

**IN THE MATTER OF:**

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

**AND**

**BMO NESBITT BURNS INC.**

**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 IIROC Rules, a hearing panel (“Hearing Panel”) should accept the settlement agreement (“Settlement Agreement”) entered into between the staff of IIROC (“Staff”) and BMO Nesbitt Burns Inc. (“BMO NBI” or the “Respondent”).

**PART II – JOINT SETTLEMENT RECOMMENDATION**

2. Staff and BMO NBI 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 only, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement.

## **Overview**

4. Between January 1, 2011 March 31, 2017 (the “Review Period”), BMO NBI failed to adequately supervise the activities of its RR Paul Brum (“Brum”) both at the tier 1 and tier 2 level, relating to the high new issue commissions and high turnover in two separate client accounts (the “Client Accounts”) which should have raised suitability and conflict of interest concerns in the instances described below.
5. The Client Accounts of the RR had high commissions which were repeatedly noted on the monthly commission reports (>\$1500 and >\$3000 monthly commission reports). For these accounts, Brum, executed frequent trades in new issues which resulted in high turnover ratios in their accounts. The trading strategy executed by Brum was not suitable for these clients.
6. BMO NBI failed to query or prevent Brum’s trading in these Client Accounts in a timely manner and accordingly did not adequately supervise Brum in the circumstances described below.

## **The Respondents**

8. The Respondent is registered as a Dealer Member with IIROC. The Respondent operates in every province and territory in Canada. Its head office is located in Toronto, Ontario.

## **Dealer Member Rules 38.1 and 2500**

9. Dealer Member Rule 38.1 requires BMO NBI to establish and maintain a system to supervise each RR that is reasonably designed to achieve compliance with IIROC Rules. Dealer Member Rule 38.1 also requires supervisors to fully and properly supervise each Registered Representative so as to ensure their compliance with IIROC Rules and all other laws,

regulations and policies applicable to the Dealer Member's securities business. BMO NBI has an obligation to supervise the activities of RRs to reasonably ensure that the trading in clients' accounts is suitable for each individual client.

10. Supervisors are allowed to delegate tasks to others but not the responsibility for those tasks. Rule 2500 notes that there are generally two levels of supervision; tier 1 which at the time was conducted by a supervisor at the branch location; and tier 2 is performed on a regional or head office basis.
11. BMO NBI maintains a two-tier system of supervision. According to IIROC Rule 2500(III) and (IV), BMO NBI was obliged to conduct daily and monthly reviews of retail customer accounts to detect, among other things, excessive trade activity, conflicts of interest, and inappropriate/high risk trading strategies. Accounts may be selected for review on a basis reasonably designed to detect improper account activity and the Dealer Member may meet this obligation by:
  - at Tier 1, reviewing the activity of all customers charged gross commissions of \$1500 or more for the month; and
  - at Tier 2 reviewing the activity of all customers charged gross commissions of \$3000 or more for the month.
12. BMO NBI included these thresholds in their selection criterion during the Review Period for monthly account review.
13. The systems in place at the time did not result in the high commissions from new issues and related suitability concerns in the Client Accounts as described below being queried in a timely manner. In circumstances where these concerns were detected prior to January 1, 2017 in relation to the Client Accounts, there was improper follow up.

14. In a separate settlement agreement Brum has admitted that he made unsuitable recommendations for client SF and clients SR and WR (the holders of the Client Accounts) involving a short-term trading strategy, particularly in new issues. The Respondent had an obligation to reasonably detect the unsuitable recommendations by the RR to his clients including the short-term trading strategy which included trading in new issues in a timely manner.

#### **Client SF**

15. Client SF opened several accounts in April 2010 with BMO NBI with Brum as her investment advisor. The accounts included a corporate account, TFSA, RRSP and a margin account. Over 90% of the average balance of all her accounts were in the RRSP and margin accounts and these were the accounts that IIROC focused on in its investigation for the period from January 31, 2011 to March 31, 2017.
16. SF's account documents for her RRSP account indicated a low to moderate risk tolerance and a balanced investment strategy with only 0-20% in aggressive investments and strategies. The account documents for SF's margin account indicated a low tolerance for risk and an income investment strategy with 0-10% in aggressive investments and strategies. This account noted that she may require income from her portfolio and preferred a low degree of price volatility. The account documents indicated that SF had limited/average investment knowledge and had annual income of \$150,000 and approximate net worth of over \$13 million in both fixed and liquid assets.
17. In July 2010, SF signed an Individual Client Account Agreement Material Change Form in relation to her RRSP and margin accounts. In the form SF adopted a growth strategy, confirming: a moderate to high level of risk tolerance; tolerance for short-term price volatility in the pursuit of long-term growth; and little to no requirement for income from the portfolio. The growth strategy provided for 30% aggressive investments and strategies.

18. As of January 31, 2011, the market value of SF's RRSP account was approximately \$1,440,000. After taking into account additions of approximately \$1,580,000 and withdrawals of approximately \$1,565,000 from the RRSP account, the market value of SF's RRSP account on March 31, 2017 was approximately \$1,150,000 which represents an approximate 20% loss on the initial investment during the Review Period.
19. As of January 31, 2011, the market value of SF's margin account was approximately \$645,000. After taking into account additions of \$530,000 and withdrawals of approximately \$1,000,000 from the margin account, the market value of SF's margin account on March 31, 2017 was approximately \$180,000 which represents a less than 1% gain on the initial investment during the Review Period.
20. The turnover ratio for SF's RRSP account for the years 2012 to 2016 was 4.13, 4.5, 2.76, 4.45 and 5.21 respectively. The turnover ratio for SF's margin account for the years 2012 to 2014 was 4.77, 3.04 and 4.06 respectively. These ratios are indicative of excessive trading in the RRSP account. Brum earned \$396,542 in fees from the excessive trading and fees from new issues in SF's RRSP and margin accounts during the Review Period. The Client Accounts were not charged the commissions in relation to new issues. The commissions for new issues come directly from the issuer.
21. The short term and frequent trading along with the emphasis on new issues, which was recommended and undertaken by Brum, was not suitable for SF given her personal and financial circumstances.

#### **Clients SR and WR**

22. Clients SR and WR were husband and wife who opened a joint account at BMO NBI Nesbitt Burns in 2004 with Brum as their investment advisor. SR and WR were an elderly retired couple. The client account documents from February 2014 indicated a low to moderate risk

tolerance and a balanced investment strategy with 0-20% aggressive investments and strategies. The account documents indicated an annual income of \$8,378, liquid assets of \$600,000, fixed assets of \$780,000 and minimal to no investment knowledge.

23. As of January 31, 2011, the market value of SR and WR's account was approximately \$290,000. After taking into account withdrawals of approximately \$37,000 from the account, the market value of their account on March 31, 2016 was approximately \$165,000 which represents an approximate 35% loss on the initial investment during the period from January 31, 2011 to March 31, 2016.
24. The turnover ratio for SR and WR's account in 2014 was 3.45 which is indicative of excessive trading in the account. SR and WR's account was a fee based account based on the market value of the account and they were not charged commissions for individual transactions. During the period from January 31, 2011 to March 31, 2016, the account of SR and WR was charged fees based on the market value of the account of approximately \$20,500. In addition to these account fees, the account also generated fees related to new issues of over \$36,000 during the same period.
25. SR and WR's account did not contain sufficient low to medium income producing securities to meet their investment objectives and risk tolerance. In addition, the emphasis on new issues, which was recommended by Brum, was not a suitable investment strategy for SR and WR given their personal and financial circumstances.

#### **Contravention of Dealer Member Rules 38.1 and 2500**

26. BMO NBI's client account supervision involves both first line and head office compliance staff reviewing reports that are generated to assist in identifying red flags that require further review or investigation. The most common investigation step taken is to create a query for the responsible RR to learn more information. Generally, a record of active

queries and how they were resolved is kept which may include responses from the responsible RR.

27. During the Review Period, as part of BMO NBI's client account supervision system, two types of reports are generated: one with accounts that have over \$1500 in monthly commissions and a second with accounts that have over \$3000 in monthly commissions. The over \$1500 monthly commission reports are available to the tier 1 supervisors and the over \$3000 monthly commission reports are available to tier 2 compliance staff and were a reasonable threshold for considering further query.
28. Between October 2014 and March 2017, SF's RRSP account had over \$1500 in monthly commissions 26 out of 30 months or 87% of the time and appeared on the tier 1 over \$1500 monthly commission reports. In that same period of time, SF's RRSP account had over \$3000 in monthly commissions 25 out of 30 months or 85% of the time and appeared on the tier 2 over \$3000 monthly commission reports. The queries during this period are referred to later in this Settlement Agreement.
29. BMO NBI's compliance department also produces a monthly report which shows the turnover ratio in clients' accounts. The turnover ratio is the total commissions in the preceding 12 months over the previous months market value of the holdings in the account. During the Review Period this report was available to both tier 1 and tier 2 compliance staff.
30. Between October 2014 and March 2017, the turnover ratio disclosed on the monthly report for SF ranged from 6.9 to 15.9, which should have required additional review.
31. The turnover ratio disclosed on the monthly report for SR and WR was 8.2% in October 2015, which should have required additional review.

32. During the Review Period, there were no tier 2 queries raised regarding the unsuitable trading in the Accounts.
33. During the Review Period there were four tier 1 queries regarding the trading in the accounts of SF and one tier 1 query regarding the trading in the accounts of SR and WR.
34. The monthly commissions in SF margin account was over \$1500 for the month of August 2013. As a result of this, tier 1 supervisors made a query of Brum regarding the margin account of SF on September 30, 2013, and again on October 31, 2013. Brum responded stating that the client was happy with the handling of her accounts. Relying on Brum's response, no further steps were taken regarding this query at that time. In response to another query on September 30, 2015, noting a turnover ratio of 10.8%, Brum stated that client was fine with the trades and liked to be active in new issues. Relying on Brum's response, no further steps were taken regarding this query at that time.
35. In January 2017, a further tier 1 query was made of Brum in relation to SF's account. Brum was asked about the suitability of a new issue purchase and whether SF was aware of the commission generated in the account. It was after this query was initiated that Brum ceased trading in new issues in the Client Accounts.
36. In relation to SR and WR's joint account, during the Review Period, there was one tier 1 query regarding the suitability of new issue trading in the account. In October 2015, tier 1 queried the high turnover ratio of 8.2% and commission generated in the account. The query was resolved when Brum indicated that the clients were okay with the current holdings and fees, and that representation was relied upon.
37. Brum left BMO NBI in September 2017.



38. Prior to January 2017, while the individuals supervising Brum at the time were trained on suitability and excessive trading they were not adequately trained to consider and failed to appreciate the significance of the high frequency of trading in new issues on the suitability of the strategy for the Accounts.
39. During the Review Period, BMO NBI failed to adequately supervise Brum and the suitability of an investment strategy relating to new issues in the Accounts.
40. BMO NBI ought to have more fully queried the high-volume new issue trading in the Accounts and required Brum to explain how the active short-term trading was suitable for the Accounts taking into consideration the clients' investment objectives and whether the trading strategy was in the clients' financial interests, and adequately addressed the suitability issues.

#### **Remedial Measures**

41. After BMO NBI learned of the first client complaint (SF), BMO NBI conducted an internal review to ensure that there were no other suitability issues relating to new issues. As a result of the internal review only one other account (the joint account of SR and WR) was identified and BMO NBI reached out to the client and compensated the client directly. Brum did not contribute any amount to that settlement.
42. The holders of the Accounts received compensation for their losses resulting from the unsuitable trading in new issues. BMO NBI paid the clients over \$675,000. Brum contributed \$300,000 to the settlement with SF.
43. Internal tier 1 discipline was issued by BMO NBI consisting of a \$10,000 fine, a warning letter and requirement to attend a one-day one-on-one training course on the supervision of new issues and related conflict of interest issues.

44. The Respondent has taken steps to enhance new issues trading supervision, including:
- training on suitability of new issues trading and conflict of interest from new issues commissions was completed for tier 1 supervisors and tier 2 staff;
  - tier 1 and tier 2 policies and procedures were updated;
  - implemented and improved an electronic trade surveillance system to detect excessive trading activity, including in new issues, replacing the paper based manual process used during the Review Period. This system is continually reviewed and updated.
45. The Respondent implemented a new regional supervision model resulting in supervisory functions previously performed by local branch management being migrated to a centralized team of supervisors and support staff.

#### **PART IV – CONTRAVENTIONS**

46. By engaging in the conduct described above, the Respondent committed the following contravention of IIROC's Rules:
- Between January 2011 and March 31, 2017, the Respondent failed to adequately supervise the activities of an RR in relation to the Accounts both on the tier 1 and tier 2 compliance levels contrary to Dealer Member Rules 38.1 and 2500.

#### **PART V – TERMS OF SETTLEMENT**

47. The Respondent agrees to the following sanctions and costs:
- Fine of \$125,000; and
  - Costs of \$15,000.

48. 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**

49. 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.
50. 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 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**

51. This Settlement Agreement is conditional on acceptance by the Hearing Panel.
52. 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.
53. 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.

54. 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.
55. 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.
56. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.
57. 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.
58. If this Settlement Agreement is accepted, the Respondent agrees that neither it nor anyone on its behalf, will make a public statement inconsistent with this Settlement Agreement.
59. 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**

60. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.
61. A fax or electronic copy of any signature will be treated as an original signature.

**DATED** this "26<sup>th</sup>" day of September, 2022.

"Geoff Newton"

Witness

Geoff Newton

Co-Head, Private Wealth Canada

Total Wealth Management

"Bruce Ferman"

Respondent

Bruce Ferman, Chief Operating Officer,  
on behalf of BMO Nesbitt Burns Inc.

"David Kwok"

Witness

"Stacy Robertson"

Stacy Robertson

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

The Settlement Agreement is hereby accepted this "4" day of "October", 2022 by the following  
Hearing Panel:

Per: "Susan E. Ross"

Panel Chair

Per: "David Duquette"

Panel Member

Per: "William Wright"

Panel Member