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Discipline

Discipline Penalties Imposed on National Bank Financial Inc. – Violations of By-law 4.9, By-law 29.1 and 29.27, By-law 38.10 and 38.11, Regulation 1300.1 and 1300.2, Regulation 1900.2 and 1900.4 and Policy No. 2.

Person Disciplined A Hearing Panel appointed pursuant to IDA By-law 20 has imposed discipline penalties on National Bank Financial Inc. (“Financial”), which at all material times was a Member of the IDA.

By-laws, Regulations or Policies Violated Following a settlement hearing held on August 17, 2007 in Montreal, Quebec, a Hearing Panel accepted a settlement agreement between Financial and the staff of the IDA. Under such agreement, Financial has acknowledged the following violations to By-law 4.9, By-law 29.1 and 29.27, By-law 38.10 and 38.11, Regulation 1300.1 and 1300.2, Regulation 1900.2 and 1900.4 and Policy No. 2:

1. From 1990 to 2002, Financial unjustifiably tolerated the known and repeated misconduct of a representative at its Joliette branch and, from 1999 to 2002, the misconduct of a team of representatives at its head office branch, and failed to ensure that its Compliance Department had sufficient means to intervene adequately, without interfering, in the monitoring of the compliance of the activities of such representatives.

2. Financial failed to ensure that adequate procedures were in place and being maintained to allow the Ultimate Designated Person to monitor options accounts and further failed to ensure that the

handling of customer business relating to options was in conformity.

3. Financial failed to ensure adequate supervision of the opening of numerous options accounts and the numerous trades effected in such accounts by a team of representatives at its head office branch.

4. Financial allowed two representatives, who were not approved to trade in options contracts, to open options accounts on behalf of clients and trade in options contracts therein.

5. Financial failed to inform the IDA for a two-year period that its head office branch manager no longer occupied that position and had been replaced by a person who lacked the qualifications for such position and for whom no approval had been sought nor received from the IDA, thus leaving the IDA with the impression that the formerly approved branch manager continued in office.

6. Financial failed to keep adequate records of the supervision of accounts at the head office branch and to ensure that supervisory and follow up actions were well documented.

7. Financial failed to ensure that adequate procedures were in place and being maintained for the monitoring of client and non-client accounts at its Joliette branch.

8. Financial failed to ensure the proper supervision of account openings and handling of the business of numerous clients by a representative at its Joliette branch.

9. Financial was imprudent in allowing a representative at its Joliette branch, known for habitual serious misconduct over many years, to pursue his activities with the knowledge that he was no longer directly supervised by the manager of that branch, and subsequently appointing him interim branch manager and then placing him under the indirect supervision of a branch manager located in another region.

10. Financial did not terminate a co-branch manager's practice of supervising and approving his own client account openings by countersigning forms which he himself had completed in his capacity as representative, nor did it do so subsequently when, from 1996 to 2001, although he was no longer registered as a co-manager, he continued to approve his own client account openings by countersigning as branch manager although he was not approved in that capacity.

11. Financial accepted the opening of many accounts in which it knew or should have known that the representative had a personal interest, without identifying such accounts as professional accounts to ensure that they would be specifically monitored as such, and even failed to change the codification of such accounts subsequently.

12. Financial was culpable of negligence and imprudence towards the clients of a representative in that it allowed such representative to pursue his activities despite repeated admonitions and formal recommendations from the Compliance Department and a documented history of misconduct on the part of such representative.

Penalties
Assessed

With respect to counts 1 to 12 inclusive, the Hearing Panel has assessed an aggregate fine of \$795,000.00. Financial shall also pay an amount equal to \$50,000.00 for costs incurred by the IDA in connection with this matter.

Summary of
Facts

Head Office Branch - Montreal

In January 1999, Financial appointed a new branch manager without seeking the approval of the IDA and without informing the IDA that the branch manager approved by the IDA no longer occupied that position. Financial allowed the new branch manager to fill such position for the next two years without approval and without having met the training requirements prescribed by the IDA.

S and P, two registered representatives, had formed a team since February 1999. In or about December 2000, while neither was approved to trade in options contracts, they began to open options accounts for the team's clients for the purpose of including the trading of options in their investment strategies. They would complete the New Client Application Forms and related documentation and have them signed by M, a representative approved to trade in options at their branch office and who was also approved as an Alternate Registered Options Principal.

In February 2001, when the opening of options accounts was requested for 84 clients of the team of P and S, the Designated Registered Options Principal agreed to an arrangement whereby the team would join forces with M, who would act as the representative approved to trade in options for the team's clients until such time as P could complete the training and obtain his registration for options. The 1TAB representative code was created for options trading in the team's client accounts and the commissions were shared among P, S and M. This arrangement was verbal and undocumented. When informed thereof at a later date, the branch manager, who had supervisory control over such accounts, expressed her disagreement to the management, to no avail.

When options accounts were opened for certain clients of the team, the risk tolerance and investment objectives indicated on the forms bore no relation to the actual risk tolerance and investment objectives. In his capacity as representative, M systematically signed the documentation relating to about one hundred options accounts opened between December 2000 and October 2001 without ever

communicating with the clients or verifying their actual risk tolerance and investment objectives.

The assistant manager approved the opening documentation for a majority of these options accounts without ever verifying whether they were appropriate for the clients concerned. The opening of such accounts was further approved by the Designated Registered Options Principal at the head office branch. No documents evidenced the supervision of the opening of such options accounts at the branch office.

At the beginning of the arrangement in February 2001, the P and S team would provide M with the information on the trades to be effected. M or a member of his team would process such trades in the order-entry system to which they had access. M never contacted the clients of the 1TAB code for permission before effecting each options trade and never ensured that the trades requested on their behalf by the team of P and S were appropriate. Subsequently and until October 2001, P or his assistant would enter the trades directly into the system, without reference to M, from the workstation of the assistant manager, who allowed him access.

This arrangement should have been supervised very closely, especially in the light of the large number of options accounts which were opened for the team's clients (about one hundred) and considering the high number of options trades effected under the 1TAB code (over 1,100) during the period where neither P nor S were approved to trade in options. The more so as most of these orders were placed from the assistant manager's, rather than M's, workstation.

The options account opening documentation clearly indicated that the desired objective of many of the clients was to reduce the risk in their portfolio. Financial should have reacted to the fact that M was seeking approval for high-risk options strategies for some of these clients and the trades effected in their accounts did not take their objectives into consideration. There was no written or documented caution on the part of the branch manager to the representatives of the 1TAB code with respect to the options trades effected during this period. From the end of August 2001, the Compliance Department cautioned P, S and M on a number of occasions. Despite repeated reminders, neither the team of S and P nor M changed their modus operandi in respect of client options accounts under the 1TAB code. Indeed, considering senior management's tolerance of such situation, the branch manager and the management of the Compliance Department did not have the required authority and credibility to take these representatives to task.

In September 2001, this branch was inspected by National Bank. The report found that improvements were necessary at the branch management level. The numerous deficiencies which supported this

finding were identified therein. Despite the seriousness of the problems raised in the report, no immediate and concrete action was taken by Financial in respect of the team of P and S or M. Several months later in April 2002, a meeting was called by the Compliance Department to confront the representatives concerned with the problems identified in some of the team's client accounts, which resulted in a warning being given to M and trading restrictions being placed on P before his ultimate suspension.

Joliette Branch

From 1990 to March 1993, T was a co-manager at the Joliette branch. In August 1990, the Chief Compliance Officer cautioned T because of significant short sales on two securities. The following month, claims by two clients were filed against T and resulted in settlements.

In January 1991, a meeting was held between T, the Chief Compliance Officer and members of the senior management of Financial as T continued to sell short despite the actions of the Compliance Department. In February, the Chief Compliance Officer contacted the senior management concerning problems with T's conduct and in respect of discretionary trades, short sales and the use of the firm's accumulation account. In March, the Chief Compliance Officer sent a memo to T as a result of problems identified in the course of the annual internal audit. In August and September, three more clients filed claims against T, which resulted in settlements.

In February 1993, the Montreal Exchange took disciplinary measures against T for unauthorized trading in a client account and for having guaranteed to such client that the securities purchased earlier by such client would be redeemed without loss. Financial subsequently terminated his functions as co-branch manager. One week later, a further client complaint was received, which resulted in a substantial settlement.

From 1990 to 1993, T opened numerous accounts for three investment clubs without identifying such accounts as professional accounts on the New Client Application Forms, which he himself had completed and then countersigned as branch manager. A verification of the documentation under a proper supervision of the account opening process would have brought to light the personal interest that T may directly or indirectly have had in such accounts and would have allowed such accounts to be designated as professional accounts. As this was not the case, the accounts were not subjected to the kind of supervision which is appropriate for this type of account, not then nor in subsequent years when Financial became aware of T's relationship with the investment clubs.

From 1990 to 1993, T would sign the New Client Application Forms or updated forms in his capacity as representative and would then approve the same himself by countersigning them in his capacity as branch manager. This alone should have triggered immediate action.

Already at this time, T paid no attention whatsoever to the supervisory role which the branch manager is required to play and disregarded his cautions or those of the Compliance Department.

From 1994 or 1995 and until 2000, because of his difficult relationship with T over whom he could exercise no authority, the branch manager asked Financial to intercede directly with T. This situation was well known and tolerated by the senior management. In April 1994, another client had to be indemnified in a substantial amount.

In August 1995, the Chief Compliance Officer warned the senior management that numerous client files of T were concentrated on a single security, which raised issues of suitability. Three months later, further communication with the senior management was required for the same reason.

In October 1996, the Chief Compliance Officer and the senior management held talks regarding the problems posed by about thirty of T's RRSP accounts. In 1996, four clients who filed complaints had to be indemnified in a significant amount.

In 1997, significant amounts had to be paid to settle the claims of numerous other clients of T.

In February 1998, the Montreal Exchange once again imposed discipline penalties on T, this time for recommending trades which did not correspond to the investment objectives of a client, which trades occurred from 1993 to 1996, and for having acted in such a way as to evade the complaint settlement procedures in force at Financial.

In March 1998, Financial warned T in writing that he was not authorized to approve account openings by signing the forms himself in his capacity as branch manager, which he had started doing again since 1996.

In 1999, a compliance officer conducted a summary analysis of certain client accounts of T. Because of the irregularities observed therein, T was called to a meeting at the head office branch with the staff of the Compliance Department, an officer and a compliance officer. He was confronted with various complaints concerning him and his responsibilities as a registered representative. He was taken to task with respect to the management of certain accounts, short sales, his management style and the incomplete information in his client records, and was required to update the documentation relating to his client accounts. This occurrence was mentioned in the monthly activity report provided by the Compliance Department to the senior management. In January 2000, the branch manager reiterated and confirmed in writing to the Compliance Department that he would no longer assume any supervisory responsibility with respect to T at the

branch.

In the year 2000, T had 1,854 clients and effected 23,048 trades in their accounts, being an average of 91.8 trades per business day. Considering the high volume of trades effected daily and the past history of this representative, Financial should have carried out audits to ensure that T had the permission of his clients before effecting each trade, the more so as he had no direct supervisor at the branch. More clients of T complained and had to be indemnified in 2000.

In July 2001, the Joliette branch was split into two branches, being "Joliette 1" and "Joliette 2" and T was appointed interim branch manager of "Joliette 1". In so doing, Financial allowed a representative who had a high production volume of his own, and whose conduct could pose a risk, to supervise himself and the activities of other representatives in a branch removed from the head office branch. On November 30, 2001, as T had not met the regulatory requirements to manage the Joliette 1 branch, Financial decided that such branch would instead become a sub-branch of the Laval branch. In May, October and December 2001, more clients of T filed complaints and had to be indemnified in substantial amounts.

In January 2002, a report resulting from the inspection and analysis of the activities of T was produced by analysts in the Compliance Department and delivered to the senior management. The report highlighted problems related to T's conduct and the supervision of his activities from 1990 to 2001. The staff of the Compliance Department met with T to apprise him of the findings of the evaluation report concerning all his business practices. In May 2002, as a result of an inspection conducted at the "Joliette 1" branch covering the period following the split in July 2001, the National Bank produced a report raising various problems concerning supervision of the activities of "Joliette 1". Soon thereafter, T received a second formal warning from Financial, which once again took exception to the dearth of relevant information in his client records.

At the beginning of July 2002, despite a formal recommendation of dismissal by the Compliance Department, it was decided that T would be given another chance. In the following weeks, two new clients filed complaints, which resulted in substantial settlements. Soon thereafter, on or about the 24th of July, T was once again cautioned in respect of unauthorized or discretionary trades in a client account. As a result of this action, T was once again reprimanded. In September 2002, another client of T had to be indemnified.

T ceased to be an employee of Financial on the 26th of November 2002.

Measures Taken by Financial Since the Above Events

Financial cooperated fully with the investigation of the matters which

are the subject of this agreement, fully acknowledged its responsibility in respect of the failures identified, and has shown itself willing to correct the weaknesses which gave rise to the violations.

Its new management has made significant and important efforts to correct the serious shortcomings in the control and supervisory mechanisms monitoring the activities of its branch offices and has taken the necessary measures to remedy the situation. The improvements are noteworthy and now ensure more controlled supervision of the activities of the representatives at the branch offices. In the circumstances, the IDA considers that there is little risk that a situation similar to the one which occurred at the time of the violations will reoccur. Financial has paid substantial amounts to compensate the clients of the representatives that it failed to supervise adequately.

All such factors were taken into consideration in the determination of the appropriate penalties.

Kenneth A. Nason
Association Secretary