

# Re BMO Nesbitt Burns

IN THE MATTER OF:

**Universal Market Integrity Rules**

**And**

**BMO Nesbitt Burns Inc**

2010 IIROC 39

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

Heard: August 16, 2010 in Toronto ON  
Decision: August 30, 2010  
(14 paras.)

**Hearing Panel:**

The Honourable Fred Kaufman, C.M., Q.C. (Chair)  
Charles F. Macfarlane  
Terry Bourne

**Appearance:**

Kathryn Andrews, Enforcement Counsel  
David Hausman, Respondent's Counsel

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## REASONS FOR THE PANEL'S DECISION

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¶ 1 By Offer of Settlement dated July 9, 2010, Senior Enforcement Counsel of the Investment Industry Regulatory Organization of Canada ("IIROC"), advised the Respondent that an investigation into the latter's conduct "has disclosed matters for which IIROC seeks certain sanctions ... pursuant to Rule 10.5 of the Universal Market Integrity Rules )"UMIR")."

¶ 2 The "matters" for which sanctions were sought were set out in Appendix "A" of the Offer of Settlement, and they consisted of the following contravention:

Between October 2008 and October 2009, it [the Respondent] failed to make reasonable efforts to connect to the Omega ATS protected marketplace, contrary to UMIR 5.2 and UMIR Policy 5.2.

¶ 3 In essence, UMIR 5.2 deals with the "Best Price Obligation," and it requires all Participants to make "reasonable efforts" at the time of the execution of an order to ensure that the order is executed at the best price, be it an offer or a bid.

¶ 4 Policy 5.2, which accompanies the Rule, provides that while "reasonable efforts" did not require a Participant to become a member, user or subscriber of each protected marketplace, a "Participant will have been found to have made 'reasonable efforts' ... if the Participant has: (i) Entered the order on a marketplace that will ensure compliance with the 'best price' obligation; (ii) Used an acceptable order router; or (iii) Provided the order to another Participant for entry on a marketplace."

¶ 5 At the time the Rule was instituted, there were five protected marketplaces: (i) Chi-X; (ii) CNQ (including Pure Trading); (iii) Omega; (iv) TSX; and (v) TSXV. Therefore, as of May 16, 2008, when this Rule and Policy came into force, a Participant had an obligation to execute against better-priced orders on the five protected marketplaces listed above before executing at an inferior price on any marketplace or foreign organized regulatory market.

¶ 6 To achieve this objective, a Participant, like the Respondent, had to be “connected” to the protected marketplaces, and indeed, between November 2008 and April 2010, BMO Nesbitt Burns (“BMONB”) connected to all but one – Omega – of the protected marketplaces.

¶ 7 In November 2008, IIROC Staff wrote to BMONB concerning “a larger than average” number of “trade through” alerts, which identify possible trade through violations. BMONB advised that it had not yet connected the Chi-X or Omega, but that it continued to work through various issues to achieve connectivity to these two marketplaces. In late February 2009, IIROC Staff again raised this issue, noting that there had not been any significant improvement since the December correspondence. BMONB replied in March 2009 to advise that while its retail trading group had connected to Chi-X, its institutional trading group had not yet done so, and that neither group was connected to Omega.

¶ 8 IIROC’s Enforcement Department began its investigation in September 2009, and it concluded that although BMONB had taken some steps to establish connectivity to Omega ATS in the relevant period, it had not met the reasonable efforts requirement of IIROC Rule 5.2, and hence the charge.

¶ 9 The Respondent accepted IIROC’s Offer of Settlement, admitting thereby that, “between October 2008 and October 2009, it failed to make reasonable efforts to connect to the Omega ATS protected marketplace, contrary to UMIR 5.2 and UMIR Policy 5.2.”

¶ 10 The Respondent further accepted the penalties proposed by IIROC Staff in the Offer: (i) a fine of \$250,000.00, and (ii) costs of \$15,000.00, both amounts to be paid by the Respondent to IIROC within 30 days of the hearing panel’s decision, should the agreement be accepted.

¶ 11 It is well accepted that hearing panels should not attempt to “fine-tune” agreements reached by the parties, particularly where, as here, the two sides are evenly matched and represented by experienced and competent counsel. What is important is that the proposed agreement appears to the panel to be reasonable given the specific facts of the case, and that the proposed penalties will not only be a punishment for the party, but also a warning to others who may be tempted to conduct themselves in a similar manner.

¶ 12 The case now before us is somewhat unusual because there is no case law dealing with violations of UMIR 5.2, and the closest analogy which counsel could find was a case involving TD Securities Inc., [2006] R.S.D.D. No. 1, where the Respondent was fined \$350,000.00 and costs of \$80,000.00, for contravening, “on hundreds of occasions,” a number of UMIR Rules dealing with the best execution obligation, audit trails, exposure of client orders, and the retention of records. That decision, too, was the result of a Settlement Agreement.

¶ 13 After reading the relevant documents and hearing the arguments of counsel, we concluded that the agreement reached was reasonable and served the purpose and objectives relating to punishment in general. We noted that the Respondent cooperated with IIROC Staff throughout, that the damage done, if any, was slight, and that the deficiencies were eventually, though belatedly, corrected. The delay between the first warning and the remedial actions was far too long, and no valid reason was advanced why compliance with the Rule could not have been achieved much earlier.

¶ 14 In the result, for the reasons set out above, the Settlement Agreement was approved.

Given in Toronto, Ontario, this 30<sup>th</sup> day of August, 2010.

Hon. Fred Kaufman, Chair

**\* \* \* \* STATEMENT OF ALLEGATIONS \* \* \* \***

**I. REQUIREMENT CONTRAVENED**

1. It is alleged that BMO Nesbitt Burns (BMONB) has committed the following contravention:

Between October 2008 and October 2009, it failed to make reasonable efforts to connect to the Omega ATS protected marketplace, contrary to UMIR 5.2 and UMIR Policy 5.2.

2. The text of the relevant Requirement is set out in Schedule A hereto.

**II. RELEVANT FACTS AND CONCLUSIONS**

**Overview**

3. During the period October 2008 to October 2009, BMONB failed to comply with UMIR 5.2 and Policy 5.2. During this time, IIROC required all Participants, including BMONB to comply with this Rule. However, BMONB did not fully comply until May 2010, two years later.

**Background**

4. BMONB is registered as an investment dealer, is a Participating Organization of the Toronto Stock Exchange (the TSX), a Member of the TSXV, and therefore, a Participant under UMIR.
5. On May 16, 2008, Market Regulation Services Inc. instituted amendments to UMIR 5.2, (the “Rule”) which required that a Participant make reasonable efforts at the time of the execution of an order to ensure that,
- (i) In the case of an offer, the order is executed at the best bid price; and
  - (ii) In the case of a bid, the order is executed at the best ask price.
6. Policy 5.2, which accompanied the Rule, further provided that “reasonable efforts” did not require that a Participant become a member, user or subscriber of each protected marketplace. A Participant will have been found to have made “reasonable efforts” to comply with the best price obligation if the Participant has:
- (i) Entered the order on a marketplace that will ensure compliance with the “best price” obligation;
  - (ii) Used an acceptable order router; or
  - (iii) Provided the order to another Participant for entry on a marketplace.
7. At the time the Rule was instituted, the following were “protected marketplaces”:
- (i) Chi-X;
  - (ii) CNQ (including Pure Trading);
  - (iii) Omega;
  - (iv) TSX; and
  - (v) TSXV.

8. Therefore, as of May 16, 2008, a Participant has an obligation to execute against better-priced orders on Chi-X, CNQ, Omega, Pure, TSX and TSXV before executing at an inferior price on any marketplace or foreign organized regulatory market.
9. On April 17, 2009, IIROC issued a Rule Notice, Notice of Approval of UMIR 09-0107. This Rules Notice advised that the Rule effected on May 16, 2008 had been approved retroactively by the recognizing securities regulators.

### **Connectivity to the Protected Marketplaces**

10. During the relevant period BMONB was connected to the TSX, TSX-V and CNX (Pure Trading). BMONB connected to Alpha ATS by November 2008.
  - a) Chi-X
    11. Chi-X was launched in February 2008, with a full list of securities available for trade by March 2008. BMONB did not sign a subscription agreement with Chi-X until December 2008. Thereafter, the following connections were made:
      - (i) Retail trading – connected February 2009;
      - (ii) Algorithmic and institutional trading/proprietary – connected October 2009;
      - (iii) Institutional trading/agency – connected February 2010; and
      - (iv) Derivatives trading – connected late April 2010.
    - b) Omega ATS
      12. Omega ATS was launched in December 2007, with a full list of securities available for trade by October 2008. BMONB did not sign a subscription agreement until October 14, 2009. Thereafter, the following connections were made:
        - (i) Retail trading – connected December 2009;
        - (ii) Institutional trading/proprietary and algorithmic – connected December 2009;
        - (iii) Institutional trading/agency – connected April 2010; and
        - (iv) Derivative trading – connected May 13, 2010.

### **Trade Through Alert Rates & Efforts to Connect**

13. In November 2008, IIROC Staff wrote to BMONB advising it that it was responsible for a larger than average number of “trade through” alerts as identified through the Integrated Transaction Systems Monitor (ITS Monitor). A “trade through” alert identifies a possible trade through violation. BMONB was asked to confirm whether it was considering better prices on all protected marketplaces and routing to those markets when necessary.
14. In December 2008, BMONB responded and advised IIROC that it had connected to four of the six protected marketplaces – TSX, TSX-V, Pure and Alpha. It had not yet connected to Chi-X or Omega. BMONB’s position in its response was that it continued to work through various issues to achieve connectivity to these two marketplaces.
15. In late February 2009, IIROC Staff again wrote to BMONB advising that IIROC had continued to monitor BMONB’s trade through rate and noted that there had not been any significant improvement since its December correspondence.
16. In March 2009, BMONB responded and advised IIROC Staff that although its retail trading group had recently established connectivity to Chi-X, their institutional trading group had not yet connected to Chi-X, and neither group had yet connected to Omega.

17. In September 2009, BMONB was advised that IIROC's Enforcement Department had begun an investigation into BMONB's compliance with Rule 5.2.
18. BMONB cooperated with IIROC Staff throughout the investigation.
- ~~19.~~ During the relevant period, the number of trade through alerts received by BMONB as a result of its failure to connect to Omega ATS was small relative to its trading volume.
20. Despite the requirement of Rule 5.2, BMONB instead relied on the following factors in determining when it would connect to Omega, the first three of which are not considerations under UMIR Policy 5.2:
  - (i) Omega's launch process;
  - (ii) Technological challenges in connecting to Omega;
  - (iii) Omega's liquidity levels; and
  - (iv) Availability of Omega's market data.
21. Although BMONB took some steps to establish connectivity to Omega ATS in the relevant period, it did not meet the reasonable efforts requirement of IIROC Rule 5.2.

July 9, 2010

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

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### ***SCHEDULE "A"***

#### ***EXCERPTS FROM THE UNIVERSAL MARKET INTEGRITY RULES MADE AND ADOPTED AS RULES OF IIROC PURSUANT TO TRANSITION RULE 1.1 SCHEDULE A.1***

#### ***EXCERPTS FROM THE UNIVERSAL MARKET INTEGRITY RULES***

##### **5.2 Best Price Obligation**

- (1) A Participant shall make reasonable efforts at the time of the execution of an order to ensure that:
  - (a) in the case of an offer, the order is executed at the best bid price; and
  - (b) in the case of a bid, the order is executed at the best ask price.
- (2) Subsection (1) does not apply to the execution of an order which is:
  - (a) required or permitted by a Market Regulator pursuant to clause (b) of Rule 6.4 to be executed other than on a marketplace in order to maintain a fair or orderly market;
  - (b) a Special Terms Order unless:
    - (i) the security is a listed security or quoted security and the Marketplace Rules of the Exchange or QTRS governing the trading of a Special Terms Order provide otherwise, or
    - (ii) the order could be executed in whole, according to the terms of the order, on a marketplace or with a market maker displayed in a consolidated market display;
  - (c) directed or consented to by the client to be entered on a marketplace as:

- (i) a Call Market Order,
  - (ii) a Volume-Weighted Average Price Order,
  - (iii) a Market-on-Close Order,
  - (iv) an Opening Order,
  - (v) a Basis Order, or
  - (vi) a Closing Price Order; or
- (d) a client order on behalf of a non-Canadian account executed other than on a marketplace pursuant to clause (d) or (e) of Rule 6.4 provided such client order does not execute with a principal order or non-client order of the Participant.

**\* \* \* \* OFFER OF SETTLEMENT \* \* \* \***

**A. 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).
2. The Investigation has disclosed matters for which IIROC seeks certain sanctions against the Respondent pursuant to Rule 10.5 of the Universal Market Integrity Rules (UMIR).
3. If this Offer of Settlement is accepted by the Respondent, the resulting settlement agreement (the Settlement Agreement), which has been negotiated in accordance with Part 3 of UMIR Policy 10.8, is conditional upon the approval by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1 (the Hearing Panel).
4. The Respondent agrees to waive all rights under UMIR to a hearing or to an appeal or review if the Settlement Agreement is approved by the Hearing Panel.
5. The Respondent consents to be subject to the jurisdiction of IIROC and its relevant disciplinary process and rules in relation to this matter.
6. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

**B. AGREEMENT AS TO REQUIREMENT CONTRAVENED**

7. The Respondent agrees that between October 2008 and October 2009, it failed to make reasonable efforts to connect to the Omega ATS protected marketplace, contrary to UMIR 5.2 and UMIR Policy 5.2.

**C. ADMITTED FACTS**

8. Staff and the Respondent agree with and rely upon the admitted facts and conclusions which are set out in the Statement of Allegations attached as Appendix A to this Settlement Agreement.

**D. DISPOSITION**

9. For the contravention in paragraph 7 above, Staff and the Respondent have agreed upon disposition as follows:
  - (i) a fine of \$250,000.00 payable by the Respondent to IIROC; and
  - (ii) costs of \$15,000.00 payable by the Respondent to IIROC.
10. If this Settlement Agreement is accepted by a Hearing Panel, the Respondent agrees to pay the amounts referred to in paragraph 9 within 30 days of such acceptance.

**E. PROCEDURES FOR ACCEPTANCE OF OFFER OF SETTLEMENT AND APPROVAL OF SETTLEMENT AGREEMENT**

11. The Respondent shall have until the close of business on July 9, 2010 to accept the Offer of Settlement and serve an executed copy thereof on Staff.
12. This Settlement Agreement shall be presented to a Hearing Panel at a public hearing (the Approval Hearing) held for the purpose of approving the Settlement Agreement, in accordance with the procedures described in UMIR Policy 10.8 in addition to any other procedures as may be agreed upon between the parties. The Respondent acknowledges that IIROC shall notify the public and media of the Approval Hearing in such manner and by such media as IIROC sees fit.
13. Pursuant to Part 3.4 of UMIR Policy 10.8, the Hearing Panel may accept or reject this Settlement Agreement.
14. In the event the Settlement Agreement is accepted by a Hearing Panel, the matter becomes final, there can be no appeal or review of the matter, the disposition of the matter agreed upon in this Settlement Agreement will be included in the permanent record of IIROC in respect of the Respondent and IIROC will publish a summary of the Requirement contravened, the facts, and the disposition agreed upon in the Settlement Agreement.
15. In the event the Hearing Panel rejects the Settlement Agreement, IIROC may proceed with a hearing of the matter before a differently constituted Hearing Panel pursuant to Part 3.7 of UMIR Policy 10.8 and this Settlement Agreement may not be referred to without the consent of both parties.
16. The Respondent agrees that, in the event it fails to comply with any of the terms of the Settlement Agreement, IIROC may enforce this settlement in any manner it deems appropriate and may, without limiting the generality of the foregoing, suspend the Respondent's access to marketplaces regulated by IIROC until IIROC determines that the Respondent is in full compliance with all terms of the Settlement Agreement.
17. The Respondent agrees that neither it, nor anyone on its behalf, will make a public statement inconsistent with this Settlement Agreement.

IN WITNESS WHEREOF the parties have signed this Settlement Agreement as of the dates noted below.

DATED at Toronto on the 12th day of July, 2010.

"Witness signature" \_\_\_\_\_

Witness Signature

"Michael Petrocco"

Name of Witness

"100 King St. W. 21<sup>st</sup> floor"

Address of Witness

DATED at Toronto, Ontario on the 9<sup>th</sup> day of July , 2010.

Per: "Diana Iannetta"

Diana Iannetta

Senior Enforcement Counsel

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

Suite 1600, 121 King Street West

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This foregoing Settlement Agreement is hereby approved this 16<sup>th</sup> day of August, 2010, by the following hearing panel constituted to review the terms thereof:

Per: “Fred Kaufman”

Panel Chair

Per: “Terry Bourne”

Panel Member

Per: “Charlie Macfarlane”

Panel Member

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