

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

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

AND

**THE BY-LAWS OF THE
INVESTMENT DEALERS ASSOCIATION OF CANADA**

AND

BMO NESBITT BURNS INC.

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. The Enforcement Department Staff (“Staff”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) has conducted an investigation (“the Investigation”) into the conduct of BMO Nesbitt Burns Inc., (“the Respondent”).
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. With respect to conduct of IDA registrants occurring before June 1, 2008, the IDA has retained IIROC to provide services necessary for the IDA to carry out its regulatory functions pursuant to the *Administrative and Regulatory Services Agreement* between the IDA and IIROC.
3. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (“the Hearing Panel”).

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

A. Registration History and Nature of Business

15. BMO Nesbitt Burns (“BMONB”) is a member of IIROC and has its head office in Toronto, Ontario.

B. The Regulatory Framework – Minimum Capital Requirements

16. IIROC Dealer Member Rule No. 17 describes the requirement to maintain minimum risk adjusted capital (“RAC”). The calculation of RAC is the primary means by which the financial status of a Member is prescribed and monitored.

17. In particular, Rule No. 17.1 provides:

Every Dealer Member shall have and maintain at all times risk adjusted capital greater than zero calculated in accordance with [Form 1](#) and with such requirements as the Board of Directors may from time to time prescribe. If at any time the risk

adjusted capital of a Dealer Member is, to the knowledge of such Dealer Member, less than zero, such Dealer Member shall immediately notify the Corporation.

C. The Capital Deficiencies

18. In March 2008, BMONB reported to IIROC a RAC deficiency having occurred in the month of September 2007 in the circumstances described below.
19. BMONB lends securities to Bank of Montreal PLC (Ireland) on market terms. Because Ireland was an affiliate of Bank of Montreal (BMO), BMONB's provider of capital, any shortfall of collateral received from Ireland would be considered a repatriation of capital, under IIROC rules and regulations.
20. BMONB in turn lends the collateral it receives from Ireland to its parent, BMO, for cash.
21. In February 2008, BMONB discovered pricing errors in the collateral it received from Ireland.
22. As a result of those errors, in February/March 2008, BMONB, at its own initiative, conducted a review of all security lending and borrowing positions with Ireland.
23. Although it was determined that in eight particular months BMONB had failed to receive sufficient collateral from Ireland, only in the month of September 2007, did this cause BMONB to be RAC deficient by approximately \$3.2 million.
24. The reduction to BMONB's RAC required BMONB to record a securities concentration charge solely for the purpose of the calculation of RAC, in the amount of approximately \$203.8 million, thereby causing a total RAC deficiency of \$207 million.
25. The RAC deficiency was less than 14% of BMONB's capital employed as at September 30, 2007.

26. BMONB brought the issue to the attention of BMO's Corporate Audit Division (CAD) and requested that it review the internal controls that were implemented to prevent a recurrence of this issue. In March and April 2008, CAD conducted a review of the stock loan/collateral unit and determined that there was a control deficiency. It made recommendations which were subsequently implemented.
27. CAD conducted a follow-up review in August 2008 and found that the system of internal control now met acceptable standards.

D. Mitigating Factors

28. BMONB proactively self-identified and corrected the deficiency. It also notified IIROC Financial Compliance Staff promptly as to the existence of the RAC deficiency.
29. BMONB cooperated with IIROC Staff throughout the investigation.
30. No client accounts were affected in any way as a result of the September 2007 RAC deficiency.

IV. CONTRAVENTIONS

31. The Respondent admits to the following contraventions of IIROC Rules, IDA By-Laws, Regulations or Policies:
 - 1) In September 2007, BMONB failed to maintain risk adjusted capital at a level greater than zero as calculated in accordance with Form 1 and was RAC deficient in the sum of \$207 million and thereby contravened IIROC Rule 17.1.

VI. TERMS OF SETTLEMENT

32. The Respondent agrees to the following terms of settlement:
 - a) A fine in the amount of \$50,000.

- 33. The Respondent shall pay a portion of Staff's costs of this proceeding in the amount of \$2,000.
- 34. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Toronto in the Province of Ontario, this _____ day of _____, 20____.

WITNESS

RESPONDENT

AGREED TO by Staff at the City of _____ in the Province of _____, this _____ day of _____, 20____.

WITNESS

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

ACCEPTED at the City of _____ in the Province of _____, this _____ day of _____, 20____, by the following Hearing Panel:

Per: _____
Panel Chair

Per: _____
Panel Member

Per: _____
Panel Member