Unofficial English Translation

Re National Bank Financial

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

National Bank Financial Inc.

2022 IIROC 27

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

Hearing: October 14 in Montréal (Québec)
Decision: October 14, 2022
Written decision: November 2, 2022

Hearing Panel
Michel Brunet, Chair
Isabelle Primeau
Danielle Le May
Appearances
Francis Larin, Enforcement Counsel
Yves Robillard, for National Bank Financial
John A. Fabello, for National Bank Financial
David Gray, representing the Respondent

DECISION AND REASONS

SETTLEMENT AGREEMENT

¶ 1 IIROC Staff and National Bank Financial Inc. signed a settlement agreement on August 18, 2022 (the Settlement Agreement). The Settlement Agreement is appended and forms an integral part hereof.

¶ 2 The settlement hearing, held in electronic format before a hearing panel (the Hearing Panel) , was to consider whether the panel should accept the Settlement Agreement jointly recommended to it by IIROC Staff (Staff) and National Bank Financial Inc. (the Respondent) pursuant to IIROC Rule 8215.

¶ 3 The parties' representations essentially concerned the adequacy of the sanctions provided in the Settlement Agreement.

¶ 4 After hearing from counsel for both parties and deliberating, the Hearing Panel advised the parties that it was accepting the Settlement Agreement and that the reasons would be communicated at a later date.

CONTRAVENTION

¶ 5 In the Settlement Agreement, the Respondent admits having contravened the following Rules of IIROC:

> *"Between January 2015 and March 2018, the Respondent failed to establish and maintain adequate internal controls relating to certain trading error transactions in eighteen accounts and options trading authorizations affecting four clients in 2015, contrary to Dealer Member Rules 17.2A and 2600."*

¶ 6 The Settlement Agreement contains the agreed-upon facts, which are summarized below:

a) The Respondent is registered as a Dealer Member with IIROC. The Respondent engages in securities and options trading activities, among others.

b) Respondent's procedures and policies presented deficiencies that resulted in: the erroneous opening of four (4) options accounts in 2015; and the failure to detect the improper processing of trading error corrections in eighteen (18) accounts when, in fact, there were no errors.

c) Regarding the opening of options accounts, Rule 2600 requires that dealer members ensure that procedures and policies clearly outline the risk management guidance for derivatives.

d) In 2015, Respondent's procedures and policies allowed for the approval of options trading in four (4) specific instances, in which each client had the same investment advisor.

e) While Respondent's procedures and policies with respect to options trading approval provided guidance, they did not provide adequate controls to reduce to a relatively low level the risk that these four clients would be authorized to trade the options in question.

f) The controls in place allowed the clients to pursue a trading strategy which, at times, directly or indirectly, gave rise to:

   (i) a large volume of trades and exposure to high risk for the clients, as well as for the Respondent;

   (ii) more commissions for the clients' investment advisor;

   (iii) margin deficiencies in one client's account.

g) The Respondent detected the trading strategy, questioned and analyzed the transactions and intervened to prevent further trades.

h) The options trading resulted in losses in the aggregate amount of $272,325 for these four clients, who were compensated by the Respondent.

i) Regarding the trade error corrections, Rule 2600 requires a balance to be struck between controls that seek to prevent the occurrence of deceptive activities, and controls that seek to detect the occurrence of deceptive activities, so that corrective measures may be taken promptly.

j) Between January 2015 and March 2018, Respondent's procedures and policies did not adequately establish controls:

   (i) to detect the occurrence of trade error transactions in 18 accounts; and

   (ii) to allow for prompt corrective measures, which led to the improper processing of trading error corrections in those same 18 accounts, when in fact there were no errors (the Purported Error Corrections).

k) The Respondent's policy respecting errors allowed an investment advisor to cancel transactions entered in error in the wrong client's account, and more particularly:

(i) after cancelling the transaction, to transfer the positions to the right account, at the initial price;

(ii) to reinstate the capital of each account as if no error had been made; and

(iii) to proceed with a cancellation without entailing costs.

l) Policies that allow investment advisors to proceed as detailed above are standard in the industry and are not against the applicable rules and regulations.

m) While the Respondent's policy provided guidance, it did not provide adequate controls to reduce to a relatively low level the risk associated with the improper use of trade error corrections and the investment advisor's ability to proceed with the Purported Errors Corrections.

n) All of the Purported Error Corrections were presented to the Respondent by an investment advisor who represented to the Respondent that she had made trading errors that needed correction, when in fact she had not made any errors but instead was seeking to artificially enhance the performance of the client accounts. The investment advisor abused the trust of the Respondent by engaging in deliberate deception.

o) Over a three-year period, from 2015 to 2018, there were 101 Purported Error Corrections, which increased the value of 18 accounts by $145,885.

p) The Respondent detected the Purported Error Corrections, questioned and analyzed the transactions and intervened to prevent further Purported Error Corrections.

SANCTIONS PROVIDED IN THE SETTLEMENT AGREEMENT

¶ 7 In the Settlement Agreement, the Respondent agrees to the following sanctions and costs:

a) A fine of $250,000;

b) Costs to IIROC in the amount of $40,000.

¶ 8 Also, as the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to pay the above amounts within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

MITIGATING FACTORS

¶ 9 Numerous mitigating factors are set out in the Settlement Agreement. These factors are worth repeating here:

a) The Respondent detected the instances in question, took action and duly reported to IIROC.

b) The Respondent did not receive complete or truthful information from the clients or the investment advisors involved in the transactions.

c) The Respondent terminated for cause the investment advisors immediately after it concluded its investigation.

d) The Respondent closed the accounts of the clients in question.

e) The client losses, which were minimal in value, were limited to a restricted number of accounts.

f) The clients were adequately compensated for their minimal losses.

g) All the transactions were suitable according to the account opening documents and internal approvals.

h) The trades connected with the Purported Error Corrections were low risk.

i) After identifying the contraventions, the Respondent conducted a thorough internal review, the results of which were promptly shared with IIROC Staff.

j) The Respondent devoted considerable amounts of time, money and resources to understanding and resolving the issues.

k) The Respondent improved the relevant controls, policies and procedures as follows:

(i) It modified the guidelines to specify the various factors that must be considered when opening an account for the purpose of trading certain types of options, notably the client's annual income, net worth, liquid assets, investment knowledge, current investment objectives, options trading experience, and age;

(ii) It made additional analytic tools available to the teams in charge of approving the opening of options accounts to allow identification of certain risks that are based on an investment advisor's practices or a client's trading habits;

(iii) It supplemented its existing controls with additional tools to track on a monthly basis the cancelled trades per client and per all accounts associated with a client, for the past month and the past 12 months. The monthly report also includes the number of trades cancelled by an investment advisor and by a branch, with details on the cancellations and underlying trades.

ACCEPTANCE OF SETTLEMENT AGREEMENT

¶ 10 It is well established that the Hearing Panel has the authority to either accept or reject the Settlement Agreement. It may not amend it. The Settlement Agreement should be accepted if the sanctions provided therein fall within "a reasonable range of appropriateness".

¶ 11 In their arguments, counsel for both parties emphasized the reasons why, in their opinion, the Hearing Panel should accept the Settlement Agreement.

¶ 12 Counsel for IIROC, Francis Larin, underscored the limited number of clients and accounts at issue and the fact that only one investment advisor was involved in the matter.

¶ 13 Mr. Yves Robillard, Counsel for the Respondent, stressed the investment advisor's lack of transparency and the Respondent's subsequent adoption of measures intended to adequately prevent situations like the one before us. He argued that the settlement outlined in the Settlement Agreement was reasonable and fair, and therefore met the objectives of deterrence. The objectives of deterrence, according to the IIROC Sanction Guidelines, are to protect the public interest by restraining future conduct that may harm the capital markets. In order to achieve this, sanctions should be significant enough to prevent and discourage future misconduct by the respondent (specific deterrence), and to deter others from engaging in similar misconduct (general deterrence).

¶ 14 Counsel for IIROC also provided us with the following list of past decisions issued in analogous cases, in order to demonstrate that the sanctions provided in the Settlement Agreement fall within a reasonable range of appropriateness:

a) *Re Scotia Capital* 2021 IIROC 37

b) *Re Canaccord Genuity* 2021 IIROC 35

c) *Re Mackie Research Capital* 2020 IIROC 42

d) *Re Peak Securities* 2020 IIROC 36

e) *Re Richardson GMP & Pytak* 2020 IIROC 41

f) *Re Raymond James* 2018 IIROC 45

g) *Re CIBC World Markets & Trickey* 2018 IIROC 50

h) *Re National Bank Financial* 2018 IIROC 09

i) *Re Laurentian Bank Securities* 2017 IIROC 38

j) *Re Jory Capital Inc. & Cooney* 2011 IIROC 07

k) *Re Jory Capital & Cooney* 2010 IIROC 52

¶ 15 All of these decisions, except for one, resulted in sanctions that were less than the fines provided in the Settlement Agreement. In *Re Scotia Capital* 2021 IIROC 37, the respondent was imposed a $140,000 fine and $5,000 in costs, for failing, over the course of nearly 10 years, to establish and maintain an adequate system of controls and supervision. In *Re Canaccord Genuity* 2021 IIROC 35, for similar violations, the fine amounted to $157,500 and $50,000 in costs. In *Re Mackie Research Capital* 2020 IIROC 42, a $75,000 fine and $10,000 in costs were imposed for failing to adequately supervise a representative. In *Re Peak Securities* 2020 IIROC 15, on two counts, the first concerning the establishment and maintenance of an adequate supervision system and the other, a system of internal controls and supervision to ensure reasonable compliance with IIROC's requirements, the fines totalled $80,000 and $50,000 respectively. In *Re Raymond James* 2018 IIROC 45, the imposed fines amounted to $75,000 for a matter of inadequate supervision, and in *Re CIBC World Markets & Trickey* 2018 IIROC 50 and *Re Laurentian Bank Securities* 2017 IIROC 38, to $125,000 and $200,000 respectively, for similar reasons. Finally, in *Re Jory Capital Inc. & Cooney*, a fine of $120,000 was accepted for systemic failures and Risk-Adjusted Capital (RAC) deficiencies. It is worth noting the existence of aggravating factors in some of these decisions, unlike the matter at hand.

¶ 16 In *Re Richardson GMP & Pytak*, Richardson GMP agreed to pay a fine of $500,000 and costs of $50,000. However, these penalties concern two distinct contraventions: the first relating to an internal control failure that persisted for more than two years, contrary to IIROC Dealer Member Rule 17A, and the second relating to a failure to supervise the activities of two representatives over a period of a few years contrary to IIROC Dealer Member Rules 38.1 and 2500. So, while the agreed fine in this matter is greater than that provided in the Settlement Agreement, it is important to emphasize that it applies to two unrelated counts. There were also some aggravating factors in the matter: Richardson GMP, though aware that its internal controls were inadequate, neglected to take appropriate measures to investigate the problem and correct the situation promptly.

¶ 17 The hearing panel that rendered the decision in *Re Peak Securities* deemed it useful to reference the *Re Laurentian Bank Securities* decision, in which aggravating factors dominated:

> In the 2020 decision, Re Laurentian Bank Securities, a settlement agreement was accepted by a hearing panel, the allegations, repeated failures to comply with supervision obligations, had occurred over a period of approximately two years. The objective gravity is considerable, notably the Respondent party having refused to honour the commitments made to IIROC. It is only through tough enforcement measures, almost as a last resort in the circumstances, that the Respondent's compliance record could be restored to an acceptable level by IIROC. Furthermore, the Respondent had had two disciplinary infractions in prior years – one of which occurred during the material period applicable here – for failing to supervise compliance

with the requirements of IIROC's Dealer Member Rules. In that matter, the aggravating factors clearly dominated. The fine was $250,000, with costs to IIROC in the amount of $25,000.

¶ 18 Keep in mind that the matter before us is characterized not only by the absence of aggravating factors, but also by numerous and significant mitigating factors.

¶ 19 We also think it is relevant to discuss the arguments presented by counsel for the Respondent in reference to the decision in *Re National Bank Financial* 2018 IIROC 09. This matter concerned a supervision failure that resulted in the dealer member being imposed a fine of $110,000, and costs of $10,000. The decision thus pertained to a different contravention, regarding facts that dated back to 2009. Mr. Robillard maintains that a disciplinary record dating back more than 10 years should not be taken into consideration. He referred us to *Re Raymond James*:

> There is a presumption that a prior disciplinary record is an aggravating factor. In this case, Staff submitted, and we agree that we should give the Respondent's three prior settlements less weight because in each of the prior cases the misconduct occurred over a decade ago. Also, we accept that the misconduct that was the subject of those settlements was different than the misconduct in this case.

¶ 20 We also agree with these observations.

¶ 21 Finally, counsel for IIROC submitted a few decisions on the general principles that should guide us in making our decision, including the decision in *Re Matte* 2022 IIROC 07, which itself cites the following excerpt from *Re Milewski*, 1999 I.D.A.C.D. 17:

> "Although a settlement agreement must be accepted by a District Council before it can become effective, the standards for acceptance are not identical to those applied by a District Council in making a penalty determination after a contested hearing. In a contested hearing, the District Council attempts to determine the correct penalty. A District Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness. Put another way, the District Council will reflect the public interest benefits of the settlement process in its consideration of specific settlements.
>
> "This understanding is reflected in paragraph 20.26 of the By-laws, which authorizes the District Council to "accept", rather than "approve", a settlement agreement. In each case, a District Council must determine appropriateness, but the standards applicable to its doing so on a settlement hearing differ from those in a contested hearing. Thus, the penalties imposed under settlement agreements, while relevant to a District Council exercising its discretion to penalize, provide only limited assistance in a hearing like this." (pp. 9-10)

¶ 22 And from *Re Jacob* :

> "Few Settlement Agreements are, in fact, rejected by IIROC or MFDA Panels, but the possibility of doing so tends to put some pressure on the parties to come up with reasonable settlements in the eyes of the members of the Panel and, in particular, in the eyes of the two experienced industry members on each Panel. Industry expectations are important for a self-regulatory body and are, in fact, specifically mentioned in the recently revised IIROC Sanction Guidelines (February 2, 2015), which state, citing the well-known case of Re Mills [2001] I.D.A.C.D No. 7 at page 3:
>
> > "General deterrence can be achieved if a sanction strikes an appropriate balance by

addressing a Regulated Person's specific misconduct but is also in line with industry expectations. Any sanction imposed must be proportionate to the conduct at issue and should be similar to sanctions imposed on respondents for similar contraventions in similar circumstances."

¶ 23 Given the *IIROC Sanction Guidelines* adopted on February 2, 2015, along with the submissions of relevant case law, the numerous mitigating factors cited above, and the arguments presented by counsel at the hearing; and given the well-established principle that the Hearing Panel must accept the Settlement Agreement if the sanctions that it provides for fall within a reasonable range of appropriateness, the Hearing Panel hereby accepts the Settlement Agreement which, in its view, clearly falls within a reasonable range of appropriateness.

Dated at Montréal (Québec) on November 2, 2022.

Michel Brunet, Chair

Isabelle Primeau

Danielle Le May

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

1. The Investment Industry Regulatory Organization of Canada ("IIROC") will issue a Notice of Application to announce that it will hold a settlement hearing to consider whether, pursuant to Section 8215 of the Rules of IIROC, a hearing panel ("Hearing Panel") should accept the settlement agreement ("Settlement Agreement") entered into between the staff of IIROC ("Staff") and National Bank Financial Inc. ("Respondent").

PART II – JOINT SETTLEMENT RECOMMENDATION

2. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

PART III – AGREED FACTS

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement

Overview

4. The Respondent had procedure and policy deficiencies which resulted in: (a) the erroneous opening of four options accounts in 2015; and (b) the failure to detect the improper processing of trading error corrections in eighteen (18) accounts when in fact there were no errors, which occurred between December 2015 and January 2018.

The Respondent

5. The Respondent is registered as a Dealer Member with IIROC. The Respondent engages in securities, options, managed account, futures contracts and future contract options trading activities.

Options Accounts Opening

6. Rule 2600 requires that the dealer member ensure that procedures and policies clearly outline risk management guidance for derivatives.

7. In 2015, Respondent's procedures and policies allowed for the approval of options trading of accounts in four specific instances for which each client had the same investment advisor.

8. While Respondent's procedures and policies with respect to options trading approval provided guidance, they did not provide adequate controls to reduce to a relatively low level the risk associated with the acceptance of these four clients to trade the specific options they traded.

9. The controls in place allowed the clients to be approved to pursue a trading strategy which has, at times, directly or indirectly, in:

   (a) a large volume of trades and exposure to high risk for the clients, as well as for the Respondent;

   (b) more commissions in favor of the investment advisor for these clients;

   (c) margin deficiencies in one client's account.

10. The Respondent has detected the trading strategy, questioned and analyzed the transactions and intervened to prevent further trades.

11. The options trading resulted in losses in the aggregate amount of $272,325 for these four clients that were compensated by the Respondent.

Trade Error Corrections

12. Rule 2600 requires a balance to be struck between controls that seek to prevent the occurrence of deceptive activities, and controls that seek to detect the occurrence of deceptive activities, so that corrective measures may be promptly taken.

13. Between January 2015 and March 2018, Respondent's procedures and policies did not adequately establish controls: (a) to detect the occurrence of trade error transactions in 18 accounts; and (b) to allow for prompt corrective measures, which resulted in the improper processing of trading error corrections in those same eighteen accounts when in fact there were no errors (the "Purported Error Corrections").

14. The applicable Respondent's error policy allowed an investment advisor to cancel transactions entered by error in the wrong client's account, and more particularly:

   (a) after cancelling the transaction, to transfer the positions in the right account, at the initial price;

   (b) to reinstate the capital of each account as if no error had been made; and

   (c) to proceed with a cancellation without being exposed to costs.

15. Policies allowing investment advisors to proceed as detailed in Paragraphs 13 and 14 above are standard in the industry and not against the applicable rules and regulations.

16. While the Respondent's Policy provided guidance, it did not provide adequate controls to reduce to a relatively low level the risk associated with the improper use of the trade error corrections and the investment advisor's ability to proceed through the Purported Errors Corrections as detailed in Paragraphs 13 and 14 above.

17. All of the Purported Error Corrections were presented to the Respondent by an investment advisor who represented to the Respondent that the investment advisor had made trading errors that needed correction, when in fact the investment advisor had not made any errors but instead sought to artificially enhance the performance of client accounts. The investment advisor abused the trust of

the Respondent by engaging in deliberate deception.

18. There were 101 Purported Error Corrections over a three year period, from 2015 to 2018, which increased the value of 18 accounts by $145,885.

19. The Respondent detected the Purported Error Corrections, questioned and analyzed the transactions and intervened to prevent further Purported Error Corrections.

Mitigating Factors

20. The Respondent has detected the instances identified, took action and duly reported to the regulator.

21. The Respondent was not provided with complete and/or truthful information from the clients and/or the investment advisors involved in the transactions.

22. The Respondent terminated for cause the investment advisors immediately after its investigation was completed.

23. The Respondent closed the clients' accounts.

24. Client losses were limited to a restricted number of accounts and minimal in value;

25. Clients were adequately compensated for the minimal losses.

26. All transaction were suitable on the face of the account opening documents and internal approvals.

27. The transactions in connection with the Purported Error Corrections were low risk.

28. The Respondent has identified the contraventions and followed with thorough internal review, the results of which were promptly shared with IIROC Staff.

29. The Respondent expended considerable amounts of time, money and personnel in understanding and dealing with the issues at hand

30. The Respondent has improved the relevant control procedures and policies procedures as follows:

    (a) the Respondent modified the guidelines setting out the various factors to be taken into consideration during the account opening process to trade certain types of options and which include a client's annual income, net worth, liquid assets, investment knowledge, current investment objectives, experience in dealing with options and a client's age;

    (b) the Respondent has made additional analytic tools available to the teams in charge of approving the opening of options accounts, to allow the identification of certain risks based on the practice of an investment advisor or a client's trading patterns;

    (c) the Respondent supplemented its existing controls with additional tools to track, on a monthly basis, the cancelled trades per client and per client relations in the last month and in the past 12 months. The monthly report also includes the numbers of cancelled trades per investment advisors and per branch along with details on the cancellations and underlying trades.

PART IV – CONTRAVENTIONS

31. By engaging in the conduct described above, the Respondent committed the following contravention of IIROC's Rules:

Between January 2015 and March 2018, the Respondent failed to establish and maintain

adequate internal controls relating to certain trading error transactions in eighteen accounts and options trading authorizations affecting four clients in 2015, contrary to IIROC Dealer Member Rules 17.2A and 2600.

PART V – TERMS OF SETTLEMENT

32. The Respondent agrees to the following sanctions and costs:

    (a) A Fine of $250,000;

    (b) An additional amount of $40,000 in respect of the IIROC's costs.

33. If this Settlement Agreement is accepted by the Hearing Panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

PART VI – STAFF COMMITMENT

34. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.

35. If the Hearing Panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under IIROC Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

36. This Settlement Agreement is conditional on acceptance by the Hearing Panel.

37. This Settlement Agreement shall be presented to a Hearing Panel at a settlement hearing in accordance with the procedures described in sections 8215 and 8428, in addition to any other procedures that may be agreed upon between the parties.

38. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the Hearing Panel.

39. If the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to waive all rights under the IIROC Rules and any applicable legislation to any further hearing, appeal and review.

40. 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 based on the same or related allegations.

41. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.

42. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel and IIROC will post a full of copy of this Settlement Agreement on the IIROC

    website. IIROC will also publish a summary of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement.

43. If this Settlement Agreement is accepted, the Respondent agrees that neither [he/she/it] nor anyone on [his/her/its] behalf, will make a public statement inconsistent with this Settlement Agreement.

44. The Settlement Agreement is effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

45. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.

46. A fax or electronic copy of any signature will be treated as an original signature.

DATED this 18th day of August, 2022.

François Lavallée

National Bank Financial Inc.

By François Lavallée

Senior VP of Legal Affairs,

Financial Markets and Wealth Management

DATED this 18th day of August, 2022.

Francis Larin Francis Larin

Senior Enforcement Counsel

on behalf of Enforcement Staff of the

Investment Industry Regulatory Organization of Canada