

IN THE MATTER OF:

THE RULES OF THE INVESTMENT INDUSTRY REGULATORY

ORGANIZATION OF CANADA

AND

NATIONAL BANK FINANCIAL 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 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 canceled 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 canceled 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 IROC 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 IROC 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 IROC will post a full of copy of this Settlement Agreement on the IROC

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 18 day of August, 2022.

(s) François Lavallée

National Bank Financial Inc.

By François Lavallée
Senior VP of legal affairs,
Financial markets and wealth management

DATED this 18 day of August, 2022.

(s) Francis Larin

Francis Larin

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