

Re National Bank Financial, Clarke and O'Reilly

IN THE MATTER OF:

The Universal Market Integrity Rules

and

National Bank Financial Inc.

and

Paul Clarke and Todd O'Reilly

2011 IIROC 1

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

Heard: December 6, 2010 in Montreal QC

Decision: January 11, 2011

(14 paras.)

Hearing Panel:

Me Guy Lafrance, chairman

Mr. Jean André Elie, member

Mr. Yves Julien member

Appearance:

Me Charles Corlett, Senior Enforcement Counsel

Me Sébastien Tisserand, Avocat de la mise en application

Me Joel Wiesenfeld for National Bank Financial Inc.

Me Paul Le Vay for Paul Clarke and Todd O'Reilly

DECISION

¶ 1 On December 6th 2010, a hearing panel of the Investment Industry Regulatory Organization of Canada (IIROC) heard the submission for approval of three settlement agreements between IIROC staff, National Bank Financial Inc. and two registered employees of National Bank's Halifax branch, Mr Paul Clarke and Mr. Todd O'Reilly which read as follows:

IN THE MATTER OF

PAUL CLARKE

OFFER OF SETTLEMENT

A. INTRODUCTION

1. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. (RS). Pursuant to the *Administrative and Regulatory Services Agreement* between RS and IIROC, effective June 1,

2008, RS has retained IIROC to provide services for RS to carry out its regulatory functions.

2. The Enforcement Department Staff (Staff) of the Investment Industry Regulatory Organization of Canada (IIROC) has conducted an investigation (the Investigation) into the conduct of Paul Clarke (the Respondent).
3. 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).
4. 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).
5. 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.
6. The Respondent consents to be subject to the jurisdiction of IIROC and its relevant disciplinary process and rules in relation to this matter.
7. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

B. AGREEMENT AS TO REQUIREMENTS CONTRAVENED

8. The Respondent agrees that between April 2006 and June 2007, he contravened the following Requirements of UMIR:
 - (i) failed to transact business openly and fairly and in accordance with just and equitable principles of trade by failing to record client account numbers or identifiers upon receipt of client orders and delaying timely allocation of trades to client accounts, which resulted in the ability to effect improper post-execution allocation of trades and grant preferential treatment to certain clients, contrary to UMIR 2.1 and UMIR Policy 2.1, for which he is liable pursuant to UMIR 10.4(1); and
 - (ii) caused contraventions of UMIR 10.11(1) by failing on receipt or origination of certain orders to record specific information relating to the orders as required by Part 11 of the Trading Rules (National Instrument 23-101), for which he is liable pursuant to UMIR 10.3(4).

C. ADMITTED FACTS

9. For the purposes of this Settlement Agreement, 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

10. For the contraventions in paragraph 8 above, Staff and the Respondent have agreed upon disposition as follows:
 - (i) a fine of \$110,000.00 payable by the Respondent to IIROC; and
 - (ii) costs of \$5,000.00 payable by the Respondent to IIROC.
11. If this Settlement Agreement is accepted by a Hearing Panel, the Respondent agrees to pay the amounts referred to in paragraph 10 within 30 days of such acceptance.

**IN THE MATTER OF
TODD O'REILLY**

OFFER OF SETTLEMENT

A. INTRODUCTION

1. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. (RS). Pursuant to the *Administrative and Regulatory Services Agreement* between RS and IIROC, effective June 1, 2008, RS has retained IIROC to provide services for RS to carry out its regulatory functions.
2. The Enforcement Department Staff (Staff) of the Investment Industry Regulatory Organization of Canada (IIROC) has conducted an investigation (the Investigation) into the conduct of Todd O'Reilly (the Respondent).
3. 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).
4. 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).
5. 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.
6. The Respondent consents to be subject to the jurisdiction of IIROC and its relevant disciplinary process and rules in relation to this matter.
7. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

B. AGREEMENT AS TO REQUIREMENTS CONTRAVENED

8. The Respondent agrees that between April 2006 and June 2007, he contravened the following Requirements of UMIR:
 - (i) failed to transact business openly and fairly and in accordance with just and equitable principles of trade by failing to record client account numbers or identifiers upon receipt of client orders and delaying timely allocation of trades to client accounts, which resulted in the ability to effect improper post-execution allocation of trades and grant preferential treatment to certain clients, contrary to UMIR 2.1 and UMIR Policy 2.1, for which he is liable pursuant to UMIR 10.4(1); and
 - (ii) caused contraventions of UMIR 10.11(1) by failing on receipt or origination of certain orders to record specific information relating to the orders as required by Part 11 of the Trading Rules (National Instrument 23-101), for which he is liable pursuant to UMIR 10.3(4).

C. ADMITTED FACTS

9. For the purposes of this Settlement Agreement, 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

10. For the contraventions in paragraph 8 above, Staff and the Respondent have agreed upon disposition as follows:
 - (i) a fine of \$15,000.00 payable by the Respondent to IIROC; and
 - (ii) costs of \$2,500.00 payable by the Respondent to IIROC.

11. If this Settlement Agreement is accepted by a Hearing Panel, the Respondent agrees to pay the amounts referred to in paragraph 10 within 30 days of such acceptance.

PAUL CLARKE AND TODD O'REILLY

STATEMENT OF ALLEGATIONS

I. REQUIREMENTS CONTRAVENED

1. Between April 2006 and June 2007, Paul Clarke, a Registered Representative at National Bank Financial Inc., contravened the following Requirements of UMIR:
 - (i) failed to transact business openly and fairly and in accordance with just and equitable principles of trade by failing to record client account numbers or identifiers upon receipt of client orders and delaying timely allocation of trades to client accounts, which resulted in the ability to effect improper post-execution allocation of trades and grant preferential treatment to certain clients, contrary to UMIR 2.1 and UMIR Policy 2.1, for which he is liable pursuant to UMIR 10.4(1); and
 - (ii) caused contraventions of UMIR 10.11(1) by failing on receipt or origination of certain orders to record specific information relating to the orders as required by Part 11 of the Trading Rules (National Instrument 23-101), for which he is liable pursuant to UMIR 10.3(4).
2. Between April 2006 and June 2007, Todd O'Reilly, an Investment Representative at National Bank Financial Inc., contravened the following Requirements of UMIR:
 - (i) failed to transact business openly and fairly and in accordance with just and equitable principles of trade by failing to record client account numbers or identifiers upon receipt of client orders and delaying timely allocation of trades to client accounts, which resulted in the ability to effect improper post-execution allocation of trades and grant preferential treatment to certain clients, contrary to UMIR 2.1 and UMIR Policy 2.1, for which he is liable pursuant to UMIR 10.4(1); and
 - (ii) caused contraventions of UMIR 10.11(1) by failing on receipt or origination of certain orders to record specific information relating to the orders as required by Part 11 of the Trading Rules (National Instrument 23-101), for which he is liable pursuant to UMIR 10.3(4).
3. Schedule "A" sets out the text of the relevant Requirements.

II. RELEVANT FACTS AND CONCLUSIONS

Overview

4. Between April 2006 and June 2007, Clarke, an investment advisor, and his sales assistant, O'Reilly, employed in NBF's Halifax retail branch (the "Halifax Representatives"), committed audit trail contraventions and engaged in a course of conduct whereby they failed to properly record certain information concerning individual trades and on more than one occasion effected improper post-execution allocation of trades.
5. The Halifax Representatives routinely placed orders with NBF's Montreal Retail Trade Desk without identifying the client account for which the order was placed and failed to keep adequate records of required audit trail information.
6. The Halifax Representatives were permitted to hold trades executed through the Montreal Retail Trade Desk in a firm inventory account for up to 30 days without allocating them to client accounts as distinct from the standard T+3 settlement date stated in NBF's policy and procedure.
7. The ability to enter orders without identifying a client account and to delay allocation to client

accounts allowed clients of the Halifax Representatives to access firm capital for up to 30 days, caused uncertainty regarding ownership of certain positions, and resulted in the ability of the Halifax Representatives to grant preferential treatment to their clients.

Background

8. NBF is registered as an investment dealer, is a Participating Organization of the Toronto Stock Exchange (the “TSX”), a Member of the TSX Venture Exchange (the “TSXV”), and therefore, a Participant under UMIR.
9. Clarke and O’Reilly have been employed in NBF’s Halifax branch since June 2004. O’Reilly was Clarke’s dedicated sales assistant and entered orders for, and assisted with the handling of, Clarke’s client accounts.
10. During the relevant period, Clarke was the investment advisor for a group of related clients (the “Client Group”). The Client Group held both personal and corporate accounts with Clarke, including an account for a publicly-traded company listed on the TSX (the “Public Company Account”).
11. During the relevant period, Clarke was one of NBF’s largest retail producers, generating significant commissions. The Client Group accounted for the majority of Clarke’s assets under management, annual commissions, and trades.
12. The orders and trades at issue were entered and executed on IIROC-regulated marketplaces.

The Montreal Retail Trade Desk Accumulation Account

13. The Montreal Retail Trade Desk had access to a firm inventory account for the purpose of accumulating shares when handling large client orders (the “Accumulation Account”). The Accumulation Account was intended to be a temporary repository for fills of large orders, and orders that otherwise required special handling.
14. During the Relevant Period, NBF had a policy whereby a client position could remain in the Accumulation Account for up to three days before being allocated to the client’s account; extensions could be granted on request in two day increments with the approval of the Montreal Retail Trade Desk supervisor.
15. The Halifax Representatives routinely held shares for the Client Group and several other clients in the Accumulation Account past standard settlement date and for up to 30 days, with the approval of and knowledge of NBF.

Audit Trail Deficiencies

16. During the relevant period, the Halifax Representatives, when accepting orders from the Client Group and from other clients, repeatedly failed to record the client account number or client identifier.
17. The Halifax Representatives on certain occasions entered orders for both large and small volumes through the Montreal Retail Trade Desk, as opposed to through NBF’s automated order entry system. Orders could not be entered through the automated order entry system without a complete record of audit trail requirements.
18. The audit trail deficiencies for orders entered by the Halifax Representatives with the Montreal Retail Trading Desk, included numerous and repeated instances of:
 - (a) as noted above, failing to immediately record the client account number or client identifier;
 - (b) time-stamped empty trade tickets;
 - (c) trade tickets with no indication of the order price and/or quantity;

- (d) trade tickets that do not indicate the date or time the order was varied and do not indicate price changes;
 - (e) trade tickets where a client identifier was later replaced by another client identifier, the latter being the account that ultimately received the purchased shares; and
 - (f) information was added or changed on trade tickets at a later time from the information included on the original ticket.
19. There were several orders and trades during the period for which NBF has been unable to locate and produce a trade ticket. The trade tickets were prepared and kept by the Montreal Retail Trading Desk, not by the Halifax Representatives.

Risks Associated with Misuse of the Accumulation Account by the Halifax Representatives

20. The manner in which the Halifax Representatives used the Accumulation Account created risks to NBF and improperly benefited clients of the Halifax Representatives on more than one occasion.
21. The Halifax Representatives generally used the Accumulation Account for orders intended for accounts of the Client Group. At varying intervals, the Halifax Representatives and representatives of the Client Group would arrange to allocate the shares to the accounts (personal and private corporate accounts and the Public Company Account). The personal and private corporate accounts sometimes received shares that had increased in market price since the date of the initial trade.

Credit Risk

22. By entering orders with the Montreal Retail Trade Desk without identifying client accounts and holding the shares, often past regular settlement date, in the Accumulation Account, the Halifax Representatives granted the Client Group, and, on more than one occasion, also to employees of the Client Group and other unrelated clients, access to firm capital, which exposed NBF to credit risk.
23. For example, on April 3, 4 and 5, 2007, the Halifax Representatives purchased a total of 1,306,600 shares of FPI Limited, a security listed on the TSX, at a cost of approximately \$19.4 million. The shares were held in the Accumulation Account until April 10, 2007 when they were transferred to a client account unrelated to the Client Group. None of the buy tickets for the purchase of the shares correctly identified the client account that ultimately received the shares. The client who received the shares was new to the firm and the newly-opened account did not hold any assets or cash until April 17, 2007.
24. For further example, between May 1 and May 11, 2007, the Halifax Representatives accumulated 1,801,500 shares of Sobey's Inc. ("SBY") in the Accumulation Account through multiple orders that did not meet audit trail requirements, including numerous order tickets without any client account numbers or identifiers. For several transactions no trade ticket could be provided by NBF. On May 11, 2007, the Accumulation Account held an intraday debit of \$102,948,268 in shares of SBY at which time 801,500 shares were allocated to a private corporate account of the Client Group, which account was not identified on any of the buy order tickets. On May 15, 2007, the supervisor of the Montreal Retail Trade Desk informed O'Reilly that the risk management department was asking questions about the remaining 1,000,000 shares of SBY and asked if O'Reilly could take the shares out of the Accumulation Account. The remaining shares were allocated to the Public Company Account of the Client Group on May 16, 2007 for settlement on May 22, 2007.
25. On more than one occasion, shares were sold for substantial profits, without the client accounts expending or risking any funds or being subject to margin.

26. For example, on January 17, 2007, buy tickets for a total of 80,000 shares of Petro-Canada (“PCA”) at an average price of \$42.615 were filled for the account of the Public Company Account and allocated to the Accumulation Account. On January 23, 2007 (1 day past standard settlement date), 80,000 shares were sold by the Accumulation Account at an average price of \$44.433. The sell ticket identified the client account as a personal account of the Client Group. The personal account sold the shares, with the client account statement showing the shares bought and sold on January 23, 2007 at a realized profit of approximately \$142,000.

Uncertain Ownership

27. The practice of the Halifax Representatives and Montreal Retail Trade Desk of not recording and maintaining a proper audit trail caused uncertainty regarding ownership of certain positions.
28. For example, on December 29, 2006, in a telephone call with a trader on the Montreal Retail Trade Desk for the purpose of allocating shares from the Accumulation Account, Clarke could not recall which client account a December 11, 2006 purchase of a thousand shares of FPI Limited belonged to.
29. The original buy order ticket indicated that the order for 250,000 shares at \$5.80 and 250,000 at \$5.76 was for the Public Company Account. The order was filled for 1,000 shares at \$5.80.
30. Clarke instructed the trader to allocate the 1,000 shares to a client account (the account in question did not have sufficient funds to cover a purchase of 500,000 shares). The client account sold the shares, buying and selling the 1,000 shares on December 29, 2006, and profiting on the intervening market price increase from \$5.80 to \$7.60.
31. The buy order ticket was subsequently changed to indicate that the account that received the 1,000 shares had placed the order.
32. The uncertainty regarding ownership of certain positions held in the Accumulation Account resulted in the ability of the Halifax Representatives to grant preferential treatment to their clients. On more than one occasion, clients of the Halifax Representatives received a resulting benefit when the Halifax Representatives allocated trades held in the Accumulation Account to accounts of clients who had apparently not placed the original orders for those securities, and thereby allowed these clients to realize profits on market price increases since the date of the initial trade. The Halifax Representatives were able to engage in this improper conduct because of the ability to bypass audit trail requirements.
33. The Halifax Representatives conduct and audit trail deficiencies described above continued to occur after the relevant period of the IIROC investigation.

Mitigating Factors

34. No clients complained and no losses were claimed as a result of the Halifax Representatives’ conduct.
35. There were no unpaid accounts by any client and NBF suffered no losses as a result of the exposure to credit risk described.
36. Some of the orders entered by the Halifax Representatives with the Montreal Trading Desk were compliant with audit trail requirements.
37. The Halifax Representatives’ use of the Accumulation Account in filling large orders was intended to avoid charging their clients duplicative commissions, and to enable them to fill large orders at reasonable cost, having regard to the transactional trading fees applied by NBF to retail accounts.

III. CONCLUSION

38. UMIR requires that an employee of a Participant shall transact business openly and fairly and in accordance with just and equitable principles of trade when trading on a marketplace or trading or otherwise dealing in securities that are eligible to be traded on a marketplace.
39. By entering orders without identifying the client account and delaying the allocation of the executed trades to client accounts, Clarke and O'Reilly were able to effect improper post-execution allocations of trades and grant preferential treatment to certain clients on more than one occasion.

**IN THE MATTER OF
NATIONAL BANK FINANCIAL INC.
OFFER OF SETTLEMENT**

A. INTRODUCTION

1. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. (RS). Pursuant to the *Administrative and Regulatory Services Agreement* between RS and IIROC, effective June 1, 2008, RS has retained IIROC to provide services for RS to carry out its regulatory functions.
2. The Enforcement Department Staff (Staff) of the Investment Industry Regulatory Organization of Canada (IIROC) has conducted an investigation (the Investigation) into the conduct of National Bank Financial Inc. (the Respondent).
3. 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).
4. 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).
5. 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.
6. The Respondent consents to be subject to the jurisdiction of IIROC and its relevant disciplinary process and rules in relation to this matter.
7. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

C. AGREEMENT AS TO REQUIREMENTS CONTRAVENED

8. The Respondent agrees that between April 2006 and June 2007, it contravened the following Requirements of UMIR:
 - (i) failed to comply with its trading supervision obligations contrary to UMIR 7.1 and Policy 7.1; and
 - (ii) failed on receipt or origination of certain orders to record specific information relating to the orders as required by Part 11 of the Trading Rules (National Instrument 23-101) contrary to UMIR 10.11(1).

C. ADMITTED FACTS

9. Only for the purposes of this Settlement Agreement, 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

10. For the contraventions in paragraph 8 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 \$30,000.00 payable by the Respondent to IIROC.
11. If this Settlement Agreement is accepted by a Hearing Panel, the Respondent agrees to pay the amounts referred to in paragraph 10 within 30 days of such acceptance.

NATIONAL BANK FINANCIAL INC.

STATEMENT OF ALLEGATIONS

I. REQUIREMENTS CONTRAVENED

1. Between April 2006 and June 2007, National Bank Financial Inc. contravened the following Requirements of UMIR:
 - (i) failed to comply with its trading supervision obligations contrary to UMIR 7.1 and Policy 7.1; and
 - (ii) failed on receipt or origination of certain orders to record specific information relating to the orders as required by Part 11 of the Trading Rules (National Instrument 23-101) contrary to UMIR 10.11(1).
2. Schedule "A" sets out the text of the relevant Requirements.

II. RELEVANT FACTS AND CONCLUSIONS

Overview

3. Between April 2006 and June 2007, NBF contravened UMIR in connection with its trading supervision obligations and audit trail requirements.
4. NBF failed to ensure that there was full and proper supervision of its Montreal Retail Trade Desk and of a Registered Representative, Paul Clarke, and an Investment Representative, Todd O'Reilly, employed in the firm's Halifax retail branch (the "Halifax Representatives").
5. The Montreal Retail Trade Desk routinely accepted client orders from the Halifax Representatives without recording required audit trail information. In particular, the Halifax Representatives routinely placed orders with the Montreal Retail Trade Desk without identifying the client account for which the order was placed and failed to keep adequate records of required audit trail information.
6. The Halifax Representatives were permitted to hold trades executed through the Montreal Retail Trade Desk in a firm inventory account for up to 30 days without allocating them to client accounts as distinct from the standard T+3 settlement date stated in NBF's policy and procedure.
7. The ability to enter orders without identifying a client account and to delay allocation to client accounts allowed clients of the Halifax Representatives to access firm capital for up to 30 days, caused uncertainty regarding ownership of certain positions, and resulted in the ability of the Halifax Representatives to grant preferential treatment to their clients.

Background

8. NBF is registered as an investment dealer, is a Participating Organization of the Toronto Stock Exchange (the "TSX"), a Member of the TSX Venture Exchange (the "TSXV"), and therefore, a Participant under UMIR.
9. In the period April 2006 to June 2007, NBF was required to supervise its Montreal Retail Trade

Desk and its retail branches, which included a branch in Halifax.

10. Clarke and O'Reilly have been employed in NBF's Halifax branch since June 2004. O'Reilly was Clarke's dedicated sales assistant and entered orders for, and assisted with the handling of, Clarke's client accounts.
11. During the relevant period, Clarke was the investment advisor for a group of related clients (the "Client Group"). The Client Group held both personal and corporate accounts with Clarke, including an account for a publicly-traded company listed on the TSX (the "Public Company Account").
12. During the relevant period, Clarke was one of NBF's largest retail producers, generating significant commissions. The Client Group accounted for the majority of Clarke's assets under management, annual commissions, and trades.
13. The orders and trades at issue were entered and executed on IIROC-regulated marketplaces.

The Montreal Retail Trade Desk Accumulation Account

14. The Montreal Retail Trade Desk had access to a firm inventory account for the purpose of accumulating shares when handling large client orders (the "Accumulation Account"). The Accumulation Account was intended to be a temporary repository for fills of large orders, and orders that otherwise required special handling.
15. During the Relevant Period, NBF had a policy whereby a client position could remain in the Accumulation Account for up to three days before being allocated to the client's account; extensions could be granted on request in two day increments with the approval of the Montreal Retail Trade Desk supervisor.
16. The Halifax Representatives routinely held shares for the Client Group and several other clients in the Accumulation Account past standard settlement date and for up to 30 days, with the approval of and knowledge of NBF.

Audit Trail Deficiencies

17. The Montreal Retail Trade Desk routinely accepted orders from the Halifax Representatives without recording required audit trail information, including a client account number or client identifier.
18. The Halifax Representatives entered orders for both large and small volumes through the Montreal Retail Trade Desk, as opposed to through NBF's automated order entry system. Orders could not be entered through the automated order entry system without a complete record of audit trail requirements.
19. The audit trail deficiencies for orders entered by the Halifax Representatives with the Montreal Retail Trading Desk, included numerous and repeated instances of:
 - (g) as noted above, failing to immediately record the client account number or client identifier;
 - (h) time-stamped empty trade tickets;
 - (i) trade tickets with no indication of the order price and/or quantity;
 - (j) trade tickets that do not indicate the date or time the order was varied and do not indicate price changes;
 - (k) trade tickets where a client identifier was later replaced by another client identifier, the latter being the account that ultimately received the purchased shares; and

- (l) information was added or changed on trade tickets at a later time from the information included on the original ticket.
20. There were several orders and trades during the period for which NBF cannot supply a trade ticket.

Risks Associated with Misuse of the Accumulation Account by the Halifax Representatives

21. NBF's trading supervision failures resulted in use of the Accumulation Account by the Halifax Representatives in a manner that created risks to NBF and improperly benefited clients of the Halifax Representatives.
22. The Halifax Representatives generally used the Accumulation Account for orders intended for accounts of the Client Group. At varying intervals, the Halifax Representatives and representatives of the Client Group would arrange to allocate the shares to the accounts (personal and private corporate accounts and the Public Company Account). The personal and private corporate accounts sometimes received shares that had increased in market price since the date of the initial trade.

Credit Risk

23. By entering orders with the Montreal Retail Trade Desk without identifying client accounts and holding the shares, often past regular settlement date, in the Accumulation Account, the Halifax Representatives granted the Client Group, and, on more than one occasion, also to employees of the Client Group and other unrelated clients, access to firm capital, which exposed NBF to credit risk.
24. For example, on April 3, 4 and 5, 2007, the Halifax Representatives purchased a total of 1,306,600 shares of FPI Limited, a security listed on the TSX, at a cost of approximately \$19.4 million. The shares were held in the Accumulation Account until April 10, 2007 when they were transferred to a client account unrelated to the Client Group. None of the buy tickets for the purchase of the shares correctly identified the client account that ultimately received the shares. The client who received the shares was new to the firm and the newly-opened account did not hold any assets or cash until April 17, 2007.
25. For further example, between May 1 and May 11, 2007, the Halifax Representatives accumulated 1,801,500 shares of Sobeys Inc. ("SBY") in the Accumulation Account through multiple orders that did not meet audit trail requirements, including numerous order tickets without any client account numbers or identifiers. For several transactions no trade ticket could be provided by NBF. On May 11, 2007, the Accumulation Account held an intraday debit of \$102,948,268 in shares of SBY at which time 801,500 shares were allocated to a private corporate account of the Client Group, which account was not identified on any of the buy order tickets. On May 15, 2007, the supervisor of the Montreal Retail Trade Desk informed O'Reilly that the risk management department was asking questions about the remaining 1,000,000 shares of SBY and asked if O'Reilly could take the shares out of the Accumulation Account. The remaining shares were allocated to the Public Company Account of the Client Group on May 16, 2007 for settlement on May 22, 2007.
26. On more than one occasion, shares were sold for substantial profits, without the client accounts expending or risking any funds or being subject to margin.
27. For example, on January 17, 2007, buy tickets for a total of 80,000 shares of Petro-Canada ("PCA") at an average price of \$42.615 were filled for the account of the Public Company Account and allocated to the Accumulation Account. On January 23, 2007 (1 day past standard settlement date), 80,000 shares were sold by the Accumulation Account at an average price of \$44.433. The sell ticket identified the client account as a personal account of the Client Group.

The personal account sold the shares, with the client account statement showing the shares bought and sold on January 23, 2007 at a realized profit of approximately \$142,000.

Uncertain Ownership

28. The practice of the Halifax Representatives and Montreal Retail Trade Desk of not recording and maintaining a proper audit trail caused uncertainty regarding ownership of certain positions.
29. For example, on December 29, 2006, in a telephone call with a trader on the Montreal Retail Trade Desk for the purpose of allocating shares from the Accumulation Account, Clarke could not recall which client account a December 11, 2006 purchase of a thousand shares of FPI Limited belonged to.
30. The original buy order ticket indicated that the order for 250,000 shares at \$5.80 and 250,000 at \$5.76 was for the Public Company Account. The order was filled for 1,000 shares at \$5.80.
31. Clarke instructed the trader to allocate the 1,000 shares to a client account (the account in question did not have sufficient funds to cover a purchase of 500,000 shares). The client account sold the shares, buying and selling the 1,000 shares on December 29, 2006, and profiting on the intervening market price increase from \$5.80 to \$7.60.
32. The buy order ticket was subsequently changed to indicate that the account that received the 1,000 shares had placed the order.
33. The uncertainty regarding ownership of certain positions held in the Accumulation Account resulted in the ability of the Halifax Representatives to grant preferential treatment to their clients. On more than one occasion, clients of the Halifax Representatives received a resulting benefit when the Halifax Representatives allocated trades held in the Accumulation Account to accounts of clients who had apparently not placed the original orders for those securities, and thereby allowed these clients to realize profits on market price increases since the date of the initial trade. The Halifax Representatives were able to engage in this improper conduct because of the ability to bypass audit trail requirements.

Internal Reviews by NBF

34. NBF was aware of the audit trail deficiencies occurring at the Montreal Retail Trade Desk and that its overall performance was unsatisfactory.
35. In May 2006 an audit by internal auditors identified that over half of all trade tickets of the Montreal Retail Trade Desk that were reviewed were inadequate, and noted that the problem was occurring in relation to “manual orders”, as opposed to orders entered through the automated order entry system.
36. NBF was also aware of issues arising from trading by the Halifax Representatives with respect to the Client Group.
37. In August 2006, an internal review by the Respondent of the Halifax Representatives and the Client Group recognized that “[a]n institutional size client served by a retail IA leads to a series of concerns regarding supervision criteria to be applied and increases unnecessarily our regulatory burden under Policy #2. This concern is notably supported by the poor quality of responses provided by the IA to either the BM [Branch Manager] or Compliance Head office inquiries.”
38. Internal Quarterly Reviews by the Respondent in the period 2006-2007 indicate that issues with respect to positions being held in Accumulation Account by the Montreal Retail Trade Desk for extended periods were identified and that audit trail deficiencies were persistent.
39. Although supervision failings with respect to both the Halifax Representatives and Montreal Retail Trade Desk were continually highlighted by NBF during the relevant period, corrective

measures were not effected in a timely manner.

Remedial Steps Taken by NBF

40. NBF's course of conduct regarding the Halifax Representatives and Montreal Retail Trade remained essentially unchanged until IIROC discovered the problems in the course of its investigation. The Halifax Representatives conduct and audit trail deficiencies described above continued to occur after the relevant period of the IIROC investigation.

Mitigating Factors

41. In late 2008 and in 2009, NBF commissioned a third party to work with compliance to review and overhaul retail trade desk compliance practices and procedures. As a result of that process, new compliance practices and procedures were drafted and implemented, including new practices and procedures regarding the Accumulation Account and governing the Montreal Retail Trade Desk.
42. No clients complained and no client losses were claimed as a result of NBF's conduct.
43. There were no unpaid accounts by any client and NBF suffered no losses as a result of the exposure to credit risk described.
44. Some of the orders entered by the Halifax Representatives with the Montreal Retail Trade Desk were compliant with audit trail requirements.

III. CONCLUSION

45. The conduct described above occurred because of NBF's failure to fully and properly supervise the Halifax Representatives and the Montreal Retail Trade Desk.
46. Participants must supervise their employees to ensure that trading in securities on a marketplace is carried out in compliance with the applicable Requirements, which include provisions of securities legislation, UMIR, the Trading Rules and the Marketplace Rules of any applicable Exchange.
47. Participants must comply strictly with audit trail requirements. Such compliance is a cornerstone of effective compliance and supervision. A complete and proper audit trail is the foundation on which Participants demonstrate and evidence compliance with regulatory requirements.

¶ 2 The jurisdiction of the panel is limited. We have to accept the facts as they are written in the settlement agreements and decide if the suggested penalties are reasonable in the circumstances.

¶ 3 The panel cannot change the penalties agreed upon even if it thinks that other penalties would have been more appropriate.

¶ 4 If a sanction is in a reasonable range of appropriateness given the gravity of the misconduct and the facts agreed to, the panel has to accept it.

¶ 5 In the cases that we are dealing with, we have to keep in mind that the credibility of the market place rests to a great extent on the confidence of investors that they will be treated justly and equitably and that all participants will abide by open and fair business practices as dictated by Regulators.

¶ 6 The manner in which the Halifax Representatives used the Accumulation Account and the National Bank Financial Inc. allowed them to do so improperly benefited certain clients and seriously infringed upon these principles. Furthermore, it created an important financial risk for NBF.

¶ 7 The Halifax Representatives admitted that their actions "resulted in the ability to effect improper post execution allocation of trades and granted preferential treatment to some clients." Among other benefits, it allowed them to allocate trades held in the Accumulation Account to the accounts of clients who had not placed the original orders for those securities, thereby allowing these clients to realize profits on market price since the

date of the initial trade. Furthermore, on more than one occasion, shares were sold for substantial profits without the client accounts expending or risking any funds or being subject to margin.

¶ 8 Mitigating factors for Clarke and/or O'Reilly

- a. There were no clients' complaints.
- b. There were no financial losses for their employer, NBF.
- c. Clarke and O'Reilly did not measurably benefit from their contraventions of UMIR. They however benefited in a roundabout way by gaining the fidelity of clients to whom they sold securities on unduly favourable terms.
- d. They have no disciplinary antecedents.

¶ 9 Aggravating factors for Clarke and O'Reilly

- a. Clarke and O'Reilly continued their reprehensible conduct and audit trail violations after the IIROC investigation.
- b. Clarke and O'Reilly allocated securities bought through the NBF Montreal trading desk Accumulation Account to clients who had not even given them orders to buy those securities. This is more serious than simply neglecting to leave an audit trail after a trade. It indicates that they were knowingly giving undue preferential treatment to clients of their choosing.
- c. The fact that there were no clients' complaints doesn't mean that there were no client losses.
- d. In the context of (c) above one has difficulty believing that Clarke's and O'Reilly's primary motivation for their repetitive violations of the audit trail was to avoid charging multiple minimum commissions to clients accumulating stock positions.

¶ 10 Sanctions for Clarke and O'Reilly

- a. IIROC sanction guidelines for individuals include fines are as follows : (i) \$5,000 to \$250,000 for violation of just and equitable principles; and (ii) \$10,000 to \$500,000 for audit trail violations.
- b. The sanctions agreed to by the Clarke, O'Reilly and IIROC are more lenient than what this panel would have believed appropriate in the circumstances.
- c. However, when compared with the cases presented to us by counsel for the two parties, we find that the proposed sanctions, a fine of \$110,000.00 and costs of \$5,000.00 for Mr. Paul Clarke and a fine off \$15,000.00 and costs of \$2,500.00 for Mr. Todd O'Reilly are not unreasonable.
- d. O'Reilly was a sales assistant with no clients of his own contrary to Clarke who was a well known registered representative. It is therefore appropriate that O'Reilly's fine be smaller than Clarke's.

¶ 11 Mitigating factors for NBF

- a. NBF changed its procedures to address the problems caused by Clarke and O'Reilly.
- b. NBF did not benefit from these contraventions. On the contrary, its capital was unduly at risk.

¶ 12 Aggravating factors for NBF

NBF was aware of the numerous audit trail deficiencies at the Halifax office and the Montreal trading desk in May of 2006 but it was only in 2009 that it resolved those problems.

¶ 13 Sanction for NBF

- a. IIROC guidelines for failing to meet its trading supervision obligations consider a fine of up to \$1 million. For audit trail violations, the suggested fine is between \$50,000 and \$500,000.
- b. This panel considers that the \$250,000 fine and costs of \$30,000 payable by the respondent to IIROC, agreed to by the parties is not unreasonable.

¶ 14 The panel approves the three settlement agreements.

Me Guy Lafrance, chairman

Jean André Elie, member

Yves Julien, member

Montreal, le 11 janvier, 2011

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