liquidity facilities: (1) general market disruption ("GMD") and (2) global-style. GMD liquidity was also called "Canadian-style" since it was only used in the Canadian ABCP market. Unlike global-style liquidity facilities, Canadian-style liquidity facilities required specified "general market disruption" events and a credit rating affirmation before liquidity was provided.

19. Liquidity agreements were subject to confidentiality provisions. Many details of the pre-conditions required for liquidity support, including the definition of a "general market disruption event", were not known to the public, to investors or to the distributors of ABCP who were not also liquidity providers. Conduits generally disclosed only the existence of their liquidity arrangements and disclosed that there were pre-conditions to draws.

20. As of September 2005, ABCP distributed in Canada was prospectus-exempt under the short-term debt exemption in section 2.35 of National Instrument 45-106 – *Prospectus and Registration Exemptions,* which provided an exemption for commercial paper with an approved credit rating from an approved credit rating organization.

21. Dominion Bond Rating Services Limited ("DBRS"), an approved credit rating organization, was the sole credit rating organization which rated third-party ABCP in Canada.

22. On January 19, 2007, DBRS announced changes to its rating methodology for certain new transactions entered into by ABCP issuers. The DBRS press release set out specific new rating criteria, including a requirement for global-style liquidity. These rating criteria were only applied prospectively in the marketplace.

**THIRD-PARTY ABCP**

23. ABCP has been in the Canadian marketplace for over a decade, and non-bank sponsors entered the marketplace in approximately 2000.

24. Historically, the assets underlying ABCP consisted of traditional assets such as consumer loans, credit card receivables and residential mortgages. Non-traditional complex synthetic assets, such as collateralized debt obligations, came into these structures over time.

25. Third-party ABCP was typically issued by a series of notes, the most common being Series "A" Notes and Series "E" Notes. The "A" Notes were supported by the Canadian-style liquidity facilities. "E" Notes were not, but could be extended up to 364 days after the original maturity date if certain conditions were met, including that market conditions did not allow for "E" Notes to be sold at a specified spread.

26. The sponsors provided limited information regarding the underlying pool of assets in conduits issuing ABCP. Sponsors typically provided an information memorandum describing the basic elements of ABCP. In most cases, the general asset classes were the only information publicly disclosed; there was no disclosure of the specific assets.

**COVENTREE INC.**

27. At all material times, Coventree Inc. was the largest sponsor of third-party ABCP in Canada. Coventree Inc. also issued third-party ABCP through a subsidiary, Nereus Financial Inc. ("Nereus").

28. At all material times, Coventree Inc. and Nereus (collectively, "Coventree") sponsored the following third-party ABCP conduits: Apollo Trust, Aurora Trust, Comet Trust, Gemini Trust, Planet Trust, Rocket Trust, Slate Trust, Venus Trust, Structured Investment Trust III ("SIT III") and Structured Asset Trust ("SAT").

29. All Coventree conduits but one received an R-1 (high) rating (the highest credit rating available, equivalent to a "AAA" for long term debt) by DBRS, as did other Canadian third-party ABCP. This rating remained in place at all material times up to and including August 13, 2007.

**THE DISTRIBUTION OF THIRD-PARTY ABCP**

30. In general, third-party ABCP was distributed to investors through a dealer group (the "dealer syndicate"). Typically, one member of the dealer syndicate would be appointed as lead dealer. Some of the lead dealer's daily duties included the allocation of ABCP notes to dealer syndicate members and setting the yield in consultation with the conduit sponsor.

31. The dealer syndicate members maintained trading lines, up to a credit limit, for third-party ABCP mainly to provide a market-making function. Dealer syndicate members would typically purchase third-party ABCP that was not sold at the end of a trading day. These positions were to be held on a short-term basis, typically overnight, until the notes could be sold to investors. Dealer syndicate members also purchased third-party ABCP from clients in the secondary market. While the dealer syndicate was under no obligation to purchase any third-party ABCP, they did so to provide a secondary market, maintain liquidity in the market and/or as a service to their clients. Dealer syndicate members other than the lead dealer also had the option to turn back ABCP to the lead dealer if they were unable to sell their daily allocation, but this was not their ordinary practice.

32. Third-party ABCP traded in a dealer market, also known as an over-the-counter ("OTC") market. Unlike an auction market or exchange, the OTC market was not transparent to investors. As such, investors relied mainly upon the dealer syndicate for information relating to issues such as pricing, market depth and market volume.

33. The primary information that dealers disclosed to investors was the yield and credit rating of third-party ABCP.

**THE MARKET FREEZE**

34. On August 13, 2007, a number of Canadian third-party ABCP conduits including the Coventree conduits were unable to sell new ABCP to fund the repayment of maturing ABCP. Many of the conduits' liquidity providers did not agree that the conditions for liquidity funding had occurred and refused to provide liquidity to the affected conduits.

35. As of August 13, 2007, the third-party ABCP market totaled approximately $35 billion, with Coventree conduits representing approximately 46 percent of the value of the third-party ABCP market.

36. On August 16, 2007, a consortium representing banks, asset providers and major ABCP holders agreed to take steps to establish normal operations in the ABCP market. This agreement was known as the Montreal Proposal.

37. A Pan-Canadian Investors Committee, including investors who were signatories to the Montreal Proposal plus other significant holders, was established to oversee the restructuring of third-party ABCP. It put forward the Plan of Compromise and Arrangement (the "Plan"), which was implemented on January 21, 2009.

38. Pursuant to the Plan, holders of the eligible third-party ABCP had their short-term notes exchanged for longer term notes to match more closely the maturity dates of the underlying assets.

**THE RESPONDENT'S OFFERING OF THIRD-PARTY ABCP**

39. The Respondent is a registered dealer with a predominantly retail client base. The Respondent is not and never was a sponsor, ABCP syndicate member dealer, asset or liquidity provider, active trader or investor in ABCP or otherwise involved in the third-party ABCP market, other than in acting as dealer for clients who wished to invest in ABCP. As such, at the relevant time, the Respondent did not have access to or detailed knowledge of certain of the information regarding third-party ABCP discussed above, including the information in paragraphs 18, 19, and 22.

40. At all material times, the Respondent was an introducing broker and had a carrying broker agreement in place with another Non-syndicate Member firm that sold third-party ABCP. While the Respondent's money market activity was handled by the carrying broker's bond desk, the Respondent's decision to make products available to its retail clients remained with it.

41. The Respondent first made third-party ABCP available to its retail clients in or about June 2006.

42. The majority of third-party ABCP made available by the Respondent to its clients was SIT III. By August 2007, SIT III held only non-traditional assets.

43. The Respondent's Product Review Committee ("the Committee") was a subcommittee of its Investment Risk Committee. The Committee was made up of senior individuals including certain department heads. Included on the Committee were individuals with expertise in compliance and financial markets. The Committee had the responsibility to create guidelines for product approval based on risk criteria. During the material time, products that were rated by a recognized bond rating agency as investment grade BBB or better were pre-approved by the Committee for distribution.

44. Since third-party ABCP met the Respondent's product approved threshold, they automatically became eligible as part of the Respondent's pool of fixed-income products available for purchase by clients through the Respondent's Approved Persons.

**PRODUCT KNOWLEDGE**

45. The Respondent did not use adequate due diligence in order to learn and remain informed that there were additional complexities relating to the third-party ABCP products that were made available to retail clients and the consequent risks (including systemic risks and counterparty risks) related to those products. The Respondent relied primarily on the credit rating provided by DBRS as the basis for making these products available.

46. More specifically, the Respondent failed to take adequate steps to ensure that its Approved Persons involved in the sale and distribution of third-party ABCP to retail clients understood the complexities and risks inherent in the product arising out of :

    - The basic structure of ABCP and the roles of the various entities (sponsors, issuer, trustee, asset providers);
    - The nature and composition of the underlying assets;
    - The lack of transparency relating to the underlying assets and liquidity agreements; and
    - The nature and limitations of the liquidity facilities.

47. Where Approved Persons had questions about third-party ABCP, they had access to the bond desk of the carrying broker through the internet, e-mail and in some circumstances telephone. The Respondent relied upon the carrying broker for information relating to third-party ABCP.

48. Staff interviewed several of the Respondent's retail advisors who revealed that, except for basic information relating to term, return and rating, they knew very little about the complexities of the ABCP product and the consequent risks (including systemic risks and counterparty risks) related to the product. Advisors based their investment recommendations on the rating, return and term of the product as well as

any information they received from the carrying broker's bond desk.

49. Without a full understanding of the complex nature of third-party ABCP, certain Approved Persons were representing the product to their clients as a safe and secure investment that was similar to a T-bill, Guaranteed Investment Certificate or a term deposit.

50. Under its relief program, the Respondent returned to the vast majority of its retail clients full face value plus interest and costs of up to $1 million in exchange for the Notes issued following the restructuring of the third-party ABCP market.

**51.** Since the time when the issues surrounding the third-party ABCP became known, the Respondent proactively undertook an examination of and has instituted several changes to its procedures and systems to strengthen the review of complex fixed income securities that are traded by its retail clients and has made additions to its risk monitoring personnel. The Respondent is in the process of instituting additional training modules for its Approved Persons regarding due diligence practices, fixed income structured products and is taking other appropriate steps.

## IV. CONTRAVENTIONS

52. In or about 2006 and 2007, the Respondent did not take adequate steps to ensure that its Approved Persons understood the complexities of the third-party ABCP product made available for purchase by its retail clients and the consequent risks (including systemic risks and counterparty risks) related to those products and, in not taking these adequate steps, did not ensure that the purchase of third-party ABCP was appropriately understood by its clients, contrary to Regulation 1300.1(a).

## V. TERMS OF SETTLEMENT

53. IIROC and the Respondent agrees to the following terms of settlement:

    (i) A fine in the amount of $200,000 (inclusive of costs); and

    (ii) The retention of an independent consultant in accordance with Schedule A of this Settlement Agreement.

54. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

55. 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.

## VI. STAFF COMMITMENT

56. If the Hearing Panel approves this Settlement Agreement, Staff, the Ontario Securities Commission and Autorité des marchés financiers will not commence any proceeding under applicable legislation and rules against the Respondent or any of its affiliates or their respective present or former directors, officers, employees or agents in relation to the facts set out in Part III of this Settlement Agreement.

**AGREED TO** by the Respondent at the City of Vancouver in the Province of British Columbia, this __17th__ day of December, 2009.

**Credential Securities Inc.**

RESPONDENT

**"Witness signature"**

**Witness**

**"Doce Tomic"**

**DOCE TOMIC**

President & Chief Executive Officer

**AGREED TO** by Staff at the City of Toronto in the Province of Ontario, this 17th day of December, 2009.

**"Witness signature"**

**Witness**

**"Tamara Brooks"**

**Tamara Brooks**

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

**"Witness signature"**

**Witness**

**"Elsa Renzella"**

**Elsa Renzella**

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

**ACCEPTED** at the City of Vancouver in the Province of British Columbia, this 21st day of December, 2009, by the following Hearing Panel:

Per: "John Rogers"

**Panel Chair**

Per: "Chris Lay"

Panel Member

Per: "Brian Field"

Panel Member

## SCHEDULE "A" – TERMS OF REFERENCE FOR COMPLIANCE REVIEW

Credential Securities Inc. (the "Respondent") agrees to retain an independent third-party Consultant to carry out a verification review concerning the Respondent's due diligence practices, policies and procedures relating to fixed income securities, subject to the terms set out below:

A. Remedial Steps Taken by the Respondent In Light of ABCP Market Disruption

After August 2007, the Respondent reviewed its policies and procedures in connection with its fixed income business particularly in relation to third-party ABCP and took the following remedial actions:

a. reviewed and revised its Product Review Policy, practices and systems;

b. engaged additional personnel to assist with risk monitoring; and

c. commenced development of additional training modules for advisors on due diligence practices and fixed income structured products.

B. Terms of Reference for Engagement of the Consultant

1. The agreement between the Respondent and the Consultant ("Agreement") shall provide that the Consultant will conduct a verification review of the implementation of the remedial actions outlined in A above insofar as they relate to:

a. The Respondent's compliance and oversight functions concerning its sales with respect to fixed income securities made available to clients;

b. any committees or other mechanisms established to review and approve new fixed income securities made available to clients and changes to those securities;

c. the training of the Respondent's staff concerning fixed income securities; and

d. the Respondent's procedures regarding staff compliance with the foregoing.

(collectively, the "Verification Review").

C. The Consultant's Reporting Obligations

1. The Consultant shall issue a draft report concerning its Verification Review to the Respondent and IIROC within 3 months of its appointment. The Consultant may request the opportunity to present its draft report to the Board of Directors of the Respondent.

2. The Consultant shall engage with the Respondent in discussions regarding the draft report with a view to reaching consensus and finalizing the report within 1 month of the delivery of its draft report. If requested by the Consultant, the Consultant will be provided with an opportunity to present its final report to the Board of Directors of the Respondent, and may explain any areas of disagreement with management of the Respondent.

3. The Consultant will deliver its final report to the Respondent and to IIROC.

4. The Consultant's report shall include a description of the Verification Review performed and whether the remedial actions taken by the Respondent conforms with the applicable requirements of Dealer Member Rules 1300.1 and 2500, and IIROC notice 09-0087 entitled Best Practices for Product Due Diligence as those Rules and Notice apply to the subject matter of the Verification Review in Section B(1) above , and if not, the Consultant's recommendations for any changes to those remedial actions that the Consultant reasonably deems necessary.

5. The Respondent will, within 60 days after receipt of the Consultant's report, advise IIROC of a timetable to implement the recommendations contained in the Consultant's report, provided however, that in the event that the Respondent disagrees with or wishes to adopt other actions, policies or procedures in lieu of any of the Consultant's recommendations, the Respondent shall so advise IIROC and provide its reasons for its position and any alternative actions, policies or procedures the Respondent intends to adopt.

6. The Respondent shall certify to IIROC, by certificate executed on its behalf by each of the CEO, the UDP and the CCO of the Respondent and the Chair of the Board of Directors of the Respondent that the Respondent has implemented those recommendations of the Consultant or other actions, policies or procedures which it has agreed to adopt, promptly following such implementation.

7. For greater certainty, the terms of this Verification Review do not limit in any respect the authority of IIROC to undertake, as part of their normal course audit activities, a review of all matters within the scope of the Verification Review or any other aspect of the business of the Respondent.

D. Required Terms of Agreement with Consultant

1. The selection of the Consultant shall be made promptly following the approval of the Settlement Agreement, but in any event by no later than January 31, 2010, by mutual agreement between the Respondent and IIROC.

2. The Consultant shall have reasonable access to all of the Respondent's books and records and the ability to meet privately with the Respondent's personnel. The Respondent shall instruct and otherwise encourage its officers, directors, and employees to cooperate fully with the Verification Review conducted by the Consultant, and inform its officers, directors, and employees that failure to cooperate with the Verification Review may be grounds for disciplinary action.

3. The Consultant shall make and keep notes of interviews conducted, and keep a copy of documents

gathered, in connection with the performance of his or her responsibilities, copies of which will be made available to the Respondent and IIROC.

4. The Consultant's reasonable compensation and expenses shall be borne by the Respondent.