The Ontario Securities Commission

OSC Bulletin

December 19, 2013

Volume 36, Issue 51

(2013), 36 OSCB

The Ontario Securities Commission administers the
Securities Act of Ontario (R.S.O. 1990, c. S.5) and the
Commodity Futures Act of Ontario (R.S.O. 1990, c. C.20)

The Ontario Securities Commission
Cadillac Fairview Tower
22nd Floor, Box 55
20 Queen Street West
Toronto, Ontario
M5H 3S8

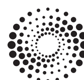
416-593-8314 or Toll Free 1-877-785-1555

Published under the authority of the Commission by:
Carswell, a Thomson Reuters business
One Corporate Plaza
2075 Kennedy Road
Toronto, Ontario
M1T 3V4

416-609-3800 or 1-800-387-5164

Contact Centre - Inquiries, Complaints: Fax: 416-593-8122
TTY: 1-866-827-1295

Office of the Secretary: Fax: 416-593-2318


THOMSON REUTERS

The OSC Bulletin is published weekly by Carswell, a Thomson Reuters business, under the authority of the Ontario Securities Commission.

Subscriptions are available from Carswell at the price of $649 per year.

Subscription prices include first class postage to Canadian addresses. Outside Canada, these airmail postage charges apply on a current subscription:

U.S.	$175
Outside North America	$400

Single issues of the printed Bulletin are available at $20 per copy as long as supplies are available.

Carswell also offers every issue of the Bulletin, from 1994 onwards, fully searchable on S*ecuritiesSource*™, Canada's pre-eminent web-based securities resource. *SecuritiesSource*™ also features comprehensive securities legislation, expert analysis, precedents and a weekly Newsletter. For more information on *SecuritiesSource*™, as well as ordering information, please go to:

http://www.westlawecarswell.com/SecuritiesSource/News/default.htm

or call Carswell Customer Relations at 1-800-387-5164 (416-609-3800 Toronto & Outside of Canada).

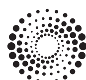
Claims from *bona fide* subscribers for missing issues will be honoured by Carswell up to one month from publication date.

Space is available in the Ontario Securities Commission Bulletin for advertisements. The publisher will accept advertising aimed at the securities industry or financial community in Canada. Advertisements are limited to tombstone announcements and professional business card announcements by members of, and suppliers to, the financial services industry.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise without the prior written permission of the publisher.

The publisher is not engaged in rendering legal, accounting or other professional advice. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

© Copyright 2013 Ontario Securities Commission
ISSN 0226-9325
Except Chapter 7 ©CDS INC.



One Corporate Plaza
2075 Kennedy Road
Toronto, Ontario
M1T 3V4

Customer Relations
Toronto 1-416-609-3800
Elsewhere in Canada/U.S. 1-800-387-5164
Fax 1-416-298-5082
www.carswell.com
Email www.carswell.com/email

Table of Contents

Chapter 1 Notices / News Releases 11983
1.1 Notices 11983
1.1.1 Current Proceedings before the Ontario Securities Commission 11983
1.1.2 CSA Staff Notice 81-323 – Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees 11989
1.1.3 CSA Staff Notice 33-316 – Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients 11998
1.1.4 Notice of Ministerial Approval of Amendments to National Instrument 81-106 Investment Fund Continuous Disclosure, Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance and Consequential Amendments 12014
1.1.5 CSA Staff Notice 91-303 – Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives 12015
1.2 Notices of Hearing 12033
1.2.1 Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele and Michael Wallace Minor – ss. 127(1), 127(10) 12033
1.3 News Releases 12038
1.3.1 Canadian Securities Regulators Seek Comments on Mutual Fund Risk Classification Methodology 12038
1.3.2 OSC Releases Results of Electronic Trading Risk Analysis 12040
1.3.3 Canadian Regulators Release Status Reports on Mutual Fund Fees and Best Interest Duty 12041
1.3.4 OSC Proposes Adopting Global Standards for Ontario Clearing Agencies 12043
1.4 Notices from the Office of the Secretary 12044
1.4.1 Ernst & Young LLP (Audits of Zungui Haixi Corporation)............................ 12044
1.4.2 Bradon Technologies Ltd. et al. 12044
1.4.3 David M. O'Brien 12045
1.4.4 North American Financial Group Inc. et al. 12045
1.4.5 Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele and Michael Wallace Minor 12046
1.4.6 Heritage Education Funds Inc. 12046
1.4.7 TransCap Corporation et al. 12047
1.4.8 Crown Hill Capital Corporation and Wayne Lawrence Pushka 12047
1.4.9 Eda Marie Agueci et al. 12048
1.4.10 Global Energy Group, Ltd. et al. 12048

Chapter 2 Decisions, Orders and Rulings.......... 12049
2.1 Decisions 12049
2.1.1 Lipari Energy, Inc. 12049
2.1.2 Timelo Investment Management Inc. et al. 12051
2.1.3 Manulife Asset Management Limited 12056
2.1.4 Aston Hill Oil & Gas Income Fund et al. 12060
2.1.5 CT Real Estate Investment Trust 12063
2.1.6 Bell Canada 12065
2.1.7 Hillsdale Investment Management Inc. 12068
2.1.8 Redwood Asset Management Inc. et al. 12073
2.2 Orders 12075
2.2.1 Ernst & Young LLP (Audits of Zungui Haixi Corporation) – ss. 127, 127.1 12075
2.2.2 Bradon Technologies Ltd. et al. – s. 127 12075
2.2.3 David M. O'Brien – s. 9(1) of the SPPA and Rules 8.1, 5.2(1) of the OSC Rules of Procedure 12076
2.2.4 North American Financial Group Inc. et al. – ss. 127, 127.1.................................. 12080
2.2.5 Heritage Education Funds Inc. 12081
2.2.6 TransCap Corporation et al. – ss. 127(1), 127(10).................................. 12082
2.2.7 Crown Hill Capital Corporation and Wayne Lawrence Pushka 12083
2.2.8 LatAm SEF LLC – s. 147 12085
2.2.9 Global Energy Group, Ltd. et al. – ss. 37, 127, 127.1 12090
2.3 Rulings... (nil)

Chapter 3 Reasons: Decisions, Orders and Rulings 12095
3.1 OSC Decisions, Orders and Rulings 12095
3.1.1 North American Financial Group Inc. et al. – s. 127 12095
3.1.2 Eda Marie Agueci et al. 12133
3.1.3 Global Energy Group, Ltd. et al. – ss. 37, 127, 127.1 12153
3.2 Court Decisions, Order and Rulings .... (nil)

Chapter 4 Cease Trading Orders 12171
4.1.1 Temporary, Permanent & Rescinding Issuer Cease Trading Orders....................... 12171
4.2.1 Temporary, Permanent & Rescinding Management Cease Trading Orders 12171
4.2.2 Outstanding Management & Insider Cease Trading Orders 12171

Chapter 5 Rules and Policies 12173
5.1.1 Amendments to NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations – Dispute Resolution Services 12173
5.1.2 Amendments to NI 81-106 Investment Fund Continuous Disclosure 12189
5.1.3 Amendments to Companion Policy 81-106CP to NI 81-106 Investment Fund Continuous Disclosure 12197
5.1.4 Amendments to NI 41-101 General Prospectus Requirements 12203
5.1.5 Amendments to NI 81-101 Mutual Fund Prospectus Disclosure 12204
5.1.6 Amendments to Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure 12205
5.1.7 Amendments to NI 81-102 Mutual Funds 12206
5.1.8 Amendments to NI 81-104 Commodity Pools 12207
5.1.9 Amendments to OSC Rule 81-801 Implementing National Instrument 81-106 Investment Fund Continuous Disclosure 12208

Chapter 6 Request for Comments 12209
6.1.1 Proposed OSC Rule 24-503 Clearing Agency Requirements and Related Companion Policy 12209

Chapter 7 Insider Reporting 12297

Chapter 8 Notice of Exempt Financings 12395
Reports of Trades Submitted on Forms 45-106F1 and 45-501F1 12395

Chapter 9 Legislation .... (nil)

Chapter 11 IPOs, New Issues and Secondary Financings 12399

Chapter 12 Registrations 12407
12.1.1 Registrants 12407

Chapter 13 SROs, Marketplaces and Clearing Agencies 12409
13.1 SROs .... (nil)
13.2 Marketplaces 12409
13.2.1 LatAm SEF LLC – Notice of Commission Order – Application for Interim Exemption Order 12409
13.3 Clearing Agencies 12410
13.3.1 CDS – Notice of Withdrawal – Material Amendments to CDS Rules – Delegation of Board Authority to Management 12410

Chapter 25 Other Information 12411
25.1 Exemptions 12411
25.1.1 Front Street Global Balanced Income Class and Front Street Tactical Bond Class 12411
25.1.2 Horizons ETFs Management (Canada) Inc. et al. 12412
25.2 Approvals 12413
25.2.1 Ewing Morris & Co. Investment Partners Ltd. – s. 213(3)(b) of the LTCA 12413

Index 12415

Chapter 1

Notices / News Releases

1.1 Notices

1.1.1 Current Proceedings Before The Ontario Securities Commission

Current Proceedings before the Ontario Securities Commission will no longer be printed in the Bulletin as of January 3, 2014. The Current Proceedings can be found on the OSC website – http://www.osc.gov.on.ca/en/Proceedings_before-commission_index.htm.

December 19, 2013

CURRENT PROCEEDINGS

BEFORE

ONTARIO SECURITIES COMMISSION

- -

Unless otherwise indicated in the date column, all hearings will take place at the following location:

Ontario Securities Commission
Cadillac Fairview Tower
20 Queen Street West, 17th Floor
Toronto, Ontario
M5H 3S8

Telephone: 416-597-0681 Telecopier: 416-593-8348

CDS **TDX 76**

- -

THE COMMISSIONERS

Howard I. Wetston, Chair	—	HIW
James E. A. Turner, Vice Chair	—	JEAT
Lawrence E. Ritchie, Vice Chair	—	LER
Mary G. Condon, Vice Chair	—	MGC
Sinan O. Akdeniz	—	SOA
Catherine E. Bateman	—	CEB
James D. Carnwath	—	JDC
Sarah B. Kavanagh	—	SBK
Edward P. Kerwin	—	EPK
Vern Krishna	—	VK
Deborah Leckman	—	DL
Alan J. Lenczner	—	AJL
Christopher Portner	—	CP
Judith N. Robertson	—	JNR
AnneMarie Ryan	—	AMR
Charles Wesley Moore (Wes) Scott	—	CWMS

SCHEDULED OSC HEARINGS

January 6, 2014 2:00 p.m.	**Kevin Warren Zietsoff** s. 127 J. Feasby in attendance for Staff Panel: AJL
January 9, 2014 10:30 a.m.	**Global RESP Corporation and Global Growth Assets Inc.** s. 127 D. Ferris in attendance for Staff Panel: JEAT
January 15-27, January 30 – February 7, March 3-7 and April 28-30, 2014 10:00 a.m.	**Eda Marie Agueci, Dennis Wing, Santo Iacono, Josephine Raponi, Kimberley Stephany, Henry Fiorillo, Giuseppe (Joseph) Fiorini, John Serpa, Ian Telfer, Jacob Gornitzki and Pollen Services Limited** s. 127 C. Price/A. Pelletier in attendance for Staff Panel: EPK/DL/AMR

January 17, 2014 10:00 a.m.	**Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele and Michael Wallace Minor** s. 127(1) and 127(10) D. Campbell in attendance for staff Panel: MGC
January 21, 2014 10:00 a.m.	**Weizhen Tang** s. 127 C. Rossi in attendance for Staff Panel: AJL
January 21, 2014 10:00 a.m.	**Oversea Chinese Fund Limited Partnership, Weizhen Tang and Associates Inc., Weizhen Tang Corp., and Weizhen Tang** s. 127 and 127.1 H. Craig in attendance for Staff Panel: AJL
January 21, 2014 11:00 a.m.	**Pro-Financial Asset Management Inc.** s. 127 D. Ferris in attendance for Staff Panel: JEAT
January 27, 2014 10:00 a.m.	**Welcome Place Inc., Daniel Maxsood also known as Muhammad M. Khan, Tao Zhang, and Talat Ashraf** s. 127 G. Smyth in attendance for Staff Panel: MGC
January 29, 2014 10:30 a.m.	**Global Energy Group, Ltd., New Gold Limited Partnerships, Christina Harper, Howard Rash, Michael Schaumer, Elliot Feder, Vadim Tsatskin, Oded Pasternak, Alan Silverstein, Herbert Groberman, Allan Walker, Peter Robinson, Vyacheslav Brikman, Nikola Bajovski, Bruce Cohen and Andrew Shiff** s. 127 C. Rossi in attendance for Staff Panel: EPK
February 3, 2014 10:00 a.m.	**Tricoastal Capital Partners LLC, Tricoastal Capital Management Ltd. and Keith Macdonald Summers** s. 127 C Johnson/G. Smyth in attendance for Staff Panel: CP
February 10 and February 12-18, 2014 10:00 a.m.	**Portfolio Capital Inc., David Rogerson and Amy Hanna-Rogerson** s. 127 J. Lynch in attendance for Staff Panel: CP
February 20, 2014 10:00 a.m.	**Quadrexx Asset Management Inc., Quadrexx Secured Assets Inc., Offshore Oil Vessel Supply Services LP, Quibik Income Fund and Quibik Opportunities Fund** s. 127 D. Ferris in attendance for Staff Panel: TBA

February 24, 26-28, 2014 10:00 a.m.	**Crown Hill Capital Corporation and Wayne Lawrence Pushka** s. 127 A. Perschy/A. Pelletier in attendance for Staff Panel: JEAT/CP/JNR
March 5, 2014 10:00 a.m.	**Heritage Education Funds Inc.** s. 127 D. Ferris in attendance for Staff Panel: JEAT
March 17-24 and March 26, 2014 10:00 a.m.	**Newer Technologies Limited, Ryan Pickering and Rodger Frey** s. 127 and 127.1 B. Shulman in attendance for staff Panel: AJL
March 24, 2014 10:00 a.m.	**North American Financial Group Inc., North American Capital Inc., Alexander Flavio Arconti, and Luigino Arconti** s. 127 M. Vaillancourt in attendance for Staff Panel: JDC
March 27, 2014 10:00 a.m.	**AMTE Services Inc., Osler Energy Corporation, Ranjit Grewal, Phillip Colbert and Edward Ozga** s. 127 C. Rossi in attendance for Staff Panel: TBA
March 31 – April 7, April 9-17, April 21 and April 23-30, 2014 10:00 a.m.	**Issam El-Bouji, Global RESP Corporation, Global Growth Assets Inc., Global Educational Trust Foundation and Margaret Singh** s. 127 and 127.1 M. Vaillancourt in attendance for Staff Panel: JEAT
March 31 – April 7 and April 9-11, 2014 10:00 a.m.	**Ronald James Ovenden, New Solutions Capital Inc., New Solutions Financial Corporation and New Solutions Financial (Ii) Corporation** s. 127 Y. Chisholm in attendance for Staff Panel: JDC
April 14-15, April 21, April 23 – May 5 and May 7, 2014 10:00 a.m.	**Ground Wealth Inc., Michelle Dunk, Adrion Smith, Joel Webster, Douglas DeBoer, Armadillo Energy Inc., Armadillo Energy, Inc., and Armadillo Energy, LLC (aka Armadillo Energy LLC)** s. 127 J. Feasby in attendance for Staff Panel: CP
May 5, May 7-16, May 21-June 2 and June 4-12, 2014 10:00 a.m.	**Fawad Ul Haq Khan and Khan Trading Associates Inc. carrying on business as Money Plus** s. 60 and 60.1 of the *Commodity Futures Act* T. Center in attendance for Staff Panel: VK

September 2-8, 10-15, October 15-17, 28-31, November 3, 5-7, 11, 19-21, 25-28, December 1, 3-5, 9-15, 17-19, 2014, January 7-12, 14-16, 20-26, 28-30, February 3-9, 11-13 and February 17-20, 2015 10:00 a.m.	**Sino-Forest Corporation, Allen Chan, Albert Ip, Alfred C.T. Hung, George Ho, Simon Yeung and David Horsley** s. 127 H. Craig in attendance for Staff Panel: TBA
September 15-22, September 24, September 29 – October 6, October 8-10, October 14-20, October 22 – November 3 and November 5-7, 2014 10:00 a.m.	**Paul Azeff, Korin Bobrow, Mitchell Finkelstein, Howard Jeffrey Miller and Man Kin Cheng (a.k.a. Francis Cheng)** s. 127 T. Center/D. Campbell in attendance for Staff Panel: TBA
November 11-17, 19-21, November 25 – December 1, December 3-5, 9-15, 17-19, 2014, January 14-16, 20-26, 28-30, February 3-9, 11-13, 17-23, 25-27 and March 3-6, 2015 10:00 a.m.	**Ernst & Young LLP** s. 127 and 127.1 Y. Chisholm / H. Craig in attendance for Staff Panel: TBA
May 1, 2015 10:00 a.m.	**Ernst & Young LLP (Audits of Zungui Haixi Corporation)** s. 127 and 127.1 J. Friedman in attendance for Staff Panel: TBA
In writing	**Morgan Dragon Development Corp., John Cheong (aka Kim Meng Cheong), Herman Tse, Devon Ricketts and Mark Griffiths** s. 127 J. Feasby in attendance for Staff Panel: EPK
In writing	**Bunting & Waddington Inc., Arvind Sanmugam and Julie Winget** s. 127 and 127.1 M. Britton/A. Pelletier in attendance for Staff Panel: EPK
In writing	**Victor George DeLaet and Stanley Kenneth Gitzel** s. 127(1) and 127(10) C. Johnson in attendance for Staff Panel: JEAT
In writing	**International Strategic Investments, International Strategic Investments Inc., Somin Holdings Inc., Nazim Gillani and Ryan J. Driscoll.** s. 127 C. Watson in attendance for Staff Panel: JEAT
TBA	**Yama Abdullah Yaqeen** s. 8(2) J. Superina in attendance for Staff Panel: TBA

TBA

Microsourceonline Inc., Michael Peter Anzelmo, Vito Curalli, Jaime S. Lobo, Sumit Majumdar and Jeffrey David Mandell

s. 127

Panel: TBA

TBA

Frank Dunn, Douglas Beatty, Michael Gollogly

s. 127

Panel: TBA

TBA

Gold-Quest International and Sandra Gale

s. 127

C. Johnson in attendance for Staff

Panel: TBA

TBA

Brilliante Brasilcan Resources Corp., York Rio Resources Inc., Brian W. Aidelman, Jason Georgiadis, Richard Taylor and Victor York

s. 127

H. Craig in attendance for Staff

Panel: TBA

TBA

Uranium308 Resources Inc., Michael Friedman, George Schwartz, Peter Robinson, and Shafi Khan

s. 127

H. Craig/C. Rossi in attendance for Staff

Panel: TBA

TBA

David M. O'Brien

s. 37, 127 and 127.1

B. Shulman in attendance for Staff

Panel: TBA

TBA

Portus Alternative Asset Management Inc., Portus Asset Management Inc., Boaz Manor, Michael Mendelson, Michael Labanowich and John Ogg

s. 127

H Craig in attendance for Staff

Panel: TBA

TBA

Garth H. Drabinsky, Myron I. Gottlieb and Gordon Eckstein

s. 127

J. Friedman in attendance for Staff

Panel: TBA

TBA

Jowdat Waheed and Bruce Walter

s. 127

J. Lynch in attendance for Staff

TBA

Alexander Christ Doulis (aka Alexander Christos Doulis, aka Alexandros Christodoulidis) and Liberty Consulting Ltd.

s. 127

J. Feasby in attendance for Staff

Panel: TBA

Conrad M. Black, John A Boultbee and Peter Y. Atkinson

s. 127 and 127.1

J. Friedman in attendance for Staff

Panel: TBA

TBA

2196768 Ontario Ltd carrying on business as Rare Investments, Ramadhar Dookhie, Adil Sunderji and Evgueni Todorov

s. 127

D. Campbell in attendance for Staff

Panel: TBA

TBA

David Charles Phillips and John Russell Wilson

s. 127

Y. Chisholm/B. Shulman in attendance for Staff

Panel: TBA

TBA

Bradon Technologies Ltd., Joseph Compta, Ensign Corporate Communications Inc. and Timothy German

s. 127 and 127.1

C. Weiler in attendance for Staff

Panel: TBA

TBA

MRS Sciences Inc. (formerly Morningside Capital Corp.), Americo DeRosa, Ronald Sherman, Edward Emmons and Ivan Cavric

s. 127 and 127(1)

D. Ferris in attendance for Staff

Panel: MGC/CP

TBA

Blackwood & Rose Inc., Steven Zetchus and Justin Kreller (also known as Justin Kay)

s. 37, 127 and 127.1

C. Rossi in attendance for Staff

Panel: JEAT

ADJOURNED SINE DIE

Global Privacy Management Trust and Robert Cranston

LandBankers International MX, S. A. De C.V.; Sierra Madre Holdings MX, S. A. De C.V.; L&B LandBanking Trust S. A. De C.V.; Brian J. Wolf Zacarias; Roger Fernando Ayuso Loyo, Alan Hemingway, Kelly Friesen, Sonja A. McAdam, Ed Moore, Kim Moore, Jason Rogers and Dave Urrutia

1.1.2 CSA Staff Notice 81-323 – Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees

Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Staff Notice 81-323
Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees

December 17, 2013

Introduction

On December 13, 2012, the Canadian Securities Administrators (CSA or we) published for comment CSA Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees* (the Discussion Paper). This notice provides a summary of the key comments received on the Discussion Paper through the comment process and subsequent in-person consultations.

Background

The Discussion Paper identified a number of investor protection and fairness issues that may arise from the mutual fund fee structure in Canada. The issues we identified related primarily to the fees for advice, otherwise known as trailing commissions, that are embedded in the mutual fund fee structure, and included:

- investors' limited understanding of fund costs and control of embedded advisor compensation;
- the potential conflicts of interests that embedded advisor compensation gives rise to at the mutual fund manufacturer and advisor levels;
- the potential for cross-subsidization by a mutual fund's investors of the different advisor compensation costs associated with different purchase options;
- the alignment of advisor compensation and the services provided to investors in exchange; and
- the limited low-cost mutual fund options available to do-it-yourself investors.

The Discussion Paper solicited comments on a range of potential regulatory options to address these issues, including:

- defining the services that dealer firms and advisors must provide in exchange for trailing commissions;
- requiring the offering of a low-cost class of fund securities for do-it-yourself investors;
- unbundling the trailing commission component of the management fee and charging it to the fund as a separate asset-based fee;
- requiring a separate class of fund securities for each purchase option;
- capping commissions;
- implementing a best interest duty for advisors; and
- discontinuing the practice of advisor compensation being set by mutual fund manufacturers and embedded in the fund product.

We also stated our intention to consult with investors and industry participants to help us determine what, if any, regulatory responses might be appropriate. We received 99 comment letters from a range of stakeholders, including investors, investor

advocates, mutual fund dealers, mutual fund manufacturers, industry advocates, academics, law firms and professional associations.[1]

Several CSA jurisdictions held consultations with stakeholders over the course of the Summer and Fall of 2013 in order to probe deeper into themes emerging from the comment letters.

The Ontario Securities Commission (OSC) held a public roundtable on June 7, 2013, featuring three panels with panellists representing investors, mutual fund manufacturers, mutual fund dealers and other financial industry stakeholders. The panel topics included:

- the role embedded advisor compensation plays in access to advice for small retail investors in the Canadian market;
- the nature and scope of the services received for trailing commissions; and
- the impact of current disclosure initiatives and whether regulatory action beyond disclosure is warranted at this time.

A transcript of the roundtable discussion is available on the OSC's website.[2]

The British Columbia Securities Commission (BCSC) held consultations with BC-based mutual fund dealers and mutual fund manufacturers on June 24 and 25, 2013. The Autorité des marchés financiers (AMF) held a consultation with retail investors on September 4, 2013, a consultation with both the Canadian Foundation for Advancement of Investor Rights (FAIR) and the Mouvement d'éducation et de défense des actionnaires (MÉDAC) on September 5, 2013, followed by consultations with mutual fund dealers, mutual fund manufacturers and other industry stakeholders on September 17 and October 3, 2013.

We thank all those who contributed to this consultation process by responding to our request for comments or by participating in the OSC, BCSC and AMF consultations. We are using the information we gathered through this process to inform our approach on this initiative going forward.

Themes from the Consultation

We have identified a number of key themes emerging from the comment process on the Discussion Paper and the subsequent consultations. The themes are largely split between industry stakeholder viewpoints and investor stakeholder viewpoints.

The key themes from industry stakeholders are:

- There is no evidence of investor harm that warrants a change to the mutual fund fee structure in Canada;
- A ban on embedded compensation will have unintended consequences for retail investors and the fund industry, including:
    - a reduction in access to advice for small retail investors,
    - the elimination of choice in how investors may pay for financial advice, and
    - the creation of an unlevel playing field among competing products and opportunities for regulatory arbitrage; and
- We should observe and assess the impact of domestic and international reforms before moving ahead with further proposals.

The key themes from investor stakeholders are:

- Embedded advisor compensation causes a misalignment of interests which impacts investor outcomes and should be banned;
- Investors should at a minimum have the true choice to not pay embedded commissions;

[1] The list of commenters and copies of the comment letters are available online at: http://www.osc.gov.on.ca/en/38419.htm.

[2] *Canadian Securities Administrators Roundtable Discussion re: Discussion Paper and Request for Comment 81-407 Mutual Fund Fees*, June 7, 2013 available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_rpt_20130607_81-407_mutual-fund-fees-roundtable.htm.

- We need to implement a best interest duty for advisors; and
- We need to increase advisor proficiency requirements and regulate the use of titles.

Below, we discuss each of these key themes in detail. The themes underscore that the issues surrounding mutual fund fees are complex and that some of the issues are interrelated with those identified in the separate CSA consultation on the appropriateness of introducing a best interest duty for advisors initiated on October 25, 2012 (Best Interest Duty Consultation).[3]

a. Key themes from industry stakeholders:

1. There is no evidence of investor harm that warrants a change to the mutual fund fee structure in Canada

The vast majority of industry stakeholders express the view that there are no substantive regulatory problems in the industry that warrant the potential reforms discussed in the Discussion Paper. Only a marginal number of industry stakeholders believe the current mutual fund fee structure raises sufficient investor protection concerns to require regulatory action at this time.

Some industry stakeholders submit that the trend away from transaction-based sales commissions towards a greater reliance on embedded trailing commissions has supported the development of aligned advisory relationships between dealer firms/advisors and investors. Previously, advisors may have had an incentive to recommend that their clients switch funds in order to receive a sales commission. With trailing commissions, the advisor's interest are better aligned with the investor's objectives since the advisor's compensation is ongoing over the life of the investment and will increase as the value of the investor's portfolio goes up and decline if it decreases.

In response to claims that mutual fund fees in Canada are among the highest in the world[4], some industry stakeholders point to a recent research report comparing mutual fund ownership costs in Canada and in the United States which finds that, for investors helped by a financial advisor, the overall cost of management and distribution of mutual funds in Canada is similar to the overall cost in the United States.[5]

Some industry stakeholders submit that there is an absence of directly related research and empirical evidence that the conflicts of interest examined in the Discussion Paper exist at all or, to the extent they do exist, impact investor outcomes to a degree that warrants a complete overhaul of the mutual fund fee structure in Canada.

While some industry stakeholders acknowledge that trailing commissions have the potential to incent advisors to sell a particular mutual fund over another comparable mutual fund with lower commission, they submit that the incidence of such a conflict is minimal in the Canadian market since trailing commissions are largely comparable across types of mutual funds as a result of an open and competitive market. They believe that any variance from the current industry standard trailing commission of 1%[6] is small and unlikely to provide an incentive to offer one fund over another similar fund. In their view, this lack of disparity amongst trailing commissions suggests that competitive market forces are working well and that regulation is therefore not required. This view is however challenged by some mutual fund manufacturers who submit that the standard trailing commission of 1% has been established by an oligopoly of large dealer firms who command this fee to provide placement on their product shelf.

Certain industry stakeholders point out that the recent prohibition of conflicted advisor remuneration for the distribution of and advice on retail investment products in the United Kingdom (U.K.)[7] and Australia[8] are responses to unique consumer protection gaps and situations in those jurisdictions, including a series of financial mis-selling scandals causing harm to investors, which are not present in Canada. They say it would be wrong for the CSA to follow suit with similar reforms as there has been no evidence of client harm arising from advisor compensation on mutual fund sales in Canada that would justify similar regulation here.

---

[3] See CSA Consultation Paper 33-403 *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (October 25, 2012). See also the transcripts of the related investor roundtable, industry roundtable and panel discussion held June 18, June 25 and July 23, 2013, respectively, available at: http://www.osc.gov.on.ca/en/37838.htm.

[4] These claims are based on studies examining fund fees in Canada and around the world, including: D. Phillips, *Why the trend in Canadian fund fees can only be down*, Morningstar Canada (August 13, 2013); B. N. Alpert, J. Rekenthaler and S. Suh, *Morningstar Global Fund Investor Experience 2013* (May 2013); B. N. Alpert, J. Rekenthaler, *Morningstar Global Fund Investor Experience 2011* (March 2011); J. Rekenthaler, M. Swartzentruber, C. Tsai, *Morningstar Global Fund Investor Experience 2009* (May 2009); A. Khorana, H. Servaes, P. Tufano, *Mutual Fund Fees Around the World* (July 23, 2007); and K. Ruckman, "Expense ratios of North American mutual funds", Canadian Journal of Economics (March 2003), p. 192-223.

[5] Investor Economics and Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios, A Canada-U.S. Perspective*, November 2012.

[6] Typical trailing commission for an equity fund sold on a front-end load basis.

[7] U.K. Financial Conduct Authority, *Retail Distribution Review - Adviser Charging*, rules in effect as of January 1, 2013.

[8] Australian Securities and Investments Commission, *Future of Financial Advice*, reforms in effect as of July 1, 2012, with compulsory compliance required from July 1, 2013.

Some industry stakeholders say that less extensive regulatory changes could be made to help improve the Canadian retail investor experience. They suggest interim steps such as more vigorous enforcement of existing regulation (e.g. suitability requirements for advisors), enhanced proficiency requirements for advisors and the regulation of advisor professional titles to ensure that investors aren't misled by deceptive titles. They also call upon the CSA to undertake investor education initiatives in an effort to improve financial literacy and help investors become more savvy consumers of financial products and advice.

2. A ban on embedded compensation will have unintended consequences for retail investors and the fund industry

Overwhelmingly, industry stakeholders think eliminating embedded advisor compensation would be detrimental to all participants in the fund industry, including and especially retail investors. They urge the CSA, before doing anything, to conduct a robust cost-benefit analysis to determine the impact that removing embedded commissions would have for investors and the fund industry.

Many industry stakeholders believe a ban on embedded commissions would have a number of unintended consequences, including (i) a reduction in access to advice for small retail investors, (ii) the elimination of choice in how investors may pay for financial advice, and (iii) the creation of an unlevel playing field among competing products and opportunities for regulatory arbitrage. We discuss each of these potential consequences below.

(i) A reduction in access to advice for small retail investors

Several industry stakeholders submit that embedded advisor compensation provides Canadians with affordable access to advisory services. Many of them point out that these advisory services include not only the advisor's advice[9], but also important dealer firm services[10] and advisor operating costs[11], all of which are funded from the trailing commission. We are told that the embedded nature of these costs enables advisors to provide up-front counselling to clients with small amounts to invest where a fixed fee or transaction-based commission model might otherwise deter clients from seeking advice.

These industry stakeholders submit that this affordability of financial advice has allowed for the significant use of advice by Canadian households, which certain industry studies find has resulted in the creation of a strong savings culture and investment discipline and the accumulation of more wealth for retail investors in Canada.[12]

Several industry stakeholders submit that smaller investors (sometimes referred to as "mass retail") benefit financially from the current embedded commission structure due to economies of scale. Under such a fee structure, the cost of providing advice and services to smaller investors is subsidized by the larger investors in the fund who pay more on account of their larger assets under management. We are told that the mandated use of a fee-for-service model would eliminate this pooling of fees from both larger and smaller investors and cause the price of servicing smaller accounts to increase. Faced with having to raise the price to service smaller investment accounts, many advisors would either cease to service those accounts or raise prices beyond which those investors would be willing to pay.

A number of industry stakeholders further submit that a mandated move to a fee-for-service model may impact the financial viability of certain advisors, especially independent financial advisors (as trailing commissions constitute the bulk of their revenues), and cause many to leave the business as a result. Such a change may also deter individuals from becoming advisors and consequently add to the industry's challenge in recruiting new advisors. We are told that this potential for a reduction in the number of advisors under a fee-for-service model, combined with the potential for higher costs for small retail investors, would cause those individuals to not be served and create an "advice gap".

Industry stakeholders further submit that small retail investors would lack the bargaining power to negotiate advisory fees in a fee-for-service model due to their generally low levels of financial literacy and the relatively small accounts they own. They would be at an information disadvantage as they would have no frame of reference as to what is reasonable. Consequently,

---

9 We are told that the portion of the trailing commission that the advisor receives compensates the advisor for the provision of various advice services, including but not limited to: suitability reviews, reviews on transfers, reviews of material changes in client circumstances, responses to client questions, general financial advice that can be unrelated to mutual funds, the rebalancing of portfolios, advice on registered products, the setting up of savings programs and the encouragement of good investment discipline.

10 We are told that the portion of the trailing commission that the dealer firm receives helps fund the daily operation of the dealer firm's business. This includes satisfying client reporting obligations, general compliance obligations, supervision requirements, regulatory fees, operational costs and product due diligence.

11 We are told that the portion of the trailing commission that the advisor receives does not operate solely as income for the advisor, but rather may also be used to cover the cost of administrative staff for which they are responsible, rental payments, marketing, travel, other costs of doing business, regulatory fees, and work associated with satisfying compliance obligations.

12 See The Investment Funds Institute of Canada (IFIC), *The Value of Advice Report 2012*. See also C. Montmarquette, N. Viennot-Briot, *Econometric Models on the Value of Advice of a Financial Advisor*, The Centre for Interuniversity Research and Analysis on Organizations (CIRANO), Montreal, July 2012.

small investors would be left with the choice of either incurring the potentially higher advice costs (including higher investment thresholds) imposed on them or, to the extent they are unable or unwilling to pay the costs, losing access to advisory services.

In support of their submissions, these industry stakeholders point to research suggesting that a fee-for-service model would result in higher advice costs and potentially higher overall ownership costs for small retail investors (i.e. those with less than $100K to invest) relative to the current embedded compensation model. Looking to U.S. data on mutual fund-centric fee-based advisory programs[13], some industry stakeholders suggest that advice costs for smaller investors would be in the range of 1.5% of assets under management.[14] This would exceed what the fund industry submits is the current industry standard trailing commission of 1% embedded in the cost of the mutual fund product.

Some industry stakeholders cite research in the U.K. which finds that investors generally have a low willingness to pay a separate fee for financial advice and that most would not opt to use advice if they had to pay for it separately.[15] They further cite related research in Australia finding that there is a significant gap between what investors are willing to pay for advice versus what it costs to provide it.[16] Other industry stakeholders also point to early surveys on the impact of the ban on conflicted advisor remuneration in the U.K. as an indication that many advisors in Canada would either abandon small retail investors to focus on a higher wealth segment or leave the business altogether, and access to advice would be reduced as a consequence.[17] One industry stakeholder however points out that while there appears to have been an initial drop in the number of advisors in the U.K., this is in part due to a new proficiency standard introduced as part of the U.K.'s reforms and which some advisors failed to initially meet.[18]

(ii) The elimination of choice in how investors may pay for financial advice

Several industry stakeholders say that Canadian retail investors should have the option to choose among various fee structures and select the one they prefer. In their view, regulation should provide flexibility and facilitate the broadest access to financial advice for individuals.

Accordingly, industry stakeholders are of the view that investors should have the freedom to choose whether they want the convenience of paying for advice embedded in the cost of a mutual fund or paying it separately to their advisor. They point out that Canadian retail investors currently have this flexibility by way of being able to select either Series A fund units (that pay an embedded trailing commission) or Series F fund units (that do not pay an embedded trailing commission but instead provide for a negotiated fee-for-service to be paid directly by the investor to the advisor). They submit that prohibiting embedded advisor compensation would eliminate this flexibility and choice for investors, to their detriment.

Many industry stakeholders submit that some investors specifically want to pay for advice through an embedded trailing commission as a matter of convenience and a matter of preference.[19] They go on to suggest that the current limited use of fee-for-service accounts by retail investors is evidence that investors are generally not interested in the fee-for-service model.

(iii) The creation of an unlevel playing field among competing products and opportunities for regulatory arbitrage

Industry stakeholders generally submit that mutual funds should not be unfairly targeted for having embedded commissions since advisor compensation is typically embedded in the prices (whether directly or through a spread) of other financial products, not just mutual funds.

---

[13] Strategic Insight, *A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Costs in the U.S. Mutual Fund Industry* (November 2012), p. 35.

[14] According to analysis from Strategic Insight on advisory fees charged by client asset size under U.S. fee-based programs (2011), 70% of U.S. investors with account sizes of $100,000 are charged advisory fees higher than 1.25% and 31% are charged over 1.50%. *Ibid*, p. 34.

[15] A. Clare, *The Guidance Gap – An investigation of the UK's post RDR savings and investment landscape*, Cass Business School, January 2013.

[16] Australian Securities and Investments Commission, *Access to financial advice in Australia*, Report 224, December 2010.

[17] Deloitte LLP, *Bridging the Advice Gap: Delivering investment products in a post-RDR world*. November 2012.

[18] On August 15, 2013, the U.K. Financial Conduct Authority (FCA) released figures showing that financial advisor numbers in that country, which initially dropped with the coming into force of the Retail Distribution Review reforms which banned third party commissions and increased proficiency requirements, are now rebounding as more advisors meet the higher level of qualification. The FCA's research shows that there were 32,690 retail investment advisors working in the UK in July 2013, up from 31,132 in December 2012, the last time the numbers were officially counted. Six months after the introduction of the new rules, the FCA reports that 97% of advisors have the appropriate level of qualification, and the other 3% are recent entrants to the industry who are still studying for full qualification within the time periods permitted by the rules. See the FCA's press release at: http://www.fca.org.uk/news/adviser-numbers-in-line-with-expectations.

[19] In support of this submission, on September 30, 2013, the Investment Funds Institute of Canada published the results of a survey finding that half of mutual fund investors (51%) prefer their advisor be compensated through an embedded fee. See POLLARA Inc., *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry 2013*, Report Prepared for the Investment Funds Institute of Canada.

Some industry stakeholders point out that embedded compensation is the standard in approximately three quarters of the total assets of all Canadian households, including deposits, fixed income, segregated funds, and insurance.[20] They say that to require mutual funds to move away from this widely accepted broader financial industry practice would create an unlevel playing field between mutual funds and competing financial products. Specifically, advisors who are dually licensed, and who already face greater regulation and compliance burdens in connection with the distribution of mutual funds[21], may have an incentive to instead sell banking and insurance investment products that some think are less regulated, less transparent, and possibly more expensive. Some industry stakeholders note that such opportunities for regulatory arbitrage have not arisen in the U.K. and Australia because their reforms[22] have been uniformly applied across competing products – securities, banking and insurance investment products.

Many industry stakeholders therefore urge the CSA to focus on initiatives that can be applied to the entire universe of financial products rather than solely target the mutual fund industry.

3. We should observe and assess the impact of domestic and international reforms before moving ahead with further proposals

Most industry stakeholders are of the view that if the main concern with embedded advisor compensation is that investors aren't aware of it and therefore don't understand it, then the solution should be to pursue initiatives that improve their understanding of such fees rather than focus immediately on prohibition. Accordingly, they think that the CSA should first assess the benefits resulting from the recent implementation of point of sale (POS) delivery of the new Fund Facts disclosure document[23] and the Client Relationship Model (CRM2) reforms to cost disclosure and performance reporting[24], and determine whether these disclosure changes improve investor understanding and decision-making before proceeding with additional regulatory reform.

The POS and CRM2 disclosure initiatives are expected to benefit investors by improving their overall awareness and understanding of mutual fund fees and ongoing advisor compensation costs, thus enabling them to make better and more informed investment decisions. Those initiatives will also give advisors an opportunity to have conversations with their clients and to show how they add value. Many industry stakeholders say that the enhanced transparency that these reforms will provide should sufficiently address the potential conflicts of interest that embedded advisor compensation raises as well as improve the alignment between advisor compensation and the services provided.

These industry participants point out that they are investing significant resources to implement the POS and CRM2 reforms. They believe that once these are fully implemented, we will have set a world-class standard in Canada for disclosure and transparency of fund costs.

We are further urged to take the time to carefully monitor relevant international reforms, such as the recent ban on conflicted advisor remuneration in the U.K. and Australia[25], and assess whether those reforms caused unintended consequences for investors, in particular small retail investors, and industry participants in those jurisdictions before pursuing similar reforms here.

b. Key themes from investor stakeholders:

1. Embedded advisor compensation causes a misalignment of interests which impacts investor outcomes and should be banned

Investor stakeholders generally think that embedded advisor compensation causes advisors to make investment recommendations that pay them higher compensation, resulting in higher costs and less optimal investment results for the investor. Most consider that this conflict of interest cannot be overcome through disclosure initiatives such as POS and CRM2 and consequently see no reason for the regulators to monitor and assess the effects of these or other reforms internationally before moving forward with a proposal to ban embedded compensation.

Most investor stakeholders therefore think that banning embedded compensation is necessary to reduce the misalignment of incentives currently affecting the client-advisor relationship and help assure investment recommendations that are in the best

[20] Investor Economics, *Household Balance Sheet 2012*.

[21] The industry points to the Client Relationship Model reforms (Phases 1 & 2) under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, and the new Fund Facts document delivery requirements under National Instrument 81-101 *Mutual Fund Prospectus Disclosure*.

[22] *Supra* notes 7 and 8.

[23] See the amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* made September 1, 2013 which, as of June 13, 2014, will require delivery of the Fund Facts document instead of the simplified prospectus in satisfaction of the prospectus delivery requirements under securities legislation.

[24] See the amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* made July 15, 2013 which, as of July 15, 2016, will require registered firms to annually disclose to their clients the dollar amount of trailing commissions and other compensation they received in connection with securities owned by the client.

[25] *Supra* note 22.

interest of the client. They say this ban would benefit investors by giving them greater awareness of and more control over the costs they pay for mutual funds and financial advice.[26] Investors will know that they pay for "advice" and will be able to compare the costs and services of different advisors as well as the operating costs of various mutual funds which will be made more transparent with the elimination of embedded compensation. This would lead to a more competitive market for both mutual funds and for financial advice, leading in turn to lower costs and improved returns for Canadian investors, thus enabling them to accumulate more savings for their retirement or other financial goals.

In response to industry participants' submissions that a ban on embedded compensation will reduce access to advice for small retail investors, investor stakeholders believe that if such an advice gap does indeed emerge, alternative fee structures or business models will develop, both within the existing institutions and through new entrants to the market, that will deliver advice tailored to small investors. Banning embedded commissions will lead to innovation and increase competition which will ultimately drive down costs for investors and improve their investment outcomes.

Certain investor stakeholders challenge the industry's "advice gap" argument by pointing out that a significant portion of small retail investors are currently serviced by the bank branch advice channel whose advisors are not commission-based. They therefore do not believe that eliminating embedded commissions would reduce access to financial advice for those investors.

Those investor stakeholders further question the industry's assertions that overall mutual fund ownership costs would increase if embedded commissions were banned. While not disputing the assertion that the cost of advice could be higher for small retail investors under a fee-for-service model, the absence of product embedded inducements under that model would allow the advisor to focus on the investor's best interests and shop the market for lower-cost products, resulting in overall cost savings and better financial outcomes for the investor over the long-term.

2. Investors should at a minimum have the true choice to not pay embedded commissions

Some investor stakeholders submit that, in the absence of an immediate ban on embedded commissions, retail investors should at least have the true choice to not pay embedded commissions.

These investor stakeholders dispute the industry's contention that retail investors currently have choice and that the prevalence of the embedded commission fee model in the Canadian fund industry is evidence that investors actually prefer that model. They submit that investors can only make a true choice if they know what the alternatives are and are provided with those options prior to actually making their decision. They point out that the majority of advisors today operate on a commission-only basis and therefore do not give their clients the option of investing in trailing commission-free Series F mutual fund units intended for fee-based accounts.[27] Furthermore, even where the option of investing in Series F units is available, many investors don't have the minimum investable assets necessary to access fee-based accounts. The overall result is that the majority of retail investors today have no choice but to invest in the full trailing commission fund units.

Several investor stakeholders further point out that even those investors who opt to go it alone and forgo the advice still must pay for advice. This is because investors who purchase mutual fund securities through discount brokerages are generally made to purchase the same full trailing commission fund units that are sold through full-service advisors.[28] While discount brokerages receive full trailing commissions for the distribution of mutual funds on their platforms, they do not provide advice to investors who trade on their platform. Under the current rules, discount brokers are not permitted to offer advice and are exempt from the suitability assessment which full-service advisors are otherwise responsible for completing. In view of that, investor stakeholders submit that mutual fund investors in the discount brokerage channel are overpaying for their mutual fund investments and do not realize any savings over the investor who uses a full-service advisor. They further argue that if true savings could be realized in the discount brokerage channel, it might then become a true market choice that mutual fund investors would opt for. This lower-cost choice would improve retail investors' ability to accumulate savings for retirement or other financial goal.

These investor stakeholders therefore recommend that the payment of trailing commissions to discount brokers who provide execution-only services be prohibited. They further urge regulators to require that trailing commission-free mutual fund series be made available to retail investors, including at discount brokerages and directly from mutual fund manufacturers, to ensure that investors have the true option of not paying embedded commissions and that those investors who opt to do it themselves realize true cost savings.

---

[26] The AMF's consultation with retail investors revealed that most investors consulted were neither aware of the embedded commissions nor did they understand the fee structure of mutual funds.

[27] The AMF's consultation with retail investors revealed that most of the investors consulted were not aware of the existence of Series F units.

[28] The CSA note that following the comment process on the Discussion Paper and the subsequent consultations held by the OSC, BCSC and AMF, certain fund industry participants have taken steps to address this issue. Up until recently, only a few Canadian mutual fund manufacturers, all of which are bank-owned, have offered discounted series units of certain of their proprietary mutual funds through their affiliated bank-owned discount brokerage arm. These discounted series units intended for do-it-yourself (DIY) investors bear a significantly reduced trailing commission which recognizes the fact that DIY investors do not receive advice services. On November 27, 2013, three independent mutual fund manufacturers announced the offering of discounted series units of their mutual funds to be distributed through a major bank-owned discount brokerage.

3. We need to implement a best interest duty for advisors

Investor stakeholders strongly believe that advisors should be required to act in their client's best interest and that a statutory best interest duty must be introduced in order to protect investors. They point out that a best interest duty would be consistent with investors' general expectations, as shown by recent investor research that found that most investors believe advisors already have a legal duty to act in their best interest.[29]

In their view, a best interest duty which addresses issues relating to conflicted remuneration, including embedded commissions, will reduce bias in advisors' investment recommendations, thus making recommendations more objective. It would at the same time eliminate much of the need for conflicts disclosure, which investor advocates submit is ineffective. In this regard, they cite certain studies whose findings suggest that most Canadian investors do not have the requisite knowledge and experience to factor disclosed conflicts of interest into their decision-making.[30] They further cite behavioural research showing the perverse effects of disclosure, such as increased trust and reliance by investors and moral licensing of advisors.[31] Given these findings, investor stakeholders submit that a "disclose and move on" approach is not acceptable.

Investor stakeholders generally consider that a best interest duty for advisors would improve outcomes for investors because it would explicitly require advisors to consider the investment's costs in determining whether the investment is in the best interest of the investor, whereas the current suitability standard fails to require this.

Many investor stakeholders however submit that the current embedded advisor compensation model, with its inherent incentives, is incompatible with a best interest duty. They believe that absent the elimination of embedded commissions, the profit objectives of advisors and of the mutual fund manufacturers whose funds they distribute would continue to prevail over the best interests of investors. These investor stakeholders therefore think that a best interest duty alone is not sufficient and should include the concurrent elimination of embedded commissions.

4. We need to increase advisor proficiency requirements and regulate the use of titles

Some investor stakeholders submit that the investor protection concerns that embedded advisor compensation raise are compounded by other potential areas of concern with the advisor-client relationship, including confusing advisor titles and low advisor proficiency.

These investor stakeholders accordingly submit that financial advisors should be required to meet higher proficiency requirements and satisfy continuing education requirements, as well as adhere to a code of professional and ethical conduct that ensures the client's interest is put first. They further urge the CSA to standardize the professional titles and designations that advisors may use so as to ensure they more accurately reflect the scope of an advisor's services and do not denote expertise that the advisor may not have.

Some suggest that the use of the title "Financial Advisor" by a product salesperson, who is trained solely to deliver trade suitability rather than financial planning and/or ongoing investment management advice, has resulted in confusion and a distinct disconnect between the level of service many investors expect from their financial advisor and the actual service provided.

These investor stakeholders therefore submit that title and holding out restrictions should be put in place to allow the public to clearly distinguish between those who offer advice limited to trade suitability and those who provide more extensive advice and services, such as financial planning and/or ongoing investment management advice.

Conclusion

A number of the key messages from industry and investor stakeholders set out above are similar to those that have emerged from the Best Interest Duty Consultation. We refer you to CSA Staff Notice 33-316 – *Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*, published concurrently with this Notice, for an overview of the key themes that emerged from that separate consultation.

The similarity of the feedback received from stakeholders demonstrates a connection between the two consultation initiatives and suggests a need for CSA staff to coordinate their policy considerations on these initiatives going forward.

---

[29] The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor-decision making study*, (2012), prepared for the Investor Education Fund.

[30] Ibid. See also Innovative Research Group Inc., *2012 CSA Investor Index* (October 16, 2012).

[31] Daylian M. Cain, George Loewenstein, and Don A. Moore, *"The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest"* (2005) The Journal of Legal Studies, 34 (1), p. 1-25.

Accordingly, in collaboration with the Best Interest Duty Consultation initiative, CSA staff continue to consider and discuss the information gathered through our consultative process with a view to determining next steps. We anticipate communicating in the coming months what, if any, regulatory actions we intend to pursue, including setting out research initiatives we intend to undertake to support such actions.

Questions

Please refer your questions to any of the following:

Bob Bouchard
Director and Chief Administrative Officer
Manitoba Securities Commission
Phone: 204-945-2555
E-mail: Bob.Bouchard@gov.mb.ca

Sarah Corrigall-Brown
Senior Legal Counsel, Legal Services Branch
Capital Markets Regulation Division
British Columbia Securities Commission
Tel: 604-899-6738
Email: Scorrigall-brown@bcsc.bc.ca

Rhonda Goldberg
Director, Investment Funds Branch
Ontario Securities Commission
Phone: 416-583-3682
E-mail: rgoldberg@osc.gov.on.ca

George Hungerford
Senior Legal Counsel, Legal Services Branch
Corporate Finance Division
British Columbia Securities Commission
Phone: 604-899-6690
E-mail: ghungerford@bcsc.bc.ca

Ian Kerr
Senior Legal Counsel, Corporate Finance
Alberta Securities Commission
Phone: 403-297-4225
E-mail: Ian.Kerr@asc.ca

Heather Kuchuran
Senior Securities Analyst
Financial and Consumer Affairs Authority of Saskatchewan
Phone: 306-787-1009
E-mail: heather.kuchuran@gov.sk.ca

Stéphane Langlois
Senior Director, Distribution Policies and Compensation
Autorité des marchés financiers
Phone: 418-525-0337, ext. 4811
E-mail: stephane.langlois@lautorite.qc.ca

Chantal Leclerc
Senior Policy Advisor, Investment Funds Branch
Autorité des marchés financiers
Phone: 514-395-0337 ext. 4463
E-mail: chantal.leclerc@lautorite.qc.ca

Chantal Mainville
Senior Legal Counsel, Project Lead
Investment Funds Branch
Ontario Securities Commission
Phone: 416-593-8168
E-mail: cmainville@osc.gov.on.ca

Mathieu Simard
Director, Investment Funds Branch
Autorité des marchés financiers
Phone: 514-397-0337, ext. 4471
E-mail: Mathieu.simard@lautorite.qc.ca

1.1.3 CSA Staff Notice 33-316 – Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients

Canadian Securities Administrators

Autorités canadiennes en valeurs mobilières

CSA Staff Notice 33-316
Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients

December 17, 2013

Introduction

The purpose of this Notice is to:

- summarize the consultation work conducted to date in respect of the best interest consultation initiative, and
- identify the key themes that emerged from the best interest consultation process.

In October 2012, the Canadian Securities Administrators (**CSA** or **we**) published *CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (the **Consultation Paper**). We received numerous comment letters on the Consultation Paper and conducted three consultation sessions in June and July 2013.

Through this consultation process, we identified four key themes:

1) There was significant disagreement about (a) whether the current regulatory framework for advisors[1] adequately protects investors and (b) what regulatory response is required.

2) A best interest standard must be clear.

3) The potential negative impact on investors and capital markets must be carefully assessed.

4) More work is needed.

Background

Consultation Paper

On October 25, 2012, the CSA published the Consultation Paper.[2] The Consultation Paper:

summarized the background of the fiduciary duty debate,

- described what a fiduciary duty is and when it arises at common law,
- discussed the current standard of conduct for registrants in Canada (including both statutory and common law requirements),
- reviewed what the United States, the United Kingdom, Australia and the European Union are doing in this area,

[1] References to “advisor” in this Notice mean, unless otherwise specified, advisers and/or dealers (and their representatives) that provide securities advice to clients.

[2] Available online at http://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20121025_33-403_fiduciary-duty.pdf.

- identified the five key investor protection concerns with the current standard of conduct applicable to advisors in Canada,
- described one possible articulation of a statutory best interest standard for advisors, and
- reviewed the potential benefits and competing considerations of imposing a statutory best interest standard.

The Consultation Paper posed a variety of questions and requested comments from all interested stakeholders on the issues raised in the Consultation Paper. The CSA received 93 comment letters from a range of stakeholders, including investors, investor advocates, advisors, industry advocates, academics, law firms and professional associations. The list of commenters and copies of the comment letters are available online at http://www.osc.gov.on.ca/en/38075.htm.

Consultation Sessions

In addition, the CSA held three consultation sessions hosted by the Ontario Securities Commission (**OSC**) to further explore and discuss the issues identified in the Consultation Paper and the themes that emerged from the comment letters:

- The first consultation session was held on June 18, 2013 (**Investor Roundtable**). The Investor Roundtable was a three-hour discussion attended by approximately 30 stakeholders from the investor community.[3] The discussion at the Investor Roundtable was focused on several key issues:
  - what problem needs to be solved,
  - shifting the suitability standard to a best interest standard,
  - mitigating information and financial literacy asymmetry,
  - impact on legal certainty of relationship,
  - potential negative impact on advisory services for investors,
  - potential shift by investors and advisors to alternative investments,
  - role of recent reforms, and
  - other policy solutions that need to be considered.
- The second consultation session was held on June 25, 2013 (the **Industry Roundtable**). The Industry Roundtable was a three-hour discussion attended by approximately 55 stakeholders from the industry community.[4] The discussion at the Industry Roundtable was focused on several key issues:
  - whether the current standard of conduct offers the most principled foundation,
  - the effectiveness of disclosure for conflicts,
  - shifting the suitability standard to a best interest standard,
  - mitigating information and financial literacy asymmetry,
  - impact on legal certainty of relationship,
  - potential negative impact on advisory services for investors,
  - costs of introducing a best interest standard, and
  - the impact on capital raising.

[3] The transcript of the Investor Roundtable is available online at http://www.osc.gov.on.ca/documents/en/Securities-Category3/oth_20130618_33-403_transcript-roundtable.pdf.

[4] The transcript of the Industry Roundtable is available online at http://www.osc.gov.on.ca/documents/en/Securities-Category3/oth_20130625_33-403_transcript-roundtable.pdf.

- The third consultation session was a panel discussion held on July 23, 2013 (the **Panel Roundtable**). There were approximately 110 attendees at this two-hour session.[5] The panel was moderated by James E. A. Turner (Vice-Chair, OSC) and consisted of:

  - Connie Craddock (OSC Investor Advisory Panel),
  - Jim Kershaw (SVP and Regional Manager, TD Wealth Private Investment Advice),
  - Anita Anand (Professor and Academic Director, University of Toronto), and
  - John Fabello (Partner, Torys).

  The intent of the Panel Roundtable was to build on the progress made at the Investor Roundtable and the Industry Roundtable and to move the dialogue forward by focusing on two fundamental issues:

  - Should dealers (and their representatives) be subject to a best interest standard when providing advice to retail clients? What would the consequences be of introducing such a standard?
  - What other policy options could securities regulators consider in addition, or as alternatives, to a statutory best interest standard?

We also had informal meetings with a variety of stakeholders to both explain the Consultation Paper and solicit feedback on the issues raised in it.

We thank those who have contributed to our consultation process to date by responding to our request for comments and/or by participating in the consultation sessions. We have gathered a great deal of information from this process and will be using it to inform our approach going forward.

Themes from the Consultation

Based on our consultations to date, the following are the four key themes that have emerged:

- There was significant disagreement about (a) whether the current regulatory framework for advisors adequately protects investors and (b) what regulatory response is required.

  - Those stakeholders that support the introduction of a statutory best interest standard felt that the current regulatory framework for advisors does not adequately protect investors. Many also felt that targeted regulatory responses are also required in several specific areas, including titles, proficiency, suitability and conflicted compensation practices. Several took the view that recent international regulatory developments have left Canadian standards at a lower level than those in leading jurisdictions.
  - Those stakeholders that do not support the introduction of a best interest standard explained how the current regulatory framework, coupled with recent Canadian regulatory reforms, provided a robust, flexible and principled regulatory foundation that affords strong investor protection and that addresses the investor protection concerns identified in the Consultation Paper. Most of these commenters also suggested that although there was no evidence of actual harm to investors under the current framework, if there were such evidence, the appropriate regulatory response would be targeted solutions to these problems, not a statutory best interest standard. Regarding the relevance of international regulatory developments, we heard that the regulatory context is different, that those jurisdictions had different experiences and regulatory starting points, and that it is too early to definitely determine their impact in any event.

- A best interest standard must be clear.

  - There was broad agreement that a best interest standard, if adopted, should be as clear as possible and include sufficient guidance to ensure all advisors understand how to comply with the standard. Many questioned whether certain restricted business models and certain compensation practices could continue under a statutory best interest standard.

[5] The transcript of the Panel Roundtable is available online at http://www.osc.gov.on.ca/documents/en/Securities-Category3/oth_20130723_33-403_transcript-roundtable.pdf.

- The potential negative impact on investors and capital markets must be carefully assessed.
  - Many commenters strongly believe that the potential for negative impact on investors and capital markets from unintended consequences of a statutory best interest standard is significant. The main concern was that a best interest standard could result in advice that is more expensive, less accessible and too conservative.
- More work is needed.
  - Many commenters suggested further work that should be completed before moving forward with a statutory best interest standard or other regulatory response.

Below, we discuss each of these key themes in detail. The themes underscore that the issues surrounding a best interest standard are complex, and some aspects of the issues are interrelated to the issues surrounding the separate CSA consultation on mutual fund fees initiated on December 13, 2012 (**Mutual Fund Fees Consultation**).

1. There was significant disagreement about (a) whether the current regulatory framework for advisors adequately protects investors and (b) what regulatory response is required

Summary

Those stakeholders that support the introduction of a statutory best interest standard felt that the current regulatory framework for advisors does not adequately protect investors. Many also felt that targeted regulatory responses are also required in several specific areas, including titles, proficiency, suitability and conflicted compensation practices. Several took the view that recent international regulatory developments have left Canadian standards at a lower level than those in leading jurisdictions.

Those stakeholders that do not support the introduction of a best interest standard explained how the current regulatory framework, coupled with recent Canadian regulatory reforms, provided a robust, flexible and principled regulatory foundation that affords strong investor protection and that addresses the investor protection concerns identified in the Consultation Paper. Most of these commenters also suggested that although there was no evidence of actual harm to investors under the current framework, if there were such evidence, the appropriate regulatory response would be targeted solutions to these problems, not a statutory best interest standard. Regarding the relevance of international regulatory developments, we heard that the regulatory context is different, that those jurisdictions had different experiences and regulatory starting points, and that it is too early to definitely determine their impact in any event.

The discussion below on this key theme is divided into the following areas:

- Supporters of a statutory best interest standard
- Opponents of a statutory best interest standard
- Appropriate influence of international developments

Supporters of a statutory best interest standard

Those commenters that support a best interest standard identified a variety of reasons why the current regulatory framework for advisors does not adequately protect Canadian investors, as follows:

- the existing regulatory requirements and industry practices are based on a regulatory foundation that cannot provide adequate protection for consumers of financial services in Canada. Fundamentally, they see the current regulatory foundation as inappropriate for the advisor-client relationship because it does not explicitly require that advisors put the interests of their clients ahead of their own and therefore does not align advisors' interests with those of their clients;
- due to continued low financial literacy among Canadian investors, coupled with the ever-increasing complexity of financial products, information and financial literacy asymmetry is becoming more pronounced. This leads to investors that place increasingly more reliance on their financial advisor;
- most investors receiving non-discretionary advice already assume that their advisor is required to act in their client's best interest when, at least in the common law jurisdictions, this is usually not the case for advisors that provide non-discretionary advice. We heard that part of this expectation gap may be driven by investor confusion caused by the lack of general understanding of various designations, titles and roles in the

investment industry. We also heard that industry marketing and advertising (which often explicitly or implicitly states that clients receive ongoing, personalized financial advice) contribute to this expectation gap;

- the suitability standard is a low one that simply involves the advisor recommending products that match the general needs of the client, not necessarily the product that is in the client's best interest. We heard that in practice, this means that the suitability analysis is vague and complex, involving a multi-factor analysis conducted by the advisor that is tied to whether the product (which may be connected to the advisor) is suitable to the client, not necessarily whether it offers the fairest price/cost for the investor based upon the complexity of the product and/or service being offered. Specific concerns in this regard related to costs of the products (and disclosure of such costs) and compensation bias affecting the recommendation, with the advisor recommending the products with the highest advisor compensation instead of products that he or she felt were objectively superior. Further, some commenters felt that a flaw with the suitability standard is that it is based on a product-transaction model rather than an ongoing-advice model and allows advisors to recommend leverage (or borrowing to invest) in order to increase assets under management, which inappropriately increases risk for most investors. The ultimate impact of this regime on investors is poor investor outcomes, including sub-optimal returns and/or inappropriate risk exposure;

- in an environment where most investors lack even basic financial literacy, the effectiveness of disclosure (which is the common industry practice) as an antidote for conflicts of interest, confusion about advisor remuneration, and other similar issues, is ineffective and leads to increased agency (monitoring) costs for investors. In addition, without a thorough understanding of such disclosure, these commenters argued, it is unlikely that truly informed consent can be granted by investors. Many commenters shared the view that some conflicts such as embedded compensation cannot be managed (they are inherently opaque, complex and difficult for consumers to understand) and should be avoided or prohibited and that this is critical for investor protection. Others proposed that all material conflicts of interest should be avoided altogether;

- advisor titles are confusing and even misleading (e.g., that inflate proficiency, scope of products reviewed and/or level of service provided), which results in investors being unable to differentiate between different financial service providers and the different advice options available to them;

- proficiency requirements for certain kinds of dealers are too low (e.g., brokers and bank staff are trained enough to know about in-house funds and products to sell them but not really whether they are beneficial for clients);

- in the absence of a statutory best interest duty, the current framework is uncertain and does not offer effective investor restitution in the event of investor harm caused by advisor misconduct;

- investors have a low level of trust and confidence in the financial services industry as a whole; and

- commenters from a variety of backgrounds touched on the importance of financial advice as part of a financial plan and expressed a concern that, because of the current regulatory framework, most Canadians are not receiving holistic advice but instead are receiving overly narrow, transaction-based advice on securities products.

These commenters felt that a statutory best interest standard is a highly desirable and feasible regulatory response to the concerns set out above and should be adopted promptly. In support of this view, they suggested that the introduction of a best interest standard would result in the following outcomes:

- it would require advisors to advance the best interests of their clients to the exclusion of all other competing interests that may exist;

- it would result in better financial outcomes for investors because it would (i) result in more objective recommendations, since a best interest duty, by addressing issues relating to conflicted remuneration, will reduce bias in recommendations, and (ii) explicitly require advisors to consider the investment costs in determining whether the investment is in the best interest of the client;

- it would ensure that conflicts are avoided and thereby eliminate much of the need for conflicts disclosure, which in their view is not effective for investors and which may cause unintended negative consequences (e.g., investors generally do not discount advice from biased advisors as much as they should; disclosure can increase the bias in advice);

- it would result in less investor confusion about the role of the advisor and ensure the most efficient allocation of responsibilities between the advisor and the client given the level of financial literacy of consumers, the

degree of knowledge, specialized skills and abilities that the advisor needs to possess, and the complexity of financial products

- it would require regulators to consider whether embedded commissions (and other compensation practices) are compatible with a best interest standard. If embedded commissions were prohibited as a result of a best interest standard, investors would be encouraged to look more critically at what they are getting for what they pay. This would improve competition and economic forces would spur innovation in the delivery of cost-effective advice that meets a best interest standard;

- it would help establish better means of restitution by removing the uncertainty about whether the standard applies and improving the chances of the client securing some restitution. The greater impact, however, may be that existence of the legislated duty and greater chance of success in court will influence the behaviour and standards of advisors and their firms, both reducing the losses and encouraging out of court settlements.

- it would support investor education initiatives which, although helpful, cannot be expected to address the significant power imbalance between advisor and client

- it would align the CSA's approach with the expectations of the International Organization of Securities Commission (IOSCO) and the G20 in how financial intermediaries should deal with their clients; and

- it would enhance the professionalism of the financial services industry and enhance public trust and confidence in the industry, thereby assisting the financial advice industry in its ambition to be recognized as a profession.

Although most of these commenters stated that a statutory best interest standard is necessary, most of them also took the view that it is not sufficient by itself. We heard that targeted reforms will likely also be necessary. Some of the key targeted reforms identified by commenters included (collectively, the **Other Policy Options**):

- Raising advisor proficiency and designations, especially for certain kinds of dealing representatives;

- Regulating advisor titles to ensure they are accurate and not misleading;

- Creating two categories of advisor similar to the U.K. model: one category ("adviser") would offer independent, holistic advice free of any conflicts and be subject to a best interest standard and another category ("salesperson") would offer restricted and/or conflicted advice that would be subject to the current regulatory requirement for advisors;

- Improving suitability (including allowing certain restricted dealers (e.g., mutual fund dealers) to offer a broader range of products);

- Improving the rules on conflicts of interest, including conflicted compensation models;

- Expanding financial literacy education programs to ensure investors understand, among other things, the standard of conduct owed to them by their advisor;

- Ensuring sound management control mechanisms at advisory firms to ensure regulatory requirements are met;

- Requiring investment policy statements in certain circumstances;

- Prohibiting or standardizing embedded commissions so that they are neutral to the type of product being distributed;

- Improving investor restitution by considering alternative (or additional) dispute resolution options;

- Examining the services provided by discount brokerages to determine if they could continue under a best interest standard and/or assessing whether certain services should be subject to a best interest standard; and

- Increasing enforcement, and compliance reviews, of the current regulatory framework.

Opponents of a best interest standard

Those commenters that do not support a best interest standard identified a variety of reasons why the current regulatory framework for advisors in fact does adequately protect Canadian investors, as follows:

- the current regulatory framework represents a robust, flexible and principled foundation that offers a high level of investor protection by:
  - addressing in what situations a fiduciary duty will appropriately be found to exist between an advisor and his or her client.
  - providing extensive investor protections through detailed rules and regulations of securities commissions and self-regulatory organizations (**SROs**), including:
    - a requirement to deal fairly, honestly and in good faith with clients;
    - suitability obligations (including recent SRO enhancements);
    - a requirement to observe high standards of ethics and conduct in the transaction of business with clients;
    - proper disclosure and handling of conflicts of interest (including recent SRO enhancements), including avoidance in certain circumstances;
    - prohibited sales practices;
    - dispute resolution requirements;
    - supervision of activity in client accounts;
    - background checks of advisors (such as police, credit, employment, education and proficiency course completion) before licensing;
    - industry-specific education requirements;
    - compensation disclosure;
    - cost disclosure and performance reporting (including the recent CRM2 reforms);
    - referral arrangement disclosure;
    - product disclosure (including management report on fund performance and Fund Facts reforms);
    - plain language requirements; and
    - insurance and bonding;
- existing comprehensive securities legislation and recent CSA and SRO initiatives, including the new SRO conflict of interest rules, the Client Relationship Model reforms to cost disclosure and performance reporting (i.e., CRM2), the management report of fund performance, the Fund Facts disclosure document, the relationship disclosure reforms, the SRO enhancements to suitability, and the CSA-sponsored investor education initiatives (collectively, the **Recent Canadian Reforms**) address the investor protection concerns (or will address these concerns, once fully implemented) expressed in the Consultation Paper;
- the Consultation Paper neither captured the perceived failure in the current regulatory regime nor presented any evidence demonstrating any actual investor harm with the current standard of conduct for advisors;
- financial literacy and information asymmetry will vary dramatically depending on the advisor and the client and is one of the reasons why clients engage advisors in the first place;
- an expectation gap does not exist in practice as most advisors already assume an obligation to provide advice in their clients' best interest;

- it is misleading to compare a best interest standard to the suitability standard in isolation from the related duty of care and duty to act fairly, honestly and in good faith. Moreover, many commenters pointed to the recent SRO enhancements to their suitability requirements, which include more frequent triggering events and reference to the client's portfolio in certain circumstances. Many were of the view that the duty to act fairly, honestly and in good faith would not allow an advisor to recommend a product that resulted in higher fees to the client. Some stated that a suitable product must, by definition, be a product in the client's best interest. Others stated that identifying the "best" or "better" products is subjective and contentious and would be difficult to enforce. Several commenters are of the view that cost is already a consideration, but that it is only one consideration as a high cost investment may also have a better long-term performance. Many commenters were also not convinced that a gap exists between suitable investments and investments in the client's best interest apart from the issue of cost and they believe that further study is required to determine what gap exists, if any; and

- since several of the Recent Canadian Reforms, including the SRO reforms relating to conflicts of interest (which now requires addressing conflicts of interest in a fair, equitable and transparent manner, and considering the best interests of the client), are not yet fully implemented, it is premature to conclude that the rules applicable to management of conflicts of interest are less effective than intended.

Finally, many industry commenters took the position that even if certain investor protection concerns remained (or emerged) after full implementation of the Recent Canadian Reforms, the appropriate regulatory response should be targeted in nature (some of the targeted reforms above were also suggested by certain industry commenters, such as improvements to title regulation, proficiency enhancements, and new investor education initiatives) rather than undertaking a foundational shift of the entire regime which may or may not address the concerns and may lead to negative unintended consequences for investors and capital markets (see discussion below under Key Theme #3). Their reasons against introducing a best interest standard as a solution to these concerns included the following:

- they did not see what investor protection issues a best interest standard would address that the current framework could not address, as the current regulatory framework either already imposes a best interest standard for advice to retail clients or imposes a standard that is functionally equivalent to a best interest standard. Certainty, advisors that provide discretionary advice to clients (or that have clients that are vulnerable and place significant trust and reliance on their advice) are subject to a best interest (or fiduciary) duty at common law. For all other advisors, the requirement to deal fairly, honestly and in good faith with investors along with rules around suitability, know your product, relationship disclosure, referral arrangement disclosure, continuous product disclosure, complaint handling, plain language requirements, conflict disclosure, compensation disclosure constitutes a standard that is functionally equivalent to a best interest standard;

- a best interest standard will exacerbate concerns around financial literacy and information asymmetry since investors will have less incentive to educate themselves on investments and place more reliance on their advisor. These commenters also feared that this will lead to increased investor apathy, with investors waiving their own responsibilities in favour of any advice they are given, and will place all of the responsibility on their advisor, even in non-discretionary relationships;

- the Recent Canadian Reforms demonstrate that Canada's regulatory framework is successfully evolving further in the direction of achieving "best interest" requirements without the need to specifically impose a vague statutory best interest standard. Although concerns may remain or emerge, these commenters expressed the view that the current regime is robust enough to address any such concerns;

- among Québec's 11 commenters, several are of the view that investors are adequately protected by Québec's current requirements. They argue that Québec's courts must keep the flexibility that the current regime provides, which allows them to factor in the specific circumstances of each case. Commenters pointed out that amending the current regime could have the effect of lowering investors' sense of responsibility and could create an obligation focused on the ends (i.e., the returns of the investments) rather than on the means (i.e., the process used by the advisor to arrive at a recommendation) of advisory services. They are of the view that Québec's current regime is (or almost is) a functional equivalent of the common law fiduciary duty, though civil law and common law remain two different regimes. Nevertheless, one Québec commenter is of the view that a statutory, uniform and flexible best interest standard should be adopted by all CSA regulators and SROs; and

- in common law jurisdictions, a best interest standard will create legal uncertainty because courts will no longer be able to rely on existing jurisprudence relating to the content of the suitability obligation or fiduciary duty. They will have to develop new law on the meaning of "best interest" as defined by the CSA.

Appropriate influence of international developments

Many commenters felt that jurisdictions such as the United Kingdom and Australia have made important strides in investor protection and, in the case of Australia, in introducing a best interest standard. They claimed that the investor protection concerns identified by regulators in these jurisdictions mirror the investor protection concerns with the current regulatory framework in Canada. These commenters suggested that Canada is lagging behind in this area, leaving Canadian standards at a lower level than those in leading jurisdictions, and should adopt a best interest standard to afford investors with similar protection as is provided in those other jurisdictions.

Others questioned the comparison between Canada and other international jurisdictions in the standard of conduct context. They pointed out that:

- the policy responses in other jurisdictions were designed to deal with market failures and deficiencies that arose in those jurisdictions. Since Canada does not exhibit these same issues and has its own statutory framework that includes a duty to deal fairly, honestly and in good faith with clients that may not have existed in some of the other jurisdictions, any move toward adopting similar reforms in Canada would be unnecessary and misguided.

- when the implementation and contextual considerations are closely examined, it is difficult to conclude that international initiatives point to Canada lagging other jurisdictions in providing a robust framework for investor protection or falling down on considering the investor's best interest. Some also said that the rationale for introducing tighter market regulation in some of the jurisdictions highlighted in the Consultation Paper is related to:

    - evidence of market failure or systemic mis-selling in these jurisdictions that does not exist in Canada, a further indication that the current rules are highly effective and appropriate to the Canadian market; and

    - at least in Australia, mandated employee savings programs that create a large pool of clients for advisors which does not exist in Canada (where the industry operates in a competitive environment); and

- the CSA should take advantage of the fact that the international reforms in the U.K. and Australia are now in force and that we should carefully review the impact on these reforms in those jurisdictions before deciding whether to pursue similar reforms in Canada. Some also suggested deferring any decision in Canada until the U.S. approach is finalized.

2. A best interest standard must be clear

Summary

There was broad agreement that a best interest standard, if adopted, should be as clear as possible and include sufficient guidance to ensure all advisors understand how to comply with the standard. Many questioned whether certain restricted business models and certain compensation practices could continue under a statutory best interest standard.

The discussion below on this key theme is divided into the following areas:

- Moving from 'suitable' investments to investments in the client's best interest

- Responding to potential conflicts of interest in the client's best interest

Moving from 'suitable' investments to investments in the client's best interest

We received significant feedback that introducing a requirement for advisors to recommend securities that are in the client's best interest (rather than investments that are suitable) is unclear and problematic. These commenters identified several areas of concern, including:

- it would be impossible to establish objective standards or guidance to determine whether one investment is "better" than another in every way. The review of trades against such a standard would not be practical and would depend on the extent of supervision expected by regulators.

- the risk that product cost would be a determinative factor in this best interest advice analysis. According to these commenters, cost is only one factor that advisors should consider when providing product-based advice

(other factors include performance, reputation of fund manager, investment strategy, track record, product reputation and stability). Their concern is that cheaper investment options would be pursued by advisors purely because they are cheaper at the time of acquisition, rather than focusing on the likelihood of reaching higher risk-adjusted returns over the client's time horizon. The commenters believe this implication to be simplistic and lacking in context as the least expensive option is not necessarily the "best" option for a client.

- that this standard may be interpreted by investors as providing perfect advice or guaranteeing positive investment returns. We heard that if a best interest standard is implemented, it would need to be clear to investors, regulators and the courts that the duty to act in a client's best interest should not mean that advisors would have to give "perfect" advice, provide "perfect" service, or provide a guaranteed positive investment outcome.

- whether the know-your-product (**KYP**) obligation under a best interest standard would require firms to be knowledgeable about the entire universe of securities products and the feasibility of such an expectation.

- how this requirement would apply to those dealers (i.e., mutual fund dealers, exempt market dealers and scholarship plan dealers) that are restricted in what they can offer their clients or for those that focus on specific sector or product specialties as a business decision. Some also questioned whether these business models could continue to exist at all and suggested that the current proficiency requirements were not sufficient enough to expect these advisors to be proficient in other kinds of products. See additional discussion below under Key Theme #3.

Other commenters believed it should be fairly straightforward to determine when advice would be in the client's best interest. One commenter suggested that the criteria should include such factors as: (a) suitability (risk of loss, volatility, etc.); (b) diversification within current asset holdings; and (c) whether the client is able to hold the investment for any anticipated or requisite illiquid period. This commenter suggested that other important criteria would include the following: conflicts of interest must be eliminated or disclosed; decisions must be based on the whole portfolio rather than by security; and execution must always be in the client's best interest and not based on soft dollars or on a commission's basis.

Responding to potential conflicts of interest in the client's best interest

We also received significant feedback on the implications of a best interest standard for how conflicts of interest must be responded to. Commenters identified a number of areas where there was potentially a conflict of interest but where they felt it was unclear how a best interest standard would apply to certain common practices today, including whether:

- commission-based accounts would be banned (or restricted) in favour of fee-based accounts, which may not be accessible to low and medium-income investors and may not be the best option for clients that undertake frequent trading.

- advisors acting as principal (which currently allows for liquidity through market making, principal trading, and bond trading from inventory) would be banned or restricted.

- advisors selling proprietary products (which currently allows advisors to recommend underwritten offerings, proprietary products and affiliated issuer products) would be banned or restricted. This is particularly relevant for those dealers that focus on certain types of securities, such as mutual fund dealers, scholarship plan dealers and exempt market dealers as well as those advisors that are part of a large integrated distribution model.

In contrast, many commenters from the investor community felt strongly that conflicts of interest were often not addressed and that when they were, disclosure was industry's preferred response. They felt that a best interest standard should, in most cases, require avoidance of any conflicts of interest, especially conflicts of interest involving advisor compensation. They felt that this was the clearest way to address conflicts in the context of advisory services.

3. *The potential negative impact on investors and capital markets must be carefully assessed*

Summary

Many commenters strongly believe that the potential for negative impact on investors and capital markets from unintended consequences of a statutory best interest standard is significant. The main concern was that a best interest standard could result in advice that is more expensive, less accessible and too conservative.

The discussion below on this key theme is divided into the following areas:

- Increase in costs
- Negative impact on choice, access and affordability
- Impact on different business models and registration categories
- Legal uncertainty
- Compensation model
- Potential for regulatory arbitrage with other non-securities products
- Application of duty on retail clients

Increase in costs

Many commenters believe that the introduction of the best interest standard will significantly increase costs for industry due to the increase in:

- litigation/complaints,
- compliance obligations,
- errors and omission insurance premiums,
- technology costs to build systems to comply with this standard,
- costs to educate individual representatives,
- costs to reassess products on firms' shelves, and
- supervision and back office procedures.

In contrast, other commenters stated that a best interest standard would not lead to increased industry costs by pointing to the following:

- if they already act in their client's best interest (as many advisory firms claim), then there should be minimal impact on cost of introducing this standard. So only advisors not acting in their client's best interest would incur material costs.
- when the interests of both the client and the advisor are aligned, this may result in fewer compliance and legal issues, thus reducing these costs and ensuring that retail clients do not need to resort to litigation, which is a path to redress that many clients cannot or will not pursue.

Negative impact on choice, access and affordability

Many commenters felt that the introduction of a best interest standard would have a negative impact on choice, access and affordability of advisory services for middle and low income Canadians for the following reasons:

- the increased costs for industry associated with implementing a best interest standard would be passed along to clients, making those services too expensive for many Canadians.
- it may cause a shift away from commission-based accounts, which for smaller investors, or those with more limited trading activity, are less expensive than fee-based accounts that often require minimum assets or a minimum fee.
- smaller profit margins for advisors may result in advisors increasing their minimum assets/account size (some suggested minimums of anywhere from $100,000 to $350,000), making advice less accessible.

- although large, integrated financial organizations will be better able to adjust to and/or absorb these costs, small and mid-market advisory firms will be less able to withstand these costs increases and will lead to their increased competitive disadvantage and their further decline.

- it may motivate firms to de-prioritize customers with small accounts.

- it may motivate firms to narrow the range of products available on their platform as the liability associated with choosing the "wrong" product for a client may drive firms to offer lower risk products that are viewed as having less liability risk. This would have the effect of lowering client returns since higher risk investments create the potential for higher returns.

- Canadians would receive less financial advice overall which would likely diminish Canadians' overall personal saving and investing.

- there is some preliminary evidence that the U.K. may be experiencing an "advice gap" where, because of the increased costs of advice as a result of its recent reforms, low-income U.K. investors who, before the reforms, were receiving advice are no longer receiving advice after the reforms.

In contrast, other commenters disagreed that a statutory best interest standard would lead to a negative impact on choice, access and affordability of advisory services for the following reasons:

- the financial services industry is extremely entrepreneurial and innovative and has shown it will find profitable ways to deliver advisory services under any regulatory regime imposed by the CSA,

- although initially some clients may potentially lose access or experience increased costs from the advice channels they have previously utilized, they believe these would be a temporary effects,

- new business models will be encouraged, new choices will emerge, and innovation and competition will drive down consumer cost, and

- claims of increased costs to investors ignore the agency (monitoring) costs that clients are incurring today as a result of the suitability standard. In particular, a best interest standard will result in lower investor agency costs of monitoring the advisor since the new standard will require that the advisor put the client's interests first.

Impact on different business models and registration categories

Some commenters expressed concerns that a statutory best interest duty has the potential to be interpreted as requiring the dealer to offer all types of securities. For many, this would call into question how dealers that are only allowed to deal in one type of security (e.g., mutual fund dealers, exempt market dealers and scholarship plan dealers) can comply with this standard. As a result, commenters have questioned if the introduction of this standard will lead to an elimination of the traditional retail dealer, and if we will have a situation where the industry goes to two extremes: discount brokerages on one end of the scale (where a best interest standard may not apply) and portfolio managers on the other end (where a fiduciary duty already applies).

In this vein, some commenters pointed out that unless the best interest standard was "business model neutral" and carefully qualified to take into account all business models, these more narrow business models may not be feasible. These commenters point out that reforms in Australia and the U.K. allow restricted advice and scaled advice, respectively, to be provided. Some commenters preferred the Australian approach where even the so-called "scaled" advice has to consider the best interest of a client.

Some commenters did not support qualifying the best interest standard because they felt such qualification has the potential of causing more confusion as to the level of service and investment advice being received. These commenters felt that any standard short of a full fiduciary duty applied uniformly will continue to perpetuate unequal investor protection. Further, these commenters felt that if there were a lower tier of duty for certain dealers and therefore the duty would not be applied equally across the continuum for providing advice, the investor protection concerns outlined in the Consultation Paper would not be addressed. Other commenters took the view that instead of having different standards and rules for advisors depending upon the advisor's registration category and rather than drafting a standard with numerous carve outs (which adds complexity and dilutes its perceived benefits to investors), the CSA's investor protection goals can be more easily achieved through targeted policy initiatives.

Legal uncertainty

Several commenters felt that there is no uncertainty when a fiduciary duty is applied at common law to a given advisor-client relationship. In fact, most of these commenters felt that a statutory best interest standard would increase (not decrease) legal uncertainty because:

- the courts' appropriate discretion to apply its principled and fact-based analysis of whether or not a fiduciary relationship exists would be replaced with a "one-size-fits-all" duty that would apply to every retail client, regardless of their vulnerability or sophistication or whether they grant discretionary authority to the advisor;
- it may take several years for courts to conclusively define what a best interest standard means in respect of all aspects of the advisor-client relationship and along the way courts may interpret the standard differently;
- the CSA will not have control over how courts handle the application of a common law fiduciary duty or how it will impact the securities industry as a whole;
- unlike the common law, a statute does not have the flexibility to consider specific fact situations and that this will cause practical implementation problems;
- the equitable remedies available to the courts (such as those for a breach of fiduciary duty) would be inappropriate in circumstances where a fiduciary duty is imposed by regulation but would not have been imposed under common law. The application of equitable remedies could be misused by retail investors, especially sophisticated retail investors;
- the courts in Québec may be uncertain with how to interpret a statutory best interest standard in light of its current regulatory framework that already references a best interest duty and a duty of loyalty; and
- it would be impossible to ensure that a common principle would be adopted across all jurisdictions, and be applicable to all competing products in any particular jurisdiction. Creating a single compliance and supervisory oversight framework for those products with national distribution would be problematic, with the likely result that Canadians would find themselves being treated differently on a regional basis, with investors in smaller provinces at the greatest risk for reduced choice and access.

Other commenters disagreed. They felt that a statutory best interest standard would clarify that a fiduciary duty was always owed at common law and therefore clients in non-managed accounts would not need to be concerned whether the relationship with their advisor demonstrated the relevant interrelated factors sufficient to result in a fiduciary relationship. They believe that a statutory best interest standard would have a positive impact on advisor-client litigation because the parties would be clear at the outset that the advisor's fundamental duty is to put the client's interests ahead of their own.

Compensation model

Several commenters were concerned that if a best interest standard required the elimination of commission-based accounts and trailing commissions, for example, this would have a variety of negative impacts on Canadian investors. In particular, these commenters were concerned that:

- middle-class and less affluent investors would be most disadvantaged by a shift away from use of commission-based brokerage accounts, especially for those who trade infrequently and/or maintain small accounts;
- this will lead to a decreased choice in affordable investment products;
- investors in the US face higher costs and less transparency in the marketplace since embedded fee compensation model have disappeared from the United States mutual fund market and has been replaced primarily by a fee-for-service model;
- the embedded fee model represents the most popular, efficient and lowest-cost option for investors; and
- this may create an "advice gap" since investors may stop seeking advice as clients are generally unwilling to pay directly for advice, which preliminary evidence suggests may be happening in U.K. as a result of its recent reforms in this area.

Several commenters urged the CSA to consider alternatives to banning certain compensation arrangements so that advisors could receive compensation in respect of product sales but which would be neutral to the type of product being distributed. This

would presumably eliminate the concern that products offering higher compensation would attract advisors to sell those products over other equivalent products with a lower compensation structure.

Some commenters submitted that permitted fee structures and compensation methods would need to be fully consistent with the duty of care established by a best interest standard. Most of these commenters stated that certain conflicts of interest, especially those related to embedded commissions, should be avoided altogether. These commenters expressed difficulty in understanding how advisors could meet a best interest duty to their clients while accepting payments from a third party.

Finally, there was broad acknowledgement that the issues around embedded compensation in the mutual fund context are explored in more detail in the Mutual Fund Fees Consultation and that CSA staff working on both projects should coordinate their analysis in this respect.

Potential for regulatory arbitrage with other non-securities products

Many commenters expressed the concern that a statutory best interest that applies only to securities products and related advice could create an opportunity for regulatory arbitrage for those advisors that are also licensed to offer non-securities products such as insurance products, which fall within a different regulatory framework. For example, these advisors would be subject to a best interest standard when selling mutual fund products but another standard when discussing segregated fund products. Commenters are concerned that this could potentially create product sales arbitrage opportunities. Some commenters felt that without a common standard of conduct that applied to all financial products, the CSA should not attempt to strengthen the standard only in the securities context. Others felt that despite the CSA's ability to regulate only the securities context and the potential for regulatory arbitrage, such concerns should not discourage the CSA from introducing a best interest standard.

Application of duty on retail clients

The best interest standard described in the Consultation Paper only applies when advisors provide advice to retail clients. Some commenters felt that all clients should have the benefit of a statutory best interest standard. In addition, commenters stated that it would not be appropriate to try to define a retail client with metrics such as income or financial assets as these are not reliable indicators of investment knowledge. Other commenters expressed that the application of the standard ought to be based on the nature of the relationship and not the type of client as sophisticated clients and those not vulnerable or dependent on advisors do not require this standard. In addition, it was pointed out that there are permitted clients that may not be sophisticated clients such as pension committees or charitable organizations that would benefit from a best interest standard.

Some commenters suggested that contractual adjustments could be allowed by some investors such as sophisticated institutional investors or certain sophisticated retail clients to opt out of a best interest standard. However, other commenters were critical of this approach and stated that if the registrant had an ability to modify the standard by contract, there would be the potential for abuse and misuse of the advisor's position, which negates a key rationale for the standard in the first place and that too often, such contractual variations would become the rule in the industry, rather than the exception.

4. More work is needed

Summary

Many commenters suggested further work that should be completed before moving forward with a statutory best interest standard or other regulatory response.

The discussion below on this key theme is divided into the following areas:

- Ensure the investor protection concerns are well defined
- Consider adopting the Québec model
- Conduct impact analysis
- Assess the international reforms
- Conduct further legal analysis
- Consider the Other Policy Options
- Coordinate with other financial-product regulators

The following sets out the main areas where further work was suggested by commenters. Several commenters from the investor community felt that the CSA should proceed as soon as possible rather than delay this initiative with further study or research.

Ensure the investor protection concerns are well defined.

As discussed above, many commenters not supportive of a best interest standard stated that there was not sufficient evidence of one or more problems or that a best interest standard would solve these problems. Many industry commenters suggested allowing the Recent Canadian Reforms to become fully implemented before evaluating whether any investor protection concerns with the regulatory framework remain. Many commenters from the investor community disagreed, arguing that the concerns are sufficiently defined and evidenced.

Consider adopting the Québec model.

Several commenters suggested conducting further research to compare the effect on investors and advisors of the standard of conduct for advisors in Québec versus the common law jurisdictions in Canada. Depending on the result of this comparison, the CSA should consider whether this model could be adopted by the common law jurisdictions in Canada.

Conduct impact analysis.

Many commenters stated that the CSA should conduct a robust Canadian cost-benefit analysis (CBA) before moving forward. Suggested areas of focus for the CBA should include the consideration of the transition from commission-based accounts to fee-based accounts, the effects of pricing low balance accounts out of the market and the resulting effects on middle class investors. Many commenters from the investor community disagreed, arguing that a best interest standard will not lend itself to traditional cost-benefit analysis.

Assess the international reforms.

Many commenters suggested that the CSA take the opportunity to allow the reforms in the U.K. and Australia to fully implement and analyze their regulatory impact before deciding whether to introduce similar reforms in Canada. Many also suggested conducting a detailed assessment of the initiatives within their jurisdictional context, including the current regulatory framework, retirement savings policy, and the market failures identified by those regulators.

Conduct further legal analysis.

Some suggested that the CSA conduct further legal analysis of what a fiduciary duty will mean for the sale of investment products. The analysis should include a survey of the principles from case law, the application to the investment industry of those principles, and a prospective understanding of the implications of a fiduciary duty. Consideration should also be given to the practical reality of how long it might take for case law to settle on an agreed understanding of the scope of a statutory best interest standard.

Consider the Other Policy Options.

As discussed above, commenters identified a variety of Other Policy Options in addition, or as an alternative, to a statutory best interest standard that the CSA should consider before deciding on its policy direction.

Coordinate with other financial-product regulators.

Many commenters highlighted the risk of regulatory arbitrage (i.e., the risk of advisors and/or clients seeking out non-securities products) with the introduction of a best interest standard or any other regulatory response that differs significantly in the regulatory approach of non-securities financial products. Commenters have requested that we make every effort to coordinate with other financial product regulators to ensure they is a consistent approach to the regulation of financial products for Canadian retail investors.

Conclusion

A number of the key messages from industry participants and investors set out above are similar to those that have emerged from the Mutual Fund Fees Consultation. We refer you to CSA Staff Notice 81-323 – *Status Report on Consultation under CSA Discussion Paper and Request for Comments 81-407 Mutual Fund Fees*, published concurrently with this Notice, for an overview of the key themes provided by stakeholders in response to that separate consultation.

The similarity of the feedback received from stakeholders demonstrates a connection between the two consultation initiatives and suggests a need for CSA staff to coordinate their policy considerations on these initiatives going forward.

Accordingly, in collaboration with the Mutual Fund Fees Consultation initiative, CSA staff continue to consider and discuss the information gathered through our consultation process with a view to determining next steps. We anticipate communicating in the coming months what, if any, regulatory actions and/or research we intend to pursue.

Questions

If you have any comments or questions, please contact any of the CSA staff listed below.

Jason Alcorn
Legal Counsel
Financial and Consumer Services Commission of New Brunswick
Tel: 506-643-7857
jason.alcorn@fcnb.ca

Chris Besko
Legal Counsel and Deputy Director
Applications and Exemptions
The Manitoba Securities Commission
Tel: 204-945-2561
Toll Free (Manitoba only): 1-800-655-5244
chris.besko@gov.mb.ca

Isabelle Boivin
Analyste en réglementation – pratiques de distribution
Direction des pratiques de distribution et des OAR
Autorité des marchés financiers
Tel: 418-525-0337, ext. 4817
1-877-525-0337, ext. 4817
Isabelle.Boivin@lautorite.qc.ca

Lindy Bremner
Senior Legal Counsel
Capital Markets Regulation
British Columbia Securities Commission
Tel: 604-899-6678
1-800-373-6393
lbremner@bcsc.bc.ca

Bonnie Kuhn
Manager, Legal
Market Regulation
Alberta Securities Commission
Tel: 403-355-3890
bonnie.kuhn@asc.ca

Jeff Scanlon
Senior Legal Counsel
Compliance and Registrant Regulation
Ontario Securities Commission
Tel: 416-204-4953
jscanlon@osc.gov.on.ca

Sonne Udemgba
Deputy Director
Legal Department
Securities Division, Financial and Consumer Affairs Authority of Saskatchewan
Tel: 306-787-5879
sonne.udemgba@gov.sk.ca

1.1.4 Notice of Ministerial Approval of Amendments to National Instrument 81-106 Investment Fund Continuous Disclosure, Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance and Consequential Amendments

NOTICE OF MINISTERIAL APPROVAL OF AMENDMENTS TO
NATIONAL INSTRUMENT 81-106 *INVESTMENT FUND CONTINUOUS DISCLOSURE,*
FORM 81-106F1 *CONTENTS OF ANNUAL AND INTERIM MANAGEMENT REPORT OF FUND PERFORMANCE*
AND CONSEQUENTIAL AMENDMENTS

On November 21, 2013, the Minister of Finance approved the following amendments and consequential amendments made by the Ontario Securities Commission:

- amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure* and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*; and

- consequential amendments to Form 41-101F2 *Information Required in an Investment Fund Prospectus*, National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, National Instrument 81-102 *Mutual Funds*, National Instrument 81-104 *Commodity Pools*, and Ontario Securities Commission Rule 81-801 *Implementing National Instrument 81-106 Investment Fund Continuous Disclosure*.

Materials related to these amendments as well as amendments to Companion Policy 81-106CP *Investment Fund Continuous Disclosure* and Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure* were previously published in the Bulletin on October 3, 2013 and are republished in Chapter 5 of this Bulletin. The amendments to the rules, forms and companion policies will come into force on January 1, 2014.

December 19, 2013

1.1.5 CSA Staff Notice 91-303 – Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives

CSA Staff Notice 91-303

Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives

December 19, 2013

Introduction

We, the Canadian Securities Administrators OTC Derivatives Committee (the "Committee") are publishing for a comment period expiring on **March 19**, 2014:

- Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (the "Central Counterparty Clearing Rule"), and

- Proposed Model Explanatory Guidance to Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (the "Central Counterparty Clearing EG").

Collectively the Central Counterparty Clearing Rule and the Central Counterparty Clearing EG will be referred to as the "Proposed Model Rule".

We are issuing this notice to provide interim guidance and solicit comments on the Proposed Model Rule. Once we have considered comments received on the Proposed Model Rule and made appropriate changes, each jurisdiction will publish its own rule, explanatory guidance and forms, with necessary local modifications.[1]

The Committee would also like to draw your attention to a recent publication by certain members of the Canadian Securities Administrators respecting clearing agencies requirements, draft *Rule 24-503* and a forthcoming publication, *Provincial Model Rule 91-304 -Derivatives Customer Clearing and Protection of Customer Positions and Collateral*. These publications, including the current one, all relate to central counterparty clearing and we therefore invite the public to consider these comprehensively.

Background

In order to implement the G-20 commitments[2] that relate to the regulation of the trading of derivatives in Canada, the Committee has been working on recommendations both independently and in collaboration with the Canadian OTC Derivatives Working Group.[3] Since November 2010, the Committee has published a series of derivatives consultation papers outlining policy recommendations for the regulation of derivatives in Canada.[4] In formulating these recommendations, the Committee has sought to strike a balance between proposing regulation that does not unduly burden participants in the derivatives market, while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities.

The regulatory framework will be implemented through provincial rules that are intended to impose specific regulatory requirements tailored to address the unique characteristics of derivatives products, how they are marketed and traded, the

---

[1] In some cases, jurisdictions with substantively similar securities legislation may consider developing and publishing multi-lateral instruments.

[2] The G-20 commitments include requirements that all standardized over-the-counter derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. Moreover, over-the-counter derivative contracts should be reported to trade repositories. Also, non-centrally cleared contracts should be subject to higher capital requirements.

[3] The Canadian OTC Derivatives Working Group consists of the Bank of Canada, the federal Department of Finance, the Office of the Superintendent of Financial Institutions, the Alberta Securities Commission, the Autorité des marchés financiers, the British Columbia Securities Commission and the Ontario Securities Commission.

[4] 91-401 *Over-the-Counter Derivatives Regulation in Canada*, 91-402 *Derivatives: Trade Repositories*, 91-403 *Derivatives: Surveillance and Enforcement*, 91-404 *Segregation and Portability in OTC Derivatives Clearing*, 91-405 *Derivatives: End User Exemption*, and 91-406 *Derivatives: OTC Central Counterparty Clearing.*

sophistication of the counterparties, existing regulation in other areas (such as the regulation of financial institution), and the risks they present to the derivatives and financial markets. To the greatest extent appropriate, the derivatives rules will be harmonized with international standards and be consistent across Canada.

Rule-making process

Continuing the process initiated for Rule 91-506 *Derivatives: Product Determination* and Rule 91-507 *Trade Repositories and Derivatives Data Reporting*, the Committee's rule-making process is the publication for comment of "model" rules covering a variety of areas of regulation that together will create a regime for the regulation of derivatives markets. The "model" rules will reflect the public commentary on the consultation papers and are the Committee's recommendations for specific proposals to regulate the derivatives market in Canada. Due to variations in provincial securities legislation, the final provincial rules will contain differences. However, it is the intention of the Committee that the substance of the rules will be the same across jurisdictions, and market participants and derivative products will receive the same treatment across Canada.

Each of the "model" rules will be published for a consultation period after which the Committee will evaluate comments received and recommend appropriate amendments to the proposed rule. Once this process is completed, each province will publish province-specific rules for comment in accordance with the legislative requirements of the province. In a number of provinces legislative amendments will need to be implemented before province-specific rules can be published for consultation. Because of this, publication dates of province-specific rules may vary. Once each province's comment period has been completed, final rules will be implemented by that province.

Substance and purpose of the Central Counterparty Clearing Rule

The Central Counterparty Clearing Rule describes proposed requirements for central counterparty clearing of OTC derivatives transactions. The purpose of the Central Counterparty Clearing Rule is to improve transparency in the derivatives market to regulators and the public, and enhance the overall mitigation of risks.

The Central Counterparty Clearing Rule is divided into two rule-making areas (i) those relating to mandatory central counterparty clearing (including proposed end-user and intragroup exemptions), and (ii) those relating to the determination of derivatives subject to mandatory central counterparty clearing. To the greatest extent appropriate, the determination process will be coordinated between the local provincial regulators to be consistent across Canada and it will also be harmonized with international standards.

Note that section (d) of the financial entity definition will be adapted by each jurisdiction to reflect local financial entities.

Finally, note that Appendix A and B are not part of this publication. At the time of this publication, no derivative or class of derivative has yet been determined to be centrally cleared.

Application of Rule 91-506 *Derivatives: Product Determination*

Rule 91-506 *Derivatives: Product Determination* will be made applicable to the Central Counterparty Clearing Rule.

Comments

We request your comments on the Proposed Model Rule. The Committee also seeks specific feedback on subsection 7(1) of the Central Counterparty Clearing Rule that proposes an exemption from mandatory central counterparty clearing for an end-user that is not a financial entity and that is entering into a derivative transaction to hedge or mitigate commercial risk related to the operation of its business.

The purpose of this exemption is to relieve market participants that are not in the business of derivatives trading but trade in OTC derivatives to mitigate commercial risks related to their business from the mandatory central counterparty clearing.

The Committee seeks guidance as to whether the proposed non-eligibility of small financial entities for purpose of this exemption is appropriate.

You may provide written comments in hard copy or electronic form. The comment period expires **March 19, 2014**.

The Committee will publish all responses received on the websites of the Autorité des marchés financiers (www.lautorite.qc.ca) and the Ontario Securities Commission (www.osc.gov.on.ca).

Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Ontario Securities Commission

Please send your comments only to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Anne-Marie Beaudoin,
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, Québec
H4Z 1G3
Fax : 514-864-6381
consultation-en-cours@lautorite.qc.ca

Questions

Please refer your questions to any of:

Derek West
Co-Chairman, CSA Derivatives Committee
Senior Director, Derivatives Oversight
Autorité des marchés financiers
514-395-0337, ext 4491
derek.west@lautorite.qc.ca

Michael Brady
Senior Legal Counsel
British Columbia Securities Commission
604-899-6561
mbrady@bcsc.bc.ca

Doug Brown
Co-Chairman, CSA Derivatives Committee
General Counsel and Director
Manitoba Securities Commission
204-945-0605
doug.brown@gov.mb.ca

Debra MacIntyre
Senior Legal Counsel, Market Regulation
Alberta Securities Commission
403-297-2134
debra.macintyre@asc.ca

Kevin Fine
Director, Derivatives Branch
Ontario Securities Commission
416-593-8109
kfine@osc.gov.on.ca

Abel Lazarus
Securities Analyst
Nova Scotia Securities Commission
902-424-6859
lazaruah@gov.ns.ca

Wendy Morgan
Legal Counsel
Financial and Consumer Services Commission
(New Brunswick)
506 643 7202
wendy.morgan@fcnb.ca

MODEL PROVINCIAL RULE ON MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES

PART 1
DEFINITIONS AND INTERPRETATION

Definitions

1. In this Rule,

"clearable derivative" means a derivative that is determined by the [*applicable local securities regulator*] to be subject to the clearing requirement in accordance with [*this Rule/ section x of the Act*];

"financial entity" means

(a) an association governed by the *Cooperative Credit Associations Act* (Canada) or a central cooperative credit society for which an order has been made under section 473(1) of that Act;

(b) a bank, loan corporation, loan company, trust company, trust corporation, insurance company, treasury branch, credit union, caisse populaire, financial services cooperative, or league that, in each case, is authorized by an enactment of Canada or a jurisdiction of Canada to carry on business in Canada or a jurisdiction of Canada;

(c) a pension fund that is regulated by either the federal Office of the Superintendent of Financial Institutions or a pension commission or similar regulatory authority of a jurisdiction of Canada;

(d) an entity created by enactment of the Parliament of Canada or of the legislature of a province that is a mandatary or agent of the Government of Canada or of the government of a province and the purpose of which is to provide management services;

(e) an investment fund;

(f) a person or company subject to a registration requirement, registered or exempted, under the securities legislation of a jurisdiction of Canada;

(g) a person or company organized in a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (f) and would be regulated under the applicable legislation of Canada or [*applicable local jurisdiction*] had it been organized in Canada or [*applicable local jurisdiction*];

"local counterparty" means a counterparty to a transaction if, at the time of the transaction, one or more of the following apply:

(a) the counterparty is a person organized under the laws of [*applicable local jurisdiction*] or that has its head office or principal place of business in [*applicable local jurisdiction*];

(b) the counterparty is an affiliate of a person described in paragraph (a), and such person is responsible for the liabilities of that affiliated party;

"transaction" means entering into, making a material amendment to, assigning, selling or otherwise acquiring or disposing of a derivative or the novation resulting from the transferring or altering of the obligations arising from the derivative, other than a novation resulting from the submission of a derivative to a clearing agency.

Interpretation of the term clearing agency

2. In this Rule, the term clearing agency means a clearing agency recognized by the [*applicable local securities regulator*] pursuant to section x of the Act, or exempted from recognition pursuant to section x of that Act.

Interpretation of hedge or mitigation of commercial risk

3. In this Rule, a derivative is held for the purpose of hedging or mitigating commercial risk when all of the following apply:

(a) it establishes a position which is intended to reduce risks relating to the commercial activity or treasury financing activity of the counterparty or of an affiliate, and, alone or in combination with other derivatives, directly or through closely correlated financial instruments meets any of the following:

(i) that derivative covers the risks arising from the change in the value of asset, services, inputs, products, commodities or liabilities that the counterparty or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business;

(ii) that derivative covers the risks arising from the indirect impact on the value of assets, services, inputs, products, commodities or liabilities referred to in subparagraph (i), resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk;

(b) such position is not held for any of the following purposes:

(i) for a purpose that is in the nature of speculation;

(ii) to offset or reduce the risk of another derivative transaction, unless that other position itself is held for the purpose of hedging or mitigating commercial risk.

PART 2
MANDATORY CENTRAL COUNTERPARTY CLEARING

Duty to submit for clearing

4. (1) A local counterparty to a transaction in a clearable derivative must, submit, or cause to be submitted, that transaction for clearing to a clearing agency that provides clearing services for such clearable derivative, in the form prescribed by the clearing agency, by the end of the day of execution unless the transaction is executed after the business hours of the clearing agency in which case the transaction must be submitted for clearing the following business day.

(2) A local counterparty satisfies its duty to submit for clearing in respect of a transaction required to be cleared under subsection (1) if

(a) the transaction is required to be cleared solely because a counterparty to the transaction is a local counterparty pursuant to paragraph (b) of the definition of “local counterparty”, and

(b) the transaction is submitted for clearing pursuant to

(i) the securities legislation of a province of Canada other than [*applicable local jurisdiction*], or

(ii) the laws of the foreign jurisdictions listed in Appendix B.

Notification

5. A clearing agency must immediately notify the local counterparty or local counterparties submitting the transaction if it rejects the transaction.

List of derivatives publicly disclosed

6. A clearing agency must publicly disclose on its website, at no cost to the public, a list of all derivatives and classes of derivatives for which the clearing agency will provide clearing services and identify which are clearable derivatives or classes of clearable derivatives.

PART 3
EXEMPTIONS FROM THE MANDATORY CENTRAL COUNTERPARTY CLEARING

End-user exemption

7. (1) Section 4 does not apply to a transaction if all of the following apply:

(a) one of the counterparties is not a financial entity;

(b) that counterparty is entering into the transaction to hedge or mitigate commercial risk related to the operation of its business.

(2) The mandatory central counterparty clearing under section 4 does not apply to a transaction entered into by an affiliated entity of a person or company that qualifies for the exemption under subsection (1) if all of the following conditions apply:

(a) the affiliated entity is acting as agent on behalf of the person or company;

(b) the transaction is a hedge or mitigates the commercial risk of the person or company, or other affiliate of the person or company, that is not a financial entity;

(c) the affiliated entity is not subject to a registration requirement under the securities legislation of a jurisdiction of Canada.

Intragroup exemption

8. (1) In this section, an "intragroup transaction" means one of the following:

(a) a transaction between two affiliated entities whose financial statements are prepared on a consolidated basis in accordance with one of the following:

(i) if the head office of the parent entity is located in Canada, International Financial Reporting Standards, Canadian GAAP applicable to publicly accountable enterprises, Canadian GAAP applicable to private enterprises or U.S. GAAP as defined by the National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*;

(ii) if the head office of the parent entity is located in a foreign jurisdiction, generally accepted accounting principles of the foreign jurisdiction in which the head office is located if those principles are substantially similar to those provided in subparagraph (i);

(b) a transaction between two counterparties prudentially supervised by the [*applicable local regulator*] on a consolidated basis.

(2) Section 4 does not apply to an intragroup transaction if all of the following conditions apply:

(a) both counterparties agree to rely on this exemption;

(b) the transaction is subject to appropriate centralized risk evaluation, measurement and control procedures;

(c) for counterparties that are not registered as dealers or subject to such registration requirement under the securities legislation of a jurisdiction of Canada, there is a written agreement setting out the terms of the transaction between the counterparties.

(3) A counterparty to an intragroup transaction that is relying on the exemption in subsection (2) must submit to the [*applicable local securities regulator*], in an electronic format, a completed Form F1 (Intragroup exemption) no later than the 30th day following the execution of the first transaction made under this exemption.

(4) Subject to subsection (5), a completed Form F1 submitted under subsection (3) is effective for the transactions entered into between the counterparties relying on the exemption during the year following the date of its submission.

(5) Within 10 days of becoming aware of an inaccuracy in or making a change to the information provided in Form F1, a counterparty must submit to the [*applicable local securities regulator*], in an electronic format, an amendment to Form F1.

Improper use of exemption

9. Notwithstanding anything else in this Rule or any exemptive relief granted, the [*applicable local securities regulator*] may direct a local counterparty to submit a transaction for clearing under section 4, if the [applicable local securities regulator] determines that improper use of an exemption is or has been made.

Record keeping

10. (1) Each counterparty that is relying on an exemption under section 7 or section 8 must maintain, for a period of 7 years following the date on which the transaction expires or terminates, records of all documentation demonstrating that such counterparty is eligible to benefit from the exemption including for the local counterparty relying on an end-user exemption under section 7, the approval by the board of directors or a group that acts in a capacity similar to a board of directors.

(2) The records required to be maintained under subsection (1) must be kept in a safe location and in a durable form in any manner that permits it to be provided to the [*applicable local securities regulator*] in a reasonable period of time.

Non-Application

11. Section 4 does not apply to a transaction if one of the counterparties is the government of Canada, a government of a province or territory of Canada, a crown corporation or an entity wholly owned by the federal or provincial government whose obligations are guaranteed by the federal or provincial government.

PART 4
DETERMINATION BY THE [*APPLICABLE LOCAL SECURITIES REGULATOR*]

Submission of information on clearing services of derivatives by the clearing agency

12. (1) No later than [*x days*] after providing new clearing services for a derivative or class of derivatives, a clearing agency must submit, in an electronic format, a completed Form F2 (Derivatives clearing services), to the [*applicable local securities regulator*].

(2) Within [*x days*] of the coming into force of this Rule, a clearing agency must submit to the [*applicable local securities regulator*], in an electronic format, a completed Form F2 for all derivatives or classes of derivatives it provides clearing services for as of [*insert date of the coming into force of this Rule*].

Notice regarding determination

13. The [*applicable local securities regulator*] may publish a notice inviting interested persons to make representations in writing for a minimum period of 60 days before it determines whether a derivative or a class of derivatives is a clearable derivative or a class of clearable derivatives.

Conditions to determination

14. The [*applicable local securities regulator*] may review or impose conditions on its determination that a derivative or class of derivatives is a clearable derivative or class of clearable derivatives.

Public register [or Appendix "A"]

15. The public register maintained by the [*applicable local securities regulator*] in accordance with section [*x*] of the Act [*or Appendix "A" of this Rule*] shall include the following:

(a) a list of the clearing agencies authorized to clear derivatives;

(b) a list of clearable derivatives and classes of clearable derivatives;

(c) the dates from which the mandatory central counterparty clearing with respect to a derivative or class of derivatives that is determined to be a clearable derivative or class of clearable derivatives takes effect, including any transitional period for implementation.

PART 5
TRANSITION

Transition

16. Section 4 does not apply to a transaction entered into before the date of the coming into force of this Rule unless there was a novation, a material amendment to the transaction or it was assigned, sold or otherwise acquired or disposed of on or after the date of the coming into force of this Rule.

PART 6
EXEMPTION

Exemption

17. The Director may grant an exemption to this Rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

PART 7
EFFECTIVE DATE

Effective date

18. This Rule comes into force on (*insert date*).

FORM F1
TO MODEL PROVINCIAL RULE – *MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES*
INTRAGROUP EXEMPTION FORM

Any counterparty to an intragroup transaction that is relying on the exemption in section 8(2) of Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives, must provide electronically to the applicable local securities regulator this form duly completed within 30 days of the first transaction under this exemption.

Type of Filing:

☐ INITIAL or ☐AMENDMENT

Section 1- Notifying Entity's Details

1. Full name:

2. Name(s) under which business is conducted, if different from item 1:

3. If this filing makes a name change on behalf of firm in respect of the name set out in item 1 or item 2, enter the previous name and the new name:

   Previous name:
   New name:

4. Head office

   Address:
   Telephone:
   Email:

5. Mailing address (if different):

6. Other offices

   Address:
   Telephone:
   Email:

7. Website address:

8. Contact employee

   Name and title:
   Telephone number:
   E-mail address:

9. Canadian counsel (if applicable)

   Firm name:
   Contact name:
   Telephone number:
   E-mail address:

Section 2 - Combined notification on behalf of other counterparties within the group to which the notifying entity belongs

1. confirmation that both counterparties to the transaction choose to rely on the exemption and on what ground the exemption is available to them:

2. confirmation that the transaction is subject to appropriate centralized risk evaluation, measurement and control procedures. Please describe:

3. the legal entity identifier of both counterparties to the transaction in accordance with section 28 of Rule 91-507 *Trade Repositories and Derivatives Data Reporting*:

4. the ownership and control structure of the affiliated counterparties:

5. if applicable, confirmation that there is a legal agreement setting out the terms of the transaction, the date of the legal agreement, the signatories to the agreement and the nature of the agreement:

Section 3 - Declaration

"I am duly authorised to make this notification on behalf of the notifying affiliate and, where applicable, on behalf of the other affiliate entities listed above in Section 2. By submitting this notification form I confirm that the information in this application is accurate and complete to the best of my knowledge and belief and that I have taken all reasonable steps to ensure that this is the case."

Please confirm you have read and understood this declaration.

Yes ☐ No ☐ Notification Date (dd/mm/yy) ______________________

Name of director or officer ______________________

Signature of director or officer ______________________

Official capacity ______________________

E-mail ______________________

Telephone number ______________________

FORM F2 - *DERIVATIVES CLEARING SERVICES*
– MODEL PROVINCIAL RULE ON MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES

SUBMISSION OF INFORMATION ON CLEARING SERVICES OF DERIVATIVES BY THE CLEARING AGENCY

A clearing agency must submit electronically to the [*applicable local securities regulator*] within [*x amount of time*] a completed Form F2 (Derivatives accepted for clearing), for all derivatives or class of derivatives that are accepted for clearing by the clearing agency, for the determination by the [*applicable local securities regulator*] whether a derivative is a mandatory clearable derivative or a class of mandatory clearable derivative.

Type of Filing: ☐ **INITIAL** ☐ **AMENDMENT**

1. Full name of clearing agency:

2. Name(s) under which business is conducted, if different from item 1:

3. If this filing makes a name change on behalf of the clearing agency in respect of the name set out in item 1 or item 2, enter the previous name and the new name.

   Previous name:
   New name:

4. Head office

   Address:
   Telephone:

5. Mailing address (if different):

6. Other offices

   Address:
   Telephone:

7. Website address:

8. Contact employee

   Name and title:
   Telephone number:

   E-mail address:

9. Canadian counsel (if applicable)

   Firm name:
   Contact name:
   Telephone number:
   Facsimile:
   E-mail address:

Section - 1

For all derivatives or class of derivatives that are accepted for clearing by the clearing house, please provide:

1. A description of all material attributes of the derivative, including:

   1. copies of any legal documentation including generally accepted contract terms;

   2. standard practices for managing any life cycle events, as defined in section 1 of Rule 91-507 *Trade Repositories and Derivatives Data Reporting*, associated with the derivative;

3. the extent to which it is electronically confirmable;

2. Evidence of the degree of standardization of the contractual terms and operational processes;

3. A description of the market for the derivative, including its participants;

4. Data on the volume and liquidity of the derivative;

5. Impact of providing clearing services for the derivative on the clearing agency's risk management framework and financial resources, including the default waterfall and the effect on the clearing members;

6. A statement that describes the extent to which it can maintain compliance with its regulatory obligations should the [*applicable local securities regulator*] mandate the clearing of the derivative;

7. A statement that includes but is not limited to information that will assist the [*applicable local securities regulator*] in making a quantitative and qualitative assessment and a referenced and detailed overview of all the elements of the clearing services that are relevant and may be useful to the [*applicable local securities regulator*] to determine if the derivative or class of derivative is a mandatory clearable derivative or a class of mandatory clearable derivative;

8. A copy of the notice the clearing agency gave its members and a summary of any concerns received;

9. Any additional information requested by the [*applicable local securities regulator*].

CERTIFICATE OF CLEARING AGENCY

The undersigned certifies that the information given in this report is true and correct.

DATED at ____________ this ________ day of _________________, 20____

____
(Name of clearing agency)

____
(Name of director, officer or partner – please type or print)

____
(Signature of director, officer or partner)

____
(Official capacity – please type or print)

IF APPLICABLE, ADDITIONAL CERTIFICATE
OF CLEARING AGENCY THAT IS LOCATED OUTSIDE OF X

The undersigned certifies that

(a) it will provide the applicable local securities regulator with access to the books and records of the clearing agency and will submit the clearing house to onsite inspection and examination by the local securities regulator;

(b) as a matter of law, it has the power and authority to

i. provide the applicable local securities regulator with access to the books and records of the clearing agency, and

ii. submit the clearing agency to onsite inspection and examination by the local securities regulator.

DATED at _____________ this ________ day of __________________, 20____

____
(Name of clearing agency)

____
(Name of director, officer or partner – please type or print)

____
(Signature of director, officer or partner)

____
(Official capacity – please type or print)

EXPLANATORY GUIDANCE TO MODEL PROVINCIAL RULE

ON MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES

GENERAL COMMENTS

Introduction

This Explanatory Guidance sets out how the OTC Derivatives Committee (the “Committee” or “we”) interprets or applies the provisions of Model Provincial *Rule on Mandatory Central Counterparty Clearing of Derivatives* (the “Model Clearing Rule” or the “Rule”) and related securities legislation.

Except for Part 1, the numbering of Parts, Divisions and sections in this Explanatory Guidance correspond to the numbering in this Model Clearing Rule. Any general guidance for a Part or a Division appears immediately after the Part or Division name. Any specific guidance on sections in the Model Clearing Rule follows any general guidance. If there is no guidance for a Part, Division or section, the numbering in this Explanatory Guidance will skip to the next provision that does have guidance.

SPECIFIC COMMENTS

Unless defined in the Model Clearing Rule or explained in this Explanatory Guidance, terms used in the Model Clearing Rule and in this Explanatory Guidance have the meaning given to them in the securities legislation of each jurisdiction including National Instrument 14-101 *Definitions* and the [*applicable local jurisdiction*] Rule 91-506 *Derivatives: Product Determination*

In this Explanatory Guidance,

“Form F2” means the Form that must be submitted to a [*applicable local securities regulator*] pursuant to section 12 of the Model Clearing Rule,

“TR Rule” means [*applicable local jurisdiction*] Rule 91-507 – *Trade Repositories and Derivatives Data Reporting*.

PART 1 Definitions and Interpretation

Definitions

1. The term « financial entity » is defined in the Model Clearing Rule for the purposes of the end-user exemption provided for in section 7 of the Model Clearing Rule which provides that a financial entity is not eligible for that exemption.

Subparagraph (d) of the definition of “financial entity” refers to Canadian institutional funds created by federal or provincial legislation which would not necessarily be a pension fund under subparagraph (c) or an investment fund under subparagraph (e).

Subparagraph (e) of the definition includes (i) funds that distribute or have distributed securities under a prospectus in a jurisdiction of Canada for which the applicable regulator has issued a receipt and (ii) funds that distribute or have distributed securities under an exemption from the prospectus requirement under securities legislation. For greater certainty, the investments funds included in subparagraph (e) are those described in subsections 1.2 (1), (2) and (3) of National Instrument 81-106 regarding the application of that instrument to investment funds.

Subparagraph (g) of the definition of “financial entity” addresses the situation where a foreign counterparty enters into a transaction in a clearable derivative with a local counterparty. If the foreign counterparty, had it been organized or had a place of business in Canada or in any applicable province, would fall under paragraphs (a) to (f) of the definition of “financial entity”, the transaction would not be eligible for the end-user exemption. However, the end-user exemption would be available for that transaction if the local counterparty qualified to benefit from the end-user exemption.

The term “transaction” is used rather than the term “trade” in part to reflect that “trade” is defined in some provincial securities legislation as including the termination of a derivative. The termination of a derivative should not trigger a requirement to submit the derivative for central clearing. Similarly, the definition of transaction in this rule excludes novation resulting from the submission of a transaction to a clearing agency as this is already a cleared transaction. Finally, the definition of “transaction” is not the same as the definition found in the TR Rule since the latter did not include material amendment as the TR Rule expressly provides that an amendment must be reported.

The term “material amendment” in the definition of “transaction” should be considered in light of the fact that only new transactions will be subject to mandatory central counterparty clearing once the Model Clearing Rule comes into force. An amendment made to a transaction that occurs before the coming into force of the Model Clearing Rule will be subject to the

mandatory clearing counterparty if it is a material amendment to the derivative. A material amendment is one that changes information that would reasonably be expected to have a significant effect on the derivative's attributes, including its value, the terms and conditions of the contract evidencing the derivative, transaction methods or the risks related to its use, excluding information that is likely to have an effect on the market price or value of its underlying interest.

The Committee would consider several factors when determining whether a modification to an existing transaction is a material amendment. Examples of modifications to an existing transaction that would be a material amendment include any modification which would result in a large change in the value of the transaction and could result in differing cash flows or creating upfront payments.

Interpretation of hedge or mitigation of commercial risk

3. The interpretation of "hedge or mitigation of commercial risk" focuses on the purpose and effect of one or more transactions. A market participant executing a transaction for the purpose of hedging would not be precluded from relying on the end-user exemption if a perfect hedge is not ultimately achieved. The use of multiple transactions as a hedging strategy would not in itself preclude an end-user from relying on the exemption. There will be situations where an end-user may be able to rely on the exemption even where some of the transactions could be interpreted as not being a hedge, as long as there is a reasonable commercial basis to conclude that such transactions were intended to be part of the end-user's hedging strategy.

The concept of hedge or mitigation of commercial risk excludes all activities that are investing or speculative in nature. However, in some cases macro, proxy or portfolio hedging may benefit from the exemption. The strategy or program should be documented and subject to regular compliance audits to ensure it continues to be used for relevant hedging purposes. Hedging a risk can be a dynamic process and it is expected that an entity may have to close out or add contracts to the original hedging position should it begin to under- or over-perform. These additional transactions may also benefit from the exemption provided the transactions are intended to hedge a commercial risk. The Committee will look at the facts and circumstances that exist at the time the transaction is executed to determine whether a derivative satisfies the criteria for hedging or mitigating commercial risk. A market participant which in the past has conducted speculative transactions using derivatives would not be prevented from availing itself of using the end-user exemption for a transaction that would meet the interpretation of hedging or mitigating commercial risk set out in Section 3.

The determination of whether the risk being hedged or mitigated is commercial will be based on the underlying activity to which the risk relates, not the type of entity claiming the end-user exemption. For example, a non-profit entity would not be prevented from relying on the end-user exemption. That determination will depend on the nature of the activity to which the risk being hedged or mitigated relates. The Committee acknowledges that the interpretation of "hedge or mitigation of commercial risk" leaves room for judgment but the Committee believes that a flexible approach is needed given the variety of derivatives, potential counterparties that may qualify for the exemption and hedging strategies to which this Rule applies.

The term "closely correlated" in subparagraph (a) refers to non-perfect hedges. A counterparty relying on the end-user exemption should be able to justify to the [*applicable local securities regulator*] why they expect the derivative to qualify as closely correlated or highly effective based on prior history, amongst others, and be able to explain how they will assess effectiveness in the future. Correlation should not be understood to be limited to linear correlation, but rather to encompass a broad range of co-dependence or co-movement in relevant economic variables.

The Committee believes that explicitly prohibiting the end-user exemption for transactions entered into for the purpose of speculating, as opposed to the purpose of hedging or mitigating commercial risk, will assist entities in understanding the limits of hedging or mitigating commercial risk and will help prevent abuse of the exemption. A counterparty's ability to elect the end-user exemption for a particular transaction depends on its purpose.

A local counterparty should develop policies and procedures sufficient to ensure that supporting documentation is prepared and retained with respect to transactions for which the end-user exemption will be relied upon. Such documentation should include: risk management objective and nature of risk being hedged, date of hedging, hedging instrument, hedged item or risk, how hedge effectiveness will be assessed, and how hedge ineffectiveness will be measured and corrected as appropriate.

PART 2 MANDATORY CENTRAL COUNTERPARTY CLEARING

Duty to submit for clearing

4. The term "cause to be submitted" refers to a transaction involving a non-clearing member of the clearing agency. The counterparties should have arrangements in place with a clearing member in advance of entering into a transaction. The Committee expects that a transaction that is subject to the mandatory central counterparty clearing will be submitted to the clearing agency as soon as practicable, but in no event later than the end of the day on which the transaction was executed.

Notification

5. The clearing agency must immediately provide written notice of the rejection of a transaction submitted for clearing.

The Committee understands that the price of a transaction depends in part on whether it is intended to be cleared or not. Consequently, if a transaction that is required to be cleared pursuant to this Rule is rejected by the clearing agency, a material term of the contract is unfulfilled. The Committee considers that a transaction that is rejected is void *ab initio*. Should a transaction be rejected by a clearing agency, the latter should therefore notify the counterparties immediately.

The Committee relies on the rules of the clearing agencies relating to the confirmations of transactions and on the legal arrangements governing indirect clearing in place to ensure that the counterparties are notified of the rejection of a transaction submitted for clearing.

PART 3 EXEMPTIONS FROM THE MANDATORY CENTRAL COUNTERPARTY CLEARING

End-user exemption

7. (1) Section 7 exempts a transaction from the clearing requirement under section 4 provided that: at least one of the counterparties is not a financial entity as defined in section 1; and such transaction is intended to hedge commercial risk, directly or indirectly, related to the operation of the business of one of the counterparties that is not a financial entity.

Entities not defined as a financial entity may benefit from the end-user exemption provided the particular transaction meets the definition of hedging or mitigating commercial risk in section 3 of the Model Clearing Rule.

(2) Certain entities may choose to centralize their trading activities through one affiliate entity. An entity that meets all conditions related to the end-user exemption can have an affiliate act as an agent for the entity. The affiliate acting as agent cannot be a registered entity although it may be a financial entity, provided that the conditions in paragraphs (a), (b) and (c) are met. The end-user exemption includes subsection (2) to allow affiliates that are part of a non-financial group to use the end-user exemption to enter into a market facing transaction so long as the transaction is a hedge under this Rule. For a transaction to maintain the characteristics of a hedge of commercial risk so as to qualify under the end-user exemption, the affiliate may act only as agent, and may not act in this capacity for non-affiliates, that is to say as a dealer.

Intragroup exemption

8. (1) and (2) The exemption for intragroup transactions is based on the premise that the risk created by these transactions is expected to be managed in a centralized manner to allow for the risk to be identified and managed appropriately. Entities making use of this exemption should have the appropriate legal documentation between the affiliates and detailed operational material outlining the robust risk management techniques used by the overall parent entity and its affiliates when entering into the intragroup transactions.

Subsection (2) sets out the conditions that must be met for the intragroup counterparties to rely on the intragroup exemption for a transaction in a clearable derivative. Paragraph (b) refers to a system of risk management policies and procedures designed to monitor and manage the risks associated with a particular transaction. The Committee is of the view that a group of affiliated counterparties may structure its centralized risk management according to its unique needs, provided that the program reasonably monitors and manages risks associated with non-cleared derivatives.

Paragraph 8(1)(b) extends the availability of the intragroup transaction exemption provided for in subsection (2) to transactions among entities that do not prepare consolidated financial statements. This may apply, e.g., to cooperatives or other entities that are supervised prudentially on a consolidated basis.

(3) Within 30 days of the first transaction between two affiliated entities relying on the section 8 intragroup exemption, a completed Form F1 must be submitted to [*applicable local securities regulator*] to notify the [*applicable local securities regulator*] that the exemption is being relied upon. The information submitted on the Form F1 will aid the [*applicable local securities regulator*] to better understand the legal and operational structure being used to allow counterparties to benefit from the intragroup exemption. The obligation to submit the completed Form F1 is imposed on one of the counterparties to a transaction that are relying on the exemption. A completed and submitted Form F1 is effective for one calendar year between the two affiliated entities and for the types of transactions set out in the completed Form F1. For greater clarity, a completed Form F1 must be submitted for each pairing of affiliated counterparties that seek to rely upon the intragroup transaction exemption.

(5) The Committee is of the view that a material change to the information submitted would include, *inter alia*, (i) a change in the control structure of one or more of the listed affiliated counterparties, (ii) any significant amendment to the risk evaluation, measurement and control procedures of an affiliated entity listed on Form F1; and (iii) any addition to the types of clearable derivative transactions listed on Form F1 for which the affiliated entities intend to rely on the intragroup exemption.

Record keeping

10. (1) The Committee is of the view that, at minimum, the following supporting documentation should be kept in accordance with section 10:

(a) Documentation of an end-user's macro, proxy or portfolio hedging strategy or program and the results of regular compliance audits to ensure such strategy or program continue to be used for relevant hedging purposes.

(b) Documentation of the approval of the board of director's, or similar body, of reliance upon the end-user exemption under section 7. Supporting documentation with respect to each transaction for which the end-user exemption will be relied upon, setting out the basis on which the transaction is for the purposes of hedging or mitigating commercial risk, including:

(i) risk management objective and nature of risk being hedged,

(ii) date of hedging,

(iii) hedging instrument,

(iv) hedged item or risk,

(v) how hedge effectiveness will be assessed, and

(vi) how hedge ineffectiveness will be measured and corrected as appropriate.

(c) Full and complete records of any analysis undertaken by the end-user to demonstrate it satisfies the requirements necessary to rely on the end-user exemption.

With respect to the end-user exemption, the board of directors would be required to approve the business plan or strategy which authorises management to use derivatives as a risk management tool. This requirement is intended to ensure both management and the board of directors are required to consider the implications of trading in derivatives and the manner in which a hedging strategy will be implemented prior to relying on the end-user exemption.

Non-Application

11. The non-application provision in section 11 applies to any transaction in a clearable derivative to which one of the entities listed is a counterparty. Such transactions are thus not subject to the duty to submit for clearing under section 4 even if the other counterparty is otherwise subject to it. For greater certainty, the duty to submit for clearing does not apply to the Bank of Canada as a crown corporation.

PART 4

DETERMINATION BY THE [*APPLICABLE LOCAL SECURITIES REGULATOR*]

12. The [*applicable local securities regulator*] has been granted the power by legislation to determine which derivatives or class of derivatives is subject to the mandatory central counterparty clearing requirement. The Model Clearing Rule includes a bottom-up approach for determining whether a derivative or class of derivative will be subject to the mandatory clearing obligation. The information required by Form F2 will allow the [*applicable local securities regulator*] to carry out this determination.

In the course of determining whether a derivative will be subject to the clearing requirement pursuant to section [x] of the Act, the [*applicable local securities regulator*] will consider, amongst others, the following factors:

(a) the level of standardization, such as the availability of electronic processing, the existence of master agreements, product definitions and short form confirmations;

(b) the effect of central clearing of the derivative on the mitigation of systemic risk, taking into account the size of the market for the derivative and the resources of the clearing agency available to clear the derivative;

(c) whether the derivative would bring undue risk to the clearing agency;

(d) the outstanding notional exposures, liquidity and reliable and timely pricing data;

(e) the existence of third party vendors providing pricing services;

(f) the existence of an appropriate rule framework, and the availability of capacity, operational expertise and resources, and credit support infrastructure to clear the derivative on terms that are consistent with the material terms and trading conventions on which the derivative is then traded;

(g) whether the clearing agency would be able to risk manage the additional derivatives that might be submitted due to the clearing requirement determination;

(h) the effect on competition, taking into account appropriate fees and charges applied to clearing, and if the proposed clearing requirement determination could harm competition;

(i) alternative derivatives or clearing services co-existing in the same market;

(j) the existence of a clearing obligation in other jurisdictions;

(k) the public interest.

Submission of information on derivatives by the clearing agency

Paragraphs (1) and (2) of section 1 of Form F2 address the potential for a derivative to be a clearable derivative given its level of standardization in terms of market conventions, including legal documentation, processes and procedures, and whether pre to post transaction operations are carried out predominantly by electronic means. The standardization of the economic terms is a key input in the determination process as discussed in the following section.

Paragraphs (3) and (4) of section 1 of Form F2 are details needed to assess the proliferation of the use of a particular derivative, the nature and landscape of the market for that derivative and the potential impact a determination for central counterparty clearing could have on market participants, including the clearing agency. The determination process will have different or additional considerations when assessing whether a derivative should be a clearable derivative in terms of liquidity and price availability, versus the considerations used by the regulator in allowing a clearing agency to offer clearing services for a derivative. The stability of the pricing availability will also be an important factor to be considered.

PART 5 TRANSITION

The Model Clearing Rule applies to transactions entered into after the date of the Rule coming into force. The Model Clearing Rule also applies to transactions entered into before that date where there is a material amendment to the transaction after the date of the Rule coming into force or a derivative is assigned, sold or otherwise acquired or disposed of or there is a novation resulting from the transferring or altering of obligations arising from the derivative on or after the date of the Rule coming into force, except where the novation is a result of being submitted to a clearing agency. Therefore, a transaction in a clearable derivative that was entered into before the date of the Rule coming into force will be subject to the duty to submit for clearing under section 4 when such transaction is materially amended, or a derivative is assigned, sold or otherwise acquired or disposed of or there is a novation resulting from the transferring or altering of the obligations arising from the derivative on or after the date of the Rule coming into force.

The Model Clearing Rule does not mandate the clearing of transactions entered into before the date of the Rule coming into force. However counterparties are invited to clear pre-existing transactions on a voluntary basis, particularly where such pre-existing transactions are expected to be novated after the date the Rule coming into force. The CSA had considered mandating the clearing of pre-existing transactions, however due to the considerable complexity involved in requiring such transactions to be centrally cleared, including the renegotiation of contract provisions and the unwinding of collateral arrangements, the CSA decided against mandating the clearing of pre-existing transactions.

1.2 Notices of Hearing

1.2.1 Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele and Michael Wallace Minor – ss. 127(1), 127(10)

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
FREDERICK LAWRENCE MARLATT, also known as
FREDERICK LAWRENCE MITSCHELE and MICHAEL WALLACE MINOR

NOTICE OF HEARING
(Subsections 127(1) and 127(10))

TAKE NOTICE THAT the Ontario Securities Commission (the "Commission") will hold a hearing pursuant to subsections 127(1) and 127(10) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act"), at the offices of the Commission, 20 Queen Street West, 17th Floor, commencing on January 17, 2014 at 10:00 a.m.;

TO CONSIDER whether, pursuant to paragraph 4 of subsection 127(10) of the Act, it is in the public interest for the Commission to make an order:

1. against Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele ("Mitschele") that:

   a. pursuant to paragraph 2 of subsection 127(1) of the Act, trading in securities by Mitschele cease until July 18, 2018, except that Mitschele may trade for his own account through a registrant, if he gives the registrant a copy of the Decision and Order of the British Columbia Securities Commission dated July 18, 2013 (the "BCSC Decision") and a copy of the Order of the Commission in this proceeding, if granted;

   b. pursuant to paragraph 7 of subsection 127(1) of the Act, Mitschele resign any positions that he holds as director or officer of any issuer, other than Photo Violation Technologies Corp. 2 ("PVT2"), including any issuer all the securities of which are owned beneficially by him or members of his family;

   c. pursuant to paragraph 8 of subsection 127(1) of the Act, Mitschele be prohibited until July 18, 2018 from becoming or acting as an officer or director of any issuer, other than PVT2, including any issuer all the securities of which are owned beneficially by him or members of his family;

2. against Michael Wallace Minor ("Minor") that:

   a. pursuant to paragraph 2 of subsection 127(1) of the Act, trading in securities by Minor cease until July 18, 2018, except that Minor may trade for his own account through a registrant, if he gives the registrant a copy of the BCSC Decision and a copy of the Order of the Commission in this proceeding, if granted;

   b. pursuant to paragraph 7 of subsection 127(1) of the Act, Minor resign any positions that he holds as director or officer of any issuer, other than One World Media ("OWM"), One World Smart Solutions ("OWSS"), including any issuer all the securities of which are owned beneficially by him or members of his immediate family;

   c. pursuant to paragraph 8 of subsection 127(1) of the Act, Minor be prohibited until July 18, 2018 from becoming or acting as an officer or director of any issuer, other than OWM and OWSS, including any issuer all the securities of which are owned beneficially by him or members of his immediate family; and

3. To make such other order or orders as the Commission considers appropriate.

BY REASON of the allegations set out in the Statement of Allegations of Staff of the Commission dated December 11, 2013 and by reason of the BCSC Order, and such additional allegations as counsel may advise and the Commission may permit;

AND TAKE FURTHER NOTICE that at the hearing on January 17, 2014 at 10:00 a.m., Staff will bring an application to proceed with the matter by written hearing, in accordance with Rule 11 of the Ontario Securities Commission *Rules of*

Procedure (2012), 35 OSCB 10071 and section 5.1 of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended, and any party to the proceeding may make submissions in respect of the application to proceed by written hearing;

AND TAKE FURTHER NOTICE that any party to the proceeding may be represented by counsel if that party attends or submits evidence at the hearing;

AND TAKE FURTHER NOTICE that upon failure of any party to attend at the time and place, the hearing may proceed in the absence of the party and such party is not entitled to any further notice of the proceeding.

DATED at Toronto this 11th day of December, 2013.

"Daisy G. Aranha"
per: John Stevenson
Secretary to the Commission

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED**

AND

**IN THE MATTER OF
FREDERICK LAWRENCE MARLATT, also known as
FREDERICK LAWRENCE MITSCHELE and MICHAEL WALLACE MINOR**

**STATEMENT OF ALLEGATIONS
OF STAFF OF THE ONTARIO SECURITIES COMMISSION**

Staff of the Ontario Securities Commission ("Staff") allege:

I. OVERVIEW

1. Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele ("Mitschele"), and Michael Wallace Minor ("Minor") (together, the "Respondents") are subject to an order made by the British Columbia Securities Commission (the "BCSC") dated July 18, 2013 (the "BC Order") that imposes sanctions, conditions, restrictions or requirements on them.

2. In its findings on liability dated July 16, 2012 (the "Findings"), a panel of the BCSC (the "BCSC Panel") found that the Respondents engaged in, and/or authorized, permitted and acquiesced, in unregistered trading, contrary to section 34(1) of the British Columbia *Securities Act*, RSBC 1996, c. 418 (the "BC Act"), and the illegal distribution of securities, contrary to section 61(1) of the BC Act.

3. Staff are seeking an inter-jurisdictional enforcement order reciprocating the BC Order, pursuant to paragraph 4 of subsection 127(10) of the Ontario *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act").

4. The conduct for which the Respondents were sanctioned took place between August 2005 and June 2008 (the "Material Time").

5. During the Material Time, the Respondents were residents of British Columbia. Mitschele was the president, CEO, and a director of Photo Violation Technologies Corp. ("PVT"), a federal company registered in British Columbia with a head office in Vancouver, BC. Minor was a director of PVT.

6. The Respondents admitted that they traded and distributed PVT securities for proceeds of $3.2 million, without being registered and without filing a prospectus, breaching subsections 34(1) and 61(1) of the BC Act.

7. PVT is now bankrupt and dormant. Accordingly, the BCSC made no order in respect of sanctions concerning PVT.

8. Michael Garfield Timothy Minor, also known as Tim Minor ("Tim"), Minor's father, was also a respondent in the BCSC proceedings, and a subject of the BCSC's Findings. However, Tim died after the date of the Findings and before the date of the BCSC's hearing on sanctions.

II. THE BCSC PROCEEDINGS

The BCSC Findings

9. A panel of the BCSC found the following:

    a. Minor traded in securities without being registered to do so, contrary to section 34(1) of the BC Act, and distributed those securities without filing a prospectus, contrary to section 61(1) of the BC Act when he distributed $3.2 million in PVT securities when no exemptions from the registration and prospectus requirements applied;

    b. PVT traded in securities without being registered to do so, contrary to section 34(1) of the BC Act and distributed those securities without filing a prospectus, contrary to section 61(1) of the Act, when it distributed PVT securities for proceeds of $3,571,604 to 272 investors in purported reliance on exemptions from the registration and prospectus requirements that were not available; and

c. Mitschele, when he authorized, permitted and acquiesced in PVT's contraventions, also contravened sections 34(1) and 61(1) under section 168.2 of the BC Act.

The BCSC Order

10. The BCSC Order imposed the following sanctions, conditions, restrictions or requirements:

   a. upon Mitschele:

      i. pursuant to section 161(1)(b) of the BC Act, that Mitschele cease trading securities or exchange contracts for a period of 5 years, except that he may trade for his own account through a registrant, if he gives the registrant a copy of the decision of the British Columbia Securities Commission dated July 18, 2013 (the "BC Decision");

      ii. pursuant to section 161(1)(d)(i) of the BC Act, that Mitschele resign from any position he holds as a director or officer of any issuer, other than Photo Violation Technologies Corp. 2 ("PVT2"), and any issuer all the securities of which are owned beneficially by him or members of his family;

      iii. pursuant to section 161(1)(d)(ii) of the BC Act, that Mitschele is prohibited for 5 years from acting as a director or officer of any issuer, other than PVT2 and any issuer all the securities of which are owned beneficially by him or members of his immediate family;

      iv. pursuant to section 161(1)(d)(iv) of the BC Act, that Mitschele is prohibited for 5 years from acting in a management or consultative capacity in connection with activities in the securities market;

      v. pursuant to section 161(1)(d)(v) of the BC Act, that Mitschele is prohibited for 5 years from engaging in investor relations activities; and

      vi. notwithstanding paragraphs (i), (iv) and (v), Mitschele may engage in conduct, including advertisement, solicitation, and negotiation, for the purpose of obtaining financing for PVT2's business, provided that he seeks an appropriate variation order from the BCSC before selling securities;

   b. upon Minor:

      i. pursuant to section 161(1)(b) of the BC Act, that Minor cease trading, securities and or exchange contracts for a period of 5 years, except that he may trade for his own account through a registrant, if he gives the registrant a copy of the BC Decision;

      ii. pursuant to section 161(1)(d)(i) of the BC Act, that Minor resign from any position he holds as a director or officer of any issuer, other than One World Media ("OWM"), One World Smart Solutions ("OWSS"), and any issuer all the securities of which are owned beneficially by him or members of his immediate family;

      iii. pursuant to section 161(1)(d)(ii) of the BC Act, that Minor is prohibited for 5 years from acting as a director or officer of any issuer, other than OWM, OWSS, and any issuer all the securities of which are owned beneficially by him or members of his immediate family;

      iv. pursuant to section 161(1)(d)(iv) of the BC Act, that Minor is prohibited for 5 years from acting in a management or consultative capacity in connection with activities in the securities market; and

      v. pursuant to section 161(1)(d)(v) of the BC Act, that Minor is prohibited for 5 years from engaging in investor relations activities.

III. JURISDICTION OF THE ONTARIO SECURITIES COMMISSION

11. The Respondents are subject to an order of the BCSC imposing sanctions, conditions, restrictions or requirements on them.

12. Pursuant to paragraph 4 of subsection 127(10) of the Act, an order made by a securities regulatory authority, derivatives regulatory authority or financial regulatory authority, in any jurisdiction, that imposes sanctions, conditions, restrictions or requirements may form the basis for an order in the public interest made under subsection 127(1) of the Act.

13. Staff allege that it is in the public interest to make an order against the Respondents.

14. Staff reserve the right to amend these allegations and to make such further and other allegations as Staff deem fit and the Commission may permit.

15. Staff request that this application be heard by way of a written hearing pursuant to Rules 2.6 and 11 of the Ontario Securities Commission Rules of Procedure.

DATED at Toronto, this 11th day of December, 2013.

1.3 News Releases

1.3.1 Canadian Securities Regulators Seek Comments on Mutual Fund Risk Classification Methodology

FOR IMMEDIATE RELEASE
December 12, 2013

CANADIAN SECURITIES REGULATORS SEEK COMMENTS ON MUTUAL FUND RISK CLASSIFICATION METHODOLOGY

Montréal – The Canadian Securities Administrators (CSA) published today for comment CSA Notice 81-324 and Request for Comments *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (CSA Notice 81-324), which sets out a proposed risk classification methodology (the Proposed Methodology) for use by mutual fund managers in the fund facts document (Fund Facts).

The Proposed Methodology has been developed in response to stakeholder feedback that the CSA has received throughout the implementation of the point of sale disclosure framework for mutual funds, notably that the lack of use by fund managers of a standardized risk classification methodology could result in inconsistent measurements of risk and make comparisons between mutual funds difficult.

Currently the Fund Facts requires the manager of a mutual fund to provide a risk rating on a scale of five categories ranging from Low to High. A mutual fund's risk classification methodology is chosen and applied at the fund manager's discretion in order to determine that rating.

"The Fund Facts is designed to ensure that key information about a mutual fund is provided to investors in a simple and comparable format," said Bill Rice, Chair of the CSA and Chair and CEO of the Alberta Securities Commission. "The consideration of a standard risk classification methodology is intended to enhance that objective, and promote consistency in how risk is measured by mutual fund managers."

The CSA welcomes feedback on the Proposed Methodology. In particular, the CSA is interested in whether the Proposed Methodology should be mandated or whether it should be adopted as a guidance for investment fund managers. CSA Notice 81-324 can be found on CSA members' websites. The comment period is open until March 12, 2014.

The CSA, the council of the securities regulators of Canada's provinces and territories, coordinates and harmonizes regulation for the Canadian capital markets.

For more information:

Sylvain Théberge
Autorité des marchés financiers
514-940-2176

Mark Dickey
Alberta Securities Commission
403-297-4481

Richard Gilhooley
British Columbia Securities Commission
604-899-6713

Carolyn Shaw-Rimmington
Ontario Securities Commission
416-593-2361

Kevan Hannah
Manitoba Securities Commission
204-945-1513

Wendy Connors-Beckett
Financial and Consumer Services Commission
New Brunswick
506-643-7745

Tanya Wiltshire
Nova Scotia Securities Commission
902-424-8586

Janice Callbeck
PEI Securities Office
Office of the Attorney General
902-368-6288

Doug Connolly
Financial Services Regulation Div.
Newfoundland and Labrador
709-729-2594

Rhonda Horte
Office of the Yukon Superintendent of
securities
867-667-5466

Louis Arki
Nunavut Securities Office
867-975-6587

Daniela Machuca
Financial and Consumer Affairs
Authority of Saskatchewan
306-798-4160

Donn MacDougall
Northwest Territories
Securities Office
867-920-8984

1.3.2 OSC Releases Results of Electronic Trading Risk Analysis

FOR IMMEDIATE RELEASE
December 12, 2013

OSC RELEASES RESULTS OF ELECTRONIC TRADING RISK ANALYSIS

TORONTO – The Ontario Securities Commission (OSC) published today Staff Notice 23-702, an update on the OSC's ongoing review of the risks associated with electronic trading, including a review of National Instrument 23-103 *Electronic Trading*. NI 23-103 came into effect on March 1, 2013, establishing the regulatory framework that oversees and manages risks associated with the use of electronic trading in Canadian marketplaces.

The OSC undertook the review to ensure the current regulatory framework continues to be effective and robust. The review included an analysis of the tools and controls on electronic trading in Canada, as well as an assessment as to whether there are any deficiencies in NI 23-103.

"The current pace of market evolution requires us to continuously examine and evaluate the policies that safeguard the marketplace and market participants from the risks associated with electronic trading," said Howard Wetston, Q.C., Chair and CEO of the OSC. "Although the risks of technological failure or human error can never be completely eliminated, we strive to ensure we have robust mechanisms in place to manage risks associated with electronic trading and to foster capital market efficiency and protect investors."

As part of the OSC's review process, an independent consultant was retained to conduct a third-party assessment of the risks posed by electronic trading. This involved an interview process with market participants to gather information regarding electronic trading practices, procedures and controls, risks posed by electronic trading, sufficiency of the current regulatory framework and how to best mitigate electronic trading risks. The assessment concluded that no deficiencies exist in NI 23-103 and that NI 23-103 provides a good framework from which industry can work. The report includes observations and recommendations, which OSC Staff are reviewing to determine next steps.

The consultant's recommendations, along with other inputs, will be considered in the context of how to enhance the broader regulatory framework for marketplaces. Any new requirements relating to electronic trading would be proposed and dealt with through the normal comment processes.

The OSC will continue to work with the Canadian Securities Administrators and Investment Industry Regulatory Organization of Canada to identify and address electronic trading risks through policy development and through consultations with market participants, investors and international regulators, in particular, the International Organization of Securities Commissions (IOSCO).

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

Follow us on Twitter: OSC_News

For Investor Inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.3.3 Canadian Regulators Release Status Reports on Mutual Fund Fees and Best Interest Duty

FOR IMMEDIATE RELEASE
December 17, 2013

CANADIAN REGULATORS RELEASE STATUS REPORTS ON MUTUAL FUND FEES AND BEST INTEREST DUTY

Toronto – The Canadian Securities Administrators (CSA) today published status reports on two recent consultations related to mutual fund fees and the appropriateness of introducing a statutory best interest duty. The coordinated release reflects the interconnectedness of the input received from various stakeholders, following extensive consultations on both topics.

The release of CSA Staff Notice 81-323 *Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees* (CSA Staff Notice 81-323) and CSA Staff Notice 33-316 *Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (CSA Staff Notice 33-316) follow the receipt of 99 and 93 comment letters, respectively, as well as in-person consultations by several jurisdictions. These consultations elicited a number of common themes from stakeholders, reflecting the connection between the topics discussed.

“We are pleased with the level of engagement and the input we received during our consultation process, and have summarized for stakeholders the various themes we heard in the interest of driving these discussions forward,” said Bill Rice, Chair of the CSA and Chair and CEO of the Alberta Securities Commission. “This process identified common issues that must be considered for Canadian regulators to achieve positive outcomes for investors, such as the dynamics of the adviser/client relationship, a need for clear identification of conflicts of interest and addressing a lack of clarity in how advisers are compensated.”

The CSA are seeking to coordinate their policy considerations on these initiatives going forward and will work jointly with a view to considering next steps and communicating in the coming months what research initiatives or regulatory actions will be undertaken.

CSA Staff Notice 81-323 and CSA Staff Notice 33-316 are available on various CSA member websites.

The CSA, the council of the securities regulators of Canada’s provinces and territories, coordinates and harmonizes regulation for the Canadian capital markets.

For more information:

Carolyn Shaw-Rimmington
Ontario Securities Commission
416-593-2361

Richard Gilhooley
British Columbia Securities Commission
604-899-6713

Kevan Hannah
Manitoba Securities Commission
204-945-1513

Tanya Wiltshire
Nova Scotia Securities Commission
902-424-8586

Doug Connolly
Financial Services Regulation Div.
Newfoundland and Labrador
709-729-2594

Louis Arki
Nunavut Securities Office
867-975-6587

Mark Dickey
Alberta Securities Commission
403-297-4481

Sylvain Théberge
Autorité des marchés financiers
514-940-2176

Wendy Connors-Beckett
Financial and Consumer Services Commission
New Brunswick
506-643-7745

Janice Callbeck
PEI Securities Office
Office of the Attorney General
902-368-6288

Rhonda Horte
Office of the Yukon Superintendent of
securities
867-667-5466

Donn MacDougall
Northwest Territories
Securities Office
867-920-8984

Daniela Machuca
Financial and Consumer Affairs
Authority of Saskatchewan
306-798-4160

1.3.4 OSC Proposes Adopting Global Standards for Ontario Clearing Agencies

FOR IMMEDIATE RELEASE
December 18, 2013

OSC PROPOSES ADOPTING GLOBAL STANDARDS FOR ONTARIO CLEARING AGENCIES

Toronto – The Ontario Securities Commission (OSC) today published for comment local Rule 24-503 *Clearing Agency Requirements*, which proposes adopting global standards for Ontario financial market infrastructures (FMIs). FMIs include clearing agencies serving both securities and derivatives markets under the Ontario *Securities Act*. The Rule sets out ongoing requirements for recognized clearing agencies in Ontario and formalizes a framework for the OSC's recognition or exemption of all clearing agencies seeking to carry on business in the province. This proposed rule would replace OSC Staff Notice 24-702 *Regulatory Approach to Recognition and Exemption from Recognition of Clearing Agencies*.

In 2012, the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) published the *Principles for Financial Market Infrastructures* to raise the international standards for payment, clearing and settlement systems. Under the OSC proposal published today, Ontario's recognized clearing agencies would be required to meet these strengthened global standards, representing the next milestone for the OSC in meeting G-20 commitments for over-the-counter (OTC) derivatives reform.

"It is important that we maintain high standards for Ontario clearing agencies to ensure they are well placed to withstand financial shocks," said Howard I. Wetston, Q.C., Chair and CEO of the OSC. "Fostering robust infrastructure will strengthen the resiliency of Ontario's capital markets."

The OSC is committed to working with clearing agencies impacted by these rules to help them meet the new standards. The affected clearing agencies are currently performing self-assessments of their operations against the global standards referred to in the proposed rules, and are developing plans to address any gaps. OSC staff will continue to work with these clearing agencies during this transition.

The PFMI Coordinating Group, made up of staff from the OSC, Autorité des marchés financiers, British Columbia Securities Commission and Bank of Canada, was formed to achieve consistent implementation of the CPSS-IOSCO standards in Canada. This group has developed supplementary guidance to clarify certain aspects of the new standards specific to the Canadian context, which is included in the companion policy to the proposed rule. The group will continue to work together to develop further guidance on this rule as necessary.

The proposed OSC rule 24-503 is open for comment until March 19, 2014 and can be found on the OSC's website at www.osc.gov.on.ca.

The OSC is meeting its G-20 commitments and reinforcing Canada's financial stability framework through the implementation of OTC derivatives reforms. The OSC is developing internationally and Canadian harmonized legislative and regulatory proposals to strengthen oversight of Ontario's OTC derivatives market.

For Media Inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

Follow us on Twitter: OSC_News

For Investor Inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4 Notices from the Office of the Secretary

1.4.1 Ernst & Young LLP (Audits of Zungui Haixi Corporation)

FOR IMMEDIATE RELEASE
December 11, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
ERNST & YOUNG LLP
(AUDITS OF ZUNGUI HAIXI CORPORATION)

TORONTO – The Commission issued an Order in the above named matter which provides that the confidential pre-hearing conference scheduled for December 11, 2013 is adjourned to February 13, 2014, at 10:00 a.m., or such other date as is agreed to by the parties and set by the Office of the Secretary.

The pre-hearing conference will be held *in camera*.

A copy of the Order dated December 10, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.2 Bradon Technologies Ltd. et al.

FOR IMMEDIATE RELEASE
December 12, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
BRADON TECHNOLOGIES LTD., JOSEPH COMPTA,
ENSIGN CORPORATE COMMUNICATIONS INC.
and TIMOTHY GERMAN

TORONTO – The Commission issued an Order in the above named matter which provides that a confidential pre-hearing conference shall take place on March 12, 2014 at 10:00 a.m. or on such other date or at such other time as set by the Office of the Secretary and agreed to by the parties.

The pre-hearing conference will be held *in camera*.

A copy of the Order dated December 9, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.3 David M. O'Brien

FOR IMMEDIATE RELEASE
December 12, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
DAVID M. O'BRIEN

TORONTO – The Commission issued an Order in the above named matter which provides that:

1. a confidential pre-hearing conference shall take place on March 6, 2014 at 10:00 a.m.; and

2. O'Brien shall file and serve any materials on which he intends to rely at the pre-hearing conference by February 24, 2014.

The pre-hearing conference will be *in camera*.

A copy of the Order dated December 11, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.4 North American Financial Group Inc. et al.

FOR IMMEDIATE RELEASE
December 12, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
NORTH AMERICAN FINANCIAL GROUP INC.,
NORTH AMERICAN CAPITAL INC.,
ALEXANDER FLAVIO ARCONTI AND
LUIGINO ARCONTI

TORONTO – Following the hearing on the merits in the above noted matter, the Commission issued its Reasons and Decision.

The Commission also issued an Order which provides that the hearing to determine sanctions and costs will be held at the offices of the Commission at 20 Queen Street West, 17th floor, Toronto, ON, on March 24, 2014, at 10:00 a.m., or on such other date or at such other time as set by the Office of the Secretary and agreed to by the parties.

A copy of the Reasons and Decision and the Order dated December 11, 2013 are available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.5 Frederick Lawrence Marlatt, also known as Frederick Lawrence Mitschele and Michael Wallace Minor

FOR IMMEDIATE RELEASE
December 12, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
FREDERICK LAWRENCE MARLATT, also known as
FREDERICK LAWRENCE MITSCHELE and
MICHAEL WALLACE MINOR

TORONTO – The Office of the Secretary issued a Notice of Hearing pursuant to subsections 127(1) and 127(10) of the Act on December 11, 2013, setting the matter down to be heard on January 17, 2014 at 10:00 a.m. as soon thereafter as the hearing can be held in the above named matter. The hearing will be held at the offices of the Commission, 20 Queen Street West, 17th Floor, Toronto.

A copy of the Notice of Hearing dated December 11, 2013 Statement of Allegations of Staff of the Ontario Securities Commission dated December 11, 2013 are available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.6 Heritage Education Funds Inc.

FOR IMMEDIATE RELEASE
December 13, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
HERITAGE EDUCATION FUNDS INC.

TORONTO – The Commission issued an Order in the above named matter with certain provisions. The hearing date of December 16, 2013 at 10:00 a.m. is vacated. The Temporary Order is extended to March 7, 2014 or until such further order of the Commission. The hearing is adjourned to March 5, 2014 at 10:00 a.m. for the purpose of providing the Commission with an update on the work completed by the Consultant and to consider the possible extension of the Temporary Order.

A copy of the Order dated December 12, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.7 TransCap Corporation et al.

FOR IMMEDIATE RELEASE
December 13, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
TRANSCAP CORPORATION,
STRATA-TRADE CORPORATION,
DALE JOSEPH EDGAR ST. JEAN AND
GREGORY DENNIS TINDALL

TORONTO – The Commission issued an Order in the above named matter which provides that:

(a) Staff's application to proceed by way of written hearing is granted;

(b) Staff's materials in respect of the written hearing shall be filed no later than December 23, 2013;

(c) the Respondents' responding materials, if any, shall be served and filed no later than January 17, 2014; and

(d) Staff's reply materials, if any, shall be served and filed no later than January 24, 2014.

A copy of the Order dated December 12, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.8 Crown Hill Capital Corporation and Wayne Lawrence Pushka

FOR IMMEDIATE RELEASE
December 13, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, C. S.5, AS AMENDED

AND

IN THE MATTER OF
CROWN HILL CAPITAL CORPORATION
and WAYNE LAWRENCE PUSHKA

TORONTO – The Commission issued an Order in the above noted matter which provides that the Motion is scheduled for January 10, 2014 at 10:00 a.m. for one half day.

A copy of the Order dated December 12, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.9 Eda Marie Agueci et al.

FOR IMMEDIATE RELEASE
December 16, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
EDA MARIE AGUECI, DENNIS WING, SANTO IACONO, JOSEPHINE RAPONI, KIMBERLEY STEPHANY, HENRY FIORILLO, GIUSEPPE (JOSEPH) FIORINI, JOHN SERPA, IAN TELFER, JACOB GORNITZKI and POLLEN SERVICES LIMITED

TORONTO – The Commission issued its Reasons for Decision on a Motion in the above named matter.

A copy of the Reasons for Decision on a Motion dated December 13, 2013 is available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.4.10 Global Energy Group, Ltd. et al.

FOR IMMEDIATE RELEASE
December 16, 2013

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
GLOBAL ENERGY GROUP, LTD., NEW GOLD LIMITED PARTNERSHIPS, CHRISTINA HARPER, VADIM TSATSKIN, MICHAEL SCHAUMER, ELLIOT FEDER, ODED PASTERNAK, ALAN SILVERSTEIN, HERBERT GROBERMAN, ALLAN WALKER, PETER ROBINSON, VYACHESLAV BRIKMAN, NIKOLA BAJOVSKI, BRUCE COHEN and ANDREW SHIFF

TORONTO – The Commission issued its Reasons and Decision on Sanctions and Costs and an Order in the above noted matter

A copy of the Reasons and Decision on Sanctions and Costs dated December 13, 2013 and an Order dated December 13, 2013 are available at www.osc.gov.on.ca.

OFFICE OF THE SECRETARY
JOHN P. STEVENSON
SECRETARY

For media inquiries:
media_inquiries@osc.gov.on.ca

Carolyn Shaw-Rimmington
Manager, Public Affairs
416-593-2361

Aly Vitunski
Senior Media Relations Specialist
416-593-8263

Alison Ford
Media Relations Specialist
416-593-8307

For investor inquiries:

OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

Chapter 2

Decisions, Orders and Rulings

2.1 Decisions

2.1.1 Lipari Energy, Inc.

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – application for an order that the issuer is not a reporting issuer.

Ontario Statutes

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10).

December 6, 2013

**IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO AND ALBERTA
(the Jurisdictions)**

AND

**IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS**

AND

**IN THE MATTER OF
LIPARI ENERGY, INC.
(the Filer)**

DECISION

Background

The securities regulatory authority or regulator in each of the Jurisdictions (the Decision Maker) has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the Legislation) that the Filer is not a reporting issuer (the Order Sought).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a coordinated review application):

(a) the Ontario Securities Commission is the principal regulator for this application, and

(b) the decision is the decision of the principal regulator and evidences the decision of each other Decision Maker.

Interpretation

Terms defined in National Instrument 14-101 – *Definitions* and MI 11-102 have the same meaning if used in this decision, unless otherwise defined.

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer was continued under the *Business Corporations Act* (British Columbia) pursuant to a reverse take-over which was completed on March 11, 2011.

2. The Filer's head office is located in London, Kentucky in the United States and its registered office in Vancouver, British Columbia.

3. The Filer is currently a reporting issuer in each of Alberta and Ontario.

4. The authorized share capital of the Filer consists of an unlimited number of common shares (the Common Shares), an unlimited number of restricted voting shares (the Restricted Shares) and common share purchase warrants (the Warrants).

5. The Common Shares and Warrants were listed on the Toronto Stock Exchange (the TSX). The Restricted Shares were not listed.

6. On October 31, 2013, 0976837 B.C. Ltd. (the Purchaser) acquired all of the issued and outstanding Common Shares and Restricted Shares of the Filer by way of a court approved plan of arrangement (the Arrangement) pursuant to Section 288 of the *Business Corporations Act* (British Columbia). The Arrangement was effected pursuant to an arrangement agreement dated effective August 22, 2013, as amended on September 20 and October 28, 2013. Under the terms of the Arrangement, the Purchaser acquired all the Common Shares and Restricted Shares which it did not already own for cash consideration of CAD$0.48 per Common Share and CAD$0.48 per Restricted Share. The cash consideration represented approximately a 25% premium to the 20-day volume weighted average price of the Common Shares on the TSX for the period ending August 22, 2013. The transaction provided total consideration to public shareholders of up to approximately CAD$9.9 million and implied an equity value for the Filer of approximately CAD$22.7 million all as more fully described in the

management information circular of the Filer dated April 2, 2013.

7. On October 29, 2013, the Arrangement was approved by the holders of Common Shares and Restricted Shares of the Filer.

8. The Common Shares and Warrants were delisted from trading on the TSX on November 1, 2013.

9. The outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide.

10. No securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported.

11. The Filer is applying for a decision that it is not a reporting issuer in all of the jurisdictions of Canada in which it is currently a reporting issuer.

12. The Filer voluntarily surrendered its status as a reporting issuer in British Columbia pursuant to BC Instrument 11-102 – *Voluntary Surrender of Reporting Issuer Status*, effective November 15, 2013.

13. The Filer is not in default of any of its obligations under the legislation as a reporting issuer as of the date hereof, other than the obligation to file its interim financial statements, management's discussion and analysis and certification of interim filings for the interim period ended September 30, 2013 (the Interim Filings), as required under National Instrument 51-102 *Continuous Disclosure Obligations* and the related certification of such financial statements as required under National Instrument 52-109 *Certification of Disclosure in Filers' Annual and Interim Filings*, all of which became due on November 14, 2013.

14. The Filer is not eligible to use the simplified procedure under CSA Staff Notice 12-307 *Application for a Decision that an Issuer is not a Reporting Issuer* because it is in default of its obligation to file the Interim Filings.

15. The Filer has no current intention to seek public financing by way of an offering of securities.

16. The Filer, upon the granting of the Order Sought, will no longer be a reporting issuer or the equivalent thereof in any jurisdiction in Canada.

Decision

Each of the Decision Makers is satisfied that the decision meets the test set out in the Legislation for the Decision Maker to make the Decision.

The decision of the Decision Makers under the Legislation is that the Order Sought is granted.

"James Turner"
Commissioner
Ontario Securities Commission

"Judith Robertson"
Commissioner
Ontario Securities Commission

2.1.2 Timelo Investment Management Inc. et al.

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – relief granted from the mutual fund self-dealing restrictions in the Securities Act (Ontario) and the conflicts of interest provisions in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations to allow a trust to invest all or substantially all of its net assets in a partnership that is under common management – relief subject to certain conditions.

Applicable Legislative Provisions

Securities Act (Ontario) R.S.O. 1990, c. S.5, as am., ss. 111(2)(b), 111(3), 113, 117(1)(a), 117(2).
National Instrument 31-103 Registration Requirements, Exemptions, and Ongoing Registrant Obligations, ss. 13.5(2)(a), 15.1.

November 22, 2013

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(the Jurisdiction)

AND

IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF
TIMELO INVESTMENT MANAGEMENT INC.
(the Filer)

AND

TIMELO STRATEGIC OPPORTUNITIES FUND
(the Trust)

AND

TIMELO STRATEGIC OPPORTUNITIES FUND LP
(the Partnership)

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filer on its own behalf and on behalf of the Trust and the Partnership for a decision under the securities legislation of the Jurisdiction (the **Legislation**) exempting the Filer, the Trust and the Partnership from:

(a) the restriction in the Legislation prohibiting a mutual fund from knowingly making and holding an investment in any person or company in which the mutual fund, alone or together with one or more related mutual funds, is a “substantial securityholder” (within the meaning of the Legislation) (the **Related Issuer Relief**);

(b) the requirement in the Legislation requiring a management company or a mutual fund manager, to file a report of every transaction of purchase and sale of securities between a mutual fund it manages and any related person or company and any transaction in which, by arrangement other than an arrangement related to insider trading of portfolio securities, a mutual fund is a joint participant with one of more of its related persons or companies, in respect of each mutual fund to which the management company provides services or advice, within 30 days after the end of the month in which it occurs (the **Reporting Requirement Relief**); and

(c) the restriction in the Legislation prohibiting a registered adviser from knowingly causing an investment portfolio managed by it, including an investment fund for which it acts as adviser, to invest in the securities of any issuer in which a responsible person or an associate of a "responsible person" (within the meaning of the Legislation) is a partner, officer or director, unless the fact is disclosed to the client and the written consent of the client to the investment is obtained before the purchase (the **Consent Relief**, and together with the Related Issuer Relief and the Reporting Requirement Relief, the **Requested Relief**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

(a) the Ontario Securities Commission (the **OSC**) is the principal regulator for this application, and

(b) the Filer has provided notice that section 4.7(1) of Multilateral Instrument 11-102 – *Passport System* (**MI 11-102**) is intended to be relied upon in each of the provinces and territories of Canada, (collectively, the **Other Jurisdictions**).

Interpretation

Unless otherwise defined herein, terms defined in National Instrument 14-101 *Definitions*, National Instrument 81-102 – *Mutual Funds* (**NI 81-102**) and MI 11-102 have the same meaning if used in this decision.

Representations

This decision is based on the following facts represented by the Filer:

The Filer

1. The Filer is a corporation existing under the laws of Canada with its head office in Aurora, Ontario.

2. The Filer is registered with the OSC as an investment fund manager, an adviser in the category of portfolio manager and a dealer in the category of exempt market dealer.

3. The Filer will be the investment fund manager of the Trust and the Partnership.

4. The Filer is not a reporting issuer in any jurisdiction of Canada and is not in default of any securities legislation of any jurisdiction of Canada.

The Trust

5. The Trust will be organized as a trust under the laws of the Province of Ontario, the securities of which will be offered for sale on a private placement basis pursuant to prospectus exemptions under National Instrument 45-106 – *Prospectus and Registration Exemptions* ("**NI 45-106**") in Canada.

6. The Trust will be a "mutual fund" under applicable Canadian securities legislation.

7. The Trust will not be a reporting issuer in any jurisdiction of Canada and is not in default of any securities legislation of any jurisdiction of Canada.

The Partnership

8. The Partnership is organized as a limited partnership under the laws of the Province of Ontario. The general partner of the Partnership is Strategic Opportunities GP Inc. (the **General Partner**), an affiliate of the Filer and the Trust.

9. The General Partner has contributed $10.00 towards the capital of the Partnership and does not intend to contribute any other capital to the Partnership.

10. Other than the General Partner, the Trust will be the sole securityholder of the Partnership.

11. The Partnership will be a "mutual fund" under applicable Canadian securities legislation.

12. The Partnership is not and will not be a reporting issuer in any jurisdiction of Canada and is not in default of any securities legislation of any jurisdiction of Canada.

Trust on Partnership Structure

13. The investment objective of the Trust is to maximize return on investment to its securityholders while seeking to mitigate market risk and volatility. The Trust intends to achieve its investment objective by investing all or substantially all of its net assets in the Partnership.

14. An investment by the Trust in securities of the Partnership will be compatible with the investment objective of the Trust.

15. Securities of the Partnership will not be eligible for investment by tax-free savings accounts (**TFSAs**) and trusts governed by registered retirement savings plans, registered retirement income funds, registered education savings plans and deferred profit sharing plans and registered disability savings plans (collectively, **Tax Deferred Plans**), each as defined in the *Income Tax Act* (Canada) (the **Tax Act**).

16. The Filer intends that securities of the Trust will be eligible for investment by TFSAs and Tax Deferred Plans by qualifying as a "mutual fund trust" under the Tax Act. This would allow investors of the Trust to benefit from making an election under the Tax Act.

17. The limited partnership structure of the Partnership provides for distributions to an affiliate of the Filer in respect of incentive allocations. An incentive allocation is common with limited partnership structures but cannot be replicated with a mutual fund trust structure on a tax-efficient basis.

Investments by the Partnership in Underlying Mutual Funds

18. The Partnership may invest in other mutual funds that are not managed by the Filer or its affiliates (the **Underlying Mutual Funds**) to achieve its investment objective. For certainty, the Partnership will not invest in any mutual funds other than the Underlying Mutual Funds.

19. An investment by the Partnership in securities of the Underlying Mutual Funds will be compatible with the investment objective of the Partnership.

20. The Partnership will not purchase or hold securities of an Underlying Mutual Fund if the Underlying Mutual Fund holds more than 10% of its net asset value, directly or indirectly, in securities of other mutual funds (other than an Underlying Mutual Fund that is a "clone fund" or holds securities of a "money market fund", or that are "index participation units" issued by a mutual fund, in each case as defined under NI 81-102).

21. No management fees or incentive fees will be payable by (i) the Trust that, to a reasonable person, would duplicate a fee payable by the Partnership for the same service; or (ii); the Partnership that, to a reasonable person, would duplicate a fee payable by the Underlying Mutual Fund for the same service.

22. No sales fees or redemption fees will be payable by (i) the Trust in relation to its purchases or redemptions of securities of the Partnership; or (ii) Partnership in relation to its purchases or redemptions of securities of the Underlying Mutual Fund that, to a reasonable person, would duplicate a fee payable by an investor in the Partnership, other than brokerage fees incurred for the purchase or sale of an "index participation unit" issued by a mutual fund.

23. The Filer will not vote any securities of the Partnership held by the Trust. However, the Filer may, if it so chooses, arrange for the securities that the Trust holds of the Partnership to be voted by the beneficial holders of securities of the Trust.

24. The offering memorandum of the Trust will be provided to all investors in the Trust prior to the time of purchase, and will disclose that:

    (a) the Trust will purchase securities of the Partnership;

    (b) the Filer is the investment fund manager of the Trust and the Partnership;

    (c) the Trust will invest all or substantially all of its net assets in the Partnership;

    (d) the relationship and potential conflicts of interest between the Trust and the Partnership.

25. Securityholders of the Trust will receive, on request, a copy of the Trust's audited annual and unaudited interim financial statements.

26. The investment by the Partnership in the Underlying Mutual Funds will represent the business judgment of “responsible persons” (within the meaning of the Legislation) uninfluenced by considerations other than the best interests of the prospective investors in the Trust.

27. The Trust and the Partnership will generally have matching redemption dates.

Generally

28. Since the Trust and the Partnership do not offer their securities under a simplified prospectus, they are not subject to NI 81-102. Therefore, the Trust and the Partnership are unable to rely upon the exemption from mutual fund conflict of interest investment restrictions and the mutual fund conflict of interest reporting requirements codified under subsection 2.5(7) of NI 81-102.

29. In the absence of the Related Issuer Relief, the Trust would be precluded from investing all or substantially all of its net assets in the Partnership due to certain investment restrictions in the Legislation.

30. In the absence of the Consent Relief, the Trust would be precluded from investing in the Partnership unless the specific fact is disclosed to securityholders of the Trust and the written consent of the securityholders of the Trust to the investment is obtained before the purchase.

31. In the absence of the Reporting Requirement Relief, the Filer would be required to file a report on every purchase or sale of securities of the Partnership by the Trust.

Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Requested Relief is granted so long as:

(a) securities of the Trust are distributed in Canada solely pursuant to exemptions from the prospectus requirement under NI 45-106;

(b) an investment by the Trust in securities of the Partnership, and an investment by the Partnership in securities of an Underlying Mutual Fund will be compatible with the investment objective of the Trust and the Partnership, respectively;

(c) no management fees or incentive fees will be payable by (i) the Trust that, to a reasonable person, would duplicate a fee payable by the Partnership for the same service; or (ii); the Partnership that, to a reasonable person, would duplicate a fee payable by the Underlying Mutual Fund for the same service;

(d) no sales fees or redemption fees will be payable by (i) the Trust in relation to its purchases or redemptions of securities of the Partnership; or (ii) Partnership in relation to its purchases or redemptions of securities of the Underlying Mutual Fund that, to a reasonable person, would duplicate a fee payable by an investor in the Partnership, other than brokerage fees incurred for the purchase or sale of an "index participation unit" issued by a mutual fund;

(e) the Filer will not vote any securities of the Partnership held by the Trust. However, the Filer may, if it so chooses, arrange for the securities that the Trust holds of the Partnership to be voted by the beneficial holders of securities of the Trust;

(f) the Partnership will not purchase or hold securities of an Underlying Mutual Fund if the Underlying Mutual Fund holds more than 10% of its net asset value, directly or indirectly, in securities of other mutual funds (other than an Underlying Mutual Fund that is a “clone fund” or holds securities of a “money market fund”, or that are “index participation units” issued by a mutual fund, in each case as defined under NI 81-102);

(g) the offering memorandum of the Trust will be provided to all investors of the Trust prior to the time of purchase, and will disclose that:

    (i) the Trust will purchase securities of the Partnership;

    (ii) the Filer is the investment fund manager of the Trust and the Partnership; and

(iii) the Trust will invest all or substantially all of its net assets in the Partnership.

"Raymond Chan"
Manager, Investment Funds Branch
Ontario Securities Commission

"Alan Lenczner"
Commissioner
Ontario Securities Commission

"Sarah B. Kavanagh"
Commissioner
Ontario Securities Commission

2.1.3 Manulife Asset Management Limited

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – relief from certain specified derivatives and custodial requirements to permit mutual funds to enter into swap transactions that are cleared through a clearing corporation – relief required because of new U.S. requirements to clear over-the-counter derivatives including swaps - decision treats cleared swaps similar to other cleared derivatives – National Instrument 81-102 Mutual Funds.

Applicable Legislative Provisions

National Instrument 81-102 Mutual Funds, ss. 2.7(1) and (4), 6.8(1), 19.1.

November 13, 2013

**IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(the Jurisdiction)**

AND

**IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS**

AND

**IN THE MATTER OF
MANULIFE ASSET MANAGEMENT LIMITED
(the Filer)**

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filer for a decision under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**), pursuant to section 19.1 of National Instrument 81-102 *Mutual Funds* (**NI 81-102**), exempting each Existing Manulife Fund (as defined below) and all current and future mutual funds managed by the Filer that enter into Swaps (as defined below) in the future (each, a **Future Manulife Fund** and, together with the Existing Manulife Funds, each, a **Manulife Fund** and, collectively, the **Manulife Funds**):

(i) from the requirement in subsection 2.7(1) of NI 81-102 that a mutual fund must not purchase an option or a debt-like security or enter into a swap or a forward contract unless, at the time of the transaction, the option, debt-like security, swap or contract has a designated rating or the equivalent debt of the counterparty, or of a person or company that has fully and unconditionally guaranteed the obligations of the counterparty in respect of the option, debt-like security, swap or contract, has a designated rating;

(ii) from the limitation in subsection 2.7(4) of NI 81-102 that the mark-to-market value of the exposure of a mutual fund under its specified derivatives positions with any one counterparty other than an acceptable clearing corporation or a clearing corporation that settles transactions made on a futures exchange listed in Appendix A to NI 81-102 shall not exceed, for a period of 30 days or more, 10 percent of the net asset value of the mutual fund; and

(iii) from the requirement in subsection 6.1(1) of NI 81-102 to hold all portfolio assets of a mutual fund under the custodianship of one custodian in order to permit each Manulife Fund to deposit cash and other portfolio assets directly with a Futures Commission Merchant (as defined below) and indirectly with a Clearing Corporation (as defined below) as margin,

in each case, with respect to cleared Swaps (the **Requested Relief**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

(a) the Ontario Securities Commission is the principal regulator for this application; and

(b) the Filer has provided notice that subsection 4.7(1) of Multilateral Instrument 11-102 *Passport System* (**MI 11-102**) is intended to be relied upon in each of the other provinces and territories of Canada (the **Other Jurisdictions**).

Interpretation

Terms defined in NI 81-102, National Instrument 14-101 *Definitions*, and MI 11-102 have the same meaning if used in this decision, unless otherwise defined. Capitalized terms used in this decision have the following meanings:

"CFTC" means the U.S. Commodity Futures Trading Commission

"Clearing Corporation" means any of the Chicago Mercantile Exchange Inc., ICE Clear Credit LLC, LCH.Clearnet Limited and any other clearing organization that is permitted to operate in the Jurisdiction or the Other Jurisdiction, as the case may be, where the Manulife Fund is located

"Dodd-Frank" means the Dodd-Frank Wall Street Reform and Consumer Protection Act

"Existing Manulife Funds" means Manulife U.S. Fixed Income Private Trust and Manulife U.S. Tactical Credit Fund

"Futures Commission Merchant" means any futures commission merchant that is registered with the CFTC and is a member of a Clearing Corporation

"OTC" means over-the-counter

"Portfolio Advisor" means each of the Filer and each affiliate of the Filer and each third party portfolio manager retained from time to time by the Filer to manage all or a portion of the investment portfolio of one or more Manulife Funds

"Swaps" means the swaps that are, or will become, subject to a clearing determination issued by the CFTC, including fixed-to-floating interest rate swaps, basis swaps, forward rate agreements in U.S. dollars, the Euro, Pounds Sterling or the Japanese Yen, overnight index swaps in U.S. dollars, the Euro and Pounds Sterling and untranched credit default swaps on certain North American indices (CDX.NA.IG and CDX.NA.HY) and European indices (iTraxx Europe, iTraxx Europe Crossover and iTraxx Europe HiVol) at various tenors

"U.S. Person" has the meaning attributed thereto by the CFTC

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer is, or will be, the investment fund manager of each Manulife Fund. The Filer is registered as an investment fund manager in each of Ontario, Quebec and Newfoundland and Labrador, as a portfolio manager and an exempt market dealer in each of the provinces of Canada and as a commodity trading manager in Ontario. The head office of the Filer is in Toronto, Ontario.

2. The Filer is, or will be, the portfolio manager to the Manulife Funds. Either an affiliate of the Filer or a third party portfolio manager is, or will be, the sub-advisor to certain of the Manulife Funds.

3. Each Manulife Fund is, or will be, a mutual fund created under the laws of the Province of Ontario and is, or will be, subject to the provisions of NI 81-102.

4. Neither the Filer nor the Manulife Funds are, or will be, in default of securities legislation in any Jurisdiction.

5. The securities of each Manulife Fund are, or will be, qualified for distribution pursuant to a prospectus that was, or will be, prepared and filed in accordance with the securities legislation of the Jurisdictions. Accordingly, each Manulife Fund is, or will be, a reporting issuer or the equivalent in each Jurisdiction.

6. The investment objective and investment strategies of each Manulife Fund permit, or will permit, the Manulife Fund to enter into derivative transactions, including Swaps. The Portfolio Advisor for the Existing Manulife Funds considers Swaps to be an important investment tool that is available to it to properly manage each Existing Manulife Fund's portfolio managed by it. Although the Existing Manulife Funds do not currently enter into Swaps, the Portfolio Advisor for the Existing Manulife Funds intends to put in place the arrangements required to permit the Existing Manulife Funds to enter into Swaps.

7. Dodd-Frank requires that certain OTC derivatives be cleared through a Futures Commission Merchant at a clearing organization recognized by the CFTC. Generally, where one party to a Swap is a U.S. Person and the other party to the Swap is a mutual fund, such as a Manulife Fund, that Swap must be cleared, absent an available exception, as of June 10, 2013. With respect to entities such as the Manulife Funds, the compliance date for the clearing of iTraxx CDS indices was July 25, 2013.

8. Currently, the Existing Manulife Funds may enter into derivatives on an OTC basis with Canadian, U.S. and other international counterparties. These OTC derivatives are entered into in compliance with the derivative provisions of NI 81-102.

9. In order to benefit from both the pricing benefits and reduced trading costs that a Portfolio Advisor may be able to achieve through its trade execution practices for its advised investment funds and other accounts and from the reduced costs associated with cleared OTC derivatives as compared to other OTC trades, the Filer wishes to have the Manulife Funds have the ability to enter into cleared Swaps.

10. In the absence of the Requested Relief, each Portfolio Advisor will need to structure the Swaps entered into by the Manulife Funds so as to avoid the clearing requirements of the CFTC. The Filer respectfully submits that this would not be in the best interests of the Manulife Funds and their investors for a number of reasons, as set out below.

11. The Filer strongly believes that it is in the best interests of the Manulife Funds and their investors to be able to execute OTC derivatives with U.S. Persons, including U.S. swap dealers.

12. In its role as a fiduciary for the Manulife Funds, the Filer has determined that central clearing represents the best choice for the investors in the Manulife Funds to mitigate the legal, operational and back office risks faced by investors in the global swap markets.

13. A Portfolio Advisor may use the same trade execution practices for all of its advised investment funds and other accounts, including the Manulife Funds. An example of these trade execution practices is block trading, where large number of securities are purchased or sold or large derivative trades are entered into on behalf of a number of investment funds and other accounts advised by one Portfolio Advisor. These practices include the use of cleared Swaps if such trades are executed with a U.S. swap dealer. If the Manulife Funds are unable to employ these trade execution practices, then each affected Portfolio Advisor will have to create separate trade execution practices only for the Manulife Funds and will have to execute trades for the Manulife Funds on a separate basis. This will increase the operational risk for the Manulife Funds, as separate execution procedures will need to be established and followed only for the Manulife Funds. In addition, the Manulife Funds will no longer be able to enjoy the possible price benefits and reduction in trading costs that a Portfolio Advisor may be able to achieve through a common practice for its advised funds and other accounts. In the Filer's opinion, best execution and maximum certainty can best be achieved through common trade execution practices, which, in the case of OTC derivatives, involve the execution of Swaps on a cleared basis.

14. As a member of the G20 and a participant in the September 2009 commitment of G20 nations to improve transparency and mitigate risk in derivatives markets, Canada has expressly recognized the systemic benefits that clearing OTC derivatives offers to market participants, such as the Manulife Funds. The Filer respectfully submits that the Manulife Funds should be encouraged to comply with the robust clearing requirements established by the CFTC by granting them the Requested Relief.

15. The Requested Relief is analogous to the treatment currently afforded under NI 81-102 to other types of derivatives that are cleared, such as clearing corporation options, options on futures and standardized futures. This demonstrates that, from a policy perspective, the Requested Relief is consistent with the views of the Canadian securities authorities in respect of cleared derivative trades.

16. For the reasons provided above, the Filer submits that it would not be prejudicial to the public interest to grant the Requested Relief.

Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Requested Relief is granted provided that, in respect of the deposit of cash and portfolio assets as margin:

(a) in Canada,

(i) the Futures Commission Merchant is a member of a SRO that is a participating member of CIPF; and

(ii) the amount of margin deposited and maintained with the Futures Commission Merchant does not, when aggregated with the amount of margin already held by the Futures Commission Merchant, exceed 10 percent of the net asset value of the Manulife Fund as at the time of deposit; and

(b) outside of Canada,

(i) the Futures Commission Merchant is a member of a Clearing Corporation and, as a result, is subject to a regulatory audit;

(ii) the Futures Commission Merchant has a net worth, determined from its most recent audited financial statements that have been made public or from other publicly available financial information, in excess of the equivalent of $50 million; and

(iii) the amount of margin deposited and maintained with the Futures Commission Merchant does not, when aggregated with the amount of margin already held by the Futures Commission Merchant, exceed 10 percent of the net asset value of the Manulife Fund as at the time of deposit.

This decision will terminate on the earlier of (i) the coming into force of any revisions to the provisions of NI 81-102 that address the clearing of OTC derivatives, and (ii) two years from the date of this decision.

"Vera Nunes"
Manager, Investment Funds Branch
Ontario Securities Commission

2.1.4 Aston Hill Oil & Gas Income Fund et al.

Headnote

Pursuant to National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions, the funds and their manager are exempted from the dealer registration requirement for certain limited trading activities to be carried out by these parties in connection with warrant offerings by the funds, as the limited trading activities involve: i) the forwarding of short form prospectuses and the distribution of warrants to acquire units to existing holders of units and ii) the subsequent distribution of units to existing holders of warrants, upon their exercise of the warrants, through an appropriately registered dealer.

Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25(1), 74(1),
Multilateral Instrument 11-102 Passport System, s. 4.7(1),
National Instrument 45-106 Prospectus and Registration Exemptions, ss. 2.1, 3.1, 3.42, 8.5.
National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, s. 8.5.

December 10, 2013

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(the Jurisdiction)

AND

IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF
ASTON HILL OIL & GAS INCOME FUND (OGF),
ASTON HILL VIP INCOME FUND (VIP)
(collectively, the Funds),

AND

ASTON HILL ASSET MANAGEMENT INC.
(the Manager)
(collectively with the Funds, the Filers)

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filers for a decision under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**) exempting the Filers from the dealer registration requirement in the Legislation in respect of the following:

i. certain trades (the **OGF Warrant Offering Activities**) to be carried out by the Manager, on behalf of OGF, in connection with a proposed offering (the **OGF Warrant Offering**) of warrants (the **OGF Warrants**) to acquire units (the **OGF Units**) of OGF, to be made pursuant to a short-form (final) prospectus (the **OGF Warrant Prospectus**); and

ii. certain trades (the **VIP Warrant Offering Activities**) to be carried out by the Manager, on behalf of VIP, in connection with a proposed offering (the **VIP Warrant Offering**) of warrants (the **VIP Warrants**) to acquire units (the **VIP Units**) of VIP, to be made pursuant to a short-form (final) prospectus (the **VIP Warrant Prospectus**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

1. the Ontario Securities Commission is the principal regulator for this application; and

2. each Filer has provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System* (**MI 11-102**) is intended to be relied upon by the Filer in British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Yukon, the Northwest Territories and Nunavut (collectively, the **Passport Jurisdictions**).

Interpretation

Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this decision, unless otherwise defined.

Representations

This decision is based on the following facts represented by the Filers:

1. Each of the Funds is a trust established by declaration of trust under the laws of the province of Ontario.

2. The Manager is the manager of the Funds and is a wholly-owned subsidiary of Aston Hill Financial Inc. (**Aston Hill**).

3. The Funds are reporting issuers in each of the provinces and territories of Canada and Aston Hill is a reporting issuer in each of the provinces of Canada and each is not in default of securities legislation in any jurisdiction.

4. The Manager performs management, portfolio management and administrative services for the Funds pursuant to management agreements.

5. The head office of each of the Filers is located in Toronto, Ontario.

6. The Funds are not considered to be mutual funds under securities legislation of the provinces and territories of Canada.

7. The authorized capital of OGF consists of an unlimited number of OGF Units. The OGF Units are listed and posted for trading on the Toronto Stock Exchange (the **TSX**).

8. The authorized capital of VIP consists of an unlimited number of VIP Units. The VIP Units are listed and posted for trading on the TSX.

9. Each of the Funds is, directly or indirectly, subject to certain investment restrictions that, among other things, limit the securities that may be acquired by the investment portfolio which the applicable Fund owns or is exposed to, as applicable.

10. The investment objectives of OGF are to provide holders of OGF Units with the benefits of high monthly cash distributions together with the opportunity for capital appreciation.

11. The investment objectives of VIP are to provide holders of VIP Units with the benefits of a high level of monthly income, together with the opportunity for capital appreciation.

12. OGF's portfolio consists of securities of oil and gas companies.

13. VIP's portfolio consists primarily of income producing securities.

14. OGF filed a final prospectus dated September 28, 2004, under the securities legislation of Ontario and each of the Passport Jurisdictions for the initial issuance of OGF Units. Pursuant to final short form prospectuses dated November 26, 2008, November 4, 2009 and February 9, 2011, respectively, OGF issued to holders of OGF Units warrants to subscribe for additional OGF Units. There are no warrants currently outstanding.

15. VIP filed a final prospectus dated January 29, 2002, under the securities legislation of Ontario and each of the Passport Jurisdictions for the initial issuance of VIP Units. Pursuant to final short form prospectuses dated November 26, 2008, November 4, 2009 and February 9, 2011, respectively, VIP issued to holders of VIP Units warrants to subscribe for additional VIP Units. There are no warrants currently outstanding.

16. Neither of the Funds engages in the continuous distribution of securities.

17. In connection with the OGF Warrant Offering, OGF has filed a preliminary short form prospectus dated November 22, 2013, under the securities legislation of Ontario and each of the Passport Jurisdictions. Under the OGF Warrant Offering, each holder of OGF Units, as at a specified record date, will be entitled to receive, for no consideration, one-half of one OGF Warrant for each OGF Unit held by such holder.

18. In connection with the VIP Warrant Offering, VIP has filed a preliminary short form prospectus dated November 22, 2013 under the securities legislation of Ontario and each of the Passport Jurisdictions. Under the VIP Warrant Offering, each holder of VIP Units, as at a specified record date, will be entitled to receive, for no consideration, one-fourth of one VIP Warrant for each VIP Unit held by such holder.

19. Holders of OGF Warrants will be entitled, upon the exercise of such OGF Warrants, to subscribe for OGF Units, pursuant to subscription privileges provided for in the OGF Warrants, at a subscription price to be specified in the OGF Warrant Prospectus. Each OGF Warrant will entitle the holder to subscribe for one OGF Unit under a basic subscription privilege. Holders of OGF Warrants who exercise OGF Warrants under the basic subscription privilege may also subscribe, pro rata, for additional OGF Units that are not subscribed for by other holders under the basic subscription privilege, pursuant to the terms of an additional subscription privilege. The term for the exercise of OGF Warrants (including both the basic subscription privilege and the additional subscription privilege) will not exceed six months.

20. Holders of VIP Warrants will be entitled, upon the exercise of such VIP Warrants, to subscribe for VIP Units, pursuant to subscription privileges provided for in the VIP Warrants, at a subscription price to be specified in the VIP Warrant Prospectus. Each VIP Warrant will entitle the holder to subscribe for one VIP Unit under a basic subscription privilege. Holders of VIP Warrants who exercise VIP Warrants under the basic subscription privilege may also subscribe, pro rata, for additional VIP Units that are not subscribed for by other holders under the basic subscription privilege, pursuant to the terms of an additional subscription privilege. The term for the exercise of VIP Warrants (including both the basic subscription privilege and the additional subscription privilege) will not exceed six months.

21. OGF has applied to list the OGF Warrants, to be distributed under the OGF Warrant Prospectus, on the TSX.

22. VIP has applied to list the VIP Warrants, to be distributed under the VIP Warrant Prospectus, on the TSX.

23. The OGF Warrant Offering Activities will consist of:

    (a) the distribution of the OGF Warrant Prospectus and the issuance of OGF Warrants to the holders of OGF Units (as at the record date specified in the OGF Warrant Prospectus), after the OGF Warrant Prospectus has been filed, and receipts obtained, under the securities legislation of Ontario and each of the Passport Jurisdictions; and

    (b) the distribution of OGF Units to holders of OGF Warrants, upon the exercise of such OGF Warrants by the holder, through a registered dealer that is registered in a category that permits the registered dealer to make such distribution.

24. The VIP Warrant Offering Activities will consist of:

    (a) the distribution of the VIP Warrant Prospectus and the issuance of VIP Warrants to the holders of VIP Units (as at the record date specified in the VIP Warrant Prospectus), after the VIP Warrant Prospectus has been filed, and receipts obtained, under the securities legislation of Ontario and each of the Passport Jurisdictions; and

    (b) the distribution of VIP Units to holders of VIP Warrants, upon the exercise of such VIP Warrants by the holder, through a registered dealer that is registered in a category that permits the registered dealer to make such distribution.

25. The Funds are in the business of trading by virtue of their portfolio investing and trading activities. As a result, their capital raising activities, including their respective OGF Warrant Offering Activities or VIP Warrant Offering Activities, would require each of the Filers to register as a dealer in the absence of this decision (or another available exemption from the dealer registration requirement).

26. Section 8.5 of National Instrument 45-106 *Prospectus and Registration Exemptions* (**NI 45-106**) provides that the exemptions from the dealer registration requirements set out in section 3.1 [*Rights offering*] and section 3.42 [*Conversion, exchange, or exercise*] of NI 45-106 no longer apply.

Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that:

A. OGF, and the Manager acting on behalf of OGF, are not subject to the dealer registration requirement in respect of the OGF Warrant Offering Activities; and

B. VIP, and the Manager acting on behalf of VIP, are not subject to the dealer registration requirement in respect of the VIP Warrant Offering Activities;

"James Turner"
Commissioner
Ontario Securities Commission

"Judith Robertson"
Commissioner
Ontario Securities Commission

2.1.5 CT Real Estate Investment Trust

Headnote

Multilateral Instrument 11-102 Passport System and National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – exemption granted from requirement file a BAR for an acquisition that is not significant to the Filer from a practical, commercial, business, or financial perspective.

Applicable Legislative Provisions

National Instrument 51-102 Continuous Disclosure Obligations, ss. 8.2, 13.1.

December 11, 2013

**IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(THE "JURISDICTION")**

AND

**IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS**

AND

**IN THE MATTER OF
CT REAL ESTATE INVESTMENT TRUST
(THE "FILER" OR THE "REIT")**

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filer for a decision under the securities legislation of the Jurisdiction of the principal regulator (the "**Legislation**") for relief from the requirement in Part 8 of National Instrument 51-102 – *Continuous Disclosure Obligations* ("**NI 51-102**") to a file a business acquisition report (a "**BAR**") in respect of the Filer's acquisition (the "**Third Party Tenant Lease Portfolio Acquisition**") of a portfolio of third-party tenant properties located across Canada (the "**Third Party Tenant Lease Portfolio**") in connection with the Filer's initial public offering "**IPO**" of trust units on October 10, 2013 (the "**Exemption Sought**").

Under the Process for Exemptive Relief Applications in Multiple jurisdictions (for a passport application):

(a) the Ontario Securities Commission is the principal regulator for this application, and

(b) the Filer has provided notice that subsection 4.7(1) of Multilateral Instrument 11-102 – *Passport System* ("**MI 11-102**") is intended to be relied upon in British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Prince Edward Island, Nova Scotia, Newfoundland and Labrador, Yukon, Northwest Territories and Nunavut.

Interpretation

Terms defined in National Instrument 14-101 – *Definitions* and MI 11-102 have the same meaning if used in this decision, unless otherwise defined in this decision.

Representations

This decision is based on the following facts represented by the Filer:

The REIT

1. The REIT is an unincorporated closed-end real estate investment trust established under the laws of the Province of Ontario by a declaration of trust and its head office is located in Toronto, Ontario.

2. The REIT is a reporting issuer under the securities legislation of each of the provinces and territories of Canada and is not in default of securities legislation in any jurisdiction.

3. The trust units of the REIT are listed and posted for trading on the Toronto Stock Exchange under the symbol "CRT.UN".

4. The REIT completed its IPO on October 23, 2013 pursuant to a long form prospectus in respect thereof dated October 10, 2013.

5. The net proceeds of the IPO were used by the REIT as partial consideration of its indirect acquisition from Canadian Tire Corporation, Limited and its subsidiaries of a portfolio of 256 commercial properties located in Canada, comprising 255 retail properties and one distribution centre.

The Third Party Tenant Lease Portfolio Acquisition

6. In connection with the closing of the IPO on October 23, 2013, the REIT acquired the Third Party Tenant Lease Portfolio in conjunction with its IPO of trust units for an aggregate purchase price of approximately $152 million.

7. The Third Party Tenant Lease Portfolio Acquisition constitutes a "significant acquisition" of the REIT for the purposes of Part 8 of NI 51-102, requiring the REIT to file a BAR within 75 days of the Third Party Tenant Lease Portfolio Acquisition pursuant to subsection 8.2(1) of NI 51-102.

Significance Test for the BAR

8. Under Part 8 of NI 51-102, the REIT is required to file a BAR for any completed business acquisition that is determined to be significant based on the

acquisition satisfying any of the three significance tests set out in subsection 8.3(2) of NI 51-102.

9. The Third Party Tenant Lease Portfolio Acquisition is a significant acquisition under each of the asset test, the investment test and the profit or loss test in subsection 8.3(2) of NI 51-102.

10. For the purposes of completing its quantitative analysis of the asset test, the investment test and the profit or loss test, the REIT is required to utilize its most recent audited financial statements. Such audited historical financial statements of the REIT were created following the creation of the REIT for purposes of the REIT's IPO prospectus. Accordingly, the applicable audited historical financial statements of the REIT only reflect assets of $10.00 and unitholders' equity of $10.00 as a result of the issuance of the initial trust unit of the REIT upon its creation and prior to the completion of the REIT's IPO. As a result, the application of the asset test, the investment test and the profit or loss test each produces an anomalous result for the REIT in comparison to the results of such tests when re-applying them using the financial metrics of the REIT that existed immediately following the closing of the REIT's IPO.

11. When using the financial metrics of the REIT that existed upon the closing of its IPO (as opposed to the above-mentioned pre-IPO audited historical financial statements) to calculate the asset test, investment test and profit or loss test with respect to the Third Party Tenant Lease Portfolio Acquisition, the results indicate that the Third Party Tenant Lease Portfolio Acquisition represented only 4.21% of the REIT's consolidated assets, 4.30% of the REIT's consolidated investments and 4.30% of the REIT' s forecasted net operating income. The application of the asset test, investment test and profit or loss test using the financial metrics of the REIT that existed immediately following the closing of its IPO more accurately reflect the true significance of the Third Party Tenant Lease Portfolio Acquisition from a practical, commercial, business and financial perspective.

De Minimis Acquisition

11. The REIT does not believe (nor did it believe at the time that it made the Third Party Tenant Lease Portfolio Acquisition) that the Third Party Tenant Lease Portfolio Acquisition is significant to it from a practical, commercial, business or financial perspective.

12. The Filer has provided the principal regulator with an additional measure which demonstrates the insignificance of the Third Party Tenant Lease Portfolio Acquisition to the Filer. This additional measure reflects that the total gross leasable area of the Third Party Tenant Lease Portfolio represented just 2.3% to the total gross leasable area of the REIT's entire real estate portfolio immediately following the closing of its IPO.

Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Exemption Sought is granted.

"Sonny Randhawa"
Manager, Corporate Finance
Ontario Securities Commission

2.1.6 Bell Canada

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – Filer granted exemptions from the prospectus requirement in connection with trades of commercial paper/short term debt instruments of the Filer that may not meet the “approved credit rating” requirement contained in the short-term debt exemption in section 2.35 of National Instrument 45-106 Prospectus and Registration Exemptions - Sufficient for commercial paper/short-term debt instruments to obtain only one credit rating at or above a prescribed standard from an approved credit rating agency - Relief granted subject to conditions.

Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25, 53, 74(1).
National Instrument 45-106 Prospectus and Registration Exemptions.

TRANSLATION

November 26, 2013

**IN THE MATTER OF
THE SECURITIES LEGISLATION OF
QUÉBEC AND ONTARIO**

(the "Jurisdictions")

AND

**IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS**

AND

**IN THE MATTER OF
BELL CANADA
(the "Filer")**

DECISION

Background

The securities regulatory authority or regulator in each of the Jurisdictions (the "**Decision Maker**") has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the "**Legislation**") that trades of negotiable promissory notes or commercial paper maturing not more than one year from the date of issue of the Filer be exempt from the prospectus requirement of the Legislation (the "**Exemption Sought**").

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a dual application):

(a) the Autorité des marchés financiers is the principal regulator for this application;

(b) the Filer has provided notice that section 4.7(1) of *Regulation 11-102 respecting Passport System* ("**Regulation 11-102**") is intended to be relied upon in British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Northwest Territories, Yukon and Nunavut (collectively the "**Passport Jurisdictions**"); and

(c) the decision is the decision of the principal regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

Interpretation

Terms defined in *Regulation 14-101 respecting Definitions* and Regulation 11-102 have the same meanings if used in this decision, unless otherwise defined.

In this decision:

> **"Asset-backed Short-term Debt"**: short-term debt that is backed, secured or serviced by or from, a discrete pool of mortgages, receivables or other financial assets or interests designed to ensure the servicing or timely distribution of proceeds to holders of that short-term debt;
>
> **"Regulation 45-106"**: *Regulation 45-106 respecting Prospectus and Registration Exemptions*; and
>
> **"Regulation 81-102"**: *Regulation 81-102 respecting Mutual Funds*.

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer is a corporation governed by the *Canada Business Corporations Act* with its principal business place located in Verdun, Québec.

2. The Filer is a reporting issuer in all of the provinces of Canada and is not in default of the securities legislation of the Jurisdictions or Passport Jurisdictions.

3. A trade in short-term debt is exempt from the prospectus requirement pursuant to section 2.35 of Regulation 45-106 only where short-term debt has a designated rating from a designated rating organization or its DRO affiliate. The terms "designated rating", "designated rating organization" and "DRO affiliate" used in Regulation 45-106 have the same meaning as in Regulation 81-102.

4. For short-term debt to satisfy the definition of designated rating in Regulation 81-102, that short-term debt (a) must have a rating at or above one of the rating categories set out in that definition issued by a "designated rating organization" or its "DRO affiliate" for that short-term debt, and (b) must not have a rating below one of the rating categories set out in that definition issued by a "designated rating organization" or any of its "DRO affiliates" for that short-term debt.

5. The negotiable promissory notes or commercial paper of the Filer have a "R-1 (low)" rating from DBRS Limited, which rating meets the prescribed threshold in the definition of "designated rating" in Regulation 81-102. However, the negotiable promissory notes or commercial paper of the Filer do not meet the other prescribed thresholds in the definition of "designated rating" in Regulation 81-102 because they have a "P-2" rating from Moody's Canada Inc. and a "A-2" rating from Standard & Poor's Ratings Services (Canada), which ratings are lower than the ratings prescribed by the definition of designated rating in Regulation 81-102.

6. The Filer has been granted relief similar in nature to the Exemption Sought under a decision document of the Decision Makers dated June 16, 2009 which terminated on June 30, 2012.

Decision

Each of the Decision Makers is satisfied that the decision meets the test set out in the Legislation for the Decision Maker to make the decision.

The decision of the Decision Makers under the Legislation is that the Exemption Sought is granted provided that:

1. the negotiable promissory notes or commercial paper of the Filer:

    (a) mature not more than one year from the date of issue;

    (b) are not convertible or exchangeable into or accompanied by a right to purchase another security other than negotiable promissory notes or commercial paper of the Filer;

    (c) are not Asset-backed Short-term Debt; and

    (d) have a rating issued by one of the following rating organizations, or any of their successors, at or above one of the following rating categories or a rating that replaces a category listed below:

Designated Rating Organization	Rating
DBRS Limited	R-1 (low)
Fitch, Inc.	F2
Moody's Canada Inc.	P-2
Standard & Poor's Ratings Services (Canada)	A-2

2. each trade by the Filer of negotiable promissory notes or commercial paper of the Filer to a resident in a Jurisdiction or Passport Jurisdiction in reliance on this decision is made:

   (a) through an agent who is a registered dealer, registered in a category that permits the trade;

   (b) through a bank listed in Schedules I, II or III to the Bank Act (Canada) trading in reliance on an exemption from the registration requirement available in the circumstances in the Jurisdictions and Passport Jurisdictions in which the trade occurs; or

   (c) through a dealer permitted to rely on the exemption from the dealer registration requirement for international dealers in section 8.18 of *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*; and

3. for each Jurisdiction and Passport Jurisdiction, the Exemption Sought will terminate on the earlier of:

   (a) 90 days after the coming into force of any rule, other regulation or blanket order or ruling under the securities legislation of that jurisdiction that amends the conditions of the prospectus exemption contained in section 2.35 of Regulation 45-106 or provides an alternate exemption; and

   (b) October 30, 2018.

"Gilles Leclerc"
Superintendant, Securities Markets

2.1.7 Hillsdale Investment Management Inc.

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – relief granted from to permit filer to trade portfolio securities between managed accounts and pooled funds, or between pooled funds, for which the filer acts as portfolio manager – relief sought to permit pooled funds and managed accounts to engage in in specie transfers of portfolio assets as payment for purchase or redemption of pooled funds units by the managed account or pooled fund – relief subject to certain conditions, including explicit consent of managed account clients to allow in specie transfers, acceptability of portfolio securities to receiving fund or managed account manager, filer to keep written records of in-specie transactions, and conditions related to pricing.

Applicable Legislative Provisions

National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, ss. 13.5(2)(b)(ii) and (iii), 15.1.

December 9, 2013

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(the Jurisdiction)

AND

IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF
HILLSDALE INVESTMENT MANAGEMENT INC.
(the Filer)

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filer for a decision under the securities legislation of the Jurisdiction of the principal regulator (the Legislation) granting an exemption from the prohibitions in paragraphs 13.5(2)(b)(ii) and (iii) of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) that prohibit a registered adviser from knowingly causing an investment portfolio managed by it, including an investment fund for which it acts as an adviser, from purchasing or selling a security from or to the investment portfolio of (i) an associate of a responsible person, or (ii) an investment fund for which a responsible person acts as an adviser, in order to permit in specie subscriptions and redemptions between:

(i) a Managed Account (defined below) and a Pooled Fund (defined below); and

(ii) a Pooled Fund and another Pooled Fund.

(the **Exemption Sought**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions:

(a) the Ontario Securities Commission is the principal regulator for the Application; and

(b) the Filer has provided notice that section 4.7(1) of Multilateral Instrument 11-102 – *Passport System* (**MI 11-102**) is intended to be relied upon in Saskatchewan, Manitoba, Quebec and New Brunswick (together with the Jurisdiction, the **Jurisdictions**).

Interpretation

Terms defined in MI 11-102, National Instrument 14-101 – *Definitions*, National Instrument 81-102 *Mutual Funds* (**NI 81-102**) National Instrument 81-107 – *Independent Review Committee for Investment Funds* (**NI 81-107**) and NI 31-103 have the same meanings if used in this Decision, unless otherwise defined. The following terms have the following meanings:

(a) **Client** refers to a person or company that has retained the Filer to provide Managed Account services.

(b) **In Specie Transfers** has the meaning set forth in paragraph 12 below.

(c) **Investment Management Agreement** means the agreement by which a Client formally retains the Filer to provide Managed Account services.

(d) **Managed Account** means an investment account over which the Filer has been granted discretionary authority by the Client to make investment decisions including executing trades.

(e) **Pooled Fund** means a current or future investment fund whose securities are distributed pursuant to a prospectus exemption and for which the Filer acts as investment fund manager and portfolio manager.

(f) **Pooled Fund Securities** means the units or shares issued by a Pooled Fund, as applicable.

Representations

This Decision is based on the following facts represented by the Filer.

The Filer

1. The Filer is a corporation incorporated under the laws of Ontario, with its registered head office located in Toronto, Ontario.

2. The Filer is registered in each of the Jurisdictions in the category of portfolio manager, in the Principal Jurisdiction and in Saskatchewan, Quebec and New Brunswick in the category of exempt market dealer and in the Principal Jurisdiction and in Quebec in the category of investment fund manager.

3. The Filer is not in default of the securities legislation in any of the Jurisdictions.

The Managed Accounts

4. The Filer is, or will be, the portfolio manager of each of the Managed Accounts.

5. Each Client who wishes to receive the Managed Account service from the Filer executes an Investment Management Agreement with the Filer whereby such Client appoints the Filer to act as a portfolio manager in connection with an investment portfolio of the Client with full discretionary authority to trade in securities for the Managed Account without obtaining the specific consent of the Client to execute a trade, including the authorization to invest the Managed Accounts in the Pooled Funds and to switch Pooled Funds as determined by the Filer in accordance with the investment objectives of the Managed Account.

6. The Filer only offers Managed Account services to Clients that are “accredited investors” as that term is defined in securities legislation.

The Pooled Funds

7. Each Pooled Fund is, or will be, an investment fund that is a trust, a corporation or a limited partnership that is established under the laws of Ontario, Canada.

8. The Filer acts, or will act, as the investment fund manager and portfolio manager of the Pooled Funds. The Filer will also act as the trustee of any Pooled Funds that are organized as a trust, which will cause such Pooled Funds to be “associates” of the Filer, as that term is defined in securities legislation.

9. The Pooled Fund Securities are, or will be, distributed on a private placement basis pursuant to the Legislation and the Pooled Funds are not (or will not be) reporting issuers.

10. The Pooled Funds are not in default of securities legislation in any of the Jurisdictions.

In Specie Transfers

11. The Filer, as registered portfolio manager of the Managed Accounts and the Pooled Funds, is a “responsible person” as that term is defined in NI 31-103.

12. The Filer may wish to or be required to (i) cause a Managed Account to deliver securities to a Pooled Fund in respect of the purchase of Pooled Fund Securities, or to receive securities from the investment portfolio of a Pooled Fund in respect of the redemption of Pooled Fund Securities by a Managed Account, or (ii) cause a Pooled Fund to deliver securities from its investment portfolio to another Pooled Fund in respect of the purchase or redemption of Pooled Fund Securities (**In Specie Transfers**).

13. Since the Filer is the portfolio manager of the Managed Accounts and the Pooled Funds, and because the Pooled Funds that are organized as trusts are considered to be associates of the Filer, absent the Exemption Sought, the Prohibition would preclude the Filer from effecting In Specie Transfers (i) between a Managed Account and a Pooled Fund and (ii) between Pooled Funds.

14. In Specie Transfers will be carried out in accordance with the Filer's written policies and procedures, which will be consistent with applicable securities legislation.

15. The Filer’s Chief Compliance Officer will pre-approve each In Specie Transfer with respect to the purchase or redemption Pooled Fund Securities by another Pooled Fund or by a Managed Account.

16. Each Investment Management Agreement or other documentation in respect of a Managed Account will contain the specific written authorization of the Client for the Filer to engage in In Specie Transfers.

17. The portfolio securities transferred to a Pooled Fund or Managed Account in respect of an In Specie Transfer will be consistent with the investment objectives of the Pooled Fund or Managed Account, as the case may be, and will be acceptable to such Pooled Fund or Managed Account’s portfolio manager.

18. The only cost which will be incurred by a Pooled Fund or a Managed Account for an In Specie Transfer is a nominal administrative charge levied by the Pooled Fund’s custodian for recording the delivery of securities in connection with the In Specie Transfers.

19. Each Pooled Fund will keep written records of each In Specie Transfer in a financial year of the Pooled Fund, reflecting details of the portfolio securities delivered to the Pooled Fund and the value assigned to such portfolio securities, in accordance with the form, accessibility and retention of record requirements as prescribed by section 11.6 of NI 31-103.

20. The Pooled Funds generally invest in liquid securities. The Filer will not cause any Pooled Fund to engage in an In Specie Transfer if illiquid securities represent more than an immaterial portion of the portfolio of the applicable Pooled Fund or Managed Account.

21. The valuation of any illiquid securities which would be the subject of an In Specie Transfer will be carried out according to the Filer's policies and procedures for the fair valuation of portfolio securities, including illiquid securities (**FV Procedures**). The Filer’s internal valuation team monitors and determines fair value according to the applicable FV Procedures. The Filer’s Chief Compliance Officer will review and approve the valuation of any illiquid securities. Any valuation of private securities, including illiquid securities, is subject to review by the Pooled Funds' auditors. If any illiquid securities are the subject of an In Specie Transfer, the illiquid securities will be transferred on a pro rata basis.

22. The Filer considers that In Specie Transfers will be beneficial to the Pooled Funds and the Managed Accounts by enabling the Filer to manage each asset class more effectively and to reduce the transaction costs to the Managed Accounts and the Pooled Funds, for the acquisition and disposition of portfolio securities. For example, In Specie Transfers reduce market impact costs, which can be detrimental to the Clients and/or Pooled Funds. In Specie Transfers will also allow a portfolio manager to retain within its control institutional-size blocks of portfolio securities that would otherwise need to be broken and re-assembled.

Decision

The principal regulator is satisfied that the Decision meets the test set out in the Legislation for the principal regulator to make the Decision.

The Decision of the principal regulator is that the Exemption Sought is granted on the following conditions:

(a) if the transaction is the purchase of Pooled Fund Securities by a Managed Account:

(i) the Investment Management Agreement or other documentation in respect of the Managed Account contains the authorization of the Client for the Filer to engage in In Specie Transfers and such consent has not been revoked;

(ii) the Pooled Fund would, at the time of payment, be permitted to purchase the portfolio securities of the Managed Account;

(iii) the portfolio securities are acceptable to the Filer as portfolio manager of the Pooled Fund and are consistent with the investment objectives of the Pooled Fund;

(iv) the value of the portfolio securities sold to the Pooled Fund is equal to the issue price of the Pooled Fund Securities for which they are used as payment, valued as if the portfolio securities were portfolio assets of that Pooled Fund;

(v) the next account statement prepared for the Managed Account will include a note describing the portfolio securities delivered to the Pooled Fund and the value assigned to such portfolio securities; and

(vi) the Pooled Fund will keep written records of each In Specie Transfer in a financial year of the Pooled Fund, reflecting details of the portfolio securities delivered to the Pooled Fund and the value assigned to such portfolio securities, in accordance with the form, accessibility and retention of record requirements as prescribed by section 11.6 of NI 31-103;

(b) if the transaction is the redemption Pooled Fund Securities by a Managed Account:

(i) the Investment Management Agreement or other documentation in respect of the Managed Account contains the authorization of the Client for the Filer to engage in In Specie Transfers and such authorization has not been revoked;

(ii) the Filer, as the portfolio manager of the Manager Account, determines that the portfolio securities meet the investment criteria of the Managed Account acquiring the portfolio securities;

(iii) the value of the portfolio securities is equal to the amount at which those portfolio securities were valued by the Pooled Fund in calculating the net asset value per Pooled Fund Securities used to establish the redemption price;

(iv) the next account statement prepared for the Managed Account will include a note describing the portfolio securities received from the Pooled Fund and the value assigned to such portfolio securities; and

(v) the Pooled Fund will keep written records of each In Specie Transfer in a financial year of the Pooled Fund, reflecting details of the securities delivered by the Pooled Fund and the value assigned to such securities, in accordance with the form, accessibility and retention of record requirements as prescribed by section 11.6 of NI 31-103;

(c) if the transaction is the purchase of Pooled Fund Securities by another Pooled Fund:

(i) the Pooled Fund issuing the Pooled Fund Securities would, at the time of payment, be permitted to purchase the portfolio securities of the other Pooled Fund;

(ii) the portfolio securities are acceptable to the Filer as portfolio manager of the Pooled Fund acquiring the portfolio securities and are consistent with the investment objectives of that Pooled Fund;

(iii) the value of the portfolio securities is equal to the issue price of the Pooled Fund Securities of the Pooled Fund issuing the Pooled Fund Securities for which they are used as payment, valued as if the portfolio securities were portfolio assets of that Pooled Fund; and

(iv) each Pooled Fund will keep written records of each In Specie Transfer in a financial year of the Pooled Fund, reflecting details of the securities delivered to the Pooled Fund and the value assigned to such portfolio securities, in accordance with the form, accessibility and retention of record requirements as prescribed by section 11.6 of NI 31-103.

(d) if the transaction is the redemption of Pooled Fund Securities by another Pooled Fund:

(i) the Pooled Fund redeeming the Pooled Fund Securities would, at the time of payment, be permitted to purchase the portfolio securities of the other Pooled Fund;

(ii) the portfolio securities are acceptable to the Filer as portfolio manager of the Pooled Fund acquiring the portfolio securities and are consistent with the investment objectives of that Pooled Fund;

(iii) the value of the portfolio securities is equal to the amount at which those portfolio securities were valued by the Pooled Fund in calculating the net asset value per Pooled Fund Security used to establish the redemption price;

(iv) each Pooled Fund will keep written records of each In Specie Transfer in a financial year of the Pooled Fund, reflecting details of the securities delivered to the Pooled Fund and the value assigned to such portfolio securities, in accordance with the form, accessibility and retention of record requirements as prescribed by section 11.6 of NI 31-103 ; and

(e) the Filer does not receive any compensation in respect of any In Specie Transfer and, in respect of any delivery of securities further to an In Specie Transfer, the only charges paid by the applicable Pooled Fund or Managed Account are administrative charges for recording the delivery of securities levied by the custodians of the Pooled Funds and Managed Accounts.

"Vera Nunes"
Manager, Investment Funds Branch
Ontario Securities Commission

2.1.8 Redwood Asset Management Inc. et al.

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – Approval granted for change of manager of a mutual fund — change of manager is not detrimental to unitholders or contrary to the public interest.

Applicable Legislative Provisions

National Instrument 81-102 Mutual Funds, ss. 5.5(1)(a), 5.5(3), 5.7.

December 12, 2013

**IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(the Jurisdiction)**

AND

**IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS
IN MULTIPLE JURISDICTIONS**

AND

**IN THE MATTER OF
REDWOOD ASSET MANAGEMENT INC. (Redwood)**

AND

**ASTON HILL ASSET MANAGEMENT INC. (Aston Hill)
(together, the Filers)**

AND

**REDWOOD ENERGY GROWTH CLASS
(the Fund)**

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filers for a decision under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**) for approval of the proposed change of manager of the Fund from Redwood to Aston Hill (the **Change of Manager**) under section 5.5(1)(a) of National Instrument 81-102 *Mutual Funds* (**NI 81-102**) (the **Approval Sought**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

(a) the Ontario Securities Commission is the principal regulator for this application, and

(b) the Filers have provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System* (**MI 11-102**) is intended to be relied upon in all of the provinces of Canada.

Interpretation

Terms defined in the Legislation, MI 11-102, National Instrument 14-101 – *Definitions*, NI 81-102 or National Instrument 81-107 – *Independent Review Committee for Investment Funds* (**NI 81-107**) have the same meanings if used in this decision, unless otherwise defined.

Representations

This decision is based on the following facts represented by the Filers:

Redwood and the Fund

1. Redwood is currently the manager of the Fund pursuant to a management agreement originally made as of October 30, 2008 (the **Management Agreement**).

2. Redwood is a corporation incorporated under the *Business Corporations Act* (Ontario) (**OBCA**) with its head office in Toronto, Ontario and is not in default of any requirements of applicable securities legislation.

3. The Fund is a class of mutual fund shares of Ark Resource Corp. (**Ark Corp.**), a corporation formed under the *Business Corporations Act* (Ontario) by articles of incorporation dated October 30, 2008.

4. The Fund is a reporting issuer in all of the provinces of Canada and is not in default of any requirements of applicable securities legislation.

5. The securities of the Fund are currently offered under a simplified prospectus and annual information form each dated November 27, 2013.

6. The Fund is subject to, among other laws and regulations, NI 81-102, National Instrument 81-106 *Investment Fund Continuous Disclosure* and NI 81-107.

Aston Hill

7. Aston Hill was formed under the laws of the Province of Ontario pursuant to articles of amalgamation dated December 30, 2011.

8. Aston Hill is currently registered in Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario and Quebec under the applicable legislation as an exempt market dealer and portfolio manager. Aston Hill is also registered in Newfoundland and Labrador, Ontario and Quebec under the applicable legislation as an investment fund manager.

9. Aston Hill is not in default of securities legislation in any jurisdiction of Canada.

10. Aston Hill is the manager of the Aston Hill Mutual Funds, a family of mutual funds currently offered by way of a combined simplified prospectus and amended and restated simplified prospectus (the **Aston Hill Prospectus**) and a combined annual information form and amended and restated annual information form (the **Aston Hill AIF**), each dated May 30, 2013.

The Change of Manager

11. Redwood and Aston Hill entered into a purchase agreement on November 6, 2013 (the **Purchase Agreement**) pursuant to which Redwood has agreed to sell, assign and transfer all its right, title and interest in and to the Management Agreement to Aston Hill.

12. As a result, effective on or about January 1, 2014 (the **Effective Date**), and subject to receipt of all necessary regulatory and shareholder approvals and the satisfaction of all other required conditions precedent set out in the Purchase Agreement, Aston Hill will become the manager of the Fund (the **Proposed Transaction**).

13. In accordance with the provisions of NI 81-107, Redwood referred the Proposed Transaction to the independent review committee of the Fund (the **IRC**) for its review. On November 13, 2013, the IRC advised Redwood that, after reasonable inquiry, the Proposed Transaction achieves a fair and reasonable result for the Fund.

14. On the Effective Date, the name of the Fund is expected to be changed by Aston Hill to "**AH Energy Growth Class**". Also on the Effective Date, by operation of section 3.10(1)(b) of NI 81-107, the members of the IRC will cease to be members of the IRC. The IRC will therefore be reconstituted such that new members will be appointed effective on that date. Such new members will be the same individuals that currently comprise the independent review committee of the other mutual funds managed by Aston Hill.

15. Redwood will have no further responsibilities in respect of the Fund after the Effective Date. Redwood will continue to act as manager for certain other open-end funds that are not relevant to the Proposed Transaction.

16. A press release in connection with the announcement of the change of manager was issued and disseminated on November 6, 2013. Amendments to the simplified prospectus, annual information form and fund facts of the Fund and a material change report were filed in connection with the announcement of the change of manager on November 15, 2013 and under SEDAR Project Nos. 1969989 and 2133694.

17. Redwood considers that the experience and integrity of each of the members of the Aston Hill current management team is apparent by their education and years of experience in the investment industry.

18. While the Fund's name will change, Aston Hill intends to manage and administer the Fund in a similar manner as Redwood. There is therefore no intention to change the investment objectives, strategies or fees and expenses of the Fund. The portfolio manager of the Fund is, and will continue to be after the Change of Manager, Aston Hill. All material agreements regarding the administration of the Fund will either be assigned to Aston Hill or Aston Hill will enter into new agreements as required.

19. Securityholders of the Fund will be asked to approve the change of manager at a special meeting to be held on December 13, 2013, as such special meeting may be postponed or adjourned (the **Special Meeting**). A notice of meeting and a management information circular (the **Circular**) was mailed to securityholders of the Fund on November 20, 2013 and filed on SEDAR in accordance with applicable securities legislation. The Circular contains: (a) sufficient information regarding the business, management and operations of Aston Hill, including details of the funds it manages and its officers and board of directors; and (b) all information necessary to allow securityholders to make an informed decision about the change of manager and to vote on the change of manager. All other information and documents necessary to comply with the applicable proxy solicitation requirements of securities legislation for the Special Meeting have been mailed to securityholders of the Fund.

20. The resignation of Redwood as manager of the Fund will be effective on the Effective Date. On that date, Aston Hill will assume the role of manager of the Fund under the Management Agreement.

Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Approval Sought is granted provided that Redwood obtains the prior approval of the securityholders of the Fund of the change of manager at the Special Meeting.

"Vera Nunes"
Manager, Investment Funds
Ontario Securities Commission

2.2 Orders

2.2.1 Ernst & Young LLP (Audits of Zungui Haixi Corporation) – ss. 127, 127.1

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED**

AND

**IN THE MATTER OF
ERNST & YOUNG LLP
(AUDITS OF ZUNGUI HAIXI CORPORATION)**

**ORDER
(Sections 127 and 127.1)**

WHEREAS on June 24, 2013 the Ontario Securities Commission (the "**Commission**") issued a Notice of Hearing in relation to a Statement of Allegations filed by Staff of the Commission ("**Staff**") pursuant to section 127 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "**Act**") with respect to Ernst & Young LLP (the "**Respondent**");

AND WHEREAS the Notice of Hearing stated that an initial hearing before the Commission would be held on July 15, 2013;

AND WHEREAS the Commission convened a hearing on July 15, 2013 and the matter was adjourned to a confidential pre-hearing conference to be held on September 30, 2013;

AND WHEREAS a confidential pre-hearing conference was held on September 30, 2013 and counsel for Staff and counsel for the Respondent both made submissions regarding the scheduling of the hearing on the merits (the "**Merits Hearing**");

AND WHEREAS on September 30, 2013, the Commission ordered that the Merits Hearing shall commence on May 1, 2015 and continue as directed by Order of the Commission, and also ordered that a further confidential pre-hearing conference shall be held on December 11, 2013 at 11:00 am.

AND WHEREAS all parties consent to adjourn the confidential pre-hearing conference of December 11, 2013 to February 13, 2014, at 10:00 a.m.;

AND WHEREAS the Commission is of the view that it is in the public interest to make this order;

IT IS HEREBY ORDERED THAT the confidential pre-hearing conference scheduled for December 11, 2013 is adjourned to February 13, 2014, at 10:00 a.m., or such other date as is agreed to by the parties and set by the Office of the Secretary.

DATED at Toronto this 10th day of December, 2013.

"Mary G. Condon"

2.2.2 Bradon Technologies Ltd. et al. – s. 127

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED**

AND

**IN THE MATTER OF
BRADON TECHNOLOGIES LTD., JOSEPH COMPTA,
ENSIGN CORPORATE COMMUNICATIONS INC.
and TIMOTHY GERMAN**

**ORDER
(Section 127)**

WHEREAS on October 3, 2013, the Commission issued a Notice of Hearing pursuant to sections 127 and 127.1 of the Act accompanied by a Statement of Allegations dated October 3, 2013, issued by Staff of the Commission ("Staff") with respect to Bradon Technologies Ltd. ("Bradon"), Joseph Compta ("Compta"), Ensign Corporate Communications Inc. ("Ensign") and Timothy German ("German") (collectively, the "Respondents");

AND WHEREAS on October 29, 2013, Staff appeared and made submissions, Compta appeared on behalf of himself and Bradon and made submissions and German appeared on behalf of himself and Ensign;

AND WHEREAS on October 29, 2013, the Commission ordered that the hearing be adjourned and that the hearing would continue on December 9, 2013, after disclosure had been provided to the Respondents, to set a date for a confidential pre-hearing conference;

AND WHEREAS Staff provided disclosure to the Respondents on November 19, 2013;

AND WHEREAS on December 9, 2013, Staff appeared and made submissions, German appeared on behalf of himself and Ensign and confirmed that he had retained counsel to represent them in this proceeding, and counsel on behalf of Compta and Bradon appeared and made submissions;

AND WHEREAS Staff requested that a confidential pre-hearing conference be scheduled;

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this Order;

IT IS HEREBY ORDERED that a confidential pre-hearing conference shall take place on March 12, 2014 at 10:00 a.m. or on such other date or at such other time as set by the Office of the Secretary and agreed to by the parties.

DATED at Toronto this 9th day of December, 2013.

"James E. A. Turner"

2.2.3 David M. O'Brien – s. 9(1) of the SPPA and Rules 8.1, 5.2(1) of the OSC Rules of Procedure

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
DAVID M. O'BRIEN

ORDER
(Subsection 9(1) of the Statutory Powers Procedure Act, R.S.O. 1990, c. S.22, as amended
and Rule 8.1 and subrule 5.2(1) of the Commission's Rules of Procedure (2012), 35 O.S.C.B. 10071)

WHEREAS on December 8, 2010, the Secretary of the Ontario Securities Commission (the "Commission") issued a Notice of Hearing, pursuant to sections 37, 127 and 127.1 of the Ontario *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act"), for a hearing to commence at the offices of the Commission on December 20, 2010 at 10:30 a.m., or as soon thereafter as the hearing could be held;

AND WHEREAS on December 9, 2010, the Respondent David O'Brien ("O'Brien") was served with the Notice of Hearing and Statement of Allegations dated December 7, 2010;

AND WHEREAS the Notice of Hearing provided for the Commission to consider, among other things, whether, in the opinion of the Commission, it is in the public interest, pursuant to section 127 of the Act, to issue temporary orders against O'Brien, as follows:

(a) O'Brien shall cease trading in any securities for a prescribed period or until the conclusion of the hearing on the merits in this matter;

(b) O'Brien is prohibited from acquiring securities for a prescribed period or until the conclusion of the hearing on the merits in this matter; and

(c) Any exemptions contained in Ontario securities law do not apply to O'Brien for a prescribed period or until the conclusion of the hearing on the merits in this matter;

AND WHEREAS on December 20, 2010, Staff of the Commission ("Staff") and O'Brien appeared before the Commission and made submissions and O'Brien advised the Commission that he was opposed to Staff's request that temporary orders be issued against him and that he wished to cross-examine Lori Toledano, a member of Staff, on her affidavit;

AND WHEREAS on December 20, 2010, the hearing with respect to the issuance of the temporary orders was adjourned until December 23, 2010 at 12:30 p.m.;

AND WHEREAS on December 23, 2010, a hearing with respect to the issuance of the temporary orders was held and the panel of the Commission considered the affidavit of Toledano, the cross-examination of Toledano and the submissions made by Staff and O'Brien;

AND WHEREAS on December 23, 2010, the Commission issued a temporary cease trade order pursuant to section 127 of the Act ordering that:

(a) O'Brien shall cease trading in securities;

(b) O'Brien is prohibited from acquiring securities; and

(c) Any exemptions contained in Ontario securities law do not apply to O'Brien (the "Temporary Cease Trade Order");

AND WHEREAS on December 23, 2010, the Commission ordered that the Temporary Cease Trade Order shall expire on April 1, 2011;

AND WHEREAS on December 23, 2010, the Commission ordered that Staff and O'Brien shall consult with the Office of the Secretary and schedule a confidential pre-hearing conference for this matter;

AND WHEREAS a confidential pre-hearing conference was scheduled for February 24, 2011;

AND WHEREAS at the confidential pre-hearing conference on February 24, 2011, Staff and O'Brien appeared and made submissions regarding the disclosure made by Staff, and Staff requested an extension of the Temporary Cease Trade Order;

AND WHEREAS on February 24, 2011, the Commission ordered that:

a) a hearing to extend the Temporary Cease Trade Order shall take place on March 30, 2011 at 11:30 a.m.;

b) a motion regarding disclosure shall take place on April 21, 2011 at 10:00 a.m., and in accordance with rule 3.2 of the Commission *Rules of Procedure* (2010), 33 OSCB 8017 (the "*Rules of Procedure*"), O'Brien shall serve and file a motion record, including any affidavits to be relied upon, by April 11, 2011 at 4:30 p.m.; and

c) a further confidential pre-hearing conference shall take place on May 30, 2011 at 10:00 a.m.;

AND WHEREAS on March 30, 2011, a hearing with respect to the extension of the Temporary Cease Trade Order was held, and the panel of the Commission considered the evidence filed and the submissions made by Staff and O'Brien;

AND WHEREAS on March 30, 2011, the Commission ordered that:

a) the Temporary Cease Trade Order shall be extended to April 26, 2011; and

b) a further hearing to extend the Temporary Cease Trade Order shall take place on April 21, 2011 at 10:00 a.m.;

AND WHEREAS on April 21, 2011, a hearing with respect to the extension of the Temporary Cease Trade Order was held, and the panel of the Commission considered the evidence filed and the submissions made by Staff and O'Brien;

AND WHEREAS on April 21, 2011, the Commission ordered that:

a) the Temporary Cease Trade Order shall be extended until the conclusion of the hearing of the merits of this matter; and

b) O'Brien may, if he wishes to do so, apply to the Commission for an order revoking or varying this Order pursuant to section 144 of the Act;

AND WHEREAS also on April 21, 2011, O'Brien brought a motion regarding disclosure, wherein he sought an order from the Commission requiring Staff to provide him with all additional disclosure materials without requiring him to execute a further undertaking, and the panel of the Commission considered the evidence filed and the submissions made by Staff and O'Brien;

AND WHEREAS on April 21, 2011, the Commission ordered that Staff shall provide further disclosure materials to O'Brien without requiring the signing by him of an undertaking as to the confidentiality of that disclosure. The Commission further ordered that:

1) all disclosure materials provided to O'Brien are confidential and may be used by him only for the purpose of making full answer and defence in this proceeding. The use of disclosure materials for any other purpose is strictly prohibited. All disclosure materials provided to O'Brien are subject to the strict confidentiality restrictions imposed by section 16 of the Act;

2) O'Brien is also subject to the implied undertaking that all disclosure materials provided to him are subject to the restrictions on use referred to in paragraph (1);

3) the Previous Undertaking signed by O'Brien is binding upon him and applies by its terms to all of the disclosure materials provided by Staff to O'Brien, including all disclosure materials provided by Staff to O'Brien in the future; if O'Brien wishes to challenge the validity of the Previous Undertaking he is entitled to bring a motion before the Commission to do so; and

4) if O'Brien wishes to use the disclosure materials provided by Staff to him for any purpose other than as provided in paragraph (1), he must make an application to the Commission under section 17 of the Act for an order of the Commission consenting to that use;

AND WHEREAS at the confidential pre-hearing conference on May 30, 2011, Staff and O'Brien appeared and Staff sought to set dates for a hearing on the merits, while O'Brien advised the Commission that he was opposed to Staff's request. The Commission adjourned the hearing to June 20, 2011 at 10:00 a.m., for the purpose of setting the dates for the hearing on the merits;

AND WHEREAS at the confidential pre-hearing conference on June 20, 2011, Staff and O'Brien appeared and scheduling of the hearing on the merits was discussed and the Commission ordered that:

1. the hearing on the merits is to commence on March 12, 2012 at 10:00 a.m. at the offices of the Commission, and shall continue on March 14, 15, 16, 19, 20, 21, 22, 23, 26, and 28, 2012, or such further or other dates as may be agreed upon by the parties and fixed by the Office of the Secretary; and

2. a further confidential pre-hearing conference shall take place on January 11, 2012 at 10:00 a.m.;

AND WHEREAS at the confidential pre-hearing conference on January 11, 2012, Staff appeared and Counsel on behalf of O'Brien appeared, who advised the Commission that he had just been appointed to represent O'Brien in this matter;

AND WHEREAS Counsel for O'Brien requested that the pre-hearing conference be continued in a few weeks time to permit him to address certain matters that had just been brought to his attention. The Commission ordered that a further confidential pre-hearing conference take place on January 31, 2012 at 3:30 p.m.;

AND WHEREAS at the confidential pre-hearing conference on January 31, 2012, Staff and Counsel for O'Brien appeared and Counsel for O'Brien requested an adjournment of the hearing on the merits to permit interim issues to be raised before the Commission. Counsel for O'Brien also requested that the records from both the January 11 and 31, 2012 confidential pre-hearing conferences be sealed and treated as confidential. The Commission ordered that the hearing dates of March 12, 14, 15, 16, 19, 20, 21, 22, 23, 26 and 28, 2012 be vacated, a further confidential pre-hearing conference take place on March 12, 2012 at 10:00 a.m., and that the records from both the January 11 and 31, 2012 confidential pre-hearing conferences be sealed and treated as confidential pursuant to subsection 9(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended (the "SPPA") and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on March 12, 2012, Staff and Counsel for O'Brien appeared and Counsel for O'Brien requested a confidential motion be scheduled to seek an adjournment of the hearing dates. The Commission ordered that a confidential motion take place on April 18, 2012 at 10:00 a.m., for which O'Brien shall serve and file a motion record, including any affidavits to be relied upon, by April 5, 2012 at 4:30 p.m., Staff shall serve and file any responding materials by April 12, 2012, O'Brien shall serve and file a factum by April 13, 2012, and Staff shall file its factum by April 16, 2012, and that the records from the March 12, 2012 confidential pre-hearing conference and from the April 18, 2012 confidential motion shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential motion on April 18, 2012, Staff and Counsel for O'Brien appeared and Counsel for O'Brien presented evidence and requested an adjournment of any hearing dates and that a further confidential pre-hearing conference be scheduled. Staff did not oppose the adjournment request and agreed to the scheduling of a further pre-hearing conference. The Commission ordered that a confidential pre-hearing conference shall take place on July 19, 2012 at 10:00 a.m., for which O'Brien shall deliver any materials relevant to the pre-hearing conference by July 9, 2012, and that the records from the July 19, 2012 confidential pre-hearing conference shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on July 19, 2012, Staff and Counsel for O'Brien appeared and presented evidence and requested that a further confidential pre-hearing conference be scheduled. The Commission ordered that a confidential pre-hearing conference shall take place on September 28, 2012 at 11:00 a.m., for which O'Brien shall deliver any materials relevant to the pre-hearing conference by September 18, 2012, and that the records from the September 28, 2012 confidential pre-hearing conference shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on September 28, 2012, Staff and Counsel for O'Brien appeared and presented evidence as contemplated at the earlier pre-hearing conference. Staff sought to set dates for a hearing on the merits, while counsel for O'Brien requested a further confidential pre-hearing conference before hearing dates are set. The Commission ordered that a confidential pre-hearing conference shall take place on October 25, 2012 at 3:00 p.m., for which O'Brien shall deliver any materials relevant to the pre-hearing conference by October 22, 2012, and that the records from the September 28, 2012 and October 25, 2012 confidential pre-hearing conferences shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on October 25, 2012, Staff and Counsel for O'Brien appeared and presented evidence and Staff did not object to Counsel for O'Brien requesting a further confidential pre-hearing conference. The Commission ordered that a confidential pre-hearing conference shall take place on March 7, 2013 at 10:00 a.m., for which O'Brien shall deliver any materials relevant to the pre-hearing conference by March 1, 2013 and that the records from the October 25, 2012 and March 7, 2013 confidential pre-hearing conferences shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS Staff requested an adjournment until March 11, 2013 and Counsel for O'Brien confirmed his availability for March 11, 2013 as an alternate date for the pre-hearing conference. The Commission ordered that the pre-hearing date of March 7, 2013 is vacated, a confidential pre-hearing conference shall take place on March 11, 2013 at 11:00 a.m., and the records of the March 11, 2013 confidential pre-hearing conference shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*, (2012), 35 OSCB 10071;

AND WHEREAS at the confidential pre-hearing conference on March 11, 2013, Staff and Counsel for O'Brien appeared and presented evidence and requested that a further confidential pre-hearing conference be scheduled. The Commission ordered that a confidential pre-hearing conference shall take place on July 18, 2013 at 10:00 a.m., for which O'Brien shall deliver any materials relevant to the pre-hearing conference by July 8, 2013 and that the records from the March 11, 2013 and July 18, 2013 confidential pre-hearing conferences shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on July 18, 2013, Staff and Counsel for O'Brien appeared and made submissions and requested that a further confidential pre-hearing conference be scheduled. The Commission ordered that a confidential pre-hearing conference shall take place on September 30, 2013 at 10:00 a.m., for which O'Brien shall file and serve any materials on which he intends to rely at the pre-hearing conference by September 23, 2013, and that the records from the July 18, 2013 and September 30, 2013 confidential pre-hearing conferences shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on September 30, 2013, Staff and Counsel for O'Brien appeared and made submissions and requested that a further confidential pre-hearing conference be scheduled. The Commission ordered that a confidential pre-hearing conference shall take place on December 11, 2013 at 10:00 a.m., for which O'Brien shall file and serve any materials on which he intends to rely at the pre-hearing conference by December 2, 2013, and that the records from the September 30, 2013 and December 11, 2013 confidential pre-hearing conferences shall be sealed and treated as confidential pursuant to subsection 9(1) of the SPPA and rule 8.1 and subrule 5.2(1) of the *Rules of Procedure*;

AND WHEREAS at the confidential pre-hearing conference on December 11, 2013, Staff and Counsel for O'Brien appeared and made submissions and requested that a further confidential pre-hearing conference be scheduled;

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this order;

IT IS HEREBY ORDERED THAT:

1. a confidential pre-hearing conference shall take place on March 6, 2014 at 10:00 a.m.; and

2. O'Brien shall file and serve any materials on which he intends to rely at the pre-hearing conference by February 24, 2014.

DATED at Toronto this 11th day of December, 2013.

"James E. A. Turner"

2.2.4 North American Financial Group Inc. et al. – ss. 127, 127.1

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED**

AND

**IN THE MATTER OF
NORTH AMERICAN FINANCIAL GROUP INC.,
NORTH AMERICAN CAPITAL INC.,
ALEXANDER FLAVIO ARCONTI AND
LUIGINO ARCONTI**

**ORDER
(Sections 127 and 127.1 of the Securities Act)**

WHEREAS on December 28, 2011, the Ontario Securities Commission (the "**Commission**") issued a Notice of Hearing (the "**Notice of Hearing**"), pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "**Act**"), accompanied by a Statement of Allegations dated December 28, 2011 filed by Staff of the Commission ("**Staff**") with respect to North American Financial Group Inc., North American Capital Inc., Alexander Flavio Arconti and Luigino Arconti (collectively, the "**Respondents**");

AND WHEREAS a hearing on the merits in this matter was held before the Commission on April 29 and 30, May 1-3, 6, 8-10, 22 and 23 and September 11, 2013;

AND WHEREAS following the hearing on the merits, the Commission issued its Reasons and Decision with respect to the merits on December 11, 2013;

IT IS ORDERED that:

(a) Staff shall file and serve written submissions on sanctions and costs by February 14, 2014;

(b) the Respondents shall file and serve written submissions on sanctions and costs by March 7, 2014;

(c) Staff shall file and serve written reply submissions on sanctions and costs by March 14, 2014; and

(d) the hearing to determine sanctions and costs will be held at the offices of the Commission at 20 Queen Street West, Toronto, commencing on March 24, 2014 at 10:00 a.m.;

IT IS FURTHER ORDERED that, upon the failure of any party to attend at the time and place aforesaid, the hearing may proceed in the absence of that party, and such party is not entitled to any further notice of the proceeding.

DATED at Toronto this 11th day of December, 2013.

"James D. Carnwath"

2.2.5 Heritage Education Funds Inc.

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED**

AND

**IN THE MATTER OF
HERITAGE EDUCATION FUNDS INC.**

ORDER

WHEREAS on August 13, 2012, the Ontario Securities Commission (the "Commission") ordered pursuant to subsections 127(1) and (5) of the *Securities Act*, R.S.O. 1990, c. S.5 as amended (the "Act"), with the consent of Heritage Education Funds Inc. ("HEFI"), that the terms and conditions set out in Schedule "A" to the Commission order (the "Terms and Conditions") be imposed on HEFI (the "Temporary Order");

AND WHEREAS on August 21, 2012, the Commission extended the Temporary Order until November 23, 2012;

AND WHEREAS the Terms and Conditions required HEFI to retain a consultant (the "Consultant") to prepare and assist HEFI in implementing plans to strengthen their compliance systems, and to retain a monitor (the "Monitor") to review applications of New Clients and contact New Clients as defined and set out in the Terms and Conditions;

AND WHEREAS HEFI retained Deloitte & Touche LLP ("Deloitte") as its Monitor and its Consultant;

AND WHEREAS by Order dated October 10, 2012, the Commission clarified certain matters with respect to the Temporary Order;

AND WHEREAS by Order dated November 22, 2012, the Commission ordered that the Temporary Order be extended to December 21, 2012 and that the hearing be adjourned to December 20, 2012;

AND WHEREAS by Order dated December 20, 2012, the Commission amended certain of the Terms and Conditions and extended the Temporary Order to March 22, 2013;

AND WHEREAS by Order dated January 28, 2013, the Manager of the Compliance and Registrant Regulation Branch (the "OSC Manager") approved the compliance plan dated January 14, 2013 (the "Plan") submitted by the Consultant;

AND WHEREAS on March 21, 2013, the Commission ordered that the Temporary Order be extended to April 19, 2013;

AND WHEREAS on April 8, 2013, HEFI filed a motion with the Commission to vary the terms of the Temporary Order by, among other matters, suspending the on-going monitoring by the Monitor of HEFI's compliance with the Terms and Conditions (the "Motion");

AND WHEREAS on April 18, 2013, the Commission heard oral submissions from the parties and issued an Order which: (i) dismissed the Motion; (ii) extended the Temporary Order to May 31, 2013, or until such further order of the Commission; (iii) adjourned the hearing to May 27, 2013 at 11:00 a.m. for the purpose of providing the Commission with an update on the work completed by the Monitor and the Consultant; and (iv) provided that the Monitor, Staff and HEFI may seek further direction from the Commission, if necessary or desirable;

AND WHEREAS on May 23, 2013, the Commission issued an order on consent of the parties that: (i) the Temporary Order be extended to June 17, 2013, or until such further order of the Commission; (ii) the hearing be adjourned to June 14, 2013 at 10:00 a.m.; and (iii) the hearing date of May 27, 2013 be vacated;

AND WHEREAS by letter dated June 12, 2013, the Manager approved Compliance Support Services to replace Deloitte as Consultant subject to three conditions;

AND WHEREAS on June 14, 2013, the Commission ordered that: (i) the Temporary Order be extended to July 22, 2013; and (ii) the hearing be adjourned to July 18, 2013 at 10:00 a.m.;

AND WHEREAS on July 17, 2013, the Commission ordered that: (i) the Temporary Order be extended to September 9, 2013; (ii) the hearing be adjourned to September 6, 2013 at 10:00 a.m.; and (iii) the hearing date of July 18, 2013 at 10:00 a.m. be vacated;

AND WHEREAS on September 6, 2013, the Commission ordered that: (i) the role and activities of the Monitor and HEFI set out in paragraphs 5, 6, 7 and 8 of the Terms and Conditions, as amended by Commission order dated December 20, 2012, be suspended as of the start of business on September 16, 2013; (ii) the resumption of any future monitoring shall take place on the recommendation of the Consultant with the agreement of the OSC Manager and the parties may seek direction from the Commission; (iii) the Temporary Order be extended to October 22, 2013; and (iv) the hearing be adjourned to October 18, 2013 at 10:00 a.m;

AND WHEREAS on October 15, 2013, the Commission ordered that: (i) the hearing date of October 18, 2013 at 10:00 a.m. be vacated; (ii) the Temporary Order be extended to December 19, 2013 or until such further order of the Commission; and (iii) the hearing be adjourned to December 16, 2013 at 10:00 a.m.;

AND WHEREAS the parties consent to the terms of this Order;

AND WHEREAS the Commission considers that it is in the public interest to make this Order;

IT IS HEREBY ORDERED pursuant to section 127 of the Act that:

1. The hearing date of December 16, 2013 at 10:00 a.m. is vacated.

2. Paragraph 11 of the Terms and Conditions is deleted and replaced with:

   "11.1 The Consultant shall submit Progress Reports on a bimonthly basis, with the next such report to be submitted no later than February 3, 2014, until the Plan has been fully implemented."

3. Paragraph 12 of the Terms and Conditions is deleted and replaced with:

   "12.1 HEFI is permitted to open new branches provided the Consultant has provided a letter in writing to the OSC Manager, in respect of each proposed new branch location, confirming that the new branch location has a suitable branch manager and that HEFI has sufficient compliance resources to oversee the proposed new branch location."

4. The Temporary Order is extended to March 7, 2014 or until such further order of the Commission.

5. The hearing is adjourned to March 5, 2014 at 10:00 a.m. for the purpose of providing the Commission with an update on the work completed by the Consultant and to consider the possible extension of the Temporary Order.

DATED at Toronto this 12th day of December, 2013.

"James E. A. Turner"

2.2.6 TransCap Corporation et al. – ss. 127(1), 127(10)

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
TRANSCAP CORPORATION,
STRATA-TRADE CORPORATION,
DALE JOSEPH EDGAR ST. JEAN AND
GREGORY DENNIS TINDALL

ORDER
(Subsections 127(1) and 127(10) of the Securities Act)

WHEREAS on November 21, 2013, the Ontario Securities Commission (the "Commission") issued a Notice of Hearing pursuant to sections 127(1) and 127(10) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act") in respect of TransCap Corporation ("TCC"), Strata-Trade Corporation ("STC"), Dale Joseph Edgar St. Jean ("St. Jean") and Gregory Dennis Tindall ("Tindall") (together, the "Respondents");

AND WHEREAS on November 21, 2013, Staff of the Commission ("Staff") filed a Statement of Allegations in respect of the same matter;

AND WHEREAS on December 13, 2013, the Commission heard an application by Staff to convert the matter to a written hearing, in accordance with Rule 11.5 of the Ontario Securities Commission *Rules of Procedure* (2012), 35 O.S.C.B. 10071, and section 5.1 of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended;

AND WHEREAS on December 13, 2013, Staff filed an affidavit sworn by Lee Crann, a law clerk for the Commission, on December 10, 2013, confirming the service on the Respondents of the Notice of Hearing, the Statement of Allegations and Staff's disclosure;

AND WHEREAS the Respondents did not appear on December 13, 2013, although the Commission is satisfied that service was effected on the Respondents;

AND WHEREAS counsel for TCC, STC and St. Jean advised that they took no position with respect to the order sought by Staff;

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this order;

IT IS HEREBY ORDERED THAT:

(a) Staff's application to proceed by way of written hearing is granted;

(b) Staff's materials in respect of the written hearing shall be filed no later than December 23, 2013;

(c) the Respondents' responding materials, if any, shall be served and filed no later than January 17, 2014; and

(d) Staff's reply materials, if any, shall be served and filed no later than January 24, 2014.

DATED at Toronto this 13th day of December, 2013.

"James E. A. Turner"

2.2.7 Crown Hill Capital Corporation and Wayne Lawrence Pushka

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, C. S.5, AS AMENDED

AND

IN THE MATTER OF
CROWN HILL CAPITAL CORPORATION
and WAYNE LAWRENCE PUSHKA

ORDER

WHEREAS on July 7, 2011, the Ontario Securities Commission (the "Commission") issued a Notice of Hearing pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act") in connection with a Statement of Allegations filed by Staff of the Commission ("Staff") on July 7, 2011 in respect of Crown Hill Capital Corporation and Wayne Lawrence Pushka (collectively the "Respondents");

AND WHEREAS the Respondents were served with the Notice of Hearing and Statement of Allegations on July 7, 2011;

AND WHEREAS the hearing on the merits in this matter commenced on May 9, 2012 and continued on May 10, 14-17, 24, 25, July 18-20, August 13 and 15, and September 18, 2012;

AND WHEREAS the Commission released its reasons and decision with respect to the hearing on the merits on August 23, 2013;

AND WHEREAS Staff and counsel for the Respondents attended at a case conference on October 15, 2013 to discuss the scheduling of the sanctions hearing and related procedural matters;

AND WHEREAS the Commission ordered that a case conference be scheduled for December 12, 2013 at 2:00 p.m. for the purpose of addressing various procedural matters or for such other purposes as the Panel hearing the matter may determine;

AND WHEREAS the Respondents requested on December 9, 2013 that a half day motion be scheduled for leave to appeal the decision with respect to the hearing on the merits prior to the Commission hearing evidence and submissions in relation to sanctions or, in the alternative, for the Commission to exercise its discretion to reopen the hearing on the merits to hear certain further submissions (the "Motion");

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this order;

IT IS HEREBY ORDERED THAT that the Motion is scheduled for January 10, 2014 at 10:00 a.m. for one half day.

DATED at Toronto this 12th day of December, 2013.

"James E. A. Turner"

2.2.8 LatAm SEF LLC – s. 147

Headnote

Application for an order that a swap execution facility registered with the United States Commodity Futures Trading Commission is exempt from the requirement to register as an exchange in Ontario – requested order granted.

Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 147.

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, CHAPTER S.5, AS AMENDED
(THE ACT)

AND

IN THE MATTER OF
LATAM SEF, LLC

ORDER
(Section 147 of the Act)

WHEREAS LatAm SEF, LLC ("**LatAm**") has filed an application dated December 5, 2013 (**Application**) with the Ontario Securities Commission (**Commission**) requesting an interim order pursuant to section 147 of the Act exempting LatAm from the requirement to be recognized as an exchange under subsection 21(1) of the Act **(Exchange Relief)**;

AND WHEREAS LatAm has represented to the Commission that:

1.1 It is a limited liability company organized under the laws of the State of Delaware and is an indirect wholly-owned subsidiary of Enlace Int SA de CV, a corporation organized under the laws of Mexico;

1.2 LatAm operates a swap execution facility that initially will facilitate transactions in Mexican peso denominated interest rate swaps and non-deliverable forward contracts;

1.3 LatAm's swap execution facility offers a central limit order book where orders are executed based on price/time priority and a request for quote functionality pursuant to which participants may transmit a request for a quote to buy or sell a specific swap to other participants;

1.4 LatAm has entered into a clearing services agreement with the Chicago Mercantile Exchange;

1.5 In the United States, LatAm operates under the jurisdiction of the Commodity Futures Trading Commission (**CFTC**) and was temporarily registered with the CFTC as a swap execution facility on November 18, 2013;

1.6 LatAm is obliged under CFTC rules to have requirements governing the conduct of participants, to monitor compliance with those requirements and to discipline participants, including by means other than exclusion from the marketplace;

1.7 LatAm does not utilize a third party as a regulatory services provider and thus is responsible for conducting its own trade practice, market and financial surveillance;

1.8 Because LatAm regulates the conduct of its participants, it is considered by the Commission to be an exchange;

1.9 Because LatAm has participants located in Ontario, it is considered by the Commission to be carrying on business as an exchange in Ontario and is required to be recognized as such or exempted from recognition pursuant to section 21 of the Act;

1.10 LatAm has no physical presence in Ontario and does not otherwise carry on business in Ontario except as described above; and

1.11 LatAm intends to file a full application to the Commission for a subsequent order exempting it from the requirement to be recognized as an exchange pursuant to section 147 of the Act (**Subsequent Order**);

AND WHEREAS the products traded on LatAm are not commodity futures contracts as defined in the *Commodity Futures Act* (Ontario) and LatAm is not considered to be carrying on business as a commodity futures exchange in Ontario;

AND WHEREAS the Commission will monitor developments in international and domestic capital markets and LatAm activities on an ongoing basis to determine whether it is appropriate for the Exchange Relief to continue to be granted subject to the terms and conditions set out in Schedule “A” to this order;

AND WHEREAS LatAm has acknowledged to the Commission that the scope of the Exchange Relief and the terms and conditions imposed by the Commission set out in Schedule “A” to this order may change as a result of the Commission’s monitoring of developments in international and domestic capital markets or LatAm activities, or as a result of any changes to the laws in Ontario affecting trading in derivatives or securities;

AND WHEREAS based on the Application, together with the representations made by and acknowledgements of LatAm to the Commission, the Commission has determined that the granting of the Exchange Relief would not be prejudicial to the public interest;

IT IS HEREBY ORDERED by the Commission that, pursuant to section 147 of the Act, LatAm is exempt on an interim basis from recognition as an exchange under subsection 21(1) of the Act,

PROVIDED THAT:

1. This Order terminates on the earlier of (i) December 10, 2014 and (ii) the effective date of the Subsequent Order;

2. LatAm complies with the terms and conditions contained in Schedule “A.”; and

3. LatAm shall file a full application to the Commission for the Subsequent Order by March 31, 2014.

DATED: December 10, 2013.

“Judith N. Robertson”

“James E. A. Turner”

SCHEDULE "A"

TERMS AND CONDITIONS

Regulation and Oversight of LatAm

1. LatAm will maintain its registration as a swap execution facility **(SEF)** with the Commodity Futures Trading Commission **(CFTC)** and will continue to be subject to the regulatory oversight of the CFTC.

2. LatAm will continue to comply with the ongoing requirements applicable to it as a SEF registered with the CFTC.

3. LatAm will notify the Commission if its registration as a SEF has been revoked, suspended, or amended by the CFTC, or the basis on which its registration as a SEF has been granted has significantly changed.

4. LatAm must do everything within its control, which includes cooperating with the Commission as needed, to cause LatAm to carry out its activities as an exchange exempted from recognition under subsection 21(1) of the Act in compliance with Ontario securities law.

Access

5. LatAm will not provide direct access to a participant in Ontario (**Ontario User**) unless the Ontario User is appropriately registered as applicable under Ontario securities laws or is exempt from or not subject to those requirements, and qualifies as an "eligible contract participant" under the United States Commodity Exchange Act, as amended (**CEA).**

6. LatAm may reasonably rely on a written representation from the Ontario User that specifies either that it is appropriately registered as applicable under Ontario securities laws or is exempt from or not subject to those requirements.

7. For each Ontario User provided direct access to its SEF, LatAm will require, as part of its application documentation or continued access to the SEF, the Ontario User to represent that it is appropriately registered as applicable under Ontario securities laws or is exempt from or not subject to those requirements.

8. LatAm will require Ontario Users to notify LatAm if their registration as applicable under Ontario securities laws has been revoked, suspended, or amended by the Commission or if they are no longer exempt from or become subject to those requirements and, following notice from the Ontario User and subject to applicable laws, LatAm will promptly restrict the Ontario User's access to LatAm if the Ontario User is no longer appropriately registered or exempt from those requirements.

9. LatAm must make available to Ontario Users appropriate training for each person who has access to trade on LatAm's facilities.

Trading by Ontario Users

10. LatAm will not provide access to an Ontario User to trading in products other than swaps and security-based swaps, as defined in section 1a of the CEA, without prior Commission approval.

Submission to Jurisdiction and Agent for Service

11. With respect to a proceeding brought by the Commission arising out of, related to, concerning or in any other manner connected with the Commission's regulation and oversight of the activities of LatAm in Ontario, LatAm will submit to the non-exclusive jurisdiction of (i) the courts and administrative tribunals of Ontario and (ii) an administrative proceeding in Ontario.

12. LatAm will file with the Commission a valid and binding appointment of an agent for service in Ontario upon whom the Commission may serve a notice, pleading, subpoena, summons or other process in any action, investigation or administrative, criminal, quasi-criminal, penal or other proceeding arising out of or relating to or concerning the Commission's regulation and oversight of LatAm activities in Ontario.

Disclosure

13. LatAm will provide to its Ontario Users disclosure that states that:

(a) rights and remedies against LatAm may only be governed by the laws of the U.S., rather than the laws of Ontario and may be required to be pursued in the U.S. rather than in Ontario;

(b) the rules applicable to trading on LatAm may be governed by the laws of the U.S., rather than the laws of Ontario; and

(c) LatAm is regulated by the CFTC, rather than the Commission.

Filings with the CFTC

14. LatAm will promptly provide staff of the Commission copies of all rules of LatAm, and amendments to those rules, that it files with the CFTC under the regulations pertaining to self-certification and/or approval.

15. LatAm will promptly provide staff of the Commission copies of all amendments to LatAm's Form SEF (including Exhibits to Form SEF) that it files with the CFTC.

16. LatAm will promptly provide to the Commission copies of all product specifications and amended product specifications that it files with the CFTC under the regulations pertaining to self-certification and/or approval.

17. LatAm will promptly provide staff of the Commission the following information to the extent it is required to provide to or file such information with the CFTC:

(a) the annual Board of Directors' report regarding the activities of the board and its committees;

(b) the annual unaudited financial statements of LatAm;

(c) details of any material legal proceeding instituted against LatAm;

(d) notification that LatAm has instituted a petition for a judgment of bankruptcy or insolvency or similar relief, or to wind up or liquidate LatAm or has a proceeding for any such petition instituted against it; and

(e) the appointment of a receiver or the making of any voluntary arrangement with creditors.

Prompt Notice or Filing

18. LatAm will promptly notify staff of the Commission of any of the following:

(a) any material change to its business or operations or the information provided in the Application, including, but not limited to:

(i) changes to the regulatory oversight by the CFTC;

(ii) the corporate governance structure of LatAm;

(iii) the access model, including eligibility criteria, for Ontario Participants;

(iv) systems and technology; and

(v) the clearing and settlement arrangements for LatAm;

(b) any change in LatAm regulations or the laws, rules and regulations in the U.S. relevant to futures and options where such change may materially affect its ability to meet the criteria set out in Appendix 1 to this schedule;

(c) any condition or change in circumstances whereby LatAm is unable or anticipates it will not be able to continue to meet the SEF Core Principles established by the CFTC or any other applicable requirements of the Commodity Exchange Act or CFTC regulations;

(d) any known investigations of, or disciplinary action against, LatAm by the CFTC or any other regulatory authority to which it is subject;

(e) any matter known to LatAm that may affect its financial or operational viability, including, but not limited to, any significant system failure or interruption; and

(f) any default, insolvency, or bankruptcy of a LatAm participant known to LatAm or its representatives that may have a material, adverse impact upon LatAm, a clearing agency or any Ontario Participant.

19. LatAm will promptly file with staff of the Commission copies of any Rule Enforcement Review report regarding LatAm once issued as final by the CFTC.

Quarterly Reporting

20. LatAm will maintain the following updated information and submit such information in a manner and form acceptable to the Commission on a quarterly basis (within 30 days of the end of each calendar quarter), and at any time promptly upon the request of staff of the Commission:

    (a) a current list of all Ontario Users;

    (b) a list of all Ontario Users against whom disciplinary action has been taken in the last quarter by LatAm, or, to the best of LatAm knowledge, by the CFTC or SEC with respect to such Ontario Users' activities on LatAm;

    (c) a list of all investigations by LatAm relating to Ontario Users;

    (d) a list of all Ontario applicants for status as a participant who were denied such status or access to LatAm during the quarter, together with the reasons for each such denial;

    (e) a list of all products available for trading during the quarter, identifying any additions, deletions, or changes since the prior quarter;

    (f) for each product,

        (i) the total trading volume and value originating from Ontario Users, presented on a per Ontario User basis, and

        (ii) the proportion of worldwide trading volume and value on LatAm conducted by Ontario Users, presented in the aggregate for such Ontario Users; and

    (g) a list outlining each incident of a material systems failure, malfunction or delay that occurred at any time during the quarter for any system relating to trading activity, including trading, routing or data, specifically identifying the date, duration and reason for the failure, malfunction or delay, and noting any corrective action taken.

Annual Reporting

21. LatAm will arrange to have the annual report and annual audited financial statements of LatAm filed with the Commission promptly after their issuance.

22. LatAm will arrange to have the annual "Service Organization Controls 1" report prepared for LatAm filed with the Commission promptly after the report is issued as final by its independent auditor.

Information Sharing

23. LatAm will provide such information as may be requested from time to time by, and otherwise cooperate with, the Commission or its staff, subject to any applicable privacy or other laws (including solicitor-client privilege) governing the sharing of information and the protection of personal information.

2.2.9 Global Energy Group, Ltd. et al. – ss. 37, 127, 127.1

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
GLOBAL ENERGY GROUP, LTD.,
NEW GOLD LIMITED PARTNERSHIPS,
CHRISTINA HARPER, VADIM TSATSKIN,
MICHAEL SCHAUMER, ELLIOT FEDER,
ODED PASTERNAK, ALAN SILVERSTEIN,
HERBERT GROBERMAN, ALLAN WALKER,
PETER ROBINSON, VYACHESLAV BRIKMAN,
NIKOLA BAJOVSKI, BRUCE COHEN and
ANDREW SHIFF

ORDER
(Sections 37, 127 and 127.1 of the Securities Act)

WHEREAS on June 8, 2010, the Ontario Securities Commission (the "Commission") issued a Notice of Hearing pursuant to sections 37, 127 and 127.1 of the *Securities Act*, R.S.O. c. S.5, as amended (the "Act") in connection with a Statement of Allegations dated June 8, 2010, filed by Staff of the Commission ("Staff") with respect to Global Energy Group, Ltd. ("Global Energy"), New Gold Limited Partnerships ("New Gold"),Vadim Tsatskin ("Tsatskin"), Christina Harper ("Harper"), Michael Schaumer ("Schaumer"), Elliot Feder ("Feder"), Oded Pasternak ("Pasternak"), Alan Silverstein ("Silverstein"), Herbert Groberman ("Groberman"), Allan Walker ("Walker"), Peter Robinson ("Robinson"), Vyacheslav Brikman ("Brikman"), Nikola Bajovski ("Bajovski"), Bruce Cohen ("Cohen") and Andrew Shiff ("Shiff");

AND WHEREAS settlement agreements were reached between Staff and each of Robinson, Pasternak, Brikman, Walker, Silverstein, Schaumer, and Feder and, as a result of those settlement agreements, the Commission issued the following Orders:

(i) On November 5, 2010, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Robinson;

(ii) On September 1, 2011, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Pasternak;

(iii) On September 1, 2011, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Brikman;

(iv) On September 1, 2011, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Walker;

(v) On November 29, 2011, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Silverstein;

(vi) On November 29, 2011, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Schaumer; and

(vii) On January 20, 2012, an Order was issued pursuant to sections 37 and 127 of the Act imposing sanctions against Feder.

AND WHEREAS on January 23, 2012, Staff filed an Amended Statement of Allegations;

AND WHEREAS the hearing on the merits began on January 23, 2012, and continued on January 24, 25, 26, 30, February 1, 2, 3, 24 and April 17, 2012 (the "Merits Hearing");

AND WHEREAS following the Merits Hearing, the Commission issued its Reasons and Decision with respect to the Merits Hearing, on December 21, 2012 (*Re Global Energy Group, Ltd.* (2013), 36 O.S.C.B. 139);

AND WHEREAS on March 22, 2013, Staff, counsel for Groberman and Shiff appeared and made submissions at a hearing with respect to sanctions and costs;

AND WHEREAS on December 13, 2013, the Commission issued its Reasons and Decision with respect to sanctions and costs;

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this order;

IT IS ORDERED that:

1. With respect to Global Energy, Tsatskin, Harper and New Gold:

   (a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any New Gold securities cease permanently;

   (b) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Global Energy, Tsatskin and Harper cease permanently;

   (c) pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Global Energy, Tsatskin and Harper cease permanently;

   (d) pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law not apply to Global Energy, Tsatskin and Harper permanently;

   (e) pursuant to clause 7 of subsection 127(1) of the Act, Tsatskin and Harper shall resign all positions as director or officer of an issuer;

   (f) pursuant to clauses 8, 8.2 and 8.4 of subsection 127(1) of the Act, Tsatskin and Harper shall be prohibited permanently from becoming or acting as officer or director of an issuer, registrant or investment fund manager;

   (g) pursuant to clause 8.5 of subsection 127(1) of the Act, Tsatskin and Harper shall be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

   (h) pursuant to subsection 37(1) of the Act, Tsatskin and Harper shall be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

   (i) pursuant to clause 9 of subsection 127(1) of the Act, Tsatskin and Harper shall each pay $1,000,000 as administrative penalties for their failure to comply with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

   (j) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable to disgorge to the Commission the amount of $2,484,748 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

   (k) pursuant to clause 10 of subsection 127(1) of the Act, Harper, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission the amount of $233,694 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

   (l) pursuant to clause 10 of subsection 127(1) of the Act, Harper shall disgorge to the Commission the amount of $400,081 obtained as a result of her non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

   (m) pursuant to clause 10 of subsection 127(1) of the Act, Bajovski, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $64,343 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

   (n) pursuant to clause 10 of subsection 127(1) of the Act, Cohen, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $45,736 obtained as a result of their non-compliance with Ontario

securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(o) pursuant to clause 10 of subsection 127(1) of the Act, Groberman, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $91,509 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(p) pursuant to clause 10 of subsection 127(1) of the Act, Shiff, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $10,532 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(q) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Robinson to disgorge to the Commission $22,000 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(r) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Brikman to disgorge to the Commission $82,748 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(s) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Pasternak to disgorge to the Commission $171,856 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(t) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Walker to disgorge to the Commission $82,521 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(u) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Schaumer to disgorge to the Commission $640,000 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(v) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Silverstein to disgorge to the Commission $114,186 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(w) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Feder to disgorge to the Commission $230,447 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act; and

(x) pursuant to section 127.1 of the Act, Tsatskin shall pay $30,430 and Harper shall pay $43,472 for hearing costs incurred by the Commission;

2. With respect to Bajovski and Cohen:

(a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Bajovski and Cohen cease for a period of 10 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade securities in a personal account in which he has sole legal and beneficial ownership, provided that:

(i) the securities traded are listed and posted for trading on an exchange recognized by the Commission or registered by the SEC or are issued by a mutual fund which is a reporting issuer;

(ii) he does not own legally or beneficially more than one percent of the outstanding securities of the class or series of the class in question; and

(iii) he carries out any permitted trading through a registered dealer (who has been given a copy of this Order) and in accounts opened in his name only, and he must close any accounts that are not in his name only;

(b) pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Bajovski and Cohen cease for a period of 10 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(c) pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law not apply to Bajovski and Cohen for a period of 10 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade and acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(d) pursuant to clause 7 of subsection 127(1) of the Act, Bajovski and Cohen shall resign all positions as director or officer of any issuer;

(e) pursuant to clause 8 of subsection 127(1) of the Act, Bajovski and Cohen shall be prohibited for a period of 10 years from becoming or acting as officer or director of a reporting issuer or any issuer that engages in a distribution to the public;

(f) pursuant to clauses 8.2 and 8.4 of subsection 127(1) of the Act, Bajovski and Cohen shall be prohibited permanently from becoming or acting as officer or director of a registrant or investment fund manager;

(g) pursuant to clause 8.5 of subsection 127(1) of the Act, Bajovski and Cohen shall be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

(h) pursuant to subsection 37(1) of the Act, Bajovski and Cohen shall be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(i) pursuant to clause 9 of subsection 127(1) of the Act, Bajovski shall pay $64,343 and Cohen shall pay $45,736 as administrative penalties for their failure to comply with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(j) pursuant to clause 10 of subsection 127(1) of the Act, Bajovski, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $64,343 and Cohen, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $45,736 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act, as determined at paragraphs 1(m) and 1(n) above; and

(k) pursuant to section 127.1 of the Act, Bajovski and Cohen shall each pay $3,260 for hearing costs incurred by the Commission;

3. With respect to Groberman and Shiff:

(a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Groberman and Shiff cease for a period of 5 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade securities in a personal account in which he has sole legal and beneficial ownership, provided that:

(i) the securities traded are listed and posted for trading on an exchange recognized by the Commission or registered by the SEC or are issued by a mutual fund which is a reporting issuer;

(ii) he does not own legally or beneficially more than one percent of the outstanding securities of the class or series of the class in question; and

(iii) he carries out any permitted trading through a registered dealer (who has been given a copy of this Order) and in accounts opened in his name only, and he must close any accounts that are not in his name only;

(b) pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Groberman and Shiff cease for a period of 5 years with the exception that, upon full payment of the administrative penalty and

disgorgement orders imposed against them, each shall be permitted to acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(c) pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law not apply to Groberman and Shiff for a period of 5 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade and acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(d) pursuant to clause 7 of subsection 127(1) of the Act, Groberman and Shiff, shall resign all positions as director or officer of a reporting issuer or any issuer that engages in a distribution to the public;

(e) pursuant to clause 8 of subsection 127(1) of the Act, Groberman and Shiff shall be prohibited for a period of 5 years from becoming or acting as officer or director of a reporting issuer or any issuer that engages in a distribution to the public;

(f) pursuant to clauses 8.2 and 8.4 of subsection 127(1) of the Act, Groberman and Shiff shall be prohibited permanently from becoming or acting as officer or director of a registrant or investment fund manager;

(g) pursuant to clause 8.5 of subsection 127(1) of the Act, Groberman and Shiff shall be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

(h) pursuant to subsection 37(1) of the Act, Groberman and Shiff shall be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(i) pursuant to clause 9 of subsection 127(1) of the Act, Groberman shall pay $91,509 and Shiff shall pay $10,532 as administrative penalties for their failure to comply with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(j) pursuant to clause 10 of subsection 127(1) of the Act, Groberman, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $91,509 and Shiff, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $10,532 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act as determined at paragraphs 1(o) and 1(p) above; and

(k) pursuant to section 127.1 of the Act, Groberman and Shiff shall each pay $3,260 for hearing costs incurred by the Commission.

Dated this 13th day of December, 2013.

“Paulette L. Kennedy”

“Judith N. Robertson”

Chapter 3

Reasons: Decisions, Orders and Rulings

3.1 OSC Decisions, Orders and Rulings

3.1.1 North American Financial Group Inc. et al. – s. 127

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
NORTH AMERICAN FINANCIAL GROUP INC.,
NORTH AMERICAN CAPITAL INC.,
ALEXANDER FLAVIO ARCONTI AND LUIGINO ARCONTI

REASONS AND DECISION
(Section 127 of the Securities Act)

Hearing:	April 29 and 30, 2013 May 1-3, 6, 8-10, 22 and 23, 2013 September 11, 2013		
Decision:	December 11, 2013		
Panel:	James D. Carnwath, Q.C.	–	Chair of the Panel and Commissioner
Appearances:	Michelle Vaillancourt	–	For Staff of the Commission
	Ian Smith	–	For North American Financial Group Inc., North American Capital Inc., Alexander Flavio Arconti and Luigino Arconti

TABLE OF CONTENTS

PART 1 – INTRODUCTION
- A. NATURE OF THE HEARING
- B. OVERVIEW
- C. STAFF ALLEGATIONS
  - 1. The Arcontis' Liability for the Conduct of Carter
  - 2. Fraud
  - 3. Trading Without Registration after September 22, 2010
  - 4. Conduct Contrary to the Public Interest
- D. THE RESPONDENTS' SUBMISSIONS
- E. EVIDENCE

PART 2 – STAFF WITNESSES
- A. MARIA CARELLI
- B. AMY TSE
- C. MARCEL TILLIE
- D. J.B.
- E. L.F.
- F. J.S.
- G. R.B.
- H. D.M.

PART 3 – RESPONDENTS' WITNESSES
A. FLAVIO ARCONTI
B. LUIGINO (GINO) ARCONTI
C. STEFANO PICONE
D. DAVID GILKES
E. C.S.
F. N.B.

PART 4 – THE APPLICABLE LAW AND ANALYSIS
A. THE STANDARD OF PROOF
B. THE ADMISSIBILITY OF HEARSAY EVIDENCE
C. ASSESSMENT OF CREDIBILITY PRINCIPLES AND ANALYSIS
D. THE LAW OF SUITABILITY OBLIGATIONS AND ANALYSIS
E. THE DUTY TO ACT FAIRLY, HONESTLY AND IN GOOD FAITH AND ANALYSIS
F. DIRECTOR AND OFFICER LIABILITY – CARTER
G. SECURITIES FRAUD AND ANALYSIS
H. DIRECTOR AND OFFICER LIABILITY – NAFG AND NAC

I. TRADING WITHOUT REGISTRATION AND ANALYSIS

PART 5 - CONCLUSION

PART 1 – INTRODUCTION

A. Nature of the Hearing

[1] This was a hearing on the merits (the "**Hearing**") before the Ontario Securities Commission (the "**Commission**" or the "**OSC**") pursuant to sections 127 and 127.1 of the Ontario *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "***Act***") to consider whether North American Financial Group Inc. ("**NAFG**"), North American Capital Inc. ("**NAC**"), Alexander Flavio Arconti ("**Flavio Arconti**") and Luigino Arconti ("**Gino Arconti**") (together, the "**Respondents**") contravened Ontario securities law and acted contrary to the public interest. Flavio and Gino Arconti will be collectively referred to as the "**Arcontis**" in these Reasons and Decision. The Hearing was held on April 29 and 30, May 1-3, 6, 8-10, 22 and 23 and September 11, 2013.

[2] On December 28, 2011, a Notice of Hearing was issued by the Commission in connection with the Statement of Allegations filed by Staff of the Commission ("**Staff**"), also dated December 28, 2011.

[3] On November 10, 2010, the Commission issued a temporary cease trade order against the Respondents (the "**Temporary Order**"). The Temporary Order was amended and extended from time to time and, pursuant to an order of the Commission dated July 5, 2012, the Temporary Order was extended, as amended, against the Respondents until the final disposition of this matter, including, if appropriate, any final determination with respect to sanctions and costs.

B. OVERVIEW

[4] This hearing on the merits began with the filing of Exhibit 1 ("**Ex. 1**"), a document entitled "Admissions of the Respondents". The document outlines the Respondents' position in respect of each paragraph of Staff's Statement of Allegations. Provided below is an overview of the facts in this matter based on the Admissions of the Respondents.

[5] During the period July 2005 to September 2010, NAFG raised funds by issuing non-prospectus qualified securities to investors. As at November 30, 2010, over $5.7 million was invested in NAFG.

[6] During the period July 2009 to April 2010, NAC issued shares to approximately 11 investors. The total proceeds of approximately $1,042,000 from the sale of NAC securities were transferred to NAFG.

[7] NAFG is a finance company in the business of the acquisition and servicing of subprime car leases in respect of cars that were acquired through 970910 Ontario Inc. (operating as Prestige Motors) ("**Prestige Motors**"), a used car dealership. NAC was organized to finance car leases, of which leasing was conducted through NAFG.

[8] From at least September 2007 to September 2010, NAFG and/or NAC securities were sold by Carter Securities Inc. ("**Carter**"), a company incorporated in Ontario in February 2007. Carter's registration as an Exempt Market Dealer ("**EMD**") was suspended on September 22, 2010 by a decision of the Director, following an opportunity to be heard ("**OTBH**") held on August 4 and 26, 2010, regarding its registration ("**Carter's Suspension**"). The Director found that Carter was not suitable for registration, that it failed to comply with Ontario securities law and that Carter's ongoing registration was objectionable (the "**Director's Decision**"). The Respondents do not admit that the decision respecting Carter's registration was correct, but the

Respondents admit that the Arcontis' registration was automatically suspended as a result of the Director's Decision (Ex. 1, para. 8). Flavio Arconti, Gino Arconti, NAC and NAFG were not named parties in the OTBH or the resulting Director's Decision.

[9] On October 22, 2010, Carter filed a request for a review of a Director's Decision. Since that time, Carter has not taken any steps to proceed with its request for a review.

[10] On October 15, 2010, less than one month after the Director's Decision suspending Carter's registration, NAFG filed a Notice of Intention to make a proposal under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*") on the basis that it was an insolvent person, pursuant to subsection 50.4(1) of the *BIA*.

C. Staff Allegations

1. The Arcontis' Liability for the Conduct of Carter

[11] Relying on section 129.2 of the *Act*, Staff alleges that the Arcontis, as actual and/or *de facto* officers and/or directors of Carter, authorized, permitted and/or acquiesced in the non-compliance with Ontario securities law by Carter. Staff alleges that during the period from September 2007 to September 2010, while Carter was selling NAFG and NAC securities, Carter did not disclose to investors the existence of an interest free loan of approximately $2 million by NAFG to Prestige Motors or the severe financial difficulties faced by NAFG. As a result, Staff alleges that:

(a) Carter did not take reasonable steps to ensure that the purchase of NAFG securities was suitable to its clients in breach of section 13.3 of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registration Obligations* ("**NI 31-103**"); and

(b) Carter failed to deal fairly, honestly and in good faith with its clients in breach of subsection 2.1(1) of OSC Rule 31-505 – *Conditions of Registration* ("**OSC Rule 31-505**").

[12] The material time period referred to in the Statement of Allegations in respect of Carter's conduct is September 2007 to September 2010. However, given that section 13.3 of NI 31-103 did not come into force until September 28, 2009, Staff relies on Carter's conduct from September 29, 2009 to September 24, 2010 (the "**Applicable Period**") in support of the allegations that Carter breached section 13.3 of NI 31-103 and that the Arcontis are liable for that breach pursuant to section 129.2 of the *Act*.

[13] Staff acknowledges that the Director's Decision is binding on Carter and the Arcontis to the extent that it resulted in the suspension of Carter's registration, and the resulting suspension of the Arcontis' registration, pursuant to subsection 29(2) of the *Act*. However, Staff submits that it does not take the position that the findings in the Director's Decision are binding on the Commission in relation to Staff's allegations of the Arcontis' liability for Carter's non-compliance with Ontario securities law under section 129.2 of the *Act*.

[14] I note that at the Hearing, the parties consented to the removal of the copy of the Director's Decision, which was included in Staff's documentary evidence (Tr. Vol. 1, p. 28, ll. 1-25; p. 31, ll. 1-19; p. 112, ll. 22-25). Staff tendered evidence during the Hearing in support of its allegations that Carter breached Ontario securities law and that the Arcontis are liable for such conduct, pursuant to section 129.2 of the *Act*.

2. Fraud

[15] Staff alleges that during the period January 1, 2009 to September 24, 2010, each of the Respondents directly or indirectly engaged or participated in acts, practices or courses of conduct relating to the securities of NAFG and NAC that they knew or reasonably ought to have known perpetrated a fraud on persons, contrary to subsection 126.1(b) of *Act* and contrary to the public interest.

[16] In addition, Staff alleges that the Arcontis, as actual and/or *de facto* officers and/or directors of NAFG and NAC, authorized, permitted or acquiesced in the breach of subsection 126.1(b) of the *Act* by NAFG and NAC and thereby also breached subsection 126.1(b) of the *Act*, pursuant to section 129.2 of the *Act*.

3. Trading Without Registration after September 22, 2010

[17] Staff alleges that on September 24, 2010, Gino Arconti engaged in and/or held himself out as engaging in the business of trading in securities without registration contrary to subsection 25(1) of the *Act*.

4. Conduct Contrary to the Public Interest

[18] Staff alleges that the conduct referred to above in paragraphs 11 to 17 was also contrary to the public interest.

D. The Respondents' Submissions

[19] NAFG was incorporated in Ontario on July 30, 1996. NAFG is not a reporting issuer and is not registered under the *Act*.

[20] NAC was incorporated in Ontario on November 25, 2008. NAC is not a reporting issuer and is not registered under the *Act*.

[21] Flavio Arconti is a resident of Vaughn, Ontario and Gino Arconti is a resident of Richmond Hill, Ontario.

[22] During the time of the conduct referred to herein, Flavio Arconti and Gino Arconti jointly owned NAFG, NAC, Carter and Prestige Motors and were the actual and/or *de facto* officers and directors of each of NAFG, NAC, Carter and Prestige Motors.

[23] Flavio Arconti and Gino Arconti are brothers and were registrants from September 17, 2007 to September 22, 2010. In particular, beginning on September 17, 2007, when Carter was registered as a Limited Market Dealer, Flavio Arconti was registered as an Officer and Director (Trading Resident), Shareholder and Designated Compliance Officer of Carter and Gino Arconti was registered as an Officer and Director (Trading Resident) and Shareholder of Carter.

[24] Following Carter's change in designation (by operation of law) to an EMD on September 28, 2009 until Carter's Suspension, Flavio Arconti was registered as the Chief Compliance Officer, Ultimate Designated Person and Dealing Representative of Carter and Gino Arconti was registered as a Dealing Representative of Carter.

[25] The Respondents admit that they acted contrary to the public interest (Ex. 1, para. 6). They admit that the Director made findings against Carter, which led to its suspension (Ex. 1, para. 4). They admit that there was a loan from NAFG to Prestige Motors that eventually amounted to approximately $2 million, although they note that this figure started out as a much smaller amount (Ex. 1, para. 22). The Respondents admit that NAFG was not profitable, but it is not admitted that its financial difficulties were "severe", as characterized in the Director's Decision (Ex. 1, para. 22). The Respondents admit that the loan was not disclosed to NAFG investors initially, but later disclosure better described the uses of investor funds and many investors were advised that NAFG experienced financial difficulties (Ex. 1, para. 22).

[26] In their submissions, the Respondents stress the following themes:

(a) NAFG's typical experience as a young company and the fact that the Respondents developed plans to address the losses of NAFG, which were similar to many start-up companies;

(b) NAFG's representations to investors that they would not receive financial information about the company, since NAFG was not a reporting issuer, nor was NAC for that matter, and that some of the marketing material may have painted a better picture than it should have and that much of the information is properly described as puffery;

(c) the Respondents' real effort to ensure that investors of NAFG and NAC were in fact accredited investors and that mistakes were made in good faith and in reliance on information provided by the investors themselves, who certified they were in fact accredited;

(d) the Respondents' reliance on qualified professionals to advise the Respondents on compliance, to help them fix problems which made them non-compliant and to assist them in charting NAFG's march to profitability;

(e) the Respondents cooperated with Staff's first compliance review in 2009 in good faith and set about addressing Staff's criticisms immediately;

(f) the Respondents cooperated fully and in good faith in the second compliance review in 2010, while expending considerable time, effort and money in responding to Staff's inquiries. The Respondents were shocked and dismayed that they did not receive a deficiency letter from Staff to which they could respond to before Carter's Suspension;

(g) the Respondents took various steps and initiatives that they submit were realistic and in good faith to address NAFG's losses, and that Carter's Suspension effectively interrupted and doomed all of those efforts to address the losses; and

(h) the Arcontis embarked on the project of growing NAFG's business in good faith and with considerable energy and effort, but they did not have the financial, accounting or legal training to make decisions on matters well-outside their prior experience in the automobile business.

E. Evidence

[27] Staff called a total of eight witnesses in this matter. Three of Staff's witnesses are members of Staff: Maria Carelli, Amy Tse and Marcel Tillie. Staff also called five investor witnesses: J.B., L.F., J.S., R.B. and D.M. Staff submitted documentary evidence totalling 21 exhibits.

[28] In order to protect the privacy of the investor witnesses, their names and personal information have been anonymized and I will refer to them by their initials, rather than using their respective names.

[29] Flavio Arconti and Gino Arconti both testified, along with four other witnesses: Stefano Picone, an accountant hired to review the accounts of NAFG and Prestige Motors; David Gilkes, the regulatory consultant hired by the Arcontis; and, two investor witnesses, C.S. and N.B. The Respondents submitted documentary evidence totalling seven exhibits.

[30] To assist the reader to follow and understand the evidence, exhibits will be referred to as "Ex. -, Tab -, p. -" and excerpts from transcripts of the evidence will be referred to as "Tr. Vol. -, p. -, l. -".

PART 2 – STAFF WITNESSES

A. Maria Carelli

[31] Staff called Maria Carelli, who works as a senior accountant in the Compliance and Registration Regulation Branch of the Commission. She is both a chartered accountant and a chartered business valuator. She participated in a compliance review of Carter in 2010 (the "**2010 Compliance Review**"), but did not participate in the compliance review of Carter in 2009 (the "**2009 Compliance Review**"). Anita Chung was the lead reviewer of the 2009 Compliance Review and was an accountant in the Compliance and Registrant Regulation Branch of the Commission at the time of the review.

[32] Ms. Carelli's evidence may be found in Tr. Vol. 1, pp. 44-212 and Tr. Vol. 2, pp. 5-86. The exhibits referred to in her testimony may be found in Exs. 2, 3 and 4.

[33] After identifying certain tabs in Ex. 2 relating to Carter's corporate documents, Ms. Carelli identified the policies and procedures manual for Carter dated November 2007 (Ex. 2, Tab 7). The policies and procedures manual at section 5.3 speaks of "Client Suitability and Disclosure" and describes what persons are required to learn about a client prior to solicitation for an investment. The requirements include finding out if the potential investor understands the benefits of the investment, has a net worth sufficient to sustain the risks inherent in the investment and that the investment is otherwise suitable for the client. The manual also states that the company and each salesperson must have reasonable grounds to believe that all material facts of the investment are adequately disclosed in the offering documents.

[34] The document goes on to provide that "salespersons will not make false or misleading statements, or fail to state material facts in connection with a securities transaction" (Ex. 2, Tab 7, p. 34). Ms. Carelli identified a document in Ex. 2, Tab 9, a "New Client Application" form for Carter. The document provides the address, financial information and the past investment experience of the investor. The document had several attachments, including: "Schedule 'A' To Certificate of Accredited Investor"; a Risk Acknowledgement form highlighting the risks of the product; and a Form of Information Statement describing the risks and investment strategies of the product.

[35] At Ex. 2, Tab 11 is the deficiency report of April 24, 2009 that was addressed to Carter from Christina Pazienza, the former assistant manager of compliance for Staff (the "**2009 Deficiency Report**"). Two significant deficiencies were noted: a lack of "Know Your Client" ("**KYC**") and suitability procedures, and a failure to determine if a prospectus exemption was available to Carter. The 2009 Deficiency Report says the following about the KYC requirements:

> Your KYC form does not include questions to obtain information about an investor's investment time horizon or level of risk tolerance. Also, forms are not always filled out completely or properly (see appendix A). From our review of a sample of your completed KYC forms of clients, we noted instances where the suitability criteria may not have been met. In addition, there were instances where you did not meet directly with your client.
>
> (Ex. 2, Tab 11, p. 210)

[36] The 2009 Deficiency Report stresses Carter's lack of a process to determine if prospectus exemptions were available:

> You do not have a process in place to determine if investors you engage with in your capital raising activities are able to rely on a valid prospectus exemption, such as the accredited investor or minimum amount exemption. For example, in some instances such as [Company X] (see appendix

A), the information in the KYC form did not match with the criteria indicated on the accredited investor form.

(Ex. 2, Tab 11, p. 210)

[37] Ms. Carelli's evidence then dealt with Flavio Arconti's response to the 2009 Deficiency Report and a response from Ms. Pazienza requesting further clarification on certain responses from Carter. That in turn prompted a response from Flavio Arconti on November 17, 2009, saying his advisors, Cassels Brock & Blackwell LLP ("**Cassels Brock**") and David Gilkes, a regulatory consultant, were working on providing an update to their efforts to comply. In this response, reference was made to J.B., an investor, and M.G., a cousin of the Arcontis who was shown to be an accredited investor.

[38] Following Staff's receipt of Flavio Arconti's response, Staff decided to complete another compliance review of Carter by way of a designation order dated January 18, 2010 (the "2010 Compliance Review", as defined above). Ms. Carelli was named as a designated person to conduct the compliance review for the Commission.

[39] On January 25, 2010, a meeting was held at Carters' office where Flavio Arconti was asked a series of questions about a number of topics, including: Carter's corporate structure, organizational structure and the roles played by Prestige Motors and NAC. Flavio Arconti answered those questions.

[40] Ms. Carelli also commented on the trial balance of NAFG, as at December 31, 2009. Ms. Carelli stated that this document indicated that the loan from NAFG to Prestige Motors was $1,987,084.74 (Ex. 2, Tab 28, p. 450). In terms of retained earnings, as at December 31, 2008, this document showed accumulated losses of $861,131.73 for NAFG.

[41] Staff referred Ms. Carelli to Ex. 3 containing the client files of 62 investors that Staff obtained during the 2010 Compliance Review. This exhibit also provides documents that are related to the investment of M.G., referred to earlier. M.G. agreed to lend NAFG $100,000 at the rate of 15% by a loan agreement dated November 1, 2009. M.G. certified that she, either alone or with a spouse, had net financial assets in excess of $1 million. NAFG was to repay the loan in 60 consecutive monthly instalments of $2,355.52 commencing on December 4, 2009. The loan would mature on November 4, 2014.

[42] Staff then referred Ms. Carelli to Ex. 4, Tab 1, which contains Staff's notes regarding the additional information received and provided to the Arcontis during the 2010 Compliance Review. The notes range from May 25, 2010 to June 14, 2010, detailing Staff's perceived deficiencies in the responses given by the Arcontis to requests for further information. Tabs 2 to 5 of Ex. 4 contain the email exchanges between Staff and NAFG personnel regarding Staff's reception of NAFG's financial statements for the year ending December 31, 2009, which are found at Tabs 7 to 18 of Ex. 4.

[43] On March 15, 2010, Staff requested a telephone conference with the Arcontis to clarify a number of items noted during its review. The telephone conference took place on March 23, 2010. Following the telephone conference, Staff required additional information from the Arcontis. In an email dated April 12, 2010, Staff listed several documents that were to be provided by the Arcontis no later than April 30, 2010. Additional questions and responses continued between Staff, Margaretha Widjojo and the Arcontis to supply further information. Ms. Carelli stated that Ms. Widjojo was the bookkeeper of NAFG and Carter at the time. As late as June 8, 2010, Ms. Widjojo was forwarding material to Staff, while thanking Staff for its patience.

[44] By a letter dated June 23, 2010, Flavio Arconti was notified by Staff that it recommended to the Director that Carter's registration as a dealer in the exempt market be suspended (the "**June 2010 Letter**"). Staff identified several violations of Ontario securities law by Carter that called into question whether Carter's operations were being conducted with the requisite integrity of securities professionals. The specific areas of concern were: the inappropriate use of investors' proceeds; the failure to adequately explain product risks to investors; and, misleading and inaccurate marketing materials (Ex. 4, Tab 39, pp. 195-196).

[45] Mr. Gilkes responded to Staff's recommendation to the Director by asking for an opportunity to be heard by way of an appearance before the Director (the "**OTBH**").

[46] Staff's evidence provides for the documents that were relevant to the OTBH of Carter, along with the transcripts of the OTBH (Ex. 4, Tabs 41-43). The OTBH was held on August 4 and 26, 2010. The Director ordered Carter's suspension. On consent of the parties, the copy of the Director's Decision included in Staff's documentary evidence was removed. In a letter dated October 22, 2010, Alexander Gillespie, Carter's legal counsel at the time, wrote to the Secretary of the Commission that Carter requested that the OSC review the Director's Decision (Ex. 4, Tab 49). Ms. Carelli testified that, to her knowledge, no such hearing or review of the Director's Decision took place.

[47] The evidence identified by Ms. Carelli also includes the Commission's news release, dated September 27, 2010, regarding the suspension of Carter's registration. Also filed was a letter dated October 22, 2010 from Farber Financial Group ("**Farber**"), NAFG's trustee in bankruptcy, informing creditors of NAFG that NAFG filed a Notice of Intention to Make a Proposal, pursuant to section 50 of the *BIA*, on October 15, 2010 (Ex. 4, Tabs 48 and 50).

[48] At the beginning of Ms. Carelli's cross-examination, counsel for the Respondents, Mr. Smith, began by obtaining her agreement that Carter and NAFG were run by a small group of people with some outside help with legal and accounting advice. Ms. Carelli agreed that the NAFG group of companies was a small operation and was challenged by Staff's demands for information during the reviews; however, she added that Staff have a number of registrants that are similar in size to the companies, and the expectation is that the information Staff was seeking would have been readily available and ready for review. Ms. Carelli had decided that the books and records were not in good order and were not produced to the Commission with the efficiency expected of registrants.

[49] Ms. Carelli then confirmed that Flavio Arconti had little experience with compliance matters.

[50] During the 2009 Compliance Review, Ms. Carelli confirmed that the areas of greatest concern were the lack of KYC and suitability procedures and the determination if a prospectus exemption was available. She pointed out that the review was a "focus review", which she described as one that is very different from a "complete review", the latter of which was conducted for the 2010 Compliance Review. She explained that it was quite possible that the reason why the marketing materials were not reviewed for deficiency purposes in the 2009 Compliance Review was that it was beyond the scope of the focus review.

[51] Carter responded to the 2009 Deficiency Report and set out in detail the proposed changes in its approach to investments. Ms. Carelli agreed that the proposed changes would be regarded as an improvement on what had been used before by Carter.

[52] Ms. Carelli was questioned about the trial balance provided by Carter in response to the 2009 Deficiency Report. She acknowledged that retained earnings of $861,131.73 were accumulated losses over a number of years. She confirmed that the delinquent accounts of $496,588.05 would have also accumulated over more than one financial year.

[53] On the question of Carter's marketing materials, Ms. Carelli confirmed her understanding that all investors received some version of Carter's marketing brochure, various examples of which were introduced by Staff in Exs. 3 to 5.

[54] Mr. Smith then directed Ms. Carelli to the letter sent by Staff following the 2010 Compliance Review, informing Flavio Arconti that Staff recommended to the Director that Carter's registration be suspended (Ex. 4, Tab 39). She confirmed that the letter was different from the 2009 Compliance Review, when Staff identified problems and gave Carter an opportunity to correct any deficiencies. No detailed report on Carter's deficiencies was sent to Carter in relation to the 2010 Compliance Review. She further confirmed that she understood that the view of Mr. Gilkes was that, once Staff's concerns were identified, he would be able to work with Carter in the same way as was done during the 2009 Compliance Review.

[55] Mr. Smith's cross-examination of Ms. Carelli ended with questions that were designed to show possible unfairness of the Director's Decision and the manner in which it was communicated at the OTBH by Ellen Bessner, who was counsel for the Respondents at the time. His line of questioning does not assist me inasmuch as the Director's Decision was not appealed.

[56] In re-examination by Staff, Ms. Carelli's attention was directed to a number of documents prepared by Carter for the intention of investors. Ms. Carelli responded that she was unable to tell by looking at the forms if any of them were used by investors, explained orally to investors or were actually read by investors. That concluded the evidence of Ms. Carelli.

B. Amy Tse

[57] Ms. Tse is a chartered accountant and a chartered financial analyst. She has worked for the Commission since 2002, apart from an absence of one year around July 2005 to July 2006. She was assigned to the matter involving Carter in June 2010. Her evidence may be found in Tr. Vol. 2, pp. 86-148. The documents on which she was referred to by Staff are found in Ex. 5.

[58] Ms. Tse first identified documents in Ex. 5, which includes corporation profile reports of NAFG, NAC, Carter and Prestige Motors, the registration data for the Arconti brothers and website print-outs for NAFG and Prestige Motors.

[59] She was referred to an email dated June 10, 2010 that she sent to her colleague, Nalini Khan, who was investigation counsel with the OSC, and to Don Panchuk, Ms. Tse's manager at the time (Ex. 5, Tab 11). The email represents the notes Ms. Tse took for a telephone conversation that she had with Gino Arconti on June 9, 2010. She posed as an individual named "Amy Thorne", who was responding to an advertisement in the *Toronto Star* that was advertising an investment with an annual rate of return of 10%. Gino Arconti told her that NAFG was under Carter, and that "all the companies involved were related" and dealt with consumer financing. The email indicates that Gino Arconti told Ms. Tse that their competitors were "TD and Scotia" and that "TD and Scotia bought out a couple of firms and they are now entering in the same industry as Carter/NAFG as well" (Ex. 5, Tab 11, p. 63). I find that Gino Arconti's description of the activities of NAFG and Carter to have been fairly straight-forward, apart from the glowing terms about competing with TD Bank and Scotia Bank.

[60] Ms. Tse testified that the advertisement in the *Toronto Star* stated that the investment was for accredited investors only. When Ms. Tse, acting as "Amy Thorne", asked what an "accredited investor" meant, Gino Arconti told her that an accredited investor had net financial assets of over $1 million. When asked to repeat the definition, he said "assets over $1 million" without specifying the word "financial". Gino Arconti also told Ms. Tse that if she decided to invest, he would ask a lot of questions to ensure suitability. Gino Arconti did not say anything about the financial circumstances of the company, nor did he mention that NAFG would be loaning money to a car dealership owned by the Arcontis, being Prestige Motors.

[61] Ms. Tse subsequently received a package of documents sent by NAFG, which contained a description of the activities and business of NAFG, described in positive terms.

[62] On June 18, 2010, Ms. Tse and Ms. Khan sent a Direction To Produce Documents made pursuant to subsection 19(3) of the *Act* to Carter. The Direction set out in considerable detail the documents required, and asked for details of the relationship Carter had with its related parties.

[63] On June 18, 2010, Staff also sent three separate letters to NAFG, NAC and North American Mortgage Investment Corporation ("**NAMIC**"), seeking documents and information regarding their activities. On July 12, 2010, Mr. Gilkes, on behalf of Carter, NAFG, NAC and NAMIC, sent a letter to Ms. Khan and Ms. Tse, enclosing responses and supporting documents requested in Staff's letters of June 18, 2010 and the Direction to Produce Documents (Ex. 5, Tab 17).

[64] At the end of her examination-in-chief, Ms. Tse was referred to an email dated August 23, 2010 that was sent by Ms. Tse to Ms. Khan (Ex. 5, Tab 18). The email documented Ms. Tse's conversation with Flavio Arconti on August 23, 2010 when she posed as a possible investor. Ms. Tse put a call to Carter as an individual named "Amy Peterson", who was responding to a voicemail Flavio Arconti left the previous week. The woman who answered the phone answered as "North American Financial" and Ms. Tse was then transferred to Flavio Arconti. Mr. Arconti described three products being offered, including mortgage investments and auto leasing. When "Amy Peterson" asked if her money was safe, she was told by Mr. Arconti that she could lose all the money she invested and that it was not guaranteed.

[65] In cross-examination, Ms. Tse confirmed to counsel that she had no independent recollection of her conversations with the Arconti brothers, other than as recorded in her notes. She confirmed that in his conversation with "Amy Thorne" on June 9, 2010, Gino Arconti told her that a potential investor's financial assets must be over $1 million to be an accredited investor. It was made clear to her that if she decided to invest in the future, Gino Arconti would ask her a lot of questions before he took her investment.

[66] Ms. Tse confirmed to counsel that in his conversation with "Amy Peterson" on August 23, 2010, Flavio Arconti told her that the money invested was used to lease cars and was also for an affiliated car dealer. She confirmed that Mr. Arconti told her that she could lose all her money in the investment. She agreed that one should not take her conversation with Flavio Arconti as the sum total of what she might have been told if she had decided to go forward with the investment. That concluded Ms. Tse's testimony.

C. Marcel Tillie

[67] Staff called Marcel Tillie, a senior forensic accountant in the Enforcement Branch of the Commission. Mr. Tillie's evidence may be found in Tr. Vol. 2, pp. 148-193, Tr. Vol. 4, pp. 113-156 and Tr. Vol. 5, pp. 5-108. Exhibits entered through Mr. Tillie include Exs. 6-11 and Exs. 17-20.

[68] Mr. Tillie obtained his designation as a chartered accountant in 1989 and has worked in the Enforcement Branch of the Commission since March 2007. He was assigned to the NAFG file in mid-April 2011. His assignment was to prepare a source and application of funds in relation to this matter.

[69] Mr. Tillie attended the compelled examination of Flavio Arconti and the voluntary examination of Gino Arconti. Before and after the examination of Flavio Arconti, Mr. Tillie received a binder of documents from counsel for the Arcontis. He also received two bankers' boxes of information from TD Bank, BMO, CIBC and NAFG. Mr. Tillie stated that the only banking documents relevant to this proceeding were those of TD Bank, since the primary banking of NAFG was done solely with TD Bank. Shortly put, the exhibits entered through Mr. Tillie gave him the information he needed to prepare an accurate source and application of funds for the two TD bank accounts operated by NAFG. There was also a third bank account, an account ending in 653 ("**Account 653**'), which was NAC's bank account. Transfers were made from Account 653 to NAFG's bank account (Tr. Vol. 5, p. 36, ll. 2-5).

[70] Found at Ex. 7 are the banking documents with respect to the TD bank account ending in 896 ("**Account 896**"). Found in Ex. 8 are the deposit account histories and some back-up documentation for the TD bank account ending 652 ("**Account 652**"). Found in Ex. 9 is a continuation of supporting documentation for Account 652 for the period July 17, 2009 to December 31, 2009. Ex. 10 contains a number of documents, including the continuing documentation for Account 652 for the period January 4, 2010 to October 4, 2010. The signing officers for the two accounts were Flavio Arconti and Gino Arconti.

[71] Mr. Tillie identified Ex. 11 as containing the transcript of Flavio Arconti's compelled examination held on June 28, 2011, together with documents provided to Mr. Tillie as a result of the compelled examination. Included at Tab 2 at the back of Ex. 11, starting at page 456, are answers to undertakings obtained during the examination of Mr. Arconti.

[72] Mr. Tillie was referred to Tab C1, an income statement for NAFG from January 1, 2010 to September 30, 2010. Lease finance income for the period was $179,327.89, which represented interest paid by the lessees of cars. Items identified as leasing financing income and "NSF income" were amounts that could have been collected or amounts that might appear in accounts receivable. Ms. Carelli testified that "**NSF**" stood for "Not Sufficient Funds" (Tr. Vol. 1, p. 147, l. 25). Mr. Tillie said that "**NSF income**" represented the fee that was charged to a lessee when a lessee defaulted on their payments or when one of the lessee's payments did not go through the bank account of NAFG. Mr. Tillie said that, based on the income statement, the revenues of NAFG at the time were less than the interest paid to investors. Net income was a loss of $866,346.66 for the nine month period ending September 30, 2010. The total loan payables of NAFG as at September 30, 2010 was $3,391,746.42 (Ex. 11, Tab C2, p. 171). Mr. Tillie stated that to calculate the total loans payable, the total loans payable would have to be added to the loans receivable from Prestige Motors ($2,503,608.43) and deduct the accrued liabilities and accrued NSF income (approximately $80,000), making a total loans payable to investors of approximately $5.8 million (Tr. Vol. 2, p. 178, ll. 7-25; p. 179, ll. 1-11; Ex. 11, Tab C2, pp. 170-171).

[73] Mr. Tillie was then referred to the financial statements of NAFG as at November 30, 2010 (Ex. 11, Tabs C7 and C8). The total revenue of NAFG was significantly less than the investment interest paid to investors for the same period. For the 11 months ending November 30, 2010, there was a net loss of $1,318,646.89.

[74] Continuing with Ex. 11, Mr. Tillie was referred to a list of transactions in Account 652 that listed both debits and credits through the account for the period January 31, 2009 to October 4, 2010 (Ex. 11, Tab D10). The entries reference the TD bank records obtained by Staff. At Tab D11 is a similar document listing all the transactions going through Account 896 for the period January 2, 2009 through October 4, 2010. The significance of Account 896 was its use by NAFG as an arrears account to collect payments returned as "NSF" by lessees. Writers of NSF cheques were required to go to the bank and make a deposit into Account 896, rather than making an electronic fund transfer ("**EFT**") to make lease payments (Tr. Vol. 4, p. 117, ll. 4-20).

[75] I inquired of Staff counsel if the witness was somehow laying the ground work for his preparation of the source and application of funds. Counsel confirmed that this was so.

[76] There then followed a series of questions put by Staff to Mr. Tillie to identify the various types of payments going in and out of Account 652 and Account 896, along with Flavio Arconti's comments on those types of payments as recorded in his compelled testimony. Areas of concentration included attempts to identify the use of the credit cards that both the Arcontis held and payments to the Arcontis of management fees or salaries.

[77] Mr. Tillie was referred to a source and application of funds, which is found in Ex. 18, Tab A, along with supporting documents found behind Tabs B to J. Mr. Tillie confirmed that he was involved in the preparation and review of these documents.

[78] Mr. Tillie described the contents of "Schedule 'A'" in Ex. 18, Tab A, as a schedule identifying the source and application of funds of NAFG for the period of January 1, 2009 to October 4, 2010 for both Account 652 and Account 896. The two primary sources of funds were receipts from investors of NAFG and NAC, and lease payments and other deposits. The schedule organizes the application of NAFG's funds into six main categories, being:

(a) interest paid to investors;

(b) the amounts paid to Prestige Motors on a net basis;

(c) net payments to or for the Arcontis;

(d) operating expenses;

(e) repayments made towards NAFG's bank loan with TD Bank; and

(f) net payments to brokerage firms.

[79] Staff submitted "Schedule 'A' Revised" as Ex. 20 for the period January 1, 2009 to September 24, 2010 ("**Schedule A Revised**"). Staff made changes to the original schedule (found in Ex. 18, Tab A). Staff also went through each of the backup schedules in Ex. 18, Tabs B to J. Staff removed transactions that occurred after September 24, 2010 and revised the balances shown in the previous version of Schedule 'A', which can be found at Ex. 18, Tab A. In the revised schedule, Mr. Tillie included a "Reconciling item", which he submitted was an immaterial amount and therefore chose not pursue. Mr. Tillie confirmed that the total source of funds of NAFG equals the total application of funds for the period of January 1, 2009 to September 24, 2010.

[80] The figures discussed below at paragraphs 81 to 92, regarding Mr. Tillie's analysis of the source and application of NAFG's funds, will refer to the updated values that correspond to Schedule A Revised, which covers the period from January 1, 2009 to September 24, 2010.

[81] The total source of funds for NAFG was calculated by including the net "Receipts from Investors" (Schedule 'B'), the "Lease Payments and Other Deposits" (Schedule 'C') and the opening bank balances of NAFG's two bank accounts, as at January 1, 2009 (Ex. 18, Tabs B and C).

[82] The opening bank balances for Account 652 and Account 896 totalled $830.70 as of January 1, 2009 and the closing bank balances for both accounts as at September 24, 2010 totalled $98,021.66. Mr. Tillie testified that Schedule 'B' contains the details of the receipts from investors (net of repayments). Matters, such as the date of the transaction, description, the account that the transaction relates to and the debits or payments out of the account, all came from the banking information supplied to Mr. Tillie. With four exceptions, all of the receipts and repayments went into Account 652.

[83] In terms of the receipts from investors, found at Schedule 'B', a total of $2,908,170 was received from investors of NAFG, a total of $126,000 was received from investors of NAC and a total of $466,777.58 was repaid to investors. Mr. Tillie took these figures from Schedule 'B' and entered them into Schedule A Revised under "Receipts from Investors". For the period from January 1, 2009 through September 24, 2010, the net receipts from investors of NAFG and NAC amounted to $2,567,392.42.

[84] Mr. Tillie identified Schedule 'C' as showing lease payment and other deposits into the account of NAFG. This category included the following: lease payments, recovery from automobile sales and "unknown" amounts. Mr. Tillie testified that he analyzed the lease payments that were received by the company through EFTs. Mr. Tillie estimated that at least half of these payments were related to principal repayments by the lessees; nevertheless, he included the entire amount into Schedule A Revised for lease payments. Lease payments collected through Account 896, the arrears account, totalled $228,238.66. Lease payments, net of NSF returns of $339,631.65, amounted to $1,147,154.72. Amounts recovered from the disposal of vehicles or vehicle recovery totalled $86,696.27. "Unknown" amounts were figures that lacked specific details in their bank information, but appeared to be lease payments, and the total amount of which was $99,483.54. The total amount for "Lease Payments and Other Deposits" amounted to $1,333.334.53.

[85] The total application of funds for NAFG was calculated by including the net amounts of the "Interest Paid to Investors" (Schedule 'D'), payments to Prestige Motors (Schedule 'E'), payments to/for the Arcontis (Schedule 'F'), "Apparent Operating Expenses" (Schedule 'G'), NAFG's bank loan with TD Bank (Schedule 'H') and payments made to brokerage firms (Schedule 'I') (Ex. 18, Tabs D to I).

[86] Mr. Tillie described Schedule 'D' as a listing of debits, or payments, made out of the main operating account of NAFG, Account 652. These funds were identified as interest payments that were made to investors and totalled $1,642,413.28. This sum was added to Schedule A Revised as "Interest Paid to Investors".

[87] Mr. Tillie identified Schedule 'E' as a listing of transactions with payments to or receipts from Prestige Motors. The total amounts received by Prestige Motors was $703,407.98. The amounts paid to Prestige Motors were $1,580,907.53. These sums were reported on Schedule A Revised and showed a net payment to Prestige Motors of $877,499.55.

[88] Mr. Tillie reported that Schedule 'F' listed the payments to or for the Arcontis and related parties, along with monies received from the Arcontis and related parties. It lists the various advances from the Arconti brothers, which were all under shareholder advances and totalled $226,000. Amounts received or advanced through various credit cards totalled $53,036.12. Payments were also made directly to Flavio Arconti and/or Gino Arconti under the "Shareholder Withdrawals", which amounted to of $85,614.08. Payments made to various credit cards held by the brothers totalled $502,318.27. The totals from Schedule 'F' are captured on Schedule A Revised under the heading "Payments to/for Arconti", and the net total for such payments was $308,183.37. This value represented the money that went out of Account 652 for the Arcontis' benefit, less any payments made to the account by the Arcontis.

[89] Mr. Tillie described Schedule 'G' as apparent operating expenses. These included expenses related to accounting, auto recovery, bank charges, collections, and legal and regulatory services. The total of Apparent Operating Expenses came up to $953,127.59, as it appears in Schedule A Revised.

[90] Schedule 'H' lists bank loan repayments made throughout the period of January 1, 2009 to September 24, 2010. These repayments relate to the loan that NAFG had with TD Bank. NAFG was repaying that loan in monthly payments of $500.00. The total sum repaid to TD Bank during the period was $10,500, which was entered into Schedule A Revised.

[91] Schedule 'I' is entitled "Brokerage Firms", which includes a direct payment to TD Waterhouse of $150,000, followed by wire transfers in and out of NAFG's Account 652. These transfers were identified by Mr. Tillie as transactions with interactive brokers. Payments to interactive brokers were $480,000 in total receipts and the amounts received from the brokers were

$468,000. After subtracting the funds received from the brokerage firms from the payments made to these firms, the net amount paid to the brokerage accounts was $12,000.

[92] Counsel asked Mr. Tillie a series of questions to demonstrate what conclusions could be drawn from his analysis of the source and application of funds for NAFG. For the period from January 1, 2009 to September 24, 2010, the total lease payments received by NAFG was $1,333,334.53. Mr. Tillie was asked to compare these payments with the interest paid to investors. The total interest paid to investors during the period was $1,642,413.28. Mr. Tillie stated that the conclusion to be drawn from these two figures was that the receipts from lease payments were not sufficient to pay the interest paid to investors during the period (Tr. Vol. 5, p. 58, ll. 14-16). Mr. Tillie said there were only two primary sources of funds for the company: one was the lease payments and the other was the receipts from the investors (Tr. Vol. 5, p. 58, ll. 20-24). In other words, the only other source of funds to make those interest payments was from new investors.

[93] Mr. Tillie identified three deposits listed in Schedule 'B' that were made after the Director's Decision was issued on September 22, 2010. A deposit of $39,270 on September 23, 2010 was made up of deposits from four investors. A deposit of $50,000 from D.M.'s company was made on September 24, 2010, and a deposit of $22,000 from L.F. was made on September 27, 2010. When he was asked if any payments were made to investors during that period, Mr. Tillie identified a draft for $116,853.41 that was made out to M.G on September 28, 2010.

[94] On September 22, 2010, the balance in the main account, Account 652, was $32,692.89. On September 22, 2010, Account 896 had a balance of $112.05. Mr. Tillie was asked by Staff if he could determine whether the payment to M.G. in the amount of $116,853.41 included any part of the investor funds that were deposited on or after September 22, 2010. He replied that if the investor funds had not been deposited on September 23, 24 and 27, 2010, there would have been insufficient funds in the account to pay the draft to M.G.

[95] Counsel then took Mr. Tillie to Ex. 8, where he identified the investor deposit records by way of deposit slips and copies of cheques. Mr. Tillie confirmed that at the end of September 28, 2010 there was an overdraft balance of $9,842.80 in the main account operated by NAFG, being Account 652.

[96] Counsel asked Mr. Tillie to turn to Ex. 18, Tab J, which contains two pages. The first page shows balance sheets for each of the years 2007, 2008, 2009 and 2010 that was prepared by Mr. Tillie from the balance sheets provided to satisfy the undertakings Flavio Arconti made at his compelled examination. The entry "Lease Receivable" is found in the balance sheets under "Current & Long Term" assets. At the end of 2007, that figure was $4,374,488. By the end of 2010, it was reduced to $1,224,708. Lien and promissory notes payable at the end of 2007 totalled $3,035,453. By the end of 2010, that figure had ballooned to $5,920,947.

[97] The second page of Ex. 18, Tab J shows income statements for the same years and was prepared from the income statements provided in response to Flavio Arconti's undertakings. Mr. Tillie confirmed that leasing interest in 2007 was $495,843. It increased slightly in 2008, but by 2010 it had dropped to $232,509. In the same four-year period, interest paid to investors started at $374,816 and grew to $537,499 by the end of 2008. By the end of 2010, investors had been paid $805,815. Mr. Tillie concluded that for the period 2007 to 2010, there was no net income for any of the years presented, rather there was a net loss for each of these years. The cumulative effect of the losses resulted in a deficit at the end of 2010 of $2,596,002.

[98] At the end of July 2011, Mr. Tillie noted that NAFG had closed its TD bank accounts. He asked NAFG's counsel at the time for the name of the financial institution where NAFG was doing business, along with account numbers and copies of the bank statements of NAFG for these accounts (other than any TD accounts) from inception to its most recent statement. Mr. Tillie also prepared an income statement for the period November 1, 2010 to June 30, 2011. The total expenses for the period were $350,000.11, of which $39,000 was paid to the Arcontis.

[99] At Tab 6 of Ex. 19 is a document called the "Trustee's Report to the Creditors" of NAFG, dated January 7, 2011. Staff asked Mr. Tillie to read several lengthy excerpts from the trustee's report which, among other things, identified a range of values for "Noteholders – Unsecured", the high value of which was $5.523 million and the low value was $5.520 million.

[100] Mr. Smith had no questions in cross-examination.

[101] Mr. Tillie was an impressive witness. I have no reason to doubt the accuracy of his calculations or his analysis of the source and application of funds, as described by him in his evidence.

D. J.B.

[102] Staff called J.B., a man in his mid-fifties with a college degree. For the last fifteen years, he has worked for a courier company driving a small cargo van. His evidence may be found in Tr. Vol. 3, pp. 5-93. The documents filed during his examination may be found in Ex. 12.

[103] J.B. saw a small ad in the *Toronto Star* seeking investments in NAFG, which would pay an annual interest rate at 15%. He responded to the ad and met with Flavio Arconti in early February 2008. J.B. filled out an application form, which was in his handwriting, showing his annual income to be $60,000. H indicated in the form that he had other investments of $60,000, and he testified that the only other assets he had was his condo and his van. He estimated his total assets to be $300,000 at the time he filled out the application form.

[104] The form required J.B. to estimate his net worth, and he filled in an amount of $1,050,000. His explanation for doing so was that Flavio Arconti told him that the only way he could proceed with the investment was to show that he had a net worth of $1 million or more. In addition, he initialed paragraph (d) on page two of the application form that indicated he had financial assets exceeding $1,000,000. He gave the same explanation as before, that is, he was told it was a formality and he could only continue by indicating that he had financial assets in excess of $1,000,000.

[105] Flavio Arconti told J.B. that NAFG was borrowing money for auto leasing to people who had little or no credit. They were offering 15% and in turn were lending money to people of poor credit at 30%. Prestige Motors was mentioned during his first meeting, which J.B. understood to be the company associated with the lending arrangements.

[106] The loan agreement that was signed by J.B. was for an investment of $60,000 at an annual interest rate of 15%, in which interest would be payable monthly (Ex. 12, Tab B).

[107] J.B. approached NAFG, seeking to invest further sums in NAFG:

(a) on January 1, 2009, he invested $20,000;

(b) in June to July 2009, he invested a total of $17,000;

(c) on November 23, 2009, he invested $15,000; and

(d) on August 1, 2010, he invested $20,000.

[108] All of the above loans, including the original amount of $60,000, totalled $132,000 at an annual interest rate of 15%.

[109] J.B. testified that on all his loans, either Flavio Arconti or Gino Arconti told him he could not make the investment unless he acknowledged that he was an "accredited investor", that is, someone with financial assets of more than $1,000,000. He acknowledged that in each of the applications he made, he was warned of the risks of investing and that he understood the difference between a low-risk loan and a high-risk loan. He continued to sign and describe himself as an accredited investor.

[110] When asked about how his interaction with NAFG impacted his life, J.B. stated that the destructive effect on his life has been severe. He remains depressed.

[111] In cross-examination, Mr. Smith obtained J.B.'s agreement that every time he was ready to make an investment, he called the Arcontis. He told the Arcontis that he had good investment knowledge and that he had invested in Nelson Financial Group ("**Nelson**"), a company that was essentially in the same business as NAFG. To make that investment with Nelson, he had described himself as an accredited investor. J.B. confirmed to counsel that at the beginning of his relationship with the Arcontis, he would have paid more attention to the documents he was signing and rather less attention as further investments were made. He knew on the basis of the documents that he was taking a risk by making the investment. He acknowledged that he voluntarily signed the investment contracts, but continued to insist that the only way he could proceed, according to the Arcontis, was to acknowledge that he was an accredited investor. He understood the role that Carter played in his investment with NAFG.

E. L.F.

[112] L.F. is a self-employed man living in Sudbury, Ontario. In 2010, he was engaged in mortgages and loans. His evidence may be found in Tr. Vol. 3, pp. 94-140. Documents relating to his evidence may be found in Ex. 13.

[113] L.F. found out about NAFG from someone who had invested in Nelson. He called NAFG and spoke to Gino Arconti. They discussed the terms of his investment in NAFG over the telephone and L.F. subsequently received an application in the mail (Ex. 13, Tab A). He filled the application in and indicated that he was an accredited investor with over $1,100,000 in net liquid assets.

[114] L.F. was unclear on how many times documents were exchanged between him and Gino Arconti. He said he received a loan agreement in the mail, which had been previously completed, apparently by Gino Arconti, which he signed on September 21, 2010. The agreement called for L.F. to lend $22,000 to NAFG for which he would receive monthly instalments of interest at a rate of 12% per annum. He initialled the second page of the loan agreement at paragraph (j), indicating that he had net financial assets exceeding $1,000,000 (Ex. 13, Tab B).

[115] L.F. was referred to Ex. 13, Tab D, which contains a copy of a cheque for $22,000, signed by L.F. and dated September 1, 2010. He sent the cheque to NAFG by Purolator from Sudbury to Toronto. He was asked if he had been told that NAFG was in financial difficulty and whether he would have made the investment if he was told that the company was experiencing financial difficulties, to which he replied, “I'm not that stupid, I don't think that I would invest with them” (Tr. Vol. 3, p. 121, ll. 10-25; p. 122, ll. 1-8). L.F. was also referred to a copy of his bank statement, showing a cheque for $22,000 that went through the account on September 28, 2010 (Ex. 13, Tab E).

[116] In cross-examination, L.F. confirmed the facts recorded on his loan application were correct. He described his interaction with Gino Arconti as sending papers back and forth. Apparently he signed some papers, forwarded them to Gino Arconti and asked that they be sent back completed by NAFG. All he could remember is that documents were sent back and forth. L.F. confirmed that he knew he was making a high-risk investment and that the proceeds would be used to finance the daily operations of NAFG and its affiliates. His understanding of Prestige Motors confirmed to him that NAFG was a going concern in dealing with the kind of cars he was interested in.

F. J.S.

[117] J.S. is a retired gentleman in his early eighties living in Toronto, Ontario. He worked as an environmental scientist until 1996. His evidence may be found in Tr. Vol. 3, pp. 141-202. Documents referred to in his evidence may be found in Ex. 14.

[118] J.S. learned about NAFG through an ad in a newspaper. He telephoned to make an appointment and went to NAFG's office and met with one of the Arconti brothers. He thought most of his dealings were with Gino Arconti. J.S. understood that NAFG would purchase used automobiles and then lease them to people over shorter periods of time at rates that would almost pay off the cost of the vehicle. He was not told anything about the financial condition of NAFG. Rather, NAFG appeared to be a viable operation that was following a business plan of a company named Carfinco, which seemed to be a successful operation. The Arcontis asked him if he was an accredited investor and he confirmed that he was. In making the calculation of his assets, he included the value of his home. He said he was never aware that you had to exclude real property. The combined income of J.S. and his wife was approximately $90,000.

[119] J.S.'s attention was drawn to Ex. 14, Tab A, which contains a loan agreement. The agreement confirms that he loaned $30,000 to NAFG and was to receive annual interest at 15%. He agreed that he and his wife signed the loan agreement, as well as an acknowledgement that they were accredited investors. J.S. confirmed that if he took his house out of his calculations, he would not qualify as an accredited investor.

[120] J.S. was referred to Tab C in Ex. 14, a document described as a “New client application form” on the letterhead of Carter. J.S. said that he knew very little about Carter, but confirmed that he and his wife signed the form. The handwriting on the form under the “Financial information” and “Investing information” headings was not that of J.S. It appears to have been the handwriting of Gino Arconti. Although the form indicated that J.S. was an accredited investor, J.S. told Staff counsel that his net financial assets at the time were less than $600,000. The form described his investment knowledge as good and J.S. agreed that that was so at the time he signed the form in January 2010. He disagreed with the box on the form that indicated he was seeking a “high-risk/high return” investment. He would have indicated that he was seeking “medium-risk/medium return” investment. Although the form indicated that the value of his investments was $1,500,000, this was denied by J.S.

[121] On September 1, 2010, J.S. invested in a convertible debenture for $40,000 (Ex. 14, Tab F). J.S. was referred to Ex. 14, Tab H, a document entitled “Notice of Conversion”, also dated September 1, 2010. The document indicates that J.S. and his wife converted their original investment of $40,000 into units of NAFG. Apart from the signatures, the handwriting on the document appears to be that of Gino Arconti. The Private Placement Subscription Agreement for the debenture is found at Ex. 14, Tab F. The document appears to have been completed by handwriting similar to that of Gino Arconti. The debenture is in the amount of $40,000, being the original amount invested by J.S. and his wife, and is completed to show that J.S. was an accredited investor. In his testimony, J.S. continued to affirm that he was not an accredited investor on September 1, 2010. His understanding of the debenture was that NAFG no longer could pay an annual interest rate of 15% to investors and that “they were doing some footwork to lower it, but still keep the investors in place” (Tr. Vol. 3, p. 173, ll. 13-19). He confirmed that neither of the Arcontis told him that NAFG was experiencing financial difficulties.

[122] In cross-examination, Mr. Smith pointed out to J.S. that he had represented that he had assets in excess of $1,000,000 at the time J.S. signed the documents. J.S. repeated that he did not understand that he had to exclude his house. He acknowledged that the term “accredited investor” was a term with which he was familiar. He confirmed that he told Gino Arconti that he was an accredited investor. He confirmed that he sought out NAFG rather than the reverse.

[123] Mr. Smith suggested to J.S. that the information in the “New client application form”, found at Ex. 14, Tab C, was provided by J.S. to the Arcontis. In other words, the Arcontis filled out the form, and J.S. then reviewed and signed it. J.S. disagreed with this suggestion.

[124] Counsel referred J.S. to Ex. 14, Tab F, which is the Private Placement Subscription Agreement dated September 1, 2010, signed by J.S. and his wife. J.S. confirmed that the Arcontis approached them about the possibility of converting their prior investment of $40,000 into a convertible debenture. The Arcontis said they could no longer afford to pay 15% and that they wanted to reduce the interest payable to 5%. Counsel pointed out a paragraph in the agreement that the proceeds of the offering would be used to finance the daily operations of NAFG and its affiliates. J.S. acknowledged that he had read that paragraph when he signed the document, but he had no discussion about those companies with the Arcontis.

G. R.B.

[125] R.B. is a man in his late forties, living with his wife just east of Toronto, Ontario. He is a teaching assistant and he is working towards a PhD. His evidence may be found in Tr. Vol. 4, pp. 7-48. The documents referred to in his evidence may be found in Ex. 15.

[126] R.B. first invested in NAFG in March 2010. At the time, his salary was $16,000 a year and his wife's salary was approximately $50,000 a year. He estimated he had financial assets of $600,000 to $700,000, excluding his house. Including his house, he estimated his total net worth to be approximately $1,200,000. In March 2010, he thought an accredited investor was someone who had good credit. Staff drew his attention to Ex. 15, Tab C, a document entitled "Schedule 'A' Certificate of Accredited Investor". R.B. and his wife had put their initials beside paragraph (j), which indicated that their financial assets were worth more than $1,000,000, but R.B. understood this paragraph to mean that they would be accredited investors if their entire worth was more than $1,000,000. He explained by saying that, including his house, his net worth was approximately $1,200,000. He was unaware that he could not include his house in calculating the total value of his net financial assets.

[127] R.B. learned of NAFG through someone who invested in Nelson. He was given a number to call and spoke with Gino Arconti. Shortly thereafter, he received a package of information from NAFG found in Ex. 15, Tab A.

[128] R.B. said he read the information received from NAFG with care and was struck by the reference to the 20-year history of the company, as well as its business plan, which he recognized to be similar to that of Nelson. He was also encouraged by the GPS locator put in the cars that NAFG sold to persons of poor credit. Summing up his reaction to the information received from NAFG, R.B. said that it appeared to be a "pretty solid company and, you know, a place you would want to invest" (Tr. Vol. 4, p. 22, ll. 1-3).

[129] He next had a conversation with Gino Arconti, where he indicated his willingness to invest. There was no discussion about the accredited investor requirement. He attempted to set up a date to meet Gino Arconti at the office, which proved difficult since they could not get their schedules to meet. Gino Arconti suggested that he would send him the documents in the mail, which R.B. was to sign and return.

[130] In Tab C of Ex. 15 is a loan agreement signed by R.B. and his wife in the amount of $70,000 with an annual interest rate at 15%. Someone signed for NAFG, but R.B. and his wife were not present when that was done. He confirmed his and his wife's signatures on the Schedule 'A' Certificate of Accredited Investor form.

[131] R.B. confirmed that no one told him about the financial condition of NAFG nor was he told that the money he was investing would be loaned to a car dealership owned the Arcontis. He also confirmed that he entered into a second loan agreement with NAFG in March 2010, advancing $14,500 with an annual interest rate at 12%.

[132] In August or September 2010, R.B. was contacted by Flavio Arconti, who informed R.B. that the Arcontis wanted to come and see him, and arranged to meet at R.B.'s house. R.B. learned at the meeting that NAFG was having difficulty paying its high interest rates to investors and it needed to lower those rates. R.B. asked the Arconti brothers if NAFG was insolvent and they responded it was not. R.B. asked if the Commission was involved with them and they responded it was not. R.B. did not enter into a new loan agreement.

[133] Subsequently R.B. learned of NAFG's receivership with Farber. His investment was reduced by 50% and he received some paperwork stating that he would receive a 1% monthly payment on his 50% remainder. He confirmed that if he had known that NAFG was in financial difficulty before he invested in March 2010, he would never have considered doing so. When asked about how his involvement with NAFG affected him, R.B. stated that it has had a very negative effect and it was a horrible experience for him and his wife.

[134] In cross-examination, R.B. confirmed that he told Gino Arconti that he had invested in Nelson before his investment in NAFG. He acknowledged that after he read paragraph (j) of "Schedule 'A' Certificate of Accredited Investor" (Ex. 15, Tab C), he then knew that an accredited investor was something more than someone with good credit. However, what he did understand was that "financial assets" included his home as well. He denied that in a subsequent conversation with one of the Arcontis that they discussed R.B.'s financial circumstances. There was no discussion of whether R.B. was a low-risk, medium-risk or high-risk investor. Regarding his meeting with the Arcontis in August or September 2010, counsel suggested that R.B. did not ask his

questions regarding the solvency of NAFG at the meeting, but that those questions were asked much later. This was denied by R.B.

H. D.M.

[135] D.M. is a man in his early forties with a degree in Engineering. He is self-employed and works for a communications company as an IT professional. His evidence may be found in Tr. Vol. 4, pp. 49-112. The documents filed during his examination may be found in Ex. 16.

[136] D.M.'s accountant recommended that he consider investing in NAFG. After meeting with Gino Arconti in September 2010, he received a Confidential Term Sheet in relation to the "Convertible Debenture Offering" (Ex. 16, Tab E), which he looked over before deciding to invest. He met with the Arcontis on September 18, 2010 and was told that there would be an announcement that NAFG would be going public. He examined a brochure (Ex. 16, Tab A), which contained a lot of information that made him confident that NAFG was a worthwhile investment. He was asked to review a number of documents found at Tabs B to E in Ex. 16, including a Joint Client Application Form, a Private Placement Subscription Agreement, a Notice of Conversion and a Confidential Term Sheet. All of these documents were filled out by either Flavio Arconti or Gino Arconti and signed by D.M. The documents indicate that D.M. had a net worth exceeding $1 million in financial assets. For example, the Joint Client Application form indicated that D.M.'s net worth was $2 million at the time he signed the form on September 20, 2010 (Ex. 16, Tab B). However, D.M. testified that he and his wife did not have financial assets in excess of $1 million, but he was told he had to show that he did or he could not participate in the investment.

[137] D.M. wrote a cheque to NAFG from the account of his company for $50,000 dated September 1, 2010 (Ex. 16, Tab H). D.M. sent an email to the Arcontis confirming their discussion, whereby NAFG would hold off cashing the cheque until D.M. rounded up the funds, which he expected to do so by the following Friday (Ex. 16, Tab I). On Friday, September 24, 2010, Gino Arconti emailed D.M. asking if he could put the cheque through. D.M. responded almost immediately that day, confirming that the cheque could go through (Ex. 16, Tab F). The cheque was deposited into NAFG's main bank account, Account 652, on September 24, 2010.

[138] At no time did the Arcontis tell D.M. that NAFG was in financial difficulty. According to D.M., what they did tell him was that they were planning to "take the company public" (Tr. Vol. 4, p 73, ll. 5-10). His investment would be converted into shares in the public company and thereby have the potential of a significant increase in value.

[139] In cross-examination, D.M. confirmed that one of the Arcontis told him the security could not legally be sold to him if he did not have a net worth above $1,000,000. D.M. confirmed that when the figure of $2 million was written in on the Joint Client Application, D.M. was aware that the information was false. D.M. further confirmed that he was looking for a high-risk, high-return investment, as indicated in the documents he signed. He knew he could lose his total investment. Counsel pointed out to D.M. that the documents made it clear that the possibility of the company going public was completely contingent. D.M. agreed, but continued to insist he was told by the Arcontis that the company was going public in January 2011. He conceded that the documents revealed the investment he was making could be used for a number of purposes, including the operation of a group of companies, such as Prestige Motors.

PART 3 – RESPONDENTS' WITNESSES

A. Flavio Arconti

[140] Mr. Arconti's evidence is found in Tr. Vol. 6, pp. 33-167, Tr. Vol. 7, pp. 4-180 and Tr. Vol. 8, pp. 8-177. Documents introduced during his testimony were entered as Exs. 21 and 22.

[141] Mr. Arconti is 42 years old. He completed one semester at York University and then left to start an automotive dealership business with his brother, Gino Arconti. He began by buying and selling mainly used cars. He moved several times over the last few years. The last location for Prestige Motors was in the Highway 400 and Finch Avenue area, which is north of Toronto, Ontario. That facility comprised of a 30,000 square foot building and three acres of space that could accommodate about 600 cars.

[142] Flavio Arconti was responsible for purchasing used vehicles through various dealer networks, as well as attending wholesale auctions. He hired salespersons, trained them and assisted with sales on the floor. He also interviewed business managers at the dealership and hired them as required. He described Gino Arconti's role as closer to an operations manager. He oversaw the re-conditioning of the vehicles that came into inventory, managed the mechanics and the re-conditioners, assisted with sales management and also hired salespersons and other employees. The Arcontis were, for all intents and purposes, 50-50 partners.

[143] The majority of the purchases from Prestige Motors were financed and many potential customers were unable to obtain bank approvals for their car loans. In 2003 and 2004, there was an expansion of sub-prime lending to such persons, which

caught the attention of the Arcontis. NAFG was created to hold motor vehicle leases and the Arcontis began issuing securities by way of loan agreements with accredited investors. They were assisted by Cassels Brock in putting the loan agreement together. In late 2005, they raised approximately $170,000 of equity financing from friends and family members. They attempted to obtain the services of as HDL Capital Corporation ("**HDL**") to see if they could assist with their financing, but were told to come back when the company was a larger size.

[144] Carter was formed in early 2007. NAFG had been advertising as an issuer of exempt market securities and received an inquiry from the OSC. They immediately contacted Cassels Brock for advice, who recommended that they apply as a limited market dealer if they wished to engage in the business of raising securities. Ultimately, they obtained approval for Carter as an Exempt Market Dealer in September 2007. Flavio and Gino Arconti became registrants, with Flavio Arconti as the designated compliance person. Their advertisements in the *Toronto Star* generated many responses, 95% of which were people who did not meet the definition of an accredited investor.

[145] Mr. Arconti then described the difficulties with the automotive industry in 2008 and the collapse in the financial markets. In late 2008 or early 2009, the Arcontis were informed that they were to be the subject of a compliance review, the 2009 Compliance Review. Cassels Brock referred the brothers to David Gilkes, a former manager of registration at the Commission, who subsequently left and went into private practice. Mr. Gilkes assisted the Arcontis with meeting the compliance review requirements.

[146] Following a visit from Staff, the Arcontis received requests for documents and information, which they provided with the help of Mr. Gilkes. Four or five months later, the Commission issued a deficiency report.

[147] One concern expressed by the OSC was the form and content of NAFG's marketing brochures, which were prepared by Flavio Arconti and for which he accepts responsibility.

[148] Counsel took Flavio Arconti through a series of different brochures that were issued by NAFG to prospective investors over several years. One could not characterize the content of the early brochures as modest. Indeed, the material conveyed a picture of a thriving company with a successful business in competition with large players in the sub-prime lending business. Based on Mr. Tillie's evidence I find nothing could be further from the truth.

[149] By letter dated April 24, 2009, the OSC sent a deficiency notice to the Arcontis, the 2009 Deficiency Report. The two significant deficiencies were the lack of procedures designed to satisfy the requirements of KYC, and the lack procedures to determine if prospectus exemptions were available to persons who invested in NAFG. The Arcontis immediately spoke with Cassels Brock and David Gilkes. Mr. Gilkes drafted a response to the Commission, which was dated May 25, 2009, signed by Flavio Arconti and addressed to the Commission (the "**May 2009 Letter"**). Mr. Arconti testified that the effort to comply with the Commission's demands was of the highest high priority for NAFG. Mr. Gilkes assisted in preparing a new version of the New Client Application Form that would be used going forward. A Certificate of Accredited Investor was also prepared. The compliance review continued almost until the end of 2009, with correspondence going back and forth between NAFG and the Commission. Mr. Arconti thought at the time that he had the best advisors money could buy and from whom he was obtaining advice on what to do and how to comply with the requests of the OSC. In late 2009, the Arcontis learned that the OSC was starting a second compliance review in early January 2010, the 2010 Compliance Review.

[150] The Arcontis immediately called Mr. Gilkes, who did not understand why there was to be a second compliance review. The OSC requested "a lot of documents" (Tr. Vol. 6, p. 86, ll. 11-14). At a meeting on January 5, 2010, Flavio Arconti told the OSC that the default rate on the leases was historically 15% every year. He explained that what he meant was that in year one of the lease, there was a 15% default ratio and that in the second year it would accumulate and continue to do so for each year that followed. The probability of default went higher and higher in each year of the lease. Flavio Arconti confirmed at the meeting that he had little experience with compliance matters.

[151] Mr. Smith then asked Flavio Arconti about NAC. Mr. Arconti confirmed that the money invested in NAC went to NAFG. NAC was not licensed to lease vehicles to consumers and therefore NAFG was the conduit for the lease transactions. Mr. Arconti said that people who invested in NAC understood that they were investing in a group of companies, primarily in NAFG.

[152] Counsel then turned to the matter of an accredited investor and asked a series of questions about how seriously Mr. Arconti took his obligations to be satisfied that investors were truly accredited investors. Mr. Arconti confirmed that if an investor included their principal residence in the calculation of financial assets, Mr. Arconti would have told them that was not permitted.

[153] Mr. Arconti was also asked a number of questions about claims contained in the various marketing brochures sent to investors. He admitted that the wording in some of the statements could be construed differently than he interpreted it to mean. He acknowledged that some of the statements in the brochures could have been reworded slightly. This led Mr. Smith to submit a brief of new documents entered as Ex. 22, containing the revised brochures prepared by David Gilkes sometime after July 22, 2009. Mr. Arconti estimated that the new brochures would have been distributed to investors in August and part of September 2010, since the Director's Decision was released in the latter half of September 2010.

[154] Staff had questioned the existence of the loan to Prestige Motors and Mr. Arconti was asked if anything was done to address that criticism. Mr. Arconti described this issue as an oversight and that there was every intention to pay back the loan.

[155] Mr. Arconti was then asked a series of questions, and the answers to which stressed the difficulty the Arcontis faced when responding to the 2010 Compliance Review. He described the time spent in preparing statements and documents for Staff and the difficulties this activity presented. All the while, Mr. Arconti said they were attempting to deal with decreased commercial activity caused by the 2008 financial crisis and the decreased activity in vehicle sales. Nevertheless, the Arcontis anticipated that, following the compliance review, Staff would issue a deficiency report that could be satisfied by the Arcontis, who were working in conjunction with their professional advisors. Mr. Arconti told his counsel:

> We were going to sit down with our advisors and clearly address any deficiencies on anything that the staff had – would request for changes. We would make sure that we would comply hundred percent.
>
> (Tr. Vol. 6, p. 143, ll. 3-7)

[156] When the Arcontis learned from the June 2010 Letter that Staff would recommend to the Director that Carter's registration as an Exempt Market Dealer be revoked, Flavio Arconti was shocked. There then followed a full review by the Enforcement Branch of the OSC.

[157] Counsel then turned Mr. Arconti's attention to the testimony of Staff's investor witnesses. Mr. Arconti remembered meeting J.B. J.B. told Mr. Arconti that he had net financial assets that exceeded $1 million and that he was an accredited investor. Mr. Arconti asked no further questions of J.B. as to his status as an accredited investor and acknowledged that he "should have dug a little deeper to identify the sources of these financial assets" (Tr. Vol. 6, p. 159, ll. 12-17). He denied ever telling J.B. that signing and initialling statements to the effect that he was an accredited investor was a mere formality. He did not force J.B. to sign any of the documents he signed. He confirmed that J.B. was invited to a meeting where he was asked to voluntarily convert from a higher-yield paying instrument into a convertible debenture with a lower yielding 5% coupon. J.B. was not interested.

[158] Mr. Arconti denied having any contact with the investor L.F.

[159] Mr. Arconti's attention was drawn to Ex. 14, containing the documents pertaining to investor J.S. Mr. Arconti said he would have discussed the issue of an accredited investor with J.S. He denied telling him that it was not important whether or not it was true that he had financial assets that exceeded $1 million. It was J.S. that supplied the number for his estimated net financial assets at $1.5 million. J.S. was one of the investors who was asked to convert his investments to a lower-yield paying instrument.

[160] Counsel then asked questions regarding the investor R.B. and his wife. Flavio Arconti stated that he had no involvement with R.B. in March 2010 when his initial investment was made. Mr. Arconti got in touch with R.B. in August or September 2010 to schedule a face-to-face meeting, when both Arcontis visited R.B. at his home. The brothers explained that NAFG could no longer pay the high rates of interest and that they needed to get their cost of capital down. However, R.B. was unwilling to change the terms of his investment. Flavio Arconti did not remember having any conversations with respect to NAFG's insolvency. He added that R.B. never asked them if there were OSC proceedings against NAFG. In his testimony, R.B. stated that he had received a marketing brochure from NAFG that described the investment as an "an attractive safe high yield income-generating investment for the investor" (Ex. 15, Tab A). Mr. Arconti explained that the version of the brochure that was sent to R.B. was never approved for distribution and that the word "safe" was a drafting error.

[161] Finally, Mr. Arconti was asked about D.M.'s investment and the documents in Ex. 16. Mr. Arconti testified that since D.M.'s accountant was an investor with NAFG and an accredited investor, his accountant would have clearly known if D.M. was an accredited investor. Mr. Arconti denied telling D.M. that it was unimportant or irrelevant whether his estimated net worth in liquid assets were accurate. He denied changing the number that appears on the form in Tab B of Ex. 16 from $1 million to $2 million. D.M. invested in a convertible debenture with NAFG and Mr. Arconti denied promising D.M. that the company was going to be publicly traded as of January 1, 2011.

[162] Counsel then directed Mr. Arconti's attention to Ex. 18, which includes documents related to Mr. Tillie's source and application of funds, receipts from investors, monies received and paid to Prestige Motors and payments to or for the Arcontis and related parties, as well as other pertinent analyses. Mr. Arconti was asked how often he looked at the company's financial statements and his reply was that he reviewed them on a yearly basis. When the financial statements were compiled for a fiscal year, he and his brother would then review the operations of the company. This usually happened probably a month or two after the fiscal year end. I find this evidence difficult to accept. My ordinary life experience and common sense tells me that persons in the sale of used cars and the financing of high interest loans would be extremely interested in how the business was doing, if not on a daily basis, then certainly weekly and monthly.

[163] Mr. Arconti said that by the time of the OTBH and the Director's Decision, he had not seen the financial numbers for 2010. He said that he had no idea how large the losses were. He pointed out that the ongoing regulatory issues they were trying to correct took a lot of time and resources away from operations of the companies, and that, unfortunately, significantly impacted the revenues for that current year. I take from what Mr. Arconti said that the reason revenues were so poor in 2010 was due, at least partially, to the regulatory activities of the OSC. I contrast this with Mr. Arconti's earlier evidence that all the financial information provided to the OSC flowed from Ms. Widjojo (Tr. Vol. 6, p. 137, ll. 9-10).

[164] During the course of his evidence, Mr. Arconti went into some detail about the efforts of the Arconti brothers to obtain financing through a third-party, HDL. There was considerable evidence about HDL's willingness and belief that it could raise $2.5 million for NAFG and the meetings that took place to develop a suitable course of action. A letter of engagement was signed. Mr. Arconti obviously felt the principals responsible for HDL were of high calibre and capable of carrying through with a suitable financing. HDL cancelled the letter of engagement when it learned of Carter's Suspension with the OSC. Mr. Arconti described the cancellation as extremely devastating for NAFG. He felt NAFG had a real plan of action to grow the company, to make it a successful company, to move the company forward and everything was taken away from them. Once again, there was a suggestion in Mr. Arconti's evidence that it was the fault of OSC that caused HDL to terminate its relationship with NAFG.

[165] Mr. Arconti concluded his examination-in-chief by repeating his shock at the suspension of Carter's registration from the Director's Decision. Shortly thereafter, NAFG filed a proposal under the *BIA*.

[166] Staff counsel began Mr. Arconti's cross-examination by asking if either he or his brother attended the OTBH. Mr. Arconti confirmed that they did, but neither of them testified. There followed a series of questions concerning NAFG's business that were neither confusing nor complex. Nevertheless Mr. Arconti did his best to avoid giving direct answers, either claiming he could not remember or giving answers unresponsive to the question. This led counsel to observe:

> Q. Mr. Arconti, it's going to be a lot smoother … I just had a very specific question. I'm not trying to trick you. My question is simply: Was NAFG deriving revenue from lease payments from lessees?
>
> A. That was one component of our business.
>
> (Tr. Vol. 7, p. 70, ll. 14-20)

[167] Mr. Arconti confirmed his evidence given in examination-in-chief that after he looked at the financial statements for the fiscal year 2008 at the beginning of 2009, he did not monitor the monies coming in from lessees until a year later. He added that he would not have looked at them until January or February 2010.

[168] Mr. Arconti was referred to Ex. 2, Tab 16, which contain notes taken by Staff at a meeting on January 25, 2010. Counsel sought confirmation about the answers given by Mr. Arconti at that meeting with respect to the policies and procedures manual of Carter. Mr. Arconti's answers to questions put to him during this portion of his cross-examination were not responsive. Immediately before the lunch recess the following exchange took place between Mr. Arconti and myself:

> Chair: Before we break – just remain standing, Mr. Arconti, if you would, please – part of my task in this hearing sometimes requires me to make findings of credibility, and in making findings of credibility one of the things that I take into account are the responses that witnesses make to questions.
>
> What I have observed in the responses that you've made during the course of your testimony both to your counsel and to Staff counsel, are not necessarily as responsive as I think they could be. Now, you're entitled to know this, you see, –
>
> The Witness: Okay.
>
> Chair: – and the reason you're entitled to know this is if there is a permanent, continual attempt to avoid answering a question directly, then at a certain point that may require me to make a finding of credibility that isn't very useful for your purposes.
>
> So what I want you to do is listen carefully to the questions. If the question is answered by a "yes" or a "no" and you're comfortable with that, then I want you to consider whether you should answer "yes" or "no".
>
> Now, let me repeat. You're entitled to know this. It's not fair to you for me to sit here for the entire hearing and then in my findings make my findings based on my observations. You're entitled to know that now before we go any further.

> The Witness: Okay.
>
> Chair: Do you understand that?
>
> The Witness: Yes, I do.
>
> (Tr. Vol. 7, p. 94, ll. 10-25; p. 95, ll. 1-16)

[169] Staff counsel then drew Mr. Arconti's attention to the two compliance reviews initiated by Staff. Mr. Arconti acknowledged that as a result of the compliance reviews, the practices and procedures of Carter and the NAFG group of companies were amended to demonstrate the importance that investors were accredited. During the course of this cross-examination, Mr. Arconti testified that every single letter that was drafted and sent to the OSC was prepared by David Gilkes and signed by Mr. Arconti on Carter's letterhead. Counsel then put to Mr. Arconti certain financial statements submitted to Staff as a result of undertakings given under his compelled examination. Mr. Arconti confirmed that he was aware as of March 2009 that Prestige Motors owed NAFG approximately $1.2 million as of the 2008 financial year-end. He also confirmed that the deficit for NAFG as of December 2008 was $861,131.73, and that in March 2009 he knew this to be so (Ex. 18, Tab J, p. 36).

[170] Counsel then drew Mr. Arconti's attention to the trial balance for December 31, 2009 for NAFG. Mr. Arconti confirmed that the document showed NAFG's loan to Prestige Motors at $1,987,084.74. He also confirmed that he was aware on January 25, 2010 that the loan had reached almost $2 million. Staff counsel referred Mr. Arconti to the trial balance item entitled "Customer Age Summary" as at December 31, 2009. Mr. Arconti confirmed that he knew that approximately 80% of the current receivables were in the "91+" day default category, but pointed out that he did not prepare the report. Ms. Widjojo was responsible for the preparation of that information. When asked if he reviewed the Customer Age receivables, he said he did glance at them occasionally, but left it up to the accountant and "receivables" people.

[171] Staff referred Mr. Arconti to documents prepared by Ms. Widjojo for the year ending December 31, 2009. Mr. Arconti acknowledged that the loan to Prestige Motors was over $2 million and that the accumulated deficit for NAFG was over $1.1 million.

[172] Mr. Arconti denied that he knew there were problems with the marketing materials for which he was responsible. He denied recalling that Staff raised issues about the marketing materials during the 2010 Compliance Review. He said that the first time he knew of any problems with the marketing materials was when he received the June 2010 Letter. He denied that compliance deficiencies with the marketing material were discussed with him prior to his receipt of the letter.

[173] Finally, Staff attempted to obtain Mr. Arconti's agreement that as of April 29, 2010, NAFG was not in a good financial situation. Mr. Arconti responded:

> I do admit that there were losses. We were attempting to repair those. We had addressed those. We understood where we were currently. We had retained financial advisors to assist us.
>
> So I understand what you're saying, and I do agree with you, but there were definite major steps towards bringing this company to profitability.
>
> (Tr. Vol. 7, p. 161, ll. 10-16)

[174] In Mr. Arconti's examination-in-chief and cross-examination, he never wavered in asserting that although NAFG and its associated companies were losing money, they were working to return the companies to profitability and were confident that they could do so.

[175] It was put to Mr. Arconti that he transferred ownership of his family home, which had previously been jointly owned by him and his wife, into his wife's name alone. He confirmed this to be so. He said he made a transfer with proper consideration and there was a personal reason. He was going to start flying again with his private pilot's license and was also buying a motorcycle. His wife thought he was being very risky with his actions and she therefore asked for the transfer of his interest in the matrimonial home. He was asked to explain why Gino Arconti did the same thing with his residence, and Flavio Arconti replied that it had nothing to do with him. He denied that he was putting the interest in the matrimonial home beyond the reach of the OSC or potential creditors.

[176] Mr. Arconti stated that the regulatory burden created by the OSC was making things difficult for him. The Arcontis had hired professionals and the professionals were telling them that NAFG had a viable plan and that it was going to work.

[177] On May 9, 2013, the cross-examination of Flavio Arconti continued all day. Much of the day was spent revisiting areas previously covered in the preceding day on May 8, 2013, particularly regarding questions designed to obtain responses from Mr. Arconti which he was not prepared to give. On more than one occasion, I was compelled to invite Staff to move on when a

particular line of questioning was either unclear or unhelpful. Three major lines of inquiry were prominent during the day's cross-examination.

[178] The first line of inquiry centered on counsel's efforts to get Mr. Arconti's agreement that NAFG was not a financial success in March 2009:

> Q. And did you view NAFG as at March 2009, a company that had losses year over year and continued to have losses from the end of 2008, did you view NAFG as a successful company?
>
> A. The – financially it was losing money, but we believed with this deployment of this technology, it was assisting us bringing in higher numbers than if we weren't.
>
> Q. So did you believe that NAFG was a successful company in March 2009?
>
> A. I believed it was going to be a successful company at some point. We did have some losses. We were working with advisors. And I believed at some point we would be profiting.
>
> Q. All right. So you understood as at March 2009, it was not a successful company?
>
> A. I believe it was successful. There were some losses. You don't measure success by just simply a snapshot of a financial statement in a specific time. There's intrinsic value and enterprise value that this company had.
>
> (Tr. Vol. 8, p. 48, ll. 21-25; p. 49, ll. 1-16)

[179] The second line of inquiry was an effort by counsel to obtain Mr. Arconti's agreement that the various marketing brochures he created were designed to give a false impression of NAFG's financial health:

> Q. And I put it to you that in preparing this brochure, you were trying to convey an image of NAFG as a large successful company.
>
> A. No.
>
> Q. And, in fact, you knew that NAFG was a small, unsuccessful company when you prepared this brochure?
>
> A. No.
>
> Q. And you were concerned that if you gave the true information about the company in this brochure, no one would want to invest in this company?
>
> A. No.
>
> (Tr. Vol. 8, p. 53, ll. 2-13)

[180] The third line of inquiry was focused on the alleged failure of NAFG to give investors an accurate picture of the financial condition of NAFG:

> Q. By June 2010, you are being told by the Ontario Securities Commission staff that it's their view that you are in breach of securities law by selling your product to investors without telling them about the severe financial condition of your company. Correct?
>
> A. Could you repeat that question one more time? Sorry.
>
> Q. On June 23, 2010, the Ontario Securities Commission staff are providing you their view that they – they are of the view you are in breach of Ontario securities law because you are not telling your investors in NAFG about the severe financial condition being faced by that company?
>
> A. Again, we're going back to the private issuer. We consulted with David Gilkes. He says there's no requirement to provide financials. And we were working it internally, restructuring, reorganizing our company to profitability.
>
> So we – I didn't know.

Q. And instead of providing information to investors about the financial circumstances of NAFG, you attach even more financial information about successful other companies that aren't at all comparable to NAFG, correct?

A. We were trying to demonstrate that we have engaged [an] investment bank, and we were moving to a similar model of the Carfinco. And that's where we were moving to. We had an investment bank. We made explanations about that. We were trying to educate people about the industry, how it – the industry is currently performing, and providing research reports that were pulled off the Carfinco website.

We would print them out and say, look, if you want to read – I didn't have a research report on my company. I had independent research reports available through the Internet. We submitted that to investors. We were just trying to educate them, and we were trying to move into that area.

(Tr. Vol. 8, p. 95, ll. 4-25; Tr. Vol. 8, p. 96, ll. 1-17)

[181] The cross-examination of Flavio Arconti concluded with questions directed to various credit card expenses analyzed in Mr. Tillie's evidence. Neither the questions nor the answers are of much help to me.

B. Luigino (Gino) Arconti

[182] Gino Arconti is 46 years old and completed grade 12. After working in construction and real estate, he and his brother started Prestige Motors together on a part-time basis which became full-time in 1994. They were simply buying and selling cars, primarily used cars.

[183] Mr. Arconti's evidence is found in Tr. Vol. 10, pp. 5-198 and Tr. Vol. 11, pp. 1-126. Documents introduced during his testimony were entered as Exs. 26, 27 and 28.

[184] Mr. Arconti had an operational role preparing and cleaning cars, and overseeing sales staff and mechanics. Prestige Motors grew gradually as it moved from location to location, until their final move to a site north of Toronto just off of Highway 400. The property spanned three acres with a large building, including an indoor show room. They had an eight-bay facility and a complete body shop. The facility was designed as a full-service dealership for reconditioning and sales, as well as servicing customers' cars. The property could house 600 vehicles.

[185] NAFG was formed in 1996, as there was a need to provide financing for potential customers of Prestige Motors. Mr. Arconti testified that people with poor credit were willing to pay a much higher rate of interest, if they could get approved for a loan to buy cars from Prestige Motors.

[186] While searching for ways to grow their business, the Arcontis came across Nelson in an advertisement in a paper. It was raising capital from accredited investors and Nelson's business model appealed to the Arcontis. The model required the Arcontis to form Carter and obtain its registration as an exempt market dealer. It was Gino Arconti's understanding that it would allow the company to raise funds from accredited investors. Their solicitors, Cassels Brock, provided the risk acknowledgement forms to NAFG and stated that they would need to be completed and signed by every investor. They advertised in the *Toronto Star*, which generated a lot of calls, which Gino Arconti calculated to be over 3,000 calls over a five-year period.

[187] Gino Arconti was a licensed sales representative for Carter and Flavio Arconti was the Chief Compliance Officer and a licensed representative. Gino Arconti dealt with most of the investors. He described the state of the automotive and financial industries in 2008 as experiencing a severe recession. The year 2009 was also a very tough year for Prestige Motors.

[188] In the fall of 2009, Carter learned that the OSC was going to conduct a compliance review. The Arcontis notified Cassels Brock who came to the office to prepare responses to the list of items that Staff asked for. Staff interviewed Flavio Arconti, and from Gino Arconti's point of view, the Arcontis provided the Commission with all the requested documents.

[189] Mr. Arconti's attention was drawn to Ex. 2, Tab 6, a version of NAFG's marketing brochure that was provided to Staff during the 2009 Compliance Review. Gino Arconti said he accepted Staff's criticism that the document tended to leave the impression that NAFG was a bigger player than it really was in the automotive and financing industry. Gino Arconti confirmed that this version of the document was more widely distributed than any of the other versions of the brochure. They sought David Gilkes' help to improve the shortcoming of this brochure. Mr. Arconti was then referred to the May 2009 Letter, which was signed by Flavio Arconti, but drafted by Mr. Gilkes. Counsel took Gino Arconti through the new forms created by David Gilkes that were attached to the May 2009 Letter and sent to Staff. Gino Arconti felt that NAFG responded to Staff's list of deficiencies. There followed a lot of back and forth communications between David Gilkes and Staff, which lasted seven months.

[190] Gino Arconti then learned of the 2010 Compliance Review that was to take place in January 2010 from Flavio Arconti, who received a call from Anita Chung. Flavio Arconti took the lead role in responding to Staff's requirements. Mr. Gilkes was again hired to help out with the second compliance review; he was involved in ensuring that everything that Staff was asking for was provided.

[191] In reviewing various documents prepared and submitted to Staff, Gino Arconti confirmed that he understood that: they did not have to provide a prospectus to investors, since Carter was in the exempt market; they were not required to provide financial information to investors; investors were told that the investments were high-risk investments; and, when soliciting investments with potential investors, he always discussed the Certificate of Accredited Investor with them.

[192] Counsel referred Gino Arconti to a conference call that was held with himself, Flavio Arconti, Margaretha Widjojo and various members of Staff on March 23, 2010. Staff raised the propriety of identifying collectability of outstanding accounts. Gino Arconti disclaimed any understanding of how a proper "Allowance for Doubtful Accounts" should be set up, and stated that Ms. Widjojo, who was NAFG and Carter's accountant at the time, was responsible for that.

[193] Gino Arconti confirmed that there was never any effort to hide NAFG's relationship with Prestige Motors. He said there was nothing wrong with the loans made by NAFG to Prestige Motors.

[194] Gino Arconti's attention was drawn to Ex. 18, Tab J, p. 37, an income statement showing a net loss of $524,727 for 2008. Mr. Arconti testified that the loss for the year 2008 was severe, but that it was manageable. The larger net loss for the year 2010 of over $1.3 million was ascribed to "the regulatory issues that we were dealing with and we weren't really focused so much with the business" (Tr. Vol. 10, p. 57, ll. 9-17). It was about this time that the Arcontis hired Stefano Picone, a chartered accountant who analyzed the accounts of both NAFG and Prestige Motors in order to make them profitable.

[195] Counsel turned Mr. Arconti to consider the telephone call made by Amy Tse, posing as an investor named "Amy Thorne", on June 9, 2010. Gino Arconti stated that he had no recollection of the telephone call. I would give Gino Arconti a passing mark for the responses he made to the questions asked by Ms. Tse, save for the claim that NAFG was competing with TD Bank and Scotia. His answers to questions about Ms. Tse's call employed the use of the words "I would have", indicating that he did not recall specifically what was said, but rather described what he said in his usual discussions with investors.

[196] Gino Arconti was asked about the investor J.B., whose documents are found in Ex. 12. Mr. Arconti denied telling J.B. that the issue of whether or not he was an accredited investor was just a formality. He also denied ever telling any investor that. At Tab D of Ex. 12 is a Carter KYC form, which was completed by Gino Arconti, save for the first line of the form and J.B.'s signatures and initials. Gino Arconti said that he asked J.B. the questions in the form. J.B. provided his answers, which were then recorded by Gino Arconti into the form. He had no doubt that J.B. understood what was required to be an accredited investor. Mr. Arconti could not recall what J.B. said specifically but "we would have had a discussion" about whether or not he was an accredited investor (Tr. Vol. 10, p. 78, ll. 12-20). Then followed a series of questions that were answered by Mr. Arconti with "I would have". Once again, Mr. Arconti denied telling J.B. that signing as an accredited investor was just a formality.

[197] Mr. Arconti then recounted the efforts he made to persuade J.B. to change his investment to the NAFG convertible debenture, which had an annual interest rate of 5%. J.B. refused to accept anything less than 15%. Gino Arconti was then asked how successful the effort was by NAFG to get investors to change from the higher to the lower interest rate. At the time the Arcontis were working with investors to convert their investments, $5 million of investor funds were tied to investments with the higher interest rate. In September 2010, $2 million of those funds were converted to investments with the lower inter payments at 5% (Tr. Vol. 10, p. 91, l. 25; p. 92, ll. 1-7).

[198] Counsel then turned to the investor L.F., whose documents are found in Ex. 13. Gino Arconti identified the writing in the document to be his own, except for the signature of L.F. (Ex. 13, Tab A). Nevertheless, Mr. Arconti confirmed that L.F. supplied the answers to the questions asked in the document. Mr. Arconti filled out the form in a telephone conversation with L.F., who was in Sudbury, Ontario at the time. He recalls speaking to L.F. Although he tried to persuade L.F. to invest in the convertible debenture at an annual interest rate of 5%, L.F. entered into the loan agreement at an annual interest rate of 12%. Gino Arconti explained this by saying that if an investor wanted the higher interest rate, NAFG would provide it. The document discloses that the proceeds of the offering would be primarily used to provide financing for the daily operations of NAFG and its affiliates, including Prestige Motors. When asked if this was discussed with L.F., Mr. Arconti replied "he actually knew that we were involved with Prestige Motors. We had some discussions about that" (Tr. Vol. 10, p. 98, ll. 3-16).

[199] Mr. Arconti was then asked about investor J.S., whose documents are found in Ex. 14. Mr. Arconti was referred to the New Client Application Form, which was filled out by J.S. and Flavio Arconti (Ex. 14, Tab C). Gino Arconti signed the document on behalf of Carter after it was completed. At the time J.S. signed the New Client Application Form on January 23, 2010, J.S. had already entered into a loan agreement on April 1, 2008 (Ex. 14, Tab A). J.S. signed the form as a result of the 2009 Compliance Review to update the Carter's KYC forms, as well as an effort to respond to Staff's list of deficiencies by contacting all investors. He denied NAFG targeted elderly investors.

[200] Counsel also questioned Gino Arconti about investor R.B., whose documents are found in Ex. 15. R.B.'s documents do not include a New Client Application form or a KYC form. Mr. Arconti had looked for those documents, but was unable to find them. However, he was confident that a KYC was prepared "because that is what I do" (Tr. Vol. 10, p. 106, ll. 13-17). R.B. received a marketing brochure, which contained information describing the investment as "an attractive safe high yield income-generating investment for the investor" (Ex. 15, Tab A). Gino Arconti testified this is the first time he had seen this actual page and said the brochure was not widely distributed. The language in this brochure was not approved by NAFG. In fact, Mr. Arconti told R.B., as he did all investors, that the investment was a high-risk investment, and that, if NAFG were to go bankrupt, all the money of the investment would be lost.

[201] Subsequent to the distribution of the brochure, a meeting was held at R.B.'s residence to see if he would agree to lower the interest rate of his investment to 5%. R.B. refused to do so. Gino Arconti denied that R.B. asked if NAFG was insolvent or whether there were OSC proceedings against it.

[202] Counsel then referred Gino Arconti to investor D.M., whose documents made be found in Ex. 16. D.M. was referred to NAFG by his accountant, who had invested with NAFG for some time. The accountant was an accredited investor. In the Joint Client Application Form, D.M. indicated that he had liquid assets of $1 million and an estimated net worth of $2 million (Ex. 16, Tab B). The $2 million figure looks as though it was altered from a previous number. Mr. Arconti denied that he or his brother altered the number and that it would have been D.M. who did so. Gino Arconti denied telling D.M. that it was unimportant what the numbers were or that he be an accredited investor. Mr. Arconti also denied telling D.M. that NAFG would be going public.

[203] Counsel then asked Gino Arconti which individuals were responsible for depositing cheques that came into NAFG. Mr. Arconti identified himself, his brother, Ms. Widjojo and Julia, the office administrator. He was also referred to the deposit account history for Account 652 (Ex. 10, Tab 1, pp. 706-707). Three deposits were singled out and brought to Mr. Arconti's attention: $39,720, $50,000 and $22,000.

[204] The first deposit of $39,720 was made at 1:08 p.m. on September 23, 2010 (Ex. 10, Tab 1, p. 706). The Director's Decision suspending Carter's registration was issued on September 22, 2010. The Director's Decision was delivered to the Respondents by mail, and a waybill establishes notice on Carter and Flavio Arconti at about 3:39 p.m. on September 23, 2010 (Ex. 4, Tab 46). Gino Arconti denied knowing of the Director's Decision at 1:08 p.m. on September 23, 2010, which is when the $39,720 was deposited. Independent evidence, found at Ex. 4, Tabs 45 and 46, confirms this to be so.

[205] Counsel next referred to the deposit for $50,000, which were funds provided by D.M. Gino Arconti deposited the funds, and he acknowledged that he knew of Carter's Suspension at the time he made the deposit. Staff also referred to an email chain dated September 24, 2010, where Gino Arconti asked D.M. if he can put D.M.'s cheque through and D.M. provided an affirmative response (Ex. 16, Tab F). Gino Arconti explained the making of the deposit by saying he understood that Carter's Suspension had no legal impact on NAFG. He thought that NAFG was able to continue operating and that depositing D.M.'s cheque was something that was "all right" to do (Tr. Vol. 10, p. 135, ll. 13-16). Mr. Arconti noted that D.M.'s investment was negotiated before the suspension, and confirmed that after the Director's Decision he did not solicit any new investment through Carter.

[206] The third deposit for $22,000 was a sum related to L.F.'s investment. In the account history of Account 652 (Ex. 10, Tab 1, p. 705), the deposit was entered on Monday, September 27, 2010, but Gino Arconti suggested it could have been deposited at any time over the weekend at a bank machine. In any event, Mr. Arconti regarded L.F.'s deposit as similar to that of D.M.'s cheque, in that the deposit was made to finalize an agreement that was negotiated and signed before Carter's Suspension.

[207] Gino Arconti was directed to Ex. 10, Tab 1, p. 720, showing a bank draft drawn in the name of M.G. for $116,853.41, which was dated and cashed in on September 28, 2010. Exhibits 27 and 28 show agreements between NAFG and M.G. that were effective as of July 1, 2010 and replaced earlier loan agreements between the two parties. M.G. had called Gino Arconti and asked for the return of her investment, because she wanted to buy a cottage. The last payment was to be made on September 4, 2010, but it was not paid out at that time since NAFG was "extremely busy" during the month of September (Tr. Vol. 10, p. 144, ll. 1-10). The Arcontis were dealing with the convertible debentures, the OSC proceedings, HDL and the death of Flavio Arconti's father-in-law. M.G. reminded Gino Arconti that she wanted her investment back at the funeral of Flavio Arconti's father-in-law, which took place in mid or late September 2010. Gino Arconti directed the draft be prepared, signed and delivered to M.G.

[208] The effect of the two agreements was that the principal amounts originally to be repaid on December 4, 2014 were paid on September 4, 2010 (Ex. 3, Tab 43). M.G. escaped the 50% loss of principal experienced by other, less fortunate, investors who approved the bankruptcy proposal under the *BIA*.

[209] Counsel asked why it was necessary to file a notice of proposal under the *BIA* for NAFG. Gino Arconti explained that they had lost Carter by way of suspension, HDL had terminated their agreement to look for capital investments and the damage to their reputation made it impossible to continue to raise funds. That concluded the examination-in-chief.

[210] Counsel began the cross-examination of Gino Arconti by referring him to Ex. 11, Tab 2, containing the financial statements for NAFG as at September 30, 2010. In referring to years 2007, 2008 and 2009, Mr. Arconti confirmed that he was aware of the accumulating deficits of NAFG. Counsel had less success with obtaining Mr. Arconti's views on the long-term portion of lease receivables and it was apparent to me that he did not have a complete understanding of what the figures meant. Gino Arconti did agree that Prestige Motors kept the money from the sale of repossessed cars instead of transferring it to NAFG, thus increasing the amount of the "loan" during the fiscal years 2007, 2008 and 2009. Mr. Arconti confirmed that no interest was paid on the loan.

[211] Counsel then read long excerpts from the policies and procedures manual of Carter dated November 2007 (Ex. 2, Tab 7). Counsel asked Gino Arconti if he understood his obligations under the various sections of the manual and he agreed that he did.

[212] Counsel then referred Mr. Arconti to the 2009 Deficiency Report (Ex. 2, Tab 11). Mr. Arconti agreed with the response to the May 2009 Letter, which was prepared by David Gilkes (Ex. 2, Tab 12). There then followed a cross-examination on matters of little assistance to me culminating in Mr. Arconti's agreement that the trial balance as of December 31, 2009 showed an owing balance to Prestige Motors from NAFG of almost $2 million, and that the total for long-term receivables at December 31, 2009 was $1,780,226.14 (Ex. 2, Tab 28, pp. 450-453). I found that Mr. Arconti's answers to the straightforward questions asked by Staff during this period were unresponsive and evasive.

[213] The cross-examination of Gino Arconti continued the next day on May 23, 2013. Counsel obtained agreement from him that he would have known by early March 2010 that the total revenue generated by NAFG was not enough to pay the interest owed to its investors. It was put to him that NAFG needed new investor money in order to pay interest to existing investors. Mr. Arconti replied that he would not say they had to rely solely on new investor money. Counsel put it to Mr. Arconti that he knew very well what the financial situation of the company was in March 2010. Mr. Arconti responded with an answer that was repeated more than once during the cross-examination of Staff that day:

> Q. I put it to you, sir, that you knew very well what your financial situation was at the time. You are the co-owner of the company?
>
> A. Correct. There were losses, but I believe 2009 was less than 2008. And in this period of time, it was a major recession. We suffered. We knew that we were going to be putting a plan in place to repair all of this. It was repairable. We didn't believe it was severe like the OSC staff has suggested. We believed that it was manageable. We believed that this could have been corrected and there were a lot of companies that suffered at the time far worse than what we did and they were able to recover and get back to business.
>
> (Tr. Vol. 11, p. 11, ll. 9-24)

[214] From this point on, Gino Arconti's answers to questions became less and less responsive. Examples can be found in Tr. Vol. 11 at p. 23, ll. 15-25; p. 24, ll. 1-8, 15-25; and p. 25, ll. 1-3, 14-23.

[215] Gino Arconti confirmed to counsel that he transferred ownership of his house, which was in his name and his wife's name, into his wife's name alone on May 5, 2010. He explained that he did this because NAFG was sued as a result of an accident involving a lease customer, who was a third party. NAFG was named because of its ownership of the vehicle. Mr. Arconti said that when the action came about, he and his wife started to learn about what their liabilities were, and his wife learned of another settlement for $13 million. After his wife spoke to a friend, who was a lawyer, she asked Mr. Arconti to have the house transferred to her name alone. The house had no equity and was completely mortgaged right up to the purchase price. He denied he did the transfer because he was worried about the financial situation of NAFG and the possibility of being sued in relation to NAFG.

[216] At this point, Staff counsel, no doubt frustrated by Mr. Arconti's evasive answers, started to interrupt the witness while he attempted to respond to questions. Examples include Tr. Vol. 11, p. 29, ll. 7-11; p. 37, ll. 20-24; p. 49, ll. 1-25; and p. 62, ll. 14-20.

[217] At the morning recess following another long response from Gino Arconti, I made the following comment:

> Commissioner Carnwath: I think we will take 15 minutes. This will give you an opportunity to speak to your counsel. Counsel, you will have an opportunity to explain to the witness what I think I explained to his brother in terms of sticking to the question and trying to give the answer. That will give you that chance. I don't think it is necessary for me to give my speech again. I think you are quite capable of doing it. 15 minutes.
>
> (Tr. Vol. 11, p. 63, ll. 19-25; p. 64, ll. 1-3)

[218] Counsel then took Gino Arconti through the June 2010 Letter, regarding Staff's recommendation to the Director that Carter's registration be suspended (Ex. 4, Tab 39). Staff then read a series of excerpts from the letter and asked if Mr. Arconti understood the excerpts. He qualified his answer by saying he understood that was Staff's view at the time. Gino Arconti did not agree that NAFG was in serious financial difficulty. He and Flavio Arconti believed that the difficulties were manageable and repairable.

[219] Staff then asked questions about J.S.'s investment and Gino Arconti confirmed that he did not tell J.S. that NAFG had a cumulative deficit of $1.2 million at the time or that over 90% of its receivables were in the "91+" day default category. Mr. Arconti also confirmed that he did not tell J.S. that Prestige Motors owed NAFG $2 million. However, he said J.S. understood that funds of the companies could be used for all of the companies related to NAFG. The Arcontis did not believe that the $2 million owed by Prestige Motors was a true loan, but rather thought that it was a receivable balance that was going to be repaid.

[220] The same questions were asked of Mr. Arconti's meetings with D.M. Similar to J.S., Gino Arconti did not tell D.M. that NAFG had an accumulative operating deficit of $1.2 million when they met or did he tell him that over 90% of NAFG's receivables were in the "91+" day default category.

[221] Gino Arconti agreed with counsel's suggestion that HDL was not told about the issues that NAFG had with the Commission until after Carter's Suspension. It was put to him that if HDL had been told about the suspension, the Arconti brothers were concerned that HDL would not want to deal with them. Gino Arconti did not agree with that statement. It was further put to him that investors like L.F. and J.S. would not have invested if they had known of NAFG's financial circumstances in the fall of 2010. Again, Mr. Arconti disagreed.

[222] Gino Arconti confirmed that it was his signature on the cheque that was made out to M.G., dated September 28, 2010 (Ex. 10, Tab 1, p. 719). He also confirmed that it was his signature on the deposit slip for $50,000 for the cheque, which was written from the account of D.M.'s company (Ex. 10, Tab 1, p. 714).

[223] It was put to Mr. Arconti that his cousin M.G. was being paid approximately $116,000, which was, in part, D.M. and L.F.'s money. Gino Arconti replied "if we look at this way and you want to interpret it that way, yes" (Tr. Vol. 11, p. 100, ll. 9-14).

[224] It was put to Gino Arconti that on September 28, 2010 when he obtained the bank draft to be paid to his cousin, he would have known that NAFG was insolvent as of that date. Gino Arconti disagreed. Mr. Arconti explained that at that point, HDL was still in the picture and that they had not received any calls from investors yet. Those calls started coming in after the Commission sent letters notifying investors about the Director's Decision (Tr. Vol. 11, p. 104, ll. 15-25; p. 105, ll. 1-8). Those letters, to Mr. Arconti's understanding, made the investors panic and, in order to get some sort of orderly control, they went to see Farber, NAFG's trustee in bankruptcy. Gino Arconti was also referred to the unaudited balance sheet of NAFG as of December 31, 2010 (Ex. 11, Tab 2-2, p. 463). After comparing the financial statements of 2007 and 2008 with the financial statements for 2009 and 2010, Mr. Arconti agreed that loans to the shareholders of NAFG (i.e. the Arcontis and their companies) began in 2009 and continued in 2010.

[225] Gino Arconti was referred to a document prepared by Mr. Tillie at Ex. 18, Tab F. Mr. Arconti confirmed that he and his brother were receiving payments on their use of credit cards for business expenses. From January 2, 2009 until September 28, 2010 the credit card usage totalled $502,318.27. Mr. Arconti thought that a lot of that sum had to do with business expenses, but stated that it was up to Ms. Widjojo to allocate how to account for business and personal expenses.

[226] It was put to Gino Arconti that Prestige Motors would not have been in a position to repay the $2.3 million as of November 30, 2010 to NAFG. Mr. Arconti said there was no cash in the bank to do that, but they would be able to pay the loan if they sought financing, which they felt was attainable. There then followed a string of long responses to further questions from Staff that repeated a theme often visited during Mr. Arconti's evidence: "Prestige Motors was in a good position to continue its business. We were forced to close it" (Tr. Vol. 11, p. 117, ll. 5-7). This response was expanded on Mr. Arconti's answers found at Tr. Vol. 11, p. 118, ll. 1-25; p. 119, ll. 1-25; and p. 120, ll. 1-5.

[227] Gino Arconti agreed that NAFG's proposal in bankruptcy enabled the Arconti brothers to continue to run NAFG and to receive management salaries. In re-examination by Mr. Smith, Mr. Arconti confirmed that the payments through Ceridian were not all going to the Arconti brothers, but to other staff members of NAFG as well. That concluded Gino Arconti's evidence.

C. Stefano Picone

[228] Mr. Picone has a Bachelor of Commerce degree from the University of Toronto, which he received in 2004. He became a chartered accountant in the fall of 2009 and in May 2010 he started doing work for NAFG. His evidence may be found in Tr. Vol. 9, pp. 7-60.

[229] The Arcontis told Mr. Picone that they needed someone with financial expertise to assist with modeling and financial planning. The Arcontis wanted to restructure and grow their businesses. The businesses were not profitable at the time, but there was, according to Mr. Picone, "nothing beyond remediation" (Tr. Vol. 9, p. 10, ll. 18-20).

[230] Mr. Picone started on a part-time consulting basis between 25 and 30 hours per week. At first, he was heavily engaged in examining the operations of Prestige Motors and NAFG to examine the cause of the financial difficulties. He referred to the difficult economic times that existed in the spring of 2009, both in the credit and automotive sectors. A plan was created to switch Prestige Motors to a consignment sales model, to reduce its overhead and to put Gino Arconti in charge of the service department on a full-time basis. For NAFG, the plan was to reduce its cost of capital by having existing noteholders convert their investments to low-interest convertible debt instruments. The plan also contemplated getting access to more capital by going public in order to get access to an institutional debt line. Mr. Picone confirmed that he was not involved in any effort to persuade existing investors to convert their high-yield notes to a lower interest rate model.

[231] Mr. Picone described his interaction with HDL who, he said, was "very enthusiastic about bringing this company public" (Tr. Vol. 9, p. 22, ll. 11-14). Mr. Picone produced a number of financial models for HDL.

[232] Mr. Picone confirmed that the various plans for reviving NAFG and Prestige Motors failed when the OSC suspended Carter's registration. Nevertheless, he felt NAFG's issues could still be resolved. His primary responsibility was to liaise with NAFG's trustee in bankruptcy, Farber, and provide it with the necessary accounting information. At this point in his evidence, I formed the opinion that Mr. Picone had drunk from the same well of optimism as the Arcontis.

[233] In cross-examination, Mr. Picone confirmed that he had no interaction with the investors until the bankruptcy proposal period, when he advised them of their options. Mr. Picone was asked about a cash-flow projection he prepared with Farber for the Trustee's Report to the Creditors, dated January 7, 2011. The Report indicates that over three years, a surplus cash flow of $322,000 was projected (Ex. 19, Tab 6, pp. 84-85). Mr. Picone's attention was also drawn to the unaudited operating losses of the two companies over the years 2008, 2009 and for the eleven-month period to November 30, 2010, which was $2.239 million for NAFG and $2.991 million for Prestige Motors (Ex. 19, Tab 6, p. 78). Mr. Picone also confirmed that as at the date of Carter's Suspension, Prestige Motors was not in a position to pay the money borrowed from NAFG but "going forward we had identified a plan to do so" (Tr. Vol. 9, p. 32, ll.5-9). The plan was for Prestige Motors to be self-sufficient, but neither of the Arcontis were able to spend the necessary time to run the business. He repeated his earlier testimony that problems of NAFG and Prestige Motors were not beyond remediation.

[234] Mr. Picone was asked a series of questions and the answers to which established that when arriving at a projected cash flow model, he did not take into account his fees, the fees of the trustee in bankruptcy, Farber, or the management fees paid to the Arcontis. This answer does not inspire confidence in his evidence.

[235] I do not accept Mr. Picone's evidence that NAFG and Prestige Motors could be rescued. Whether through lack of experience, his wish to encourage the Arcontis or through a refusal to recognize that the two companies had operating losses of over $2.5 million, his optimism was not supported by the facts. This compels me to reject his evidence on this point.

D. David Gilkes

[236] David Gilkes has a Bachelor of Arts in Economics from McMaster University and a Master's degree from Carleton University. His evidence may be found in Tr. Vol. 9, pp. 102-161.

[237] Mr. Gilkes is a certified fraud examiner. Since May 2011, he has been the president of North Star Compliance & Regulatory Solutions Inc., a firm that helps investment companies that are in the investment industry. Before that time, he was employed with Sutton, Boyce, Gilkes Regulatory Consulting Group, which was also engaged in helping companies in the investment industry, for two years. From January 2002 until December 2008, he was the manager of Registrant Regulation with the Commission. During that time, he led the team for the OSC that drafted NI 31-103.

[238] Cassels Brock referred the Arcontis to Mr. Gilkes for his help in dealing with the 2009 Compliance Review. Staff had identified issues and the Arcontis wanted help to become compliant, resolve the issues and continue to operate their companies in a compliant manner. The two significant deficiencies identified by Staff were lack of KYC and suitability procedures, that is, the determination if prospectus exemptions were available.

[239] Counsel referred Mr. Gilkes to the May 2009 Letter, which was drafted by Mr. Gilkes and sent by Flavio Arconti to Staff (Ex. 2, Tab 12). The letter lays out the proposed actions to be taken by Carter and NAFG, which included contacting investors to collect more KYC information than had previously been collected by the companies. The letter also referred to new forms that were created to determine whether or not a person was an accredited investor. Mr. Gilkes continued to work with Carter and with the Arcontis to help them implement new policies, new procedures and to address what issues needed to be corrected. Between May and November 2009, this entailed many discussions with the Arcontis and with the OSC. He described the relationship with the OSC as a good one, where both sides were working well together.

[240] Between December 25, 2008 and January 1, 2009, Carter received a letter requiring a full compliance review by the OSC, the 2010 Compliance Review. Mr. Gilkes continued to work with the Arcontis to revise their policies and procedures and to inform them how to cooperate fully with the OSC. The OSC visited Carter's premises and were there for approximately four weeks. This had a demonstrable effect on the Arcontis' ability to carry on their businesses.

[241] Mr. Gilkes believed that following its full compliance review in 2010, Staff would issue a Compliance Field Review Report that would identify deficiencies that needed correction. He believed there was a tacit understanding with Staff that this would be the course of action. However, no deficiency report was supplied to Carter. Instead, Mr. Gilkes learned that the Arcontis received a letter saying that Staff was recommending Carter's suspension to the Director. Mr. Gilkes prepared a letter to the Commission, the June 2010 Letter, requesting an OTBH. He was deeply involved in preparing for the hearing before the Director. Mr. Gilkes confirmed that up until that time, all he knew about the state of NAFG and Carter was that their business was a going concern. He said that he first knew of the level of difficulty that NAFG was in, in terms of its financial situation, from the June 2010 Letter.

[242] Mr. Smith then reviewed with Mr. Gilkes a number of documents, which he prepared for NAFG and which were designed to improve the disclosure provided to investors, regarding the type of product that they would be investing in the period leading up to the Director's Decision. He described this as a work in progress in attempting to meet Staff's concerns.

[243] Mr. Gilkes was involved in the preparation of and attending the OTBH. He was hoping that the Arcontis were going to be able to convince the Director that a more appropriate solution would have been imposing terms and conditions, rather than a suspension. He was surprised to learn that the Director imposed the suspension of Carter's registration.

[244] In cross-examination, Mr. Gilkes was referred to the letter of engagement between HDL and the Arcontis dated September 2, 2010. Mr. Gilkes was not providing NAFG with advice on raising capital.

[245] Staff referred Mr. Gilkes once again to the May 2009 Letter that Carter sent to the OSC. Mr. Gilkes reviewed Carter's policies and procedures manual, which was updated in May 2009, with the Arcontis. Mr. Gilkes said that in his dealings with the Arcontis, he never formed the impression that they did not understand what their obligations were under the manual. He further understood that the Arcontis were going to treat their communications with the public on the basis of truthfulness and fair dealing. He then confirmed that he was never present during the Arcontis' meetings with investors. That concluded the significant portions of the cross-examination of Mr. Gilkes. There was no re-examination by Mr. Smith.

E. C.S.

[246] C.S. is 69 years old and a retired professor of mathematics. He read an ad in the *Toronto Star* and invested in the NAFG group of companies. He arranged a meeting with the Arcontis and had a tour of the operation. His evidence may be found in Tr. Vol. 9, pp. 60-86 and the documents introduced during his testimony may be found in Ex. 23.

[247] C.S. first invested $20,000 and subsequently made a series of investments culminating in a total sum of $130,000. On September 1, 2010 C.S. applied the principal from his loan agreements towards subscription proceeds for convertible debentures of NAFG in the principal amount of $130,000 (Ex. 23, Tab 14). C.S. and his wife signed a "Direction", and this Direction attached loan agreements under "Schedule '1" (Ex. 23, Tab 14, p. 260). I note that there is no Schedule '1' found anywhere in Ex. 23, Tab 14.

[248] C.S. made it clear that he knew the risk involved in his investments with NAFG, that he received interest payments on his loans and that he was an accredited investor. He confirmed that he and his wife signed the documents in Ex. 23, Tab 14, following a conversation with the Arcontis, who wished to reduce their interest expenses. He acknowledged that the information contained in the documents he received over the years expanded on the documents at the beginning of his relationship.

[249] My difficulty with the evidence of C.S. is that neither Staff nor Mr. Smith asked him whether he received all his money back or whether he formed part of the investors in NAFG's bankruptcy proposal for creditors that lost 50% of their principal. He certainly displayed none of the disappointment of Staff's investor witnesses, who suffered the 50% reduction in their principal. By not knowing the result of his investment in NAFG, his evidence is of little assistance to me.

F. N.B.

[250] N.B. is 66 years old and farms near Oshawa, Ontario. His evidence may be found in Tr. Vol. 9, pp. 86-101. Documents connected with his evidence were entered as Ex. 24.

[251] N.B. purchased a convertible debenture from NAFG for $40,000 on September 1, 2010 (Ex. 24, Tab 3). A "Notice of Conversion" was also entered into on September 1, 2010, which, at the option of N.B., converted his units in NAFG on the basis of one unit for each $0.25 of the $40,000 invested. As with C.S., I can find no evidence that deals with the question of whether

his investment has been reduced by 50%, according to the terms of the bankruptcy arrangement with creditors. His evidence is of little assistance to me.

PART 4 – THE APPLICABLE LAW AND ANALYSIS

A. The Standard of Proof

[252] The standard of proof which must be met by Staff in a section 127 proceeding under the *Act* is the civil standard of the balance of probabilities (*Re Sunwide Finance Inc.* (2009), 32 O.S.C.B. 4671 ("***Sunwide***") at para. 28).

[253] The Supreme Court of Canada has made it clear that there is only one civil standard of proof for all allegations regardless of the seriousness of the allegations or consequences at issue. That standard requires a proof on a balance of probabilities. On this standard, a trier of fact must decide "whether it is more likely than not" (*F.H. v. MacDougall*, [2008] 3 S.C.R. 41 at paras. 26-40 ("***MacDougall***")).

[254] The Supreme Court of Canada's decision in *MacDougall* has been applied by the Commission in considering the standard of proof applicable to administrative proceedings (*Sunwide*, above at paras. 26-28).

B. The Admissibility of Hearsay Evidence

[255] Some of the evidence introduced at the Hearing was in the nature of hearsay evidence. Subsection 15(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended (the "***SPPA***") governs the use of hearsay evidence in Commission proceedings:

> **15(1)** Subject to subsections (2) and (3), a tribunal may admit as evidence at a hearing, whether or not given or proven under oath or affirmation or admissible as evidence in court,
>
> (a) any oral testimony; and
>
> (b) any document or other thing,
>
> relevant to the subject-matter of the proceeding and may act on such evidence, but the tribunal may exclude anything unduly repetitious.

[256] Although hearsay evidence is admissible under the *SPPA*, the Commission must determine the appropriate weight to be given to that evidence. In making an assessment as to appropriate weight, the Commission can consider whether documentary evidence adduced by Staff is corroborated or consistent with other documentary evidence (*Sunwide*, above at para. 22).

[257] The documentary evidence that was introduced by the parties at the Hearing corroborated and was consistent with the hearsay evidence in this matter. I therefore am of the view that admitting the hearsay evidence does not undermine the requirement for procedural fairness to the Respondents (*Sunwide*, above at para. 25).

C. Assessment of Credibility Principles and Analysis

[258] An assessment of a witness' credibility refers to the process undertaken by the trier of fact to assess the trustworthiness or believability of the witness' testimony. This process will involve:

(a) as assessment of the general integrity, powers of observation, capacity to remember and accuracy of statements of the witness;

(b) the extent to which the witness' evidence is internally consistent;

(c) the extent to which the witness' evidence is consistent with other proven or undisputed facts; and

(d) in the rarest of cases, the demeanour of the witness.

(CED, (Ont 4th), Vol. 31, Title 82 at § 126)

[259] Investor witnesses described their interactions with the Arconti brothers leading up to, and after, their investment with NAFG. The Arcontis flatly denied several statements made by the investor witnesses. The situation requires me to engage in an assessment of the relative credibility of the two sides, while always remembering that both the investors and the Arcontis may be found not to be credible.

[260] Investor J.B. testified that Flavio Arconti told him that, in order to invest, he had to sign papers showing that he had net assets of over $1 million, which he did not have. Mr. Arconti told him that it was a "formality" (Tr. Vol. 3, p. 15, ll. 21-23). He repeated this evidence in cross-examination (Tr. Vol. 3, p. 78, ll. 11-13).

[261] Investor J.S. signed documents indicating he was an accredited investor. He did not know that he had to exclude his real estate; if he had, his net worth was less than $1 million (Tr. Vol. 3, p. 149, ll. 10-12; p. 161, ll. 20-23). There is no evidence that Gino Arconti made any inquiry into the financial situation of J.S.

[262] R.B. testified that when he first invested with NAFG, he thought an accredited investor was someone who had good credit. The documents for his first investment were prepared by NAFG, sent to him for signature and signed. At no time did Flavio Arconti discuss R.B.'s financial circumstances regarding the accredited investor requirements. In his first conversation with Flavio Arconti, R.B. asked if NAFG was insolvent and if it was under investigation by the OSC. When he was asked to convert to a debenture, he asked the same questions. R.B. said that on both occasions, the Arcontis denied NAFG was insolvent or under investigation.

[263] D.M. testified that he signed his debenture application on September 18, 2010, although it is dated September 20, 2010. His total assets came to approximately $700,000. He indicated on his Joint Client Application form that his net worth was $2 million and explained that Gino or Flavio Arconti told him "that's the profile I had to put in order to be – in order to participate in the offering" (Tr. Vol. 4, p. 75, ll. 5-16).

[264] Investor witnesses called by Staff did not display any animus towards the Arcontis that caused me to suspect they were fabricating their evidence. On the contrary, they seemed to be trying as best they could to recall the events of almost three years ago.

[265] As indicated earlier, I found the evidence of both Arcontis to be evasive and unresponsive. Questions that called for a simple, direct answer were deflected and used as a platform to extol their confidence in their business plans of Carter and NAFG. In doing so, their refusal to acknowledge their lamentable financial circumstances indicated a tenuous, if not non-existent, grasp on commercial reality.

[266] In several instances, both Arcontis describe what they "would have" done. This indicates a lack of specific memory coupled with an intention to justify their failures to inform or inquire about their companies' financial situations. Having dealt with numerous investors, they had less reason to recall their interaction with individual investors. The latter are more likely to have a better recollection of events, given their financial loss.

[267] Independent evidence of Mr. Tillie confirms the financial disarray of NAFG, thus putting considerable pressure on the Arcontis to obtain new and further investments at all costs. In many instances, documents were prepared by NAFG and submitted to investors for signature with no apparent attempt to be satisfied that the investors met, or continued to meet, the definition of an accredited investor.

[268] The Arcontis have admitted that the existence of the Prestige Motor's loan and NAFG's financial position were not disclosed to NAFG investors initially. They allege that "later" many investors were advised that NAFG was experiencing financial difficulty. However, the investors who were told of NAFG's financial difficulty were those who had already invested and who were asked to convert to a debenture at a lower interest rate.

[269] The foregoing state of affairs compels me to conclude that where the evidence of the Arcontis is in direct conflict with investor witnesses, I prefer the evidence of the latter. I am satisfied on the balance of probabilities that the evidence of the investor witnesses is reliable.

D. The Law of Suitability Obligations and Analysis

[270] Staff submit during the Applicable Period, Carter did not take reasonable steps to ensure that the purchase of NAFG securities was suitable for its clients, contrary to section 13.3 of NI 31-103.

[271] The Respondents concede that there were failures to identify certain investors who were not properly accredited, and, in this limited way, Carter violated its requirements under section 13.3 of NI 31-103. The Respondents also concede that Carter did not disclose to investors all negative information about NAFG that could or ought to have been disclosed.

[272] The relevant parts of section 13.3 of NI 31-103 state:

> **13.3 Suitability** – (1) A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client.

(2) If a client instructs a registrant to buy, sell or hold a security and in the registrant's reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant's opinion and must not buy or sell the security unless the client instructs the registrant to proceed nonetheless.

(3) This section does not apply if the client is a registered firm, a Canadian financial institution or a Schedule III bank.

(4) This section does not apply to a registrant in respect of a permitted client if

(a) the permitted client has waived, in writing, the requirements under this section, and

(b) the registrant does not act as an adviser in respect of a managed account of the permitted client.

[273] The Commission has recognized that the KYC and suitability requirements "are an essential component of the consumer protection scheme of the *Act* and a basic obligation of a registrant, and a course of conduct by a registrant involving a failure to comply with them is an extremely serious matter" (*Re Daubney* (2008), 31 O.S.C.B. 4817 ("***Daubney***") at para. 15, citing *Re E.A. Manning Ltd.* (1995), 18 O.S.C.B. 5317).

[274] Canadian securities authorities have adopted a three-stage analysis of suitability, according to which a registrant is obliged to:

(a) use due diligence to know the product and know the client;

(b) apply sound professional judgement in establishing the suitability of the product for the client; and

(c) disclose the negative as well as the positive aspects of the proposed investment.

(*Daubney*, above at para. 17, citing *Re Foresight Capital Corp.*, 2007 BCSECCOM 101 (B.C. Securities Comm.))

[275] The Companion Policy to NI 31-103 also addresses the suitability rule, and states in part:

Subsection 13.3(1) requires registrants to take reasonable steps to ensure that a proposed trade is suitable for a client before making a recommendation or accepting instructions from the client. To meet this suitability obligation, registrants should have in-depth knowledge of all securities that they buy and sell for, or recommend to, their clients. This is often referred to as the "know your product" or KYP obligation.

Registrants should know each security well enough to understand and explain to their clients the security's risks, key features, and initial and ongoing costs and fees. Having the registered firm's approval for representatives to sell a product does not mean that the product will be suitable for all clients. Individual registrants must still determine the suitability of each transaction for every client.

Registrants should also be aware of, and act in compliance with, the terms of any exemption being relied on for the trade or distribution of the security.

In all cases, we expect registrants to be able to demonstrate a process for making suitability determinations that are appropriate in the circumstances.

(Companion Policy 31-103 CP – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, s. 13.3)

[276] CSA Staff Notice 33-315 provides a list of some factors that registrants should consider when assessing investment products for their clients, which include the issuers' financial position and history (CSA Staff Notice 33-315 – *Suitability Obligation and Know Your Product* (2009), 32 O.S.C.B. 6890).

[277] Investor witness J.B. made two investments in the Applicable Period, on December 1 and August 1, 2010 (Ex. 12, Tabs J and L). He testified that on all the loans he made to NAFG, one or the other of the Arcontis told him he could not make the investment unless he acknowledged that he was an accredited investor. I note that J.B. also signed a $40,000 debenture on September 1, 2010 (Ex. 12, Tab F).

[278] Investor J.S. made an investment of $10,000 during the Applicable Period, on September 22, 2010 (Ex. 14, Tab D). J.S. was the investor who told Gino Arconti that he was an accredited investor. He did so mistakenly believing he could include his real estate in making the calculation.

[279] Investor R.B. invested $84,500 in NAFG in March 2010 (Ex. 15, Tabs C and H). He indicated that he was an accredited investor on the form he signed, also mistakenly believing that he could include the value of his real estate in making the calculation. There was no discussion about the accredited investor requirement with Gino Arconti. The documents were sent to him in the mail, which he signed and returned.

[280] Investor D.M. invested in NAFG in September 2010. D.M. was told by one of the Arcontis that he had to have financial assets in excess of $1 million or he could not participate in the investment.

[281] The evidence of the above investors persuades me that the Arcontis made no attempt to investigate their investors' financial circumstances. In each instance, the question was asked by the Arcontis about their qualification as accredited investors. In each case, they received an affirmative answer and made no further inquiries about the actual circumstances of each individual investor. This in and of itself I find to be a breach of section 13.3 of NI 31-103. In addition, the analysis of the law on NI 31-103 outlined above makes it clear that the Arcontis were obliged to tell investors about NAFG's financial circumstances (Daubney, above, at para. 17).

[282] In addition, the Arcontis acknowledged in the Admissions of the Respondents that there was a loan from NAFG to Prestige Motors ultimately for $2 million (Ex. 1, para. 22). The Respondents also admit that NAFG was not profitable (Ex. 1, para. 22). It is also admitted that the existence of the loan in NAFG's financial position were not disclosed to NAFG investors initially. The Respondents submit that later disclosure better described the uses to which the investors' money was to be put. This is true. It was disclosed that the investment could be used by NAFG and its affiliates. That does not constitute disclosure of the difficulties in which NAFG found itself. The Respondents further submit that "many investors" were advised that NAFG was experiencing financial difficulties (Ex. 1, para. 22). My review of the evidence persuades me that the only time investors were so advised was when they were being asked to convert their original investment to a lower paying debenture, because of NAFG's financial difficulties. That does not constitute disclosure at the time of the original investment made by investors. I find this failure to disclose NAFG's financial difficulties and its loan to Prestige Motors constitutes a breach of section 13.3 of NI 31-103.

[283] Moreover, the Respondents submit that they did not purposefully mislead investors. They submit that although they took serious efforts to obtain professional advice, the Arcontis did not understand their obligations to disclose to investors the negative financial information of NAFG or the loan to Prestige Motors. The Respondents also submit that this failure was due to either inadequate advice or that the Arcontis misunderstood the advice that was given to them. I agree with Staff's submission that it is not credible that the Arcontis did not understand their obligation to disclose significant investment risks to their investors. The evidence has shown that:

(a) Carter's own policies and procedures manual includes a "Client Suitability and Disclosure" section that requires that the company and each salesperson to disclose all material facts of the investment (Ex. 2, Tabs 7 and 26);

(b) during the 2009 Compliance Review, Staff sent a letter to Flavio Arconti on September 3, 2009 that referred to Carter's suitability obligations and directed Mr. Arconti to refer to CSA Staff Notice 33-315 (Ex. 2, Tab 14, p. 280);

(c) Flavio Arconti testified that he read Staff's letter when he received it (Tr. Vol. 7, p. 108, ll. 5-25; p. 109, l. 1);

(d) David Gilkes testified that he went through Carter's policies and procedures with the Arcontis and explained the documents to them, and he also testified that he always thought that the Arcontis understood their obligations (Tr. Vol. 9, p. 153, ll. 2-14; p. 154, ll. 3-8); and

(e) the Respondents concede that Carter did not disclose to investors all negative information about NAFG (particularly regarding the loan between NAFG and Prestige Motors and that the lease income of NAFG could not cover interest payments to investors), and that such information resulted in risks that should have been shared with prospective investors.

[284] I therefore find that during the period September 29, 2009 to September 24, 2010, Carter failed to take necessary steps to ensure that the purchase of NAFG securities was suitable for its clients, contrary to section 13.3 of NI 31-103 and contrary to the public interest.

E. The Duty to Act Fairly, Honestly and in Good Faith and Analysis

[285] Staff submit that from the time Carter was registered on September 17, 2007 to September 24, 2010, Carter failed to deal fairly, honestly and in good faith with its clients, contrary to subsection 2.1(1) of OSC Rule 31-505.

[286] The Respondents deny that Carter failed to act fairly, honestly or in good faith. However, in the Admissions of the Respondents, the Respondents admit that the disclosure made to investors was inadequate. They also admit that the Director made the findings that Carter failed to disclose the $2 million loan by NAFG to Prestige Motors, and that Carter failed to disclose the severe financial difficulties being faced by NAFG. Although they admit that the existence of the loan and NAFG's financial position were not disclosed to NAFG investors initially, later disclosure better described the uses to which the investors' money was to be put and many investors were advised that NAFG was experiencing financial difficulties. The Respondents also submit that the loan started out as a much smaller amount. They admit that NAFG was not profitable, but they do not admit that its financial difficulties were "severe", as characterized in the Director's Decision.

[287] Subsection 2.1(1) of OSC Rule 31-505 states: "A registered dealer or adviser shall deal fairly, honestly and in good faith with its clients"; and subsection 2.1(2) of OSC Rule 31-505 provides: "A representative of a registered dealer or a registered adviser shall deal fairly, honestly and in good faith with his or her clients".

[288] In *Re Norshield Asset Management (Canada) Ltd.* (2010), 33 O.S.C.B. 7171 at para. 79, the Commission said that: "The duty to deal fairly, honestly and in good faith goes to the heart of what securities regulation is about and a breach of this obligation is especially serious".

[289] Carter failed to disclose to its clients the interest-free loans granted to Prestige Motors by NAFG. The Respondents submit that the losses suffered by NAFG were "not severe" (Ex. 1, para. 22). I disagree. The losses were "severe", as submitted by Staff, or catastrophic, as I would describe them. In any event, the Arcontis were obliged to inform investors of the financial state of NAFG. In failing to do so, they failed to deal fairly, honestly and in good faith with its clients, contrary to subsection 2.1(1) of OSC Rule 31-505 by failing to disclose to its clients the interest-free loans it was granting to Prestige Motors and the severe financial difficulties being faced by NAFG from September 17, 2007 to September 24, 2010.

F. Director and Officer Liability – Carter

[290] Staff submit that Flavio Arconti and Gino Arconti, as actual and/or *de facto* officers and directors of Carter, authorized, permitted and/or acquiesced in the non-compliance with Ontario securities law by Carter and thereby were also not in compliance with section 13.3 of NI 31-103 and subsection 2.1(1) of OSC Rule 31-505, pursuant to section 129.2 of the *Act*.

[291] In their submissions, the Respondents concede that, to the extent Carter is found to have violated Ontario securities law, the Arcontis will also be found to have violated Ontario securities law. They admit that as actual and/or *de facto* officers and directors of Carter, the Arcontis are deemed to be liable for Carter's non-compliance with section 13.3 of NI 31-103, pursuant to section 129.2 of the *Act*. In relation to section 2.1 of OSC Rule 31-505, the Respondents deny that they acted contrary to this section, but they admit that the disclosure made to investors was inadequate (Ex. 1, para. 25).

[292] Section 129.2 of the *Act* provides:

> **129.2 Directors and officers** – For the purposes of this Act, if a company or a person other than an individual has not complied with Ontario securities law, a director or officer of the company or person who authorized, permitted or acquiesced in the non-compliance shall be deemed to also have not complied with Ontario securities law, whether or not any proceeding has been commenced against the company or person under Ontario securities law or any order has been made against the company or person under section 127.

[293] The threshold for a finding of liability against a director or officer under section 129.2 of the *Act* is low. Indeed, merely acquiescing in the conduct or activity in question will attract liability. As stated by the Commission in *Re Momentas Corp.* (2006), 29 O.S.C.B. 7407 ("***Momentas***"):

> Although these terms have been interpreted to include some form of knowledge or intention, the threshold for liability under section 122 and 129.2 is a low one, as merely acquiescing the conduct or activity in question will satisfy the requirement of liability. The degree of knowledge of intention found in each of the terms "authorize", "permit", and "acquiesce" varies significantly. "Acquiesce" means to agree or consent quietly without protest. "Permit" means to allow, consent, tolerate, give permission, particularly in writing. "Authorize" means to give official approval or permission, to give power or authority or to give justification.
>
> (*Momentas*, above at para. 118)

[294] A "director" is defined in subsection 1(1) of the *Act* as "a director of a company or an individual performing a similar function or occupying a similar position for any person". The term "officer" is also defined in subsection 1(1) of the *Act*, which provides:

> **"officer"**, with respect to an issuer or registrant, means,
>
> (a) a chair or vice-chair of the board of directors, a chief executive officer, a chief operating officer, a chief financial officer, a president, a vice-president, a secretary, an assistant secretary, a treasurer, an assistant treasurer and a general manager,
>
> (b) every individual who is designated as an officer under a by-law or similar authority of the registrant or issuer, and
>
> (c) every individual who performs functions similar to those normally performed by an individual referred to in clause (a) or (b)

[295] Therefore, a respondent who performs similar functions to an officer or director is considered a *de facto* officer or director and may be captured by the language of section 129.2 of the *Act* as a person who authorized, permitted or acquiesced to the non-compliance of Ontario securities law by the relevant person or company.

[296] Relevant factors, which have been identified for the determination of whether a representative was a *de facto* director or officer, include an individual who was:

(a) responsible for the supervision, direction, control and operation of the company;

(b) ran the company from their office;

(c) negotiated on behalf of the company;

(d) substantially reorganized and managed the company;

(e) selected the name of the company;

(f) made all significant business decisions; and

(g) formed part of the management of the company.

(*Momentas*, above at paras. 102, 103 and 106)

[297] Flavio Arconti and Gino Arconti were both directors, officers and shareholders of Carter. The Arcontis were also the co-owners of Carter (Ex. 2, Tabs 2, 3 and 5; Ex. 5, Tabs 3, 4, 6 and 7).

[298] The Arcontis were active participants in Carter's investment activities and authorized Carter's conduct. I find that Flavio Arconti and Gino Arconti, as actual and *de facto* directors and officers of Carter, are deemed to be liable for Carter's breaches of section 13.3 of NI 31-103 and subsection 2.1(1) of OSC Rule 31-505, pursuant to section 129.2 of the *Act*.

G. Securities Fraud and Analysis

[299] Staff submit that each of the Respondents directly or indirectly engaged or participated in acts, practices or courses of conduct relating to the securities of NAFG and NAC that they knew or reasonably ought to have known perpetrated a fraud on persons contrary to subsection 126.1(b) of the *Act* and contrary to the public interest.

[300] Staff alleges that the Respondents sold securities to investors promising interest, in the case of NAFG, and dividends, in the case of NAC, ranging from 10 to 15% and that they represented to investors that NAFG was a profitable and/or successful business when in fact, unbeknownst to investors, the Respondents used new NAFG and/or NAC investor money either in whole or in part to pay interest, dividends or principal to other NAC or NAFG investors.

[301] The Respondents deny that they acted contrary to subsection 126.1(b) of the *Act*. The Respondents offered and sold securities to investors promising interest rates of 12% to 15%, in the case of NAFG, and a 10% to 12% dividend rate, in the case of NAC. The Respondents note that some securities of NAFG also carried a 5% interest rate. The Respondents admit that some disclosure provided to investors may have had the effect of implying that NAFG was a profitable business, and that the returns to investors were funded, in part, by new investments made in NAFG and/or NAC (Ex. 1, paras. 28 and 29). The Respondents confirm that on October 15, 2010, less than one month after the Director's Decision suspending Carter's registration was issued,

NAFG filed a Notice of Intention to make a proposal under the *BIA* on the basis that it was an insolvent person, pursuant to subsection 50.4(1) of the *BIA*.

[302] Subsection 126.1(b) of the *Act* prohibits conduct relating to securities that a person or company knows or reasonably ought to know would perpetrate a fraud. Subsection 126.1(b) of the *Act* states:

> **126.1 Fraud and market manipulation** – A person or company shall not, directly or indirectly, engage or participate in any act, practice or course of conduct relating to securities…that the person or company knows or reasonably ought to know,
>
> …
>
> (b) perpetrates a fraud on any person or company.

[303] In previous decisions, this Commission has adopted the interpretation of the fraud provision in provincial securities legislation as set out by the British Columbia Court of Appeal in *Anderson v. British Columbia (Securities Commission)* (2004 B.C.C.A. 7 ("***Anderson***"); leave to appeal to the Supreme Court of Canada denied [2004], S.C.C.A. No. 81 (S.C.C.)). In *Anderson*, the British Columbia Court of Appeal held that the fraud provision in the British Columbia *Securities Act*, which is similar to the Ontario fraud provision, requires proof of the same elements of fraud as in a prosecution under the *Criminal Code*, R.S.C., 1985, c. C-46. The fraud provision in the *Act* merely broadens the ambit of liability to those who knew or reasonably ought to have known that a person or company engaged in conduct that perpetrated a fraud. The words "knows or reasonably ought to know" do not diminish the requirement of Staff to prove subjective knowledge of the facts concerning the dishonest act by someone accused of fraud (*Anderson*, above at para. 26).

[304] In previous decisions, this Commission has also referred to the legal test for fraud set out in the leading case of *R v. Théroux*, [1993] 2 S.C.R. 5 (S.C.C.) ("***Théroux***"). In *Théroux*, McLachlin J. (as she then was) summarized the elements of fraud:

> … the *actus reus* of the offence of fraud will be established by proof of:
>
> 1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
>
> 2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.
>
> Correspondingly, the *mens rea* of fraud is established by proof of:
>
> 1. subjective knowledge of the prohibited act; and
>
> 2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist of knowledge that the victim's pecuniary interest are put at risk).
>
> (*Théroux*, above at para. 27)

[305] The act of fraud is established by two elements: a dishonest act and deprivation. The dishonest act is established by proof of deceit, falsehood or other fraudulent means. A dishonest act may be established by proof of "other fraudulent means". The phrase "other fraudulent means" encompasses all other means other than deceit or falsehood, which can properly be characterized as dishonest and is "determined objectively, by reference to what a reasonable person would consider to be a dishonest act" (*Théroux*, above at para. 17). The courts have included within the meaning of "other fraudulent means" the "use of corporate funds for personal purposes, non-disclosure of important facts, exploiting the weakness of another, unauthorized diversion of funds, and unauthorized arrogation of funds or property" (*Théroux*, above at para. 18). The use of investors' funds in an unauthorized manner has been determined to be "other fraudulent means" (*R. v. Currie*, [1984] O.J. No. 147 (Ont. CA) at paras. 14-17).

[306] The second element of the *actus reus* of fraud, deprivation, is established by proof of detriment, prejudice or risk of prejudice to the economic interests of the victims caused by the dishonest act. Actual economic loss suffered by the victim may establish deprivation, but it is not required. Prejudice or risk of prejudice to an economic interest is sufficient (*Théroux*, above at paras. 16-17; *R. v. Olan*, [1978] 2 S.C.R. 1175).

[307] A person who deprives another person of what the latter has should not escape criminal responsibility merely because, according to his moral or her personal code, he or she was doing nothing wrong or because of a sanguine belief that all will come out right in the end. Many frauds are perpetrated by people who think there is nothing wrong in what they are doing or who sincerely believe that their act of placing other people's property at risk will not ultimately result in actual loss to those persons. If

the offence of fraud is to catch those who actually practise fraud, its *mens rea* cannot be cast so narrowly as this (*Théroux*, above, p. 27).

[308] With regards to NAC, Mr. Tillie testified that some deposits found in NAFG's bank accounts appeared to have been transferred directly from the bank account of NAC (Tr. Vol. 5, p. 27, ll. 20-24; p. 36, ll. 2-9). The source and application of fund analysis completed by Mr. Tillie indicate that all deposits made by NAC investors were deposited into Account 652, which was the main account of NAFG (Ex. 18, Tab B). The Respondents also admit that during the period July 2009 to April 2010, NAC issued shares to approximately 11 investors. The Respondents also admit that the total proceeds of approximately $1,042,000 from the sale of NAC securities were transferred to NAFG (Ex. 1, para. 2). I note, however, that Mr. Tillie's analysis shows that a total of $126,000 was received from NAC investors from the period of January 1, 2009 to September 24, 2010 (Ex. 20).

[309] With regards to NAFG, I accept Mr. Tillie's analysis of NAFG's income statement for the years 2007 to 2010 (Ex. 18, Tab J, p. 37). The income statement indicates that in 2007, NAFG lost $68,047 and the losses continued to the end of 2010. The cumulative effect of the losses resulted in a deficit by December 31, 2010 of $2,596,002. I therefore disagree with the Respondents' description of the effect of the marketing brochures distributed to investors. I find that considerable disclosures were made that implied that NAFG was a profitable business when it was not. This constitutes an act of deceit, falsehood or some other fraudulent means.

[310] I note that the Respondents admit that at no time did they advise investors in NAFG or NAC that their funds would be used either in whole or in part to pay interest, dividends or principal to other NAFG or NAC investors (Ex. 1, para. 30). Mr. Tillie's source and application of funds analysis (Ex. 20) established that the receipts from the lease payments were not sufficient to pay the interest paid to investors from January 1, 2009 to September 24, 2010. As Mr. Tillie said, there were only two primary sources of funds for the company, the lease payments and receipts from the investors. The only source of funds to make the interest payments to investors was funds received from new investors. This activity is often referred to as a "Ponzi" scheme. I find these payments of "new" investor money to "old" investors to be an act of deceit, falsehood or some other fraudulent means.

[311] There is incontrovertible evidence that investors were deprived by the prohibited acts identified in the preceding paragraph. Most of the investors of NAFG and NAC, who were unsecured investors, lost at least half of their investment pursuant to the terms of the arrangement agreed upon in the bankruptcy proceedings of NAFG. The interest rate applied to the remainder of their funds was reduced to 1%.

[312] I find that the prohibited acts coupled with the resulting losses establish the *actus reus* of the offensive fraud committed by the Respondents.

[313] The mental element of fraud is established by proof of subjective knowledge of the prohibited act and subjective knowledge that the prohibited act would have caused the deprivation of another as a consequence. The Alberta Court of Appeal has confirmed that it is appropriate to draw an inference as to the requisite subjective mental element from the totality of the evidence (*Alberta (Securities Commission) v. Brost*, 2008 ABCA 326 at paras. 42 and 43).

[314] Previous decisions issued by the Commission have also found that for a finding of fraud against a corporate respondent, it is sufficient to show that its directing minds knew or reasonably ought to have known that the corporation perpetrated a fraud to prove a breach of subsection 126.(1)(b) of the *Act* (*Re Richvale Resource Corp.* (2012), 35 O.S.C.B. 4286 at para. 104, citing *Re Al-Tar Energy Corp.* (2010), 33 O.S.C.B. 5535 at para. 221 and *Re Global Partners* (2010), 33 O.S.C.B. 7783 at para. 245).

[315] I find that each of the Arcontis were aware that NAFG never made a profit in the years 2007, 2008, 2009 or 2010 (Ex. 18, Tab J, p. 37). Each of them knew that the unsecured interest-free loan to Prestige Motors reached over $2 million. As of September 30, 2010, the loan amounted to a substantial $2,503,608.43 (Ex.1, para. 22; Ex. 11, Tab C2, p. 170).

[316] Each of the Arcontis transferred their interest in their residence to their spouses in May 2010. Each had an explanation for why they did so, which I do not accept. The transfers were made within days of each other and the timing of the transfers coincided with the increasing losses of the NAFG group of companies. This persuades me that the reason for the transfers was to place whatever value there might be in the residences out of the reach of potential creditors.

[317] The Respondents admit that the Arcontis were the directing minds of NAFG, NAC, Carter and Prestige Motors and that "returns to investors were funded in part by new investment in NAFG and/or NAC" (Ex. 1, paras. 4 and 29). I therefore find that the Arcontis each had the requisite *mens rea* for fraud as alleged by Staff. Accordingly, I also find that NAFG and NAC knew that the representations to investors regarding NAFG's financial situation and the use of investor funds were false and misleading and would cause deprivation to investors by exposing them to risks not contemplated by them

[318] I find that on a balance of probabilities, the Respondents' conduct constituted a breach of subsection 126.1(b) of the *Act* and was contrary to the public interest.

H. Director and Officer Liability – NAFG and NAC

[319] Staff submits that the Arcontis, as actual and/or *de facto* officers and/or directors of NAFG and NAC, are liable for the breaches of subsection 126.1(b) of the *Act* by NAFG and NAC, pursuant to section 129.2 of the *Act*.

[320] The Respondents submit that to the extent that NAFG and NAC are found to have violated Ontario securities law, it is conceded that the Arcontis will also be found to have violated Ontario securities law. However, the Respondents deny Staff's allegation that the Respondents breached subsection 126.1(b) of the *Act*.

[321] Section 129.2 of the *Act* applies to directors or officers of a company that fail to comply with Ontario securities law. I note that the Respondents admit that the Arcontis were co-owners, the directing minds and actual and/or *de facto* officers and directors of NAFG and NAC (Ex. 1, paras. 5 and 12). I agree with Staff's submission that the Arcontis were active members in the fraud committed by NAFG and NAC. The evidence has shown that:

(a) Flavio Arconti prepared the marketing brochures of NAFG, which contained statements that conveyed NAFG as a successful business, when it was not;

(b) Gino Arconti distributed NAFG's marketing brochures to investors;

(c) the Arcontis were two of the four people that were responsible for depositing cheques that came into NAFG;

(d) the Arcontis reviewed the financial statements of NAFG on an annual basis and were aware of NAFG's growing cumulative losses and the growing unsecured, interest-free loan to Prestige Motors; and

(e) the Arcontis were both engaged in discussions with investors.

[322] I find that the Arcontis authorized, permitted or acquiesced in the non-compliance with Ontario securities law by NAFG and NAC, and the Arcontis are therefore are deemed to have failed to comply with Ontario securities law under section 129.2 of the *Act*.

I. Trading without Registration and Analysis

[323] Staff alleges that Gino Arconti, having become aware of his suspension as a registrant on September 23, 2010, did trade in securities contrary to subsection 25(1) of the *Act*.

[324] The Respondents deny Staff's allegation that Gino Arconti continued to engage in and/or hold himself out as engaging in the business of trading in securities.

[325] Subsection 25(1) of the *Act* provides that:

> **25 Registration** – **(1) Dealers** – Unless a person or company is exempt under Ontario securities law from the requirement to comply with this subsection, the person or company shall not engage in or hold himself, herself or itself out as engaging in the business of trading in securities unless the person or company,
>
> (a) is registered in accordance with Ontario securities law as a dealer; or
>
> (b) is a representative registered in accordance with Ontario securities law as a dealing representative of a registered dealer and is acting on behalf of the registered dealer.

[326] The definition of "security" provided for in subsection 1(1) of the *Act* includes "a bond, debenture, note or other evidence of indebtedness or a share, stock, unit, unit certificate, participation certificate, certificate of share or interest".

[327] The definition of "trade" or "trading" under subsection 1(1) of the *Act* provides for a broad definition, which includes "any sale or disposition of a security for valuable consideration" and "any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance" of such a sale or disposition.

[328] The Commission has adopted a contextual approach to determining whether nonregistered individuals or companies have engaged in acts in furtherance of a trade. The contextual approach examines "the totality of the conduct and the setting in which the acts have occurred" and has as a primary consideration of which is "the effect the acts had on those to whom they were directed" (*Momentas*, above at para. 77).

[329] A variety of conduct has been found by the Commission to constitute acts in furtherance of trade, including:

(a) providing potential investors with subscription agreements to execute;

(b) distributing promotional materials concerning potential investments;

(c) issuing and signing share certificates;

(d) preparing and disseminating materials describing investment programs;

(e) preparing and disseminating forms of agreements for signature by investors;

(f) conducting information sessions with groups of investors;

(g) meeting with individual investors;

(h) accepting investor funds for the purpose of an investment; and

(i) offering securities to investors on the Internet.

(*Momentas*, above at para. 80; *Re Lett* (2004), 27 O.S.C.B. 3215 ("***Lett***") at paras. 50-51 and 64; *Re Allen* (2005), 28 O.S.C.B. 8541 ("***Allen***") at para. 85; *Re Limelight Entertainment Inc.* (2008), 31 O.S.C.B. 1727 ("***Limelight***") at para. 133; *Re First Federal Capital (Canada) Corp.* (2003), 27 O.S.C.B. 1603 ("***First Federal***") at para. 45)

[330] Therefore, taking steps to facilitate the mechanical, or logistical, aspects of trading has been found by the Commission to be an act in furtherance of a trade. In *Lett*, investors transferred, deposited, or caused to be deposited, funds into the accounts of the corporate respondents, which had been opened by an individual respondent. The Commission found that the investors' funds were deposited into the accounts and accepted by the respondents for the purpose of selling securities and held that the respondents had carried out acts in furtherance of trades (*Lett*, above at paras. 60 and 64).

[331] A respondent does not have to have direct contact or make a direct solicitation of an investor for an act to constitute an act in furtherance of a trade (*Lett*, above at paras. 48-51 and 64). An act in furtherance of a trade does not require that an investment contract be completed or that an actual trade otherwise occur (*Allen*, above at para. 85). Any claim that an actual trade must occur for there to be an act in furtherance of a trade would necessarily limit the effectiveness and negate the purpose of the *Act*, which is to regulate those who trade, or who purport to trade, in securities (*First Federal*, above at paras. 46, 47, 50 and 51).

[332] In *Lett*, above, the Commission found that the investors' funds were deposited into the accounts and accepted by the respondents for the purpose of selling securities. The Commission held that the respondents had carried out acts in furtherance of trades (*Lett*, above, at para. 60 and 64).

[333] Once Staff has established that a respondent has engaged in an activity for which registration or a prospectus is required, the onus is on the respondent to prove facts establishing the availability of an exemption.

[334] Gino Arconti's registration as a Dealing Representative of Carter ended on September 22, 2010 when it was automatically suspended by the Director's Decision. This was admitted by the Respondents (Ex. 1, para. 15). It is also admitted that the Arcontis' registration was automatically suspended as a result of the Director's Decision (Ex. 1, para. 8). At the Hearing, Staff introduced certified statements, pursuant to section 139 of the *Act*, with respect to the registration statuses of the Respondents and Carter. Based on the certificates, Gino Arconti was not registered in any capacity with the Commission after September 22, 2010 (Ex. 19, Tab 9). There was also no evidence that a registration exemption was available to Gino Arconti at any time he traded the securities of NAFG or NAC.

[335] It will be recalled that D.M. wrote a cheque to NAFG for $50,000 dated September 1, 2010. D.M. instructed Gino Arconti not to cash the cheque until Friday, September 24, 2010. Following D.M.'s consent, Gino Arconti deposited the cheque into Account 652, NAFG's main bank account, on September 24, 2010.

[336] I find that the debenture transaction of D.M. constituted a "security" under the *Act*. I also find that the sale of the debenture to D.M. constituted a "trade" under the *Act*, and that Gino Arconti's active steps to complete this transaction constituted an "act in furtherance of a trade".

[337] I therefore find that on September 24, 2010, Gino Arconti engaged in or held himself out as engaging in the business of trading in securities without registration, contrary to subsection 25(1) of the *Act* and contrary to the public interest.

PART 5 – CONCLUSION

[338] For the reasons set out above, I find that:

(a) during the period September 29, 2009 to September 24, 2010, Carter's actions constituted a breach of section 13.3 of NI 31-103 and was contrary to the public interest;

(b) during the period September 17, 2007 to September 24, 2010, Carter's actions constituted a breach of subsection 2.1(1) of OSC Rule 31-505 and was contrary to the public interest;

(c) Flavio Arconti and Gino Arconti, as actual and *de facto* officers and directors of Carter, authorized, permitted or acquiesced in the non-compliance with Ontario securities law by Carter, and are therefore deemed to also have not complied with Ontario securities law, pursuant to section 129.2 of the *Act*;

(d) during the period January 1, 2009 to September 24, 2010, the Respondents directly or indirectly engaged or participated in acts, practices or courses of conduct relating to the securities of NAFG and NAC that they knew or reasonably ought to have known perpetrated a fraud on persons contrary to subsection 126.1(b) of the *Act* and contrary to the public interest;

(e) Flavio Arconti and Gino Arconti, as actual and *de facto* officers and directors of NAFG and NAC, authorized, permitted or acquiesced in the non-compliance with Ontario securities law by NAFG and NAC, and are therefore deemed to also have not complied with Ontario securities law, pursuant to section 129.2 of the *Act*; and

(f) on September 24, 2010, Gino Arconti engaged in or held himself out as engaging in the business of trading in securities without being registered to do so in circumstances in which no exemption was available, contrary to subsection 25(1) of the *Act* and contrary to the public interest.

[339] For the reasons outlined above, I will also issue an order dated December 11, 2013 which sets down the date for the hearing with respect to sanctions and costs in this matter and the schedule for the serving and filing of written submissions on sanctions and costs from the parties.

Dated at Toronto this 11th day of December, 2013.

"James D. Carnwath"

3.1.2 Eda Marie Agueci et al.

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
EDA MARIE AGUECI, DENNIS WING, SANTO IACONO,
JOSEPHINE RAPONI, KIMBERLEY STEPHANY,
HENRY FIORILLO, GIUSEPPE (JOSEPH) FIORINI,
JOHN SERPA, IAN TELFER, JACOB GORNITZKI
and POLLEN SERVICES LIMITED

REASONS FOR DECISION ON A MOTION

Hearing: September 16, 23 and 27, 2013

Decision: December 13, 2013

Panel:
Edward P. Kerwin – Commissioner and Chair of the Panel
Deborah Leckman – Commissioner
Anne Marie Ryan – Commissioner

Appearances:
Cullen Price, Usman Sheikh, Albert Pelletier, Clare Devlin – For Staff of the Commission

Nigel Campbell, Erin Hoult – For Jacob Gornitzki

Patricia McLean – For Dennis Wing

Peter Howard, Ellen Snow – For Henry Fiorillo

Ken Jones – For Kimberley Stephany

TABLE OF CONTENTS

I. OVERVIEW

II. ISSUES

III. FACTS

IV. SUBMISSIONS OF THE PARTIES
- A. Staff
- B. Gornitzki
  - 1. Response to the Motion
  - 2. The Cross-Motion
- C. Telfer
- D. Wing
- E. Stephany
- F. Fiorillo
- G. Agueci
- H. Staff's Reply
  - 1. Reply to the Motion Submissions of the Respondents
  - 2. Response to the Cross-Motion
  - 3. Response to Wing's Constitutional Question on the Motion

V. LAW AND ANALYSIS
A. Admissibility of Compelled Testimony
1. The Scheme of the Act
2. Hearsay is Admissible
3. Protections for Compelled Testimony
a. The *Charter*
b. The SPPA
c. The *Evidence Act*
d. Procedural Fairness and Reasonable Expectations
B. Procedural Direction
C. Confidentiality Cross-Motion

VI. CONCLUSION

REASONS FOR DECISION ON A MOTION

I. OVERVIEW

[1] Enforcement Staff of the Ontario Securities Commission (the "**Commission**") brought a motion seeking an order to admit into evidence selected excerpts from transcripts of compelled examinations of respondents conducted pursuant to section 13 of the *Securities Act*, R.S.O. 1990, as amended (the "**Act**") (the "**Motion**").

[2] The Commission issued a Notice of Hearing pursuant to sections 127 and 127.1 of the Act in connection with a Statement of Allegations filed by Enforcement Staff ("**Staff**") on February 7, 2012 against Eda Marie Agueci ("**Agueci**"), Dennis Wing ("**Wing**"), Santo Iacono ("**Iacono**"), Josephine Raponi ("**Raponi**"), Kimberley Stephany ("**Stephany**"), Henry Fiorillo ("**Fiorillo**"), Giuseppe (Joseph) Fiorini ("**Fiorini**"), John Serpa ("**Serpa**"), Ian Telfer ("**Telfer**"), Jacob Gornitzki ("**Gornitzki**") and Pollen Services Limited ("**Pollen**") (collectively, the "**Respondents**").

[3] In the Statement of Allegations, Staff alleges that the Respondents engaged in conduct in breach of the Act and contrary to the public interest, including insider trading and/or tipping contrary to section 76 of the Act. Agueci and Wing are also alleged to have made misleading statements contrary to section 122 of the Act and Agueci is alleged to have disclosed information regarding Staff's investigation contrary to section 16 of the Act. Staff further alleges that Wing authorized, permitted or acquiesced in Pollen's breaches of the Act and is therefore, deemed to have not complied with Ontario securities law.

[4] The Motion was filed by Staff on August 30, 2013. A cross-motion was filed by counsel for Gornitzki on September 6, 2013 requesting that the Motion and cross-motion be heard *in camera*, and seeking orders that the Motion and cross-motion materials and the transcript of the Motion hearing remain confidential following determination of the Motion (the "**Cross-Motion**"). Thereafter, the Panel received written submissions on the Motion from various counsel on behalf of Gornitzki, Telfer, Wing, Stephany and Fiorillo. The Panel also received correspondence from counsel for Agueci adopting the submissions of Telfer.

[5] Oral submissions of the parties on the Motion and Cross-Motion were heard *in camera* before the Commission on September 16, 23 and 27, 2013 (the "**Motion Hearing**").

[6] On September 20, 2013, the Commission approved a settlement between Telfer and Staff (*Re Eda Marie Agueci et al.* (2013), 36 O.S.C.B. 9341). Counsel for Telfer appeared before the Panel on September 23, 2013 to confirm that Telfer was no longer a party and withdrew his submissions in respect of the Motion and a confidentiality cross-motion brought by Telfer. Counsel for Telfer also submitted that he was content to leave his written memorandum of fact and law as part of the record for the Panel's consideration as parties who were not actively participating in the Motion adopted and relied upon legal argument within it. We accept these submissions and have considered them as the written record relied upon by other respondents.

[7] On September 26, 2013, Staff filed an Amended Statement of Allegations against the Respondents, which contained substantially similar allegations as those articulated above.

[8] On October 1, 2013, the Panel delivered its oral ruling with respect to the Motion and the Cross-Motion. The Panel decided that the excerpts from transcripts of compelled examinations of the Respondents are admissible into evidence in the context of regulatory proceedings before the Commission, and their admission is not precluded by *Canada's Charter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c.11 (the "***Charter***") or the Ontario *Evidence Act*, R.S.O. 1990, c. E.23, as amended (the "***Evidence Act***").

[9] However, the Panel also determined that the oral evidence of those Respondents who chose to testify would provide the Panel with the best evidence of their conduct. Therefore, the Panel determined that at the conclusion of Staff's case, Staff may seek to tender into evidence excerpts from the transcripts of compelled examinations of the Respondents who have not

undertaken to testify. The Panel acknowledged, however, that the onus is on Staff to prove the allegations against the Respondents and made an exception to allow Staff to put forward the excerpts from transcripts of compelled examination of Wing and Agueci for the limited purpose of making its case with respect to allegations of breaches of section 122 of the Act by them.

[10] With respect to the Cross-Motion for confidentiality, the Panel agreed that, in the public interest, an appropriate balance would be to order that all materials and transcripts of the Motion and Cross-Motion remain confidential, but that the Panel's decision on the matter shall be public and except for such excerpts of compelled examinations as may be admitted into evidence by the Panel in the course of the hearing on the merits.

II. ISSUES

[11] Addressing the Motion involves considering two main issues:

(a) Are transcripts of compelled examinations of the Respondents admissible against them as part of Staff’s case?

(b) If such transcripts are so admissible, what procedure should be followed?

[12] With respect to the Cross-Motion, the Panel must consider whether it is in the public interest to order that any or all of the Motion and Cross-Motion materials, transcripts and decision remain confidential.

III. FACTS

[13] On May 4, 2011 and July 18, 2011, the Commission issued orders under subsection 11(1)(a) of the Act, authorizing members of Staff to investigate the Respondents and others connected to GMP Securities L.P. (“**GMP**”) and its employees, in relation to insider trading, tipping or conduct in relation to securities that is in breach of the Act and/or contrary to the public interest (the “**Investigation Order**”).

[14] Each of the individual Respondents was summoned to be examined and provided testimony pursuant to section 13 of the Act.

IV. SUBMISSIONS OF THE PARTIES

[15] Staff submits that transcripts of compelled examinations of the individual Respondents, conducted pursuant to section 13 of the Act (the “**compelled testimony**”), are admissible evidence at hearings before the Commission and that Staff should be allowed to read-in excerpts of the compelled testimony at the outset of its case.

[16] Those Respondents who made submissions opposed the Motion on the basis that compelled testimony is not admissible evidence at hearings before the Commission for various reasons. In the alternative, many of the Respondents also took the position that, if the compelled testimony is admissible, the Panel should not admit the compelled testimony of a Respondent who undertakes to testify at the hearing because oral testimony would provide the best evidence and Staff could use transcripts of the compelled testimony for purposes of cross-examination, if necessary.

A. Staff

[17] Staff submits that the compelled testimony must be admitted for three reasons: (i) it is well-established law that transcripts of compelled testimony may be admitted for use by Staff in the same regulatory proceeding in which they were obtained (*Re York Rio Resources Inc.* (2012), 35 O.S.C.B. 99 (“***York Rio***”) at para. 67); (ii) the admission of the compelled testimony would cause no prejudice to the Respondents as the admission of transcript evidence is consistent with their reasonable expectations; and (iii) the alternate proposal of admitting compelled testimony only for the purposes of cross-examination is unfair to Staff and the Respondents.

[18] On the first point, Staff relies on subsection 15(1) of the SPPA, which provides for admission of relevant hearsay evidence. Staff submits that compelled transcript evidence is a form of permissible hearsay under section 15 of the SPPA. Staff also submits that the Commission and other Ontario tribunals have regularly admitted compelled testimony into evidence in regulatory proceedings (*Re Al-Tar Energy Corp.* (2010), 33 O.S.C.B. 5535 at para. 40; *Re Sextant Capital Management Inc.* (2011), 34 O.S.C.B. 5829 (“***Sextant***”) at para. 8; *York Rio*, *supra* at para. 67; *Re Jain*, [2012] O.C.P.S.D. No. 30 (“***Jain***”) at paras. 31-33 (QL)). Staff noted that in *Boock* the Commission stated “a principal purpose of compelled testimony is to permit Staff to obtain relevant documents and evidence for use at a hearing” (*Re Boock* (2010), 33 O.S.C.B. 1589 (“***Boock***”) at para. 109).

[19] Staff takes the position that the admission of the compelled testimony is contemplated by the Act, the provisions of which should be construed liberally to achieve its purpose and objectives, and interpreted contextually and harmoniously to allow each of the parts to work together to achieve the goal of the legislation (*Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27 ("***Rizzo***") at paras. 21-22; *Interpretation Act*, R.S.O. 1990, c. I.11, as amended, s.10). Therefore, Staff argues, subsection 16(2) of the Act states that compelled testimony is for the "exclusive use of the Commission" and shall not be disclosed "except as permitted under section 17", which should be read together with subsection 17(6) of the Act. Staff submits that subsection 17(6) of the Act expressly authorizes disclosure of the compelled testimony in connection with "a proceeding commenced or proposed to be commenced by the Commission under … [the] Act". The combined reading of those provisions is supported by the Commission's decision in *Sextant*, in which the panel accepted Staff's submission that the combination of subsections 16(2) and 17(6) contemplate that compelled testimony may be used in a section 127 proceeding before the Commission (*supra* at para. 8).

[20] Furthermore, Staff submits that section 18 of the Act sets out the only prohibited uses of compelled testimony. Section 18 of the Act provides that compelled testimony "shall not be admitted in evidence against the person from whom the testimony was obtained in a prosecution for an offence under section 122 or in any other prosecution governed by the Provincial Offences Act." Staff submits that the provision requires application of the maxim expressio unius est exclusio alterius, or the "implied exclusion" doctrine of statutory interpretation, that the Legislature's silence can be taken as deliberate (Ruth Sullivan, Sullivan on the *Construction of Statutes*, 5th ed. (Markham: LexisNexis Canada, 2008) ("***Sullivan on the Construction of Statutes***") at pp. 243-244). Therefore, Staff states that if the Legislature had intended to prohibit the use of compelled testimony in section 127 proceedings it would have done so expressly (*Sextant*, *supra* at para. 9).

[21] Staff also submits that the admission of transcripts of the compelled testimony as part of Staff's case in chief does not conflict with the *Evidence Act* or the *Charter* because neither apply. Section 9 of the *Evidence Act*, Staff submits, does not serve as a basis to exclude compelled transcript evidence for use within the same regulatory proceeding for which it was obtained. Staff relies on the Commission's decision in *Sextant*, which found that the word "subsequent" must be read into subsection 9(2) of the *Evidence Act* "so that it provides that "the answer so given shall not be used or receivable in evidence against him or her in any civil proceeding or in **any subsequent proceeding** under any Act of the Legislature" [emphasis added] (*supra* at para.15; see also *York Rio*, *supra* at paras. 78-79). Staff also directs us to consider the statement in *Sextant* that to deny the use of compelled evidence "would hamper effective enforcement for many boards and commissions throughout Ontario that have the power to compel testimony" (*supra* at para. 14).

[22] Staff also relies on *Jain*, a decision of the College of Physicians and Surgeons of Ontario (the "**CPSO**") which determined that section 9 of the *Evidence Act* offers a protection to witnesses in a proceeding from having "their answers used against them in a subsequent criminal proceeding or a civil proceeding that by its nature is penal or involves forfeiture" (*supra* at para. 32). As a result, the CPSO concluded that section 9 of the *Evidence Act* did not provide a basis to exclude Dr. Jain's evidence, given at her interview, in her discipline hearing (*Jain*, *supra* at para. 33).

[23] Staff further relies on the Alberta Court of Appeal decision in *Brost*, which determined that section 6 of the Alberta *Evidence Act*, R.S.A. 2000, c. A-18 (the "***Alberta Evidence Act***"), which Staff submits is similar in substance to section 9 of the *Evidence Act* in Ontario, has no application to Alberta Securities Commission (the "**ASC**") proceedings and prohibits the use of a witness' testimony to incriminate the witness in other proceedings (*Alberta (Securities Commission) v. Brost*, 2008 A.B.C.A. 326 (CanLII) ("***Brost***") at para. 37). The Court of Appeal went on to state that the "interviews were not used to incriminate these appellants in the sense that criminal proceedings were involved nor were they used in other proceedings. Rather, the interviews were used in the same regulatory proceedings in which they were obtained." (*ibid*).

[24] Staff submits that in Ontario civil actions, which are also subject to the *Evidence Act*, Rule 31.11(1) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 ("***Rules of Civil Procedure***") expressly allows for transcript evidence of an examination for discovery to be read into evidence in the same civil proceeding for which the evidence was obtained. In any event, Staff argues that the protection of section 9 of the *Evidence Act* was not asserted by four of the respondents, including Gornitzki, Fiorini, Serpa and Wing.

[25] The *Charter* does not apply, Staff submits, because the predominant purpose of securities commission regulatory investigations and enforcement proceedings arising out of them is not to incriminate a respondent and therefore they do not engage the *Charter* (*British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3, 1995 CanLII 142 ("***Branch***") at paras. 34-35; *Boock*, *supra* at paras. 94-99; *Sextant*, *supra* at paras. 17-24).

[26] With respect to its second point, Staff submits that as market participants in a highly regulated securities industry, the admission of the compelled testimony is consistent with the Respondents' reasonable expectations. Staff relies on *Branch*, in which the Supreme Court of Canada (the "**SCC**") noted that market participants are well-aware that the securities industry is highly regulated and are deemed to know the rules of the game (*Branch*, *supra* at paras. 57-58 and 64). Furthermore, Staff takes the position that the Respondents must have known or are deemed to have known that they would or could be questioned by regulators from time to time to ensure their compliance with the rules (*Branch*, *supra* at para. 78). Staff relies on *Brost* and *Boock* in support of its submission that Respondents must have known that the contents of their interviews conducted during Staff's investigation would be used for the purposes of the Act (*Boock*, *supra* at para. 74; *Brost*, *supra* at para. 38). Staff takes

the position that save for Serpa and Gornitzki, the Respondents were represented at the time of their compelled examinations by experienced counsel who were aware of the Commission's practice of admitting compelled transcript evidence in a Commission proceeding.

[27] Staff's third point is that if the Panel were to admit compelled testimony only for purposes of cross-examination, it would be unfair to Staff and the Respondents. Staff argues that this alternative would severely impede Staff's ability to properly present Staff's case. Staff directed the Panel to the SCC's decision in *Branch*, which states:

> Compelling the testimony of certain individuals may be the only reasonable means by which regulators can obtain evidence or gain a full appreciation of important information. The alternative, which I believe to be far less palatable, is for investigators to resort to highly intrusive search and seizure powers. This Court has previously recognized and taken into consideration the difficulties involved in regulating activities in a licensed sphere, where important information is generally only in the possession of the private individuals whose activity is the focus of the regulation […]
>
> (*Branch*, *supra* at para. 91)

[28] Staff submits that reading-in the compelled testimony is critical to Staff's case because: (a) the compelled testimony is required to establish elements of certain offences, including allegations of misleading or untrue statements made by some of the Respondents in the course of their compelled examination and contents of an examination which Staff alleges were divulged; (b) the compelled testimony is required to explain code words; (c) the compelled testimony is required to understand relationships between the Respondents, as context and motivation for many of the impugned trades as well as conduct alleged to be contrary to the public interest; (d) the compelled testimony is required to understand Staff's forensic accountant's analysis; (e) the compelled testimony is required to explain trades and other transactions; and (f) the compelled testimony is required to assess credibility of the Respondents. Specifically with respect to submission (a), Staff submits that it intends to rely upon the compelled testimony of Iacono and Fiorillo to prove Staff's allegation of Agueci's breach of section 16 of the Act with respect to confidentiality.

[29] Staff also asserts that the proposal to admit compelled testimony only for purposes of cross-examination of the Respondents who do testify and otherwise to admit the compelled testimony after the Respondents have presented their evidence, only for the Respondents who do not testify, would prejudice all the Respondents who have not consented to such a method, because it would require Staff to split its case. Staff submits that there is a fundamental rule which prohibits the Crown from splitting its case and that all relevant evidence should be advanced by the Crown as part of its case as it would be unfair to wait and permit the accused to trap himself or herself (Alan W. Bryant, Sidney N. Lederman and Michelle K. Fuerst, *The Law of Evidence in Canada*, 3d ed. (Markham: LexisNexis Canada, 2009) ("***Law of Evidence***") at para. 8.168). Staff submits that this rule is intended to prevent surprise, prejudice and confusion on the part of a Respondent and to avoid infringing on a Respondent's right to know the case he or she has to meet (*R. v. Krause*, [1986] 2 S.C.R. 466 at 473-74, 33 DLR (4th) 267).

[30] Lastly, Staff submits that the Commission's decision in *Donald* was a significant departure from the Commission's well-established practice of admitting a respondent's compelled transcript into evidence as part of Staff's case in chief. In *Donald*, the panel determined that because the only respondent in that matter had undertaken to testify on his own behalf, Staff would not be permitted to read into the record excerpts from his compelled testimony, with the exception that his transcript could be used to impeach his testimony in cross-examination (*Re Donald* (2012), 35 O.S.C.B. 7383 ("***Donald***") at para. 34). Staff submits that in the past two years at least five panels of the Commission have allowed Staff to tender a respondent's transcript evidence, even where the respondent also later testified as part of his/her defense (*Re MRS Sciences Inc.* (2011), 34 O.S.C.B. 1547 at paras. 90-96 (transcript ruling on June 22, 2009 at 8-9); *York Rio*, *supra* at paras. 55-56, 63, 67, 74-76, 78; *Re MP Global Financial Ltd.* (2011), 34 O.S.C.B. 8897 ("***MP Global***") at paras. 4, 6 and 34; *Re McErlean* (2012), 35 O.S.C.B. 7474 ("***McErlean***") at paras. 59,118 and 175-178; *Re New Found Freedom Financial* (2012), 35 O.S.C.B. 11522 ("***New Found Freedom***") at paras. 22-24, 119 and 134; *Re Goldbridge Financial Inc.* (2011), 34 O.S.C.B. 1064 ("***Goldbridge***") at paras. 6, 87, 89 and 111). In any event, Staff submits, *Donald* is distinguishable as there are significant differences in the nature and types of allegations (ex. misleading Staff in this matter) and unlike in *Donald*, not all the Respondents have undertaken to testify.

B. Gornitzki

1. Response to the Motion

[31] Gornitzki opposes the Motion on the following grounds: (i) the Act prohibits public disclosure of compelled testimony; (ii) alternatively, while Staff may avail itself of compelled testimony transcripts for purposes of impeaching Gornitzki during cross-examination, the transcripts of compelled testimony should not be admissible evidence at a section 127 hearing (except in exceptional circumstances which are not present here) because such examinations are bereft of reliability safeguards; and (iii) in the further alternative, principles of natural justice and procedural fairness dictate that the compelled testimony cannot be admitted in this particular case as Gornitzki was not afforded procedural fairness during Staff's investigation.

[32] Gornitzki submits that the starting point in the Act is that testimony and information obtained as a result of the exercise of section 13 powers of investigation are confidential pursuant to section 16 of the Act and shall not be disclosed or produced except as permitted under section 17 of the Act. Gornitzki takes the position that subsections 17(1) and (6) of the Act set out very limited exceptions to the general rule of confidentiality and they are expressly limited by subsections 17(3) and (7) of the Act, which state that compelled testimony cannot be disclosed to police or law enforcement officials without written consent of the party from whom the testimony was obtained. Gornitzki notes that subsection 17(1) of the Act permits the Commission, if it is in the public interest, to make an order authorizing disclosure of compelled testimony once the Commission has given reasonable notice and an opportunity to be heard to person who gave the testimony, pursuant to subsection 17(2) of the Act.

[33] Gornitzki submits that implicit in Staff's argument, in reliance on subsections 16(2) and 17(6) of the Act, is the notion that a public interest inquiry by the Panel pursuant to subsection 17(1) of the Act is not necessary. That is a position that Gornitzki submits should be rejected. Gornitzki's counsel relies on Naster, for its submission that subsection 17(6) of the Act permits disclosure and production of section 13 materials by Staff for two reasons only: (1) to meet Staff's disclosure obligations; or (2) to continue its investigation (*A. Co. v. Naster*, [2001] O.J. No. 4997 (Div. Ct.) (QL) ("***Naster***") at paras. 25-30). Therefore, Gornitzki submits, Staff cannot be permitted to read-in the compelled testimony at the hearing on the basis of subsection 17(6) of the Act. Gornitzki takes the position that the *Naster* interpretation is consistent with the well-established principle that it is for the Panel to determine the admissibility of evidence a party proposes to introduce at a hearing and it accords with principles of purposive statutory interpretation considering a provision in its entire context and its grammatical and ordinary sense, harmoniously with the scheme of the Act (*Rizzo*, *supra* at para. 21; *Sullivan on the Construction of Statutes*, *supra* at pp. 1 and 257).

[34] Gornitzki submits that, if it had been the intention of the Legislature to permit the compelled testimony to be read-in, the Legislature would have done so expressly as it did in the context of transcripts of an examination for discovery in civil proceedings (*Rules of Civil Procedure*, r. 31.11). Gornitzki's counsel argues that a section 13 examination under the Act is nothing like an examination for discovery, in that before an examination for discovery in a civil proceeding the parties have exchanged pleadings and affidavits so that a deponent: (a) knows the allegations; (b) has had a chance to review his own documents; (c) has had a chance to review the other party's documents; and (d) has had a chance to speak to others who may have relevant information, all before giving an answer under oath.

[35] Gornitzki directs the Panel to the Commission's decision in *Black*, which acknowledges that confidentiality is essential both to facilitate the investigation and to avoid prejudice to a person's right to fair process if he or she becomes the subject of the proceedings (*Re Black* (2007), 31 O.S.C.B. 10397 at paras. 112-114, citing *Re Coughlan* (2000), 143 O.A.C. 244 (Ont. Div. Ct.) at para. 57). Gornitzki submits that Staff's investigative powers are extraordinary, intrusive, do not include the safeguards afforded to parties in civil proceedings in examinations for discovery and are unlike the powers of law enforcement officials, who cannot compel people to answer questions.

[36] Further, Gornitzki submits that Staff has not requested that the Panel consider an order under subsection 17(1) of the Act and, if such a request were made, Gornitzki reserves his right to object and make submissions in that respect. Gornitzki asserts that if the Act prohibits admission of compelled testimony, section 15 of the SPPA cannot override that prohibition.

[37] With respect to his second ground for opposing the Motion, Gornitzki submits that if the Act does not prohibit the admission of compelled transcripts into evidence, such transcripts should nonetheless be inadmissible at a hearing in all but exceptional circumstances as they were obtained in the absence of reliability safeguards (e.g. notice of allegations, availability of documents, and time for preparation). Exceptional circumstances, Gornitzki argues, include when a witness has died, is infirm or otherwise fails to testify. Gornitzki submits that he is available and will testify. Gornitzki also agreed that where appropriate, Staff may be permitted to use compelled transcripts for purposes of impeachment (*Donald*, *supra* at para. 34).

[38] The further alternative submission made by Gornitzki is that principles of fairness and natural justice prohibit the reading-in of the compelled testimony in this case. Gornitzki argues that principles of natural justice must inform admissibility decisions. Gornitzki submits that the Respondents are owed a duty of procedural fairness which requires a fair opportunity to participate in the decision-making process. In the context of a hearing pursuant to section 127 of the Act, Gornitzki relies on *Baker* and *Judicial Review of Administrative Action in Canada* for his submission that procedural fairness requires: adequate notice, reasonable expectations to be adhered to, adequate disclosure, the opportunity to fully and fairly present their respective cases, including being able to present evidence and to cross-examine adverse evidence and that all parties be treated equally (*Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817 ("***Baker***") at para. 24; Donald Brown and The Honourable John Evans, *Judicial Review of Administrative Action in Canada*, loose-leaf (Toronto: Canvasback, 2009) vol. 2 ("***Judicial Review of Administrative Action in Canada***") at pp. 7-20, 7-72, 9-1, 10-1). Gornitzki takes the position that he was not afforded the foregoing procedural protections in Staff's compelled examination of him and therefore, to permit Staff to read-in the compelled testimony would taint the fairness of the hearing.

[39] Gornitzki submits that if Staff intends to attempt to use compelled testimony of a respondent at a hearing, then Staff should be expected to adhere to the principles of procedural fairness applicable at a hearing in obtaining the information. Further, Gornitzki argues that there is a duty of fairness owed in investigations to provide witnesses with some details of the

nature of the investigation and Staff fell short in this obligation in respect of their examination of Gornitzki (Sara Blake, *Administrative Law in Canada*, 5th ed. (Markham: LexisNexis Canada Inc., 2011) at pp. 15-16; *Ontario (Securities Commission) v. Biscotti*, [1988] O.J. No. 1115 (H.C.J.) (QL) ("***Biscotti***") at p. 11; R. v. Landen, 2007 ONCJ 531 at paras. 58, 68). Gornitzki's counsel relies on the Commission's decision in *Norshield* in support of his position that "[n]atural justice and fairness issues must still be considered by the Panel when ruling on admissibility" (*Re Norshield Asset Management (Canada) Ltd*. (2010), 33 O.S.C.B. 2139 ("***Norshield***") at para. 87, aff'd 2011 O.N.S.C. 4685 (Div. Ct.)). In that case the panel declined to admit a transcript of evidence given by a respondent before a receiver in circumstances where Staff had not conducted its own examination under section 13 of the Act (*Norshield*, *supra* at para. 90).

[40] Gornitzki submits that reading-in his compelled testimony would offend the principles of natural justice and procedural fairness because:

(a) There was not adequate notice that his evidence could be used against him and that he was the target of the investigation, nor had he received a copy of the Investigation Order prior to his examination;

(b) It would be inconsistent with reasonable expectations of fair procedure, given his entitlement to a fair hearing, Staff's emphasis on confidentiality in the investigation, Staff's failure to caution Gornitzki that his answers could be used against him later and the automatic protections granted to witnesses against derivative use of their testimony at any hearing governed by the SPPA (Act, s.127(4); SPPA, s. 14);

(c) Gornitzki had not received any disclosure at the time of his compelled examination and was not permitted to keep copies of documents put to him; and

(d) Gornitzki was treated differently than other respondents in the investigation to whom Staff provided more and different information, for example advising Agueci, Serpa, Fiorillo, Raponi, Stephany, Iacono, Fiorini and others of the relevant timeframe that the investigation concerned.

[41] Gornitzki submits that the information he was given led him to believe he was not a target of the investigation and that his inability to prepare for his examination combined with personal matters he was facing at the time of his examination raise doubts about the reliability of the evidence obtained at the investigation stage. Therefore, Gornitzki submits, the Panel should prefer his viva voce evidence over excerpts from a written transcript obtained in the particular circumstances of this case.

[42] Gornitzki also submits that admitting the compelled testimony of other respondents as part of Staff's case against him would be contrary to the principles of natural justice and procedural fairness because of the denial of ability to cross-examine on the evidence (SPPA, s.10.1).

2. The Cross-Motion

[43] With respect to the Cross-Motion, Gornitzki submits that all materials filed in respect of the Motion and Cross-Motion should be ordered to be kept confidential and that both be heard in the absence of the public. In the alternative, Gornitzki requests that the public only have access to redacted copies of the materials and transcripts and that personal information of Gornitzki and the compelled testimony proposed by Staff to be admitted be removed from the public record. Gornitzki cites the Commission's authority pursuant to subsection 9(1) of the SPPA and rules 5.2 and 8.1 of the Commission's *Rules of Procedure* (2012), 35 O.S.C.B. 10071 ("***Rules of Procedure***") to consider whether intimate financial or personal matters may be disclosed which, according to Gornitzki, having regard to the circumstances, the desirability of avoiding disclosure thereof, in the interest of any person affected or in the public interest, outweighs the desirability of adhering to the principle that hearings be open to the public.

[44] Gornitzki submits that his objection to the Motion can only be fully and fairly considered by the Panel if the Motion is heard *in camera* and public access to the Motion documents is restricted prior to the Panel's determination. Further, Gornitzki submits that following the determination of the Motion, the transcripts should remain confidential, regardless of the outcome, because Gornitzki's responding materials contain personal information and Staff has, by way of reply filed the entirety of Gornitzki's investigation transcript. Such complete public disclosure, Gornitzki submits, offends the Act's presumption of confidentiality for the reasons discussed above.

C. Telfer

[45] In his submissions, which have been adopted by Wing, Stephany and Agueci, Telfer submits that it would not be in the interests of justice or the public interest to allow Staff to read-in the compelled testimony of any of the Respondents and it would be in breach of Ontario law. Telfer requests that the Motion be dismissed because: (i) the compelled testimony is not admissible in this proceeding, commenced on February 7, 2012; (ii) the admission of the compelled testimony is not consistent with Telfer's reasonable expectations; and (iii) Telfer has undertaken to testify in the proceeding and therefore, the compelled testimony should only be used for the purposes of impeachment during cross-examination, should that ever be necessary.

[46] On the first point, Telfer relies on three arguments. First, Telfer submits it is not well-established that the compelled testimony is admissible in administrative proceedings. Second, the admission of the compelled testimony is not permissible under the Act. Third, the admission of the compelled testimony is in contravention of the *Evidence Act*.

[47] Telfer submits that the *York Rio* panel, which stated that it is well-established law that transcripts of compelled testimony may be admitted for use by Staff, placed significant reliance on *Branch* (*York Rio*, *supra* at para. 68). However, Telfer submits, the SCC in *Branch* was faced with the issue of whether to quash an investigative summons issued to compel an individual to give evidence and produce documents, not whether that evidence can be properly admitted in subsequent proceedings. Telfer takes the position that the SCC concluded that unless the predominant purpose of the summons was to obtain incriminating evidence, the witness was compelled to testify, but fell short of making a ruling on what use could be made of that testimony (*Branch*, *supra* at paras. 1, 36-37).

[48] It is Telfer's submission that the panel on a hearing is the one to determine what use can be made of compelled examination transcripts (*Boock*, *supra* at para. 115). Telfer invites the Panel to distinguish *Brost* on the basis that Alberta securities and evidence legislation are significantly different. Subsection 215(2) of the Alberta *Securities Act*, R.S.A. 2000, c. S-4 (the "**ASA**"), provides that where a person is compelled to testify, that testimony shall not be admitted in evidence against that person in a prosecution of an offence under section 194 of the ASA or any other prosecution of an offence under an enactment of Alberta. Subsection 6(2) of the *Alberta Evidence Act* provides that a "witness who testifies in any proceedings has the right not to have any incriminating evidence so given used to incriminate that witness in any **other** proceedings, except in a prosecution for perjury or for the giving of contradictory evidence" [emphasis added]. Telfer suggests that subsection 215(2) of the ASA, which was found in *Brost* to be a specific provision that overrides the general provision at section 6 of the *Alberta Evidence Act*, does not exist in the Act.

[49] Telfer also submits that sections 44, 45 and 46 of the ASA are significantly different from sections 16 and 17 of the Act, including that there is no prohibition of disclosure of compelled evidence to the police in the ASA. Finally, Telfer submits that subsection 29(e) of the ASA states that the ASC "shall receive the evidence that is relevant", whereas section 15 of the SPPA states that the Commission "may" admit evidence.

[50] Similar to Gornitzki's submission, Telfer argues that the admission of transcript evidence is not permissible under the Act. Telfer submits that neither section 16 nor section 17 of the Act speak to admissibility of the compelled testimony transcripts in a subsequent proceeding. Telfer submits that subsection 17(1) of the Act provides that no disclosure of information obtained pursuant to section 13 of the Act shall be disclosed without an order and subsection 17(6) of the Act permits disclosure only in connection with a proceeding. Telfer takes the position that the purpose of subsection 17(6) of the Act is not to allow Staff to read-in previously compelled testimony in a subsequent proceeding, but rather to allow Staff to carry out disclosure obligations they owe to respondents. Telfer submits that this position is consistent with the Commission's commentary at the time when subsection 17(6) was introduced in 1999, including that "[s]ection 17 of the Act has been amended to allow disclosure by an investigator of information obtained pursuant to powers of compulsion, for the purpose of conducting an examination or in connection with a proceeding... without the requirement to obtain further Commission orders" (*Notice of Amendments to the Securities Act and the Commodity Futures Act* (1999), 22 O.S.C.B. 8395 at 8396).

[51] Telfer also submits that subsection 17(7) of the Act provides that there can be no disclosure to police, but that if a party is permitted to file the transcript of compelled testimony in a public hearing before the Commission, this is the equivalent of disclosure to the public and the police. Therefore, Staff's use of the compelled testimony in the manner proposed would be in breach of the Act.

[52] Further, Telfer argues that section 18 of the Act is, in effect, a reflection of *Charter* rights that would apply to any defendant in a subsequent quasi-criminal proceeding. Telfer notes that although section 18 does not refer to section 128 proceedings, Staff has failed to provide any support or explanation that would suggest that the failure to mention section 128 of the Act creates an inherent right on the part of Staff to file and rely upon compelled transcripts in a section 128 proceeding.

[53] Telfer also takes the position that admission of compelled transcript evidence is in contravention of section 9 of the *Evidence Act*, which provides that compelled testimony may not be used against a respondent in any civil proceeding or any proceeding under an act of Legislature. Telfer submits that *Sextant*, in which the Commission determined that the word "subsequent" should be read into subsection 9(2) of the *Evidence Act*, should not be followed (*Sextant*, *supra* at para. 15).

[54] In the event that *Sextant* is followed, Telfer submits, a proceeding commenced under section 127 of the Act is a subsequent and distinct proceeding from an investigation commenced under section 11 of the Act. Telfer submits that in *Sextant* there was no case law or reasonable legal support for the conclusion that a subsequent section 127 proceeding is part of the same proceeding as a section 11 investigation. Telfer notes that Rule 2.5 of the Commission's *Rules of Procedure* states that "a proceeding commences upon the issuance of a Notice of Hearing by the Secretary." Telfer submits that it would be misleading to disclose these rules to the public, creating reasonable expectations, and then for Staff to rely on a completely different and contradictory definition of when a proceeding commences. Telfer takes the position that his compelled examination of July 15, 2011 is a prior proceeding to the proceedings commenced by Staff on February 7, 2012. In support of his submission, Telfer

notes that subsection 17(6) of the Act distinguishes between a proceeding and a section 13 examination conducted in an investigation. Therefore, a section 13 examination and a proceeding, Telfer submits, are different and separate – not the same proceeding.

[55] In addition, Telfer submits that the application of the *Evidence Act* protections to Commission hearings should be analogous to how they are applied in civil cases involving discoveries, but that reading-in the transcripts of an examination for discovery into civil proceedings is not analogous to the present case. Telfer suggests that the cases cited by Staff in which examinations for discovery were allowed to be read into evidence in the same civil proceeding for which the evidence was obtained are distinguishable because they do not appear to deal with situations where individuals availed themselves of the protection under the *Evidence Act*. Furthermore, Rule 31.11 of the *Rules of Civil Procedure* only allows read-ins of discovery transcripts "if the evidence is otherwise admissible" and there is no debate that the discoveries occur within the same proceeding. Additionally, Telfer submits, parties examined for discovery are afforded several measures of fairness: relevant issues are defined by pleadings, there is a mutual exchange of documents and an opportunity for mutual discovery of the parties.

[56] With respect to his second ground for opposing the Motion, Telfer submits that he did not reasonably expect that his compelled testimony would be admitted in this proceeding in violation of the Act and his section 9 of the *Evidence Act* protections. Telfer submits that *Branch* is not applicable to the present case as it focused on reasonable expectations that the securities industry is heavily regulated and that individuals in the industry can reasonably expect to be questioned by regulators, but not the use of that evidence. Further, Telfer submits that he did not expect to face allegations unless and until a subsequent proceeding was commenced against him.

[57] It is Telfer's position that in situations where a witness testifies at the proceeding, limiting the use of compelled examinations for the purpose of impeachment in cross-examinations is fair. Telfer relies on the Commission's decision in *Donald*, which concluded that direct testimony of the Respondent, where the respondent chooses to testify, is the best evidence (*Donald*, *supra* at para. 34). Since Telfer has undertaken to testify, he submits that Staff should not be permitted to read-in excerpts of his compelled testimony. Further, to the extent that Staff is relying upon the compelled testimony of one respondent against other, Telfer submits this is not permissible. Telfer argues that out-of-court admissions are binding only against the party who made them and are not evidence against another and to allow such use would be unfair to the other respondents as they would not have the opportunity to cross-examine the declarant (*Chote v. Rowan*, 1943 CarswellOnt 294, [1943] O.W.N. 646 at para. 5). Telfer further submits that the admission of one party will be evidence against another as to the truth of its contents only if that other person was present and assented, but the only people present at the section 13 examination were Staff, the witness and in some cases the witness' lawyer (*Law of Evidence*, *supra* at para. 6.482).

D. Wing

[58] Wing submits that pursuant to section 13 of the *Charter*, the excerpts from transcripts of his compelled examination cannot be admitted into evidence in this proceeding because: (i) Wing's examinations were compelled; (ii) Wing's examinations were in a different proceeding; and (iii) Staff confirmed that they are using Wing's compelled testimony in another proceeding to incriminate him, in particular, with respect to the allegations of misleading Staff. In addition, Wing agrees with arguments submitted by Gornitzki and Telfer with respect to the Motion and to avoid duplication did not repeat those legal arguments in his submissions.

[59] Wing attended an examination at the Commission pursuant to a summons issued under section 13 of the Act on August 17, 2011, November 17, 2011 and December 14, 2011 ("**Wing's Compelled Examination"**). The style of cause on the cover pages of Wing's Compelled Examination for those three dates reads "*In the Matter of GMP Securities L.P.*". Counsel submits that Wing was not given the opportunity to review the Investigation Order, that Wing's counsel requested copies of the exhibits to Wing's examination August 17, 2011 and was advised that it was not standard practice of Staff to release exhibits to a section 13 examination and that it would not do so. As a result, Wing submits that substantial unfairness and prejudice would result if Wing's Compelled Examination, or of any other individuals examined in the proceeding "*In the Matter of GMP Securities L.P.*", was simply read-in by Staff at the hearing in this proceeding. Further, Wing submits that he intends to testify at the hearing on the merits.

[60] Wing submits that section 13 of the *Charter* confers a right against self-incrimination by use of evidence in one proceeding in any other proceeding, including an administrative proceeding (*Branch*, *supra* at para. 87). Wing also takes the position that the right conferred by this section is not dependent on any objection made by a witness giving evidence at the time it is given and therefore, Wing was not required to assert any protections under it (*Dubois v. Queen*, [1985] 2 S.C.R. 350 at pp. 360 and 362).

[61] Wing relies on *Nedelcu* in support of his submission that the historical rationale underlying section 13 of the *Charter* is the *quid pro quo*. The "*quid*", Wing submits, refers to the incriminating evidence the witness has given and the "*quo*" is the state's side of the bargain that in return for compelling the witness to testify, to the extent that the witness provided incriminating evidence, the state will not use that evidence to incriminate the witness in any other proceeding, except in a prosecution for

perjury or for giving of contradictory evidence (*R. v. Nedelcu*, 2012 S.C.C. 59 ("***Nedelcu***") at paras. 1, 3, 6 and 7). Wing submits that the meaning of "incriminating evidence" in the context of section 13 of the *Charter* can only mean evidence given by a witness at a prior proceeding that the Crown could use at the subsequent proceeding (*Nedelcu*, *supra* at para. 9). As Staff takes the position that it needs excerpts of Wing's Compelled Examination to make out elements of the allegations against him, Wing submits that the excerpts of compelled testimony are incriminating. Further, Wing takes that the position that because it meets the test for incriminating evidence, Staff cannot use it for any purpose at the hearing, including to impeach Wing, aside from uses for prosecution for perjury or for giving contradictory evidence (*Nedelcu*, *supra* at para. 15).

[62] Wing also submits that the time for determining whether the evidence given at the prior proceeding may be properly characterized as "incriminating" is the time when the Crown seeks to use it at the subsequent proceeding. Therefore, Wing submits that evidence given at the prior proceeding, although seemingly innocuous or exculpatory at that time, may become "incriminating evidence" at the subsequent proceeding (Nedelcu, *supra* at para. 17).

[63] Wing submits that the exception to section 13 of the *Charter* does not apply in this administrative proceeding because it is not a prosecution for perjury or for giving contradictory evidence in this proceeding. Counsel for Wing argues that, by definition, a prosecution refers to a criminal proceeding, whereas this matter is commenced pursuant to section 127 and 127.1 of the Act (*Black's Law Dictionary*, 5th ed., *sub verbo* "prosecution"; *Boock*, *supra* at para. 99).

[64] Wing requests an order that Staff may not read in excerpts of Wing's Compelled Examination, or of compelled examinations of any of the Respondents, from the proceeding "*In the Matter of GMP Securities L.P.*" in this proceeding, "*In the Matter of Eda Marie Agueci*". In the alternative, Wing requests an order that if Wing testifies at the hearing in this proceeding, Staff may only use transcripts of Wing's Compelled Examination to cross-examine Wing.

[65] In correspondence dated September 10, 2013, counsel for Wing expressed his agreement with the Cross-Motion. Specifically, counsel states that the Motion materials and the Motion Hearing should proceed in the absence of the public until such time as the Motion is heard and determined by the Panel.

E. Stephany

[66] Stephany adopts and relies upon the submissions of Gornitzki, Telfer and Wing. In addition, Stephany submits that at her compelled examination, she relied upon protections of the *Evidence Act* and the *Canada Evidence Act*, R.S.C. 1985, c. C-5 (the "***Canada Evidence Act***"). Further, Stephany submits that during the course of her examination, several objections were made that it was being conducted unfairly, based upon selective and incomplete production of documents and emails in a context where her trading activities had occurred several years prior and were minimal in volume and value.

[67] In opposing the Motion, Stephany made the following specific submissions: (i) admission of transcript evidence violates the *Evidence Act*; (ii) subsection 17(6) confines disclosure to other respondents or persons being interviewed in an effort to obtain information; and (iii) administrative agencies are bound by a duty of fairness.

[68] Stephany submits that subsection 17(6) does not govern admissibility of compelled testimony, but rather allows compelled testimony to be produced or disclosed in connection with Commission proceedings. Stephany argues that section 15 of the SPPA governs the admissibility of compelled testimony and that subsections 15(2) and (3) of the SPPA support her submission that regardless of subsection 17(6) of the Act, the compelled testimony is inadmissible if it violates any other statute.

[69] It is Stephany's position that Staff's intention to admit the compelled testimony violates section 9 of the *Evidence Act*. Specifically, Stephany relies on subsection 9(2) of the *Evidence Act*, which states that if a witness objects upon certain grounds and if, but for this section or any Act of the Parliament of Canada, he or she would therefore be excused from answering, then although the witness is compelled to answer, the answer given shall not be used or receivable in evidence against him or her in any civil proceeding or in any proceeding under any Act of the Legislature. Stephany submits that Staff has provided no court authority to support the position that the word "subsequently" must be read into the provision. Stephany relies on the findings of the panel in *Liberman* where the prohibition in section 9(2) of the *Evidence Act* was applied (*Liberman v. College of Physicians and Surgeons of Ontario*, 2010 O.N.S.C. 337 ("***Liberman***")). Further, Stephany submits that the Panel should interpret the provision in accordance with the express language used by the legislature, which is the better interpretation.

[70] Stephany distinguishes *Brost* on the basis that section 6 of the *Alberta Evidence Act* expressly states that the evidence will not be used to incriminate the witness "in any **other** proceeding" [emphasis added]. Rather, Stephany suggests, the conclusion to be drawn is the opposite from that proposed by Staff. If the qualification suggested by Staff could properly be read-in, there would be no need for the word "other" in the Alberta legislation.

[71] Stephany also relies on the *Naster* decision in which the court found that subsection 17(6) of the Act appears to confine disclosure "to other respondents, or persons being interviewed in an effort to obtain information" (*Naster*, *supra* at para. 25).

[72] Furthermore, Stephany submits that administrative agencies are bound by a duty of fairness even though traditional rules of proof and evidence do not apply (*Mooring v. Canada (National Parole Board*), [1996] 1 S.C.R. 75 ("***Mooring***") at paras. 25 and 37). In *Mooring*, the SCC determined that "where incriminating statements are obtained from the offender, the law of confessions based on an admixture of reliability and fairness will be pertinent although not binding" and stated that the Board may, in appropriate circumstances, "conclude that reliance on a coerced confession is unfair" (*Mooring*, *supra* at para. 37). Stephany directs the Panel to consider the Saskatchewan's Queen Bench decision in *Murray*, which held that the tribunal had breached its duty of fairness by failing to give sufficient reasons for its decision to admit a sworn videotaped statement in the absence of the actual witness appearing (*Murray v. Saskatchewan Veterinary Medical Assn.*, 2008 S.K.Q.B. 424, aff'd 2011 S.K.C.A. 1 ("***Murray Appeal Decision***")). The Court of Appeal disagreed with the trial judge's reasoning, but held that the respondent's right to examine, cross-examine and re-examine all witnesses does not preclude the tribunal from considering hearsay when admission of that hearsay is necessary (*ibid* at para. 28). The Court of Appeal went on to state that before it can admit evidence that would not be subject to cross-examination, the tribunal must determine it is necessary to admit it, whereas the decision-maker "will ultimately decide on the probative value, including the reliability, of the hearsay evidence after it has been admitted" (*ibid*).

[73] In email correspondence dated September 27, 2013, counsel for Stephany advised that it was inappropriate for Staff to be permitted to read-in compelled testimony of a respondent who availed themselves of the protections applicable to such testimony and that a determination to that effect should not depend on the willingness of a respondent to give the undertaking to testify. Notwithstanding that position, counsel for Stephany confirmed that Stephany is prepared to undertake to be a witness at the merits hearing at the appropriate time following completion of Staff's case.

F. Fiorillo

[74] Fiorillo requests that the Motion be dismissed. Fiorillo submits that it would be inherently unfair to Fiorillo to allow Staff to require him to submit to an examination process, in connection with an investigation of a different corporate entity, which lacked even the most basic procedural safeguards to ensure that any evidence elicited from Fiorillo met the thresholds of fairness and reliability, and then use the transcript of that compelled testimony to attempt to incriminate Fiorillo in this proceeding. Further, while Fiorillo supports the other Respondents' submissions as being right in law and fairness, he submits that there is absolutely nothing in his transcript that is an admission by him in the sense of supporting a conclusion that he did anything improper. Regardless of how the issues are decided in the Motion, Fiorillo submits that he has concerns that the particular proposed passages are out of context, misleading or otherwise irrelevant to the issues to be determined at the hearing and therefore, reserves his right to object to particular excerpts of compelled testimony being read-in at the merits hearing.

[75] Fiorillo takes the position that the compelled testimony is inadmissible in evidence in this proceeding because: (i) the Act prohibits admission of the compelled testimony into evidence; (ii) the compelled testimony is inadmissible in accordance with the *Evidence Act*; and (iii) admission of the compelled testimony is inconsistent with the principles of fairness and the requirements of justice.

[76] Fiorillo adopts the submissions of Gornitzki as to the correct interpretation of sections 16 and 17 of the Act and submits that they are consistent with the majority reasons of *Branch*. Similar to Telfer, Fiorillo submits that the SCC in *Branch* does not expressly deal with the issue of whether compelled testimony is admissible in a regulatory proceeding, but rather whether compelling individuals to provide testimony during an investigation could be justified under the provisions of the *Charter*.

[77] Fiorillo argues that to the extent that the SCC in *Branch* did address admissibility of the compelled testimony, the majority reasons suggest that such evidence is not admissible. Specifically, Fiorillo relies on findings of the SCC that, if it is shown that the only prejudice is the possible subsequent derivative use of the testimony, the compulsion will occasion no prejudice because the witness will be protected against such use (*Branch*, *supra* at para. 9). Further, Fiorillo relies on the SCC determination that the proposed compelled testimony in furtherance of the predominant purpose of the inquiry is governed by the general rule applicable under the *Charter*, pursuant to which a witness receives evidentiary immunity (*Branch*, *supra* at para. 35).

[78] Similar to other respondents, Fiorillo also relies upon the protection of subsection 9(2) of the *Evidence Act*. Like Telfer and Wing, Fiorillo submits that he was compelled to testify in the matter "*Re GMP Securities L.P.*" at which time he invoked protections of the *Evidence Act* and Canada *Evidence Act*, but now Staff seeks to use the compelled testimony in the matter "*Re Eda Marie Agueci*", which, Fiorillo submits, is a separate and distinct proceeding from the investigation conducted under section 11 of the Act with respect to GMP.

[79] Fiorillo disputes that the *Sextant* decision, which determined that compelled transcripts can be admitted in the same proceeding, should be followed, but submits that Staff should nevertheless be barred from attempting to adduce the compelled testimony of Fiorillo in this, subsequent, proceeding. Fiorillo also distinguishes the present case from *Sextant* and submits that this matter requires a finding that the section 11 investigation and the proceeding commenced in February 2012 are separate proceedings since: (i) one investigation order was issued on July 18, 2011; (ii) that investigation order did not name Fiorillo as a target of the investigation; (iii) at the time he was examined, Fiorillo was not notified he was a subject of investigation; (iv) Fiorillo

was not apprised of the issues under investigation; (v) the Notice of Hearing in the *Re Eda Marie Agueci* matter was not issued until February 7, 2012; and (vi) Staff's investigation morphed considerably into a separate proceeding as GMP is not included as a respondent.

[80] Similar to Stephany, Fiorillo relies on *Liberman* to support his submission that compelled testimony from an investigation of Liberman's colleague should not be allowed in a subsequent proceeding directed against Liberman himself on the basis that subsection 9(2) of the *Evidence Act* prohibited it (*Liberman*, *supra* at paras. 39-42). Fiorillo acknowledges that there is little doubt the section 11 investigation and the proceeding in *Re Eda Marie Agueci* are related as the latter flowed from the former. The current matter, Fiorillo submits, should be equated to the prosecution of Liberman, which was related to and evolved out of the prosecution of his colleague. Fiorillo takes the position that since the targets of the investigation and the targets of the proceeding are markedly different, it cannot be said that they are the same proceeding, thereby falling directly within the prohibition contained in section 9(2) of the *Evidence Act*.

[81] Even in the absence of a breach of the Act or the *Evidence Act*, it is submitted that the Motion should be dismissed because admitting the compelled testimony is inconsistent with principles of fairness owed to Fiorillo and requirements of natural justice. Fiorillo submits that at the bare minimum he should have been permitted to attend the examination with counsel and provided with details as to the subjects upon which he would be questioned (*Biscotti*, *supra* at pp. 3 and 11). Fiorillo acknowledged he was afforded the right to attend with counsel, but not the other entitlements enumerated in *Biscotti* such as advising Fiorillo that he was a target or person of interest, giving him particulars of the matters under investigation, other than a vague reference to insider trading, and identifying the transactions or conduct in issue to allow Fiorillo to refresh his recollection of events (*ibid*). Fiorillo also notes that he had no right to object to questions or challenge their relevance.

[82] In response to Staff's reliance on *Branch* with respect to reasonable expectations, Fiorillo submits that it is nonsensical to maintain that a respondent ought to have reasonably expected that he or she be forced to submit to an examination, without notice or context of the matters to be examined and without the right to challenge the questions being asked, to then have that evidence used as part of the case to be made against him or her in the proceeding. Further, in addressing Rule 31.11 of the *Rules of Civil Procedure*, which permits the reading-in of discovery transcripts of an adverse party, Fiorillo submits that the overall context and safeguards of examinations for discovery must be considered. Like Gornitzki, Fiorillo lists safeguards in the discovery context, which he submits would ensure reading-in the compelled testimony do not result in unfairness to the examined parties.

G. Agueci

[83] In correspondence dated September 13, 2013, counsel for Agueci confirmed that Agueci opposes the Motion for a number of reasons discussed below. Agueci also adopts the arguments advanced by Telfer, as she too availed herself of the protections of the *Evidence Act*.

[84] Agueci submits that Part VI of the Act contains extraordinarily invasive investigative powers that are not and were not intended to be equivalent to a civil examination for discovery. Further, Agueci takes the position that Staff's proposed use of powers under Part IV of the Act is both wrong in principle and in law.

[85] Agueci takes the position that section 16 of the Act provides a general prohibition on disclosure of the compelled testimony including "in any other proceeding except as permitted under section 17". Agueci submits that a proceeding commenced pursuant to section 127 of the Act is an "other proceeding" and therefore, use of compelled testimony obtained pursuant to section 13 of the Act may only be used in the context of a section 127 proceeding as permitted by section 17.

[86] Agueci submits that subsection 17(1) of the Act does not permit the Commission to order disclosure for the purposes of a section 127 proceeding. On the other hand, Agueci submits, subsection 17(6) of the Act permits a person appointed under section 11 of the Act to "disclose or produce" the compelled testimony in connection with a proceeding commenced by the Commission under the Act (which would include a section 127 proceeding) or in connection with the "examination of a witness". Agueci submits that nothing in the Act permits the Commission or a person appointed under section 11 of the Act to read the compelled testimony into evidence, file or tender compelled testimony to establish liability of a respondent. Agueci states that any recent jurisprudence that suggests the contrary is simply wrong.

[87] Agueci submits that no documents were provided to her in advance of the examination, nor was she afforded a meaningful opportunity to review materials at the examination prior to being questioned. Further, Agueci submits that over the course of five days she corrected many, if not all misstatements she may have made as a result of memory lapses.

[88] With respect to Staff's submissions on the necessity of using compelled examinations to prove allegations of misleading statements, Agueci submits that section 122 has no application in the circumstances. Agueci submits that it would be fatuous to suggest that, as a compelled witness on an examination, she "submitted" her evidence to the persons appointed under section 11 of the Act. Agueci submits that the Concise Oxford English Dictionary defines "submit" as "to present for consideration or judgment" which connotes an element of voluntariness which was absent in Agueci's examination.

H. Staff's Reply

1. Reply to the Motion Submissions of the Respondents

[89] Staff submits that the Respondents were treated fairly during the investigation. In the case of Wing, Staff submits that he was reminded of and exercised his right to counsel, he did not ask for a copy of the Investigation Order prior to his examination, and he did review the Investigation Order at the examination. In the case of Gornitzki, Staff submits that he was reminded three times of his right to retain counsel and he was advised on at least two occasions of the nature of Staff's investigation. Further, Staff suggests that Gornitzki's position with respect to personal matters that may have affected his testimony has no merit since there was no evidence that he was affected at the time of his interview, the examination was held on a date of Gornitzki's choosing to accommodate him and Gornitzki was able to answer all questions.

[90] Staff further submits that Agueci was provided with a copy of the Investigation Order as well as other information in advance of her examination with Staff. Finally, in the case of Fiorillo, Staff submits he and his counsel were aware of the nature of Staff's investigation, and his factum notes the scope of the investigation as set out in the Investigation Order. Also, Staff submits that Fiorillo and his counsel were provided with an opportunity to review the Investigation Order at the commencement of his examination and that they did have the opportunity to object to questions including on the basis of relevance and actively did so.

[91] Staff submits that *Naster* has no application to this matter as the Divisional Court was considering Staff's ability to disclose information, prior to the hearing, to respondents as part of Staff's *Stinchcombe* obligations, and did not consider the ability of Staff to use subsection 17(6) of the Act to admit transcript evidence at a Commission hearing. In any event, Staff submits, the Commission, as an expert tribunal interpreting its own enabling statute, has considered the limits of subsection 17(6) of the Act to admit compelled evidence since *Naster*. Staff takes the position that if Gornitzki's submissions relating to subsections 17(6) and 17(7) of the Act were true, the Commission would not even be permitted to admit into evidence any of the documents obtained under section 13 summonses, which would be an absurd result. Furthermore, it would render section 122 of the Act meaningless, Staff submits, if the very statements alleged to be misleading were inadmissible to prove the allegation.

[92] Staff takes the position that the compelled transcripts are highly reliable as they were taken under oath and transcribed by a court reporter who certified the transcript as true and accurate. Further, Staff submits that the Respondents do not claim inaccuracies in the statements, which have been in their possession for a year and a half, and that any deficiencies as to circumstances surrounding the taking of the statements are not a matter of admissibility, but rather weight. With respect to the "reliability safeguards" derived from the civil context, Staff submits that they make sense for a civil discovery, but not in the context of a confidential investigation pursued by a regulator in furtherance of its mandate to protect investors and foster confidence in Ontario's capital markets.

[93] Staff directs the Panel's attention to the purpose of the confidentiality provision in section 16 of the Act as being two-fold: to control information passed on regarding the investigation, including that the investigation is being conducted to, among other things, avoid collusion among witnesses who may discuss their evidence and provide statutory protections to a witness (Ministry of Finance, *Five Year Review Committee Final Report – Reviewing the Securities Act (Ontario)* (Toronto: Queen's Printer for Ontario, 2003) at 241 ("***Five Year Review***")). Staff submits the concern is legitimate and particularly relevant in this case where Staff alleges that Agueci breached section 16 of the Act by divulging information to others, including some of the Respondents, which provided them with an opportunity to tailor their evidence to hers. Staff submits concerns for preserving the integrity of investigations is heightened when insider trading allegations are at issue because they are often based on the content of private discussions between respondents.

[94] Staff further submits that Gornitzki, Agueci, Fiorillo and Stephany's submissions with respect to notice of particulars of an investigation are inconsistent with the Act itself. Section 11 of the Act requires that the order set out the matters to be investigated. Staff submits that the Investigation Order in this case describes that employees of GMP and others connected to GMP employees may have engaged in insider tipping and trading or conduct related to those securities that was contrary to the public interest. Consequently, Staff submits, the Respondents knew the subject matter of the investigation. Staff argues that subsection 13(2) of the Act sets out the rights of witnesses, which include the right to counsel and to claim privilege to which the person is entitled.

[95] Staff directs the Panel to consider the *Azeff* decision, in which the Commission noted that the rights to procedural fairness owing to a witness during an investigation conducted by Staff are minimal (*Re Azeff* (2012), 35 O.S.C.B. 5159 ("***Azeff***") at paras. 223-227 and 258-260). Further, Staff relies on the Divisional Court's decision in *Biscotti* for the proposition that at the investigation stage, the witness is entitled to have counsel present and that any evidence not be used in subsequent criminal proceedings (*Biscotti*, *supra* at p. 11).

[96] Staff also takes the position that there are not two distinct and separate proceedings, as the investigation order in "*GMP Securities L.P.*" led to, and is the genesis of, the current proceeding. Staff relies on the Commission's decision in *Sextant*,

which finds that the investigation and adjudicative stage of a matter are simply stages of one and the same proceeding (*Sextant*, *supra* at paras. 5 and 10).

[97] With respect to use of the compelled testimony, Staff submits that it may, and in this case must, be admitted against the Respondent who made the statement and in limited circumstances, also against other Respondents. Specifically, Staff relies on statements made by Iacono and Fiorillo, who admit to Staff that Agueci divulged information from her compelled examinations with Staff. Staff submits that there is not unfairness to the Respondents by admitting such evidence as it is being used for the very purpose for which it was obtained. Staff submits that in a regulatory proceeding the Respondents are all compellable witnesses, including by and against each other pursuant to section 12 of the SPPA. Staff submits that in *Brost* the Alberta Court of Appeal stated that the regulatory proceedings do not deny an opportunity to test the impugned hearsay evidence as the respondents could apply to the Commission for a subpoena to have other respondents testify (*Brost*, *supra* at paras. 35-36). Similarly, Staff relies upon *York Rio* for the proposition that nothing prevents Staff from using compelled evidence of others against the respondent, Schwartz, subject to evidence law considerations relating to hearsay, particularly relating to co-respondents (*York Rio*, *supra* at para. 80).

2. Response to the Cross-Motion

[98] Staff objects to the proceeding being held *in camera* and the request that materials be sealed, but does not oppose a temporary order for confidentiality. Staff submits that it is the basic principle of law that hearings be open to the public and the Respondents have the burden of proving exceptional circumstances and they have not done so (*Re Vancouver Sun*, 2004 S.C.C. 43, [2004] 2 S.C.R. 332; *Toronto Star Newspapers Ltd. v. Ontario*, 2005 S.C.C. 41, [2005] 2 S.C.R. 188). Staff relies on subsection 9(1) of the SPPA for its submission that exceptions to the public hearing rule, including intimate financial or personal matters, may be disclosed and that the desirability of adhering to principles that hearings be open to the public outweighs the desirability of avoiding disclosure. Staff submits that the test for confidentiality orders is that: (1) such an order is necessary to prevent a serious risk to an important interest, and (2) the salutary effects of the confidentiality order outweigh its deleterious effects on the right to free expression (*Sierra Club of Canada v. Canada (Minister of Finance)*, 2002 S.C.C. 41, [2002] 2 S.C.R. 522 at para. 45). Staff submits that the risk must be real and substantial, well grounded in evidence, and pose serious threats to the interest. Staff also submits that the Panel must consider whether reasonable alternatives are available and restrict the order as much as reasonably possible.

[99] Staff submits that the public interest in having access to tribunal records greatly outweighs the interests expressed by the Respondents. Staff submits that the Respondents' financial information is necessary for Staff's case on the merits and that Gornitzki's personal information has become relevant because he is using it to attempt to retreat from the compelled evidence he gave. Further, Staff submits that the Respondents have not proven any real and substantial risk to their interests.

3. Response to Wing's Constitutional Question on the Motion

[100] Staff takes the position that Wing's motion to challenge the constitutionality of Staff's request is without merit and out of time. Staff submits that section 13 of the *Charter* does not apply to this hearing because it is not a criminal prosecution and the provision applies to prevent "incriminating" evidence from being used by the Crown in a prosecution to prove guilt (*Nedelcu*, *supra* at para. 9).

[101] Further, Staff submits that the request is time-barred pursuant to the 15-day service requirements of Rule 2.7 of the *Rules of Procedure* and subsection 109(2.2) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 (the "***Courts of Justice Act***").

V. LAW AND ANALYSIS

A. Admissibility of Compelled Testimony

1. The Scheme of the Act

[102] Pursuant to section 11 of the Act, the Commission may issue an order to appoint one or more persons to investigate with respect to a matter as it considers expedient, for the due administration of Ontario securities law or the regulation of the capital markets in Ontario and such order shall describe the matter to be investigated.

[103] Once an order is issued pursuant to section 11 of the Act, the investigator has the power to summon any person and to compel him or her to testify under oath and to produce documents pursuant to subsection 13(1) of the Act. Subsection 13(2) of the Act provides a person or company giving evidence under subsection (1) the right to be represented by counsel and to claim any privilege to which the person or company is entitled.

[104] As expressed in the *Five Year Review*, *supra*, section 16 of the Act serves to maintain the integrity of Commission investigations, among other things. Except in accordance with section 17 of the Act, section 16 of the Act expressly prohibits disclosure, except to counsel, of the nature or content of an order issued under section 11 of the Act or of:

> the name of any person examined or sought to be examined under section 13, any testimony given under section 13, any information obtained under section 13, the nature or content of any questions asked under section 13, the nature or content of any demands for the production of any document or other thing under section 13, or the fact that any document or other thing was produced under section 13.
>
> (Subsection 16(1)(b) of the Act)

[105] Furthermore, testimony given under section 13 of the Act and all documents and other things obtained under that section relating to the investigation or examination that is the subject of the order are for the exclusive use of the Commission pursuant to subsection 16(2) of the Act.

[106] Section 17 of the Act permits disclosure or production of testimony given under section 13 of the Act in certain instances, as discussed in detail below, and prohibits disclosure in others. Section 18 of the Act specifically indicates that testimony given under section 13 of the Act shall not be admitted in evidence against the person from whom the testimony was obtained in a prosecution for an offence under section 122 or in any other prosecution governed by the *Provincial Offences Act*, R.S.O. 1990, c. P.33, as amended (the "***Provincial Offences Act***").

[107] Subsection 17(6) of the Act provides:

> **Disclosure in investigation or proceeding**
>
> [17] (6) A person appointed to make an investigation or examination under this Act may disclose or produce anything mentioned in subsection (1)[including compelled testimony], but may do so only in connection with,
>
> (a) a proceeding commenced or proposed to be commenced by the Commission under this Act; or
>
> (b) an examination of a witness, including an examination of a witness under section 13.

[108] We find that subsection 17(6) of the Act, construed liberally and purposively, in the context of surrounding provisions and to achieve the purposes of the Act, permits Staff to produce compelled testimony at a hearing commenced pursuant to section 127 of the Act (*Rizzo*, *supra* at paras. 21-22). We agree that if the Legislature had intended to prohibit the use of compelled testimony in section 127 proceedings it would have done so expressly as it did in section 18 of the Act for prosecutions under the *Provincial Offences Act* (*Sextant*, *supra* at para. 9) and that the Legislature's silence can be taken as deliberate (*Sullivan on the Construction of Statutes*, *supra* at 243-44). To find otherwise would also prohibit the use of documentary evidence compelled by Staff pursuant to section 13 of the Act, which cannot have been the legislative intention given the context of the scheme of the Act in respect of investigations and enforcement.

[109] For clarity, Staff does not need to rely upon subsection 17(1) of the Act in order to satisfy the Panel that it is permissible to admit compelled testimony in a section 127 proceeding (*Boock*, *supra* at paras. 71 and 74).

[110] This administrative proceeding was commenced by a Notice of Hearing issued pursuant to sections 127 and 127.1 of the Act in connection with a Statement of Allegations filed by Staff. The hearing process, including admissibility of evidence, is governed by the SPPA and the Commission's *Rules of Procedure*, where applicable. While subsection 17(6) of the Act permits the production of compelled evidence, including testimony and documentary evidence, at an administrative proceeding commenced under the Act, it remains at the discretion of the panel hearing the matter to determine the admissibility of such evidence in accordance with section 15 of the SPPA and such considerations as the Panel deems appropriate for a fair and efficient hearing (*Boock*, *supra* at para. 115).

2. Hearsay is Admissible

[111] With respect to the admissibility of evidence, subsection 15(1) of the SPPA provides:

> **What is admissible in evidence at a hearing**
>
> **15 (1)** Subject to subsections (2) and (3), a tribunal may admit as evidence at a hearing, whether or not given or proven under oath or affirmation or admissible as evidence in a court,
>
> (a) any oral testimony; and

(b) any document or other thing,

relevant to the subject-matter of the proceeding and may act on such evidence, but the tribunal may exclude anything unduly repetitious. [emphasis added]

[112] Subsections 15(2) and (3) of the SPPA create certain exceptions to the broad authority of a tribunal to admit relevant hearsay evidence:

What is inadmissible in evidence at a hearing

(2) Nothing is admissible in evidence at a hearing,

(a) that would be inadmissible in a court by reason of any privilege under the law of evidence; or

(b) that is inadmissible by the statute under which the proceeding arises or any other statute.

Conflicts

(3) Nothing in subsection (1) overrides the provisions of any Act expressly limiting the extent to or purposes for which any oral testimony, documents or things may be admitted or used in evidence in any proceeding. [emphasis added]

[113] We find that transcripts of the compelled testimony are relevant hearsay and are therefore admissible pursuant to subsection 15(1) of the SPPA. For the reasons discussed herein, we are not satisfied that the compelled testimony is otherwise inadmissible pursuant to subsections (2) or (3) of the SPPA. The Act does not make the compelled testimony inadmissible in an administrative hearing and the Act does not expressly limit the extent to or purposes for which the compelled testimony may admitted or used in evidence at an administrative hearing under the Act. Further, we were not satisfied that the other statutes cited by the Respondents make the compelled testimony inadmissible in an administrative hearing under the Act or expressly limit the extent to or purposes for which the compelled testimony may be admitted or used in evidence at an administrative hearing under the Act.

[114] Once tendered at an administrative hearing under the Act, the compelled testimony is protected by section 14 of the SPPA, which provides that "no answer given by a witness at a hearing shall be used or be receivable in evidence against the witness in any trial or other proceeding against him or her thereafter taking place, other than a prosecution for perjury in giving such evidence".

[115] We are mindful of the dangers of hearsay evidence and note that the weight to be afforded to such evidence is a determination for the Panel. In making such a determination, we will consider whether there are sufficient indicia of reliability, corroboration of the hearsay evidence and the extent to which such evidence was tested by cross-examination.

3. Protections for Compelled Testimony

a. The *Charter*

[116] We recognize that Wing has not complied with the 15-day service requirements of Rule 2.7 of the *Rules of Procedure* and subsection 109(2.2) of the *Courts of Justice Act*. We have nevertheless considered the submissions of the parties in this respect given the nature of this question and its importance to fully determine the Motion.

[117] Section 13 of the *Charter* provides:

Self-crimination

13. A witness who testifies in any proceedings has the right not to have any incriminating evidence so given used to incriminate that witness in any other proceedings, except in a prosecution for perjury or for the giving of contradictory evidence.

[118] In our view, section 13 of the *Charter* does not apply to restrict the use of compelled evidence in the context of administrative proceedings, which are not penal. The public interest purpose of the Commission's securities regulatory investigations and administrative enforcement proceedings does not engage the *Charter* because the predominant purpose of the inquiries or proceedings is not to incriminate the witness (*Branch*, *supra* at paras. 34-35; *Boock*, *supra* at paras. 94-99; *Sextant*, *supra* at paras. 17-24).

[119] The Commission's public interest mandate is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets (section 1.1 of the Act). The purpose of Commission investigations is not criminal or penal in nature, but rather it serves a public purpose for the regulation of capital markets.

[120] We do not agree with Wing's submission that because Staff is relying on the transcripts to prove allegations of misleading statements made during Wing's Compelled Examination, the evidence somehow becomes "incriminating" within the meaning of section 13 of the *Charter*. Such use of the compelled evidence does not alter the regulatory nature of these proceedings. Allegations, which may lead to orders in the public interest pursuant to section 127 of the Act, deal with matters that may require protective and preventative action by the Commission and are not criminal.

b. The SPPA

[121] A witness who testifies at a hearing is protected pursuant to section 14 of the SPPA. Subsection 14(1) of the SPPA provides:

> A witness at an oral or electronic hearing shall be deemed to have objected to answer any question asked him or her upon the ground that the answer may tend to criminate him or her or may tend to establish his or her liability to civil proceedings at the instance of the Crown, or of any person, and no answer given by a witness at a hearing shall be used or be receivable in evidence against the witness in any trial or other proceeding against him or her thereafter taking place, other than a prosecution for perjury in giving such evidence.

c. The *Evidence Act*

[122] Section 9 of the *Evidence Act* provides:

> **Witness not excused from answering questions tending to criminate**
>
> **9. (1)** A witness shall not be excused from answering any question upon the ground that the answer may tend to criminate the witness or may tend to establish his or her liability to a civil proceeding at the instance of the Crown or of any person or to a prosecution under any Act of the Legislature.
>
> **Answer not to be used in evidence against witness**
>
> **(2)** If, with respect to a question, a witness objects to answer upon any of the grounds mentioned in subsection (1) and if, but for this section or any Act of the Parliament of Canada, he or she would therefore be excused from answering such question, then, although the witness is by reason of this section or by reason of any Act of the Parliament of Canada compelled to answer, the answer so given shall not be used or receivable in evidence against him or her in any civil proceeding or in any proceeding under any Act of the Legislature.

[123] The Commission's mandate, as articulated under section 1.1 of the Act, is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. As noted above, the statutory scheme under which the Commission operates grants an investigator power to summon any person and to compel him or her to testify under oath and to produce documents pursuant to subsection 13(1) of the Act. We agree that to accept the submissions of the Respondents that the compelled testimony cannot be admitted into evidence would hamper effective enforcement of the Act by the Commission, which has the legislative power to compel testimony and use it in accordance with the Act (*Sextant*, *supra* at para. 14). One of the purposes of compelled testimony is to obtain relevant documents and evidence for use in an administrative hearing (*Boock*, *supra* at para. 109).

[124] In determining the scope of section 9 of the *Evidence Act*, the Panel has considered the apparent purpose of the legislation and the ordinary meaning of its language. In order to give subsection 9(2) of the *Evidence Act* a liberal and purposive interpretation in the context of this administrative hearing, the word "other" should be read into the provision, such that it would read "the answer so given shall not be used or receivable in evidence against him or her in any **other** civil proceeding or in any **other** proceeding under any Act of the Legislature" (*Rizzo*, *supra* at paras. 21-22). We would not read in the word "subsequent" as the *Sextant* panel did because it is possible that another proceeding could proceed concurrently with an administrative hearing. It is our view that use of compelled testimony in this administrative hearing would prevent concurrent as well as subsequent use of the compelled testimony of the witness who asserts the protection under section 9 of the *Evidence Act*.

[125] We find that the style of cause on a transcript of compelled evidence is not determinative of whether the compelled testimony was obtained in the same or another proceeding. We agree with Fiorillo that there is little doubt that the current

matter, entitled "*Re Eda Marie Agueci*" flowed from the Investigation Order, entitled "*Re GMP Securities L.P.*". We do not agree that the nature of the investigation changed such that the current matter becomes another proceeding. We agree with the determination in *Sextant* that an investigation is a stage of a proceeding, as is the adjudicative stage (*Sextant*, *supra* at paras. 5 and 10).

d. Procedural Fairness and Reasonable Expectations

[126] We agree with the Commission's analysis of the *Baker* factors in Azeff, which determined that the duty of fairness during an investigation is minimal (*Azeff*, *supra* at paras. 208-258; *Baker*, *supra* at paras. 21-28). The duty of fairness owed to a respondent during the investigation of a matter is clearly distinguishable from the procedural fairness requirements at the hearing (*Azeff*, *supra* at para. 258).

[127] We are not satisfied that the Respondents were treated unfairly during the investigation with respect to the circumstances under which the compelled testimony was obtained. Each of the individual Respondents was provided with a summons and the opportunity to review the Investigation Order at the outset of the compelled examinations. The Investigation Order, as discussed above, authorized members of Staff to investigate the Respondents, although not by name, and others connected to GMP and its employees in relation to insider trading, tipping or conduct in relation to securities that is in breach of the Act and/or contrary to the public interest. Most of the Respondents exercised their right to be represented by counsel at their compelled examinations and those who did not were reminded of their right to do so. We are satisfied that it would not result in unfairness to the Respondents to permit the compelled testimony to be admitted in this case in the manner directed by the Panel below, at the end of Staff's case and once the election is made by the Respondents as to whether they undertake to testify in this hearing.

[128] Further, we do not find the use of the compelled evidence in an administrative proceeding to be beyond the reasonable expectations of the Respondents. We note that in *Branch* the SCC acknowledged that securities market participants are deemed to know the "rules of the game" (*Branch*, *supra* at para. 64). We concur with the findings of the Commission in *Boock* that:

> a respondent in an administrative proceeding before the Commission should have a very low expectation of privacy with respect to the use in a *Commission administrative proceeding* of that respondent's own compelled testimony and evidence. Subsection 17(6) of the Act expressly contemplates that compelled evidence can be disclosed or produced in connection with a proceeding commenced or proposed to be commenced by the Commission under the Act, without the necessity for a Commission order under subsection 17(1).
>
> (*Boock*, *supra* at para. 74)

[129] We also consider the Alberta Court of Appeal's decision in *Brost* to be consistent with our view that respondents do not have a reasonable expectation that the content of their compelled examinations will not be used for the purposes of the Act (*Brost*, *supra* at para. 38).

B. Procedural Direction

[130] Compelled testimony is admissible at an administrative proceeding commenced under the Act. Nevertheless, it remains at the discretion of the panel hearing the matter to determine whether to admit such evidence in accordance with section 15 of the SPPA and such considerations the Panel deems appropriate for a fair and efficient hearing (*Boock*, *supra* at para. 115). The Panel's discretion to control the process of the hearing includes the ability to determine the process by which evidence should be tendered.

[131] We acknowledge Staff's submission that in the past, panels of the Commission have, on occasion, allowed Staff to tender a respondent's transcript evidence, even where the respondent also later testified as part of his or her defense (*York Rio*, *MP Global*, *McErlean*, *New Found Freedom* and *Goldbridge*). In this case, however, the Panel is of the view that it is more appropriate to follow the process in *Donald* since the oral evidence of the Respondents who testify would provide us with the best evidence because it would afford the Panel an opportunity to observe the witness during examination-in-chief and cross-examination, including with respect to prior admissions and prior inconsistent statements, if any (*Donald*, *supra* at para. 34). We agree with submissions of the Respondents that Staff should not propose to tender excerpts of the Respondents' compelled testimony into evidence until the conclusion of its case. At that time, Staff may seek to tender into evidence selected excerpts from transcripts of compelled testimony of those respondents who have not undertaken and do not undertake to testify. This provides the Respondents with an opportunity to consider the evidence tendered by Staff before determining whether they will undertake to testify at the merits hearing while also attempting to avoid any unfairness that could result from Staff splitting its case.

[132] In addition, we agree with the submissions of Gornitzki and Telfer that where a respondent chooses to give oral testimony, Staff may use the compelled testimony for the purpose of cross-examination of the Respondents in relation to statements made during their compelled examinations. However, we also acknowledge that the onus is on Staff to prove the allegations against the Respondents and that, out of necessity, there may be limited circumstances which require the panel to be seized of the contents of a compelled examination to have an opportunity to fully and fairly assess the allegations against the Respondents. In this case, by virtue of the allegations of misleading statements made by certain of the Respondents in the course of their compelled examinations, we find that the misleading statements are by necessity required to be put before the Panel. As with *Goldbridge*, in which the panel heard the compelled evidence of a respondent to prove that he misled the Commission, we shall also permit the use of the compelled testimony for that purpose (*Goldbridge*, *supra* at paras. 87 and 89).

[133] On the other hand, we do not agree with Staff that allegations of breaching confidentiality of the investigation brought pursuant to section 16 of the Act require, by necessity, that the compelled testimony be put before the Panel by way of read-in at the outset of Staff's presentation of its evidence. In this case, the Panel is of the view that Staff should bring, through its investigator, relevant evidence gathered by the investigator of the breach of section 16 of the Act. In addition, at the conclusion of its case, Staff may seek to tender into evidence selected excerpts from transcripts of compelled examinations of those respondents who have not undertaken and do not undertake to testify, which will be subject to evidence law considerations relating to hearsay and the use of one respondent's statements against another.

C. Confidentiality Cross-Motion

[134] We recognize and agree with the well-established principle that hearings should be open to the public, pursuant to section 9 of the SPPA and rules 5.1 and 8.1 of the *Rules of Procedure*. In this case, we were persuaded that, for the Respondents to have a meaningful opportunity to respond to the Motion it should be heard *in camera*. We found that the matters to be disclosed at the hearing were of such a nature that the desirability of avoiding disclosure thereof, in the interests of the Respondents affected and in the public interest of fairness, outweighed the desirability of adhering to the principle that the hearing be open to the public.

[135] We note that Staff included substantial portions, if not all of the excerpts, of the compelled testimony at issue in its motion record. We were mindful that those excerpts may or may not be tendered at the public hearing on the merits. Further, we were persuaded that some of the materials contain personal information as contemplated in section 9 of the SPPA, for which avoiding disclosure outweighed the desirability of public access.

[136] Pursuant to subsection 9(1)(b) of the SPPA and rules 5.2 and 8.1 of the Commission's *Rules of Procedure*, we find that, in the public interest, an appropriate balance is to order that all materials and transcripts of the Motion and Cross-Motion remain confidential, but that the Panel's decision on the matter shall be public and except for such excerpts of compelled examinations as may be admitted into evidence by the Panel in the course of the hearing on the merits.

[137] In order to balance the interests of fairness to the Respondents and the public interest in having opening hearings, we have endeavored to provide a fulsome decision, which acknowledges and discloses the submissions of the parties and the reasoning of this Panel.

VI. CONCLUSION

[138] Upon considering the submissions of the parties, the Panel concludes that the excerpts from transcripts of compelled examinations of the Respondents are admissible into evidence in the context of regulatory proceedings before the Commission, and their admission is not precluded by the *Charter* or the *Evidence Act*. The Panel may admit relevant hearsay evidence, and the weight to be afforded to such evidence is to be determined by the Panel.

[139] However, the Panel is of the opinion that the oral evidence of the Respondents who testify would provide us with the best evidence. We agree with submissions of the Respondents that Staff should not propose to tender excerpts of the Respondents' compelled examinations into evidence until the conclusion of its case. At that time, Staff may seek to tender into evidence selected excerpts from transcripts of compelled examinations of those respondents who have not undertaken and do not undertake to testify. In addition, where a Respondent chooses to give oral testimony, Staff may cross-examine the Respondent in relation to statements made during their compelled examination.

[140] The Panel also acknowledges that the onus is on Staff to prove the allegations against the Respondents. Therefore, the Panel is prepared to make an exception to allow Staff to put forward the excerpts from transcripts of compelled examination of Mr. Wing and Ms. Agueci for the limited purpose of making its case with respect to allegations of breaches of section 122 of the Act by them.

[141] With respect to the Cross-Motion for confidentiality, the Panel agrees that, in the public interest, an appropriate balance is to order that all materials and transcripts of the Motion and Cross-Motion remain confidential, but that the Panel's decision on

the matter shall be public and except for such excerpts of compelled examinations as may be admitted into evidence by the Panel in the course of the hearing on the merits.

Dated at Toronto this 13th day of December, 2013.

“Edward P. Kerwin”

“AnneMarie Ryan”

“Deborah Leckman”

3.1.3 Global Energy Group, Ltd. et al. – ss. 37, 127, 127.1

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
GLOBAL ENERGY GROUP, LTD., NEW GOLD LIMITED PARTNERSHIPS,
CHRISTINA HARPER, VADIM TSATSKIN, MICHAEL SCHAUMER, ELLIOT FEDER,
ODED PASTERNAK, ALAN SILVERSTEIN, HERBERT GROBERMAN, ALLAN WALKER,
PETER ROBINSON, VYACHESLAV BRIKMAN, NIKOLA BAJOVSKI, BRUCE COHEN and ANDREW SHIFF

REASONS AND DECISION ON SANCTIONS AND COSTS
(Sections 37, 127 and 127.1 of the Act)

Hearing: March 22, 2013

Decision: December 13, 2013

Panel: Paulette L. Kennedy – Commissioner and Chair of the Panel
Judith N. Robertson – Commissioner

Counsel: Cameron Watson, Carlo Rossi – For Staff of the Commission
Simon Bieber – For Herbert Groberman
Andrew Shiff – Self-Represented
– No one appeared for the other respondents.

TABLE OF CONTENTS

I. INTRODUCTION

II. THE MERITS DECISION

III. SANCTIONS AND COSTS REQUESTED

IV. POSITIONS OF THE PARTIES
A. STAFF'S SUBMISSIONS
B. GROBERMAN'S SUBMISSIONS
C. SHIFF'S SUBMISSIONS
D. REPLY SUBMISSIONS

V. THE LAW ON SANCTIONS

VI. SPECIFIC SANCTIONING FACTORS APPLICABLE IN THIS MATTER
A. SERIOUSNESS OF MISCONDUCT AND BREACHES OF THE ACT
B. THE RESPONDENTS' EXPERIENCE IN THE MARKETPLACE
C. LEVEL OF ACTIVITY IN THE MARKETPLACE
D. RESPONDENTS' RECOGNITION OF THE SERIOUSNESS OF THEIR CONDUCT AND REMORSE 11
E. SPECIFIC AND GENERAL DETERRENCE
F. MITIGATING FACTORS
G. SIZE OF PROFIT GAINED OR LOSS AVOIDED FROM ILLEGAL CONDUCT
H. RESPONDENT'S ABILITY TO PAY
I. SANCTIONS IMPOSED ON SETTLING RESPONDENTS
J. EFFECT OF SANCTIONS ON LIVELIHOOD OF RESPONDENTS

VII. APPROPRIATE SANCTIONS IN THIS MATTER
A. TRADING, ACQUIRING AND EXEMPTION PROHIBITIONS
B. OTHER MARKET PROHIBITIONS
C. DIRECTOR AND OFFICER BANS
D. DISGORGEMENT
E. ADMINISTRATIVE PENALTIES

VIII. COSTS

IX. CONCLUSION 21

I. INTRODUCTION

[1] This was a hearing before the Ontario Securities Commission (the "**Commission**") pursuant to sections 37, 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "**Act**") to consider whether it is in the public interest to make an order with respect to sanctions and costs against Global Energy Group, Ltd. ("**Global Energy**"), New Gold Limited Partnerships ("**New Gold**"), Christina Harper ("**Harper**"), Vadim Tsatskin ("**Tsatskin**"), Herbert Groberman ("**Groberman**"), Nikola Bajovski ("**Bajovski**"), Bruce Cohen ("**Cohen**") and Andrew Shiff ("**Shiff**") (collectively, the "**Respondents**").

[2] The hearing on the merits began on January 23, 2012 and continued from time to time over a period of 13 days (the "**Merits Hearing**"). The decision on the merits was issued on December 21, 2012 (*Re Global Energy Group, Ltd. et al.* (2013), 36 O.S.C.B. 202 (the "**Merits Decision**")).

[3] Prior to the Merits Hearing, Peter Robinson ("**Robinson**"), Vyacheslav Brikman ("**Brikman**"), Oded Pasternak ("**Pasternak**"), Allan Walker ("**Walker**"), Michael Schaumer ("**Schaumer**"), Alan Silverstein ("**Silverstein**") and Elliot Feder ("**Feder**") (collectively, the "**Settling Respondents**"), also named as respondents in the Statement of Allegations filed by Staff of the Commission ("**Staff**") on June 8, 2010 in this matter, settled with the Commission (See *Re Global Energy Group, Ltd. et al.* (2010), 33 O.S.C.B. 10427; (2011), 34 O.S.C.B. 9290; (2011), 34 O.S.C.B. 9296; (2011), 34 O.S.C.B. 9302; (2011), 34 O.S.C.B. 12113; (2011), 34 O.S.C.B. 12120; and (2012), 35 O.S.C.B. 905 respectively (the "**Settlement Agreements**")).

[4] After the release of the Merits Decision, a separate hearing was held on March 22, 2013 to consider submissions from Staff and the Respondents regarding sanctions and costs (the "**Sanctions and Costs Hearing**").

[5] On March 22, 2012, Staff, Shiff and counsel for Groberman appeared, tendered evidence and made submissions at the Sanctions and Costs Hearing. Ms. Harper communicated to Staff that she would not be attending the Sanctions and Costs Hearing. None of the other Respondents appeared or made submissions. In the Merits Decision, we decided we were satisfied that Staff took all reasonable steps to provide the Respondents with adequate notice. The Panel is satisfied by the Affidavit of Peaches Barnaby, sworn March 22, 2013, that appropriate efforts were made by Staff to serve the Respondents with notice of the Sanctions and Costs Hearing and as such, we were entitled to proceed with the hearing in the absence of the Respondents that did not participate in the Sanctions and Costs Hearing, in accordance with subsection 7(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended.

II. THE MERITS DECISION

[6] In the Merits Decision, we concluded that:

(a) the Respondents breached subsection 25(1)(a) of the Act by trading in securities of New Gold without registration and where no exemptions to registration apply;

(b) the Respondents traded in New Gold securities which had not been previously issued, for which no prospectus was issued and which did not qualify for any exemptions to the prospectus requirements, contrary to subsection 53(1) of the Act;

(c) Tsatskin, Harper and Global Energy perpetrated a fraud, contrary to subsection 126.1(b) of the Act;

(d) as *de facto* directors or officers of Global Energy, Tsatskin and Harper authorized, permitted or acquiesced in Global Energy's breaches of Ontario securities law and accordingly, they are liable for the contraventions of Ontario securities law by Global Energy, pursuant to section 129.2 of the Act; and

(e) the conduct of the Respondents was contrary to the public interest.

(Merits Decision, *supra* at paras. 189, 199, 229, 240 and 250)

III. SANCTIONS AND COSTS REQUESTED

[7] Staff has requested that the following sanctions and costs orders be made against the Respondents:

(a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Global Energy, New Gold, Tsatskin, Harper, Groberman, Bajovski and Cohen cease permanently;

(b) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Shiff cease for a period of 10 years;

(c) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities of New Gold cease permanently;

(d) pursuant to clause 2.1 of subsection 127(1) of the Act, that the acquisition of any securities by Global Energy, New Gold, Tsatskin, Harper, Groberman, Bajovski and Cohen cease permanently;

(e) pursuant to clause 2.1 of subsection 127(1) of the Act, that the acquisition of any securities by Shiff cease for a period of 10 years;

(f) pursuant to clause 3 of subsection 127(1) of the Act, that any exemptions contained in Ontario securities law not apply to Global Energy, New Gold, Tsatskin, Harper, Groberman, Bajovski and Cohen permanently;

(g) pursuant to clause 3 of subsection 127(1) of the Act, that any exemptions contained in Ontario securities law not apply to Shiff for a period of 10 years;

(h) pursuant to clause 7 of subsection 127(1) of the Act, that Tsatskin, Harper, Groberman, Bajovski, Cohen and Shiff resign all positions as director or officer of an issuer;

(i) pursuant to clauses 8, 8.2 and 8.4 of subsection 127(1) of the Act, that Tsatskin, Harper, Groberman, Bajovski and Cohen be prohibited permanently from becoming or acting as officer or director of any issuer, registrant or investment fund manager;

(j) pursuant to clauses 8, 8.2 and 8.4 of subsection 127(1) of the Act, that Shiff be prohibited for a period of 10 years from becoming or acting as officer or director of any issuer, registrant or investment fund manager;

(k) pursuant to clause 8.5 of subsection 127(1) of the Act, that Tsatskin, Harper, Groberman, Bajovski and Cohen be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

(l) pursuant to clause 8.5 of subsection 127(1) of the Act, that Shiff be prohibited for a period of 10 years from becoming or acting as a registrant, investment fund manager or as a promoter;

(m) pursuant to subsection 37(1) of the Act, that Tsatskin, Harper, Groberman, Bajovski and Cohen be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(n) pursuant to subsection 37(1) of the Act, that Shiff be prohibited for a period of 10 years from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(o) pursuant to clause 9 of subsection 127(1) of the Act, that Tsatskin pay $1,000,000, Harper pay $1,000,000, Groberman pay $182,000, Bajovski pay $128,000, Cohen pay $90,000 and Shiff pay $20,000 as administrative penalties, to be designated for allocation to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act;

(p) pursuant to clause 10 of subsection 127(1) of the Act, that Tsatskin, Harper and Global Energy be jointly and severally liable to disgorge to the Commission US$16,197,125.02, to be designated for allocation to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act;

(q) pursuant to clause 10 of subsection 127(1) of the Act, that Groberman disgorge $91,509, Bajovski disgorge $64,343, Cohen disgorge $45,736 and Shiff disgorge $10,532 to the Commission, to be designated for allocation to or for the benefit of third parties in accordance with subsection 3.4(2)(b) of the Act; and

(r) pursuant to section 127.1 of the Act, Tsatskin pay $30,430, that Harper pay $43,472 and each of Groberman, Bajovski, Cohen and Shiff pay $3,260 for hearing costs incurred by the Commission.

IV. POSITIONS OF THE PARTIES

A. Staff's submissions

[8] Staff distinguished between sanctioning factors to be considered for Tsatskin, Harper and Global Energy, who were found to have committed securities fraud, and the remaining respondents, whose activities related to unregistered trading and the illegal distribution of shares.

[9] Staff submits that the conduct of Tsatskin, Harper and Global Energy involves significant contraventions of the Act, including fraud, and that their activities were planned, prolonged and widespread. Staff emphasized that the Global Energy scheme defrauded over 200 investors of over US$16 million, which resulted in losses of approximately US$15 million. With respect to profit made or losses avoided, Staff submit that US$16,197,125 was obtained from investors, of which US$4,232,000 was transferred to accounts controlled by or for the benefit of Tsatskin and a further US$396,119.65 was transferred to accounts controlled by Harper. Harper also received $233,693.84 from funds included in the US$4,232,000 transferred to accounts controlled by or for the benefit of Tsatskin.

[10] Staff further submits that Tsatskin and Harper have demonstrated a lack of regard for Ontario securities law and failed to recognize the seriousness of their improprieties. Also, Staff argues there are no mitigating factors available to them and the risk to the public warrants the serious sanctions proposed by Staff to remove them permanently from the capital markets. Staff submits the sanctions sought are proportionate to the misconduct and will provide specific and general deterrence.

[11] With respect to Groberman, Bajovski, Cohen and Shiff (the "**Salesperson Respondents**"), Staff submits that they breached key provisions of Ontario securities law by using high pressure sales tactics and aliases when communicating with investors. Staff further submits that Bajovski and Cohen have shown indifference to the proceedings and that Groberman, despite his advanced age and health concerns, made no admissions. Shiff, Staff argues, only participated in the Global Energy scheme for a short period of two months, Shiff acknowledged that he failed to conduct due diligence and has expressed some remorse for his conduct.

[12] Staff also indicated that Groberman received $91,509.02, Bajovski received $64,343.29, Cohen received $45,736.33 and Shiff received $10,532.27 as a result of their conduct in breach of Ontario securities law.

[13] Staff relied on *Sabourin Sanctions*, *Limelight Sanctions* and *Al-Tar Sanctions*, among other cases, in support of their submission that fraudulent conduct has attracted the imposition of permanent prohibitions and substantial monetary penalties (*Re Sabourin* (2010), 33 O.S.C.B. 5299 ("***Sabourin Sanctions***"); *Re Limelight Entertainment Inc.* (2008), 31 O.S.C.B. 12030 ("***Limelight Sanctions***"); and *Re Al-Tar Energy Corp.* (2011), 34 O.S.C.B. 447 ("***Al-Tar Sanctions***")). Staff took the position in its written submissions that no carve-outs for personal trading should be granted to Tsatskin, Harper or Global Energy because they cannot be trusted to participate in the capital markets, not even in a limited capacity.

[14] On the matter of administrative penalties, Staff took the position that Tsatskin and Harper should each be ordered to pay $1,000,000 and that the remaining respondents should pay double the amount they earned as commission or, in other words, roughly two times the amount sought as disgorgement from each. Staff relies on *Rowan* for the proposition that an administrative penalty should be of a magnitude sufficient to ensure effective specific and general deterrence (*Re Rowan* (2009), 33 O.S.C.B. 91 ("***Rowan***") at para. 158). Further Staff notes that in *Al-Tar Sanctions* the Commission imposed higher sanctions than those requested by Staff because the administrative penalty "must be more than a fee for or cost of carrying out a fraudulent scheme" (*Al-Tar Sanctions*, *supra* at para. 47).

[15] Staff argued that the panel has the discretion to order Tsatskin, Harper and Global Energy to disgorge US$16,197,125.02, representing the full amount raised from investors, and that it is open to the panel to direct Staff not to exceed that amount of recovery, by taking into account recoveries received from other Respondents or in other proceedings. Staff submits that, similar to the direction of the *Suman and Rahman Sanctions* panel, Staff would coordinate with U.S. authorities to ensure that there is no double recovery (*Re Shane Suman and Monie Rahman* (2012), 35 O.S.C.B. 11218). Staff argued that any amount of commissions disgorged by the remaining salesperson respondents would be deducted from the whole amount to be disgorged by Tsatskin, Harper and Global Energy. Furthermore, Staff agreed that it is the Commission's practice to deduct from the amount to be disgorged monies returned to investors. However, in *Limelight Sanctions*, the panel found that while Staff has the onus on a balance of probabilities of proving the amounts obtained by the Respondents as a result of non-compliance, any risk in calculating disgorgement falls on the wrongdoer whose non-compliance with the Act caused the uncertainty (*Limelight Sanctions*, *supra* at para. 53). Therefore, Staff argues, it would be open to the panel to deduct either the approximate US$900,000 that was directed to Global Energy in the Bahamas or, at the very least, the amounts referred to in evidence has having been returned to investors.

[16] Staff also noted in its submissions that settlement agreements arrived at with co-respondents are not binding, but that the Supreme Court of Canada has found that settlements "are among the relevant factors to consider" (*Re Cartaway Resources Corp.*, [2004] 1 S.C.R. 672 ("***Cartaway***") at paras. 67-69). Staff submitted that with the exception of Schaumer, who settled on the basis of fraud, all other Settling Respondents had dollar for dollar disgorgement and administrative penalties, which Staff argued were the lowest administrative penalties appropriate in the circumstances and reflected early resolution of the matter.

[17] Costs sought for a total amount of $86,942 include the costs of two Staff counsel and an investigator beginning December 1, 2011, at which time litigation preparation began and all settlements were substantively completed. Staff did not request disbursement costs. Staff argued that Tsatskin and Harper should be responsible for the majority of the costs as a result of their central roles in the Global Energy scheme and that Harper's conduct throughout the proceedings should result in her paying a more significant amount.

B. Groberman's Submissions

[18] In his written submissions, counsel for Groberman requested that the panel consider several factors when deciding on the imposition of sanctions on Groberman. Those factors include: Groberman is 79 years old and in poor health, he had no experience in the marketplace, he does not need specific deterrence because he quit the scheme voluntarily and this is an isolated incident on his otherwise unblemished record.

[19] Counsel for Groberman made oral submissions on the administrative penalty and costs sought against Groberman. Specifically, he argued that Groberman should not be ordered to pay an administrative penalty and that Staff's dockets on costs did not allow Groberman to adequately assess the amounts incurred with respect to Groberman.

[20] With respect to the administrative penalty sought by Staff, counsel for Groberman argued that nonmonetary sanctions against Groberman amounted to a lifetime ban due to Groberman's advanced age. This, Groberman's counsel submitted, served the purpose of specific deterrence and was harsh for a respondent that was not involved in fraud. His submission was that Groberman's administrative penalty should be zero given the effective lifetime bans and disgorgement sought. In support of his proposition counsel relied upon the *Maitland Sanctions* decision, a matter which included sanctioning of salespersons in a boiler room. Groberman's counsel specifically directed the panel to sanctions imposed on Lanys, a salesperson who made admissions of fact and was ordered to pay disgorgement and given three year bans, but was not ordered to pay an administrative penalty (*Re Maitland Capital et al.* (2012), 35 O.S.C.B. 6500 ("***Maitland Sanctions***") at paras. 31 and 36). Counsel argued that Groberman's conduct was almost identical to that of Lanys, but a key difference, which weighs in favour of Groberman, is that Groberman was less experienced in the securities market.

[21] Counsel also submitted that an administrative penalty in the amount of two times the disgorgement sought against Groberman crossed the line from prevention to punishment. Groberman's counsel argued that there was no difference between the Settling Respondents and Groberman, other than the fact that they settled. However, he also noted that another difference was that Groberman left Global Energy voluntarily when he realized that investors were unhappy and not getting what they wanted.

[22] Groberman's counsel argued that Groberman's inability to attend the proceeding should be treated as a neutral factor and tendered evidence with respect to Groberman's medical condition to support his submissions (*Re Goldpoint Resources Corp.* (2013), 36 O.S.C.B. 1464 ("***Goldpoint Santions***") at para. 55). He also submitted that limited time was spent dealing with allegations against Groberman at the Merits Hearing and in support of that submission he directed the panel to portions of Groberman's compelled testimony, in which Groberman admitted to trading without a license. Further, the panel was directed to Staff's docket, which allocated three hours of Staff's time to settlement discussions, but did not otherwise detail specific time spent dealing with his involvement. With that in mind, counsel for Groberman argues, the Commission should not order Groberman to pay costs.

C. Shiff's Submissions

[23] Shiff began by conveying his remorse stating "I wanted to express, once again, that I am absolutely remorseful, that I have experienced tremendous embarrassment, loss of business and especially reputation" (Shiff – Hearing Transcript of March 22, 2013 at p. 91). Shiff requested that no sanctions be imposed and indicated he was the director of his own company and needed to be able to offer shares of his company for growth with a potential partner.

[24] It was submitted to the panel that Shiff could not make restitution. Shiff gave evidence about his financial situation and inability to pay. He testified with respect to four accounts: a VISA credit card, a personal account, a business account and a VISA debit card. Shiff's evidence was that in August 2012 his credit rating dropped and his VISA credit card was no longer renewed. As at the date of the hearing, Shiff testified that the VISA credit card account had $5,700 outstanding and the maximum credit limit was supposed to be $5,000. Shiff also testified that the VISA debit card had a balance of $100 and his personal account balance was in the negative, approximately $700.

[25] Shiff stated he had a first-aid health and safety company in the business of teaching people how to save lives. Shiff gave evidence that his business account had approximately $100. He also testified that one of his suppliers would not continue to work with him unless he dealt with a balance owing of $1,000. More generally, Shiff testified that his income fluctuated, he could not say what his actual annual income was, but stated that it was not very high and "[a] lot of stuff goes back into the business" (Shiff – Transcript of March 22, 2013 at p. 98). Shiff's evidence was that he had no significant assets and was behind on his rent, which added to the pressure. Given the opportunity to testify at the Sanctions and Costs Hearing about his income, Shiff did not answer directly, nor did he tender documentary evidence that would support his testimony in that respect.

D. Reply Submissions

[26] Staff argued that ability to pay is one relevant sanctioning factor, but not a predominant or determinative one (*Sabourin Sanctions*, *supra* at para. 60). Staff submitted that the panel could not give much weight to Shiff's testimony on ability to pay without knowing his total income or the worth of his business. Staff also acknowledged that Shiff participated in the scheme for a shorter period of time, but nonetheless lied about his location and name, which should be aggravating factors. On the matter of whether the panel should narrow the scope of prohibitions to permit Shiff to be an officer or director of a non-reporting issuer, Staff submitted that it was not appropriate given the aggravating circumstances, and stated that Shiff is not in a position to be trusted to sell securities or issue his own.

[27] In response to Groberman's submissions on the inadequacy of Staff's dockets, Staff relied upon the Commission's decision in *Ochnick*, which considered Staff's dockets and found them to be sufficient to support the requested costs (*Re Ochnick* (2006), 29 O.S.C.B. 3929 ("***Ochnick***")).

[28] Staff also reiterated that no settlement was reached and no agreed facts were entered which could provide the basis of mitigating factors for Groberman. Staff submitted that less weight should be given to Groberman's compelled testimony which was not tested by cross-examination with the same scrutiny that could be provided at a hearing. Further, Staff argued that the suggestion that Groberman left Global Energy because he felt something was wrong is self-serving and in fact contradictory in the sense that he also admits in his compelled testimony that he stayed for several months after complaints started coming in every day or every other day.

[29] In terms of the application of *Maitland Sanctions*, Staff distinguished the case for three reasons. First, Lanys agreed to a statement of facts, which could have been considered a mitigating factor. Second, Staff did not seek an administrative penalty in that matter and therefore the panel did not consider whether it was appropriate. Third, while his counsel argued that Groberman had less market experience than Lanys, Groberman still lied about his name and his location while selling securities and should have known better.

[30] In response to Staff's reply with respect to Groberman's compelled testimony, Counsel for Groberman directed the panel to the portions of Groberman's compelled testimony which he submitted were relevant and argued that this was not hearsay evidence which commented on the conduct of other respondents, and therefore did not raise the same concerns of fairness on ability to cross-examine the evidence. Groberman's counsel submitted that Staff was the party conducting the compelled interview and it would have had the opportunity to ask whatever questions it saw fit at the time of the interview. He agreed that the weight to be given to the evidence is at the discretion of the panel.

V. THE LAW ON SANCTIONS

[31] Pursuant to section 1.1 of the Act, the Commission's mandate is to: (i) provide protection to investors from unfair, improper or fraudulent practices; and (ii) foster fair and efficient capital markets and confidence in capital markets. As stated by the Supreme Court of Canada in *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario Securities Commission*, [2001] 2 S.C.R. 132 ("***Asbestos***") at para. 42, the Commission's public interest mandate in making an order under section 127 of the Act is neither remedial nor punitive; instead, it is protective and preventive, and it is intended to prevent future harm to Ontario's capital markets.

[32] The purpose of an order under section 127 of the Act is "to restrain future conduct that is likely to be prejudicial to the public interest in fair and efficient capital markets" and the role of the Commission under section 127 of the Act is "to protect the public interest by removing from the capital markets those whose past conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets" (*Asbestos*, *supra* at para. 43).

[33] The Commission must ensure that the sanctions imposed in each case are proportionate to the circumstances and conduct of each of the particular respondents. Some of the factors the Commission has considered in determining appropriate sanctions include:

(a) the seriousness of the allegations;

(b) the respondent's experience in the marketplace;

(c) the level of a respondent's activity in the marketplace;

(d) whether or not there has been recognition of the seriousness of the improprieties;

(e) whether or not the sanctions imposed may serve to deter not only those involved in the case being considered, but any like-minded people from engaging in similar abuses of the capital markets;

(f) any mitigating factors;

(g) the size of any profit made or loss avoided from the illegal conduct;

(h) the size of any financial sanctions or voluntary payment when considering other factors;

(i) the effect any sanction might have on the livelihood of a respondent;

(j) the restraint any sanctions may have on the ability of a respondent to participate without check in the capital markets;

(k) the reputation and prestige of the respondent;

(l) the shame or financial pain that any sanction would reasonably cause to the respondent; and

(m) the remorse of the respondent.

(*Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743 ("***Belteco***") at paras. 23-26; *Re M.C.J.C. Holdings Inc.* (2002), 25 O.S.C.B. 1133 ("***MCJC Holdings***") at paras. 18-19 and 26).

[34] Deterrence is an important factor that the Commission may consider when determining appropriate sanctions. In *Cartaway*, *supra* at paragraph 60, the Supreme Court of Canada stated that: "… it is reasonable to view general deterrence as an appropriate, and perhaps necessary, consideration in making orders that are both protective and preventative".

[35] The Commission has held that an administrative penalty "may not act as a sufficient deterrent if its magnitude is inadequate compared with the benefit obtained by non-compliance" (*Rowan*, *supra* at para. 74). The panel in *Limelight Sanctions*, *supra* at para. 67, stated:

> The purpose of an administrative penalty is to deter the particular respondents from engaging in the same or similar conduct in the future and to send a clear deterrent message to other market participants that the conduct in question will not be tolerated in Ontario capital markets.

[36] There is no formula for determining an administrative penalty. Factors to be considered in determining an appropriate administrative penalty include: the scope and seriousness of the misconduct; whether there were multiple and/or repeated breaches of the Act; whether the respondent realized a profit as a result of the misconduct; the amount of money raised from investors; and the level of administrative penalties imposed in other cases (*Rowan*, *supra* at para. 67; and *Limelight Sanctions Decision*, *supra* at paras. 71 and 78).

[37] Subsection 127(1)10 of the Act provides that a person or company that has not complied with Ontario securities law can be ordered to disgorge to the Commission "any amounts obtained" as a result of the non-compliance. When determining the appropriate disgorgement orders, we are guided by a non-exhaustive list of factors set out in *Limelight Sanctions* at para. 52, including:

a) whether an amount was obtained by a respondent as a result of non-compliance with the Act;

b) the seriousness of the misconduct and the breaches of the Act and whether investors were seriously harmed;

c) whether the amount that a respondent obtained as a result of non-compliance with the Act is reasonably ascertainable;

d) whether the individuals who suffered losses are likely to be able to obtain redress; and

e) the deterrent effect of a disgorgement order on the respondents and other market participants.

VI. SPECIFIC SANCTIONING FACTORS APPLICABLE IN THIS MATTER

[38] In determining appropriate sanctions, the Commission is guided by the factors set out in *Belteco* and *M.C.J.C. Holdings*. We have considered those factors summarized in the following paragraphs to be specifically applicable in this matter.

A. Seriousness of Misconduct and Breaches of the Act

[39] Registration is one of the cornerstones of securities law which serves as a gate-keeping function to ensure only properly qualified individuals are permitted to trade with, or on behalf of, the public (*Goldpoint Sanctions*, *supra* at para. 48; *Re Richvale Resource Corp.* (2012), 35 O.S.C.B. 10699 ("***Richvale Sanctions***") at para. 15(a); and *Re Lyndz Pharmaceuticals Inc.* (2012), 35 O.S.C.B. 7257 ("***Lyndz Sanctions***") at para.63). All of the Respondents engaged in unregistered trading contrary to subsection 25(1)(a) of the Act and engaged in the distribution of securities without a prospectus or a prospectus exemption contrary to subsection 53(1) of the Act.

[40] Fraud is among the most egregious securities law violations; it decreases confidence in the fairness and efficiency of the capital markets (*Re Al-Tar Energy Corp.* (2010), 33 O.S.C.B. 5535 ("***Al-Tar Merits Decision***") at para. 214). In the Merits Decision *supra*, we found that Global Energy, Tsatskin and Harper perpetrated and participated in a fraud on investors contrary to subsection 126.1(b) of the Act.

[41] We also note that the Respondents misappropriated, or assisted in the misappropriation of investor funds paid to enrich themselves, the directing minds and salespersons of Global Energy (Merits Decision, *supra* at paras. 170, 172 and 187).

[42] While the conduct of Tsatskin, Harper and Global Energy, who were found to have committed securities fraud, can be distinguished from that of the Salesperson Respondents, we consider the use of aliases to sell securities to investors a deceitful course of conduct that cannot and should not be ignored when considering the seriousness of the Respondents' breaches. The use of aliases, high pressure sales tactics and misrepresentations, are aggravating factors.

B. The Respondents' Experience in the Marketplace

[43] Counsel for Groberman submitted that Groberman's lack of experience in the marketplace should be taken into account in imposing sanctions. There was no evidentiary support for this submission. In fact, we have no evidence on any of the Respondents' activities in the market from which to draw a conclusion, aside from the conduct in question and that there is no record that Tsatskin, Harper, Groberman, Bajovski and Shiff have been registered with the Commission in any capacity (Merits Decision, *supra* at para. 141). We do not find Groberman's submissions to be of assistance in our determination.

C. Level of Activity in the Marketplace

[44] We found that US$16,197,125 of investor funds were obtained through the Global Energy investment scheme through the sale of New Gold partnership units (Merits Decision, *supra* at para. 168). This is a substantial sum of money obtained through high pressure solicitation of investors over the course of one year. Tsatskin paid commissions to at least eleven others, aside from the directing minds of Global Energy, to assist in executing the fraudulent scheme (Merits Decision, *supra* at paras. 171-172).

D. Respondents' Recognition of the Seriousness of their Conduct and Remorse

[45] Shiff is the only respondent who repeatedly expressed remorse for his involvement in this matter. We accept his submissions in this respect to be genuine. Groberman also recognized the seriousness of his conduct in his compelled testimony by admitting to misconduct and not disputing the non-monetary sanctions sought to be imposed upon him. None of the other Respondents took responsibility for their actions or presented evidence of remorse or that they recognized the seriousness of their offenses.

E. Specific and General Deterrence

[46] Given the seriousness of the conduct, it is important that the Respondents and like-minded individuals engaging in deceitful conduct such as fraud, use of aliases or high pressure sales tactics, should be deterred from doing so in the future by imposing appropriate sanctions which reflect the harm done to investors.

[47] Groberman's counsel argued that he did not need specific deterrence because he left the scheme on his own. We agree with Staff that the transcript of Groberman's compelled testimony is telling in that it confirms Groberman continued to work for several months, using an alias to sell securities, even with the knowledge of the daily or near daily complaints from investors. We find that specific deterrence is necessary for Groberman in this case.

[48] Staff referred to Shiff's short term of involvement in the Global Energy scheme. However, we note that Shiff did not cease unregistered trading out of his own accord. Shiff's misconduct terminated when the entire Global Energy scheme was brought to a halt. We find that specific deterrence is necessary for Shiff in this case.

F. Mitigating Factors

[49] We found no mitigating factors to be applicable for Tsatskin, Harper, Bajovski or Cohen.

[50] As stated above, we accept Shiff's repeatedly expressed remorse to be genuine. Further, Groberman also recognized the seriousness of his conduct in his compelled testimony by admitting to misconduct and not disputing the non-monetary sanctions sought to be imposed upon him. We consider these to be mitigating factors for Shiff and Groberman.

G. Size of Profit Gained or Loss Avoided from Illegal Conduct

[51] Of the US$16,197,125 obtained from investors, we had evidence that US$4,232,000 was transferred to accounts controlled by or for the benefit of Tsatskin and a further US$396,120 was transferred to accounts controlled by Harper. Of the US$4,232,000 transferred to accounts controlled by or for the benefit of Tsatskin, the merits panel accepted that:

a) Harper received $233,694;

b) Groberman received $91,509;

c) Bajovski received $64,343;

d) Cohen received $45,736;

e) Shiff received $10,532; and

f) the Settling Respondents received further amounts.

(Merits Decision, *supra* at paras. 170, 172 and 187).

The Salesperson Respondents and Harper obtained the above noted amounts listed in a) through e) in Canadian currency.

[52] The Salesperson Respondents obtained the above noted values as commissions for their sales of New Gold securities, and thus as a result of their conduct in breach of Ontario securities law. Likewise, amounts obtained by Tsatskin, Harper and Global Energy were obtained a result of their activities in breach of the Act. None of the Respondents should be allowed to profit from breaches of Ontario securities law.

H. Respondent's Ability to Pay

[53] The panel was given inadequate evidence of Shiff's ability to pay. We found his testimony to be vague and unpersuasive. Although Shiff provided some information on his financial situation, when Shiff was given the opportunity to tender evidence of his income he did not do so. In the absence of information with respect to the value of Shiff's business and income, we cannot give much weight to Shiff's testimony. No evidence was presented with regard to any of the other Respondents' ability to pay.

I. Sanctions Imposed on Settling Respondents

[54] The Settling Respondents agreed and were ordered to permanently cease trading and acquiring securities and that exemptions contained in Ontario securities law would not apply to them permanently, subject to certain exceptions for personal trading for some of the Settling Respondents. They were further prohibited from becoming or acting as directors or officers of any issuer, registrant or investment fund manager or from becoming or acting as registrants, investment fund managers or promoters permanently, with the exception of Feder whose director and officer prohibition specified any "reporting" issuer or issuer that distributes to the public (See *Re Global Energy Group, Ltd. et al.* (2010), 33 O.S.C.B. 10412; (2011), 34 O.S.C.B. 9261; (2011), 34 O.S.C.B. 9262; (2011), 34 O.S.C.B. 9264; (2011), 34 O.S.C.B. 12072; (2011), 34 O.S.C.B. 12073; and (2012), 35 O.S.C.B. 891 (collectively, the "**Global Energy Settlement Orders**")).

[55] The Settling Respondents who settled only on the basis of contraventions of sections 25 and 53 of the Act, were further ordered to pay administrative penalties (Global Energy Settlement Orders, *supra*). Further, the Settling Respondents were ordered to disgorge amounts admitted to have been obtained as commissions for sales of New Gold securities. In most cases, the Settling Respondents administrative penalties matched dollar for dollar with their disgorgement amount (Global Energy Settlement Orders, *supra*). Robinson was ordered to disgorge $22,000, Brikman was ordered to disgorge $82,748, Pasternak

was ordered to disgorge $171,856, Walker was ordered to disgorge $82,521, Schaumer was ordered to disgorge $640,000, Silverstein was ordered to disgorge $114,186 and Feder was ordered to disgorge $230,447 (Global Energy Settlement Orders, *supra*). In total, the Commission has ordered that $1,343,758 be disgorged by the Settling Respondents.

[56] We find that the Salesperson Respondents' involvement is comparable to that admitted by the Settling Respondents (Settlement Agreements, *supra*). The Salesperson Respondents, like the Settling Respondents, solicited investors through the use of high pressure sales tactics and used aliases for that purpose. We also recognize that the sanctions imposed in the Global Energy Settlement Orders reflect mitigating factors for the Settling Respondents' acknowledgement of wrongdoing and cooperation with Staff. This factor was not determinative, but we found it a consideration with respect to proportionality.

J. Effect of Sanctions on Livelihood of Respondents

[57] Shiff submitted that sanctions would make it more difficult for him to make a living, worsen an already precarious position and make operation of his company more difficult. We could not give the submission much weight due to lack of an evidentiary basis for his claim.

VII. APPROPRIATE SANCTIONS IN THIS MATTER

[58] In determining the appropriate sanctions for each of the Respondents, we have remained cognizant of the role and conduct of each respondent in the Global Energy investment scheme. We have also taken into account the Merits Decision findings of contraventions of the Act, which differ between certain of the Respondents, the submissions of the parties and the sanctioning factors considered above.

A. Trading, Acquiring and Exemption Prohibitions

[59] We agree that the Respondents cannot be trusted to participate in the capital markets. We found that US$16,197,125 was obtained from investors through the Global Energy investment scheme through the sale of New Gold partnership units, in contravention of the Act (Merits Decision, *supra* at para. 168). The scheme was found to be fraudulent and affected many Canadian investors. Furthermore, Global Energy and Tsatskin and Harper, as controlling minds, were found to have perpetrated a fraud contrary to subsection 126.1 (b) of the Act and to have authorized, permitted or acquiesced in Global Energy's breaches of Ontario securities law. Accordingly, Tsatskin and Harper are deemed to have not complied with Ontario securities law, pursuant to section 129.2 of the Act (Merits Decision, *supra* at para. 240).

[60] Specifically, Tsatskin admitted that investors were misled about the true ownership and control of Global Energy, investor funds were comingled despite representations in subscription agreements that the funds would be held in escrow accounts and used for the purpose of a specific drilling project, and that oil wells in Kentucky were not all drilled and those that were produced little or no oil at all, contrary to the estimates and representations made by Global Energy salespersons (Merits Decision, *supra* at para. 221). Further, Harper knowingly misled investors about the length of time that Global Energy had been in operation, made false statements about Global Energy's performance, used an alias and made false and misleading statements about her past experience in the oil and gas industry, clearly knowing them to be false (Merits Decision, *supra* at para. 223-225).

[61] We are guided by the Commission's practice of applying permanent cease trade bans, acquisition bans and exemption application bans in circumstances where respondents were found to have engaged in fraudulent conduct (*Al-Tar Sanctions*, *supra* at para. 82; *Richvale Sanctions*, *supra* at para. 15(a); *Lyndz Sanctions*, *supra* at para. 63; and *Goldpoint*, *supra* at para. 48). Therefore, we find permanent bans are appropriate for Tsatskin, Harper and Global Energy. We also agree that Tsatskin, Harper and Global Energy should not be granted any exception for personal trading because they cannot be trusted to participate in Ontario's capital markets even in a limited capacity.

[62] Staff made no submissions with respect to New Gold, other than seeking certain sanctions against it. We find that it would not serve the public interest to order sanctions against New Gold, which appears to be a fictitious entity. However, given that we found in the Merits Decision at paragraph 166 that the partnership units of New Gold constituted evidence of an interest in the royalties generated by the New Gold drilling programs, and therefore constituted securities for the purposes of subsection 1(1) the Act (the "**New Gold securities**"), it is necessary to ensure that such securities do not continue to be sold to the public. Therefore, we find that trading in any New Gold securities should cease permanently, without exception.

[63] The Salesperson Respondents deceived investors, used aliases and lied about their location to solicit potential investors by telephone. Given this misconduct, we agree with Staff that the Salesperson Respondents should not be permitted to trade in or acquire securities or rely on exemptions contained in Ontario securities law, however we disagree that this sanction should be permanent.

[64] The Commission in *Sabourin Sanctions*, considered a similar matter where investors were sold sham investments through salespersons who were found to have contravened sections 25 and 53 of the Act (*Sabourin Sanctions*, *supra* at para.

7). In that decision, the panel decided the salespersons should permanently cease trading securities, be prohibited from acquiring securities and that there should be a permanent removal of exemptions against each of them, subject to a carve-out for RRSPs with respect to trading and acquiring securities (*Sabourin Sanctions*, *supra* at para. 7).

[65] The Panel was also directed to the *Maitland Sanctions* decision, in which the Commission considered the agreed facts of respondent Lanys, who participated as a salesperson in a fraudulent investment scheme (*Maitland Sanctions*, *supra* at para. 33). In that matter, the Commission ordered Lanys to cease trading securities, be prohibited from acquiring securities and that exemptions from securities law would not apply to him for a period of 3 years, subject to a carve-out for RRSPs once his disgorgement order was paid in full (*Maitland Sanctions*, *supra* at para. 73). The *Maitland Sanctions* matter can be distinguished from the current proceeding on the basis that the panel had only limited agreed facts on which to base its decision and there was no indication that Lanys used an alias or high pressure sales tactics to solicit investors. Further, the agreed facts in that matter stipulate that Lanys was contacting existing investors whom he had understood to have already signed a document signifying they were accredited investors (*Maitland Sanctions*, *supra* at para. 31).

[66] In *Limelight Sanctions* the salesman, Daniels, received 10 year prohibitions with respect to trading and removal of exemptions, subject to a carve-out for RRSPs (*Limelight Sanctions*, *supra* at para. 42). In that matter, the panel noted that the respondents engaged in cold calling and used misleading representations and high pressure sales tactics (*Limelight Sanctions*, *supra* at para. 41).

[67] We consider it appropriate in the circumstances to impose 10 year prohibitions on Bajovski and Cohen's ability to trade securities, acquire securities or benefit from exemptions contained in Ontario securities law, subject to the carve-out described in paragraph 68. Shiff has shown, and the panel has accepted, his remorse for involvement in this scheme. He has shown recognition of the seriousness of the breaches through his participation, which coupled with his remorse are mitigating factors in favour of Shiff. We find that in Groberman's admission in his compelled testimony he accepted responsibility for his actions, stated that he did not know he had to be licensed and later accepted the non-monetary sanctions requested by Staff. For these reasons, we consider it appropriate to impose 5 year prohibitions on Shiff and Groberman's ability to trade securities, acquire securities or benefit from exemption application under Ontario securities law, subject to the carve-out described in paragraph 68.

[68] We have also decided that the Salesperson Respondents should be granted an exception for personal trading once amounts ordered to be paid for the administrative penalty and disgorgement of the respective respondent are paid. The exception would be for an account in which the Salesperson Respondent has sole legal and beneficial ownership, provided that certain conditions are met. Also, given his misconduct, we do not find it appropriate to allow Shiff to trade in or distribute securities of his own company prior to expiry of his specific prohibition period.

B. Other Market Prohibitions

[69] In considering the circumstances of this case, including the fact that salespersons engaged in high pressure sales tactics and that Tsatskin, Harper, Groberman, Bajovski, Cohen or Shiff (the "**Individual Respondents**") all engaged in deceitful conduct for the purpose of trading or acting in furtherance of trading securities, none of the Individual Respondents should be allowed to call at a residence or telephone from a location in Ontario to a residence located in or out of Ontario for such purposes.

[70] The Individual Respondents should not be entitled to become or act as a registrant, investment fund manager or as a promoter. To protect the public, we find that it is appropriate to impose these market prohibitions on the Individual Respondents on a permanent basis.

[71] There will be no differentiation between Shiff or Groberman and the other the Salesperson Respondents with respect to these other market prohibitions. We find that all the Salesperson Respondents engaged in deceitful conduct, Shiff just participated for a shorter period of time and Groberman took no issue with any of the non-monetary prohibitions. Further, neither Shiff nor Groberman indicated they planned to work in the investment industry or that registration was important to their livelihood.

C. Director and Officer Bans

[72] We agree that permanent director and officer bans, coupled with permanent trading, acquisition and exemption prohibitions, are necessary where a respondent has violated sections 25 and 53 and engaged in misleading and deceptive behaviour (*Ochnik*, *supra* at paras. 92, 108-113).

[73] In the Merits Decision, the panel found that Global Energy, of which Tsatskin and Harper were the directing minds, conducted a fraudulent scheme resulting from: (a) the use of aliases to solicit potential investors; (b) misleading investors; (c) high pressure sales tactics; and (d) the misappropriation of investors' funds (Merits Decision, *supra* at paras. 170, 172, 187, 221 and 246). In *Al-Tar Sanctions*, the Commission ordered permanent director or officer bans for a fraudulent scheme where $648,109.03 was raised from sales of shares and investors were harmed (*Al-Tar Sanctions*, *supra* at paras. 12 and 82). In

Sabourin Sanctions, the Commission ordered the salespersons and directing mind to resign and be permanently banned from becoming or acting as a directors or officers of an issuer, in which approximately $33.9 million was obtained in an investment scheme that was found to be a sham (*Sabourin Sanctions*, *supra* at para. 64). In *Limelight Sanctions*, a matter in which $2.75 million was raised from investors through unregistered trading and an illegal distribution, the directing minds were also permanently banned, and the salespersons were banned for a period of 10 years, from becoming or acting as a directors or officers of an issuer (*Limelight Sanctions*, *supra* at para. 87(d) and (e)).

[74] In our view, the orders for resignation and imposition of director and officer bans requested by Staff will ensure that the Individual Respondents will be not be placed in a position of control or trust with respect to issuers, registrants or investment fund managers in the near future, or permanently in the case of Tsatskin and Harper. For Shiff and Groberman, we find it to be sufficient general and specific deterrence for the ban to be qualified to a director or officer of a reporting issuer or any issuer that engages in a distribution to the public, for a period of 5 years, but permanent bans from becoming or acting as directors or officers of a registrant or investment fund manager. For Bajovski and Cohen, we find that a 10 year ban from becoming or acting as director or officer of any issuer and a permanent ban from becoming or acting as director or officer of a registrant or investment fund manager would be more appropriate general and specific deterrence.

D. Disgorgement

[75] In determining appropriate disgorgement, we are guided by the Commission's decision in Limelight Sanctions, which states that in determining disgorgement the panel should consider whether the amount obtained by a respondent was a result of non-compliance with the Act and whether that amount is reasonably ascertainable (*Limelight Sanctions*, *supra* at para. 52).

[76] The Global Energy investment scheme raised US$16,197,125 of investor funds through the the illegal distribution of New Gold securities (Merits Decision, *supra* at paras. 168 and 199). Sales were effected as a result of the Individual Respondents' acts of deceit or falsehood including making false statements to investors about salesperson identities, the success of the business, and the allocation of investor funds (Merits Decision, *supra* at paras. 221). The conduct of the Respondents, particularly the commission of securities fraud and deceitful representations, was very serious and resulted in substantial harm to investors. We find it highly unlikely that the investors of the Global Energy investment scheme who suffered losses will be able to obtain redress.

[77] The amounts obtained from investors were directed by the Individual Respondents to a company by the name of American Oil and Gas. A portion of those funds was in turn paid to the Individual Respondents either directly or through accounts controlled by or for the benefit of Tsatskin, one of the directing minds of this investment scheme.

[78] We acknowledge that Mr. Chad Harlan, a Certified Financial Institutions Examiner with the Commonwealth of Kentucky Division of Securities, testified that US$11.5 million of the obtained investor funds had been distributed by Bryan Coffman ("**Coffman**") to other accounts controlled by Coffman or by other persons or entities who are not respondents in this proceeding. Mr. Harlan further testified that the funds directed to the benefit of Mr. Coffman were the subject of a prosecution in the State of Kentucky against Coffman, his wife Megan Coffman and Gary Milby. It was not disputed in this proceeding that approximately US$11.5 million was obtained by Coffman into accounts in his name, his wife's name, or in the names of other individuals or entities who are not respondents in this proceeding (Merits Decision, *supra* at paras. 94 and 168).

[79] We recognize that the Global Energy investment scheme impacted Canadian investors, that operations were carried out from an office in Ontario and that investors were directed by Global Energy and its agents to send their funds to accounts controlled by individuals or entities who are not respondents to this proceeding. We further recognize that the Commission has found it appropriate that a respondent disgorge all of the funds that were obtained by the respondent as a result of illegal activity and not just profit (*Limelight Sanctions*, *supra* at para. 49).

[80] Further, the Commission has found that where a scheme was wholly fraudulent and the respondent was a director or officer of the company, it is not necessary for the individual respondent to have obtained the funds personally for the Commission to order disgorgement (*Limelight Sanctions*, *supra* at paras. 59-62). The panel in that matter found that the individual respondents were jointly and severally responsible for the disgorgement of funds resulting from illegal actions that were carried out through a corporation which they directed and controlled and which received the investor funds. In *Sabourin Sanctions*, the panel ordered joint and several disgorgement of the total $33.9 million obtained from investors less $6 million that appeared to have been returned to investors (*Sabourin Sanctions*, *supra* at paras. 70 and 93(g)). The panel in that matter found that joint and several liability of Sabourin and the corporate respondents was appropriate, despite the fact that Sabourin did not personally receive all of the funds, because he was the directing and controlling mind of all of the companies which received investor funds and therefore it would impossible to treat them differently (*Sabourin Sanctions*, *supra* at para. 70).

[81] We distinguish our findings regarding the Global Energy investment scheme from both *Sabourin Sanctions* and *Limelight Sanctions* in one important respect. While we found that US$16,197,125 was raised from investors through the Global Energy investment scheme, we also found that approximately US$11.5 million of those funds were directed to accounts over which none of Global Energy, Tsatskin or Harper appear to have exercised control or authority. Therefore, while we agree that

US$16,197,125 was obtained from investors through fraudulent means and ought to be subject to a disgorgement order as requested by Staff, we did not have sufficient evidence upon which to conclude that the total amount of US$16,197,125 was obtained by Global Energy, Tsatskin and/or Harper. We did, however, have evidence that an individual who is not a respondent obtained and directed the disposition of a large portion of the investor funds. Given these circumstances, it would be consistent with previous Commission decisions to only order the disgorgement of the funds obtained by the Respondents as opposed to the total amount of funds obtained from investors, as requested by Staff. We are not able to make findings or orders against Coffman, American Oil and Gas or others who are not respondents in this proceeding.

[82] An amount of US$4,232,000 of investor funds was transferred to accounts controlled by or for the benefit of Tsatskin (Merits Decision, *supra* at paras. 170). For the purpose of calculations in these reasons, we have converted the amount of US$4,232,000 to $4,274,320 in Canadian currency based on the Bank of Canada's exchange rate of $1.01 on June 25, 2008, the last date of the material time in the Merits Decision.

[83] Commissions obtained by the Salesperson Respondents were paid from accounts controlled by or for the benefit of Tsatskin and are directly related to their non-compliance with sections 25 and 53 of the Act. Specifically, as accepted by the merits panel, Groberman received $91,509, Bajovski received $64,343, Cohen received $45,736 and Shiff received $10,532 for unregistered sales of New Gold securities (Merits Decision, *supra* at para. 172). Given the reasonably ascertainable value of funds obtained by Salesperson Respondents, we find that they shall individually disgorge the amounts obtained as commissions from sales of New Gold securities, which total $212,120. We also find that Tsatskin, through whom the funds flowed, and Global Energy shall be jointly and severally liable for the $212,120 obtained by the Salesperson Respondents as a result of non-compliance with the Act.

[84] Of the $4,274,320 transferred to accounts controlled by or for the benefit of Tsatskin, Harper received $233,694 (Merits Decision, *supra* at para. 170). Harper also received a further US$396,120 of investor funds directly from the American Oil and Gas accounts, which was transferred to accounts controlled by Harper (Merits Decision, *supra* at para. 187). We have converted the amount of US$396,120 to $400,081 in Canadian currency based on same methodology used above at paragraph 82. We find that Harper shall be liable for the $400,081 and $233,694 obtained by her, as a directing mind of Global Energy and as a result of her non-compliance with the Act. We also find that Tsatskin, through whom the funds flowed, and Global Energy shall be jointly and severally liable for the $233,694 obtained by Harper as a result of non-compliance with the Act.

[85] We find that Tsatskin and Global Energy shall be jointly and severally liable for the $2,484,748 obtained by Tsatskin, as a directing mind of Global Energy, as a result of non-compliance with the Act. We arrived at the $2,484,748 disgorgement value by reducing the amount of $4,274,320 that was transferred to accounts controlled by or for the benefit of Tsatskin less: (i) $212,120, the total of amounts ordered to be disgorged by the Salesperson Respondents, jointly and severally with Tsatskin and Global Energy; (ii) $1,343,758, the total of amounts ordered to be disgorged by the Settling Respondents, to be jointly and severally disgorged with Tsatskin and Global Energy; and (iii) $233,694 that Tsatskin transferred to Harper and ordered to be disgorged by her jointly and severally with Tsatskin and Global Energy. To be consistent, Tsatskin and Global Energy shall be jointly and severally liable for the disgorgement amounts ordered against the Settling Respondents as well, as cited in paragraph 55 above. While both Tsatskin and Harper were controlling minds of Global Energy, we find that Tsatskin had more overall control of the funds and therefore he should be held accountable together with Global Energy for the funds obtained from investors which flowed to the other Individual Respondents.

[86] We agree that Staff has the onus of proving the amounts obtained by the Respondents as a result of non-compliance, and that once proven the risk in calculating disgorgement falls on the wrongdoer whose non-compliance with the Act caused an uncertainty (*Limelight Sanctions*, *supra* at para. 53). We did not have conclusive evidence on amounts that may have been returned to investors, whether these amounts came from the funds received by the Respondents and are uncertain whether amounts may be ordered in other proceedings. Therefore, no further deductions were made in those respects.

[87] In summary, we conclude that Harper shall disgorge $400,081. Further, Harper and Tsatskin and Global Energy shall be jointly and severally liable for the $233,694, transferred by Tsatskin to Harper. Finally, Global Energy and Tsatskin shall be jointly and severally liable for the $2,484,748 obtained as a result of non-compliance with the Act. A total of $212,120 shall be ordered to be disgorged by the Salesperson Respondents, jointly and severally with Tsatskin and Global Energy. Tsatskin and Global Energy shall be jointly and severally liable for the disgorgement amounts ordered against the Settling Respondents.

[88] Recognizing that Tsatskin and Harper were found to be directing minds of Global Energy, and committed the very serious offense of fraud, we will now turn our attention to the administrative penalties for each.

E. Administrative Penalties

[89] We find that orders for administrative penalties against Tsatskin and Harper in the amount of $1 million each are appropriate in the circumstances because they committed multiple and repeated violations of the Act, including fraud, which caused serious harm to investors of the Global Energy investment scheme. Such conduct requires a clear deterrent message.

[90] We are not persuaded by Staff's submission that the Salesperson Respondents should be ordered to pay administrative penalties that amount to double the amounts disgorged. While the Salesperson Respondents violated several key provisions of the Act, we consider an administrative penalty that mirrors the amount to be disgorged is more appropriately linked to their misconduct in these circumstances. Furthermore, this treatment of the Salesperson Respondents delivers consistent and proportionate deterrence.

[91] Under the circumstances, we find that it would be appropriate to order Groberman to pay $91,509, Bajovski to pay $64,343, Cohen to pay $45,736 and Shiff to pay $10,532 as administrative penalties for each respondent's failure to comply with Ontario securities law.

VIII. COSTS

[92] Pursuant to subsections 127.1(1) and 127.1(2) of the Act, the Commission has discretion to order a person or company to pay the costs of an investigation and hearing if the Commission is satisfied that the person or company has not complied with the Act or has not acted in the public interest. Rule 18.2 of the OSC *Rules of Procedure* (2012), 35 O.S.C.B. 10071 (the "***Rules of Procedure***") sets out a number of factors a panel may consider in exercising its discretion to order costs.

[93] We consider the costs of $86,942 sought by Staff to be reasonable and conservative. These total costs include the time of two Staff litigators and one investigator from December 1, 2011 to April 17, 2012. Staff does not seek any costs related to the investigation, time sent preparing or attending the sanctions hearing or disbursements for the Merits Hearing or Sanctions and Costs Hearing. Further, costs are requested as incurred from the point that the Settling Respondents were no longer a part of the proceeding, and after which amounts incurred were attributable to the hearing against the Respondents.

[94] In support of this request, Staff provided written submissions, an affidavit of Laura Fisher, sworn March 6, 2013, supported by a summary statement of hours and fees and a weekly docket summary, as required by Rule 18.1(2)(b) of the *Rules of Procedure*. The weekly docket summary timesheet provided dates, numbers of hours worked and details of the tasks performed by each of the Staff members listed. We reject the submissions of counsel for Groberman that the supporting documents lacked clarity. We are satisfied that the evidence supports an adequate reflection of costs as a whole. Further, we accept Staff's submission that Groberman did not settle or agree to facts, which could have expedited the Merits Hearing. Groberman contributed no more than any of the other Salesperson Respondents to the efficiency of the hearing.

[95] We reject Staff's submissions that Harper's conduct throughout the proceedings should result in her paying a higher amount relative to Tsatskin. However, we find that Tsatskin's admissions for the purpose of the criminal proceeding in his "Statement of Facts for Guilty Plea" made the Merits Hearing more efficient and therefore reduced costs for Tsatskin reflect that fact.

[96] We agree that Staff's estimate of costs is reasonable in the circumstances and that allocation was appropriate. We find that it would be appropriate to order Tsatskin to pay $30,430, Harper to pay $43,472 and each of the Salesperson Respondents to pay $3,260 for hearing costs incurred by the Commission.

IX. CONCLUSION

[97] We consider that it is important in this case to impose sanctions that reflect the seriousness of the securities law violations that occurred in this matter and that will deter the Respondents and like-minded individuals from engaging in future conduct that violates securities law. Accordingly, we make the following orders:

1. With respect to Global Energy, Tsatskin, Harper and New Gold:

   (a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any New Gold securities cease permanently;

   (b) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Global Energy, Tsatskin and Harper cease permanently;

   (c) pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Global Energy, Tsatskin and Harper cease permanently;

   (d) pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law not apply to Global Energy, Tsatskin and Harper permanently;

   (e) pursuant to clause 7 of subsection 127(1) of the Act, Tsatskin and Harper shall resign all positions as director or officer of an issuer;

(f) pursuant to clauses 8, 8.2 and 8.4 of subsection 127(1) of the Act, Tsatskin and Harper shall be prohibited permanently from becoming or acting as officer or director of an issuer, registrant or investment fund manager;

(g) pursuant to clause 8.5 of subsection 127(1) of the Act, Tsatskin and Harper shall be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

(h) pursuant to subsection 37(1) of the Act, Tsatskin and Harper shall be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(i) pursuant to clause 9 of subsection 127(1) of the Act, Tsatskin and Harper shall each pay $1,000,000 as administrative penalties for their failure to comply with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(j) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable to disgorge to the Commission the amount of $2,484,748 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(k) pursuant to clause 10 of subsection 127(1) of the Act, Harper, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission the amount of $233,694 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(l) pursuant to clause 10 of subsection 127(1) of the Act, Harper shall disgorge to the Commission the amount of $400,081 obtained as a result of her non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(m) pursuant to clause 10 of subsection 127(1) of the Act, Bajovski, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $64,343 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(n) pursuant to clause 10 of subsection 127(1) of the Act, Cohen, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $45,736 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(o) pursuant to clause 10 of subsection 127(1) of the Act, Groberman, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $91,509 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(p) pursuant to clause 10 of subsection 127(1) of the Act, Shiff, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $10,532 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(q) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Robinson to disgorge to the Commission $22,000 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(r) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Brikman to disgorge to the Commission $82,748 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(s) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Pasternak to disgorge to the Commission $171,856 obtained as a result of

Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(t) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Walker to disgorge to the Commission $82,521 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(u) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Schaumer to disgorge to the Commission $640,000 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(v) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Silverstein to disgorge to the Commission $114,186 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(w) pursuant to clause 10 of subsection 127(1) of the Act, Global Energy and Tsatskin shall be jointly and severally liable with Feder to disgorge to the Commission $230,447 obtained as a result of Global Energy and Tsatskin's non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act; and

(x) pursuant to section 127.1 of the Act, Tsatskin shall pay $30,430 and Harper shall pay $43,472 for hearing costs incurred by the Commission;

2. With respect to Bajovski and Cohen:

(a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Bajovski and Cohen cease for a period of 10 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade securities in a personal account in which he has sole legal and beneficial ownership, provided that:

(i) the securities traded are listed and posted for trading on an exchange recognized by the Commission or registered by the SEC or are issued by a mutual fund which is a reporting issuer;

(ii) he does not own legally or beneficially more than one percent of the outstanding securities of the class or series of the class in question; and

(iii) he carries out any permitted trading through a registered dealer (who has been given a copy of this Order) and in accounts opened in his name only, and he must close any accounts that are not in his name only;

(b) pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Bajovski and Cohen cease for a period of 10 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(c) pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law not apply to Bajovski and Cohen for a period of 10 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade and acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(d) pursuant to clause 7 of subsection 127(1) of the Act, Bajovski and Cohen shall resign all positions as director or officer of any issuer;

(e) pursuant to clause 8 of subsection 127(1) of the Act, Bajovski and Cohen shall be prohibited for a period of 10 years from becoming or acting as officer or director of a reporting issuer or any issuer that engages in a distribution to the public;

(f) pursuant to clauses 8.2 and 8.4 of subsection 127(1) of the Act, Bajovski and Cohen shall be prohibited permanently from becoming or acting as officer or director of a registrant or investment fund manager;

(g) pursuant to clause 8.5 of subsection 127(1) of the Act, Bajovski and Cohen shall be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

(h) pursuant to subsection 37(1) of the Act, Bajovski and Cohen shall be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(i) pursuant to clause 9 of subsection 127(1) of the Act, Bajovski shall pay $64,343 and Cohen shall pay $45,736 as administrative penalties for their failure to comply with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(j) pursuant to clause 10 of subsection 127(1) of the Act, Bajovski, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $64,343 and Cohen, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $45,736 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act, as determined at paragraphs 1(m) and 1(n) above; and

(k) pursuant to section 127.1 of the Act, Bajovski and Cohen shall each pay $3,260 for hearing costs incurred by the Commission;

3. With respect to Groberman and Shiff:

(a) pursuant to clause 2 of subsection 127(1) of the Act, that trading in any securities by Groberman and Shiff cease for a period of 5 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade securities in a personal account in which he has sole legal and beneficial ownership, provided that:

(i) the securities traded are listed and posted for trading on an exchange recognized by the Commission or registered by the SEC or are issued by a mutual fund which is a reporting issuer;

(ii) he does not own legally or beneficially more than one percent of the outstanding securities of the class or series of the class in question; and

(iii) he carries out any permitted trading through a registered dealer (who has been given a copy of this Order) and in accounts opened in his name only, and he must close any accounts that are not in his name only;

(b) pursuant to clause 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Groberman and Shiff cease for a period of 5 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(c) pursuant to clause 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law not apply to Groberman and Shiff for a period of 5 years with the exception that, upon full payment of the administrative penalty and disgorgement orders imposed against them, each shall be permitted to trade and acquire securities in accordance with the terms specified in paragraphs (a)(i)-(iii) above;

(d) pursuant to clause 7 of subsection 127(1) of the Act, Groberman and Shiff, shall resign all positions as director or officer of a reporting issuer or any issuer that engages in a distribution to the public;

(e) pursuant to clause 8 of subsection 127(1) of the Act, Groberman and Shiff shall be prohibited for a period of 5 years from becoming or acting as officer or director of a reporting issuer or any issuer that engages in a distribution to the public;

(f) pursuant to clauses 8.2 and 8.4 of subsection 127(1) of the Act, Groberman and Shiff shall be prohibited permanently from becoming or acting as officer or director of a registrant or investment fund manager;

(g) pursuant to clause 8.5 of subsection 127(1) of the Act, Groberman and Shiff shall be prohibited permanently from becoming or acting as a registrant, investment fund manager or as a promoter;

(h) pursuant to subsection 37(1) of the Act, Groberman and Shiff shall be prohibited permanently from telephoning from within Ontario to a residence within or outside of Ontario for the purpose of trading in any security or any class of securities;

(i) pursuant to clause 9 of subsection 127(1) of the Act, Groberman shall pay $91,509 and Shiff shall pay $10,532 as administrative penalties for their failure to comply with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act;

(j) pursuant to clause 10 of subsection 127(1) of the Act, Groberman, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $91,509 and Shiff, Global Energy and Tsatskin shall jointly and severally disgorge to the Commission $10,532 obtained as a result of their non-compliance with Ontario securities law, to be designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b) of the Act as determined at paragraphs 1(o) and 1(p) above; and

(k) pursuant to section 127.1 of the Act, Groberman and Shiff shall each pay $3,260 for hearing costs incurred by the Commission.

[98] We will issue a separate order giving effect to our decision on sanctions and costs.

Dated this 13th day of December, 2013.

“Paulette L. Kennedy”

”Judith N. Robertson”

Chapter 4

Cease Trading Orders

4.1.1 Temporary, Permanent & Rescinding Issuer Cease Trading Orders

Company Name	Date of Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/Revoke
BioExx Specialty Proteins Ltd.	26 Nov 13	09 Dec 13	09 Dec 13	10 Dec 13
Mirabela Nickel Limited	02 Dec 13	13 Dec 13	13 Dec 13	
Platmin Limited	09 Dec 13	20 Dec 13		23 Dec 13

4.2.1 Temporary, Permanent & Rescinding Management Cease Trading Orders

Company Name	Date of Order or Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/ Expire	Date of Issuer Temporary Order

THERE ARE NO ITEMS FOR THIS WEEK.

4.2.2 Outstanding Management & Insider Cease Trading Orders

Company Name	Date of Order or Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/ Expire	Date of Issuer Temporary Order
Stans Energy Corp.	09 Dec 13	20 Dec 13			
Strike Minerals Inc.	19 Sept 13	01 Oct 13	01 Oct 13		
*Strike Minerals Inc.	18 Nov 13	29 Nov 13	29 Nov 13		

***NEW RESPONDENT WAS ADDED TO THE MCTO AGAINST STRIKE MINERALS INC.**

This page intentionally left blank

Chapter 5

Rules and Policies

5.1.1 Amendments to NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations – Dispute Resolution Services

CSA Notice of Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

Dispute Resolution Services

December 19, 2013

Introduction

The Canadian Securities Administrators (the CSA or we) are implementing amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103 or the Rule) as well as Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (31-103CP or the Companion Policy) relating to the provision of dispute resolution services to clients of all registered dealers and registered advisers (collectively, the Amendments). We refer to the Rule and Companion Policy as the "Instrument".

The Amendments have been or are expected to be adopted by each member of the CSA.

In Québec, the Autorité des marchés financiers (the AMF) already provides a mediation service to clients of all registered dealers and registered advisers (the Québec regime). Although Québec is participating in the making of the Amendments, the Québec regime will remain unchanged. Québec is not expressing any views on the dispute resolution regime which applies in other CSA jurisdictions. In this Notice, all references to outcomes sought by the CSA, or responses to comments, concerning the 2012 Proposal (defined below), are made by CSA members excluding Québec.

In some jurisdictions, ministerial approvals are required for the implementation of the Amendments. Subject to obtaining all necessary approvals, the Amendments will come into force on **May 1, 2014**.

The text of the Amendments to the Rule is in Annex C to this Notice. A black-lined extract of the Companion Policy, incorporating the Amendments is in Annex D to this Notice. The Amendments are available on websites of CSA jurisdictions, including the following:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
www.gov.ns.ca/nssc
www.nbsc-fcnb.ca
www.osc.gov.on.ca
www.fcaa.gov.sk.ca

Purpose

The CSA consider effective dispute resolution or mediation through an independent service provider to be an important component of a well functioning investor protection framework. Our purpose in making the Amendments is to ensure the independence of dispute resolution and mediation services, and consistency in expectations and outcomes for those services, while also setting reasonable limits on the complaints that will be eligible to be considered by an independent service paid for by a registered dealer or adviser.

Complaints considered by a common dispute resolution service will be handled to a uniform standard. It will also be clear to investors whom they should contact when complaints are not resolved at the registrant level. There should be no perception that competition for business from registered firms might influence the recommendations of the common service provider.

We believe that designating the Ombudsman for Banking Services and Investments (OBSI) as the common service provider for these purposes will be in the best interests of both investors and registrants. OBSI is independent, not-for-profit and has extensive experience, having served SRO members and other registrants for more than 10 years.

Substance

Section 13.16 [*dispute resolution service*] of NI 31-103 requires a registered dealer or registered adviser to ensure that an independent dispute resolution or mediation service is made available at the firm's expense to any of its clients that has a complaint about any trading or advising activity of the firm or one of its representatives. The Amendments provide that, outside Québec, a firm must take reasonable steps to ensure that OBSI will be the independent dispute resolution and mediation service that is made available to a client that has an eligible complaint. The eligibility of a complaint is determined by reference to specified deadlines. A client must agree to a specified limit on the amount that will be claimed for the purpose of the independent service's consideration of an eligible complaint.

The reasonable steps we expect a firm to take include maintaining ongoing membership in OBSI as a "Participating Firm" and, with respect to each complaint, participating in the dispute resolution process in a manner consistent with the firm's obligation to deal fairly, honestly and in good faith with its client. A registered firm should not make an alternative independent dispute resolution or mediation service available to a client at the same time as it makes OBSI available. Such a parallel offering would not be consistent with the requirement to take reasonable steps to ensure that OBSI will be *the* independent service offered to the client. It is our expectation that alternative service providers will only be used in exceptional circumstances.

The Amendments to the Rule also include requirements for communicating with clients about the dispute resolution or mediation services that are available to them. The Amendments provide that section 13.16 does not apply in respect of a permitted client that is not an individual.

The Amendments to the Companion Policy provide guidance on the application of the amended Rule requirements.

The Amendments do not restrict a client's ability to take a complaint to a dispute resolution service of their own choosing at their own expense, or to bring an action in court.

Investment fund managers are only subject to the Amendments if they also operate under a dealer or adviser registration, in which case the Amendments apply in respect of the activities conducted under their dealer or adviser registration.

Background

The Amendments have been approved further to a proposal (the 2012 Proposal) which was published for comment on November 15, 2012 (see below regarding the public comments).

The CSA have created a framework intended to ensure that OBSI will have the capacity to effectively discharge its mandate under the Amendments. A Memorandum of Understanding (the MOU) provides an oversight framework for the participating CSA members and OBSI to cooperate and communicate constructively. The purpose of the oversight framework is to ensure that OBSI continues to meet the standards set by the participating CSA members with respect to the following matters:

- governance
- independence and standard of fairness
- processes to perform functions on a timely and fair basis
- fees and costs

- resources
- accessibility
- systems and controls
- core methodologies for dispute resolution
- transparency in respect of material changes to OBSI's operations or services, including material changes to its terms of reference or by-laws
- information sharing with the CSA

The MOU includes provision for an independent evaluation of OBSI's operations and practices within two years of the Amendments coming into force. The MOU will replace the oversight framework contemplated in the Joint Forum of Financial Market Regulators' *The Financial Services OmbudsNetwork – A Framework for Collaboration*, which was endorsed and adopted by the CSA in August 2007.

The MOU is not intended to be used to share information that relates to individual complaints made to OBSI, including the identity of any complainant, registered firm or registered individual against whom a complaint has been made.

The MOU provides that OBSI should have a fair, transparent and appropriate process for setting fees and allocating costs across its membership. The CSA intend to review OBSI's model for setting fees for its Participating Firms after OBSI has developed some practical experience with its expanded mandate under the Amendments. We intend to ensure that fees are set fairly across categories of registered dealer and registered adviser.

The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) (together referred to as the self-regulatory organizations or SROs) already mandate the use of OBSI as the dispute resolution service provider for their member firms. SRO members will continue to be subject to their SRO's rules concerning complaint handling after the Amendments come into effect.

The CSA jurisdictions and OBSI have agreed with the SROs to form the OBSI Joint Regulators Committee (JRC) to

- facilitate a holistic approach to information sharing and monitoring of the dispute resolution process with an overall view to promoting investor protection and confidence in the external dispute resolution system
- support fairness, accessibility and effectiveness of the dispute resolution process
- facilitate regular communication and consultation among the regulators and OBSI

The Québec regime, which is unaffected by the Amendments, is set out in sections 168.1.1 to 168.1.3 of the *Securities Act* (Québec) and in sections 74 and 75 of the *Derivatives Act* (Québec). Under that regime, all registered dealers and registered advisers must first provide equitable resolution of complaints filed and establish a policy dealing with the examination of complaints and claims and the resolution of disputes. Registered dealers and registered advisers must also inform complainants in writing that if they are dissatisfied with the complaint examination procedure or its outcome, they may require that a copy of their file be forwarded to the AMF. The AMF examines the forwarded complainants' files and may, if it considers it appropriate, act as a mediator if the parties agree.

Information about OBSI is available at www.obsi.ca.

Summary of Written Comments Received by the CSA on the 2012 Proposal

We received submissions on the 2012 Proposal from 24 commenters. We have considered the comments received and thank all of the commenters for their input. A summary of the comments together with our responses and a list of the commenters is contained in Annex B to this Notice.

Copies of the comment letters are posted on the following websites:

www.lautorite.qc.ca
www.osc.gov.on.ca

Summary of Changes to the Instrument

After considering the comments, we have made some changes to certain of the proposed amendments which were in the 2012 Proposal. As these changes are not material, we are not republishing the Amendments for a further comment period. A description of the key changes we made to the Instrument and the 2012 Proposal is contained in Annex A of this Notice.

Transition

The amending instrument provides for a transition period of 3 months after the Amendments come into effect. If they come into effect as anticipated on May 1, 2014 the transition period will end on August 1, 2014. We believe the total of more than 7 months from the publication of this Notice to that date is adequate time for registered dealers and registered advisers outside of Québec, that are not already Participating Firms of OBSI, to become so in order that they can comply with the Amendments.

In contemplation of the 2012 Proposal, on July 5, 2012 CSA jurisdictions published parallel orders extending temporary relief from the application of section 13.16 for firms that were registered on September 28, 2009, the date when NI 31-103 came into effect, until the earlier of (i) the coming into force of amendments to section 13.16 and (ii) September 28, 2014. The temporary relief under the orders will therefore expire on May 1, 2014 if the Amendments come into force on that day. The transition provisions in the amending instrument preserve the temporary relief until August 1, 2014. The temporary relief does not apply in Québec by reason of the existing regime in that jurisdiction.

Local Matters

Certain jurisdictions are publishing other information required by local securities legislation. In Ontario, this information is contained in Annex E of this Notice.

Annexes

A. Summary of Changes to the Instrument

B. Summary of Comments on the 2012 Proposal and CSA Responses

C. Amending Instrument to NI 31-103

D. Amendments to the Companion Policy

E. Local matters, where applicable

Questions

Please refer your questions to any of the following:

Christopher Jepson
Senior Legal Counsel
Compliance and Registrant Regulation
Ontario Securities Commission
Tel: 416-593-2379
cjepson@osc.gov.on.ca

Chris Besko
Deputy Director, Legal Counsel
The Manitoba Securities Commission
Tel: 204-945-2561
Toll Free (Manitoba only) 1-800-655-5244
chris.besko@gov.mb.ca

Gérard Chagnon
Analyste expert en réglementation
Direction des pratiques de distribution et des OAR
Autorité des marchés financiers
418-525-0337, ext 4815 and
1-877-525-0337 (Toll-free)
gerard.chagnon@lautorite.qc.ca

Brian W. Murphy
Deputy Director, Capital Markets
Nova Scotia Securities Commission
Tel: 902-424-4592
murphybw@gov.ns.ca

Lindy Bremner
Senior Legal Counsel, Capital Markets Regulation
British Columbia Securities Commission
Tel: 604-899-6678
Fax: 1-800-801-0607
lbremner@bcsc.bc.ca

Jason Alcorn
Legal Counsel, Securities
Financial and Consumer Services Commission (NB)
Tel: 506-643-7857
jason.alcorn@fcnb.ca

Navdeep Gill
Manager, Registration
Alberta Securities Commission
Tel: 403-355-9043
navdeep.gill@asc.ca

Liz Kutarna
Deputy Director, Capital Markets
Financial and Consumer Affairs Authority of Saskatchewan
Tel: 306-787-5871
liz.kutarna@gov.sk.ca

Louis Arki
Director, Legal Registries
Department of Justice, Government of Nunavut
Tel: 867-975-6587
larki@gov.nu.ca

Rhonda Horte
Deputy Superintendent
Office of the Yukon Superintendent
of Securities
867-667-5466
rhonda.horte@gov.yk.ca

Katharine Tummon
Superintendent of Securities
Prince Edward Island Securities Office
Tel: 902-368-4542
kptummon@gov.pe.ca

Craig Whalen
Manager of Licensing, Registration and Compliance
Office of the Superintendent of Securities,
Newfoundland and Labrador
Tel: 709-729-5661
cwhalen@gov.nl.ca

Donn MacDougall
Deputy Superintendent, Legal & Enforcement
Office of the Superintendent of Securities
Government of the Northwest Territories
Tel: 867-920-8984
Donald_macdougall@gov.nt.ca

ANNEX A

Summary of Changes to the Instrument

This Annex describes the key changes we made to the Instrument and the 2012 Proposal.

Section 13.16 of NI 31-103 provides in very general terms that a registered dealer or registered adviser must ensure that independent dispute resolution or mediation services are made available, at the firm's expense, to resolve clients' complaints about trading or advising activity of the firm or its registered representatives.

We are amending section 13.16 to specify which complaints will be eligible for independent dispute resolution or mediation services paid for by a registered dealer or adviser:

- a complaint must be brought within 6 years from the time when the client first knew or reasonably ought to have known of an act or omission that is a cause of the complaint

- a client may refer a complaint to the independent service provider if the firm has not responded with its decision in respect of the complaint within 90 days of receiving the complaint

- a client has up to 180 days after the firm has responded with its decision in which to refer the complaint to the independent service provider

A client must agree that, for the purpose of the independent service's consideration of an eligible complaint, the amount claimed (if any) will be no greater than $350,000. Clients retain the option of pursuing claims for amounts exceeding this limit through other means, such as civil litigation.

The Amendments substantially align the complaints that are eligible for dispute resolution or mediation services paid for by the registered firm under section 13.16 with the complaints that OBSI will consider under its terms of reference. The Amendments specify that, outside of Québec, firms must take reasonable steps to ensure that OBSI will be the independent resolution and mediation service that is made available to a client at the firm's expense.

The Amendments provide that section 13.16 does not apply in respect of a permitted client that is not an individual.

Among other things, the Amendments to the Companion Policy also clarify that:

- We expect that all client complaints will be addressed under a registered firm's internal complaint handling policy under section 13.15 of NI 31-103. Recourse to an independent dispute resolution or mediation service is intended to be provided at a registered firm's expense for specified complaints where the firm's internal complaint handling process has not produced a timely decision that is satisfactory to the client.

- In order to comply with the requirement to take reasonable steps to ensure that OBSI will be the independent dispute resolution and mediation service that is made available to any client with a complaint eligible under section 13.16, we will expect a registered firm to maintain ongoing membership in OBSI as a "Participating Firm" and participate in OBSI's services in a manner consistent with the firm's obligation to deal fairly, honestly and in good faith with its clients.

- A registered firm is only required to make one dispute resolution or mediation service available at its expense for each complaint.

We have made conforming changes to the requirement in paragraph 14.2(2)(j) of NI 31-103 to provide clients with relationship disclosure information about the availability of dispute resolution services.

The Amendments are generally consistent with the 2012 Proposal. A 90 day trigger for escalation of a complaint was added to section 13.16 to align with our stated purpose of creating a common standard for dispute resolution services. This is consistent with requirements for OBSI Participating Firms and SRO members. The $350,000 limit has been changed from a limit on the amount of the claim, to a limit on the amount that may be claimed for the purpose of the independent service's consideration of the complaint. This was done because when a complaint is first brought by a client to a firm's internal complaint handling system, it might include a claim for a higher amount.

ANNEX B

Summary of Comments on the 2012 Proposal and CSA Responses

This Annex summarizes the public comments we received on the 2012 Proposal and our responses to those comments.

In this document, we have consolidated and summarized the comments and our responses by the general theme of the comments. In general, we have not included drafting comments.

Time limit to bring complaint

The 2012 Proposal included a provision that complaints must be brought within 6 years from the time when the client knew or reasonably ought to have known of the trading or advising activity giving rise to the complaint. The notice of publication of the 2012 Proposal asked “Would the time limit on complaints be more appropriate if it was counted from the time when the trading or advising activity that it relates to occurred, rather than from the time when the client knew or reasonably ought to have known of the trading or advising activity?”

Investor advocates supported counting the time limit on raising complaints from the time when the client knew or reasonably ought to have known of the trading or advising activity. There were also proposals for a subjective standard or special provisions for elderly clients.

Industry commenters generally supported counting from the time when the trading or advising activity actually occurred. Some industry commenters advocated for a shorter time limit. This included suggestions that a 6 year period would be objectionable on the basis that it is longer than the 2 year statutory limitation periods in some jurisdictions.

We acknowledge that counting from the time when the activity occurred has the merit of providing greater certainty. However, we have concluded that this advantage is outweighed by the investor protection benefits of counting from the time when the client should have discovered the problem giving rise to the complaint. In many cases, this will be the same as the time when the trading or advising activity that the complaint relates to occurred. In other cases, it may take longer before it would be fair to say that a client should have discovered the problem.

We have revised the drafting of this provision to more closely conform with the drafting used in limitation period statutes, but we do not agree that the time limit for seeking a recommendation from an informal dispute resolution service should be the same as the statutory limitation periods for a civil action in court that leads to an enforceable remedy.

We also do not think that a subjective standard would be workable or fair in all cases. Whether an elderly investor was vulnerable and exploited is a matter for factual determination during the consideration of their complaint and should not be assumed without investigation.

Escalating a complaint to an independent dispute resolution or mediation service

The notice of publication of the 2012 Proposal also included a second issue for comment: “OBSI’s current terms of reference require a complaint to be made to the ombudsman within 180 days of the client’s receipt of notice of the firm’s rejection of their complaint or recommended resolution of the complaint, subject to the ombudsman’s authority to receive and investigate a complaint in other circumstances if the ombudsman considers it fair to do so. Should NI 31-103 include a deadline for clients to bring complaints to it? If so, is 180 days the appropriate period?”

Most commenters were in favour of specifying that a complaint must be made within 180 days of the client’s receipt of notice of the firm’s rejection of their claim or recommended resolution of the complaint. There were some comments for and against the qualification that the 180 day limit could be extended if the ombudservice considers it fair to do so. We believe the 180 day time frame is reasonable and understand that it has worked well in practice for OBSI and SRO member firms. We think that it may sometimes be appropriate for OBSI (or an alternative service provider where OBSI is unwilling to consider an eligible complaint) and the firm and client involved in a complaint to agree to a longer notice period as a matter of fairness. However, we believe it is desirable to provide a specific and unambiguous time limit in the Rule. The same is true with respect to the 90 days that a firm is allowed to inform a client of its decision before the client can escalate the complaint.

General support

There were expressions of general support for mandating OBSI as the common service provider for all registered dealers and advisers. This support came in the letters from investor advocates and some industry associations.

Criticism of OBSI and calls for CSA oversight

Several commenters that are registered firms or industry associations expressed a lack of confidence in OBSI. Some investor advocates, while supporting the proposal to mandate OBSI in the Rule, expressed concerns about the timeliness of its process for making recommendations. Linked to these comments were calls for the CSA to exercise oversight of OBSI.

As stated in the notice of publication of the 2012 Proposal, we believe OBSI is the appropriate choice to be the common dispute resolution service provider for all registered dealers and registered advisers. OBSI is independent and not-for-profit. It has extensive experience, having served in that capacity for SRO members and other registrants for the past 10 years. During that time it has resolved thousands of complaints from investors. OBSI has adhered to standards established by the Joint Forum of Financial Market Regulators. Under that oversight framework, OBSI has been subject to independent third party evaluations on a regular basis, the most recent of which was conducted in 2011. OBSI was found to substantially meet the Joint Forum's standards. OBSI has established an effective system to respond to investors with a call centre and infrastructure to respond to public enquiries in over 170 languages. It also has the ability to redirect callers to the appropriate organization if a matter is outside its mandate.

This notice discusses the CSA oversight regime that will be implemented with the MOU, and also discusses the introduction of the JRC which will also play an important role in ensuring OBSI's effectiveness. We have considered OBSI's capacity both to resolve its backlog of unresolved cases and to assume its expanded mandate under the Amendments and will monitor its performance going forward.

We also note that OBSI has implemented corporate governance changes and amended its terms of reference since the publication of the 2012 Proposal. We support these changes.

OBSI fees

Industry commenters expressed concerns that OBSI's fees for non-SRO dealers and advisers that would be required to become Participating Firms under the 2012 proposal had not been made public at the time it was published for comment. These concerns focused on the possibility that fees might be excessive, and that firms in a category of registrant which might place few demands on OBSI's services might subsidize firms in categories of registrant that make relatively greater use of OBSI.

OBSI has finalized its fee model for non-SRO members after consulting with the CSA jurisdictions outside of Québec. The existing fee models for SRO members will remain in place. This notice refers to the MOU provision that OBSI should have a fair, transparent and appropriate process for setting fees and allocating costs across its membership, and notes that OBSI's model for setting fees for its Participating Firms will be reviewed after OBSI has developed some practical experience with its expanded mandate under the Amendments. We have stated our intention to ensure that fees are set fairly across categories of registered dealer and registered adviser.

Recommendations should be replaced with binding decisions

Some investor advocates took the position that OBSI's current 'name and shame' sanction is not sufficient and that the recommendations contemplated in the proposed amendments should become binding decisions. On the other side there were industry comments that 'name and shame' is too powerful a sanction, in that firms might agree to recommendations simply to avoid it.

Implementing the Amendments and ongoing CSA oversight of OBSI will put us in a better position to assess over time whether its recommendations should be made binding.

Not appropriate for PMs and EMDs; alternative service providers

Portfolio managers (PMs) and exempt market dealers (EMDs) took the position that mandating OBSI is not appropriate for their client base. Among other things, they say that

- they have relatively small numbers of clients who are generally of higher net worth and sophistication, so firms will seek to resolve their complaints without the need to turn to a third party service provider

- in the few cases where dispute resolution is required, their clients are of a kind that prefers to be able to choose service providers, and they do not need protection in the form of a choice prescribed by regulators

- OBSI lacks expertise in regard to managed accounts and the exempt market

We do not think that OBSI lacks the expertise to consider complaints relating to managed accounts or exempt market investments. OBSI has experience of managed accounts because some IIROC member firms provide discretionary trading

services. It has experience with the exempt market because all IIROC member firms are authorized to trade in exempt market securities and many MFDA members are registered as EMDs, as well as being mutual fund dealers. We also note that the Amendments provide that section 13.16 does not apply in respect of a permitted client that is not an individual.

$350,000 limit

Some commenters suggested that the $350,000 limit should be raised or eliminated. We have changed the limit so that it applies only to the amount that can be recommended, recognizing that a complaint might begin as a claim for a larger amount. However, we do not think it is necessary to change the amount at this time. OBSI's experience is that the large majority of recommendations are for amounts well below $350,000. We believe that if a client wishes to seek an award larger than $350,000 in a complaint that is escalated from the firm's internal complaint handling process, that complaint would be more appropriately handled by another forum, such as the courts or arbitration agreed to by the parties. Again, implementing the Amendments and ongoing CSA oversight of OBSI will put us in a better position to assess whether a change to the limit may be appropriate in the future.

OBSI corporate governance and terms of reference

We received comments recommending changes to OBSI's corporate governance or terms of reference.

OBSI remains an independent agency and the oversight model adopted by the CSA jurisdictions outside of Québec does not contemplate a role for us that would extend to determining the structure of OBSI's board of directors. As noted above, since the publication of the 2012 Proposal, OBSI has implemented corporate governance changes which we support.

With respect to OBSI's terms of reference, we observe that OBSI has a separate process to receive public comments on the content of its terms of reference. Also, the MOU contemplates that OBSI will at an early stage

- consult with designated CSA jurisdictions on issues that might have significant implications for the dispute resolution system and for OSBI's members
- share with designated CSA jurisdictions any draft documents that are proposed to be published for stakeholder feedback, including any proposed changes to its terms of reference.

List of commenters

We received submissions from the following 24 commenters:

1. Advocis
2. Alternative Investment Management Association
3. Association of Canadian Compliance Professionals
4. Borden Ladner Gervais LLP
5. Brandes Investment Partners & Co.
6. Canadian Foundation for Advancement of Investor Rights
7. CI Financial Corp.
8. Exempt Market Dealers Association of Canada
9. Fidelity Investments Canada ULC
10. Invesco Canada Ltd.
11. Investment Industry Association of Canada
12. Kenmar Associates
13. National Exempt Market Association
14. Portfolio Management Association of Canada
15. RBC Dominion Securities Inc., RBC Direct Investing Inc., Royal Mutual Funds Inc., RBC Global Asset Management, Phillips Hager & North Investment Funds Ltd. and RBC PH&N Investment
16. RESP Dealers Association of Canada
17. Robertson-Devir
18. Scotia Asset Management L.P.
19. Small Investor Protection Association
20. Stikeman Elliott LLP
21. The Canadian Advocacy Council for Canadian CFA Institute Societies
22. The Investment Funds Institute of Canada
23. The Investor Advisory Panel
24. Walton Capital Management Inc.

ANNEX C

AMENDMENTS TO NATIONAL INSTRUMENT 31-103 *REGISTRATION REQUIREMENTS, EXEMPTIONS AND ONGOING REGISTRANT OBLIGATIONS*

1. ***National Instrument 31-103*** **Registration Requirements, Exemptions and Ongoing Registrant Obligations** ***is amended by this Instrument.***

2. ***Section 13.16 is replaced with the following:***

13.16 Dispute resolution service

(1) In this section,

"complaint" means a complaint that

(a) relates to trading or advising activity of a registered firm or a representative of the firm, and

(b) is received by the firm within 6 years of the day when the client first knew or reasonably ought to have known of an act or omission that is a cause of or contributed to the complaint;

"OBSI" means the Ombudsman for Banking Services and Investments.

(2) If a registered firm receives a complaint from a client, the firm must, as soon as possible, provide the client with a written acknowledgement of the complaint that includes the following:

(a) a description of the firm's obligations under this section;

(b) the steps that the client must take in order for an independent dispute resolution or mediation service to be made available to the client under subsection (4);

(c) the name of the independent dispute resolution or mediation service that will be made available to the client under subsection (4) and contact information for the service.

(3) If a registered firm decides to reject a complaint or to make an offer to resolve a complaint, the firm must, as soon as possible, provide the client with written notice of the decision and include the information referred to in subsection (2).

(4) A registered firm must as soon as possible ensure that an independent dispute resolution or mediation service is made available to a client at the firm's expense with respect to a complaint if either of the following apply:

(a) after 90 days of the firm's receipt of the complaint, the firm has not given the client written notice of a decision under subsection (3), and the client has notified the independent dispute resolution or mediation service specified under paragraph (2)(c) that the client wishes to have the complaint considered by the service;

(b) within 180 days of the client's receipt of written notice of the firm's decision under subsection (3), the client has notified the independent dispute resolution or mediation service specified under paragraph (2)(c) that the client wishes to have the complaint considered by the service.

(5) Subsection (4) does not apply unless the client agrees that any amount the client will claim for the purpose of the independent dispute resolution or mediation service's consideration of the complaint will be no greater than $350,000.

(6) For the purposes of the requirement to make available an independent dispute resolution or mediation service under subsection (4), a registered firm must take reasonable steps to ensure that OBSI will be the service that is made available to the client.

(7) Subsection (6) does not apply in Québec.

(8) This section does not apply in respect of a complaint made by a permitted client that is not an individual.

3. Paragraph 14.2(2)(j) is replaced with the following:

(j) disclosure of the firm's obligations if a client has a complaint contemplated under section 13.16 [*dispute resolution service*] and the steps that the client must take in order for an independent dispute resolution or mediation service to be made available to the client at the firm's expense;

4. Transition – firms that registered before September 29, 2009

Except in Québec, section 13.16 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, as amended by this instrument, does not apply to a registered dealer or registered adviser if

(a) the dealer or adviser first registered in a jurisdiction of Canada before September 29, 2009, and

(b) the complaint was received by the firm on or before August 1, 2014.

5. Transition – firms that registered between September 28, 2009 and April 30, 2014

Section 13.16 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, as amended by this instrument, does not apply to a registered dealer or registered adviser if

(a) the dealer or adviser first registered in a jurisdiction of Canada during the period commencing on September 28, 2009 and ending on April 30, 2014,

(b) the complaint was received by the firm on or before August 1, 2014, and

(c) the firm complies with section 13.16 of that National Instrument as that provision was in force on April 30, 2014.

6. Coming into force

This Instrument comes into force on May 1, 2014.

ANNEX D

AMENDMENTS TO COMPANION POLICY 31-103 CP
REGISTRATION REQUIREMENTS, EXEMPTIONS AND ONGOING REGISTRANT OBLIGATIONS

The Canadian Securities Administrators are publishing changes to the Companion Policy. These changes come into effect when the corresponding changes to the Rule are implemented.

This Annex shows the amendments to the Companion Policy against the relevant portions of the unofficial consolidation of NI 31-103 published on July 15, 2013.

Division 5 Complaints

13.14 Application of this Division

Investment fund managers are only subject to Division 5 if they also operate under a dealer or adviser registration, in which case the requirements in this Division apply in respect of the activities conducted under their dealer or adviser registration.

~~Registered firms in Québec must comply~~In Québec, a registered firm is deemed to comply with this Division if it complies with sections 168.1.1 to 168.1.3 of the Québec *Securities Act*, which ~~has provided~~provides a substantially similar regime ~~since 2002.~~ for complaint handling.

The guidance in Division 5 of this Companion Policy applies to firms registered in any jurisdiction, including Québec.

However, section 168.1.3 of the Québec *Securities Act*, includes requirements with respect to dispute resolution or mediation services that are different than those set out in section 13.16 of NI 31-103. In Québec, registrants must inform each complainant, in writing and without delay, that if the complainant is dissatisfied with how the complaint is handled or with the outcome, they may request the registrant to forward a copy of the complaint file to the Autorité des marchés financiers. The registrant must forward a copy of the complaint file to the Autorité des marchés financiers, which will examine the complaint. The Autorité des marchés financiers may act as a mediator if it considers it appropriate to do so and the parties agree.

13.15 Handling complaints

General duty to document and respond to complaints

Section 13.15 requires registered firms to document complaints, and to effectively and fairly respond to them. We are of the view that registered firms should document and respond to all complaints received from a client, a former client or a prospective client who has dealt with the registered firm (complainant).

Firms are reminded that they are required to maintain records which demonstrate compliance with complaint handling requirements under paragraph 11.5(2)(m).

Complaint handling policies

An effective complaint system should deal with all formal and informal complaints or disputes in a timely and fair manner. To achieve the objective of handling complaints fairly, the firm's complaint system should include standards allowing for objective factual investigation and analysis of the matters specific to the complaint.

We take the view that registered firms should take a balanced approach to the gathering of facts that objectively considers the interests of

- the complainant
- the registered representative, and
- the firm

Registered firms should not limit their consideration and handling of complaints to those relating to possible violations of securities legislation.

Complaint monitoring

The firm's complaint handling policy should provide for specific procedures for reporting the complaints to superiors, in order to allow the detection of frequent and repetitive complaints made with respect to the same matter which may, on a cumulative basis, indicate a serious problem. Firms should take appropriate measures to deal with such problems as they arise.

Responding to complaints

Types of complaints

All complaints relating to one of the following matters should be responded to by the firm by providing an initial and substantive response, both in writing and within a reasonable time:

- a trading or advising activity
- a breach of client confidentiality
- theft, fraud, misappropriation or forgery
- misrepresentation
- an undisclosed or prohibited conflict of interest, or
- personal financial dealings with a client

Firms may determine that a complaint relating to matters other than the matters listed above is nevertheless of a sufficiently serious nature to be responded to in the manner described below. This determination should be made, in all cases, by considering if an investor, acting reasonably, would expect a written response to their complaint.

When complaints are not made in writing

We would not expect that complaints relating to matters other than those listed above, when made verbally and when not otherwise considered serious based on an investor's reasonable expectation, would need to be responded to in writing. However, we do expect that verbal complaints be given as much attention as written complaints. If a complaint is made verbally and is not clearly expressed, the firm may request the complainant to put the complaint in writing and we expect firms to offer reasonable assistance to do so.

Firms are entitled to expect the complainant to put unclear verbal issues into written format in order to try to resolve confusion about the nature of the issue. If the verbal complaint is clearly frivolous, we do not expect firms to offer assistance to put the complaint in writing. The firm may nonetheless ask the complainant to put the complaint in writing on his or her own.

Timeline for responding to complaints

Firms should

- promptly send an initial written response to a complainant: we consider that an initial response should be provided to the complainant within five business days of receipt of the complaint
- provide a substantive response to all complaints relating to the matters listed under "Types of complaints" above, indicating the firm's decision on the complaint

A firm may also wish to use its initial response to seek clarification or additional information from the client.

Requirements for providing information about the availability of dispute resolution or mediation services paid for by the firm are discussed below.

We encourage firms to resolve complaints relating to the matters listed above within 90 days.

13.16 Dispute resolution service

Section 13.15 requires a registered firm to document and respond to each complaint made to it about any product or service that is offered by the firm or one of its representatives. Section 13.16 provides for recourse to an independent dispute resolution or

mediation service at a registered firm's expense for specified complaints where the firm's internal complaint handling process has not produced a timely decision that is satisfactory to the client.

Registered firms may be required to make an independent dispute resolution or mediation service paid for by the firm available to a client in respect of a complaint that

- relates to a trading or advising activity of the firm or its representatives, and
- is raised within six years of the date when the client knew or reasonably ought to have known of the ~~trading or advising activity~~act or ommission that is a cause of or contributed to the complaint

As soon as possible after a client makes a complaint (for example, when sending its acknowledgment or initial response to the complaint), and again when the firm informs the client of its decision in respect of the complaint, a registered firm must provide a client with information about

- the firm's obligations under section 13.16,
- the steps the client must take for an independent dispute resolution or mediation service to be made available to the client at the firm's expense, and
- the name of the independent service that will be made available to the client (outside of Québec, this will normally be the Ombudsman for Banking Services and Investments (OBSI), as discussed below) and how to contact it

A client may escalate an eligible complaint to the independent dispute resolution or mediation service made available by the registered firm in two circumstances:

- If the firm fails to give the client notice of its decision within 90 days of receiving the complaint (telling the client that the firm plans to take more than 90 days to make its decision does not 'stop the clock'). The client is then entitled to escalate the complaint to the independent service immediately or at any later date until the firm has notified the client of its decision.
- If the firm has given the client notice of its decision about the complaint (whether it does so within 90 days or after a longer period) and the client is not satisfied with the decision, the client then has 180 days in which escalate the complaint to the independent service.

In either instance, the client may escalate the complaint by directly contacting the independent service.

We think that it may sometimes be appropriate for the independent service, the firm and the client involved in a complaint to agree to longer notice periods than the prescribed 90 and 180 day periods as a matter of fairness. We recognize that where a client does not cooperate with reasonable requests for information relating to a complaint, a firm may have difficulty making a timely decision in respect of the complaint. We expect that this would be relevant to any subsequent determination or recommendation made by an independent service about that complaint.

The client must agree that the amount of any recommendation by the independent service for monetary compensation will not exceed $350,000. This limit applies only to the amount that can be recommended. Until it is escalated to the independent service, a complaint made to a registered firm may include a claim for a larger amount.

Except in Québec, a registered firm must take reasonable steps to ensure that the dispute resolution and mediation service that is made available to its clients for these purposes will be OBSI. The reasonable steps we expect a firm to take include maintaining ongoing membership in OBSI as a "Participating Firm" and, with respect to each complaint, participating in the dispute resolution process in a manner consistent with the firm's obligation to deal fairly, honestly and in good faith with its client. This would include entering into consent agreements with clients contemplated under OBSI's procedures.

Since section 13.16 does not apply in respect of a complaint made by a permitted client that is not an individual, we would not expect a firm that only has clients of that kind to maintain membership in OBSI.

A registered firm should not make an alternative independent dispute resolution or mediation service available to a client at the same time as it makes OBSI available. Such a parallel offering would not be consistent with the requirement to take reasonable steps to ensure that OBSI will be *the* independent service that is made available to the client. Except in Québec, we expect that alternative service providers will only be used for purposes of section 13.16 in exceptional circumstances.

We would regard it as a serious compliance issue if a firm misrepresented OBSI's services or exerted pressure on a client to refuse OBSI's services.

If a client declines to make use of OBSI in respect of a complaint, or if a client abandons a complaint that is under consideration by OBSI, the registered firm is not obligated to provide another service at the firm's expense. A firm is only required to make one dispute resolution or mediation service available at its expense for each complaint.

Nothing in section 13.16 affects a client's right to choose to seek other recourse, including through the courts.

Registrants that are members of an SRO, including those that are registered in Québec, must also comply with their SRO's requirements with respect to the provision of independent dispute resolution or mediation services.

~~A registered firm must ensure that the complainant is aware of the dispute resolution or mediation services that are available to them and that the firm will pay for the services. Registered firms should know all applicable mechanisms and processes for dealing with different types of complaints, including those prescribed by the applicable SRO.~~

~~In Québec, registrants must inform each complainant, in writing and without delay, that if the complainant is dissatisfied with how the complaint is handled or with the outcome, they may request the registrant to forward a copy of the complaint file to the Autorité des marchés financiers. The registrant must forward a copy of the complaint file to the Autorité des marchés financiers, which will examine the complaint. The Autorité des marchés financiers may act as a mediator if it considers it appropriate to do so and the parties agree.~~

Registrants who do business in other sectors

Some registrants are also registered or licensed to do business in other sectors, such as insurance. These registrants should inform their clients of the complaint mechanisms for each sector in which they do business and how to use them.

ANNEX E

LOCAL MATTERS

Notice of Commission Approval

On December 3, 2013, the Ontario Securities Commission (the Commission) approved the amending instrument to NI 31-103 (the Amending Instrument) pursuant to section 143 of the *Securities Act* (Ontario) (the Act). Also on that day, the Commission adopted the changes to 31-103CP.

Delivery to the Minister

The Materials were delivered to the Minister of Finance on December 19, 2013. The Minister may approve or reject the Amending Instrument or return it for further consideration. If the Minister approves the Amending Instrument or does not take any further action by February 18, 2014 the Amending Instrument will come into force on May 1, 2014. The changes to 31-103CP will also take effect on May 1, 2014.

5.1.2 Amendments to NI 81-106 Investment Fund Continuous Disclosure

AMENDMENTS TO
NATIONAL INSTRUMENT 81-106 *INVESTMENT FUND CONTINUOUS DISCLOSURE*

Although this amendment instrument amends section headers in National Instrument 81-106, section headers do not form part of the instrument and are inserted for ease of reference only.

1. National Instrument 81-106 Investment Fund Continuous Disclosure is amended by this instrument.

2. Section 1.1 of National Instrument 81-106 is amended by

(a) adding the following after the definition of "EVCC"***:***

"financial statements" includes interim financial reports;***;***

(b) repealing the definition of "net asset value" ***and substituting the following:***

"net asset value" means the value of the total assets of the investment fund less the value of the total liabilities, other than net assets attributable to securityholders, of the investment fund, as at a specific date, determined in accordance with Part 14;***;***

(c) adding the following after the definition of "non-redeemable investment fund"***:***

"publicly accountable enterprise" means a publicly accountable enterprise as defined in the Handbook;***; and***

(d) adding the following after the definition of "scholarship plan"***:***

"statement of changes in financial position" means a statement of changes in equity or a statement of changes in net assets attributable to securityholders;***.***

3. Section 2.1 of National Instrument 81-106 is amended by

(a) striking out "statement of net assets" ***in paragraph (1)(a) wherever it occurs and substituting*** "statement of financial position"***;***

(b) striking out "statement of operations" ***in paragraph (1)(b) wherever it occurs and substituting*** "statement of comprehensive income"***;***

(c) striking out "statement of changes in net assets" ***in paragraph (1)(c) wherever it occurs and substituting*** "statement of changes in financial position"***;***

(d) repealing paragraph (1)(d) and substituting the following:

(d) for financial years beginning on or after January 1, 2014, a statement of cash flows for that financial year and a statement of cash flows for the immediately preceding financial year;***; and***

(e) striking out "; and" ***at the end of paragraph (1)(e) and repealing paragraph (1)(f) and substituting the following:***

(f) a statement of financial position as at the beginning of the immediately preceding financial year if the investment fund discloses in its annual financial statements an unreserved statement of compliance with IFRS and the investment fund:

(i) applies an accounting policy retrospectively in its annual financial statements,

(ii) makes a retrospective restatement of items in its annual financial statements, or

(iii) reclassifies items in its annual financial statements; and

(g) notes to the annual financial statements.

4. Section 2.3 of National Instrument 81-106 is amended by

(a) in the title, striking out “Interim Financial Statements” ***and substituting*** “Interim Financial Report”***;***

(b) striking out “interim financial statements” ***and substituting*** “an interim financial report”***;***

(c) striking out “include” ***and substituting*** “includes”***;***

(d) striking out “statement of net assets” ***in paragraph (a) wherever it occurs and substituting*** “statement of financial position”***;***

(e) striking out “statement of operations” ***in paragraph (b) wherever it occurs and substituting*** “statement of comprehensive income”***;***

(f) striking out “statement of changes in net assets” ***in paragraph (c) wherever it occurs and substituting*** “statement of changes in financial position”***;***

(g) repealing paragraph (d) and substituting the following:

(d) for financial years beginning on or after January 1, 2014, a statement of cash flows for that interim period and a statement of cash flows for the corresponding period in the immediately preceding financial year;***; and***

(h) repealing paragraph (f) and substituting the following:

(f) a statement of financial position as at the beginning of the immediately preceding financial year if the investment fund discloses in its interim financial report an unreserved statement of compliance with International Accounting Standard 34 *Interim Financial Reporting* and the investment fund

(i) applies an accounting policy retrospectively in its interim financial report,

(ii) makes a retrospective restatement of items in its interim financial report, or

(iii) reclassifies items in its interim financial report; and

(g) notes to the interim financial report.

5. Section 2.4 of National Instrument 81-106 is amended by

(a) in the title, striking out “Interim Financial Statements” ***and substituting*** “Interim Financial Report”***; and***

(b) striking out “interim financial statements” ***and substituting*** “interim financial report”***.***

6. Section 2.6 of National Instrument 81-106 is repealed and substituted by the following:

2.6 Acceptable Accounting Principles

(1) For financial years beginning before January 1, 2014, the financial statements of an investment fund must be prepared in accordance with Canadian GAAP applicable to public enterprises.

(2) For financial years beginning on or after January 1, 2014, the financial statements of an investment fund must be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises.

(3) Financial statements must be prepared in accordance with the same accounting principles for all periods presented in the financial statements.

7. Section 2.7 of National Instrument 81-106 is amended by repealing subsection (2) and substituting the following:

(2) For financial years beginning before January 1, 2014, audited financial statements must be accompanied by an auditor’s report prepared in accordance with Canadian GAAS and the following requirements:

1. The auditor's report must not contain a reservation or express a modified opinion.

2. The auditor's report must identify all financial periods presented for which the auditor has issued an auditor's report.

3. If the investment fund has changed its auditor and a comparative period presented in the financial statements was audited by a different auditor, the auditor's report must refer to the former auditor's report on the comparative period.

4. The auditor's report must identify the auditing standards used to conduct the audit and the accounting principles used to prepare the financial statements.

(3) For financial years beginning on or after January 1, 2014, audited financial statements must be accompanied by an auditor's report prepared in accordance with Canadian GAAS and the following requirements:

1. The auditor's report expresses an unmodified opinion.

2. The auditor's report identifies all financial periods presented for which the auditor has issued an auditor's report.

3. The auditor's report is in the form specified by Canadian GAAS for an audit of financial statements prepared in accordance with a fair presentation framework.

4. The auditor's report refers to IFRS as the applicable fair presentation framework.

5. If the investment fund has changed its auditor and a comparative period presented in the financial statements was audited by a predecessor auditor, the financial statements are accompanied by the predecessor auditor's report on the comparative period or the auditor's report refers to the predecessor auditor's report on the comparative period.

8. Section 2.9 of National Instrument 81-106 is amended by

(a) striking out "interim financial statements" ***wherever it occurs and substituting*** "an interim financial report"***;***

(b) striking out "statement of net assets" ***wherever it occurs and substituting*** "statement of financial position"***;***

(c) striking out "statement of operations" ***wherever it occurs and substituting*** "statement of comprehensive income"***;***

(d) striking out "statement of changes in net assets" ***wherever it occurs and substituting*** "statement of changes in financial position"***;***

(e) striking out "statement of cashflows" ***wherever it occurs and substituting*** "statement of cash flows"***;***

(f) in subsection (4), striking out "subsections 4.8(7) and (8)" ***and substituting*** "paragraphs 4.8(7)(a) and (b) and (8)(a) and (b)"***; and***

(g) striking out ", if applicable," ***in subparagraph (4)(a)(ii) and subparagraph (4)(b)(ii).***

9. Section 2.10 of National Instrument 81-106 is amended in paragraph (j) by striking out "interim and annual financial statements" ***and substituting*** "interim financial report and annual financial statements"***.***

10. Section 2.12 of National Instrument 81-106 is amended by

(a) in the title, striking out "Interim Financial Statements" ***and substituting*** "Interim Financial Report"***;***

(b) striking out "interim financial statements" ***wherever it occurs and substituting*** "interim financial report"***; and***

(c) in subsection (2), striking out "have" ***and substituting*** "has"***.***

11. Section 3.1 of National Instrument 81-106 is amended by

(a) in the title, striking out “Statement of Net Assets” ***and substituting*** “Statement of Financial Position”***;***

(b) striking out “statement of net assets” ***and substituting*** “statement of financial position”***;***

(c) repealing paragraph 14 and substituting the following:

14. total equity or net assets attributable to securityholders and, if applicable, for each class or series.***; and***

(d) repealing paragraph 15 and substituting the following:

15. total equity per security or net assets attributable to securityholders per security, or if applicable, per security of each class or series.

12. Section of 3.2 of National Instrument 81-106 is amended by

(a) in the title, striking out “Statement of Operations” ***and substituting*** “Statement of Comprehensive Income”***;***

(b) striking out “statement of operations” ***and substituting*** “statement of comprehensive income”***;***

(c) repealing paragraph 12;

(d) striking out “provision for” ***in paragraph 14;***

(e) repealing paragraph 15;

(f) adding the following after paragraph 17:

17.1 if recognized as an expense, distributions, showing separately the amount distributed out of net investment income and out of realized gains on portfolio assets sold.***;***

(g) repealing paragraph 18 and substituting the following:

18. increase or decrease in total equity from operations, or in net assets attributable to securityholders from operations, excluding distributions, and, if applicable, for each class or series.***; and***

(h) repealing paragraph 19 and substituting the following:

19. increase or decrease in total equity from operations per security, or in net assets attributable to securityholders from operations, excluding distributions, per security or, if applicable, per security of each class or series.

13. Section 3.3 of National Instrument 81-106 is amended by

(a) in the title, striking out “Statement of Changes in Net Assets” ***and substituting*** “Statement of Changes in Financial Position”***;***

(b) striking out “statement of changes in net assets” ***and substituting*** “statement of changes in financial position”***;***

(c) repealing paragraph 1 and substituting the following:

1. total equity or net assets attributable to securityholders at the beginning of the period.***;***

(d) repealing paragraph 2;

(e) repealing paragraph 6 and substituting the following:

6. if not recognized as an expense, distributions, showing separately the amount distributed out of net investment income and out of realized gains on portfolio assets sold.

6.1 return of capital.***; and***

(f) repealing paragraph 7 and substituting the following:

7. total equity or net assets attributable to securityholders at the end of the period.

14. Section 3.4 of National Instrument 81-106 is amended by

(a) in the title, striking out "Statement of Cashflows" ***and substituting*** "Statement of Cash Flows"***;***

(b) striking out "statement of cashflows" ***and substituting*** "statement of cash flows"***;***

(c) repealing paragraph 1; and

(d) repealing paragraph 3 and substituting the following:

3. payments for the purchase of portfolio assets.

15. Section 3.6 of National Instrument 81-106 is amended by

(a) adding the following after paragraph (1)1:

1.1 for financial years beginning on or after January 1, 2014, the basis for classifying the investment fund's outstanding securities, or each class or series of outstanding securities, as either equity instruments or financial liabilities.***;***

(b) striking out "statement of changes in net assets" ***in paragraph (1)4 and substituting*** "statement of changes in financial position"***;***

(c) repealing paragraph (1)5 and substituting the following:

5. the net asset value per security as at the date of the financial statements compared to the total equity per security or net assets attributable to securityholders per security as shown on the statement of financial position, and an explanation of each of the differences between these amounts.***; and***

(d) adding the following after subsection (2):

(3) For financial years beginning on or after January 1, 2014, the notes to the financial statements must disclose

(a) in the case of annual financial statements, an unreserved statement of compliance with IFRS; and

(b) in the case of interim financial reports, an unreserved statement of compliance with International Accounting Standard 34 *Interim Financial Reporting*.

16. Section 3.8 of National Instrument 81-106 is amended by

(a) striking out "statement of net assets" ***in subsection (2) and substituting*** "statement of financial position"***; and***

(b) striking out "statement of operations" ***in subsection (3) and substituting*** "statement of comprehensive income"***.***

17. Section 3.9 of National Instrument 81-106 is amended by

(a) striking out "statement of net assets" ***wherever it occurs in subsection (2) and substituting*** "statement of financial position"***; and***

(b) striking out "statement of operations" ***in subsection (3) and substituting*** "statement of comprehensive income"***.***

18. Section 3.10 of National Instrument 81-106 is amended by

(a) ***striking out*** "statement of net assets" ***in subsection (2) and substituting*** "statement of financial position"***; and***

(b) ***striking out*** "statement of operations" ***in subsection (3) and substituting*** "statement of comprehensive income"***.***

19. Section 3.11 of National Instrument 81-106 is amended by

(a) ***striking out*** "statement of net assets" ***in subparagraph (1)(a)(iii) and substituting*** "statement of financial position"***;***

(b) ***striking out*** "statement of operations" ***in paragraph (1)(c) and substituting*** "statement of comprehensive income"***; and***

(c) ***repealing subsection (2) and substituting the following:***

(2) Despite sections 3.1 and 3.2, an investment fund that is a scholarship plan may omit the "total equity per security or net assets attributable to securityholders per security" and "increase or decrease in total equity from operations per security, or in net assets attributable to securityholders from operations, excluding distributions, per security" line items from its financial statements.

20. Section 4.2 of National Instrument 81-106 is amended by striking out "interim financial statements" ***and substituting*** "interim financial report"***.***

21. Section 5.1 of National Instrument 81-106 is amended in paragraph (2)(b) by striking out "interim financial statements" ***and substituting*** "the interim financial report"***.***

22. Section 8.2 of National Instrument 81-106 is amended in paragraph (d) by striking out "interim financial statements" ***and substituting*** "an interim financial report"***.***

23. Section 8.4 of National Instrument 81-106 is amended by striking out "the net assets" ***and substituting*** "of the total equity or net assets attributable to securityholders"***.***

24. Section 8.5 of National Instrument 81-106 is amended in paragraph (b) by striking out "[net assets/venture investments]" ***and substituting*** "[total equity/net assets attributable to securityholders/venture investments]"***.***

25. Section 15.1 of National Instrument 81-106 is amended by repealing clause (1)(a)(i)(A) and substituting the following:

(A) total expenses of the investment fund, excluding distributions if recognized as an expense, commissions and other portfolio transaction costs, before income taxes, for the financial year or interim period, as shown on its statement of comprehensive income; and ***.***

26. Section 15.2 of National Instrument 81-106 is amended by

(a) ***repealing subparagraph (1)(a)(i) and substituting the following:***

(i) multiplying the total expenses of each underlying investment fund, excluding distributions if recognized as an expense, commissions and other portfolio transaction costs, before income taxes, for the financial year or interim period, by ***; and***

(b) ***repealing paragraph (1)(b) and substituting the following:***

(b) the total expenses of the investment fund, excluding distributions if recognized as an expense, commissions and other portfolio transaction costs, before income taxes, for the period.

27. Part 18 of National Instrument 81-106 is amended by adding the following before section 18.6:

18.5.1 Transition to IFRS

(1) For the first interim period in the financial year beginning on or after January 1, 2014, an investment fund must file, with its interim financial report for that interim period, an opening statement of financial position as at the date of transition to IFRS.

(2) For the first financial year beginning on or after January 1, 2014, an investment fund must file, with its annual financial statements for that financial year, an audited opening statement of financial position as at the date of transition to IFRS.

(3) Despite sections 3.1, 3.2, 3.3, 3.4 and 3.6, for financial years beginning before January 1, 2014, an investment fund may present line items and use terminology in its financial statements consistent with the immediately preceding financial year.

28. Part A, Item 1 of Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance is amended by

(a) striking out "This concept of materiality is consistent with the financial reporting notion of materiality contained in the Handbook." ***in paragraph (e); and***

(b) striking out the first sentence in paragraph (f) and substituting the following:

All references to "net assets" or "net assets per security" in this Form are references to total equity or net assets attributable to securityholders determined in accordance with Canadian GAAP as presented in the financial statements of the investment fund.

29. Part B, Item 1 of Form 81-106F1 is amended by repealing the third paragraph and substituting the following:

Securityholders may also contact us using one of these methods to request a copy of the investment fund's interim financial report, proxy voting policies and procedures, proxy voting disclosure record or quarterly portfolio disclosure.

30. Part B, Item 3, section 3.1 of Form 81-106F1 is amended by

(a) in subsection (1), striking out "total expenses" ***in The Fund's Net Assets Per [Unit/Share] table and substituting*** "total expenses [excluding distributions]"***;***

(b) in subsection (1), striking out "From income (excluding dividends)" ***in The Fund's Net Assets Per [Unit/Share] table and substituting*** "From net investment income (excluding dividends)"***;***

(c) in subsection (1), striking out "(excluding commissions and other portfolio transaction costs)" ***in footnote (2) to the Ratios and Supplemental Data table and substituting*** "(excluding [distributions], commissions and other portfolio transaction costs)"***; and***

(d) adding the following after subsection (7):

(7.1) (a) For financial years beginning before January 1, 2014, the financial highlights may be derived from the investment fund's financial statements prepared in accordance with subsection 2.6(1) of the Instrument.

(b) For financial periods beginning on or after January 1, 2014, derive the financial highlights from the investment fund's financial statements prepared in accordance with subsection 2.6(2) of the Instrument.

(c) Despite paragraph (a), in an annual MRFP for a financial year beginning on or after January 1, 2014, derive the financial highlights for the immediately preceding financial year from financial statements prepared in accordance with subsection 2.6(2) of the Instrument.

(d) If the financial highlights relate to financial periods beginning both before and on or after January 1, 2014, disclose, in a note to the table, the accounting principles applicable to each period.

31. Part B, Item 3, section 3.2 of Form 81-106F1 is amended by

(a) ***striking out*** "Balance Sheet" ***in the Financial & Operating Highlights (with comparative figures) table and substituting*** "Statement of Financial Position"***; and***

(b) ***striking out*** "Statement of Operations" ***in the Financial & Operating Highlights (with comparative figures) table and substituting*** "Statement of Comprehensive Income"***.***

32. Part C, Item 1 of Form 81-106F1 is amended by repealing the second paragraph and substituting the following:

"This interim management report of fund performance contains financial highlights but does not contain either the interim financial report or annual financial statements of the investment fund. You can get a copy of the interim financial report or annual financial statements at your request, and at no cost, by calling [toll-free/collect call telephone number], by writing to us at [insert address] or by visiting our website at [insert address] or SEDAR at www.sedar.com.

33. This Instrument comes into force on January 1, 2014.

5.1.3 Amendments to Companion Policy 81-106CP to NI 81-106 Investment Fund Continuous Disclosure

AMENDMENTS TO
COMPANION POLICY 81-106CP
TO NATIONAL INSTRUMENT 81-106 INVESTMENT FUND CONTINUOUS DISCLOSURE

1. Companion Policy 81-106CP to National Instrument 81-106 Investment Fund Continuous Disclosure is amended.

2. Section 1.3 is amended by adding the following after subsection (2):

(3) The Instrument uses accounting terms that may be defined or referred to in Canadian GAAP applicable to publicly accountable enterprises. Some of these terms may be defined differently in securities legislation. National Instrument 14-101 *Definitions* provides that a term used in the Instrument and defined in the securities statute of a local jurisdiction has the meaning given to it in the statute unless the definition in that statute is restricted to a specific portion of the statute, or the context otherwise requires.

3. Section 2.1 is amended by

(a) adding the following before subsection (2):

(1.1) Subsection 2.6(2) of the Instrument, applicable to financial years beginning on or after January 1, 2014, refers to Canadian GAAP for publicly accountable enterprises, which is IFRS incorporated into the Handbook, contained in Part I of the Handbook. IFRS is defined in National Instrument 14-101 *Definitions* as the standards and interpretations adopted by the International Accounting Standards Board.

Subsection 2.6(1) of the Instrument, applicable to financial years beginning before January 1, 2014, refers to Canadian GAAP as applicable to public enterprises, which the CSA considers to be the standards in Part V of the Handbook.***;***

(b) repealing subsection (2) and substituting the following:

(2) The CSA believe that an investment fund's financial statements must include certain information, at a minimum, in order to provide full disclosure. The Instrument sets out these minimum requirements, but does not mandate all the required disclosure. Canadian GAAP applicable to publicly accountable enterprises also contains minimum requirements relating to the content of financial statements. An investment fund's financial statements must meet these requirements as well.

In some cases, the Instrument prescribes line items that may already be required by Canadian GAAP, but these line items are expressed more specifically for the activities of an investment fund. For example, Canadian GAAP requires a "trade and other receivables" line item on the statement of financial position, but the Instrument requires accounts receivable to be broken down into more specific categories. In other instances, the line items prescribed in the Instrument are in addition to those in Canadian GAAP.

While the Instrument prescribes line items, it does not prescribe the order in which those line items are presented. Investment funds should present line items, as well as any subtotals or totals, in a logical order that will contribute to a reader's overall understanding of the financial statements.

Investment funds are responsible for disclosing all material information concerning their financial position and financial performance in the financial statements. ***; and***

(c) repealing subsection (3).

4. Part 2 is amended by adding the following after section 2.1:

2.1.1 Classification of Securities Issued by an Investment Fund

(1) One goal of the Instrument is comparable financial statement presentation between investment funds. However, the adoption of IFRS results in certain changes to this presentation. For example, the presentation is impacted by the classification of an investment fund's securities as either equity instruments or financial liabilities. Certain line items, such as "total equity or net assets attributable to

securityholders", acknowledge the difference between an equity and liability presentation, but maintain a comparable measurement between investment funds regardless of this classification.

(2) If an investment fund's securities are classified as financial liabilities, IFRS requires financing costs to include certain distributions made by the investment fund to those securityholders. However, if an investment fund's securities are classified as equity instruments, distributions to holders of these securities are not included in financing costs (and are not recognized as an expense), creating a difference that reduces comparability. To address this, the Instrument requires distributions to be excluded from certain calculations, specifically: (i) increase or decrease in net assets attributable to securityholders from operations as disclosed in the statement of comprehensive income, and (ii) determination of total expenses for the management expense ratio (MER).

(3) For investment funds that classify their own securities as financial liabilities, "net assets attributable to securityholders" represents the equivalent of "total equity" for investment funds that classify their own securities as equity instruments. Net assets attributable to securityholders does not include amounts owed on securities issued by the investment fund that provide leverage to the fund.

5. Section 2.3 is repealed.

6. Section 2.5 is amended by striking out "statement of operations" ***wherever it occurs and substituting*** "statement of comprehensive income"***.***

7. Section 2.5.1 is repealed and the following substituted:

2.5.1 Disclosure of Investment Portfolio

(1) The term "statement of investment portfolio" is used to describe the disclosure required by section 3.5 of the Instrument. As this term is not used in the Handbook, preparers may refer to it as a "schedule of investment portfolio" within a complete set of investment fund financial statements. Regardless of how the disclosure is described, sections 2.1 and 2.3 of the Instrument require it to be included within a complete set of investment fund financial statements, and subsection 2.1(2) of the Instrument requires annual financial statements to be accompanied by an auditor's report, for the purposes of securities legislation.

If financial statements for more than one investment fund are bound together, Part 7 of the Instrument requires all of the information pertaining to each investment fund to be presented together and not intermingled with information relating to another investment fund. The CSA is of the view that this requirement applies equally to the portfolio disclosure, which should be presented together with the other financial information relating to the investment fund.

(2) If an investment fund invests substantially all of its assets directly, or indirectly through the use of derivatives, in securities of one other investment fund, the investment fund should provide in the statement of investment portfolio, or the notes to that statement, additional disclosure concerning the holdings of the other investment fund, as available, in order to assist investors in understanding the actual portfolio to which the investment fund is exposed. The CSA is of the view that such disclosure is consistent with the requirements in the Handbook relating to financial instrument disclosure.

8. Section 2.7 is amended by

(a) in the title, striking out "Accounting For"***;***

(b) repealing subsection (1) and substituting the following:

(1) Section 3.8 of the Instrument imposes certain reporting requirements on investment funds in connection with any securities lending transactions entered into by the investment fund. These requirements were included to ensure that certain aspects of securities lending transactions are disclosed in the same manner.

Generally, in a securities lending transaction, the investment fund is able to call the original securities back at any time, and the securities returned must be the same or substantially the same as the original securities. The investment fund retains substantially all of the risks and rewards of ownership. ***; and***

(c) ***repealing subsection (2).***

9. ***Subsection 2.8(3) is amended by striking out*** “Interim financial statements” ***and substituting*** “The interim financial report”***.***

10. ***Section 3.2 is repealed and the following substituted:***

3.2 Modification of Opinion

(1) The Instrument prohibits an auditor’s report from expressing a modified opinion under Canadian GAAS. A modification of opinion includes a qualification of opinion, an adverse opinion, and a disclaimer of opinion.

(2) Part 17 of the Instrument permits the regulator or securities regulatory authority to grant exemptive relief from the Instrument, including the requirement that an auditor’s report express an unmodified opinion or other similar communication that would constitute a modification of opinion under Canadian GAAS. However, we will generally recommend that such exemptive relief should not be granted if the modification of opinion or other similar communication is

(a) due to a departure from accounting principles permitted by the Instrument, or

(b) due to a limitation in the scope of the auditor’s examination that

(i) results in the auditor being unable to form an opinion on the financial statements as a whole,

(ii) is imposed or could reasonably be eliminated by management, or

(iii) could reasonably be expected to be recurring.

11. ***Section 3.3 is repealed and the following substituted:***

3.3 Auditor’s Involvement with Management Reports of Fund Performance - Investment funds’ auditors are expected to comply with the Handbook with respect to their involvement with the annual and interim management reports of fund performance required by the Instrument as these reports contain financial information extracted from the financial statements.

12. ***Section 3.4 is amended by***

(a) ***in the title, striking out*** “Interim Financial Statements” ***and substituting*** “Interim Financial Reports”***;***

(b) ***repealing subsection (1) and substituting the following:***

(1) The board of directors of an investment fund that is a corporation or the trustees of an investment fund that is a trust, in discharging their responsibilities for ensuring a reliable interim financial report, should consider engaging an external auditor to carry out a review of the interim financial report.***;***

(c) ***in subsection (2), striking out the first occurrence of*** “interim financial statements” ***and substituting*** “interim financial report”***;***

(d) ***in subsection (2), striking out the second occurrence of*** “interim financial statements” ***and substituting*** “an interim financial report”***; and***

(e) ***repealing subsections (3) and (4) and substituting the following:***

(3) The terms “review” and “written review report” used in section 2.12 of the Instrument refer to the auditor’s review of and report on an interim financial report using standards for a review of an interim financial report by the auditor as set out in the Handbook.

(4) The Instrument does not specify the form of notice that should accompany an interim financial report that has not been reviewed by the auditor. The notice accompanies, but does not form part of, the interim financial report. We expect that the notice will normally be provided on a separate page

appearing immediately before the interim financial report, in a manner similar to an auditor's report that accompanies annual financial statements.

13. Section 9.2 is repealed and the following substituted:

9.2 Fair Value Guidance – Section 14.2 of the Instrument requires an investment fund to calculate its net asset value based on the fair value of the investment fund's assets and liabilities. This may differ from the calculation of "current value" for financial statement purposes. Section 3.6 of the Instrument requires an explanation of this difference.

While investment funds are required to comply with the definition of "fair value" in the Instrument when calculating net asset value, they may also look to the Handbook for guidance on the measurement of fair value. The fair value principles articulated in the Handbook can be applied by investment funds when valuing assets and liabilities.

14. Section 9.3 is repealed.

15. Section 9.4 is amended by

(a) in the title, striking out "Determination of Fair Value" ***and substituting*** "Determination of Fair Value in Calculating Net Asset Value"***; and***

(b) repealing subsection (1) and substituting the following:

(1) A market is generally considered active when quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices reflect actual and regularly occurring market transactions on an arm's length basis. Accordingly, fair value should not reflect the amount that would be received or paid in a forced transaction, involuntary liquidation or distress sale.

16. Section 10.1 is amended by

(a) repealing subsection (2) and substituting the following:

(2) Paragraph 15.1(1)(a) requires the investment fund to use its "total expenses" (other than distributions if these are an expense for the investment fund) before income taxes for the relevant period as the basis for the calculation of MER. Total expenses, before income taxes, include interest charges and taxes, including sales taxes, GST and capital taxes payable by the investment fund. Withholding taxes need not be included in the MER calculation.

The CSA is of the view that if an investment fund issues debt-like securities or securities that otherwise provide leverage to the fund, payments to holders of these securities should be treated as financing costs from the perspective of the investment fund's other classes of securities (the classes that benefit from the financing or leverage). These costs should not be excluded from total expenses when calculating the MER of the investment fund's other classes of securities. Securities that provide leverage generally include preferred shares.

Non-optional fees paid directly by investors in connection with the holding of an investment fund's securities do not have to be included in the MER calculation. ***;***

(b) in subsection (5),

(i) striking out "Handbook Section 1506 *Accounting Changes*" ***and substituting*** "International Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors*" ***in the first paragraph;***

(ii) striking out "retroactive restatement of the financial information" ***and substituting*** "retrospective application of the change" ***in the first paragraph; and***

(iii) striking out "retroactively" ***in the second paragraph.***

17. Appendix B is amended by

(a) striking out

Alberta Securities Commission
4th Floor
300 - 5th Avenue S.W.
Calgary, Alberta
T2P 3C4
Attention: Corporate Finance

and substituting

Alberta Securities Commission
Suite 600
250 - 5th Street SW
Calgary, Alberta
T2P 0R4
Attention: Corporate Finance ***;***

(b) striking out

New Brunswick Securities Commission
606 – 133 Prince William Street
Saint John, NB
E2L 2B5
Attention: Corporate Finance

and substituting

Financial and Consumer Services Commission (New Brunswick)
85 Charlotte Street, Suite 300
Saint John, NB
E2L 2J2
Attention: Corporate Finance ***;***

(c) striking out

Newfoundland and Labrador Securities Commission
P.O. Box 8700
2nd Floor, West Block
Confederation Building
75 O'Leary Avenue
St. John's, NFLD
A1B 4J6
Attention: Director of Securities

and substituting

Financial Services Regulation Division
Department of Government Services
P.O. Box 8700
St. John's, NL
A1B 4J6
Attention: Superintendent of Securities ***;***

(d) in the address for Department of Justice, Northwest Territories,

(i) striking out "Legal Registries" ***and substituting*** "Securities Office"***, and***

(ii) striking out "Director, Legal Registries" ***and substituting*** "Superintendent of Securities"***;***

(e) ***in the address for Department of Justice, Nunavut, striking out*** "Attention: Director, Legal Registries Division" ***and substituting*** "Attention: Superintendent of Securities"***;***

(f) ***in the address for Ontario Securities Commission,***

(i) ***striking out*** "Suite 1903, Box 55"***, and***

(ii) ***striking out*** "20 Queen Street West" ***and substituting*** "20 Queen Street West, 22nd Floor"***;***

(g) ***in the address for Autorité des marchés financiers, striking out*** "Direction des marchés des capitaux" ***and substituting*** "Direction des fonds d'investissement"***;***

(h) ***striking out***

Saskatchewan Financial Services Commission - Securities Division
6th Floor,
1919 Saskatchewan Drive
Regina, SK S4P 3V7
Attention: Deputy Director, Corporate Finance

and substituting

Financial and Consumer Affairs Authority of Saskatchewan – Securities Division
601 – 1919 Saskatchewan Drive
Regina, SK
S4P 4H2
Attention: Deputy Director, Corporate Finance ***; and***

(i) ***in the address for the Government of Yukon, striking out*** "Registrar of Securities" ***wherever it occurs and substituting*** "Superintendent of Securities"***.***

18. These amendments become effective on January 1, 2014.

5.1.4 Amendments to NI 41-101 General Prospectus Requirements

AMENDMENTS TO
NATIONAL INSTRUMENT 41-101 *GENERAL PROSPECTUS REQUIREMENTS*

Although this amendment instrument amends section headers in National Instrument 41-101, section headers do not form part of the instrument and are inserted for ease of reference only.

1. National Instrument 41-101 General Prospectus Requirements is amended by this instrument.

2. The general instructions of Form 41-101F2 Information Required in an Investment Fund Prospectus are amended in instruction (3) by striking out "This concept of materiality is consistent with the financial reporting notion of materiality contained in the Handbook."

3. Section 1.5 of Form 41-101F2 is amended by striking out "reporting"***.***

4. Section 1.15 of Form 41-101F2 is amended by striking out "interim financial statements" ***and substituting*** "interim financial report"***.***

5. Subsection 3.6(4) of Form 41-101F2 is amended by

(a) ***striking out*** ""MER" means management expense ratio based on total expenses, excluding commissions and other portfolio transaction costs and expressed as an annualized percentage of daily average net asset value." ***and substituting*** ""MER" means management expense ratio based on management fees and operating expenses (excluding commissions and other portfolio transaction costs) expressed as an annualized percentage of daily average net asset value."***, and***

(b) ***striking out*** ""TER" means trading expense ratio and represents total commissions and portfolio transaction costs expressed as an annualized percentage of daily average net asset value." ***and substituting*** ""TER" means trading expense ratio and represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value."***.***

6. Section 11.1 of Form 41-101F2 is amended by

(a) ***striking out*** ""MER" means management expense ratio based on total expenses, excluding commissions and other portfolio transaction costs and expressed as an annualized percentage of daily average net asset value." ***and substituting*** ""MER" means management expense ratio based on management fees and operating expenses (excluding commissions and other portfolio transaction costs) expressed as an annualized percentage of daily average net asset value."***, and***

(b) ***striking out*** ""TER" means trading expense ratio and represents total commissions and portfolio transaction costs expressed as an annualized percentage of daily average net asset value." ***and substituting*** ""TER" means trading expense ratio and represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value."***.***

7. Section 37.1 of Form 41-101F2 is amended by striking out "interim financial statements" ***and substituting*** "interim financial report"***.***

8. Subsection 38.1(4) of Form 41-101F2 is amended by striking out "opening balance sheet" ***and substituting*** "opening statement of financial position"***.***

9. Section 38.2 of Form 41-101F2 is amended by striking out "Interim Financial Statements" ***and substituting*** "Interim Financial Reports" ***in the section header.***

10. This Instrument comes into force on January 1, 2014.

5.1.5 Amendments to NI 81-101 Mutual Fund Prospectus Disclosure

AMENDMENTS TO
NATIONAL INSTRUMENT 81-101 *MUTUAL FUND PROSPECTUS DISCLOSURE*

1. ***National Instrument 81-101 Mutual Fund Prospectus Disclosure is amended by this instrument.***

2. ***Section 1.1 of National Instrument 81-101 is amended by adding the following after the definition of*** "executive officer"***:***

   "financial statements" includes interim financial reports;***.***

3. ***Clause 2.3(1)(b)(i)(A) of National Instrument 81-101 is amended by striking out*** "draft opening balance sheet" ***and substituting*** "draft opening statement of financial position"***.***

4. ***Subparagraph 2.3(3)(a)(ii) of National Instrument 81-101 is amended by striking out*** "audited balance sheet" ***and substituting*** "audited statement of financial position"***.***

5. ***Section 3.1 of National Instrument 81-101 is amended by***

   (a) ***striking out*** "interim financial statements" ***wherever it occurs and substituting*** "interim financial report"***, and***

   (b) ***striking out*** "audited balance sheet" ***in paragraph 1.3 and substituting*** "audited statement of financial position"***.***

6. ***Section 3.1.1 of National Instrument 81-101 is amended by striking out*** "interim financial statements" ***and substituting*** "interim financial reports"***.***

7. ***Section 3.1 of Part A of Form 81-101F1 Contents of Simplified Prospectus is amended by striking out*** "interim financial statements" ***and substituting*** "interim financial report"***.***

8. ***Section 3.2 of Part A of Form 81-101F1 is amended by striking out*** "interim financial statements" ***and substituting*** "interim financial report".

9. ***This Instrument comes into force on January 1, 2014.***

5.1.6 Amendments to Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure

AMENDMENTS TO
COMPANION POLICY 81-101CP
TO NATIONAL INSTRUMENT 81-101 MUTUAL FUND PROSPECTUS DISCLOSURE

1. ***Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure is amended.***

2. ***Section 2.4 is amended by striking out*** "interim statements" ***and substituting*** "interim financial reports"***.***

3. ***These amendments become effective on January 1, 2014.***

5.1.7 Amendments to NI 81-102 Mutual Funds

AMENDMENTS TO
NATIONAL INSTRUMENT 81-102 *MUTUAL FUNDS*

1. ***National Instrument 81-102 Mutual Funds is amended by this instrument.***

2. ***Section 1.1 of National Instrument 81-102 is amended by***

   (a) ***repealing the definition of*** "net asset value" ***and substituting the following:***

   "net asset value" means the value of the total assets of the investment fund less the value of the total liabilities, other than net assets attributable to securityholders, of the investment fund, as at a specific date, determined in accordance with Part 14 of National Instrument 81-106 *Investment Fund Continuous Disclosure*;***, and***

   (b) ***in the definition of*** "report to securityholders"***, striking out*** "annual or interim financial statements" ***and substituting*** "annual financial statements or interim financial reports"***.***

3. ***Subparagraph 5.6(1)(f)(iii) of National Instrument 81-102 is amended by striking out*** "annual and interim financial statements" ***and substituting*** "annual financial statements and interim financial reports"***.***

4. ***Subsection 5.6(2) of National Instrument 81-102 is amended by striking out*** "contains a reservation" ***and substituting*** "contains a modified opinion"***.***

5. ***Section 6.2 of National Instrument 81-102 is amended by striking out*** "shareholders' equity" ***wherever it occurs and substituting*** "equity"***.***

6. ***Section 6.3 of National Instrument 81-102 is amended by striking out*** "shareholders' equity" ***wherever it occurs and substituting*** "equity"***.***

7. ***Paragraph 15.8(3)(b) of National Instrument 81-102 is amended by striking out*** "balance sheet" ***and substituting*** "statement of financial position"***.***

8. ***Appendix B-1 – Audit Report, Appendix B-2 – Audit Report, and Appendix B-3 – Audit Report of National Instrument 81-102 are amended by striking out*** "We conducted our audit in accordance with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants." ***and substituting*** "We conducted our audit in accordance with standards for assurance engagements set out in the CICA Handbook – Assurance."***.***

9. ***Appendix B-1 – Audit Report of National Instrument 81-102 is amended by striking out*** "In our opinion, the Fund's report presents fairly, in all material respects, the Fund's compliance for the year ended [insert date]" ***and substituting*** "In our opinion, the Fund's statement of compliance for the year ended [insert date] complies, in all material respects,"***.***

10. ***Appendix B-2 – Audit Report and Appendix B-3 – Audit Report of National Instrument 81-102 are amended by striking out*** "In our opinion, the Company's report presents fairly, in all material respects, the Company's compliance for the year ended [insert date]" ***and substituting*** "In our opinion, the Company's statement of compliance for the year ended [insert date] complies, in all material respects,"***.***

11. ***This instrument comes into force on January 1, 2014.***

5.1.8 Amendments to NI 81-104 Commodity Pools

AMENDMENTS TO
NATIONAL INSTRUMENT 81-104 *COMMODITY POOLS*

1. ***National Instrument 81-104 Commodity Pools is amended by this instrument.***

2. ***Subsection 8.5(1) of National Instrument 81-104 is amended by striking out*** "interim financial statements" ***and substituting*** "interim financial reports"***.***

3. ***This Instrument comes into force on January 1, 2014.***

5.1.9 Amendments to OSC Rule 81-801 Implementing National Instrument 81-106 Investment Fund Continuous Disclosure

AMENDMENTS TO
ONTARIO SECURITIES COMMISSION RULE 81-801
IMPLEMENTING NATIONAL INSTRUMENT 81-106 INVESTMENT FUND CONTINUOUS DISCLOSURE

Although this amendment instrument amends section headers in Ontario Securities Commission Rule 81-801, section headers do not form part of the rule and are inserted for ease of reference only.

1. Ontario Securities Commission Rule 81-801 Implementing National Instrument 81-106 Investment Fund Continuous Disclosure is amended by this instrument.

2. Section 3.2 is amended in the title by striking out "Interim Financial Statements – Content" ***and substituting*** "Interim Financial Reports – Content"***.***

3. Section 3.4 is amended in the title by striking out "Filing Interim Financial Statements – Exemption" ***and substituting*** "Filing Interim Financial Reports – Exemption"***.***

4. Paragraph 3.5(b) is amended by striking out "interim financial statements" ***and substituting*** "interim financial reports"***.***

5. Section 4.1 is amended by renumbering it as subsection 4.1(1) and by adding the following after subsection (1):

(2) Despite subsection (1), the amendments to this Rule which came into force on January 1, 2014 only apply to financial periods relating to financial years beginning on or after January 1, 2014.

6. These amendments only apply to financial periods relating to financial years beginning on or after January 1, 2014.

7. This instrument comes into force on January 1, 2014.

Chapter 6

Request for Comments

6.1.1 Proposed OSC Rule 24-503 Clearing Agency Requirements and Related Companion Policy

ONTARIO SECURITIES COMMISSION

NOTICE AND REQUEST FOR COMMENT ON
PROPOSED OSC RULE 24-503
CLEARING AGENCY REQUIREMENTS
AND RELATED COMPANION POLICY

I. INTRODUCTION

The Ontario Securities Commission (Commission, OSC or we) is publishing for a ninety (90)-day comment period proposed OSC Rule 24-503 *Clearing Agency Requirements* (Rule) and related Companion Policy 24-503CP to OSC Rule 24-503 *Clearing Agency Requirements* (CP). The comment period will end on **March 19, 2014**.

II. BACKGROUND AND PURPOSE OF RULE

Section 21.2 of the *Securities Act* (Ontario) (Act) prohibits clearing agencies from carrying on business in Ontario unless they are recognized as a clearing agency or are exempt from the recognition requirement.

The term "clearing agency" is defined in subsection 1(1) of the Act. It has two separate definitions: paragraph (a) of the definition applies to a clearing agency serving the securities markets; paragraph (b) of the definition applies to a clearing agency serving the derivatives markets.

Most entities that are securities clearing agencies act as, or perform the services of, one or more of the following:

- a central counterparty (CCP),
- a central securities depository (CSD), and
- a securities settlement system (SSS).

A derivatives clearing agency is typically only a CCP.

The Rule has several purposes. It sets out certain requirements in connection with the application process for recognition as a clearing agency by the Commission, or for exemption from the recognition requirement. Guidance on the OSC's regulatory approach to applications for recognition as a clearing agency or exemption from the recognition requirement is set out in the CP. The Rule also sets out on-going requirements for recognized clearing agencies that act as, or perform the services of, a CCP, CSD or SSS. These requirements are based largely on international standards applicable to financial market infrastructures (FMIs) developed jointly by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements and the Board of the International Organization of Securities Commissions (IOSCO). In particular, the proposed Rule and CP incorporate newly strengthened international standards governing FMIs set out in the CPSS-IOSCO report *Principles for financial market infrastructures*, published in April 2012 (PFMI Report).[1] The Rule and CP will replace OSC Staff Notice 24-702 *Regulatory Approach to Recognition and Exemption from Recognition of Clearing Agencies*, which was based in part on previous CPSS-IOSCO international standards.[2]

The standards included in the PFMI Report are called "principles" (or the "PFMIs"). They are intended to enhance the safety and efficiency in clearing, settlement and recording arrangements, and more broadly, to limit systemic risk and foster transparency and financial stability. The PFMI Report is viewed as containing *minimum* international standards that must be applied

[1] The PFMI Report is available on the Bank for International Settlements' website (www.bis.org) and the IOSCO website (www.iosco.org).

[2] See the 2001 CPSS-IOSCO report *Recommendations for securities settlement systems* (together with the 2002 CPSS-IOSCO report *Assessment methodology for Recommendations for securities settlement systems*), and 2004 CPSS-IOSCO report *Recommendations for central counterparties*. All of these reports are available on the Bank for International Settlements' website (www.bis.org) and IOSCO website (www.iosco.org).

consistently on a global level to all systemically important FMIs, including CCPs, CSDs and SSSs.[3] Moreover, the new CPSS-IOSCO standards are intended to support the initiatives of the Group of Twenty Finance Ministers and Central Bank Governors (G20) and the Financial Stability Board (FSB) to strengthen core financial infrastructures and markets, including derivatives markets and critical market infrastructures. The global and uniform implementation of the new standards is considered to be crucial to meeting the G20 commitments for derivative markets regulatory reforms, including requirements for centralized clearing and data reporting.[4] Accordingly, the Commission considers the Rule and CP to be an important component of the efforts by the Canadian Securities Administrators (CSA) Derivatives Committee to develop a comprehensive regulatory framework for the trading of derivatives in Canada intended to implement the G20 commitments. We also believe that a rule-based framework is the preferred approach to adopting the new CPSS-IOSCO standards explicitly into Ontario securities law.

CPSS and IOSCO have stated that they expect full, timely and consistent implementation of the standards by the authorities in all member-jurisdictions. In this regard, they have established an international task force to monitor implementation of the standards by relevant authorities, including the OSC.[5]

We are publishing for a 90-day public comment period the proposed Rule and CP. We are seeking comment on all aspects of the Rule and CP, including on the specific issues raised in Part IV of this Notice. Readers are encouraged to read the Rule and CP alongside the PFMI Report. We note that the Rule and CP have been drafted to be consistent with the terminology and text used in the PFMI Report.

The comment period for this Notice will end on **March 19, 2014**. Please refer to Part XI of this Notice for information on the means for providing comment.

III. OVERVIEW OF RULE AND CP

Part 1 of the Rule sets out definitions, other interpretive provisions, and a scope provision.[6]

Part 2 of the Rule sets out certain requirements in connection with the application process for recognition as a clearing agency or exemption from the recognition requirement. The OSC's regulatory approach to such an application is set out in Part 2 of the CP.

Part 3 of the Rule, which adopts the principles of the PFMI Report, sets out the ongoing requirements for clearing agencies recognized in Ontario that act as, or perform the services of, a CCP, CSD or SSS. In general, the PFMI Report contains 23 headline *principles* applicable to clearing agencies, each with its own set of *key considerations* and more detailed *explanatory notes*. The Commission's approach to drafting Part 3 of the Rule was to generally incorporate all of the principles and key considerations within the Rule, to the extent possible. Part 3 also includes a small number of additional provisions that govern matters closely related to the principles and key considerations.

The Rule is supplemented by a CP. Part 3 of the CP incorporates, among other guidance, most of the explanatory notes contained in the PFMI Report. It also provides supplementary guidance (found in text boxes) that has been jointly developed by a working group (PFMI Coordinating Group) comprised of staff of the OSC, the Autorité des marchés financiers (AMF), the British Columbia Securities Commission (BCSC) and the Bank of Canada (BoC). The purpose of the supplementary guidance is to provide additional discussion and clarity on certain aspects of these new standards in the Canadian context that are not dealt with in the PFMI Report. The PFMI Coordinating Group has been cooperating and coordinating the implementation in Canada of the new CPSS-IOSCO standards.

---

[3] Other FMIs are payment systems and trade repositories. Payment systems (which are not regulated by the OSC) and trade repositories are not covered by the Rule.

[4] The G-20 commitments include requirements that all standardized over-the-counter derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties. Moreover, over-the-counter derivative contracts should be reported to trade repositories. Also, non-centrally cleared contracts should be subject to higher capital requirements.

[5] Reports on PFMI implementation monitoring are available on the Bank for International Settlements' website (http://www.bis.org/cpss/index.htm) and the IOSCO website (http://www.iosco.org/library/index.cfm?section=pubdocs).

[6] Part 1 of the Rule also includes a provision that is intended to address any potential conflict or inconsistency between a provision in Part 3 of the Rule and a provision of a proposed new rule (CSA Model Rule) being developed by the CSA Derivatives Committee (described in subsections 1.4(2) and 5.1(3) of the Rule as "Rule 91-*** *Model Provincial Rule – Derivatives – Customer Clearing: Protection of Customer Assets*"). The proposed CSA Model Rule, which will be published for comment subsequent to the date of this Notice, will include requirements on clearing agencies that act as CCPs for the clearing and settlement of trades in OTC derivatives. To the extent a provision of the Rule applies to a clearing agency that acts as a CCP for the clearing and settlement of trades in OTC derivatives, and a conflict or inconsistency may exist between the Rule and the proposed CSA Model Rule, the CSA Model Rule will prevail over the Rule. See Part IV of this Notice for a brief description of the proposed CSA Model Rule.

IV. SPECIFIC QUESTIONS

In this section, we identify and discuss certain key issues on which we are seeking specific comments. Responses to specific questions are solicited below.

(a) Systemically Important Clearing Agencies to Ontario

As discussed in subsections 2.0(4) to (7) of the CP, the Commission would generally require a clearing agency that is considered to be of "systemic importance" to the Ontario capital markets to be recognized, rather than be exempted from recognition as a clearing agency. Recognition by the Commission means that the clearing agency would become subject to Part 3 of the Rule if the clearing agency acts as, or performs any of the services of, a CCP, CSD or SSS. We have considered international precedent for determining the systemic importance of an FMI. In our view, the following are guiding factors to assess the systemic importance of a clearing agency to Ontario:

- value and volume of transactions processed, cleared and settled by the clearing agency for Ontario residents;
- risk exposures of the clearing agency to its Ontario-resident counterparties;
- complexity of the clearing agency; and
- centrality of the clearing agency to the Ontario capital markets.

We briefly expand on these factors in subsections 2.0(4) and (5) of the CP, and emphasize that the factors are non-exhaustive and that no single factor will be determinative in an assessment of systemic importance in Ontario. We may consider additional quantitative and qualitative factors as may be relevant and appropriate, such as the nature of a clearing agency's operations, its corporate structure, or its business model.

Question 1: Are there other factors that could be considered by the Commission in determining the systemic importance of a clearing agency to Ontario? If so, please describe such factors and your reasons for including them.

(b) Segregation and Portability

Section 3.14 of the Rule requires all CCPs to have rules and procedures to enable the segregation and portability of positions of a CCP participant's customers and related collateral upon the default or insolvency of the participant. It is a principles-based requirement that adopts Principle 14 of the PFMI Report on segregation and portability (Principle 14). We note that, as currently drafted, section 3.14 of the Rule applies to all CCPs, serving the cash or derivatives markets, whether exchange-traded or over-the-counter-traded (OTC) products.

In February 2012, the CSA Derivatives Committee published CSA Consultation Paper 91-404 – *Derivatives: Segregation and Portability in OTC Derivatives Clearing* (Paper 91-404). The CSA Derivatives Committee is developing a proposed CSA model rule (CSA Model Rule) that would implement some of its recommendations in Paper 91-404, and be in line with Principle 14. The CSA Model Rule will contain detailed requirements for market participants, including CCPs serving the OTC derivatives markets, governing the segregation and portability of customer derivatives positions and related collateral assets. We have built into the Rule a provision that addresses any potential conflicts or inconsistencies that may exist between the CSA Model Rule and the Rule.[7]

We believe further analysis is required to determine the appropriate application of Principle 14 to CCPs serving markets other than the OTC derivatives markets. The broader application of Principle 14 to all (particularly cash market) CCPs may have, in certain circumstances, unintended consequences for existing customer protection frameworks. In this regard, Principle 14 offers an "alternate approach" to implementation in jurisdictions that have an existing legal regime which achieves the protection of customer assets in cash markets to the same degree as the approach required by Principle 14. Features of such legal regimes are that, if a participant fails, (a) the customer positions can be identified in a timely manner, (b) customers will be protected by an investor protection scheme designed to move customer accounts from the failed or failing participant to another participant in a timely manner, and (c) customer assets can be restored. As an example, the PFMIs suggest that domestic law may subject participants to explicit and comprehensive financial responsibility and customer protection requirements that obligate participants to make frequent determinations (for example, daily) that they maintain possession and control of all customers' fully paid and excess margin securities and to segregate their proprietary activities from those of their customers. Under these types of regimes, pending securities purchases do not belong to the customer; thus there is no customer trade or position entered into the CCP. As a result, participants who provide collateral to the CCP do not identify whether the collateral is provided on behalf of

[7] See footnote 6 of this Notice.

their customers regardless of whether they are acting on a principal or agent basis, and the CCP is not able to identify positions or the assets of its participants' customers.

Particularly for certain cash market CCPs (e.g. the Canadian Depository for Securities Ltd.'s (CDS) continuous net settlement services (CNS)), once netting and novation have been completed, the CCP is not able to track customer positions directly. To do otherwise would require fundamental changes to the operations, and potentially the effectiveness of, these CCPs, as well as impact the market structure more broadly. In this regard, the requirements of Principle 14 may not be appropriate for certain cash markets.

As part of our efforts to implement the PFMI Report's standards, and in light of Principle 14's requirements and the prospect of an alternate approach for the cash markets, we are seeking specific input on the proper manner of applying Principle 14 in Ontario. At present, section 3.14 of the proposed Rule is drafted to require all CCPs to adhere to the minimum standards of Principle 14. However, we are of the preliminary view that the alternate approach is appropriate for some of Ontario's cash market CCPs. See section 3.14 of the CP, which discusses the Commission's view that it may grant an exemption from the requirements of section 3.14 of the Rule to a CCP that applies for such an exemption, if the alternate approach is appropriate for the CCP.

Question 2: ***Do you agree with the current drafting approach of section 3.14 of the Rule, ie, requiring all CCPs to meet Principle 14 in its entirety (without referencing the alternate approach), and granting exemptions on a case-by-case basis to those CCPs for which the alternate approach is appropriate?***

Question 3: ***Should all CCPs serving the Canadian cash markets be able to avail themselves of the alternate approach to implementation of Principle 14? How could such CCPs demonstrate that customer assets and positions are protected to the same degree envisioned by Principle 14?***

(c) Two Hour Timeframe for Resumption of Critical Information Technology Operations

Subparagraph 3.17(12)(c)(i) of the Rule requires a recognized clearing agency to develop and maintain a reasonable business continuity plan that is designed to ensure that critical information technology systems can resume operations within two hours following a disruptive event. This provision is consistent with the CPSS-IOSCO standard in Principle 17. We note that the two hour timeframe commences from the 'disruptive event'. While a resumption-timeframe of two hours after an event seems to be an emerging industry objective for FMIs, there appears to be some views that the two-hour resumption-timeframe should commence only after the declaration by the clearing agency of a 'disaster'. We recognize that, currently, a two hour timeframe for resuming operations from a disruptive event may pose operational difficulties for certain clearing agencies. However, we believe that a recognized clearing agency that performs any of the services of a CCP, CSD or SSS should maintain a reasonable business continuity plan that is designed to meet the two hour resumption period, in line with the emerging industry objective.

Question 4: ***What are a clearing agency's current abilities and future prospects to meet the objective of recovering and resuming critical systems and processes within two hours of a disruptive event? Should recovery and resumption-time objectives differ according to critical importance of markets?***

(d) Tiered Participation

Section 3.19 of the Rule governs so-called tiered participation arrangements. A tiered participation arrangement occurs when firms (indirect participants) rely on the services provided by other firms – who are direct participants of a clearing agency – to use the clearing agency's services. The dependencies and risk exposures (including credit, liquidity, and operational risks) inherent in these tiered arrangements can present risks to the clearing agency and its smooth functioning as well as to its participants and the broader financial markets. These risks are more likely to be material where there are indirect participants whose business through the clearing agency is a significant proportion of the clearing agency's overall business or is large relative to that of the direct participant through which they access the clearing agency's services.

Question 5: ***To what extent can a CCP identify and gather information about a tiered (indirect) participant?***

Question 6: ***In Canada, what types of risks (such as credit, liquidity, and operational risks) arise in tiered participation arrangements between customers and direct participants or between customers and other intermediaries that provide clearing services to such customers?***

Question 7: ***How can a clearing agency properly manage the risks posed by tiered participation arrangements?***

(e) Effective Dates and Transition

Depending on the conclusion and timing of the rule-making process, we would propose to seek approval of the final Rule in spring of 2014. As a result, we would expect that the Rule will be in force by June 30, 2014. However, the principles in the PFMI

Report represent a substantial strengthening of the previous CPSS-IOSCO standards on SSSs and CCPs. We recognize that clearing agencies will need time to implement the new standards, from both financial and operational perspectives. Therefore, we are proposing longer transition periods for implementing certain provisions of the Rule. Transitional effective dates are proposed for the following provisions of the Rule:

- *Sections 3.4 (Credit Risk), 3.5 (Collateral), 3.6 (Margin) and 3.7 (Liquidity risk)*: March 31, 2015, which is 9 months from June 30, 2014;

- *Paragraphs 3.3(3)(b) to (d) (Framework for comprehensive management of risks: requirements relating to recovery, orderly wind-down or resolution plans) and paragraph 3.15(3)(a) (General business risk: maintaining and implementing a viable recovery and orderly wind-down plan)*: January 1, 2016, which is 18 months from June 30, 2014.

- *Section 3.14 (Segregation and portability)*: same effective date as the proposed CSA Model Rule (on the assumption that the CSA Model Rule will be implemented after the implementation of the Rule);

- *Subparagraph 3.17(12)(c)(i) (Operational risks: resumption of critical IT systems within 2 hours from a disruptive event)*: June 30, 2015, which is 12 months from June 30, 2014; and

- *Section 3.19 (Tiered participation)*: June 30, 2015, which is 12 months from June 30, 2014.

Question 8: ***Are the above transition periods appropriate? If yes, please give your reasons. If not, what alternative transition periods would balance the CPSS-IOSCO's expectation of timely implementation of the PFMIs and the practical implementation needs of our markets?***

V. PUBLICATION OF SIMILAR RULES IN OTHER JURISDICTIONS AND COORDINATION BY PFMI COORDINATING GROUP

(a) Publication of Similar Rules in Other Jurisdictions

It is the Commission's understanding that the AMF intends to publish concurrently with the OSC a regulation substantially similar to the Ontario Rule and CP. We have also been advised by staff of the BCSC that they intend to work with other CSA jurisdictions to develop and publish a multi-lateral instrument that is materially the same as the Ontario Rule and CP.

(b) PFMI Coordinating Group

The PFMI Report notes that relevant authorities (including central banks and market regulators) are expected to incorporate the PFMIs in their legal and regulatory framework and oversight activities as soon as possible. Such authorities are also expected to cooperate in order to support each other in fulfilling their respective regulatory, supervisory, or oversight mandates with respect to FMIs. Consistent with these expectations, we have been cooperating and coordinating the implementation of the new CPSS-IOSCO standards in Canada with staff of the AMF, BCSC and BoC through the PFMI Coordinating Group.

The BoC has adopted the PFMIs as minimum requirements for clearing and settlement systems that it has designated as systemically important pursuant to the federal *Payment Clearing and Settlement Act*. In addition, the AMF, BCSC and BoC intend to coordinate a public consultation process with the OSC regarding the joint supplementary guidance which is presented in the CP, including respecting the timing of the consultation and the resolution of public comments received.

We will continue to work with the other Canadian authorities through the PFMI Coordinating Group to consider any additional guidance that may be necessary as a result of implementing the PFMIs in Canada. We expect additional guidance will be necessary in areas that are still being considered internationally (e.g. recovery and resolution planning, quantitative disclosure) or areas that are prone to different interpretation (e.g. liquidity risk).

VI. AUTHORITY FOR INSTRUMENT IN ONTARIO

The Rule is being made under the following provisions of the Act:

- Paragraph 11 of subsection 143(1) of the Act allows the Commission to make rules regulating the listing or trading of publicly traded securities or the trading of derivatives, including rules relating to clearing and settling trades.

- Paragraph 12 of subsection 143(1) of the Act allows the Commission to make rules regulating recognized clearing agencies, including prescribing requirements in respect of the review or approval by the Commission

of any by-law, rule, procedure, interpretation or practice and prescribing restrictions on its ownership, control and direction.

VII. ALTERNATIVES TO INSTRUMENT CONSIDERED

Many of the provisions in the Rule are closely modeled on the CPSS-IOSCO standards set out in the PFMI Report. The Commission considered, as general alternatives, adopting the CPSS-IOSCO standards set out in the PFMI Report in a policy, or including them on a case-by-case basis as terms and conditions to a recognition order of a clearing agency. The Commission decided against these alternatives because it believes the PFMI standards should be contained in a rule to provide for greater transparency of clearing agency requirements and to promote consistency across all recognized clearing agencies that act as a CCP, CSD or SSS in carrying on business in Ontario.

VIII. UNPUBLISHED MATERIALS

In proposing the Rule and CP, the OSC did not rely on any significant unpublished study, report, or other material.

IX. ANTICIPATED COSTS AND BENEFITS

The purpose of the proposed Rule is to enhance the regulatory framework for recognized clearing agencies. This regulatory framework will facilitate ongoing compliance with the requirements of Ontario securities law. The Rule also enhances harmonization with and observance of international minimum standards applicable to clearing agencies. The Commission believes that these requirements will support resilient and cost-effective clearing agency operations, as well as promote transparency that would consequently support confidence among market participants in clearing agencies' ability to serve as efficient and financially stable mechanisms for clearance and settlement and to facilitate capital formation.

The Commission believes the proposed clearing agency regulatory framework should enhance confidence in the market and better serve market participants. With the adoption of the Rule, clearing agencies may be better positioned to withstand market volatility and evolve with market developments and technological advancements. Establishing rules that are consistent with current practice and international standards provides a good starting point for promoting appropriate risk management practices.

X. REGULATIONS OR OTHER INSTRUMENTS TO BE AMENDED OR REVOKED (ONTARIO)

OSC Staff Notice 24-702 *Regulatory Approach to Recognition and Exemption from Recognition of Clearing Agencies* will be withdrawn upon the implementation of the Rule and CP.

XI. COMMENT PROCESS

Please provide your comments in writing by **March 19, 2014**. If you are not sending your comments by email, an electronic file containing the submissions should also be provided (Windows format, Word). **Please deliver your comments to the following address**:

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
E-mail: comments@osc.gov.on.ca

Please note that comments received will be made publicly available and posted at www.osc.gov.on.ca. We cannot keep submissions confidential because Ontario securities law requires that a summary of the written comments received during the comment period be published. In this context, you should be aware that some information which is personal to you, such as your e-mail and address, may appear in the websites. It is important that you state on whose behalf you are making the submission.

Additionally, **where comments pertain specifically to the supplementary guidance** developed jointly by the Canadian authorities (as presented in text boxes within the CP), it is requested that these particular **comments *also* be sent to the PFMI Coordinating Group as follows**:

Autorité des marchés financiers:
Email: consultation-en-cours@lautorite.qc.ca

Bank of Canada:
Email: PFMI-consultation@bankofcanada.ca

British Columbia Securities Commission:
Doug MacKay
Manager, Market and SRO Oversight
Email: dmackay@bcsc.bc.ca

Please refer your questions to any of:

Antoinette Leung
Manager, Market Regulation
Email: aleung@osc.gov.on.ca

Maxime Paré
Senior Legal Counsel, Market Regulation
Email: mpare@osc.gov.on.ca

Oren Winer
Legal Counsel, Market Regulation
Email: owiner@osc.gov.on.ca

December 18, 2013

OSC RULE 24-503
CLEARING AGENCY REQUIREMENTS

TABLE OF CONTENTS

PART 1 DEFINITIONS, INTERPRETATION AND APPLICATION

PART 2 CLEARING AGENCY RECOGNITION OR EXEMPTION FROM RECOGNITION

PART 3 ON-GOING REQUIREMENTS APPLICABLE TO RECOGNIZED CLEARING AGENCIES

PART 4 EXEMPTION

PART 5 EFFECTIVE DATES AND TRANSITION

FORMS

PART I
DEFINITIONS, INTERPRETATION AND APPLICATION

Definitions

1.1 In this Rule,

"board of directors" includes, in the case of a recognized clearing agency that is not a company, a group of individuals that acts for the clearing agency in a capacity similar to a board of directors;

"central counterparty" means a person or company that interposes itself between the counterparties to securities or derivatives transactions in one or more financial markets, acting functionally as the buyer to every seller and the seller to every buyer or the counterparty to every party;

"central bank money" means a liability of a central bank in the form of deposits held at the central bank which can be used for settlement purposes;

"central securities depository" means a person or company that provides centralized facilities as a depository of securities, including securities accounts, central safekeeping services, and asset services, which may include the administration of corporate actions and redemptions;

"commercial bank money" means a liability of a commercial bank in the form of deposits held at the commercial bank which can be used for settlement purposes;

"concentration limit" means a limit imposed by a clearing agency that restricts a participant's ability to provide certain collateral assets above a specified threshold established by the clearing agency;

"CPSS-IOSCO FMI Disclosure Framework Document" means the disclosure document required to be completed regularly and disclosed publicly by financial market infrastructures in accordance with Principle 23 – *Disclosure of rules, key procedures, and market data* – of the April 2012 report *Principles for financial market infrastructures* published by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO); and as more fully described in Annex A – *FMI disclosure template* – of the related December 2012 report *Principles for financial market infrastructures: Disclosure framework and Assessment methodology* published by CPSS and IOSCO;

"current exposure" means the loss that a clearing agency (or, in some cases, its participants) would face immediately if a participant were to default, being the market value or replacement cost of a transaction (or portfolio of transactions within a netting set) with the participant that would be lost upon the latter's default;

"exempt clearing agency" means a clearing agency that has been granted an order of the Commission pursuant to section 147 of the Act exempting it from the requirement in subsection 21.2(0.1) of the Act to be recognized by the Commission as a clearing agency;

"haircut", when used in relation to collateral received by a clearing agency to manage credit risk, means a risk control measure applied to the collateral whereby its value is calculated by the clearing agency as the market value of such collateral reduced by a certain percentage;

"initial margin", in relation to a clearing agency's margin system to manage credit exposures to its participants, means collateral that is required by the clearing agency to cover potential changes in the value of each participant's position (that is, potential future exposure) over an appropriate close-out period in the event the participant defaults;

"link" means, in relation to a clearing agency, a set of contractual and operational arrangements that directly or indirectly through an intermediary connects the clearing agency and one or more other systems or arrangements for the clearing or settlement of payments or securities or derivatives transactions;

"participant" means a person or company that has entered into an agreement with a clearing agency to access the services of the clearing agency and is bound by the clearing agency's rules and procedures;

"potential future exposure" means any potential credit exposure that a clearing agency could face at a future point in time arising from potential fluctuations in the market value of a participant's open positions between the time they are incurred (or reset to the current market price) and the time they are liquidated (or effectively hedged);

"procyclical" means the changes in risk-management requirements or practices that are positively correlated with business or credit cycle fluctuations and that may cause or exacerbate financial instability;

"product", when used in relation to a clearing agency's depository, clearance or settlement services, means a security or derivative, or class of securities or derivatives, or, where the context so requires, a trade or other transaction in or related to a security or derivative, or class of securities or derivatives, that is eligible for such services;

"securities settlement system" means a system that enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules;

"stress test" or "stress testing" means (except in subsection 3.17(5)) a test conducted periodically by a clearing agency to estimate credit and liquidity exposures that would result from the realization of extreme price changes to determine the amount and sufficiency of the clearing agency's total financial resources available in the event of a default or multiple defaults in extreme but plausible market conditions;

"variation margin", in relation to a clearing agency's margin system to manage credit exposures to its participants for all products it clears, means funds that are collected and paid out on a regular and *ad hoc* basis by the clearing agency to reflect current exposures resulting from actual changes in market prices.

Interpretation

1.2 In this Rule, each of the following terms has the same meaning as in National Instrument 52-107 *Accounting Principles and Auditing Standards*: "accounting principles", "auditing standards", "publicly accountable enterprises", "U.S. AICPA GAAS", "U.S. GAAP", and "U.S. PCAOB GAAS".

1.3 For the purposes of sections 3.4, 3.5 and 3.7, a person or company is also considered to be an affiliate of a participant (in this section, the person or company and the participant each described as a "party") where,

(a) a party holds directly or indirectly, otherwise than by way of security only, voting securities of the other party carrying at least 20 percent of the votes for the election of directors; or

(b) in the event paragraph (a) is not applicable,

(i) a party holds directly or indirectly, otherwise than by way of security only, an interest in the other party that allows it to direct the management or operations of the other party; or

(ii) financial information in respect of both parties is consolidated for financial reporting purposes.

Application

1.4 (1) Unless the context otherwise indicates, Part 3 of this Rule applies to a recognized clearing agency that acts as, or performs the services of, any of the following:

(a) a central counterparty;

(b) a central securities depository; or

(c) a securities settlements system.

(2) If there is a conflict or an inconsistency between a provision in Part 3 of this Rule and a provision of [Rule 91-*** *Model Provincial Rule – Derivatives – Customer Clearing: Protection of Customer Assets*] as they apply to a clearing agency that acts as a central counterparty for the clearing and settlement of trades in derivatives, the latter provision prevails.

PART 2
CLEARING AGENCY RECOGNITION OR EXEMPTION FROM RECOGNITION

Application and Initial Filing of Information

2.1 (1) An applicant for recognition as a clearing agency under section 21.2 of the Act, or for exemption from the requirement to be recognized as a clearing agency pursuant to section 147 of the Act, must include in its application package:

(a) the applicant's most recently completed CPSS-IOSCO FMI Disclosure Framework Document; and

(b) any additional relevant information sufficient to demonstrate that it is in the public interest for the Commission to recognize or exempt the applicant under section 21.2 or 147, as the case may be, of the Act.

(2) In addition to the requirement set out in subsection (1), an applicant whose head office or principal place of business is located outside of Ontario must,

(a) certify that it will provide the Commission with access to its books and records and will submit to onsite inspection and examination by the Commission;

(b) certify that it will provide the Commission with an opinion of legal counsel that,

(i) the applicant has the power and authority to provide the Commission with prompt access to its books and records; and

(ii) the applicant has the power and authority to submit to onsite inspection and examination by the Commission.

(3) In addition to the requirements set out in subsections (1) and (2), an applicant whose head office or principal place of business is located outside of Ontario must file a completed Form 24-503-F1 *Submission to Jurisdiction and Appointment of Agent for Service*.

(4) An applicant must inform the Commission in writing of any material change to the information provided in its application package, or if any of the information becomes materially inaccurate for any reason, as soon as the change occurs or the applicant becomes aware of any inaccuracy.

Significant Changes and Other Changes in Information

2.2 (1) In this section,

"notice and approval protocol" means a protocol or procedure, forming part of the terms and conditions of a clearing agency's recognition by the Commission, that governs, among other things, providing notice to the Commission of a significant change;

"significant change" includes, in relation to a recognized clearing agency,

(a) any change to the clearing agency's constating documents;

(b) any change to the clearing agency's by-laws;

(c) any change to the clearing agency's corporate governance or corporate structure, including any change to its ownership whether directly or indirectly;

(d) any material change to an agreement among the clearing agency and participants in connection with the clearing agency's operations and services, including those agreements to which the clearing agency is a party and those agreements among participants to which the clearing agency is not a party, but which are referred to in the clearing agency's rules or procedures and are made available by participants to the clearing agency;

(e) any material change to the clearing agency's rules, operating procedures, user guides, manuals, or other documentation governing or establishing the rights, obligations and relationships among the clearing agency and participants in connection with the clearing agency's operations and services;

(f) any material change to the design, operation or functionality of any of the clearing agency's operations and services;

(g) the establishment or removal of a link or any material change to an existing link;

(h) either directly or indirectly through an affiliate, commencing to engage in a new type of business activity or ceasing to engage in a business activity in which the clearing agency is then engaged; and

(i) any other matter identified as a significant change in the notice and approval protocol.

(2) Except as otherwise provided in the notice and approval protocol, a recognized clearing agency must not implement a significant change without the prior written approval of the Commission in accordance with the procedures set out in the notice and approval protocol.

(3) If a proposed significant change would affect the information set out in its CPSS-IOSCO FMI Disclosure Framework Document that is filed with the Commission, a recognized clearing agency must complete and file with the Commission an appropriate amendment to such document within the period and in accordance with the procedures set out in the notice and approval protocol.

(4) Except as otherwise provided in the notice and approval protocol, where a recognized clearing agency proposes to modify a fee or introduce a new fee for any of its clearing, settlement or depository services, the clearing agency must inform the Commission at least thirty business days before implementing the fee.

(5) Unless the exemption order provides otherwise, an exempt clearing agency must inform the Commission in writing of any material change to the information provided in its CPSS-IOSCO FMI Disclosure Framework Document that is filed with the Commission, or if any of the information becomes materially inaccurate for any reason, as soon as the change occurs or the exempt clearing agency becomes aware of any inaccuracy.

Ceasing to Carry on Business

2.3 (1) A recognized clearing agency or exempt clearing agency that intends to cease carrying on business in Ontario as a clearing agency must file a report on Form 24-503-F2 *Ceasing to Carry on Business* with the Commission,

(a) at least 180 days before ceasing to carry on business if a significant reason for ceasing to carry on business relates to the clearing agency's financial viability or any other matter that is preventing, or may potentially prevent, it from being able to provide its operations and services as a going concern; or

(b) at least 90 days before ceasing to carry on business for any other reason.

(2) A recognized clearing agency or exempt clearing agency that involuntarily ceases to carry on business in Ontario as a clearing agency must file a report on Form 24-503-F2 with the Commission as soon as practicable after it ceases to carry on that business.

Filing of Initial Audited Financial Statements

2.4 (1) An applicant must file audited financial statements for its most recently completed financial year with the Commission as part of its application under section 2.1.

(2) The financial statements referred to in subsection (1) must,

(a) be prepared in accordance with one of the following

(i) Canadian GAAP applicable to a publicly accountable enterprise,

(ii) IFRS, or

(iii) U.S. GAAP, if the person or company is incorporated or organized under the laws of the United States of America,

(b) identify in the notes to the financial statements the accounting principles used to prepare the financial statements,

(c) disclose the presentation currency, and

(d) be audited in accordance with,

(i) Canadian GAAS,

(ii) International Standards on Auditing, or

(iii) U.S. AICPA GAAS or U.S. PCAOB GAAS if the person or company is incorporated or organized under the laws of the United States of America.

(3) The financial statements referred to in subsection (1) must be accompanied by an auditor's report that,

(a) expresses an unmodified opinion, if the financial statements are audited in accordance with Canadian GAAS or International Standards on Auditing,

(b) expresses an unqualified opinion if the financial statements are audited in accordance with U.S. AICPA GAAS or U.S. PCAOB GAAS,

(c) identifies all financial periods presented for which the auditor's report applies,

(d) identifies the auditing standards used to conduct the audit,

(e) identifies the accounting principles used to prepare the financial statements,

(f) is prepared in accordance with the same auditing standards used to conduct the audit, and

(g) is prepared and signed by a person or company that is authorized to sign an auditor's report under the laws of a jurisdiction of Canada or a foreign jurisdiction, and that meets the professional standards of that jurisdiction.

Filing of annual audited and interim financial statements

2.5. (1) A recognized clearing agency or exempt clearing agency must file annual audited financial statements that comply with the requirements in subsections 2.4(2) and (3) with the Commission no later than the 90th day after the end of its financial year.

(2) A recognized clearing agency or exempt clearing agency must file interim financial statements that comply with the requirements in paragraphs 2.4(2)(a) and (2)(b) with the Commission no later than the 60th day after the end of each interim period.

Legal Entity Identifiers

2.6 (1) For the purposes of any recordkeeping and reporting requirements required under Ontario securities law, a recognized clearing agency or an exempt clearing agency must identify itself by means of a single legal entity identifier.

(2) Each of the following rules apply to legal entity identifiers:

(a) a legal entity identifier must be a unique identification code assigned to a clearing agency in accordance with the standards set by the Global Legal Entity Identifier System, and

(b) a clearing agency must comply with all applicable requirements imposed by the Global Legal Entity Identifier System.

(3) Despite subsection (2), if the Global Legal Entity Identifier System is unavailable to a clearing agency, all of the following rules apply:

(a) each clearing agency must obtain a substitute legal entity identifier which complies with the standards established by the LEI Regulatory Oversight Committee for pre-legal entity identifiers,

(b) a clearing agency must use the substitute legal entity identifier until a legal entity identifier is assigned to the clearing agency in accordance with the standards set by the Global Legal Entity Identifier System as required under paragraph (2)(a), and

(c) after the holder of a substitute legal entity identifier is assigned a legal entity identifier in accordance with the standards set by the Global Legal Entity Identifier System as required under paragraph (2)(a), the clearing agency must ensure that it is identified only by the assigned identifier.

(4) In this section,

(a) "Global Legal Entity Identifier System" means the system for unique identification of parties to financial transactions developed by the Legal Entity Identifier System Regulatory Oversight Committee; and

(b) "LEI Regulatory Oversight Committee" means the international working group established by the Finance Ministers and the Central Bank Governors of the Group of Twenty nations and the Financial Stability Board, under the Charter of the Regulatory Oversight Committee for the Global Legal Entity Identifier System dated November 5, 2012.

PART 3
ON-GOING REQUIREMENTS APPLICABLE TO RECOGNIZED CLEARING AGENCIES

Legal Framework

– ***General principle***

3.1 (1) A recognized clearing agency must establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities.

– ***Comprehensive and enforceable rules***

(2) The rules, procedures and related contracts of a recognized clearing agency must,

(a) be clear, understandable, and consistent with Ontario securities law;

(b) provide sufficient information to enable participants and, where relevant, participants' customers to have an accurate understanding of the rights and obligations of the participants and their customers;

(c) be reasonably designed to govern all aspects of the services offered by the clearing agency;

(d) be enforceable in Ontario; and

(e) provide a reasonable degree of certainty that actions taken by the clearing agency under its rules and procedures will not be voided, reversed, or subject to stays.

– ***Articulating legal basis***

(3) A recognized clearing agency must be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way.

– ***Conflict-of-laws issues***

(4) Without limiting subsection (1), if a recognized clearing agency conducts business in multiple jurisdictions, the policies and procedures referred to in subsection (1) must be reasonably designed to identify and mitigate the risks arising from any potential conflicts of laws across jurisdictions.

Governance

– ***General principle***

3.2 (1) A recognized clearing agency must establish, implement and maintain written governance arrangements that are clear and transparent, promote the safety and efficiency of the clearing agency, support the stability of the broader financial system and other relevant public interest considerations, and properly balance the objectives of relevant stakeholders.

– ***Board of directors and documented governance arrangements***

(2) A recognized clearing agency must have,

(a) a board of directors, and

(b) documented governance arrangements that,

(i) provide clear and direct lines of responsibility and accountability;

(ii) are publicly disclosed on its Website;

(iii) clearly specify the roles and responsibilities of the board of directors; and

(iv) ensure that the risk-management and internal control functions have sufficient authority, independence, resources, and access to the board of directors.

(3) The board of directors and management of the recognized clearing agency must have clearly documented governance procedures for their functioning, including procedures to,

(a) ensure performance accountability for board members and senior management, such as regular reviews of the board of director's overall performance and the performance of its individual board members;

(b) identify, address and manage any conflicts of interest issues that may arise; and

(c) manage possible risk spill over where the clearing agency provides services with a different risk profile than its depository, clearing, and settlement services.

– ***Board member skills and composition***

(4) The board of directors of a recognized clearing agency must include,

(a) individuals who have an appropriate level of skill, experience, knowledge and incentives to effectively and efficiently fulfill the board's multiple roles and responsibilities with respect to the clearing agency's operations, and

(b) appropriate representation by individuals who are independent of the clearing agency.

– ***Management roles, responsibilities and skills***

(5) Management of a recognized clearing agency must,

(a) have clearly specified and documented roles and responsibilities that include,

(i) active involvement in the clearing agency's risk control process including responsibility for ensuring that significant resources are devoted to its risk-management framework; and

(ii) responsibility for ensuring that the clearing agency's

(A) internal controls and related procedures are appropriately designed and executed, and;

(B) operations are consistent with the objectives, strategy and risk tolerance of the clearing agency, as determined by the board of directors;

(b) have the appropriate experience, mix of skills, and the integrity necessary to discharge its responsibilities for the operation and risk management of the clearing agency; and

(c) appoint a chief risk officer and a chief compliance officer, who must report directly to the board of directors or, if determined by the board of directors, to the chief executive officer of the clearing agency.

– ***Role of chief risk officer***

(6) A recognized clearing agency's chief risk officer must,

(a) have full responsibility and authority to maintain, implement and enforce the risk management framework established by the clearing agency, as required pursuant to this section and section 3.3;

(b) make recommendations to the clearing agency's board of directors regarding the clearing agency's risk management framework;

(c) monitor the effectiveness of the clearing agency's risk management framework on an ongoing basis; and

(d) report to the clearing agency's board of directors on a timely basis upon becoming aware of any significant deficiency with the risk management framework.

– ***Role of chief compliance officer***

(7) A recognized clearing agency's chief compliance officer must,

(a) establish, implement, maintain and enforce written policies and procedures to identify and resolve conflicts of interest and ensure that the clearing agency complies with Ontario securities law;

(b) monitor compliance with the policies and procedures described under paragraph (a) on an ongoing basis;

(c) report to the board of directors of the clearing agency as soon as practicable upon becoming aware of any circumstance indicating that the clearing agency, or any individual acting on its behalf, is not in compliance with Ontario securities law and one or more of the following apply:

(i) the non-compliance creates a risk of harm to a participant,

(ii) the non-compliance creates a risk of harm to the broader financial system,

(iii) the non-compliance is part of a pattern of non-compliance, or

(iv) the non-compliance may have an impact on the ability of the clearing agency to carry on business in compliance with Ontario securities law;

(d) prepare and certify an annual report assessing compliance by the clearing agency, and individuals acting on its behalf, with Ontario securities law and submit the report to the board of directors; and

(e) report to the clearing agency's board of directors as soon as practicable upon becoming aware of a conflict of interest that creates a risk of harm to a participant or to the capital markets; and

(f) concurrently with submitting a report under paragraphs (c), (d) or (e), file a copy of such report with the Commission.

– ***Risk management governance***

(8) The board of directors of a recognized clearing agency must establish a clear, documented risk-management framework that,

(a) includes the clearing agency's risk-tolerance policy,

(b) assigns responsibilities and accountability for risk decisions, and

(c) addresses decision making in crises and emergencies.

(9) Without limiting subsection (8), the board of directors of a recognized clearing agency must have in place a validation process of models used to manage risk that is independent of the development, implementation, and operation of the models and their methodologies.

(10) The validation process described in subsection (9) must be subjected to periodic independent review of its adequacy and effectiveness.

(11) The board of directors of a recognized clearing agency must ensure that the clearing agency's design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders.

– ***Board and advisory committees***

(12) The board of directors of a recognized clearing agency must establish and maintain one or more committees on risk management, finance and audit, whose mandates must include, at a minimum, the following:

(a) providing advice and recommendations to the board of directors to assist it in fulfilling its risk management responsibilities, including reviewing and assessing the clearing agency's risk management policies and

procedures, the adequacy of the implementation of appropriate procedures to mitigate and manage such risks, and the clearing agency's participation standards and collateral requirements;

(b) ensuring adequate processes and controls are in place over the models used to quantify, aggregate, and manage the clearing agency's risks;

(c) monitoring the financial performance of the clearing agency and providing financial management oversight and direction to the business and affairs of the clearing agency; and

(d) a requirement that these committees,

(i) where the committee is a board committee, be chaired by a sufficiently knowledgeable individual who is an independent director, and

(ii) have an appropriate representation by individuals who are independent of the clearing agency.

– ***Transparency of major decisions***

(13) A recognized clearing agency must,

(a) clearly disclose to relevant stakeholders its major decisions; and

(b) disclose on its Website a major decision that has a broad market impact.

Framework for comprehensive management of risks

– ***General principle***

3.3 (1) A recognized clearing agency must have a clear and documented risk-management framework for comprehensively managing legal, credit, liquidity, operational and other risks.

– ***Policies, procedures and systems, etc.***

(2) A recognized clearing agency's risk management framework must,

(a) include risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the range of risks that arise in or are borne by it;

(b) be subject to periodic review; and

(c) encourage its participants and, where relevant, their customers to manage and contain the risks they pose to the clearing agency.

(3) Without limiting subsections (1) and (2), the recognized clearing agency must,

(a) regularly review the material risks it bears from and poses to other entities (such as other clearing agencies, payments systems, trade repositories, settlement banks, liquidity providers, exchanges and other trading platforms, and service providers) as a result of interdependencies and develop appropriate risk-management tools to address these risks;

(b) identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down;

(c) prepare appropriate plans for its recovery or orderly wind-down based on its assessment of scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern;

(d) where applicable, provide relevant authorities with the information needed for purposes of resolution planning;

(e) develop, implement and maintain information systems that enable it to,

(i) monitor and measure its aggregate risk exposures, including overall credit and liquidity exposures and limits, and the relationship between these exposures and limits;

(ii) manage individual risk exposures and the interdependencies between them; and

(iii) assess the impact of various economic and financial shocks that could affect it; and

(f) have comprehensive internal control processes to assist the board of directors and senior management to monitor and assess the adequacy and effectiveness of the clearing agency's risk-management policies, procedures, systems, and controls.

Credit risk

– ***General principles***

3.4 (1) A recognized clearing agency that acts as, or performs the services of, a central counterparty or securities settlement system must effectively measure, monitor, and manage its credit exposures to participants and those arising from its clearing and settlement processes.

(2) A recognized clearing agency that performs the services of a securities settlement system must cover its current exposures and, where they exist, potential future exposures to each participant fully with a high degree of confidence using collateral and other equivalent financial resources.

(3) A recognized clearing agency that acts as a central counterparty must cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and other prefunded financial resources.

(4) A recognized clearing agency that acts as a central counterparty must maintain, in addition to the financial resources described in subsection (3), financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure to the clearing agency in extreme but plausible market conditions.

(5) Notwithstanding subsection (4), if the Commission determines that a recognized clearing agency that acts as a central counterparty is involved in activities with a more-complex risk profile or is systemically important in multiple jurisdictions, the clearing agency must maintain, in addition to the financial resources described in subsection (3), financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the clearing agency in extreme but plausible market conditions.

– ***Identifying, measuring and monitoring credit exposures***

(6) Without limiting subsection (1), a recognized clearing agency must,

(a) establish a robust framework to manage its credit exposures (whether current exposures, potential future exposures, or both) to its participants and the credit risks arising from its clearing and settlement processes; and

(b) identify sources of credit risk, routinely measure and monitor its credit exposures, and use appropriate risk-management tools to control these risks.

– ***Documenting governance arrangements***

(7) A recognized clearing agency that acts as a central counterparty must document its supporting rationale for, and have appropriate governance arrangements relating to, the amount of total financial resources it maintains.

– ***Stress testing***

(8) A recognized clearing agency that acts as a central counterparty must,

(a) at least on a daily basis, conduct rigorous stress testing to,

(i) determine the sufficiency of its total financial resources available in the event of one or more participant defaults in extreme but plausible market conditions,

(ii) report the results of the stress tests to its management, and

(iii) use the results of the stress tests to evaluate the adequacy of, and adjust as necessary, its total financial resources;

(b) regularly, at least on a monthly basis, perform comprehensive and thorough analyses of stress testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for determining the clearing agency's required level of default protection in light of current and evolving market conditions; and

(c) regularly, at least on a yearly basis, perform a full validation of its risk management model.

(9) Notwithstanding paragraph (8)(b), a recognized clearing agency that acts as a central counterparty must perform the analysis of stress testing described in that paragraph more frequently when,

(a) the products cleared or markets served display high volatility or become less liquid, or

(b) the size or concentration of positions held by the clearing agency's participants increases significantly.

(10) In conducting stress testing, the recognized clearing agency that acts as a central counterparty must consider the effect of a wide range of relevant stress scenarios in terms of both defaulters' positions and possible price changes in liquidation periods, including the following scenarios:

(a) relevant peak historic price volatilities;

(b) shifts in other market factors such as price determinants and yield curves;

(c) multiple defaults over various time horizons;

(d) simultaneous pressures in funding and asset markets; and

(e) a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

– ***Uncovered credit losses***

(11) A recognized clearing agency must have explicit rules and procedures to address any credit losses resulting from one or more defaults among its participants.

(12) The recognized clearing agency's rules and procedures required by subsection (11) must also address,

(a) how potentially uncovered credit losses would be allocated, including the repayment of any funds the clearing agency may borrow from liquidity providers; and

(b) the process for replenishing any financial resources employed by the clearing agency during a stress event.

Collateral

– ***General principle***

3.5 (1) A recognized clearing agency that acts as, or performs the services of, a central counterparty or securities settlement system and that requires collateral to manage its or its participants' credit exposure must,

(a) accept collateral with low credit, liquidity, and market risks, and

(b) set and enforce appropriately conservative haircuts and concentration limits on collateral that it collects.

– ***Valuation practices and haircuts***

(2) A recognized clearing agency must establish, implement and maintain prudent collateral acceptance and valuation practices and develop haircuts that are regularly tested and take into account stressed market conditions for the purpose of reasonably assuring itself of the collateral's value in the event of liquidation.

(3) Without limiting subsections (1) and (2), the recognized clearing agency must,

(a) not allow a participant to post its own debt or equity securities, or debt or equity securities issued by an affiliate of the participant, as collateral;

(b) mitigate against specific wrong-way risk by limiting the acceptance of collateral that would likely lose value in the event that the participant providing the collateral defaults;

(c) at a minimum, mark the collateral it receives to market daily; and

(d) independently validate its haircut procedures at least annually.

– ***Limiting procyclicality***

(4) For the purposes of paragraph (1)(b), a recognized clearing agency must establish stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practicable and prudent, in order to reduce the need for procyclical adjustments.

– ***Concentrations limits or charges***

(5) A recognized clearing agency must establish, implement and maintain appropriate concentration limits or charges across all acceptable asset classes of collateral to avoid concentrated holdings of certain assets which would significantly impair its ability to liquidate such assets quickly without adverse price effects.

(6) The recognized clearing agency must periodically review the concentration limits or charges described in subsection (5) to determine their adequacy.

– ***Cross-border collateral***

(7) A recognized clearing agency that accepts cross-border collateral must mitigate the risks associated with its use and ensure that the collateral can be used in a timely manner.

– ***Collateral management systems***

(8) A recognized clearing agency must use a collateral management system that is well-designed and operationally flexible.

Margin

– ***General principle***

3.6 (1) A recognized clearing agency that acts as a central counterparty must cover its credit exposures to its participants for all products through an effective margin system that is risk-based and regularly reviewed.

– ***Margin system***

(2) Without limiting subsection (1), the margin system should be designed to establish margin levels commensurate with risks and particular attributes of each product, portfolio, and market that the clearing agency serves.

– ***Price information***

(3) A recognized clearing agency that acts as a central counterparty must have,

(a) a reliable source of timely price data for its margin system; and

(b) procedures and valuation models for addressing circumstances in which pricing data are not readily available or reliable.

– ***Initial margin methodology***

(4) A recognized clearing agency that acts as a central counterparty must adopt initial margin models and parameters that are risk-based and generate margin requirements sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default.

(5) For the purposes of subsection (4),

(a) initial margin must meet an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure; and

(b) the initial margin model must,

(i) use a conservative estimate of the time horizons for the effective hedging or close out of the particular types of products cleared by the clearing agency (including in stressed market conditions);

(ii) have an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products; and

(iii) to the extent practicable and prudent, limit the need for destabilising, procyclical changes.

(6) Where the recognized clearing agency calculates initial margin,

(a) at the portfolio level, the requirement of paragraph (5)(a) must apply to each portfolio's distribution of future exposure; or

(b) at more-granular levels, such as at the subportfolio level or by product, the requirement of paragraph (5)(a) must be met for the corresponding distributions of future exposure.

– ***Variation margin***

(7) A recognized clearing agency that acts as a central counterparty must,

(a) mark participant positions to market and collect variation margin at least daily to limit the build-up of current exposures; and

(b) have the authority and operational capacity to make intraday margin calls and payments, both scheduled and unscheduled, to participants.

– ***Portfolio margining and cross-margining***

(8) Subject to the provisions of section 3.14, in calculating margin requirements, a recognized clearing agency that acts as a central counterparty may allow offsets or reductions in required margin across products that it clears or between products that it and another central counterparty clear, provided that the risk of one product is significantly and reliably correlated with the risk of the other product.

(9) Where the recognized clearing agency is authorized to offer cross-margining with one or more other central counterparties, it and the other central counterparties must have appropriate safeguards and harmonised overall risk-management systems.

– ***Testing model coverage and validation of margin methodology***

(10) A recognized clearing agency that acts as a central counterparty must,

(a) analyse and monitor its model performance and overall margin coverage by conducting rigorous,

(i) daily backtesting, and

(ii) at least monthly, and more frequently where appropriate, sensitivity analysis;

(b) regularly conduct an assessment of the theoretical and empirical properties of its margin model for all products it clears; and

(c) regularly review and validate its margin system.

(11) In conducting sensitivity analysis of the model's coverage under subparagraph (10)(a)(ii), the clearing agency must take into account a wide range of parameters and assumptions that reflect possible market conditions, including the most volatile periods that have been experienced by the markets it serves and extreme changes in the correlations between prices of products it clears.

– *Timeliness of margin payments*

(12) A recognized clearing agency that acts as a central counterparty must establish and rigorously enforce timelines for margin collections and payments and set appropriate consequences for failure to pay on time.

Liquidity risk

– *General principles*

3.7 (1) A recognized clearing agency that acts as, or performs the services of, a central counterparty or securities settlement system must effectively measure, monitor, and manage its liquidity risk.

(2) The recognized clearing agency must maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the clearing agency in extreme but plausible market conditions.

– *Sources of, and managing, liquidity risk*

(3) A recognized clearing agency must have a robust framework to manage its liquidity risks from its participants, settlement banks, *nostro* agents, custodian banks, liquidity providers, and other entities.

– *Measuring and monitoring liquidity risk*

(4) A recognized clearing agency must have effective operational and analytical tools to identify, measure, and monitor its settlement and funding flows on an ongoing and timely basis, including its use of intraday liquidity.

– *Maintaining sufficient liquid resources*

(5) A recognized clearing agency that performs the services of a securities settlement system, including one that employs a deferred net settlement mechanism, must maintain sufficient liquid resources in all relevant currencies to effect same-day settlement, and where appropriate intraday or multiday settlement, of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation in extreme but plausible market conditions.

(6) A recognized clearing agency that acts as a central counterparty must maintain sufficient liquid resources in all relevant currencies to settle securities-related payments, make required variation margin payments, and meet other payment obligations on time with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation to the clearing agency in extreme but plausible market conditions.

(7) Notwithstanding subsection (6), if the Commission determines that a recognized clearing agency that acts as a central counterparty is involved in activities with a more-complex risk profile or is systemically important in multiple jurisdictions, the clearing agency must consider maintaining additional liquidity resources sufficient to cover a wider range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would generate the largest aggregate payment obligation to the clearing agency in extreme but plausible market conditions.

– *Qualifying liquid resources*

(8) Only the following liquidity resources of a recognized clearing agency are eligible for the purpose of meeting the requirements to maintain sufficient liquid resources under subsections (5), (6) and (7):

(a) cash in the currency of the requisite obligations, held either at the central bank of issue or at a commercial bank that meets the clearing agency's strict criteria under subsection 3.9(4);

(b) committed lines of credit;

(c) committed foreign exchange swaps;

(d) committed repurchase agreements; or

(e) highly marketable collateral held in custody and investments that are readily available and convertible into cash pursuant to prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions.

(9) For the purposes of subsection (8), if the clearing agency has access to routine credit at the central bank of issue, the clearing agency may count such access as part of the minimum requirement to the extent it has collateral that is eligible for pledging to, or for conducting other appropriate forms of transactions with, the relevant central bank.

– ***Other liquid resources***

(10) If a recognized clearing agency maintains financial resources in addition to those eligible under subsections (8) and (9) to satisfy the sufficient liquid resources requirements, then those resources must be in the form of assets that are likely to be saleable with proceeds available promptly or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an ad hoc basis following a default, even if this saleability or acceptability as collateral cannot be reliably prearranged or guaranteed in extreme market conditions.

(11) The recognized clearing agency should consider maintaining collateral that is typically accepted by a central bank of issue for any currency in which it may have settlement obligations, but must not assume the availability of emergency central bank credit as a part of its liquidity plan.

– ***Due diligence of liquidity providers***

(12) A recognized clearing agency must undertake rigorous due diligence to assure itself that each provider of its eligible liquid resources under subsections (8) and (9), whether a participant of the clearing agency or an external party, has sufficient information to understand and to manage its associated liquidity risks, and that it has the capacity to perform as required under its commitment.

(13) For the purposes of subsection (12), where relevant to assessing a liquidity provider's performance reliability with respect to a particular currency, a liquidity provider's potential access to credit from the central bank of issue may be taken into account.

(14) The recognized clearing agency must regularly test its procedures for accessing its liquid resources at a liquidity provider.

– ***Central bank services***

(15) A recognized clearing agency with access to central bank accounts, payment services, or securities services must use these services, where practical, to enhance its management of liquidity risk.

– ***Stress testing of liquidity needs and resources***

(16) A recognized clearing agency must,

(a) determine the amount and regularly test the sufficiency of its liquid resources through rigorous stress testing, and

(b) have clear procedures to

(i) report the results of its stress tests to appropriate decision makers at the clearing agency, and

(ii) use these results to evaluate the adequacy of and adjust its liquidity risk-management framework.

(17) In conducting stress testing, the recognized clearing agency must consider a wide range of relevant scenarios, including,

(a) relevant peak historic price volatilities,

(b) shifts in other market factors such as price determinants and yield curves,

(c) multiple defaults over various time horizons,

(d) simultaneous pressures in funding and asset markets, and

(e) a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

(18) For the purposes of subsection (17), scenarios must also take into account the design and operation of the clearing agency, include all entities that may pose material liquidity risks to the clearing agency, such as settlement banks, *nostro* agents, custodian banks, liquidity providers, and linked clearing agencies, trade repositories and payment systems, and where appropriate, cover a multiday period.

(19) A recognized clearing agency must at all times document its supporting rationale for, and have appropriate governance arrangements relating to, the amount and form of total liquid resources it maintains.

– *Contingency planning for uncovered liquidity shortfalls*

(20) A recognized clearing agency must establish explicit rules and procedures that,

(a) enable it to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations on time following any individual or combined default among its participants;

(b) address unforeseen and potentially uncovered liquidity shortfalls which aim to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations; and

(c) indicate the clearing agency's process to replenish any liquidity resources it may employ during a stress event.

Settlement finality

– *General principles*

3.8 (1) A recognized clearing agency that acts as, or performs the services of, a central counterparty or securities settlement system must provide clear and certain final settlement, at a minimum by the end of the value date.

(2) Where necessary, the clearing agency must provide final settlement intraday or in real time.

– *Final settlement*

(3) Without limiting subsection (1), the clearing agency's rules and procedures must clearly define the point,

(a) at which settlement is final; and,

(b) after which unsettled payments, transfer instructions, or other obligations may not be revoked by a participant.

Money settlements

– *General principles*

3.9 (1) A recognized clearing agency that acts as, or performs the services of, a central counterparty or securities settlement system must conduct its money settlements in central bank money, where practical and available.

(2) Where central bank money is not used, the clearing agency must,

(a) conduct its money settlements using a settlement asset with little or no credit or liquidity risk, and

(b) minimize and strictly control the credit and liquidity risk arising from the use of commercial bank money.

– *Commercial bank money*

(3) Without limiting subsection (2), where the clearing agency settles in commercial bank money, it must,

(a) monitor, manage, and limit its credit and liquidity risks arising from the commercial settlement banks; and

(b) monitor and manage the concentration of credit and liquidity exposures to the commercial settlement banks.

(4) For the purposes of paragraph (3)(a), the clearing agency must establish and monitor adherence to strict criteria for its commercial settlement banks that take account of, among other things, their,

(a) regulation and supervision,

(b) creditworthiness,

(c) capitalisation,

(d) access to liquidity, and

(e) operational reliability.

– ***Settlement on books of clearing agency***

(5) Where the clearing agency conducts money settlements on its own books, it must minimize and strictly control its credit and liquidity risks.

– ***Finality of funds transfers between settlement accounts***

(6) The clearing agency's legal agreements with any commercial settlement banks must state clearly,

(a) when transfers on the books of individual settlement banks are expected to occur,

(b) that transfers are to be final when effected, and

(c) that funds received are to be transferable as soon as possible and, at a minimum, by the end of the day.

Physical deliveries

– ***General principle***

3.10 (1) A recognized clearing agency must,

(a) clearly state in its rules and procedures its obligations with respect to the delivery of physical instruments or commodities, and

(b) identify, monitor and manage the risks and costs associated with the storage and delivery of physical instruments and commodities.

Central securities depositories

– ***General principle***

3.11 (1) A recognized clearing agency that acts as a central securities depository must,

(a) have appropriate rules, procedures and controls, including robust accounting practices, to help ensure the integrity of securities issues and minimize and manage the risks associated with the safekeeping and transfer of securities; and

(b) maintain securities in an immobilized or dematerialized form for their transfer by book entry.

– ***Safeguarding integrity of securities issues***

(2) Without limiting subsection (1), where it acts as a central securities depository, a recognized clearing agency must,

(a) safeguard the rights of securities issuers and holders,

(b) prevent the unauthorised creation or deletion of securities,

(c) conduct periodic and at least daily reconciliation of securities issues it maintains, and

(d) prohibit overdrafts and debit balances in securities accounts.

– ***Protection of assets***

(3) A recognized clearing agency that acts as a central securities depository must protect assets against custody risk through appropriate rules and procedures consistent with its legal framework.

(4) The clearing agency must also,

(a) employ a robust system that ensures segregation between its own assets and the securities of its participants and segregation among the securities of participants, and

(b) where supported by the legal framework, support operationally the segregation of securities belonging to a participant's customers on the participant's books and facilitate the transfer of customer holdings.

– ***Other activities***

(5) Where a clearing agency acts as a central securities depository and provides services other than central safekeeping and administration of securities, it must identify, measure, monitor, and manage the risks associated with those activities.

Exchange-of-value settlement systems

– ***General principle***

3.12 (1) Where a recognized clearing agency acts as, or performs the services of, a central counterparty or securities settlement system and settles transactions that involve the settlement of two linked obligations, it must eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other, regardless of whether the clearing agency settles on a gross or net basis and when finality occurs.

Participant default rules and procedures

– ***General principles***

3.13 (1) A recognized clearing agency must have effective and clearly defined rules and procedures to manage a participant default.

(2) The clearing agency's rules and procedures under subsection (1) must be designed to ensure that the clearing agency can take timely action to contain losses and liquidity pressures and continue to meet its obligations.

– ***Use and sequencing of financial resources***

(3) The rules and procedures of a recognized clearing agency must specify the order in which different types of financial resources that the clearing agency maintains for covering losses and containing liquidity pressures arising from a participant default, including liquidity facilities, will be used to contain such losses and liquidity pressures.

– ***Default rules and procedures***

(4) Without limiting subsections (1) to (3), the recognized clearing agency's default rules and procedures must clearly describe:

(a) the circumstances that constitute a participant default,

(b) whether a declaration of default by the clearing agency is automatic or discretionary, and if discretionary, which person or group shall exercise that discretion,

(c) the actions that the clearing agency can take when a default is declared, and the extent to which such actions are automatic or discretionary,

(d) potential changes to its normal settlement practices, should these changes be necessary in extreme circumstances,

(e) the management of transactions at different stages of processing,

(f) the expected treatment of proprietary and customer transactions and accounts,

(g) the probable sequencing of its actions in response to a participant default,

(h) the roles, obligations, and responsibilities of the various parties, including non-defaulting participants, and

(i) the existence of other mechanisms that may be activated to contain the impact of a default.

(5) A recognized clearing agency must publicly disclose on its Website key aspects of its default rules and procedures.

– ***Testing of default procedures***

(6) A recognized clearing agency must involve its participants and other stakeholders in the testing and review of the clearing agency's default rules and procedures, including any close-out procedures.

(7) The testing and review described in subsection (6) must be conducted at least annually or following material changes to the clearing agency's default rules and procedures to ensure that they are practical and effective.

– ***Use of own capital***

(8) A recognized clearing agency that acts as a central counterparty must dedicate and use a reasonable portion of its own capital to cover losses resulting from one or more participant defaults prior to applying the collateral of, or other prefunded financial resources contributed by, the non-defaulting participants.

Segregation and portability

– ***General principles***

3.14 (1) A recognized clearing agency that acts as a central counterparty must have rules and procedures that provide for the segregation and portability of positions of a participant's customers and the collateral provided to it with respect to those positions.

(2) The segregation and portability arrangements provided for in the clearing agency's rules and procedures under subsection (1) must, at a minimum, effectively protect a participant's customers' positions and related collateral from the default or insolvency of that participant.

– ***Fellow customer default***

(3) To the extent that, in addition to the protection described in subsection (2), the clearing agency offers to protect a participant's customers' positions and related collateral from the concurrent default or insolvency of the participant and a fellow customer, the clearing agency must take steps to ensure that such protection is effective.

– ***Customer account structures and transfer of positions and collateral***

(4) To ensure effective segregation and portability arrangements in accordance with this section, the clearing agency must:

(a) employ an account structure that,

(i) allows the clearing agency to readily identify positions of a participant's customers and to segregate related collateral; and

(ii) is comprised of individual customer accounts or omnibus customer accounts; and

(b) structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting participant's customers will be transferred to one or more other participants.

– ***Disclosure***

(5) A recognized clearing agency that acts as a central counterparty must publicly disclose on its Website,

(a) its rules, policies, and procedures relating to the segregation and portability of a participant's customers' positions and related collateral, including whether customer collateral is protected on an individual or omnibus basis; and

(b) any constraints, such as legal or operational constraints, that may impair its ability to segregate or port the participant's customers' positions and related collateral.

General business risk

– *General principles*

3.15 (1) A recognized clearing agency must,

(a) have robust management and control systems to identify, monitor, and manage its general business risks, including losses from poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses, and

(b) hold sufficient liquid net assets funded by equity (such as common stock, disclosed reserves, or other retained earnings) to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialise.

(2) The clearing agency's liquid net assets for the purposes of paragraph (1)(b) must at all times be determined by its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken.

– *Determining sufficiency of liquid net assets*

(3) A recognized clearing agency must,

(a) maintain a viable recovery or orderly wind-down plan approved by the board of directors, and

(b) hold sufficient liquid net assets funded by equity to implement the plan that are:

(i) at a minimum, equal to at least six months of the clearing agency's current operating expenses, and

(ii) in addition to the clearing agency's resources available to cover participant defaults and other risks required to be covered pursuant to sections 3.4 to 3.7.

(4) For the purposes of paragraph (3)(b), the assets held to cover the clearing agency's general business risk must be of high quality and sufficiently liquid in order to allow the clearing agency to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions.

(5) The recognized clearing agency must,

(a) maintain a viable plan for raising additional equity should its equity fall close to or below the amount required under paragraph (3)(b); and

(b) have the plan described in paragraph (a) approved by the board of directors and updated regularly.

Custody and investment risks

– *General principles*

3.16 (1) A recognized clearing agency must safeguard its own and its participants' assets and minimize the risk of loss on and delay in access to these assets.

(2) The clearing agency's investments must be in instruments with minimal credit, market, and liquidity risks.

– *Use of custodians*

(3) Without limiting subsection (1), the recognized clearing agency must,

(a) hold its own and its participants' assets at supervised or regulated banks or custodians that have robust accounting practices, safekeeping procedures, and internal controls that fully protect such assets;

(b) when required, have prompt access to its assets and the assets provided by participants; and

(c) evaluate and understand its exposures to its banks and custodians, taking into account the full scope of its relationships with each.

– *Investment strategy*

(4) Without limiting subsection (2), a recognized clearing agency's investment strategy must,

(a) be consistent with the clearing agency's overall risk-management strategy;

(b) be publicly disclosed on its Website;

(c) limit the clearing agency's investments to instruments that are secured by, or claims on, high-quality obligors; and

(d) allow the clearing agency to liquidate its investments quickly with little, if any, adverse price effect.

Operational risks

– *General principles*

3.17 (1) A recognized clearing agency must identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls.

(2) The clearing agency's systems must be designed to ensure a high degree of security and operational reliability and have adequate, scalable capacity.

(3) The clearing agency's business continuity management must aim for timely recovery of operations and fulfillment of the clearing agency's obligations, including in the event of a wide-scale or major disruption.

– *Identifying sources of operational risk, operational risk management, and operational reliability*

(4) Without limiting subsection (1), the clearing agency must ensure the following:

(a) the clearing agency has a robust operational risk-management framework with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks;

(b) the clearing agency's board of directors clearly defines the roles and responsibilities for addressing operational risk and endorses the clearing agency's operational risk-management framework;

(c) the clearing agency's systems, operational policies, procedures, and controls are reviewed, audited, and tested periodically and after significant changes; and

(d) the clearing agency has clearly defined operational reliability objectives, and policies in place that are designed to achieve those objectives.

– *Operational capacity, systems requirements, and incident management*

(5) Without limiting subsection (2), a recognized clearing agency must,

(a) ensure that it has scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives;

(b) have comprehensive physical and information security policies that address potential vulnerabilities and threats;

(c) develop and maintain,

(i) an adequate system of internal controls over its systems that support the clearing agency's operations and services, and

(ii) adequate information technology general controls, including without limitation, controls relating to information systems, operations, information security, change management, problem management, network support and system software support; and

(d) in accordance with prudent business practice, on a reasonably frequent basis and, in any event, at least annually,

(i) make reasonable current and future capacity estimates,

(ii) conduct capacity stress tests to determine the ability of those systems to process transactions in an accurate, timely and efficient manner, and

(e) promptly notify the Commission of any material systems failure, malfunction or delay or other incident disruptive to the clearing agency's operations, or any breach of data security, integrity or confidentiality, and provide to the Commission a post-incident report that includes a root-cause analysis as soon as practicable.

(6) For each of the systems referred to in paragraph 5(c), a recognized clearing agency must annually engage a qualified party to conduct an independent systems review and prepare a report in accordance with established audit standards to ensure that it is in compliance with paragraphs (5)(c) and (d) and subsection (12).

(7) A recognized clearing agency must provide the report resulting from the review conducted under subsection (6) to,

(a) its board of directors, or audit committee, promptly upon the report's completion; and

(b) the Commission within 30 days of providing the report to its board of directors or audit committee.

(8) A recognized clearing agency must make publicly available, in their final form, all technology requirements regarding interfacing with or accessing the clearing agency,

(a) if operations have not begun, sufficiently in advance of operations to allow a reasonable period for testing and system modification by participants, and

(b) if operations have begun, sufficiently in advance of implementing a material change to technology requirements to allow a reasonable period for testing and system modification by participants.

(9) After complying with subsection (8), a recognized clearing agency must make available testing facilities for interfacing with or accessing the clearing agency,

(a) if operations have not begun, sufficiently in advance of operations to allow a reasonable period for testing and system modification by participants, and

(b) if operations have begun, sufficiently in advance of implementing a material change to technology requirements to allow a reasonable period for testing and system modification by participants.

(10) A recognized clearing agency must not begin operations in Ontario until it has complied with paragraphs (8)(a) and (9)(a).

(11) Paragraphs (8)(b) and (9)(b) do not apply to a recognized clearing agency if,

(a) the change to its technology requirements must be made immediately to address a failure, malfunction or material delay of its systems or equipment,

(b) the clearing agency immediately notifies the Commission of its intention to make the change to its technology requirements, and

(c) the clearing agency publicly discloses on its Website the changed technology requirements as soon as practicable.

– ***Business continuity plan***

(12) Without limiting subsection (3), a recognized clearing agency must develop and maintain a reasonable business continuity plan, including a disaster recovery plan, that,

(a) addresses events posing a significant risk of disrupting the clearing agency's operations, including events that could cause a wide-scale or major disruption;

(b) incorporates the use of a secondary site;

(c) is designed to

(i) ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events; and

(ii) enable the clearing agency to complete settlement by the end of the day of the disruption, even in extreme circumstances; and

(d) is tested on a reasonably frequent basis and, in any event, at least annually.

(13) A recognized clearing agency must identify and keep current a record of all potential single points of failure in its operations.

– ***Interdependencies, including outsourcing***

(14) A recognized clearing agency must identify, monitor, and manage the risks that,

(a) key participants, other clearing agencies, trade repositories, payment systems, and service and utility providers may pose to its operations; and

(b) its operations may pose to other clearing agencies, trade repositories, and payment systems.

(15) If a recognized clearing agency outsources a critical service or system to a service provider, including to an affiliate or associate of the clearing agency, the clearing agency must,

(a) establish, implement, maintain and enforce written policies and procedures for the selection of service providers to which a critical service and system may be outsourced and for the evaluation and approval of those outsourcing arrangements;

(b) identify any conflicts of interest between the clearing agency and the service provider to which a critical service and system is outsourced, and establish, implement, maintain and enforce written policies and procedures to mitigate and manage those conflicts of interest;

(c) enter into a contract with the service provider to whom a critical service and system is outsourced that is appropriate for the materiality and nature of the outsourced activities and that provides for adequate termination procedures;

(d) maintain access to the books and records of the service providers relating to the outsourced activities;

(e) ensure that the Commission has the same access to all data, information and systems maintained by the service provider on behalf of the clearing agency that it would have absent the outsourcing arrangements;

(f) ensure that all persons conducting audits or independent reviews of the clearing agency under this Rule have appropriate access to all data, information and systems maintained by the service provider on behalf of the clearing agency that such persons would have absent the outsourcing arrangements,

(g) take appropriate measures to determine that the service provider to which a critical service or system is outsourced establishes, maintains and periodically tests an appropriate business continuity plan, including a disaster recovery plan;

(h) take appropriate measures to ensure that the service providers protect the participants' confidential information and disclose it only in circumstances where legislation or an order of a court or tribunal of competent jurisdiction requires the disclosure of such information; and

(i) establish, implement, maintain and enforce written policies and procedures to regularly review the performance of the service provider under the outsourcing arrangements.

Access, participation and due process requirements

– ***General principle***

3.18 (1) A recognized clearing agency must have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access to its services, including by direct and, where relevant, indirect participants and other clearing agencies, payment systems and trade repositories.

– *Basic access standards*

(2) A recognized clearing agency must establish written risk-related participation requirements for granting access to each of its services that are justified in terms of the safety and efficiency of the clearing agency, are tailored to and commensurate with its specific risks, and are publicly disclosed on its Website.

(3) Without limiting subsection (2), a recognized clearing agency must not,

(a) unreasonably prohibit, condition or limit access by a person or company to the services offered by it;

(b) permit unreasonable discrimination among its participants or the customers of its participants;

(c) impose any burden on competition that is not reasonably necessary and appropriate;

(d) unreasonably require the use or purchase of another service for a person or company to utilize the clearing agency's services offered by it; and

(e) impose fees and other material costs on its participants that are unfairly and inequitably allocated among the participants.

– *Due process*

(4) For any decision made by a recognized clearing agency that adversely affects a participant or an applicant that applies to become a participant the clearing agency must ensure that,

(a) the participant or applicant is given an opportunity to be heard or make representations; and

(b) it keeps records of, gives reasons for, and provides for reviews of its decisions, including, for each applicant that applies to become a participant, the reasons for granting access or for denying or limiting access to the applicant, as the case may be.

(5) Nothing in subsection (4) shall be construed as to limit or prevent the clearing agency from taking timely action in accordance with its rules and procedures to manage the default of one or more participants or in connection with the clearing agency's recovery or orderly wind-down, whether or not such action adversely affects a participant.

– *Participant monitoring*

(6) A recognized clearing agency must monitor compliance by its participants with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for sanctioning non-compliance with its participation requirements, including the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements.

Tiered participation arrangements

– *General principles*

3.19 (1) A recognized clearing agency must,

(a) identify, monitor, and manage the material risks to the clearing agency arising from any tiered participation arrangements; and

(b) regularly review such risks and take mitigating action when appropriate.

– *Gathering and assessing information on risks arising from tiered participation arrangements*

(2) A recognized clearing agency must ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the clearing agency arising from such tiered participation arrangements.

– *Understanding material dependencies in tiered participation arrangements*

(3) Without limiting subsection (1), a recognized clearing agency must identify material dependencies between direct and indirect participants that may adversely affect the clearing agency and, in particular, have policies and procedures that enable it to identify indirect participants,

(a) who are responsible for a significant proportion of transactions processed by the clearing agency, or

(b) whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the clearing agency.

Links with other financial market infrastructures

– ***General principle***

3.20 (1) A recognized clearing agency that establishes a link with one or more clearing agencies or trade repositories must identify, monitor, and manage link-related risks.

– ***Identifying and managing link-related arrangements***

(2) Without limiting subsection (1), the clearing agency must identify and assess all potential sources of risk arising from a potential link before it enters into the link and, if it enters into the link, must identify, monitor, and manage such risks on an ongoing basis.

(3) A link described in subsection (1) must,

(a) have a well-founded legal basis that supports its design and provides adequate protection to the parties involved in the link, and

(b) be designed to enable the clearing agency to comply with this Rule.

– ***CSD-CSD links***

(4) A recognized clearing agency that acts as a central securities depository must meet the following relevant standards applicable to links it has entered into with one or more other central securities depositories:

(a) Linked central securities depositories measure, monitor, and manage the credit and liquidity risks arising from each other;

(b) Any credit extensions between linked central securities depositories are covered fully with high-quality collateral and are subject to limits;

(c) Provisional transfers of securities between linked central securities depositories are prohibited or, at a minimum, the retransfer of provisionally transferred securities are prohibited prior to the transfer becoming final;

(d) An investor central securities depository only establishes a link with an issuer central securities depository if the link provides a high level of protection for the rights of the investor central securities depository's participants;

(e) An investor central securities depository that uses an intermediary to operate a link with an issuer central securities depository measures, monitors, and manages the additional risks (including custody, credit, legal, and operational risks) arising from the use of the intermediary.

– ***CCP-CCP links***

(5) A recognized clearing agency that acts as a central counterparty must meet the following relevant standards applicable to links it has entered into with one or more other central counterparties:

(a) Before entering into a link with another central counterparty, a central counterparty identifies and assesses the potential spill-over effects from the default of the linked central counterparty;

(b) After entering into a link with another central counterparty, a central counterparty identifies, assesses, and manages the potential spill-over effects from the default of the linked central counterparty;

(c) If a link has three or more central counterparties, each central counterparty identifies, assesses, and manages the risks of the collective link;

(d) Each central counterparty in a central counterparty link is able to cover, at least on a daily basis, its current and potential future exposures to the linked central counterparty and its participants, if any, fully with a high degree of confidence without reducing the central counterparty's ability to fulfill its obligations to its own participants at any time.

Efficiency and effectiveness

– ***General principle***

3.21 (1) A recognized clearing agency must be efficient and effective in meeting the requirements of its participants and the markets it serves.

– ***Presumption***

(2) For the purposes of subsection (1), the clearing agency establishes that it is operating efficiently and effectively if it demonstrates that it,

(a) meets the needs of its participants and the markets it serves, in particular, with regard to:

(i) choice of a clearing and settlement arrangement;

(ii) operating structure;

(iii) scope of products cleared, settled, or recorded; and

(iv) use of technology and procedures;

(b) has clearly defined goals and objectives that are measurable and achievable including minimum service levels, risk-management expectations, and business priorities, and

(c) has mechanisms for the regular review of its efficiency and effectiveness.

Communication procedures and standards

– ***General principle***

3.22 (1) A recognized clearing agency must use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient clearing, settlement, depository, recording and payment processes.

– ***Systems that translate or convert data***

(2) Where a recognized clearing agency does not itself use internationally accepted communication standards, it must accommodate systems that translate or convert data from international standards into the domestic equivalent and vice versa.

Transparency

– ***General principles***

3.23 (1) A recognized clearing agency must have clear and comprehensive rules and procedures that are fully disclosed to participants and provide sufficient additional information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the clearing agency.

(2) All relevant rules and key procedures of the clearing agency must be publicly disclosed on its Website.

– ***Understanding risks***

(3) Without limiting subsection (1), a recognized clearing agency must disclose to its participants the following in order that they can assess the risks they would incur by participating in the clearing agency:

(a) the clearing agency's systems' design and operations; and

(b) the rights and obligations of the clearing agency and its participants.

(4) Without limiting subsection (1), a recognized clearing agency must provide all necessary and appropriate documentation and training to facilitate participants' understanding of the clearing agency's rules and procedures and the risks they face from participating in the clearing agency.

– ***Changes to rules and procedures***

(5) A recognized clearing agency must have a clear and fully disclosed process for proposing and implementing changes to its rules and procedures and for informing participants and the Commission of these changes.

– ***Disclosure of fees***

(6) A recognized clearing agency must publicly disclose on its Website its fees at the level of individual services it offers as well as its policies on any available discounts.

(7) The clearing agency must also provide clear descriptions of priced services for comparability purposes.

– ***Disclosure framework and basic data***

(8) A recognized clearing agency must complete regularly and disclose publicly on its Website responses to the CPSS-IOSCO FMI Disclosure Framework Document.

(9) The clearing agency must also, at a minimum, publicly disclose on its Website basic data on transaction volumes and values.

PART 4
EXEMPTIONS

Exemption

4.1 A Director may grant an exemption to this Rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

PART 5
EFFECTIVE DATES AND TRANSITION

Effective date

5.1 (1) Except as provided in subsections (2) to (5), this Rule comes into force on June 30, 2014.

(2) Sections 3.4 to 3.7 come into force on March 31, 2015.

(3) Section 3.14 comes into force on the later of,

(a) the day on which this Rule comes into force in accordance with subsection (1), and

(b) the day on which [Rule 91-xxx *Model Provincial Rule – Derivatives – Customer Clearing: Protection of Customer Assets*] comes into force.

(4) Paragraphs 3.3(3)(b), (c) and (d) and paragraph 3.15(3)(a) come into force on January 1, 2016.

(5) Subparagraph 3.17(12)(c)(i) and section 3.19 come into force on June 30, 2015.

FORM 24-503F1
OSC RULE 24-503 – *CLEARING AGENCY REQUIREMENTS*

CLEARING AGENCY SUBMISSION TO JURISDICTION AND APPOINTMENT OF AGENT FOR SERVICE OF PROCESS

1. Name of clearing agency (the "Clearing Agency"):

   ____

2. Jurisdiction of incorporation, or equivalent, of Clearing Agency:

   ____

3. Address of principal place of business of Clearing Agency:

   ____

4. Name of the agent for service of process for the Clearing Agency (the "Agent"):

   ____

5. Address of Agent for service of process in Ontario:

   ____

6. The Ontario Securities Commission ("Commission") issued an order recognizing the Clearing Agency as a clearing agency pursuant to subsection 21.2(0.1) of the *Securities Act* (Ontario) ("Act") or the Commission issued an order pursuant to section 147 of the Act exempting the Clearing Agency from the requirement to be recognized as a clearing agency pursuant to subsection 21.2(0.1) of the Act on ____________________.

7. The Clearing Agency designates and appoints the Agent as its agent upon whom may be served a notice, pleading, subpoena, summons or other process in any action, investigation or administrative, criminal, quasi-criminal, penal or other proceeding arising out of or relating to or concerning the activities of the Clearing Agency in Ontario. The Clearing Agency hereby irrevocably waives any right to challenge service upon its Agent as not binding upon the Clearing Agency.

8. The Clearing Agency agrees to unconditionally and irrevocably attorn to the non-exclusive jurisdiction of (i) the courts and administrative tribunals of Ontario and (ii) any proceeding in any province or territory arising out of, related to, concerning or in any other manner connected with the regulation and oversight of the activities of the Clearing Agency in Ontario.

9. The Clearing Agency shall file a new submission to jurisdiction and appointment of agent for service of process in this form at least 30 days before the Clearing Agency ceases to be recognized or exempted by the Commission, to be in effect for six years from the date it ceases to be recognized or exempted unless otherwise amended in accordance with section 9.

10. Until six years after it has ceased to be recognized or exempted by the Commission, the Clearing Agency shall file an amended submission to jurisdiction and appointment of agent for service of process at least 30 days before any change in the name or above address of the Agent.

11. This submission to jurisdiction and appointment of agent for service of process shall be governed by and construed in accordance with the laws of Ontario.

Dated: ________________________________

____
Signature of the Clearing Agency

____
Print name and title of signing
officer of the Clearing Agency

AGENT

CONSENT TO ACT AS AGENT FOR SERVICE

I, ____________________ (name of Agent in full; if Corporation, full Corporate name) of ________________________________ (business address), hereby accept the appointment as agent for service of process of __________________________________ (insert name of Clearing Agency) and hereby consent to act as agent for service pursuant to the terms of the appointment executed by ____________________________ (insert name of Clearing Agency) on ___________________ (insert date).

Dated: _________________________________

____
Signature of Agent

____
Print name of person signing and, if Agent is not an individual, the title of the person

FORM 24-503F2
OSC RULE 24-503 – *CLEARING AGENCY REQUIREMENTS*

CESSATION OF OPERATIONS REPORT FOR CLEARING AGENCY

1. Identification:

   A. Full name of the recognized or exempted clearing agency:

   B. Name(s) under which business is conducted, if different from item 1A:

2. Date clearing agency proposes to cease carrying on business as a clearing agency:

3. If cessation of business was involuntary, date clearing agency has ceased to carry on business as a clearing agency:

Exhibits

File all Exhibits with the Cessation of Operations Report. For each exhibit, include the name of the clearing agency, the date of filing of the exhibit and the date as of which the information is accurate (if different from the date of the filing). If any Exhibit required is inapplicable, a statement to that effect shall be furnished instead of such Exhibit.

Exhibit A

The reasons for the clearing agency ceasing to carry on business as a clearing agency.

Exhibit B

A list of all participants in Ontario during the last 30 days prior to ceasing business as a clearing agency.

Exhibit C

A description of the alternative arrangements available to participants in respect of the services offered by the clearing agency immediately prior to the cessation of business as a clearing agency.

Exhibit D

A description of all links the clearing agency had immediately prior to the cessation of business as a clearing agency with other clearing agencies or trade repositories, within the meaning of section 3.20 of OSC Rule 24-503 *Clearing Agency Requirements*.

CERTIFICATE OF CLEARING AGENCY

The undersigned certifies that the information given in this report is true and correct.

DATED at ____________ this ____________ day of ____________________, 20 _____

____
(Name of clearing agency)

____
(Name of director, officer or partner – please type or print)

____
(Signature of director, officer or partner)

____
(Official capacity – please type or print)

COMPANION POLICY
TO
OSC RULE 24-503
CLEARING AGENCY REQUIREMENTS

TABLE OF CONTENTS

PART 1 GENERAL COMMENTS

PART 2 CLEARING AGENCY RECOGNITION OR EXEMPTION FROM RECOGNITION

PART 3 ON-GOING REQUIREMENTS APPLICABLE TO RECOGNIZED CLEARING AGENCIES

PART I
GENERAL COMMENTS

Introduction

1.1 (1) This Companion Policy ("CP") provides explanatory guidance, and sets out the views of the Ontario Securities Commission (the "OSC", "Commission", or "we") on various matters relating to OSC Rule 24-503 *Clearing Agency Requirements* (the "Rule") and related securities legislation.

(2) Except for Part 1, the numbering of Parts, sections and subsections in this CP generally corresponds to the numbering in the Rule. Any guidance for a Part appears immediately after the Part's name. Specific guidance on a section or subsection in the Rule follows any general guidance. If there is no guidance for a Part, section or subsection, the numbering in this CP will skip to the next provision that does have guidance. Parts 2 and 3 each contain introductory comments on the guidance provided in the Part (see sections 2.0 and 3.0). Part 3 also contains supplemental guidance in text boxes, which has been jointly developed by the Canadian authorities.

(3) Unless otherwise stated, any reference to a Part, section, subsection, paragraph or definition in this CP is a reference to the corresponding Part, section, subsection, paragraph or definition in the Rule.

Background

1.2 (1) Section 21.2 of the *Securities Act* (Ontario), as amended (the "Act"), prohibits clearing agencies from carrying on business in Ontario unless they are recognized by the Commission as a clearing agency or are exempt from the requirement to be recognized by order of the Commission.

(2) The Rule sets out certain requirements in connection with the application process for recognition as a clearing agency or exemption from the recognition requirement. Guidance on the OSC's regulatory approach to such an application is set out in this CP. The Rule also sets out on-going requirements for recognized clearing agencies, which are largely based on international standards developed jointly by the Committee on Payment and Settlement Systems of the Bank for International Settlements and the Board of the International Organization of Securities Commissions ("CPSS-IOSCO Principles") that apply to financial market infrastructures ("FMIs").[1]

(3) The CPSS-IOSCO Principles are international minimum standards for systemically important payment systems ("PSs"), central securities depositories ("CSDs"), securities settlement systems ("SSSs"), central counterparties ("CCPs") and trade repositories ("TRs"), collectively identified as FMIs. The CPSS-IOSCO Principles harmonize and, where appropriate, strengthen previous international standards for FMIs.[2] Part 3 of the Rule incorporates those principles that are relevant to entities that meet the definition of a "clearing agency" in section 1(1) of the Act and that act as, or perform the services of, a CCP, CSD and SSS.

Definitions and Interpretation

1.3 (1) Unless otherwise defined in subsection 1.3(3) of this CP, the terms in this CP have the meaning given to them in the Rule or Ontario securities law, including, for greater certainty, in National Instrument 14-101 *Definitions* and OSC Rule 14-501 *Definitions*.

---

[1] See the CPSS-IOSCO *Principles for Financial Market Infrastructures* Report, published in April 2012, available on the Bank for International Settlements' website (www.bis.org) and the IOSCO website (www.iosco.org).

[2] See the (i) 2001 CPSS report *Core principles for systemically important payment systems*, (ii) 2001 CPSS-IOSCO report *Recommendations for securities settlement systems* (together with the 2002 CPSS-IOSCO report *Assessment methodology for Recommendations for securities settlement systems*); and (iii) 2004 CPSS-IOSCO report *Recommendations for central counterparties*. All of these reports are available on the Bank for International Settlements' website (www.bis.org). The CPSS-IOSCO reports are also available on IOSCO website (www.iosco.org).

(2) With respect to the terms defined in section 1.1 of the Rule, for greater clarity,

(a) the purpose of a "concentration limit" is to help avoid concentrated holdings of certain collateral assets where this would significantly impair the ability to liquidate such assets quickly without significant adverse price effects;

(b) a "haircut", when used in relation to collateral received by a clearing agency to manage credit risk, is used by a clearing agency to protect itself from losses resulting from declines in the market value of the collateral in the event that the clearing agency needs to liquidate the collateral.

(3) In this CP,

"Canadian authorities" means the Bank of Canada and applicable Canadian securities regulatory authorities that have regulatory authority over clearing agencies;

"CPSS" means the Committee on Payment and Settlement Systems of the Bank for International Settlements;

"FMI" means a financial market infrastructure, which the PFMI Report describes as follows: PSs, CSDs, SSSs, CCPs and TRs;

"IOSCO" means the Board of the International Organization of Securities Commissions;

"PFMI Report" means the April 2012 Report *Principles for financial market infrastructures* published by the CPSS and IOSCO, which contains the CPSS-IOSCO Principles;

"principle" means, unless the context otherwise indicates, a principle forming part of the CPSS-IOSCO Principles, as set out in the PFMI Report.

Application

1.4 (1) Subsection 1.4(1) of the Rule specifies that Part 3 of the Rule applies, unless the context otherwise indicates, to a clearing agency that acts as, or performs the services of, any of a CCP, CSD or SSS. The term "clearing agency" is defined in subsection 1(1) of the Act. It has two separate definitions: paragraph (a) applies to a clearing agency for the securities markets; paragraph (b) applies to a clearing agency for the derivatives markets. A securities clearing agency can be a CCP, CSD or SSS. A derivatives clearing agency is typically only a CCP. The terms CCP, CSD and SSS are defined in section 1.1 of the Rule. PSs and TRs are not clearing agencies and therefore are not covered by the Rule.

The Commission notes that, while Part 3 applies only to a recognized clearing agency that acts as, or performs the services of, a CCP, CSD or SSS, the definition of a clearing agency for securities in the Act is broad, and may incorporate certain functions that are not necessarily those of a CCP, CSD or SSS. For example, an entity that provides centralized facilities for comparing data respecting the terms of settlement of a trade or transaction would be considered a clearing agency for securities, but would not be considered a CCP, CSD or SSS. Such an entity would still be required to apply for recognition as a clearing agency under section 21.2 of the Act, or apply for an exemption from the requirement to be recognized as a clearing agency pursuant to section 147 of the Act. Whether applying for recognition or an exemption, the entity would be subject to Part 2 of the Rule, but Part 3 would not apply to the entity. See Part 2 of this CP.

(2) A clearing agency that acts as a CCP for the clearing and settlement of trades in derivatives may also be subject to [Rule 91-*** *Model Provincial Rule – Derivatives – Customer Clearing: Protection of Customer Assets*]. Subsection 1.4(2) of the Rule addresses any conflict or inconsistency between [Rule 91-***] and this Rule. The term derivative is defined broadly in s. 1(1) of the Act, but excludes commodity futures contracts or commodity futures options as defined in subsection 1 (1) of the *Commodity Futures Act*, as well as contracts or instruments that, by reason of an order of the Commission, are not derivatives or contracts or instruments in a class of contracts or instruments prescribed by the regulations under the Act not to be derivatives.

PART 2
CLEARING AGENCY RECOGNITION
OR EXEMPTION FROM RECOGNITION

Regulatory Framework for Recognition or Exemption of Clearing Agencies

2.0 (1) Part 2 of the Rule governs the application process for recognition of a clearing agency that seeks to carry on business in Ontario, or for an exemption from the recognition requirement.

– ***Recognition of a Clearing Agency***

(2) A clearing agency that seeks to operate in Ontario is required to either apply for recognition under subsection 21.2(0.1) of the Act or to apply for an exemption under section 147 of the Act. Generally, the Commission takes the view that a clearing agency that is systemically important to the Ontario capital markets, or that is not subject to regulation by another regulatory body, should be recognized. Recognition by the Commission means that the clearing agency would be subject to Part 3 of the Rule, where the clearing agency acts as, or performs any of the services of, a CCP, CSD or SSS. See also subsection 1.4(1) of this CP.

(3) For the purposes of the Rule and this CP, the Commission may consider the systemic importance of a clearing agency to the Ontario capital markets based on the following list of guiding factors: value and volume of transactions processed, cleared and settled by the clearing agency, risk exposures of the clearing agency to its participants, complexity of the clearing agency, and centrality of the clearing agency with respect to its role in the market, its substitutability, and its relationships, interdependencies and interactions.

(4) In respect of the value and volume of transactions processed, cleared or settled by an applicant, the Commission may consider the current aggregate monetary values and volumes of such transactions, as well as the entity's potential for growth. Risk exposures, both credit and liquidity-related, may also be considered. In addition, the Commission may look to the nature and complexity of the clearing agency, taking into account an analysis of the various products it processes, clears or settles. Finally, the Commission may assess the centrality or importance of the clearing agency to the particular market or markets it serves, based on the degree to which it critically supports, or that its failure or disruption would affect, such markets.

(5) No single factor described above will be determinative in an assessment of systemic importance. Further, the list of guiding factors is non-exhaustive. The Commission retains the ability to consider additional quantitative and qualitative factors as may be relevant and appropriate. Additional factors may be based on the characteristics of the clearing agency under review, such as the nature of its operations, its corporate structure, or its business model.

– ***Exemption from Recognition***

(6) Depending on the circumstances, the Commission may grant a clearing agency an exemption from recognition subject to appropriate terms and conditions pursuant to section 147 of the Act, where it is not considered systemically important or where it does not otherwise pose significant risk to the Ontario capital markets. For example, the Commission may consider this approach for an entity that provides limited services or facilities, thereby not warranting full regulation, such as a clearing agency that does not perform the functions of a CCP, CSD or SSS. However, in such cases, the Commission may also impose terms and conditions that would generally be analogous to certain requirements found in Part 3 of the Rule. In addition, a clearing agency based outside of Ontario that is carrying on business or intends to carry on business in the province would generally be required to apply either for recognition or for an exemption from recognition.[3] We recognize, however, that such clearing agency may already be subject to a regulatory regime in its home jurisdiction. Accordingly, full regulation may be duplicative and inefficient when imposed in addition to the regulation of the home jurisdiction. The Commission may therefore grant the clearing agency an exemption from the recognition requirement. In almost all cases, the exemption will be subject to certain terms and conditions, including reporting requirements. Where the regulatory regime of the clearing agency's home jurisdiction is not comparable to that of Ontario, the Commission may also consider it necessary to impose additional requirements.

Application and Initial Filing of Information

2.1 The application process for both recognition and exemption from recognition as a clearing agency is similar. The entity that applies to be a recognized or exempted clearing agency will typically be the entity that operates the facility or performs the functions of a clearing agency, as defined in section 1(1) of the Act. Where an applicant owns and operates more than one facility or performs more than one function (e.g. of CCP, CSD and SSS), it may choose to file one set of application materials to cover all of the facilities or functions, or it may file separate application materials in respect of each facility or function.

An application for recognition of a clearing agency pursuant to section 21.2 of the Act, or for an exemption from the requirement, will require completion of appropriate documentation. This will include an application package consisting of the applicant's most recently completed CPSS-IOSCO FMI Disclosure Framework Document,[4] and any additional information which demonstrates that it is in the public interest for the Commission to recognize or exempt the applicant as a clearing agency under the Act. Together, the application materials should present a detailed description of the history, regulatory structure (if any), and business operations of the clearing agency. A clearing agency that acts as, or performs the service of, a CCP, CSD or SSS will

[3] A clearing agency that offers to provide its services or facilities to a person or company resident in Ontario would be considered to be carrying on business in Ontario.

[4] The CPSS-IOSCO FMI Disclosure Framework Document, as defined in s. 1.1 of the Rule, entails the *FMI Disclosure Template* found in Annex A of the *Principles for Financial Market Infrastructures; Disclosure framework and Assessment methodology*, published in December 2012. It is available on the Bank for International Settlements' website (www.bis.org) and the IOSCO website (www.iosco.org).

need to describe how it meets or will meet the requirements of Part 3 of the Rule, or, if the applicant has its head office or principal place of business located outside of Ontario, how the clearing agency meets or will meet requirements that are substantively similar to those in Part 3 of the Rule. An applicant located outside of Ontario should also provide a detailed description of the regulatory regime of the home jurisdiction and the regulatory requirements imposed on the clearing agency in its home jurisdiction, along with the certification and opinion of legal counsel required under subsection 2.1(2) of the Rule.

Where specific information items of the CPSS-IOSCO FMI Disclosure Framework Document are not relevant to an applicant because of the nature or scope of its clearing agency activities, its structure, the products it clears or settles, or its regulatory environment, the application should explain in reasonable detail why the information items are not relevant. This may be especially the case for a clearing agency that does not perform any of the functions or services of a CCP, CSD or SSS.

The application package filed by an applicant under the Rule will generally be kept confidential in accordance with Ontario securities law. The OSC may, if it considers that it is in the public interest to do so, require the applicant to publicly disclose a summary of the information contained in its application materials. We note that the clearing agency is required to publicly disclose its responses to the CPSS-IOSCO FMI Disclosure Framework Document. See subsection 3.23(8) of the Rule.

Significant Changes and Other Changes in Information

2.2 (2) Under subsection 2.2(2) of the Rule, a recognized clearing agency must receive prior written approval for implementing a "significant change", as defined in the subsection, except as otherwise provided in the "notice and approval protocol".[5] The procedures for notifying the Commission of a significant change and for the Commission's review, approval and publication of the significant change, will be set out in the notice and approval protocol, a term defined in subsection 2.2(1) of the Rule.

(4) The OSC generally considers a change in a recognized clearing agency's fees or fee structure to be a significant change. However, the OSC recognizes that a recognized clearing agency may frequently change their fees or fee structure and may need to implement fee changes within tight timeframes. To facilitate this process, subsection 2.2(4) of the Rule provides that a recognized clearing agency may provide information that describes the change in fees or fee structure in a shorter timeframe (at least 30 days before the expected implementation date of the change in fees or fee structure).

Ceasing to Carry on Business

2.3 A recognized or exempt clearing agency that intends to cease carrying on business in Ontario as a clearing agency, either voluntarily or involuntarily, must file a completed Form 24-503F2 *Ceasing to Carry on Business* within the appropriate timelines.

A recognized clearing agency intending to cease carrying on business in Ontario should also make an application to voluntarily surrender its recognition to the Commission pursuant to section 21.4 of the Act. The Commission may accept the voluntary surrender subject to terms and conditions.

Legal Entity Identifiers

2.6 (1) Section 2.6 of the Rule requires that a clearing agency that applies to be recognized or exempted from the recognition requirement possess and utilize a legal entity identifier ("LEI") for the purposes of any recordkeeping and reporting requirements required under Ontario securities law. It is envisioned that this identifier be a LEI under the Global LEI System. The Global LEI System is a G20 endorsed initiative[6] that will uniquely identify parties to transactions. It is currently being designed and implemented under the direction of the LEI Regulatory Oversight Committee ("ROC"), a governance body endorsed by the G20.

(2) The "Global Legal Entity Identifier System" referred to in subsection 2.6(2) and paragraph 2.6(4)(a) of the Rule is a G20 endorsed system that will serve as a public-good utility responsible for overseeing the issuance of legal entity identifiers globally to counterparties who enter into transactions.

(3) If the Global LEI System is not available at the time a clearing agency is required to fulfill their recordkeeping or reporting requirements under Ontario securities law, they must use a substitute legal entity identifier. The substitute legal entity identifier must be in accordance with the standards established by the LEI ROC for pre-LEI identifiers. At the time the Global LEI System is operational, a clearing agency or its affiliates must cease using their substitute LEI and commence using their LEI. It is conceivable that the two identifiers could be identical.

[5] The recognition order can also relieve the clearing agency from some of the requirements to seek prior approval for the implementation of a significant change.

[6] See http://www.financialstabilityboard.org/list/fsb_publications/tid_156/index.htm for more information.

PART 3
ON-GOING REQUIREMENTS APPLICABLE TO RECOGNIZED CLEARING AGENCIES

Introduction

3.0 (1) Part 3 of the Rule contains on-going requirements applicable to recognized clearing agencies. The requirements are primarily derived from the international minimum standards applicable to FMIs set out in the PFMI Report. Those principles that are relevant to clearing agencies that act as, or perform the services of, a CCP, CSD or SSS are adapted here to the Ontario context.

– ***General drafting and interpretive approaches to Part 3 of the Rule and CP***

(2) Unless the context otherwise requires, the provisions of Part 3 of the Rule are intended to be interpreted in a manner consistent with the relevant headline principles in the PFMI Report, each principle's key considerations, and the related explanatory notes. In this regard, and unless otherwise specified, Part 3 of the Rule should be read in concert with the PFMI Report. For provisions in the Rule that are not based on the PFMI Report, additional guidance is provided in a relevant subsection of this CP. Moreover, where the Canadian authorities have jointly developed supplementary guidance in order to provide additional discussion and clarity on certain aspects of these new standards in the Canadian context that are not dealt with in the PFMI Report, such supplementary guidance is inserted in a separate text box in this CP, to highlight its importance.

The following sections in Part 3 of the Rule generally correspond to the following CPSS-IOSCO Principles:

Relevant Section of the Clearing Rule	Principle in the PFMI Report
3.1 – Legal framework	Principle 1: Legal basis
3.2 – Governance	Principle 2: Governance
3.3 – Framework for comprehensive management of risks	Principle 3: Framework for comprehensive management of risks
3.4 – Credit risk	Principle 4: Credit risk
3.5 – Collateral	Principle 5: Collateral
3.6 – Margin	Principle 6: Margin
3.7 – Liquidity risk	Principle 7: Liquidity Risk
3.8 – Settlement finality	Principle 8: Settlement finality
3.9 – Money settlements	Principle 9: Money settlements
3.10 – Physical deliveries	Principle 10: Physical deliveries
3.11 – Central securities depositories	Principle 11: Central securities depositories
3.12 – Exchange-of-value settlement systems	Principle 12: Exchange-of-value-settlement systems
3.13 – Participant default rules and procedures	Principle 13: Participant-default rules and procedures
3.14 – Segregation and portability	Principle 14: Segregation and portability
3.15 – General business risk	Principle 15: General business risk
3.16 – Custody and investment risks	Principle 16: Custody and investment risks
3.17 – Operational risks	Principle 17: Operational risks
3.18 – Access, participation requirements and due process	Principle 18: Access and participation arrangements
3.19 – Tiered participation arrangements	Principle 19: Tiered participation arrangements
3.20 – Links with other financial market infrastructures	Principle 20: FMI links
3.21 – Efficiency and effectiveness	Principle 21: Efficiency and effectiveness
3.22 – Communication procedures and standards	Principle 22: Communication procedures and standards
3.23 – Transparency	Principle 23: Disclosure of rules, key procedures, and market data

In each section of Part 3 of the Rule, one or more subsections set forth a high-level principle applicable to a recognized clearing agency that generally correspond to the relevant headline principle in the PFMI Report. Most sections include additional subsections that are intended to set forth, without limiting the general principle in each section, certain detailed aspects of the general principle that correspond to a key consideration in the PFMI Report. In certain other cases, additional subsections set out one or more specific requirements that are related to the general principle or address a matter of a similar nature.

Most of the explanatory notes from the PFMI Report are incorporated in the CP. The explanatory notes discuss each principle's objective and rationale, and provide guidance on how a standard can be implemented. As noted above, supplementary guidance from the Canadian authorities is also included in text boxes in this CP.

Legal Framework

– ***General principle***

3.1 (1) A clearing agency should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities. Subsection 3.1(1) of the Rule requires a recognized clearing agency to establish, implement, maintain and enforce appropriate policies and procedures to achieve this legal basis. A robust legal basis for a clearing agency's activities is critical to its overall soundness. The legal basis defines, or provides the foundation for relevant parties to define, the rights and obligations of the clearing agency, its participants, and other relevant parties, such as its participants' customers, custodians, settlement banks, and service providers. Most risk-management mechanisms are based on assumptions about the manner and time at which these rights and obligations arise through the clearing agency. Therefore, if risk management is to be sound and effective, the enforceability of rights and obligations relating to the clearing agency and its risk management should be established with a high degree of certainty. If the legal basis for the clearing agency's activities and operations is inadequate, uncertain, or opaque, then the clearing agency, its participants, and their customers may face unintended, uncertain, or unmanageable credit or liquidity risks, which may also create or amplify systemic risks.

The legal basis consists of the legal framework and the clearing agency's rules, procedures, and contracts. The legal framework includes general laws and regulations that govern, among other things, property, contracts, insolvency, corporations, securities, banking, secured interests, and liability. In some cases, the legal framework that governs competition and consumer and investor protection may also be relevant. Laws and regulations specific to the clearing agency's activities include those governing its authorization and its regulation, supervision, and oversight; rights and interests in financial instruments; settlement finality; netting; immobilization and dematerialization of securities; arrangements for exchange of value settlement systems; collateral arrangements (including margin arrangements); default procedures; and the resolution of the clearing agency. The clearing agency should establish rules, procedures, and contracts that are clear, understandable, and consistent with the legal framework and provide a high degree of legal certainty. The clearing agency also should consider whether the rights and obligations of the clearing agency, its participants, and as appropriate, other parties, as set forth in its rules, procedures, and contracts are consistent with relevant industry standards and market protocols.

– ***Comprehensive and enforceable rules***

(2) Subsection 3.1(2) of the Rule articulates the requirement that the clearing agency's rules, procedures and related contracts be clear and comprehensive.

(a) The requirement under paragraph 3.1(2)(a) of the Rule includes explanatory material that should be written in plain language such that participants (and where relevant, participants' customers) can fully understand the system's design and operations, their rights and obligations, and the risks, fees and other material costs of participating in the system.

(d) The rules, procedures and related contracts must also be enforceable in Ontario. In particular, the legal basis should support the enforceability of the participant-default rules and procedures that the clearing agency uses to handle a defaulting or insolvent participant, especially any transfers and close-outs of a direct or indirect participant's assets or positions.

(e) Paragraph 3.1(2)(e) of the Rule requires the rules, procedures and related contracts of the clearing agency provide a reasonable degree of certainty that any actions taken under such rules and procedures will not be voided, reversed, or subject to stays. For example, ambiguity about the enforceability of procedures that facilitate the implementation of the clearing agency's plans for recovery, orderly wind-down, or resolution could delay and possibly prevent it or the relevant authorities from taking appropriate actions and hence increase the risk of a disruption to its critical services or a disorderly wind-down. In the case that the clearing agency is being wound down or resolved, the legal basis should support decisions or actions concerning termination, close-out netting, the transfer of cash and securities positions of the clearing agency, or the transfer of all or parts of the rights and obligations provided in a link arrangement to a new entity.

– *Articulating legal basis*

(3) The clearing agency should be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers in a clear and understandable way. One recommended approach to articulating the legal basis for each material aspect of the clearing agency's activities is to obtain well-reasoned and independent legal opinions or analyses. A legal opinion or analysis should, to the extent practicable, confirm the enforceability of the clearing agency's rules and procedures and must provide reasoned support for its conclusions. The clearing agency should consider sharing these legal opinions and analyses with its participants in an effort to promote confidence among participants and transparency in the system. In addition, the clearing agency should seek to ensure that its activities are consistent with the legal basis in all relevant jurisdictions. These jurisdictions could include (a) those where the clearing agency is conducting business (including through linked clearing agencies); (b) those where its participants are incorporated, located, or otherwise conducting business for the purposes of participation; (c) those where collateral is located or held; and (d) those indicated in relevant contracts.

– *Conflict-of-laws issues*

(4) Legal risk due to conflict of laws may arise if the clearing agency is, or may reasonably become, subject to the laws of various other jurisdictions (for example, when it accepts participants established in those jurisdictions, when assets are held in multiple jurisdictions, or when business is conducted in multiple jurisdictions). In such cases, under subsection 3.1(4) of the Rule, the clearing agency is required to identify and analyze potential conflict-of-laws issues and ensure its policies and procedures are designed to mitigate risk. For example, the rules governing its activities should clearly indicate the law that is intended to apply to each aspect of the clearing agency's operations. The clearing agency and its participants should be aware of applicable constraints on their abilities to choose the law that will govern the clearing agency's activities when there is a difference in the substantive laws of the relevant jurisdictions. For example, such constraints may exist because of jurisdictions' differing laws on insolvency and irrevocability. A jurisdiction ordinarily does not permit contractual choices of law that would circumvent that jurisdiction's fundamental public policy. Thus, when uncertainty exists regarding the enforceability of the clearing agency's choice of law in relevant jurisdictions, it should obtain reasoned and independent legal opinions and analysis in order to address properly such uncertainty.

In general, there is no substitute for a sound legal basis and full legal certainty. In some practical situations, however, full legal certainty may not be achievable. In such cases, the clearing agency should investigate steps to mitigate its legal risk through the selective use of alternative risk-management tools that do not suffer from legal uncertainty. These could include, in appropriate circumstances and if legally enforceable, participant requirements, exposure limits, collateral requirements, and prefunded default arrangements. The use of such tools may limit the clearing agency's exposure if its activities are found to be not supported by relevant laws and regulations. If such controls are insufficient or not feasible, the clearing agency could apply activity limits and, in extreme circumstances, restrict access or not perform the problematic activity until the legal situation is addressed.

Governance

– *General principle*

3.2 (1) Governance is the set of relationships between a clearing agency's owners, board of directors (or equivalent), management, and other relevant parties, including participants, authorities, and other stakeholders (such as participants' customers, other interdependent clearing agencies, and the broader market). Governance provides the processes through which an organization sets its objectives, determines the means for achieving those objectives, and monitors performance against those objectives. Good governance provides the proper incentives for clearing agency's board and management to pursue objectives that are in the interest of its stakeholders and that support relevant public interest considerations. Under subsection 3.2(1) of the Rule, a recognized clearing agency is required to establish, implement and maintain written governance arrangements that meet certain public interest policy objectives. The clearing agency should have objectives that place a high priority on the safety and efficiency of the clearing agency and explicitly support financial stability and other relevant public interest considerations. Further guidance by the Canadian authorities is given in Box 1 below.

Box 1:
Additional Joint Guidance from the Canadian Authorities –
Financial Stability and Other Public Interest Considerations

Context

This guidance was prepared by the Canadian authorities to provide additional context and clarity on certain aspects of these new standards in the Canadian context.

The PFMI Report defines governance as the set of relationships between an FMI's owners, board of directors (or equivalent), management, and other relevant parties, including participants, authorities, and other stakeholders (such as participants' customers, other interdependent FMIs, and the broader market). Governance provides the processes through which an organisation sets its objectives, determines the means for achieving those objectives, and monitors performance against those objectives. This note provides supplementary regulatory guidance for Canadian FMIs on their governance arrangements as it relates to supporting relevant public interest considerations.

Public interest considerations in the context of the PFMI Report

The PFMI Report indicates that FMIs should "explicitly support financial stability and other relevant public interests." However, there may be circumstances where providing explicit support of relevant public interests conflict with other FMI objectives and therefore require appropriate prioritization and balancing. For example, addressing the potential trade-offs between protecting the participants and the FMI while ensuring the financial stability interests are upheld.

Guidance within the PFMI Report

The following text has been extracted directly from the PFMI Report. The pertinent information is in bold.

PFMI Report, paragraph 3.2.2: **Given the importance of FMIs and the fact that their decisions can have widespread impact, affecting multiple financial institutions, markets, and jurisdictions, it is essential for each FMI to place a high priority on the safety and efficiency of its operations and explicitly support financial stability and other relevant public interests. Supporting the public interest is a broad concept that includes, for example, fostering fair and efficient markets.** For example, in certain over-the-counter derivatives markets, industry standards and market protocols have been developed to increase certainty, transparency, and stability in the market. If a CCP in such markets were to diverge from these practices, it could, in some cases, undermine the market's efforts to develop common processes to help reduce uncertainty. An FMI's governance arrangements should also include appropriate consideration of the interests of participants, participants' customers, relevant authorities, and other stakeholders. *(...)* For all types of FMIs, governance arrangements should provide for fair and open access (see Principle 18 on access and participation requirements) and for effective implementation of recovery or wind-down plans, or resolution.

PFMI Report, paragraph 3.2.8: **An FMI's board has multiple roles and responsibilities that should be clearly specified. These roles and responsibilities should include** (a) establishing clear strategic aims for the entity; (b) ensuring effective monitoring of senior management (including selecting its senior managers, setting their objectives, evaluating their performance, and, where appropriate, removing them); (c) establishing appropriate compensation policies (which should be consistent with best practices and based on long-term achievements, in particular, the safety and efficiency of the FMI); (d) establishing and overseeing the risk-management function and material risk decisions; (e) overseeing internal control functions (including ensuring independence and adequate resources); (f) ensuring compliance with all supervisory and oversight requirements; **(g) ensuring consideration of financial stability and other relevant public interests**; and (h) providing accountability to the owners, participants, and other relevant stakeholders.

The CPSS-IOSCO PFMI Disclosure framework and Assessment methodology provides questions to guide the assessment of the FMI against the PFMI Report. Questions related to public interest considerations are focused on ensuring that the FMI's objectives are clearly defined, giving a high priority to safety, financial stability and efficiency while also ensuring all other public interest considerations are identified and reflected in the FMI's objectives.

Supplementary Guidance for designated Canadian FMIs

- By definition the PFMIs apply to systemically important FMIs, so safety and financial stability objectives should be given a high priority.
- Efficiency is also a high priority that should contribute to (but not supersede) the safety and financial stability objectives.
- Other public interest considerations such as competition and fair and open access should also be considered in the broader safety and financial stability context.
- A framework (objectives, policies and procedures) should be in place for default and other emergency situations. The framework should articulate explicit principles to ensure financial stability and other relevant public interests are considered as part of the decision making process. For example, it should provide guidance on discretionary management decisions, consider the trade-offs between protecting the participants and the FMI while also ensuring the financial stability interests are upheld, and articulate a communication protocol with the board and regulators.

- Practical questions/approaches to assessing the appropriateness of the framework include:

  – Does the enabling legislation, articles of incorporation, corporate by-laws, corporate mission, vision statements, corporate risk statements/frameworks/methodology clearly articulate the objectives and are they appropriately aligned and communicated (transparent)?

  – Do the objectives give appropriate priority to safety, financial stability, efficiency and other public interest considerations?

  – Does the Board structure ensure the right mix of skills/experience and interests are in place to ensure the objectives are clear, appropriately prioritized, achieved and measured?

  – What is the training provided to the Board and management to support the objectives?

  – Do the service offerings and business plans support the objectives?

  – Do the system design, rules, procedures support the objectives?

  – Are the inter-dependencies and key dependencies considered and managed in the context of the broader financial stability objectives? For instance, do problem and default management policies and procedures appropriately provide for consideration of the broader financial stability interests and do they engage the key stakeholders and regulators?

  – Are there procedures in place to get timely engagement of the Board to discuss emerging/current issues, consider scenarios, provide guidance and make decisions?

  – Does the framework ensure that the broader financial stability issues are considered in any actions relating to a participant suspension?

– ***Board of directors and documented governance arrangements***

(2) Further to the general principle under subsection 3.2(1) of the Rule, paragraph 3.2(2)(a) of the Rule requires that the clearing agency have a board of directors. Under subparagraph 3.2(2)(b)(i) of the Rule, the clearing agency is also required to provide clear and direct lines of responsibility and accountability related to its governance arrangements, particularly between management and the board. Under subparagraph (ii), these arrangements must be publicly disclosed. Governance arrangements, which define the structure under which the board and management operate, should include certain key components such as: (i) the role and composition of the board and any board committees, (ii) senior management structure, (iii) reporting lines between management and the board, (iv) ownership structure, (v) internal governance policy, (vi) design of risk management and internal controls, (vii) procedures for the appointment of board members and senior management, and (viii) processes for ensuring performance accountability. Subparagraph 3.2(b)(iii) of the Rule requires that the roles of the clearing agency's board of directors be clearly specified. These roles and responsibilities should include: (i) establishing clear strategic aims for the entity; (ii) ensuring effective monitoring of senior management (including selecting its senior managers, setting their objectives, evaluating their performance, and, where appropriate, removing them); (iii) establishing appropriate compensation policies (which should be consistent with best practices and based on long-term achievements, in particular, the safety and efficiency of the clearing agency); (iv) establishing and overseeing the risk-management function and material risk decisions; (v) overseeing internal control functions (including ensuring independence and adequate resources); (vi) ensuring compliance with all supervisory and oversight requirements; (vii) ensuring consideration of financial stability and other relevant public interests; and (viii) providing accountability to the owners, participants, and other relevant stakeholders. Finally, subparagraph 3.2(b)(iv) of the Rule requires that the documented governance arrangements ensure sufficient independence for key functions such as risk management, internal control, and audit.

Depending on its ownership structure and organizational form, the clearing agency may need to focus particular attention on certain aspects of its governance arrangements. If the clearing agency is part of a larger organization, for example, it should place particular emphasis on the clarity of its governance arrangements, including in relation to any conflicts of interests and outsourcing issues that may arise because of the parent or other affiliated organization's structure. The clearing agency's governance arrangements should also be adequate to ensure that decisions of affiliated organizations are not detrimental to the clearing agency. If the clearing agency is, or is part of, a for-profit entity, it may need to place particular emphasis on managing any conflicts between income generation and safety. Where relevant, cross-border issues should be appropriately identified, assessed, and dealt with in the governance arrangements, both at the clearing agency level and at the level(s) of its parent entity(ies).

Where the clearing agency is part of a larger organization, additional guidance has been given by the Canadian authorities in Box 2.

Box 2:
Additional Joint Guidance from the Canadian authorities –
Vertically and Horizontally Integrated FMIs

Context

This guidance was prepared by the Canadian authorities to provide additional context and clarity on certain aspects of these new standards in the Canadian context.

Consolidation, or integration, of FMI services may bring about benefits for merging FMIs; however it may also create new governance challenges. The PFMI Report contains some general guidance regarding how FMIs should manage governance issues that arise in integrated entities. This note provides supplementary regulatory guidance for Canadian FMIs that either belong to an integrated entity or are considering consolidating with another entity to form one. The guidance applies to both vertically and horizontally integrated entities.

Vertical and horizontal integration in the context of FMIs

CPSS defines a vertically integrated FMI group as one that brings together post-trade infrastructure providers under common ownership with providers of other parts of the value chain (for example, one entity owning and operating an exchange, central counterparty (CCP) and securities settlement system (SSS)) and a horizontally integrated group as one that provides the same post-trade service offerings across a number of different products(for example, one entity offering CCP services for derivatives and cash markets).[7]

Guidance within the PFMI Report

The following text has been extracted directly from the PFMI Report. The pertinent information is in bold.

PFMI Report, paragraph 3.2.5: Depending on its ownership structure and organisational form, an FMI may need to focus particular attention on certain aspects of its governance arrangements. **An FMI that is part of a larger organisation, for example, should place particular emphasis on the clarity of its governance arrangements, including in relation to any conflicts of interests and outsourcing issues that may arise because of the parent or other affiliated organisation's structure. The FMI's governance arrangements should also be adequate to ensure that decisions of affiliated organisations are not detrimental to the FMI.[8] An FMI that is, or is part of, a for-profit entity may need to place particular emphasis on managing any conflicts between income generation and safety.**

PFMI Report, paragraph 3.2.6: An FMI may also need to focus particular attention on certain aspects of its risk-management arrangements as a result of its ownership structure or organisational form. **If an FMI provides services that present a distinct risk profile from, and potentially pose significant additional risks to, its payment, clearing, settlement, or recording function, the FMI needs to manage those additional risks adequately. This may include separating the additional services that the FMI provides from its payment, clearing, settlement, and recording function legally, or taking equivalent action.** The ownership structure and organisational form may also need to be considered in the preparation and implementation of the FMI's recovery or wind-down plans or in assessments of the FMI's resolvability.

Supplementary guidance for designated Canadian FMIs

An FMI that is part of a larger entity faces additional risk considerations compared to stand-alone FMIs. While there are potential benefits from integrating services into one large entity, including potential risk reduction benefits, integrated entities could face additional risks such as a greater degree of general business risk. Examples of how this could occur include the following:

- losses in one function may spill-over to the entity's other functions;

---

7 CPSS-IOSCO 2010. "Market structure developments in the clearing industry: implications for financial stability." CPSS-IOSCO Paper No 92. Available at: http://www.bis.org/publ/cpss92.htm.

8 If an FMI is wholly owned or controlled by another entity, authorities should also review the governance arrangements of that entity to see that they do not have adverse effects on the FMI's observance of this principle.

- the consolidated entity may face high combined exposures across its functions; and
- the consolidated entity may face exposures to the same participants across its functions.

For a more extensive discussion of potentially heightened risks that integrated FMIs may face, see CPSS-IOSCO, "Market structure developments in the clearing industry: implications for financial stability" (2010).

If an FMI belongs to a larger entity, or is considering consolidating with another entity, it should consider how its risk profile differs as part of the consolidated entity, and take appropriate measures to mitigate these risks.

In addition, FMIs that either belong to an integrated entity or are considering merging to form one should meet the following conditions.

1) Measures to protect critical FMI functions

- FMIs fulfill critical functions for the markets they serve. Therefore, FMI functions should be legally separated from other functions performed by the consolidated entity in order to maximize bankruptcy remoteness of the FMI functions.
- If an FMI performs multiple functions with distinct risk profiles, the operator should effectively manage the additional risks that may result. The FMI should hold sufficient financial resources to manage the risks in all services it offers, including the combined or compounded risks that would be associated with offering the services through a single legal entity. If the FMI provides multiple services, it should disclose information about the risks of the combined services to existing and prospective participants to give an accurate understanding of the risks they incur by participating in the FMI. The FMI should carefully consider the benefits of offering critical services with distinct risk profiles through separate legal entities.
- Central counterparties (CCPs) take on more risk than other FMIs, and are inherently at higher risk of failure. Therefore, the FMI must either legally separate its CCP functions from other critical (non-CCP) FMI functions, or will need to satisfy its regulators that additional risks are managed appropriately to ensure the FMI's financial and operational viability.
- Legal separation of critical functions is intended to maximize their bankruptcy remoteness and would not necessarily preclude integration of common organizational management activities such as IT and legal services across functions as long as any related risks are appropriately identified and mitigated.

2) Independence of governance and risk management

- FMIs and non-FMIs may have different corporate objectives and risk management appetites which could conflict at the parent level. For example, non-FMI functions, such as trading venues, are generally more focused on profit generation than risk management and do not have the same risk profile as FMI functions. A trading venue in a vertically integrated entity may benefit from increased participation in its service if its associated clearing function lessens its participation requirements.
- To mitigate potential conflicts, in particular the ability of other functions to negatively influence the FMI's risk controls, each FMI subsidiary should have a governance structure and risk management decision-making process that is separate and independent from the other functions and should maintain an appropriate level of autonomy from the parent and other functions to ensure efficient decision making and effective management of any potential conflicts of interest. In addition, the consolidated entity's broad governance arrangements should be reviewed to ensure they do not impede the FMI function's observance of the CPSS-IOSCO principle on governance.

3) Comprehensive management of risks

- Although risk management governance and decision-making should remain independent, it is nonetheless necessary that the consolidated entity is able to manage risk appropriately across the entity. At a consolidated level, the entity should have an appropriate risk management framework that considers the risks of each subsidiary and the additional risks related to their interdependencies.
- An FMI should identify and manage the risks it bears from and poses to other entities as a result of interdependencies. Consolidated FMIs should also identify and manage the risks they pose to one another as a result of their interdependencies. Consolidated FMIs may have exposures to the same participants, liquidity providers, and other critical service providers across products, markets and/or functions. This may increase the entity's dependence on these providers and may heighten the systemic risk associated with the consolidated entity

compared to a stand-alone FMI. Where possible, the consolidated entity and its FMIs should consider ways to mitigate risks arising from shared dependencies. The consolidated entity and its FMIs should also consider conducting entity-wide operational risk testing related to identifying and mitigating these risks.

4) Sufficient capital to cover potential losses

- Consolidated entities face the risk that a single participant defaults in more than one subsidiary simultaneously. This could result in substantial losses for the consolidated entity which will then also need to replenish resources for the FMIs to continue to operate. FMIs should consider such risks in developing their resource replenishment plan.

- Consolidated entities may face higher or lower business risk than individual FMIs depending on size, complexity and diversification across affiliates. Consolidated entities should consider these impacts in their general business risk profiles and in determining the appropriate level of liquid assets needed to cover their potential general business losses.[9]

(3) Subsection 3.2(3) of the Rule requires the clearing agency to have clear and comprehensively documented procedures for its functioning.

(a) As part of its governance procedures, the clearing agency must include those which ensure performance accountability, through the regular review of the overall performance of the board and of the performance of its individual board members and senior management, as well as, potentially, periodic independent assessments of performance.

(b) Governance procedures documenting the functioning of the board and management must also identify, address, and manage potential conflicts of interest. Conflicts of interest include, for example, circumstances in which a board member or member of management has material competing business interests with the clearing agency.

(c) Finally, the clearing agency may also need to focus particular attention on certain aspects of its risk-management arrangements as a result of its ownership structure or organizational form. Accordingly, if the clearing agency provides services that present a distinct risk profile from, and potentially pose significant additional risks to its depository, clearing and settlement functions, the clearing agency's governance procedures must address and manage those additional risks adequately. This may include legally separating the additional services that the clearing agency provides, or taking equivalent action. The ownership structure and organizational form may also need to be considered in the preparation and implementation of the clearing agency's recovery or wind-down plans or in assessments of the clearing agency's resolvability.

– ***Board member skills and composition***

(4) (a) Governance arrangements should clearly document policies for the appointment of members to its board of directors, and for its composition. Pursuant to paragraph 3.2(4)(a) of the Rule, the board must be composed of suitable members with the appropriate mix of skills (including strategic and relevant technical skills), experience and knowledge (including an understanding of the clearing agency's interconnectedness with other parts of the financial system and of relevant law) to effectively and efficiently fulfill the board's multiple roles and responsibilities. Members should also have a clear understanding of their roles in corporate governance, be able to devote sufficient time to their roles, ensure that their skills remain up-to-date, and have appropriate incentives to fulfill their roles. Members should be able to exercise objective and independent judgment. Independence from the views of management typically requires the inclusion of non-executive board members, including independent board members, as further required by paragraph 3.2(4)(b) of the Rule.

(b) Paragraph 3.2(4)(b) of the Rule requires that an appropriate number of board members be independent of the clearing agency. We generally view individuals as independent if they have no direct or indirect material relationships with the clearing agency (for example, clearing members), its officers or employees, its shareholders who hold a significant interest in the clearing agency, and those with cross-directorships. While generally also excluded, parties with significant business relationship with the clearing agency may, depending on the circumstances, also be considered independent. Members should be able to exercise objective and independent judgment after fair consideration of all relevant information and views and without undue influence from internal or external parties or interests. The clearing agency should publicly disclose which board members it regards as independent. The OSC would expect that independent members of a clearing agency would represent the public interest by ensuring that regulatory and public objectives are fulfilled and that the interests of participants are considered.

[9] Liquid assets held for general business losses must be funded by equity (such as common stock, disclosed reserves, or retained earnings) rather than debt.

– ***Management roles, responsibilities and skills***

(5) (a) Paragraph 3.2(5)(a) of the Rule requires that the roles and responsibilities of the management of the clearing agency should be clearly specified and documented. The clearing agency should also have clear and direct reporting lines between its board of directors and its management, in order to promote accountability.

(i) Under subparagraph 3.2(5)(a)(i) of the Rule, management is required to be actively involved in the risk-control processes of the clearing agency, as directed by the board.

(ii) Under subparagraph 3.2(5)(a)(ii) of the Rule, management should ensure that internal controls and related procedures are appropriately designed and executed in order to promote the clearing agency's objectives. These procedures should include a sufficient level of management oversight. With board direction, management should ensure that the clearing agency's activities are consistent with its objectives, strategy, and risk tolerance, as determined by the board. Internal controls and related procedures should be subject to regular review and testing by well-trained and staffed risk-management and internal-audit functions.

(b) As with the clearing agency's board of directors, management should have the appropriate experience and mix of skills, as well as the integrity necessary to suit their roles and discharge their responsibilities for the operation and risk management of the clearing agency.

(c) Under paragraph 3.2(5)(c) of the Rule, the management of the clearing agency is required to appoint both a chief risk officer and a chief compliance officer, and to entitle them to report directly to the board of directors, unless the board determines that the chief risk officer or chief compliance officer should report to the chief executive officer of the clearing agency. These roles are further elaborated on in subsections 3.2(6) and (7) of the Rule, respectively.

The reference to "harm to the broader financial system" in subparagraph 3.2(7)(c)(ii) of the Rule may be in relation to the local or international financial system.

– ***Risk management governance***

(8) The board is ultimately responsible for managing the clearing agency's risks. Under subsection 3.2(8) of the Rule, the clearing agency is required to establish a clear, documented risk-management framework. Governance arrangements should ensure that the risk-management and internal control functions have sufficient authority, independence, resources, and access to the board. The board should also ensure that the clearing agency's design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders. Major decisions should be clearly disclosed to relevant stakeholders and, where there is a broad market impact, the public. The board should regularly monitor the clearing agency's risk profile to ensure that it is consistent with its business strategy and risk-tolerance policy. In addition, the board should ensure that the clearing agency has an effective system of controls and oversight, including adequate governance and project management processes, over the models used to quantify, aggregate, and manage its risks. Board approval should be required for material decisions that would have a significant impact on the risk profile of the entity, such as the limits for total credit exposure and large individual credit exposures. Other material decisions that may require board approval include the introduction of new products, implementation of new links, use of new crisis-management frameworks, adoption of processes and templates for reporting significant risk exposures, and adoption of processes for considering adherence to relevant market protocols.

In the over-the-counter ("OTC") derivatives markets, clearing agencies that act as a CCP are expected to adhere to practices or arrangements that have become established market conventions or to act in a manner that does not conflict with such terms, unless the CCP has reasonable grounds not to do so and that do not conflict with the market's wider interest. In this regard, where a CCP supports a market and is expected to fully adhere to market-wide protocols and related decisions, it should be involved in the development and establishment of such standards. It is critical that market governance processes fully reflect the role of the CCP in the market. The arrangements adopted by a CCP should be transparent to its participants and regulators.

The board and governance arrangements, generally, should support the use of clear and comprehensive rules and key procedures, including detailed and effective participant-default rules and procedures. The board should have procedures in place to support its capacity to act appropriately and immediately if any risks arise that threaten the clearing agency's viability as a going concern. The governance arrangements should also provide for effective decision making in a crisis and support any procedures and rules designed to facilitate the recovery or orderly wind-down of the clearing agency.

In addition, the governance of the risk-management function is particularly important. It is essential that the clearing agency's risk-management personnel have sufficient independence, authority, resources, and access to the board to ensure that the operations of the clearing agency are consistent with the risk-management framework set by the board. The reporting lines for risk management should be clear and separate from those for other operations of the clearing agency, and there should be an additional direct reporting line to a non-executive director on the board via a chief risk officer (or equivalent). To help the board

discharge its risk-related responsibilities, the clearing agency should establish a risk committee, responsible for advising the board on the clearing agency's overall current and future risk tolerance and strategy. The committee should have a clear and public mandate and operating procedures and, where appropriate, have access to external expert advice.

(9) Subsection 3.2(9) of the Rule requires that the clearing agency validate, on an ongoing basis, the models and their methodologies used to quantify, aggregate, and manage its risks. The validation process should be independent of the development, implementation, and operation of the models and their methodologies. Validation should include (i) an evaluation of the conceptual soundness of (including developmental evidence supporting) the models, (ii) an ongoing monitoring process that includes verification of processes and benchmarking, and (iii) an analysis of outcomes that includes backtesting.

(10) An independent review may include a review carried out by qualified individuals who are independent of the development, implementation and operation of the models and their methodologies, as well as the development, implementation and operation of a validation process for these models.

(11) Under subsection 3.2(11) of the Rule, the clearing agency's board is required to consider all relevant stakeholders' interests, including those of its direct and indirect participants, in making major decisions, including those relating to the system's design, rules, and overall business strategy. In particular, where the clearing agency has cross-border operations, it should ensure that the full range of views across the jurisdictions in which it operates is appropriately considered in the decision-making process. Mechanisms for involving stakeholders in the board's decision-making process may include stakeholder representation on the board (including direct and indirect participants), user committees, and public consultation processes. As opinions among interested parties are likely to differ, the clearing agency should have clear processes for identifying and appropriately managing the diversity of stakeholder views and any conflicts of interest between stakeholders and the clearing agency. Without prejudice to local requirements on confidentiality and disclosure, the clearing agency should clearly and promptly inform its owners, participants, other users, and, where appropriate, the broader public, of the outcome of major decisions, and consider providing summary explanations for decisions to enhance transparency where it would not endanger candid board debate or commercial confidentiality.

– ***Board and advisory committees***

(12) Subsection 3.2(12) of the Rule requires the board of directors of the clearing agency to establish and maintain one or more board or advisory committees on risk management, finance and audit functions. All such committees should have clearly assigned responsibilities and procedures.

A clearing agency's internal audit function should have sufficient resources and independence from management to provide, among other activities, a rigorous and independent assessment of the effectiveness of its risk-management and control processes. A board will typically establish an audit committee to oversee the internal audit function. In addition to reporting to senior management, the audit function should have regular access to the board through an additional reporting line.

Under paragraph 3.2(12)(d) of the Rule, a committee will be required to have an appropriate composition of sufficiently knowledgeable independent individuals. With respect to independence, policies and procedures related to committees should include processes to identify, address, and manage potential conflicts of interest. Conflicts of interest include, for example, circumstances in which a board member has material competing business interests with the clearing agency.

Framework for comprehensive management of risks

– ***General principle***

3.3 (1) Subsection 3.3(1) of the Rule requires a recognized clearing agency to have a clear and documented risk-management framework for comprehensively managing its various risks. As further discussed in subsection 3.3(2), the clearing agency should take an integrated and comprehensive view of its risks, including the risks it bears from and poses to its participants and their customers, as well as the risks it bears from and poses to other entities, such as other clearing agencies, settlement banks, liquidity providers, and service providers (for example, matching and portfolio compression service providers). The clearing agency should consider how various risks relate to, and interact with, each other. The clearing agency should have a sound risk-management framework (including policies, procedures, and systems) that enable it to identify, measure, monitor, and manage effectively the range of risks that arise in or are borne by the clearing agency. The clearing agency's framework should include the identification and management of interdependencies. The clearing agency should also provide appropriate incentives and the relevant information for its participants and other entities to manage and contain their risks vis-à-vis the clearing agency. The board of directors plays a critical role in establishing and maintaining a sound risk-management framework.

– *Policies, procedures and systems, etc.*

(2) Under paragraphs 3.3(2)(a) and (b) of the Rule, the clearing agency's risk management framework must have appropriate risk-management policies, procedures, and systems that are subject to periodic review. To establish a sound risk-management framework, the clearing agency should first identify the range of risks that arise within the clearing agency and the risks it directly bears from or poses to its participants, its participants' customers, and other entities. It should identify those risks that could materially affect its ability to perform or to provide services as expected. Typically these include legal, credit, liquidity, and operational risks. The clearing agency should also consider other relevant and material risks, such as market (or price), concentration, and general business risks, as well as risks that do not appear to be significant in isolation, but when combined with other risks become material. The consequences of these risks may have significant reputational effects on the clearing agency and may undermine its financial soundness as well as the stability of the broader financial markets. In identifying risks, the clearing agency should take a broad perspective and identify the risks that it bears from other entities, such as other clearing agencies, settlement banks, liquidity providers, service providers, and any entities that could be materially affected by the clearing agency's inability to provide services.

The clearing agency's board is ultimately responsible for managing the clearing agency's risks. The board should determine an appropriate level of aggregate risk tolerance and capacity for the clearing agency. The board and senior management should establish policies, procedures, and controls that are consistent with the clearing agency's risk tolerance and capacity. The clearing agency's policies, procedures, and controls serve as the basis for identifying, measuring, monitoring, and managing the clearing agency's risks and should cover routine and non-routine events, including the potential inability of a participant, or the clearing agency itself, to meet its obligations. The clearing agency's policies, procedures, and controls should address all relevant risks. These policies, procedures, and controls should be part of a coherent and consistent framework that is reviewed and updated periodically and shared with the relevant authorities.

(c) In establishing risk-management policies, procedures, and systems, the clearing agency is required to encourage participants and, where relevant, their customers to manage and contain the risks they pose to the clearing agency. Doing so can help reduce the moral hazard that may arise from formulas in which losses are shared equally among participants or other formulas where losses are not shared proportionally to risk.

(3) (a) Under paragraph 3.3(3)(a) of the Rule, the clearing agency is expected to regularly review, and develop risk-management tools, to address the material risks it bears from and poses to other entities (such as other clearing agencies, settlement banks, liquidity providers, and service providers). In particular, the clearing agency should have effective risk-management tools to manage all relevant risks, including the legal, credit, liquidity, general business, and operational risks that it bears from and poses to other entities, in order to limit the effects of disruptions from and to such entities as well as disruptions from and to the broader financial markets. These tools should include business continuity arrangements that allow for rapid recovery and resumption of critical operations and services in the event of operational disruptions, liquidity risk-management techniques, and recovery or orderly wind-down plans (as further discussed under paragraph 3.3(3)(c). Because of the interdependencies between and among systems, the clearing agency should ensure that its crisis-management arrangements allow for effective coordination among the affected entities, including cases in which its own viability or the viability of an interdependent entity is in question.

(b) In respect of recovery and orderly wind-down, the clearing agency must identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern. These scenarios should take into account the various independent and related risks to which the clearing agency is exposed. The clearing agency must also assess the effectiveness of a full range of options for recovery or orderly wind-down.

(c) Using the analysis required under paragraph 3.3(3)(b) of the Rule (and taking into account any constraints potentially imposed by domestic legislation), the clearing agency is required to prepare appropriate plans for its recovery or orderly wind-down. The plan should contain, among other elements, a substantive summary of the key recovery or orderly wind-down strategies, the identification of the clearing agency's critical operations and services, and a description of the measures needed to implement the key strategies. The clearing agency should have the capacity to identify and provide to related entities the information needed to implement the plan on a timely basis during stress scenarios. In addition, these plans should be reviewed and updated regularly.

(e) Moreover, the clearing agency should employ robust information and risk-control systems to provide it with the capacity to obtain timely information necessary to apply risk-management policies and procedures. In particular, these systems should allow for the accurate and timely measurement and aggregation of risk exposures across the clearing agency, the management of individual risk exposures and the interdependencies between them, and the assessment of the impact of various economic and financial shocks that could affect the clearing agency. Information systems should also enable the clearing agency to monitor its credit and liquidity exposures, overall credit and liquidity limits, and the relationship between these exposures and limits. These information systems should permit, where practicable, the provision of real time information to enable participants to manage risks. If the clearing agency does not provide real time information, it should provide clear, full, updated information to participants throughout the day (as frequently as possible) and consider appropriate enhancements to its systems.

Where appropriate, the clearing agency should also provide its participants and its participants' customers with the relevant information to manage and contain their credit and liquidity risks. The clearing agency may consider it beneficial to provide its participants and its participants' customers with information necessary to monitor their credit and liquidity exposures, overall credit and liquidity limits, and the relationship between these exposures and limits. For example, where the clearing agency permits participants' customers to create exposures in the clearing agency that are borne by the participants, the clearing agency should provide participants with the capacity to limit such risks.

(f) Under paragraph 3.3(3)(f), the clearing agency is required to have comprehensive internal processes to help the board and senior management monitor and assess the adequacy and effectiveness of the clearing agency's risk-management policies, procedures, systems, and controls. While business-line management serves as the first "line of defence," the adequacy of and adherence to control mechanisms should be assessed regularly through independent compliance programmes and independent audits. Audits should be performed by qualified and independent individuals who did not participate in the creation of the control mechanisms. At times the clearing agency may find it necessary to engage a team of external auditors. A robust internal audit function can provide an independent assessment of the effectiveness of the clearing agency's risk-management and control processes. An emphasis on the adequacy of controls by senior management and the board as well as internal audit can also help counterbalance a business-management culture that may favour business interests over establishing and adhering to appropriate controls. In addition, proactive engagement of audit and internal control functions when changes are under consideration can also be beneficial. Specifically, clearing agencies that involve their internal audit function in pre-implementation reviews will often reduce their need to expend additional resources to retrofit processes and systems with critical controls that had been overlooked during initial design phases and construction efforts.

Credit risk

– ***General principle***

3.4 (1) Credit risk is broadly defined as the risk that a counterparty will be unable to meet fully its financial obligations when due or at any time in the future. The default of a participant (and its affiliates) has the potential to cause severe disruptions to a clearing agency, its other participants, and the financial markets more broadly. In meeting the requirement of subsection 3.4(1) of the Rule, a recognized clearing agency that acts as, or performs the services of, a CCP or SSS is required to measure, monitor and manage its credit exposures. Credit exposure may arise from current exposures, potential future exposures, or both. Current exposure, in this context, is defined as the loss that a clearing agency (or in some cases, its participants) would face immediately if a participant were to default. Potential future exposure is broadly defined as any potential credit exposure that a clearing agency could face at a future point in time. The type and level of credit exposure faced by a clearing agency will vary based on its design and the credit risk of the counterparties concerned. The clearing agency should also identify sources of credit risk, routinely measure and monitor credit exposures, and use appropriate risk-management tools to control these risks.

(2) An SSS may face a number of credit risks from its participants or its settlement processes. An SSS faces counterparty credit risk when it extends intraday or overnight credit to participants. This extension of credit creates current exposures and can lead to potential future exposures, even when the SSS accepts collateral to secure the credit. An SSS would face potential future exposure if the value of collateral posted by a participant to cover this credit might fall below the amount of credit extended to the participant by the SSS, leaving a residual exposure. In addition, an SSS that explicitly guarantees settlement would face current exposures if a participant were not to fund its net debit position or meet its obligations to deliver financial instruments. Further, depending on the settlement mechanism, the SSS or its participants face principal risk, which is the risk of loss of securities or payments made to the defaulting participant prior to the detection of the default. If the clearing agency provides the services of an SSS, it should cover its current and, where they exist, potential future exposures to each participant fully with a high degree of confidence using collateral and other equivalent financial resources (see also the Rule's section 3.5 on collateral requirements).

(3) A CCP typically faces both current and potential future exposures because it typically holds open positions with its participants. Current exposure arises from fluctuations in the market value of open positions between the CCP and its participants. Potential future exposure arises from potential fluctuations in the market value of a defaulting participant's open positions until the positions are closed out, fully hedged, or transferred by the CCP following an event of default. For example, during the period in which a CCP neutralizes or closes out a position following the default of a participant, the market value of the position or asset being cleared may change, which could increase the CCP's credit exposure, potentially significantly. A CCP can also face potential future exposure due to the potential for collateral (initial margin) to decline significantly in value over the close-out period. If the clearing agency is operating as a CCP, it should cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and other prefunded financial resources (see also the Rule's sections 3.5 on collateral requirements and 3.6 on margin requirements).

(4) Subsection 3.4(4) of the Rule sets out the requirement that if the clearing agency acts as a CCP, it must maintain, in addition to the financial resources described in paragraph 3.4(3) of the Rule, financial resources sufficient to meet a so-called "Cover 1" threshold.

(5) The Rule also requires that the clearing agency that acts as a CCP and that is involved in activities with a more-complex risk profile or that is systemically important in multiple jurisdictions to maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions (otherwise known as a "Cover 2" threshold).

The Commission is of the view that a CCP will be involved in activities with a more-complex risk profile where it is clearing, for example, credit default swaps, credit default futures, any derivatives that reference either credit default swaps or credit default futures, and any other products the characteristics of which include jump-to-default price changes or high correlations with potential participant defaults.

In determining whether a CCP is systemically important in multiple jurisdictions, the Commission will consider, among other factors, (i) the location of its participants, (ii) the aggregate volume and value of transactions that originate in each jurisdiction in which it operates, (iii) the proportion of its total volume and value of transactions that originate in each jurisdiction in which it operates, (iv) the range of currencies in which the instruments it clears are cleared or settled, (v) any links it has with other clearing agencies, payment systems or trade repositories located in other jurisdictions, and (vi) the extent to which it clears instruments that are subject to mandatory clearing obligations in multiple jurisdictions. The Commission will also consider whether the CCP has been designated as systemically important by a regulatory authority both in Canada and outside Canada.

– ***Identifying, measuring and monitoring credit exposures***

(6) Under subsection 3.4(6), the clearing agency must establish a robust framework to manage its credit exposures to its participants and those arising from its clearing and settlement processes. Credit exposure may arise from current exposures, potential future exposures, or both. The clearing agency must also routinely measure and monitor credit exposures, and use appropriate risk-management tools to control these risks.

If the clearing agency provides the services of an SSS, it should frequently and regularly measure and monitor its credit risks throughout the day using timely information. The SSS should ensure it has access to adequate information, such as appropriate collateral valuations, to allow it to measure and monitor its current exposures and degree of collateral coverage. If credit risk exists between participants, the SSS should provide the capacity to participants to measure and monitor their current exposures to each other in the system or adopt rules that require participants to provide relevant exposure information. Current exposure should be relatively straightforward to measure and monitor; however, potential future exposure may require modeling or estimation. In order to monitor its risks associated with current exposure, an SSS should monitor market conditions for developments that could affect these risks, such as collateral values. In order to estimate its potential future exposure and associated risk, an SSS should model possible changes in collateral values and market conditions over an appropriate liquidation period. An SSS, where appropriate, should monitor the existence of large exposures to its participants and their customers. Additionally, it should monitor any changes in the creditworthiness of its participants. If a financial exposure is a liquidity exposure, section 3.7 would apply.

The SSS should mitigate its credit risks to the extent possible. The SSS should, for example, eliminate its or its participants' principal risk associated with the settlement process by employing an exchange-of-value settlement system. The use of a system that settles securities and funds on a gross, obligation-by-obligation basis would further reduce credit and liquidity exposures among participants and between participants and the SSS. In addition, the SSS should limit its current exposures by limiting intraday credit extensions and, where relevant, overnight credit extensions. Such limits should balance the usefulness of credit to facilitate settlement within the system against the SSS's credit exposures.

In order to manage the risk from a participant default, the SSS should consider the impact of participant defaults and use robust techniques for managing collateral. The SSS should cover its current and, where they exist, potential future exposures to each participant fully with a high degree of confidence using collateral and other equivalent financial resources (equity can be used after deduction of the amount dedicated to cover general business risk). By requiring collateral to cover the credit exposures, an SSS mitigates, and in some cases eliminates, its current exposures and may provide participants with an incentive to manage the credit risks they pose to the SSS or other participants. Further, this collateralization allows an SSS that employs certain settlement mechanisms to avoid unwinding transactions or to mitigate the effect of an unwind should a participant default on its obligations. Collateral and other equivalent financial resources can fluctuate in value, however, so the SSS needs to establish prudent haircuts to mitigate the resulting potential future exposures.

If the clearing agency is acting as a CCP, it should frequently and regularly measure and monitor its credit risks throughout the day using timely information. The CCP should ensure that it has access to adequate information to allow it to measure and monitor its current and potential future exposures. Current exposure is relatively straightforward to measure and monitor when relevant market prices are readily available. Potential future exposure is typically more challenging to measure and monitor and usually requires modelling and estimation of possible future market price developments and other variables and conditions, as well as specifying an appropriate time horizon for the close out of defaulted positions. In order to estimate the potential future exposures that could result from participant defaults, the CCP should identify risk factors and monitor potential market

developments and conditions that could affect the size and likelihood of its losses in the close out of a defaulting participant's positions. The CCP should monitor the existence of large exposures to its participants and, where appropriate, their customers. Additionally, it should monitor any changes in the creditworthiness of its participants.

The CCP should mitigate its credit risk to the extent possible. For example, to control the build-up of current exposures, the CCP should require that open positions be marked to market and that each participant pay funds, typically in the form of variation margin, to cover any loss in its positions' net value at least daily; such a requirement limits the accumulation of current exposures and therefore mitigates potential future exposures. In addition, the CCP should have the authority and operational capacity to make intraday margin calls, both scheduled and unscheduled, from participants. Further, the CCP may choose to place limits on credit exposures in some cases, even if collateralised. Limits on concentrations of positions or additional collateral requirements may also be warranted.

A CCP typically uses a sequence of prefunded financial resources, often referred to as a "waterfall," to manage its losses caused by participant defaults. The waterfall may include a defaulter's initial margin, the defaulter's contribution to a prefunded default arrangement, a specified portion of the CCP's own funds, and other participants' contributions to a prefunded default arrangement. Initial margin is used to cover a CCP's potential future exposures, as well as current exposures not covered by variation margin, to each participant with a high degree of confidence. However, a CCP generally remains exposed to residual risk (or tail risk) if a participant defaults and market conditions concurrently change more drastically than is anticipated in the margin calculations. In such scenarios, a CCP's losses may exceed the defaulting participant's posted margin. Although it is not feasible to cover all such tail risks given the unknown scope of potential losses due to price changes, the CCP should maintain additional financial resources, such as additional collateral or a prefunded default arrangement, to cover a portion of the tail risk.

– ***Stress testing***

(8) If the clearing agency is operating as a CCP, subsection 3.4(8) of the Rule sets out requirements governing routine stress testing of the adequacy of the clearing agency's total financial resources. The CCP must determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default of one or more participants in extreme but plausible market conditions through rigorous stress testing. The CCP must have clear procedures to report the results of its stress tests to appropriate decision makers at the CCP and to use these results to evaluate the adequacy of and adjust its total financial resources. Stress tests are to be performed at least daily, using standard and predetermined parameters and assumptions. On at least a monthly basis, the CCP must perform a comprehensive and thorough analysis of stress testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for determining the CCP's required level of default protection in light of current and evolving market conditions. A full validation of the CCP's risk-management model must be performed at least annually.

Moreover, the CCP should conduct, as appropriate, reverse stress tests aimed at identifying the extreme scenarios and market conditions in which its total financial resources would not provide sufficient coverage of tail risk. Reverse stress tests require a CCP to model hypothetical positions and extreme market conditions that may go beyond what are considered extreme but plausible market conditions in order to help understand margin calculations and the sufficiency of financial resources given the underlying assumptions modelled. Modelling extreme market conditions can help a CCP determine the limits of its current model and resources. However, it requires the CCP to exercise judgment when modelling different markets and products. The CCP should develop hypothetical extreme scenarios and market conditions tailored to the specific risks of the markets and of the products it serves. Reverse stress testing should be considered a helpful management tool but need not necessarily drive the CCP's determination of the appropriate level of financial resources.

(10) Extreme but plausible conditions should not be considered a fixed set of conditions, but rather, conditions that evolve. Stress tests should quickly incorporate emerging risks and changes in market assumptions (for example, departures from usual patterns of co-movements in prices among the products the CCP clears). If the CCP proposes to clear new products, it should consider movements in prices of any relevant related products.

– ***Uncovered credit losses***

(11) As required by subsection 3.4(11) of the Rule, the clearing agency should establish explicit rules and procedures that address fully any credit losses it may face as a result of any individual or combined default among its participants with respect to any of their obligations to the clearing agency. The rules and procedures of the clearing agency should expressly set out a waterfall, including the circumstances in which specific resources of the clearing agency can be used in a participant default. For the purposes of subsection 3.4(12) of the Rule, the clearing agency should not include as "available" to cover credit losses from participant defaults those resources that are needed to cover current operating expenses, potential general business losses, or other losses from other activities in which the clearing agency is engaged. In addition, if the clearing agency serves multiple markets (either in the same jurisdiction or multiple jurisdictions), its ability to use resources supplied by participants in one market to cover losses from a participant default in another market should have a sound legal basis, be clear to all participants, and avoid significant levels of contagion risk between markets and participants. The design of the clearing agency's stress tests should take into account the extent to which resources are pooled across markets in scenarios involving one or more participant defaults across several markets.

(12) In certain extreme circumstances, the post-liquidation value of the collateral and other financial resources that secure the clearing agency's credit exposures may not be sufficient to cover credit losses resulting from those exposures fully. The clearing agency should analyze and plan for how it would address any uncovered credit losses. The clearing agency should establish explicit rules and procedures that address fully any credit losses it may face as a result of any individual or combined default among its participants with respect to any of their obligations to the clearing agency. The clearing agency's rules and procedures should address how potentially uncovered credit losses would be allocated, including the repayment of any funds a clearing agency may borrow from liquidity providers. These rules and procedures should also indicate the clearing agency's process to replenish any financial resources that the clearing agency may employ during a stress event, so that it can continue to operate in a safe and sound manner.

Collateral

– ***General principle***

3.5 (1) (a) Collateralizing credit exposures protects a clearing agency, and where relevant, its participants, against potential losses in the event of a participant default. Besides mitigating a clearing agency's own credit risk, the use of collateral can provide participants with incentives to manage the risks they pose to a clearing agency or other participants. Paragraph 3.5(1)(a) of the Rule sets out the general principle that a recognized clearing agency that acts as, or performs the services of, a CCP or SSS must limit the assets it (routinely) accepts as collateral to those with low credit, liquidity, and market risks. Prudent collateral acceptance and valuation practices are further required under subsection 3.5(2) of the Rule.

(b) While the clearing agency is required to generally limit the assets it (routinely) accepts as collateral to those with low credit, liquidity, and market risks, in the normal course of business, it may be exposed to risk from certain types of collateral that are not considered to have low credit, liquidity, and market risks. However, in some instances, these assets may be acceptable collateral for credit purposes if an appropriate haircut is applied. Where the clearing agency accepts collateral with credit, liquidity, and market risks above minimum levels, it should demonstrate that it sets and enforces appropriately conservative haircuts and concentration limits. The clearing agency must apply prudent haircuts to the value of the collateral to achieve a high degree of confidence that the liquidation value of the collateral will be greater than or equal to the obligation that the collateral secures in extreme but plausible market conditions. Additionally, the clearing agency should have the capacity to use the collateral promptly when needed.

– ***Valuation practices and haircuts***

(2) In order to have adequate assurance of the collateral's value in the event of liquidation, subsection 3.5(2) of the Rule requires the clearing agency to establish, implement and maintain collateral acceptance and valuation practices. The clearing agency should regularly adjust its requirements for acceptable collateral in accordance with changes in underlying risks. When evaluating types of collateral, the clearing agency should consider potential delays in accessing the collateral due to the settlement conventions for transfers of the asset. In addition, participants should not be allowed to post their own debt or equity securities, or debt or equity of companies closely linked to them, as collateral, as further required under paragraph 3.5(3)(a) of the Rule. More generally, the clearing agency should mitigate specific wrong-way risk, as further required under paragraph 3.5(3)(b) of the Rule. The clearing agency should measure and monitor the correlation between a counterparty's creditworthiness and the collateral posted and take measures to mitigate the risks, for instance by setting more-conservative haircuts, as otherwise required by this subsection and under paragraph 3.5(1)(b) and subsection 3.5(4) of the Rule.

If the clearing agency plans to use assets held as collateral to secure liquidity facilities in the event of a participant default, the clearing agency will also need to consider, in determining acceptable collateral, what will be acceptable as security to lenders offering liquidity facilities.

Additionally, the clearing agency is required to apply prudent haircuts to the value of the collateral, in order to achieve a high degree of confidence that the liquidation value of the collateral will be greater than or equal to the obligation that the collateral secures in extreme but plausible market conditions, as well as to reduce the need for procyclical adjustments. Haircuts should reflect the potential for asset values and liquidity to decline over the interval between their last revaluation and the time by which the clearing agency can reasonably assume that the assets can be liquidated. Haircuts also should incorporate assumptions about collateral value during stressed market conditions and reflect regular stress testing that takes into account extreme price moves, as well as changes in market liquidity for the asset.

(3) (a) Under paragraph 3.5(3)(a) of the Rule, the clearing agency is required to prohibit participants from posting collateral that is their own debt or equity securities, or debt or equity of their affiliates. Covered bonds issued by a participant or a closely linked company may be accepted as collateral, provided the underlying collateral of these covered bonds would be appropriately segregated by the issuer from its own assets and considered as acceptable under this section.

(b) Specific wrong-way risk refers to the risk that an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty is deteriorating. Generally, the clearing agency must mitigate specific wrong-way risk by limiting the acceptance of collateral that would likely lose value in the event that the participant providing the collateral defaults.

(c) The clearing agency must, at a minimum, mark its collateral to market daily. "Marking to market" is the practice if revaluing securities and other financial instruments, including collateral, using current market prices. If market prices do not fairly represent the true value of the assets, the clearing agency should have the authority to exercise discretion in valuing assets according to predefined and transparent methods.

(d) The clearing agency's haircut procedures must be validated at least annually. Validation should be performed by personnel of sufficient expertise who are independent of the personnel that created and applied the haircut procedures. These expert personnel could be drawn from within the clearing agency. However, a review by personnel external to the clearing agency may also be necessary at times.

– ***Limiting procyclicality***

(4) Subsection 3.5(4) of the Rule requires that the clearing agency appropriately address procyclicality in its collateral arrangements. To the extent practicable and prudent, the clearing agency should establish stable and conservative haircuts that are calibrated to include periods of stressed market conditions in order to reduce the need for procyclical adjustments. In this context, procyclicality typically refers to changes in risk-management practices that are positively correlated with market, business, or credit cycle fluctuations and that may cause or exacerbate financial instability. While changes in collateral values tend to be procyclical, collateral arrangements can increase procyclicality if haircut levels fall during periods of low market stress and increase during periods of high market stress. For example, in a stressed market, the clearing agency may require the posting of additional collateral both because of the decline of asset prices and because of an increase in haircut levels. Such actions could exacerbate market stress and contribute to driving down asset prices further, resulting in additional collateral requirements. This cycle could exert further downward pressure on asset prices. Addressing issues of procyclicality may create additional costs for clearing agencies and their participants in periods of low market stress because of higher collateral requirements, but result in additional protection and potentially less-costly and less-disruptive adjustments in periods of high market stress.

– ***Concentrations limits or charges***

(5) Under subsection 3.5(5) of the Rule, the clearing agency is required to avoid concentrated holdings of certain assets, as they can significantly impair the ability to liquidate such assets quickly without significant adverse price effects. High concentrations within holdings can be avoided by establishing concentration limits, thereby restricting participants' ability to provide certain collateral assets above a specified threshold. High concentrations can also be avoided by imposing concentration charges, which would penalize participants for maintaining holdings of certain assets beyond a specified threshold. Further, concentration limits and charges should be constructed to prevent participants from covering a large share of their collateral requirements with the most risky assets acceptable.

– ***Cross-border collateral***

(7) Subsection 3.5(7) requires the clearing agency, if it accepts cross-border (or foreign) collateral, to identify and mitigate any additional risks associated with its use and ensure that it can be used in a timely manner. A cross-border collateral arrangement can provide an efficient liquidity bridge across markets, help relax collateral constraints for some participants, and contribute to the efficiency of some asset markets. These linkages, however, can also create significant interdependencies and risks to the clearing agency that should be evaluated and managed. For example, the clearing agency should have appropriate legal and operational safeguards to ensure that it can use the cross-border collateral in a timely manner and should identify and address any significant liquidity effects. The clearing agency also should consider foreign-exchange risk where collateral is denominated in a currency different from that in which the exposure arises, and set haircuts to address the additional risk to a high level of confidence. The clearing agency should have the capacity to address potential operational challenges of operating across borders, such as differences in time zones or operating hours of foreign CSDs or custodians.

– ***Collateral management systems***

(8) Under subsection 3.5(8) of the Rule, the clearing agency is required to use a well-designed and operationally flexible collateral management system. Such a system should accommodate changes in the on-going monitoring and management of collateral. Where appropriate, the system should allow for the timely calculation and execution of margin calls, the management of margin call disputes, and the accurate daily reporting of levels of initial and variation margin. Further, a collateral management system should track the extent of reuse of collateral (both cash and non-cash) and the rights of the clearing agency to the collateral provided to it by its counterparties. The clearing agency's collateral management system should also have functionality to accommodate the timely deposit, withdrawal, substitution, and liquidation of collateral. The clearing agency should allocate sufficient resources to its collateral management system to ensure an appropriate level of operational performance, efficiency,

and effectiveness. Senior management should ensure that the clearing agency's collateral management function is adequately staffed to ensure smooth operations, especially during times of market stress, and that all activities are tracked and reported, as appropriate, to senior management.

Additionally, the clearing agency should have clear and transparent rules regarding the reuse of collateral. Reuse of collateral refers to the clearing agency's subsequent use of collateral that has been provided by participants in the normal course of business. This differs from the clearing agency's use of collateral in a default scenario during which the defaulter's collateral, which has become the property of the clearing agency, can be used to access liquidity facilities or can be liquidated to cover losses. In particular, the rules should clearly specify when a clearing agency may reuse its participant collateral and the process for returning that collateral to participants. In general, clearing agency should not rely on the reuse of collateral as an instrument for increasing or maintaining its profitability. However, it may invest any cash collateral received from participants on their behalf.

Margin

– ***General principle***

3.6 (1) An effective margining system is a key risk-management tool for a CCP to manage the credit exposures posed by its participants' open positions. Accordingly, a CCP will typically collect margin (i.e. collateral) to assure performance and to mitigate its credit exposures for all products that it clears if a participant defaults. Subsection 3.6(1) of the Rule sets out the general requirement that where a recognized clearing agency is operating as a CCP, it must cover its credit exposures to its participants for all products through an effective risk-based margin system. The balance of section 3.6 of the Rule also has application to such a CCP.

Margin systems typically differentiate between initial margin and variation margin. Initial margin is typically collected to cover potential changes in the value of each participant's position (that is, potential future exposure) over the appropriate close-out period in the event the participant defaults. Calculating potential future exposure requires modeling potential price movements and other relevant factors, as well as specifying the target degree of confidence and length of the close-out period. Variation margin is collected and paid out to reflect current exposures resulting from actual changes in market prices. To calculate variation margin, open positions are marked to current market prices and funds are typically collected from (or paid to) a counterparty to settle any losses (or gains) on those positions.

The CCP's margin system should be regularly reviewed. Validation of the margin system should be performed by personnel of sufficient expertise who are independent of the personnel that created and apply the margin system. These expert personnel could be drawn from within the CCP. However, a review by personnel external to the CCP may also be necessary at times.

– ***Margin system***

(2) When setting margin requirements, the CCP should have a margin system that establishes margin levels commensurate with the risks and particular attributes of each product, portfolio, and market it serves. Product risk characteristics can include, but are not limited to, price volatility and correlation, non-linear price characteristics (for example, where some derivatives, such as options, provide payoff functions that are not linear as compared to the payoff of the underlying asset), jump-to-default risk (i.e. the risk of a default that would result in significant financial payment obligations, such as for credit default swap protection sellers), market liquidity, possible liquidation procedures (for example, tender by or commission to market-makers), and correlation between price and position such as wrong-way risk. Margin requirements need to account for the complexity of the underlying instruments and the availability of timely, high-quality pricing data. For example, OTC derivatives require more-conservative margin models because of their complexity and the greater uncertainty of the reliability of price quotes. Furthermore, the appropriate close-out period may vary among products and markets depending upon the product's liquidity, price, and other characteristics. Additionally, a CCP for cash markets (or physically deliverable derivatives products) should take into account the risk of "fails to deliver" of securities (or other relevant instruments) in its margin methodology. In a fails-to-deliver scenario, the CCP should continue to margin positions for which a participant fails to deliver the required security (or other relevant instrument) on the settlement date.

– ***Price information***

(3) The CCP is required to have a reliable source of timely price data for its margin system, as such data is critical for the system to operate accurately and effectively. In most cases, the CCP should rely on market prices from continuous, transparent, and liquid markets. If the CCP acquires pricing data from third-party pricing services, it should continually evaluate the data's reliability and accuracy.

The CCP should also have procedures and sound valuation models for addressing circumstances in which pricing data from markets or third-party sources are not readily available or reliable. The valuation models should be validated under a variety of market scenarios at least annually by a qualified and independent party to ensure that its model accurately produces appropriate prices, and where appropriate, the CCP should adjust its calculation of initial margin to reflect any identified model risk. The

CCP should address all pricing and market liquidity concerns on an ongoing basis in order to conduct daily measurement of its risks.

– *Initial margin methodology*

(4) Subsections 3.6(4) to 3.6(6) of the Rule set out requirements relating to the initial margin methodology of the CCP. Under subsection 3.6(4) of the Rule, the CCP is required to adopt initial margin models and parameters that are risk-based and generate margin requirements sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Under paragraph 3.6(5)(a) of the Rule, initial margin is required to meet an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure.[10] Under paragraph 3.6(6)(a) of the Rule, where the CCP calculates margin at the portfolio level, the above requirement applies to each portfolio's distribution of future exposure. If the CCP calculates margin at more-granular levels, such as at the sub-portfolio level or by product, the requirement under paragraph 3.6(5)(a) of the Rule must be met for the corresponding distributions of future exposure at a stage prior to margining among sub-portfolios or products, as specified by paragraph 3.6(6)(b) of the Rule. Under paragraph 3.6(5)(b) of the Rule, the initial margin model should (i) use a conservative estimate of the time horizons for the effective hedging or close out of the particular types of products cleared by the CCP (including in stressed market conditions), (ii) have an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products, and (iii) to the extent practicable and prudent, limit the need for destabilizing, procyclical changes.

In respect of close-out periods, the CCP should select an appropriate period for each product that it clears and document the close-out periods and related analysis for each product type. The CCP should base its determination of the close-out periods for its initial margin model upon historical price and liquidity data, as well as reasonably foreseeable events in a default scenario. The close-out period should account for the impact of a participant's default on prevailing market conditions. Inferences about the potential impact of a default on the close-out period should be based on historical adverse events in the product cleared, such as significant reductions in trading or other market dislocations. The close-out period should be based on anticipated close-out times in stressed market conditions but may also take into account the CCP's ability to hedge effectively the defaulter's portfolio. Further, close-out periods should be set on a product-specific basis because less-liquid products might require significantly longer close-out periods. The CCP should also consider and address position concentrations, which can lengthen close-out timeframes and add to price volatility during close outs.

The CCP should select an appropriate sample period for its margin model to calculate required initial margin for each product that it clears and should document the period and related analysis for each product type. The amount of margin may be very sensitive to the sample period and the margin model. Selection of the period should be carefully examined based on the theoretical properties of the margin model and empirical tests on these properties using historical data. In certain instances, the CCP may need to determine margin levels using a shorter historical period to reflect new or current volatility in the market more effectively. Conversely, the CCP may need to determine margin levels based on a longer historical period in order to reflect past volatility. The CCP should also consider simulated data projections that would capture plausible events outside of the historical data especially for new products without enough history to cover stressed market conditions.

The CCP should identify and mitigate any credit exposure that may give rise to specific wrong-way risk. Specific wrong-way risk arises where an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty is deteriorating. For example, participants in a CCP clearing credit-default swaps should not be allowed to clear single-name credit-default swaps on their own names or on the names of their legal affiliates. The CCP is expected to review its portfolio regularly in order to identify, monitor, and mitigate promptly any exposures that give rise to specific wrong-way risk.

The CCP should appropriately address procyclicality in its margin arrangements. In this context, procyclicality typically refers to changes in risk-management practices that are positively correlated with market, business, or credit cycle fluctuations and that may cause or exacerbate financial instability. For example, in a period of rising price volatility or credit risk of participants, the CCP may require additional initial margin for a given portfolio beyond the amount required by the current margin model. This could exacerbate market stress and volatility further, resulting in additional margin requirements. These adverse effects may occur without any arbitrary change in risk-management practices. To the extent practicable and prudent, the CCP should adopt forward-looking and relatively stable and conservative margin requirements that are specifically designed to limit the need for destabilizing, procyclical changes. To support this objective, the CCP could consider increasing the size of its prefunded default arrangements to limit the need and likelihood of large or unexpected margin calls in times of market stress. These procedures may create additional costs for central counterparties and their participants in periods of low market volatility due to higher margin or prefunded default arrangement contributions, but they may also result in additional protection and potentially less costly and less disruptive adjustments in periods of high market volatility. In addition, transparency regarding margin practices when market volatility increases may help mitigate the effects of procyclicality. Nevertheless, it may be impractical and even imprudent for a CCP to establish margin requirements that are independent of significant or cyclical changes in price volatility.

[10] A single-tailed (also known as one-tailed or one-sided) confidence interval of at least 99% means that the initial margin should cover estimated future loss over an appropriate time horizon at least 99% of the time.

– *Variation margin*

(7) (a) A CCP faces the risk that its exposure to its participants can change rapidly as a result of changes in prices, positions, or both. Adverse price movements, as well as participants building larger positions through new trading, can rapidly increase a CCP's exposures to its participants (although some markets may impose trading limits or position limits that reduce this risk). Under paragraph 3.6(7)(a) of the Rule, the CCP is required to ascertain its current exposure to each participant by marking each participant's outstanding positions to current market prices (i.e. to mark participant positions to market) and collect variation margin at least daily to limit the build-up of current exposures; such a requirement limits the accumulation of current exposures and therefore mitigates potential future exposures.

(b) In addition, the CCP is required to have the authority and operational capacity to make intraday margin calls, both scheduled and unscheduled, to participants. The CCP should consider the potential impact of its intraday variation margin collections and payments on the liquidity position of its participants and should have the operational capacity to make intraday variation margin payments. Further, the CCP may choose to place limits on credit exposures in some cases, even if collateralized. Limits on concentrations of positions or additional collateral requirements may also be warranted.

– *Portfolio margining and cross-margining*

(8) Subsection 3.6(8) of the Rule sets out requirements for the CCP, if it offers portfolio margining, subject to the segregation and portability requirements under section 3.14. The offsets the CCP may allow, where the risk of one product is significantly and reliably correlated with the risk of another product, should be based on an economically meaningful methodology that reflects the degree of price dependence between the products. Often, price dependence is modeled through correlations, but more complete or robust measures of dependence should be considered, particularly for non-linear products. In any case, the CCP should consider how price dependence can vary with overall market conditions, including in stressed market conditions. Following the application of offsets, the CCP needs to ensure that the margin meets or exceeds the single-tailed confidence level of at least 99 percent with respect to the estimated distribution of the future exposure of the portfolio. If the CCP uses portfolio margining, it should continuously review and test offsets among products. It should test the robustness of its portfolio method on both actual and appropriate hypothetical portfolios. It is especially important to test how correlations perform during periods of actual and simulated market stress to assess whether the correlations break down or otherwise behave erratically. Prudent assumptions informed by these tests should be made about product offsets.

(9) If authorized, two or more CCPs may enter into a cross-margining arrangement, which is an agreement among the CCPs to consider positions and supporting collateral at their respective organizations as a common portfolio for participants that are members of two or more of the organizations. The aggregate collateral requirements for positions held in cross-margined accounts may be reduced if the value of the positions held at the separate CCPs move inversely in a significant and reliable fashion. In the event of a participant default under a cross-margining arrangement, participating CCPs may be allowed to use any excess collateral in the cross-margined accounts to cover losses.

CCPs that participate in cross-margining arrangements must share information frequently and ensure that they have appropriate safeguards, such as joint monitoring of positions, margin collections, and price information. Each CCP must thoroughly understand the others' respective risk-management practices and financial resources. The CCPs are also required to have harmonized overall risk-management systems and should regularly monitor possible discrepancies in the calculation of their exposures, especially with regard to monitoring how price correlations perform over time. This harmonization is especially relevant in terms of selecting an initial margin methodology, setting margin parameters, segregating accounts and collateral, and establishing default-management arrangements. All of the precautions with regard to portfolio margining discussed above would apply to cross-margining regimes between or among CCPs. CCPs operating a cross-margining arrangement should also analyze fully the impact of cross-margining on prefunded default arrangements and on the adequacy of overall financial resources. The CCPs must have in place arrangements that are legally robust and operationally viable to govern the cross-margining arrangement.

– *Testing model coverage and validation of margin methodology*

(10) (a) Under paragraph 3.6(10)(a) of the Rule, in order to validate its margin models and parameters, the CCP is required to analyze and monitor its model performance and overall margin coverage by conducting rigorous daily backtesting of its initial margin models against identified targets. Backtesting is an ex-post comparison of observed outcomes with the outputs of the margin models. The CCP should backtest its margin coverage using participant positions from each day in order to evaluate whether there are any exceptions to its initial margin coverage. This assessment of margin coverage should be considered an integral part of the evaluation of the model's performance. Coverage should be evaluated across products and participants and take into account portfolio effects across asset classes within the CCP. The initial margin model's actual coverage, along with projected measures of its performance, should meet at least the established single-tailed confidence level of 99 percent with respect to the estimated distribution of future exposure over an appropriate close-out period. In case backtesting indicates that the model did not perform as expected (that is, the model did not identify the appropriate amount of initial margin necessary to achieve the intended coverage), the CCP should have clear procedures for recalibrating its margining system, such as by

making adjustments to parameters and sampling periods. Further, the CCP should evaluate the source of backtesting exceedances to determine if a fundamental change to the margin methodology is warranted or if only the recalibration of current parameters is necessary. Backtesting procedures alone are not sufficient to evaluate the effectiveness of models and adequacy of financial resources against forward-looking risks.

In addition, the CCP, at least monthly, and more-frequently as appropriate, should conduct a sensitivity analysis which assesses the coverage of the margin methodology under various market conditions. Sensitivity analysis should also be used to determine the impact of varying important model parameters. Sensitivity analysis is an effective tool to explore hidden shortcomings that cannot be discovered through backtesting. The CCP should conduct sensitivity analysis on its margin model coverage at least monthly using the results of these sensitivity tests and conduct a thorough analysis of the potential losses it could suffer. The CCP should evaluate the potential losses in individual participants' positions and, where appropriate, their customers' positions. Furthermore, for a CCP clearing credit instruments, parameters reflective of the simultaneous default of both participants and the underlying credit instruments should be considered. Sensitivity analysis should be performed on both actual and simulated positions. Rigorous sensitivity analysis of margin requirements may take on increased importance when markets are illiquid or volatile. This analysis should be conducted more frequently when markets are unusually volatile or less liquid or when the size or concentration of positions held by its participants increases significantly.

The results of both the backtesting and sensitivity analyses should be disclosed to participants.

(c) Under paragraph 3.6(10)(c) of the Rule, the CCP is required to regularly review and validate its margin system. The CCP's margin methodology should be reviewed and validated by a qualified and independent party at least annually, or more frequently if there are material market developments. Any material revisions or adjustments to the methodology or parameters should be subject to appropriate governance processes and validated prior to implementation. CCPs operating a cross-margining arrangement should also analyze the impact of cross-margining on prefunded default arrangements and evaluate the adequacy of overall financial resources. Additionally, the margin methodology, including the initial margin models and parameters used by the CCP, should be made as transparent as possible. At a minimum, the basic assumptions of the analytical method selected and the key data inputs should be disclosed to participants. Ideally, the CCP would make details of its margin methodology available to its participants for use in their individual risk-management efforts.

(11) Further to subparagraph 3.6(10)(a)(ii) of the Rule, subsection 3.6(11) of the Rule requires the CCP to test the sensitivity of its margin model coverage using a wide range of parameters and assumptions that reflect possible market conditions in order to understand how the level of margin coverage might be affected by highly stressed market conditions. The CCP should ensure that the range of parameters and assumptions captures a variety of historical and hypothetical conditions, including the most-volatile periods that have been experienced by the markets it serves and extreme changes in the correlations between prices of products it clears.

– ***Timeliness of margin payments***

(12) The CCP should establish and rigorously enforce timelines for margin collections and payments and set appropriate consequences for failure to pay on time. A CCP with participants in a range of time zones may need to adjust its procedures for margining (including the times at which it makes margin calls) to take into account the liquidity of a participant's local funding market and the operating hours of relevant payment and settlement systems. Margin should be held by the CCP until the exposure has been extinguished; that is, margin should not be returned before settlement is successfully concluded.

Liquidity risk

– ***General principle***

3.7 (1) Liquidity risk arises in a clearing agency when it, its participants, or other entities cannot settle their payment obligations when due as part of the clearing or settlement process. Depending on the design of a clearing agency, liquidity risk can arise between it and its participants, between it and other entities, such as its settlement banks, nostro agents (i.e. those agents who facilitate the settlement of foreign exchange and trade transactions through the use of a bank account held in a foreign country by a domestic bank, denominated in the currency of that country), custodian banks, and liquidity providers, or between participants in a clearing agency. It is particularly important for a clearing agency to manage carefully its liquidity risk if, as is typical in many systems, it relies on incoming payments from participants or other entities during the settlement process in order to make payments to other participants. If a participant or another entity fails to pay the clearing agency, it may not have sufficient funds to meet its payment obligations to other participants. In such an event, the clearing agency would need to rely on its own liquidity resources to cover the funds shortfall and complete settlement. Subsections 3.7(1) and (2) of the Rule, sets out the general principle that a recognized clearing agency that acts as, or performs the services of a CCP or SSS is required to effectively measure, monitor, and manage its liquidity risk, as well as maintain sufficient liquid resources.

– ***Sources of, and managing, liquidity risk***

(3) Subsection 3.7(3) of the Rule requires the clearing agency to manage its liquidity risk from a variety of sources. Within its framework for managing its liquidity risks, the clearing agency must therefore clearly identify its sources of liquidity risk and assess its current and potential future liquidity needs on a daily basis. A clearing agency can face liquidity risk from the default of a participant, or from its settlement banks, nostro agents, custodian banks, and liquidity providers, as well as linked clearing agencies and service providers, if they fail to perform as expected. Moreover, a clearing agency may face additional risk from entities that have multiple roles within the clearing agency (for example, a participant that also serves as the clearing agency's settlement bank or liquidity provider). These interdependencies and the multiple roles that an entity may serve within the clearing agency should be considered in determining the clearing agency's liquidity needs.

A clearing agency that employs a deferred net settlement ("DNS") mechanism, which is a mechanism that settles on a net basis at the end of a pre-defined settlement cycle, may create direct liquidity exposures between participants. A long-standing concern is that these types of systems may address a potential settlement failure by unwinding transfers involving the defaulting participant. An unwind imposes liquidity pressures (and, potentially, replacement costs) on the non-defaulting participants. If all such transfers must be deleted, and if the unwind occurs at a time when money markets and securities lending markets are illiquid (for example, at or near the end of the day), the remaining participants could be confronted with shortfalls of funds or securities that would be extremely difficult to cover. The potential total liquidity pressure of unwinding could be equal to the gross value of the netted transactions.

After identification of its liquidity risks, the clearing agency is required to have a robust framework for their management. The clearing agency should regularly assess its design and operations to manage liquidity risk in the system. Where the clearing agency employs a DNS mechanism, it may be able to reduce its or its participants' liquidity risk by using alternative settlement designs, such as new real-time gross settlement designs with liquidity-saving features or a continuous or extremely frequent batch settlement system. In addition, it could reduce the liquidity demands of its participants by providing participants with sufficient information or control systems to help them manage their liquidity needs and risks. Furthermore, the clearing agency should ensure that it is operationally ready to manage the liquidity risk caused by participants' or other entities' financial or operational problems. Among other things, the clearing agency should have the operational capacity to reroute payments, where feasible, on a timely basis in case of problems with a correspondent bank.

The clearing agency may employ other risk-management tools to manage its or, where relevant, its participants' liquidity risk. To mitigate and manage liquidity risk stemming from a participant default, the clearing agency could use, either individually or in combination, exposure limits, collateral requirements, and prefunded default arrangements. To mitigate and manage liquidity risks from the late-day submission of payments or other transactions, the clearing agency could adopt rules or financial incentives for timely submission. To mitigate and manage liquidity risk stemming from a service provider or a linked clearing agency, the clearing agency could use, individually or in combination, selection criteria, concentration or exposure limits, and collateral requirements. For example, the clearing agency should seek to manage or diversify its settlement flows and liquid resources to avoid excessive intraday or overnight exposure to one entity. This, however, may involve trade-offs between the efficiency of relying on an entity and the risks of being overly dependent on that entity. These tools are often also used by a clearing agency to manage its credit risk.

– ***Measuring and monitoring liquidity risk***

(4) Pursuant to subsection 3.7(4) of the Rule, the clearing agency should, in particular, understand and assess the value and concentration of its daily settlement and funding flows through its settlement banks, nostro agents, and other intermediaries. The clearing agency should also be able to monitor on a daily basis the level of liquid assets (such as cash, securities, other assets held in custody, and investments) that it holds. The clearing agency should be able to determine the value of its available liquid assets, taking into account the appropriate haircuts on those assets. Where appropriate, the clearing agency should provide sufficient information and analytical tools to help its participants measure and monitor their liquidity risks in the clearing agency.

If the clearing agency maintains prearranged funding arrangements, it should also identify, measure, and monitor its liquidity risk from the liquidity providers of those arrangements. The clearing agency should obtain a high degree of confidence through rigorous due diligence that each liquidity provider, whether or not it is a participant in the clearing agency, would have the capacity to perform as required under the liquidity arrangement and is subject to commensurate regulation, supervision, or oversight of its liquidity risk-management requirements. Where relevant to assessing a liquidity provider's performance reliability with respect to a particular currency, the liquidity provider's potential access to credit from the relevant central bank may be taken into account.

– ***Maintaining sufficient liquid resources***

(5) If the clearing agency performs the services of an SSS (including one that employs a DNS mechanism), it should ensure that it has sufficient liquid resources, as determined by regular and rigorous stress testing, to effect settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios. The SSS, including one

employing a DNS mechanism, should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday or multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation in extreme but plausible market conditions. In some instances, the SSS may need to have sufficient liquid resources to effect settlement of payment obligations over multiple days to account for any potential liquidation of collateral that is outlined in the clearing agency's participant-default procedures.

(6) Similarly, if the clearing agency acts as a CCP, it should maintain sufficient liquid resources in all relevant currencies to settle securities-related payment obligations, make required variation margin payments, and meet other payment obligations on time with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation to the CCP in extreme but plausible market conditions. The CCP should carefully analyse its liquidity needs, and the analysis is expected to be reviewed by the relevant authorities. In many cases, the CCP may need to maintain sufficient liquid resources to meet payments to settle required margin and other payment obligations over multiple days to account for multiday hedging and close-out activities as directed by the CCP's participant-default procedures.

(7) Subsection 3.7(7) of the Rule provides the added requirement that if the clearing agency, which acts as a CCP, is involved in activities with a more-complex risk profile or that is systemically important in multiple jurisdictions, it must maintain additional liquidity resources sufficient to cover a wider range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would generate the largest aggregate payment obligation to the CCP in extreme but plausible market conditions.

The Commission will consider the factors discussed in subsection 3.4(5) of this CP in determining whether the clearing agency is involved in activities with a more complex risk profile or is systemically important in multiple jurisdictions.

– ***Qualifying liquid resources***

(8) For the purpose of meeting the requirements to maintain sufficient liquid resources, the clearing agency's qualifying liquid resources in each currency may include only those listed in subsection 3.7(8) of the Rule. All such resources should be available when needed. However, such access does not eliminate the need for sound risk-management practices and adequate access to private-sector liquidity resources.

– ***Other liquid resources***

(10) The clearing agency may supplement its qualifying liquid resources with other forms of liquid resources. If the clearing agency does so, then these liquid resources must be in the form of assets that are likely to be saleable or acceptable as collateral for lines of credit, swaps, or repurchase agreements ("repos") on an ad hoc basis following a default, even if this saleability or acceptability as collateral cannot be reliably prearranged or guaranteed in extreme market conditions. The clearing agency may consider using such resources within its liquidity risk management framework in advance of, or in addition to, using its qualifying liquid resources. This may be particularly beneficial where liquidity needs exceed qualifying liquid resources, where qualifying liquid resources can be preserved to cover a future default, or where using other liquid resources would cause less liquidity dislocation to the clearing agency's participants and the financial system as a whole. Even if the clearing agency does not have access to routine central bank credit, it should take account of what collateral is typically accepted by the relevant central bank of issue, as such assets may be more likely to be liquid in stressed circumstances. In any case, the clearing agency should not assume the availability of emergency central bank credit as a part of its liquidity plan, as is specified under subsection 3.7(11) of the Rule.

– ***Due diligence of liquidity providers***

(12) Under subsection 3.7(12) of the Rule, if the clearing agency has prearranged funding arrangements, it must obtain a high degree of confidence, through rigorous due diligence, that each provider of its minimum required qualifying liquid resources has sufficient information to understand and to manage its associated liquidity risks, and that it has the capacity to perform as required under its commitment. Additionally, the clearing agency should adequately plan for the renewal of prearranged funding arrangements with liquidity providers in advance of their expiration.

(14) Under subsection 3.7(14) of the Rule, the clearing agency is required to regularly test its procedures for accessing its liquid resources at a liquidity provider, including by activating and drawing down test amounts from committed credit facilities and by testing operational procedures for conducting same-day repos.

In addition, the clearing agency should have detailed procedures for using its liquid resources to complete settlement during a liquidity shortfall. The clearing agency's procedures should clearly document the sequence for using each type of liquid resource (for example, the use of certain assets before prearranged funding arrangements). These procedures may include instructions for accessing cash deposits or overnight investments of cash deposits, executing same-day market transactions, or drawing on prearranged liquidity lines.

– *Central bank services*

(15) If the clearing agency has access to central bank accounts, payment services, securities services, or collateral management services, it is required under subsection 3.7(15) to use these services, where practical, to enhance its management of liquidity risk. Cash balances at the central bank of issue, for example, offer the highest liquidity.

– *Stress testing of liquidity needs and resources*

(16) Under subsection 3.7(16) of the Rule, the clearing agency is required to determine the amount and regularly test the sufficiency of its liquid resources through rigorous stress testing, and have clear procedures for reporting results and evaluating the adequacy of and adjusting its liquidity risk-management framework.

Further, the clearing agency should conduct, as appropriate, reverse stress tests aimed at identifying the extreme default scenarios and extreme market conditions for which the clearing agency's liquid resources would be insufficient. In other words, these tests identify how severe stress conditions would be covered by the clearing agency's liquid resources. The clearing agency should assess whether it would be prudent to prepare for these severe conditions and various combinations of factors influencing these conditions. Reverse stress tests require the clearing agency to model extreme market conditions that may go beyond what are considered extreme but plausible market conditions in order to help understand the sufficiency of liquid resources given the underlying assumptions modelled. Modelling extreme market conditions can help the clearing agency determine the limits of its current model and resources; however, it requires exercising judgment when modelling different markets and products. The clearing agency should develop hypothetical extreme scenarios and market conditions tailored to the specific risks of the markets and of the products it serves. Reverse stress tests should be considered a helpful risk-management tool but they need not, necessarily, drive the clearing agency's determination of the appropriate level of liquid resources.

Liquidity stress testing should be performed on a daily basis using standard and predetermined parameters and assumptions. In addition, on at least a monthly basis, the clearing agency should perform a comprehensive and thorough analysis of stress testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for achieving the clearing agency's identified liquidity needs and resources in light of current and evolving market conditions. The clearing agency should perform stress testing more frequently when markets are unusually volatile, when they are less liquid, or when the size or concentration of positions held by its participants increases significantly. A full validation of the clearing agency's liquidity risk-management model should be performed at least annually.

– *Contingency planning for uncovered liquidity shortfalls*

(20) In certain extreme circumstances, the liquid resources of the clearing agency or its participants may not be sufficient to meet the payment obligations of the clearing agency to its participants or the payment obligations of participants to each other within the clearing agency. In a stressed environment, for example, normally liquid assets held by the clearing agency may not be sufficiently liquid to obtain same-day funding, or the liquidation period may be longer than expected. In this regard, the contingency planning requirements of subsection 3.7(20) of the Rule apply. Under subsection 3.7(20) of the Rule, the clearing agency is required to establish explicit rules and procedures that enable it to effect same-day, and where appropriate, intraday and multiday settlement of payment obligations on time following any individual or combined default among its participants. These rules and procedures should address unforeseen and potentially uncovered liquidity shortfalls and should aim to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations. These rules and procedures should also indicate the clearing agency's process to replenish any liquidity resources it may employ during a stress event, so that it can continue to operate in a safe and sound manner.

If the clearing agency allocates potentially uncovered liquidity shortfalls to its participants, it should have clear and transparent rules and procedures for the allocation of shortfalls. These procedures could involve a funding arrangement between the clearing agency and its participants, the mutualization of shortfalls among participants according to a clear and transparent formula, or the use of liquidity rationing (for example, reductions in payouts to participants). Any allocation rule or procedure must be discussed thoroughly with and communicated clearly to participants, as well as be consistent with participants' respective regulatory liquidity risk-management requirements. Furthermore, the clearing agency should consider and validate, through simulations and other techniques and through discussions with each participant, the potential impact on each participant of any such same-day allocation of liquidity risk and each participant's ability to bear proposed liquidity allocations.

Settlement finality

– *General principle*

3.8 (1) A clearing agency should be designed to provide clear and certain final settlement of payments, transfer instructions, or other obligations. Under subsection 3.8(1) of the Rule, a payment, transfer instruction, or other obligation that a recognized clearing agency (which acts as, or performs the services of a CCP or SSS) accepts for settlement in accordance with its rules and procedures must therefore be settled with finality no later than the end of the intended value date, as further required under

subsection 3.8(3) of the Rule. “Final settlement” is a legal defined moment, and refers to the irrevocable and unconditional transfer of an asset or financial instrument, or the discharge of an obligation by the clearing agency or its participants in accordance with the terms of the underlying contract. As defined in s. 1.1 of the Rule, the “value date” refers to the day on which the payment, transfer instruction, or other obligation is due and the associated funds and securities are typically available to the receiving participant in a trade or other transaction. Completing final settlement by the end of the value date is important because deferring final settlement to the next-business day can create both credit and liquidity pressures for the clearing agency’s participants and other stakeholders, and potentially be a source of systemic risk. A clear definition of when settlements are final also greatly assists in a resolution scenario such that the positions of the participant in resolution and other affected parties can be quickly ascertained.

(2) Depending on the type of obligations that the clearing agency settles, the use of intraday settlement, either in multiple batches or in real time, may be necessary or desirable to reduce settlement risk. As such, some types of clearing agencies should consider adopting real time gross settlement (“RTGS”) or multiple-batch settlement to complete final settlement intraday. RTGS is the real-time settlement of payments, transfer instructions, or other obligations individually on a transaction-by-transaction basis. Batch settlement is the settlement of groups of payments, transfer instructions, or other obligations together at one or more discrete, often pre-specified times during the processing day. With batch settlement, the time between the acceptance and final settlement of transactions should be kept short. To speed up settlements, the clearing agency should encourage its participants to submit transactions promptly. To validate the finality of settlement, the clearing agency also should inform its participants of their final account balances and, where practical, settlement date and time as quickly as possible, preferably in real time.

– ***Final settlement***

(3) Under subsection 3.8(3) of the Rule, the clearing agency is required to define the point at which settlement is final. The clearing agency’s legal framework and rules should generally determine the finality of settlement. The legal basis governing the clearing agency, including the insolvency law, must acknowledge the discharge of a payment, transfer instruction, or other obligation between the clearing agency and system participants, or between or among participants, for the transaction to be considered final. The clearing agency should take reasonable steps to confirm the effectiveness of cross-border recognition and protection of cross-system settlement finality, especially when it is developing plans for recovery or orderly wind-down or providing relevant authorities information relating to its resolvability. Because of the complexity of legal frameworks and system rules, particularly in the context of cross-border settlement where legal frameworks are not harmonized, a well-reasoned legal opinion is generally necessary to establish the point at which finality takes place.

As required by subsection 3.8(1), the clearing agency’s processes must be designed to complete final settlement, at a minimum no later than the end of the value date. This means that any payment, transfer instruction, or other obligation that has been submitted to and accepted by the clearing agency in accordance with its risk management and other relevant acceptance criteria should be settled on the intended value date. If the clearing agency is not designed to provide final settlement on the value date (or same-day settlement), it would not satisfy section 3.8 of the Rule, even if the transaction’s settlement date is adjusted back to the value date after settlement. This is because, in most of such arrangements, there is no certainty that final settlement will occur on the value date as expected. Further, deferral of final settlement to the next-business day can entail overnight risk exposures. For example, if an SSS or CCP conducts its money settlements using instruments or arrangements that involve next-day settlement, a participant’s default on its settlement obligations between the initiation and finality of settlement could pose significant credit and liquidity risks to the clearing agency and its other participants.

Subsection 3.8(3) also requires the clearing agency to clearly define the point after which unsettled payments, transfer instructions, or other obligations may not be revoked by a participant. In general, the clearing agency should prohibit the unilateral revocation of accepted and unsettled payments, transfer instructions, or other obligations after a certain point or time in the settlement day, so as to avoid creating liquidity risks. In all cases, cutoff times and materiality rules for exceptions should be clearly defined. The rules should make clear that changes to operating hours are exceptional and require individual justifications. For example, the clearing agency may want to permit extensions for reasons connected with the implementation of monetary policy or widespread financial market disruption. If extensions are allowed for participants with operating problems to complete processing, the rules governing the approval and duration of such extensions should be clear to participants.

Money settlements

– ***General principle***

3.9 (1) A clearing agency typically needs to conduct money settlements with or between its participants for a variety of purposes. To conduct such money settlements, a clearing agency might use central bank money or commercial bank money, or a combination of both. Refer to subsection 1.1 of the Rule for definitions of “central bank money” and “commercial bank money”. Subsection 3.9(1) of the Rule requires a recognized clearing that acts as, or performs the services of a CCP or SSS to conduct its money settlements using central bank money, where practical and available, to avoid credit and liquidity risks.

Credit risk may arise when a settlement bank has the potential to default on its obligations (for example, if the settlement bank becomes insolvent). Liquidity risk may arise in money settlements if, after a payment obligation has been settled, participants or the clearing agency itself are unable to transfer readily their assets at the settlement bank into other liquid assets, such as claims on a central bank. The requirement under subsection 3.9(1) of the Rule thus arises given that central banks have the lowest credit risk and are the source of liquidity with regard to their currency of issue. Indeed, one of the fundamental purposes of central banks is to provide a safe and liquid settlement asset. With the use of central bank money, a payment obligation is typically discharged by providing the clearing agency or its participants with a direct claim on the central bank, that is, the settlement asset is central bank money.

(2) The use of central bank money, however, may not always be practical or available. For example, the clearing agency or its participants may not have direct access to all relevant central bank accounts and payment services. Further, a multicurrency clearing agency that has access to all relevant central bank accounts and payment services may find that some central bank payment services do not operate, or provide finality, at the times when it needs to make money settlements. In this regard, the use of commercial bank money may be a necessity.

Pursuant to subsection 3.9(2), where central bank money is not used, the clearing agency must conduct its money settlements using a settlement asset with little or no credit or liquidity risk. The use of commercial bank money (or a combination of central bank and commercial bank monies) to settle payment obligations, however, can create additional credit and liquidity risks for the clearing agency and its participants. Accordingly, the clearing agency must minimize and strictly control the credit and liquidity risks arising from the use of commercial bank money, as further described in subsections 3.9(3) and (4).

Settlement in commercial bank money typically occurs on the books of a commercial bank. In this model, a clearing agency establishes an account with one or more commercial settlement banks and requires each of its participants to establish an account with one of them. In some cases, the clearing agency itself can serve as the settlement bank. Money settlements are then effected through accounts on the books of the clearing agency

– ***Commercial bank money***

(3) (a) Where commercial bank money is used in lieu of central bank money, paragraph 3.9(3)(a) of the Rule requires that the clearing agency monitor, manage, and limit its credit and liquidity risks arising from the commercial settlement bank. For example, the clearing agency should limit both the probability of being exposed to a commercial settlement bank's failure and limit the potential losses and liquidity pressures to which it would be exposed in the event of such a failure. The clearing agency should establish and monitor adherence to strict criteria for its commercial settlement banks that take into account, among other things, their regulation and supervision, creditworthiness, capitalization, access to liquidity, and operational reliability.

(b) In addition, the clearing agency should take steps to limit its credit exposures and liquidity pressures by diversifying the risk of a commercial settlement bank failure, where reasonable, through use of multiple commercial settlement banks. The clearing agency must monitor and manage the full range and concentration of exposures to its commercial settlement banks and assess its potential losses and liquidity pressures as well as those of its participants in the event that the commercial settlement bank with the largest share of activity were to fail.

– ***Settlement on books of clearing agency***

(5) Settlement in commercial bank money typically occurs on the books of a commercial bank. In this model, a clearing agency will typically establish an account with one or more commercial settlement banks and requires each of its participants to establish an account with one of them. In some cases, the clearing agency itself can serve as the settlement bank. Money settlements are then effected through accounts on the books of the clearing agency. Where money settlement does not occur in central bank money and the clearing agency conducts money settlements on its own books, subsection 3.9(5) of the Rule requires that it minimize and strictly control its credit and liquidity risks. In such an arrangement, the clearing agency offers cash accounts to its participants, and a payment or settlement obligation is discharged by providing the clearing agency's participants with a direct claim on the clearing agency itself. The credit and liquidity risks associated with a claim on the clearing agency are therefore directly related to its overall credit and liquidity risks. One way the clearing agency could minimize these risks is to limit its activities and operations to clearing and settlement and closely related processes. Further, to settle payment obligations, the clearing agency could limit the provision of cash accounts to only participants. In some cases, the clearing agency can further mitigate risk by having participants fund and defund their cash accounts at the clearing agency using central bank money. In such an arrangement, the clearing agency is able to back the settlements conducted on its own books with balances that it holds in its account at the central bank.

– ***Finality of funds transfers between settlement accounts***

(6) In settlements involving either central bank or commercial bank money, a critical issue is the timing of the finality of funds transfers. These transfers should be final when effected. To this end, the clearing agency's legal agreements with any commercial settlement banks should state clearly when transfers on the books of individual settlement banks are expected to

occur, that transfers are to be final when effected, and that funds received should be transferable as soon as possible, at a minimum by the end of the day and ideally intraday, in order to enable the clearing agency and its participants to manage credit and liquidity risks. If the clearing agency conducts intraday money settlements (for example, to collect intraday margin), the arrangement should provide real-time finality or intraday finality at the times when the clearing agency wishes to effect money settlement.

Physical deliveries

– ***General principle***

3.10 (1) Where a recognized clearing agency settles transactions using physical delivery, which is the delivery of an asset, such as an instrument or a commodity in physical form, paragraph 3.10(1)(a) of the Rule requires that the clearing agency have rules and procedures that clearly state its obligations with respect to the delivery of those physical instruments or commodities. The obligations that the clearing agency may assume with respect to physical deliveries vary based on the types of assets that it settles. In this regard, the clearing agency should clearly state which asset classes it accepts for physical delivery and the procedures surrounding the delivery of each. As well, it should be clearly stated whether the clearing agency's obligation is to make or receive physical deliveries or to indemnify participants for losses incurred in the delivery process.

In addition, the clearing agency is required under paragraph 3.10(1)(b) of the Rule to identify, monitor, and manage the risks and costs associated with the storage and delivery of physical instruments and commodities. Issues relating to delivery may arise, for example, when a derivatives contract requires physical delivery of an underlying instrument or commodity. The clearing agency should plan for and manage physical deliveries by establishing definitions for acceptable physical instruments or commodities, the appropriateness of alternative delivery locations or assets, rules for warehouse operations, and the timing of delivery, when relevant. If the clearing agency is responsible for the warehousing and transportation of a commodity, it should make arrangements that take into account the commodity's particular characteristics (for example, storage under specific conditions, such as an appropriate temperature and humidity for perishables).

Further, the clearing agency should have appropriate processes, procedures, and controls to manage the risks of storing and delivering physical assets, such as the risk of theft, loss, counterfeiting, or deterioration of assets. The clearing agency's policies and procedures should ensure that its record of physical assets accurately reflects its holdings of assets, for example, by separating duties between handling physical assets and maintaining records. The clearing agency should also have appropriate employment policies and procedures for personnel that handle physical assets and should include appropriate pre-employment checks and training. As well, the clearing agency should consider other measures, such as insurance coverage and random storage facility audits, to mitigate its storage and delivery risks (other than principal risk).

In some instances, clearing agencies serving a commodity market can reduce its risks associated with the physical storage and delivery of commodities by matching participants that have delivery obligations with those due to receive the commodities, thereby removing itself from direct involvement in the storage and delivery process. In such instances, the legal obligations for delivery should be clearly expressed in the rules, including default rules, and any related agreements. In particular, it should be clear whether the receiving participant should seek compensation from the clearing agency or the delivering participant in the event of a loss. Additionally, the clearing agency holding margin should not release the margin of the matched participants until it confirms that both have fulfilled their respective obligations. The clearing agency should also monitor its participants' performance and, to the extent practicable, ensure that its participants have the necessary systems and resources to be able to fulfil their physical delivery obligations.

Central securities depositories

– ***General principle***

3.11 (1) (a) In general, a CSD is an entity that provides securities accounts and, in many countries, performs the services of an SSS. A CSD also provides central safekeeping and asset services, which may include the administration of corporate actions and redemptions, and plays an important role in helping to ensure the integrity of securities issues. See the definition of CSD under s. 1.1 of the Rule. Under paragraph 3.11(1)(a) of the Rule, where a recognized clearing agency acts as a CSD, it must have clear and comprehensive rules, procedures and controls to ensure that the securities it holds on behalf of its participants are appropriately accounted for on its books and protected from risks, including those associated with the other services that the CSD may provide.

(b) Securities can be held at a CSD either in physical (but immobilized) form or in dematerialized form (that is, as electronic records). Securities held in physical form may be transferred via physical delivery or immobilized and transferred via book entry. Book entry refers to the transfer of securities or other financial assets without physical movement of paper documents or certificates. The safekeeping and transferring of securities in physical form, however, creates additional risks and costs, such as the risk of destruction or theft of certificates, increased processing costs, and increased time to clear and settle securities transactions. By immobilizing securities and transferring them via book entry, a CSD can improve efficiency through increased

automation and reduce the risk of errors and delays in processing. Dematerializing securities also eliminates the risk of destruction or theft of certificates. Under paragraph 3.11(1)(b), the CSD is therefore required to maintain securities in an immobilized or dematerialized form for their transfer by book entry. To facilitate the immobilization of all physical securities of a particular issue, a global note representing the whole issue can be issued. In certain cases, however, immobilization or dematerialization within a CSD may not be legally possible or practicable. In such cases, the CSD should provide incentives to immobilize or dematerialize securities.

– ***Safeguarding integrity of securities issuers***

(2) The preservation of the rights of issuers and holders of securities is essential for the orderly functioning of a securities market. Therefore, subsection 3.11(2) of the Rule requires the CSD to (a) safeguard the rights of securities issuers and holders, (b) prevent the unauthorized creation or deletion of securities, and (c) conduct periodic and at least daily reconciliation of the securities issues that it maintains, in order to ensure that the securities it holds on behalf of its participants are appropriately accounted for on its books and protected from risks associated with the other services that the CSD may provide. The CSD should, in particular, maintain robust accounting practices and perform end-to-end auditing to verify that its records are accurate and provide a complete accounting of its securities issues. If the CSD records the issuance of securities (alone or in conjunction with other entities), it should verify and account for the initial issuance of securities and ensure that newly issued securities are delivered in a timely manner. To further safeguard the integrity of the securities issues, the CSD is required to conduct periodic and at least daily reconciliation of the totals of securities issues in the CSD for each issuer (or its issuing agent), and ensure that the total number of securities recorded in the CSD for a particular issue is equal to the amount of securities of that issue held on its books. Reconciliation may require coordination with other entities if the CSD does not (or does not exclusively) record the issuance of the security or is not the official registrar of the security. For instance, if the issuer (or its issuing agent) is the only entity that can verify the total amount of an individual issue, it is important that the CSD and the issuer cooperate closely to ensure that the securities in circulation in a system correspond to the volume issued into that system. If the CSD is not the official securities registrar for the securities issuer, reconciliation with the official securities registrar should be required. Finally, the CSD is required to (d) prohibit overdrafts and debit balances in securities accounts to avoid credit risk and reduce the potential for the creation of securities. If the CSD were to allow overdrafts or a debit balance in a participant's securities account in order to credit another participant's securities account, it would effectively be creating securities and would affect the integrity of the securities issue.

– ***Protection of assets***

(3) Subsection 3.11(3) requires that the CSD protect assets against custody risk, including the risk of loss because of negligence, misuse of assets, fraud, poor administration, inadequate recordkeeping, or failure to protect a participant's interests in securities or because of the CSD's insolvency or claims by its creditors. The CSD should have rules and procedures consistent with its legal framework and robust internal controls to achieve these objectives. Where appropriate, it should consider insurance or other compensation schemes to protect participants against misappropriation, destruction, and theft of securities.

(4) Moreover, the CSD must employ a robust system that ensures segregation between its own assets and the securities of its participants, and segregation among the securities of participants through the provision of separate accounts. While the title to securities is typically held in a CSD, often the beneficial owner, or the owner depending on the legal framework, of the securities does not participate directly in the system. Rather, the owner establishes relationships with CSD participants (or other intermediaries) that provide safekeeping and administrative services related to the holding and transfer of securities on behalf of customers. Where supported by the legal framework, the CSD must also support operationally the segregation of securities belonging to a participant's customers on the participant's books and facilitate the transfer of customer holdings to another participant. Where relevant, the segregation of accounts typically helps provide appropriate protection against the claims of a CSD's creditors or the claims of the creditors of a participant in the event of its insolvency.

– ***Other activities***

(5) If the CSD provides services other than central safekeeping and administration of securities, it must identify, measure, monitor, and manage the risks associated with those activities, particularly credit and liquidity risks, consistent with the respective requirements of the Rule. Additional tools may be necessary to address these risks, including the need for the CSD to separate legally the other activities. For example, a CSD that performs the services of an SSS may provide a centralized securities lending facility to help facilitate timely settlement and reduce settlement fails or may otherwise offer services that support the bilateral securities lending market. If the CSD acts as a principal in a securities lending transaction, it should identify, monitor, and manage its risks, including potential credit and liquidity risks. For example, the securities lent by the CSD may not be returned when needed because of a counterparty default, operational failure, or legal challenge. The CSD would then need to acquire the lent securities in the market, perhaps at a cost, thus exposing the CSD to credit and liquidity risks.

Exchange-of-value settlement systems

– ***General principle***

3.12 (1) The settlement of a financial transaction by a recognized clearing agency may involve the settlement of two linked obligations, such as the delivery of securities against payment of cash or securities or the delivery of one currency against delivery of another currency. In this context, principal risk – the risk that a counterparty will lose the full value involved in a transaction, such as the risk that a seller of a financial asset will irrevocably deliver the asset but not receive payment – may be created when one obligation is settled, but the other obligation is not. Under subsection 3.12(1) of the Rule, principle risk must be eliminated by clearing agencies that act as, or perform the services of a CCP or SSS which settle transactions that involve the settlement of two linked obligations through the use of a delivery versus payment (DvP),[11] delivery versus delivery (DvD),[12] or payment versus payment (PvP)[13] settlement mechanism. These mechanisms ensure that the final settlement of one obligation occurs if and only if the final settlement of the linked obligation also occurs, regardless of whether the clearing agency settles on a gross or net basis and when finality occurs.

The final settlement of two linked obligations can be achieved either on a gross basis or on a net basis. For example, an SSS can settle the transfers of both securities and funds on a gross basis throughout the settlement day. Alternatively, an SSS can settle securities transfers on a gross basis throughout the day but settle funds transfers on a net basis at the end of the day or at certain times during the day. An SSS can also settle both securities and funds transfers on a net basis at the end of the day or at certain times during the day. Regardless of whether the clearing agency settles on a gross or net basis, the legal, contractual, technical, and risk-management framework should ensure that the settlement of an obligation is final if and only if the settlement of the corresponding obligation is final.

DvP, DvD, and PvP can be achieved through different timing arrangements. Strictly speaking, DvP, DvD, and PvP do not require a simultaneous settlement of obligations. In some cases, settlement of one obligation could follow the settlement of the other. For example, when a SSS does not itself provide cash accounts for settlement, it may first block the underlying securities in the account of the seller. The system may then request a transfer of funds from the buyer to the seller at the settlement bank for funds transfers. The securities are delivered to the buyer or its custodian if and only if the system receives confirmation of settlement of the cash leg from the settlement bank. In such DvP arrangements, however, the length of time between the blocking of securities, the settling of cash, and the subsequent release and delivery of the blocked securities should be minimised. Further, blocked securities must not be subject to a claim by a third party (for example, other creditors, tax authorities, or even the system itself) because these claims would give rise to principal risk.

Participant default rules and procedures

– ***General principle***

3.13 (1) Participant-default rules and procedures facilitate the continued functioning of a clearing agency in the event that a participant fails to meet its obligations. These rules and procedures help limit the potential for the effects of a participant's failure to spread to other participants and undermine the viability of the clearing agency. Under subsections 3.13(1) and (2) of the Rule, a recognized clearing agency is required to have default rules and procedures that enable it to continue to meet its obligations in the event of a participant default and that address the replenishment of resources following a default. The clearing agency should be well prepared to implement its default rules and procedures, including any appropriate discretionary procedures provided for in its rules. Key objectives of default rules and procedures should include (i) ensuring timely completion of settlement, even in extreme but plausible market conditions; (ii) minimizing losses for the clearing agency and for non-defaulting participants; (iii) limiting disruptions to the market; (iv) providing a clear framework for accessing clearing agency liquidity facilities as needed; and (v) managing and closing out the defaulting participant's positions and liquidating any applicable collateral in a prudent and orderly manner.

In some instances, managing a participant default may involve hedging open positions, funding collateral so that the positions can be closed out over time, or both. The clearing agency may also decide to auction or allocate open positions to its participants. To the extent consistent with these objectives, the clearing agency should allow non-defaulting participants to continue to manage their positions as normal.

---

[11] "Delivery versus payment" is defined in the PFMI Report as "a securities settlement mechanism that links a securities transfer and a funds transfer in such a way as to ensure that delivery occurs if and only if the corresponding payment occurs".

[12] "Delivery versus delivery" is defined in the PFMI Report as "a securities settlement mechanism that links two securities transfers in such a way as to ensure that delivery of one security occurs if and only if the corresponding delivery of the other security occurs".

[13] "Payment versus payment" is defined in the PFMI Report as "a settlement mechanism that ensures that the final transfer of a payment in one currency occurs if and only if the final transfer of a payment in another currency or currencies takes place".

– ***Use and sequencing of financial resources***

(3) The clearing agency's default rules and procedures should enable it to take timely action to contain losses and liquidity pressures, before, at, and after the point of participant default. Accordingly, the clearing agency's rules and procedures must allow the prompt use of any financial resources that it maintains for covering losses and containing liquidity pressures arising from default, including liquidity facilities, in a specified order. This information enables participants to assess their potential future exposures from using the clearing agency's services. Typically, the clearing agency should first use assets provided by the defaulting participant, such as margin or other collateral, to provide incentives for participants to manage prudently the risks, particularly credit risk, they pose to the clearing agency. The application of previously provided collateral should not be subject to prevention, stay, or reversal under applicable law and the rules of the clearing agency. The clearing agency should also have a credible and explicit plan for replenishing its resources over an appropriate time horizon following a participant default so that it can continue to operate in a safe and sound manner. In particular, its rules and procedures should define the obligations of the non-defaulting participants to replenish the financial resources depleted during a default so that the time horizon of such replenishment is anticipated by non-defaulting participants without any disruptive effects.

– ***Default rules and procedures***

(4) Further to subsections 3.13(1) to (3) of the Rule, under subsection 3.13(4) of the Rule, the clearing agency is required to clearly describe the items listed, in its default rules and procedures. These elements of the default rules and procedures will enable the clearing agency to continue to meet its obligations to non-defaulting participants in the event of a participant default. The clearing agency should involve its participants, relevant authorities, and other relevant stakeholders in developing its default rules and procedures.

In addition, if the clearing agency acts as a CCP, it should have rules and procedures to facilitate the prompt close out or transfer of a defaulting participant's proprietary and customer positions. Typically, the longer these positions remain open on the books of the CCP, the larger the CCP's potential credit exposures resulting from changes in market prices or other factors will be. The CCP should have the ability to apply the proceeds of liquidation, along with other funds and assets of the defaulting participant, to meet the defaulting participant's obligations. It is critical that the CCP has the authority to act promptly to contain its exposure, while having regard for overall market effects, such as sharp declines in market prices. The CCP should have the information, resources, and tools to close out positions promptly. In circumstances where prompt close out is not practicable, the CCP should have the tools to hedge positions as an interim risk-management technique. In some cases, the CCP may use seconded personnel from non-defaulting participants to assist in the close-out or hedging process. The CCP's rules and procedures should clearly state the scope of duties and term of service expected from seconded personnel. In other cases, the CCP may elect to auction positions or portfolios to the market. The CCP's rules and procedures should clearly state the scope for such action, and any participant obligations with regard to such auctions should be clearly set out. The close out of positions should not be subject to prevention, stay, or reversal under applicable law and the rules of the clearing agency.

In general, the clearing agency should be well prepared to implement its default rules and procedures, including any appropriate discretionary procedures provided for in the rules. Management should ensure that the clearing agency has the operational capacity, including sufficient well-trained personnel, to implement its procedures in a timely manner. The clearing agency's rules and procedures should outline examples of when management discretion may be appropriate and should include arrangements to minimise any potential conflicts of interests. Management should also have internal plans that clearly delineate the roles and responsibilities for addressing a default and provide training and guidance to its personnel on how the procedures should be implemented. These plans should address documentation, information needs, and coordination when more than one clearing agency or authority is involved. In addition, timely communication with stakeholders, in particular with relevant authorities, is of critical importance. The clearing agency, to the extent permitted, should clearly convey to affected stakeholders information that would help them to manage their own risks. The internal plan should be reviewed by management and the relevant board committees at least annually or after any significant changes to the clearing agency's arrangements.

(5) To provide certainty and predictability regarding the measures that a clearing agency may take in a default event, a recognized clearing agency is required under subsection 3.13(5) of the Rule to publicly disclose on its Website key aspects of its default rules and procedures. This disclosure should include: (i) the circumstances in which action may be taken; (ii) who may take those actions; (iii) the scope of the actions which may be taken, including the treatment of both proprietary and customer positions, funds, and other assets; (iv) the mechanisms to address the clearing agency's obligations to non-defaulting participants; and (v) where direct relationships exist with participants' customers, the mechanisms to help address the defaulting participant's obligations to its customers. This transparency fosters the orderly handling of defaults, enables participants to understand their obligations to the clearing agency and to their customers, and gives market participants the information they need to make informed decisions about their activities in the market. The clearing agency should ensure that its participants and their customers, as well as the public, have appropriate access to the default rules and procedures and should promote their understanding of those procedures in order to foster confidence in the market.

– ***Testing of default procedures***

(6) Under subsections 3.13(6) and (7) of the Rule, the clearing agency is required to involve its participants and other stakeholders in the testing and review of its default rules and procedures, including any close-out procedures. The testing and review must be conducted at least annually or following material changes to the clearing agency's default rules and procedures. The periodic testing and review of default procedures is important to help the clearing agency and its participants understand fully the rules and procedures and to identify any lack of clarity in, or discretion allowed by, the rules and procedures. Such tests should include all relevant parties, or an appropriate subset, that would likely be involved in the default procedures, such as members of the appropriate board committees, participants, linked or interdependent clearing agencies, relevant authorities, and any related service providers. This is particularly important where the clearing agency relies on non-defaulting participants or third parties to assist in the close-out process and where the default rules and procedures have never been tested by an actual default. The results of these tests and reviews should be shared with the clearing agency's board of directors, risk committee, and relevant authorities.

Furthermore, part of the clearing agency's participant-default testing should facilitate the implementation of a resolution regime for its participants, as relevant. The clearing agency should be able to take appropriate steps to assist the resolution process of a participant; specifically, the clearing agency, or if applicable a resolution authority, should be able to transfer a defaulting participant's open positions and customer accounts to a receiver, third party, or bridge financial company.

– ***Use of own capital***

(8) Under subsection 3.13(8) of the Rule, in applying its "waterfall" of prefunded financial resources in a default situation, the CCP is required to include a reasonable portion of its own capital to cover losses resulting from one or more participant defaults, prior to applying the collateral of the non-defaulting participants (i.e. a "skin-in-the-game" requirement). The Commission is of the view that a CCP should be required to participate in the default waterfall with its own capital contribution, to be used immediately after a defaulting participant's contribution and prior to non-defaulting participants' contributions. Such equity should be in reasonable proportion to the size of the CCP's default fund.

Segregation and portability

– ***General principle***

3.14 (1) Segregation refers to a method of protecting customer collateral and contractual positions by holding or accounting for them separately. Effective segregation arrangements can reduce the impact of a participant's insolvency on its customers by providing for clear and reliable identification of a participant's customer's positions and related collateral. Segregation also protects a customer's collateral from becoming lost to a participant's other creditors. In addition, segregation facilitates the transfer of customers' positions and collateral. Even if no transfers take place, segregation can improve a customer's ability to identify and recover its collateral (or the value thereof), which, at least to some extent, contributes to retaining customers' confidence in their clearing participants and may reduce the potential for "counterparty runs" on a deteriorating clearing participant.

Portability refers to the operational aspects of the transfer of contractual positions, funds, or securities from one party to another party. By facilitating transfers from one participant to another, effective portability arrangements lessen the need for closing out positions, including during times of market stress. Portability thus minimizes the costs and potential market disruption associated with closing out positions and reduces the possible impact on customers' ability to continue to obtain access to central clearing.

Under subsection 3.14(1) to (2) of the Rule, a recognized clearing agency that acts as a CCP must have rules and procedures that provide for the segregation and portability of positions of a participant's customers and the collateral provided to it with respect to those positions. In this regard, customer collateral should be segregated from the assets of the participant through which the customers clear. In addition, individual customer collateral may be held separately from the collateral of other customers of the same participant to protect customers from each other's default. The CCP should also structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting participant's customers will be effectively transferred to one or more other participants, taking into account all relevant circumstances.

The PFMI Report notes that in certain jurisdictions, cash market CCPs operate in legal regimes that facilitate segregation and portability to achieve protection of customer assets by alternate means that offer the same degree of protection as the approach required by Principle 14 as adopted in section 3.14. Features of such a regime are that if a participant fails, (i) the customer positions can be identified timely, (ii) customers will be protected by an investor protection scheme designed to move customer accounts from the failed or failing participant to another participant in a timely manner, and (iii) customer assets can be restored. The Commission is currently conducting further policy work on the application of section 3.14 to the CCPs serving the cash markets in Ontario. Accordingly, in cases where it is determined by the Commission that cash market CCPs are operating in a manner, and within a framework, that achieves the same degree of protection and efficiency for customers that would otherwise be achieved by segregation and portability arrangements at the CCP level required by section 3.14, the Commission may provide an exemption from the application of this section.

Where the CCP is clearing derivatives transactions, it will be required to have rules and procedures that enable the segregation and portability of positions of a participant's customers and the collateral provided to it with respect to those positions, in accordance with the requirements set out in [Rule 91-*** *Model Provincial Rule – Derivatives – Customer Clearing: Protection of Customer Assets*]. See section 1.4(2) for greater clarity on the term "derivative" as well as the interaction of [Model Provincial Rule 91-***] and the Rule.

(4) Under subparagraph 3.14(4)(a)(ii) of the Rule, omnibus customer accounts refers to an account structure where securities or collateral belonging to some or all customers of a particular participant is comingled and held in a single account segregated from that of the participant.

General business risk

– ***General principle***

3.15 (1) General business risk refers to the risks and potential losses arising from a clearing agency's administration and operation as a business enterprise that are neither related to participant default nor separately covered by financial resources under the credit or liquidity risk requirements. General business risk includes any potential impairment of a clearing agency's financial position (as a business concern) as a consequence of a decline in its revenues or an increase in its expenses, such that expenses exceed revenues and result in a loss that must be charged against capital. Such impairment can be caused by a variety of business factors, including poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses. Business-related losses also may arise from risks covered by other principles, for example, legal risk (in the case of legal actions challenging a clearing agency's custody arrangements), investment risk affecting a clearing agency's resources, and operational risk (in the case of fraud, theft, or loss). In these cases, general business risk may cause a clearing agency to experience an extraordinary one-time loss as opposed to recurring losses. Under subsections 3.15(1) and (2) of the Rule, a recognized clearing agency is required to have robust management and control systems to identify, monitor, and manage general business risk. The clearing agency must also hold liquid net assets funded by equity (such as common stock, disclosed reserves, or other retained earnings) so that it can continue operations and services as a going concern if it incurs general business losses. The amount of liquid net assets funded by equity the clearing agency should hold must be determined by its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken. Further specificity to these general principles is also provided under subsection 3.15(3) of the Rule.

As part of the general principles of subsections 3.15(1) and (2), the clearing agency should identify and assess the sources of business risk and their potential impact on its operations and services by taking into account past loss events and financial projections. The clearing agency should assess and thoroughly understand its business risk and the potential effect that this risk could have on its cash flows, liquidity, and capital positions. In doing so, the clearing agency should consider a combination of tools, such as risk management and internal control assessments, scenario analysis, and sensitivity analysis. Internal control assessments should identify key risks and controls and assess the impact and probability of the risks and the effectiveness of the controls. Scenario analysis should examine how specific scenarios would affect the clearing agency. Sensitivity analysis should test how changes in one risk affect the clearing agency's financial standing, for example, conducting the analysis of how the loss of a key customer or service provider might impact its existing business activities. In some cases, the clearing agency may want to consider an independent assessment of specific business risks.

The clearing agency should clearly understand its general business risk profile so that it is able to assess its ability either (a) to avoid, reduce, or transfer specific business risks or (b) to accept and manage those risks. This requires the ongoing identification of risk-mitigation options that the clearing agency may use in response to changes in its business environment. When planning an expansion of activity, the clearing agency should conduct a comprehensive enterprise risk assessment. In particular, when considering any major new product, service, or project, the clearing agency should project potential revenues and expenses as well as identify and plan how it will cover any additional capital requirements. Further, the clearing agency may eliminate or mitigate some risks by instituting appropriate internal controls or by obtaining insurance or indemnity from a third party.

Once the clearing agency has identified and assessed its business risk, it should measure and monitor these risks on an ongoing basis and develop appropriate information systems as part of a robust enterprise risk-management program. Key components of a robust enterprise risk-management program include: establishing strong financial and internal control systems so that the clearing agency can monitor, manage, and control its cash flows and operating expenses and mitigate any business-related losses. In particular, the clearing agency should minimize and mitigate the probability of business-related losses and their impact on its operations across a range of adverse business and market conditions, including the scenario that its viability as a going concern is questioned. The clearing agency should also ensure that it has rigorous and appropriate investment guidelines and monitoring procedures.

– *Determining sufficiency of liquid net assets*

(3) As required by subsections 3.15(1) and (2) of the Rule, a clearing agency must hold a sufficient amount of liquid net assets funded by equity so that it can continue operations and services as a going concern if it incurs general business losses, or for the purposes of an orderly wind-down of its critical operations and services, where necessary. Equity allows the clearing agency to absorb losses and should be permanently available for this purpose. Further to the requirements under paragraphs 3.3(3)(b) to (d) of the Rule, subsection 3.15(3) of the Rule requires the clearing agency to maintain a viable recovery or orderly wind-down plan that is approved by the board of directors, as well as sufficient liquid net assets funded by equity to implement this plan.

A determination of the appropriate amount of liquid net assets funded by equity will depend on the content of the plan and, specifically, on the size of the clearing agency, the scope of its activities, the types of actions included in the plan, and the length of time needed to implement them. The clearing agency should also take into consideration the operational, technological, and legal requirements for participants to establish and move to an alternative arrangement in the event of an orderly wind-down. At a minimum, however, the clearing agency should hold liquid net assets funded by equity equal to at least six months of current operating expenses.

In order to estimate the amount of liquid net assets funded by equity that a particular clearing agency would need, it should regularly analyze and understand how its revenue and operating expenses may change under a variety of adverse business scenarios as well as how it might be affected by extraordinary one-time losses. This analysis should also be performed when a material change to the assumptions underlying the model occurs, either because of changes to the clearing agency's business model or because of external changes. The clearing agency needs to consider not only possible decreases in revenues but also possible increases in operating expenses, as well as the possibility of extraordinary one-time losses, when deciding on the amount of liquid net assets to hold to cover general business risk.

Assets held by the clearing agency to cover risks or losses other than business risk (for example, the financial resources required under the credit and liquidity risk principles) or to cover losses from other business lines that are unrelated to its activities as the clearing agency should not be included when accounting for liquid net assets available to cover business risk. However, equity held under international risk-based capital standards should be included where relevant and appropriate to avoid duplicate capital requirements.

(4) To ensure the adequacy of its own resources, the clearing agency should regularly assess and document its liquid net assets funded by equity relative to its potential business risks.

(5) Under subsection 3.15(5) of the Rule, the clearing agency is required to provide a viable capital plan for maintaining an appropriate level of equity which includes detail regarding how the clearing agency would raise new capital if its equity capital were to fall close to or below the amount needed. This plan must be approved by the board of directors and updated regularly. The clearing agency may also need to consult its participants and others during the development of its plan.

In developing such a capital plan, the clearing agency should consider a number of factors, including its ownership structure and any insured business risks. For example, the clearing agency should determine if and to what extent specific business risks are covered by (i) explicit insurance from a third party or (ii) explicit indemnity agreements from a parent, owners, or participants (for example, general loss-allocation provisions and parent guarantees), which would be realizable within the recovery or orderly wind-down time frame. Given the contingent nature of these resources, the clearing agency should use conservative assumptions when taking them into account for its capital plan. Furthermore, these resources should not be taken into account when assessing the clearing agency's capital adequacy.

Custody and investment risks

– *General principle*

3.16 (1) Custody risk is the risk of loss on assets held in custody in the event of a custodian's (or sub-custodian's) insolvency, negligence, fraud, poor administration, or inadequate recordkeeping. Under subsection 3.16(1) of the Rule, a recognized clearing agency has the responsibility to safeguard its assets, such as cash and securities, as well as the assets that its participants have provided to the clearing agency. Assets that are used by a clearing agency to support its operating funds or capital funds or that have been provided by participants to secure their obligations to the clearing agency should be held at supervised or regulated entities that have strong processes, systems, and credit profiles, including other clearing agencies (for example, CSDs). In addition, assets should generally be held in a manner that assures the clearing agency of prompt access to those assets in the event that it needs to draw on them.

(2) Investment risk refers to the risk of loss faced by a clearing agency when it invests its own or its participants' assets. Under subsection 3.16(2) of the Rule, the clearing agency is required to invest its own and its participants' assets in instruments with minimal credit, market, and liquidity risks, as further specified by subsection 3.16(4) of the Rule.

– *Use of custodians*

(3) (a) The clearing agency is required to mitigate its custody risk by using only supervised or regulated banks or custodians with robust accounting practices, safekeeping procedures, and internal controls that fully protect its own and its participants' assets. It is particularly important that assets held in custody are protected against claims of a custodian's creditors. The custodian should have a sound legal basis supporting its activities, including the segregation of assets. The custodian also should have a strong financial position to be able to sustain losses from operational problems or non-custodial activities.

(b) The clearing agency is required to confirm that its interest or ownership rights in the assets can be enforced and that it can have prompt access to its assets and the assets provided by participants, when required. Timely availability and access should be ensured even if these securities are held in another time zone or jurisdiction. Furthermore, the clearing agency should confirm it has prompt access to the assets in the event of a default of a participant.

(c) The clearing agency is required to evaluate and understand its exposures to its banks and custodians, taking into account the full scope of its relationships with each custodian bank. For example, a financial institution may serve as a custodian bank to the clearing agency as well as a settlement bank and liquidity provider to the clearing agency. The custodian bank also might be a participant in the clearing agency and offer clearing services to other participants. The clearing agency should carefully consider all of its relationships with a particular custodian bank to ensure that its overall risk exposure to an individual custodian remains within acceptable concentration limits. Where feasible, the clearing agency could consider using multiple custodians for the safekeeping of its assets to diversify its exposure to any single custodian. For example, if the clearing agency acts as a CCP, it may want to use one custodian for its margin assets and another custodian for its prefunded default arrangement. Such a CCP, however, may need to balance the benefits of risk diversification against the benefits of pooling resources at one or a small number of custodians. In any event, the clearing agency should monitor the concentration of risk exposures to, and financial condition of, its custodian banks on an ongoing basis.

– *Investment strategy*

(4) Under paragraph 3.16(4)(a) of the Rule, the clearing agency's strategy for investing its own and its participants' assets must be consistent with its overall risk-management strategy and fully disclosed to its participants. When making its investment choices, the clearing agency should not allow pursuit of profit to compromise its financial soundness and liquidity risk management. Paragraph 3.16(4)(c) of the Rule requires that investments be secured by, or be claims on, high-quality obligors to mitigate the credit risk to which the clearing agency is exposed. Also, because the value of the clearing agency's investments may need to be realized quickly, investments are to allow for quick liquidation with little, if any, adverse price effect pursuant to paragraph 3.16(4)(d). For example, the clearing agency could invest in overnight reverse repo agreements backed by liquid securities with low credit risk. The clearing agency should carefully consider its overall credit risk exposures to individual obligors, including other relationships with the obligor that create additional exposures such as an obligor that is also a participant or an affiliate of a participant in the clearing agency. In addition, the clearing agency should not invest participant assets in the participant's own securities or those of its affiliates. If the clearing agency's own resources can be used to cover losses and liquidity pressures resulting from a participant default, the investment of those resources should not compromise the clearing agency's ability to use them when needed.

Operational risks

– *General principle*

3.17 (1) Operational risk is the risk that deficiencies in information systems, internal processes, and personnel or disruptions from external events will result in the reduction, deterioration, or breakdown of services provided by a clearing agency. Operational failures can damage a clearing agency's reputation or perceived reliability, lead to legal consequences, and result in financial losses incurred by the clearing agency, participants, and other parties. In certain cases, operational failures can also be a source of systemic risk. Accordingly, subsection 3.17(1) of the Rule requires that a recognized clearing agency establish a robust framework to manage its operational risks with appropriate systems, policies, procedures, and controls.

As part of the clearing agency's robust risk-management framework under the general principle of section 3.3 of the Rule, the clearing agency should identify the plausible sources of operational risk; deploy appropriate systems; establish appropriate policies, procedures, and controls; set operational reliability objectives; and develop a business continuity plan. The clearing agency should take a holistic approach when establishing its operational risk-management framework.

(2) Under the general principle of subsection 3.17(2) of the Rule, the systems of a recognized clearing agency must be designed to ensure a high degree of security and operational reliability. Accordingly, the clearing agency should have clearly defined operational reliability objectives and should have policies in place that are designed to achieve those objectives. As well, the clearing agency is required to have scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives.

(3) Under the general principle of subsection 3.17(3) of the Rule, the clearing agency must have a business continuity plan that has clearly stated objectives as well as policies and procedures that allow for the rapid recovery and timely resumption of critical operations following a disruption to a service, including in the event of a wide-scale or major disruption. Business continuity management is a key component of the clearing agency's operational risk-management framework.

– ***Identifying sources of operational risk, operational risk management, and operational reliability***

(4) (a) Paragraph 3.17(4)(a) of the Rule provides greater specificity regarding the need for a robust operational risk management framework which allows the clearing agency to actively identify, monitor, and manage the plausible sources of operational risk and establish clear policies and procedures to address them.

In identifying sources of operational risk, the clearing agency should take into account that operational risk can stem from both internal and external sources. Internal sources of operational risk include inadequate identification or understanding of risks and the controls and procedures needed to limit and manage them, inadequate control of systems and processes, inadequate screening of personnel, and, more generally, inadequate management. External sources of operational risk include the failure of critical service providers or utilities or events affecting a wide metropolitan area such as natural disasters, terrorism, and pandemics. Both internal and external sources of operational risk can lead to a variety of operational failures that include (i) errors or delays in message handling, (ii) miscommunication, (iii) service degradation or interruption, (iv) fraudulent activities by staff, and (v) disclosure of confidential information to unauthorized entities. If the clearing agency provides services in multiple time zones, it may face increased operational risk due to longer operational hours and less downtime for maintenance. The clearing agency should identify all potential single points of failure in its operations. Additionally, the clearing agency should assess the evolving nature of the operational risk it faces on an ongoing basis (for example, pandemics and cyber-attacks), so that it can analyze its potential vulnerabilities and implement appropriate defence mechanisms.

The various sources of operational risk should then be monitored, mitigated and managed, according to clear policies, procedures, and controls. Overall, operational risk management is a continuous process encompassing risk assessment, defining an acceptable tolerance for risk, and implementing risk controls. This process results in the clearing agency accepting, mitigating, or avoiding risks consistent with its operational reliability objectives. The clearing agency's governance arrangements are pertinent to its operational risk-management framework.

To ensure the proper functioning of its risk controls, the clearing agency should have sound internal controls. For example, the clearing agency should have adequate management controls, such as setting operational standards, measuring and reviewing performance, and correcting deficiencies. There are many relevant international, national, and industry-level standards, guidelines, or recommendations that the clearing agency may use in designing its operational risk-management framework. Conformity with commercial standards can help the clearing agency reach its operational objectives. For example, commercial standards exist for information security, business continuity, and project management. The clearing agency should regularly assess the need to integrate the applicable commercial standards into its operational risk-management framework. In addition, the clearing agency should seek to comply with relevant commercial standards in a manner commensurate with the clearing agency's importance and level of interconnectedness.

The clearing agency's operational risk-management framework should include formal change-management and project-management processes to mitigate operational risk arising from modifications to operations, policies, procedures, and controls. Change-management processes should provide mechanisms for preparing, approving, tracking, testing, and implementing all changes to the system. Project-management processes, in the form of policies and procedures, should mitigate the risk of any inadvertent effects on the clearing agency's current or future activities due to an upgrade, expansion, or alteration to its service offerings, especially for major projects. In particular, these policies and procedures should guide the management, documentation, governance, communication, and testing of projects, regardless of whether projects are outsourced or executed in-house.

(b) Under paragraph 3.17(4)(b) of the Rule, the clearing agency's board must explicitly define the roles and responsibilities for addressing operational risk and endorse the clearing agency's operational risk-management framework.

Because the proper performance of the clearing agency's employees is a core aspect of any operational risk-management framework, the clearing agency should employ sufficient, well-qualified personnel. The clearing agency's personnel should be able to operate the system safely and efficiently and consistently follow operational and risk-management procedures during normal and abnormal circumstances. The clearing agency should implement appropriate human resources policies to hire, train, and retain qualified personnel, thereby mitigating the effects of high rates of personnel turnover or key-person risk. Additionally, the clearing agency should have appropriate human resources and risk-management policies to address fraud prevention.

(c) Under paragraph 3.17(4)(c) of the Rule, the clearing agency's systems, policies, procedures and controls, including arrangements with participants, must be periodically, and whenever necessary, tested and reviewed, especially after significant changes occur to the system or a major incident occurs. In order to minimize any effects of the testing on operations, tests should be carried out in a "testing environment." This testing environment should, to the extent possible, replicate the production

environment (including the implemented security provisions, in particular, those regarding data confidentiality). Additionally, key elements of the clearing agency's operational risk-management framework should be audited periodically and whenever necessary. In addition to periodic internal audits, external audits may be necessary, depending on the clearing agency's importance and level of interconnectedness. Consistent with the evolving nature of operational risk management, the clearing agency's operational objectives should be periodically reviewed to incorporate new technological and business developments.

(d) Under paragraph 3.17(4)(d) of the Rule, the clearing agency must have clearly defined operational reliability objectives and should have policies in place that are designed to achieve those objectives. These objectives serve as benchmarks for the clearing agency to evaluate its efficiency and effectiveness and evaluate its performance against expectations. These objectives should be designed to promote confidence among the clearing agency's participants. Operational reliability objectives should include the clearing agency's operational performance objectives and committed service-level targets. Operational performance objectives and service-level targets should define both qualitative and quantitative measures of operational performance and should explicitly state the performance standards the clearing agency is intending to meet. The clearing agency should monitor and assess regularly whether the system is meeting its established objectives and service-level targets. The system's performance should be reported regularly to senior management, relevant board committees, participants, and authorities. In addition, the clearing agency's operational objectives should be periodically reviewed to incorporate new technological and business developments.

– ***Operational capacity, systems requirements, and incident management***

(5) Under paragraph 3.17(5)(c) of the Rule, the clearing agency is required to develop and maintain an adequate system of internal controls that support the clearing agency's operations and services. As well, the clearing agency is required to develop and maintain adequate information technology general controls. These are the controls which are implemented to support information technology planning, acquisition, development and maintenance, computer operations information systems support, and security. Recognized guides as to what constitutes adequate information technology controls include 'Information Technology Control Guidelines' from the Canadian Institute of Chartered Accountants (CICA) and 'COBIT' from the IT Governance Institute.

As part of its information technology general controls, the clearing agency should have comprehensive physical and information security policies that address all potential vulnerabilities and threats. In particular, the clearing agency should have policies effective in assessing and mitigating vulnerabilities in its physical sites from attacks, intrusions, and natural disasters. The clearing agency should also have sound and robust information security policies, standards, practices, and controls to ensure an appropriate level of confidence and trust in the clearing agency by all stakeholders. These policies, standards, practices, and controls should include the identification, assessment, and management of security threats and vulnerabilities for the purpose of implementing appropriate safeguards into its systems. Data should be protected from loss and leakage, unauthorized access, and other processing risks, such as negligence, fraud, poor administration, and inadequate recordkeeping. The clearing agency's information security objectives and policies should conform to commercially reasonable standards for confidentiality, integrity, authentication, authorization, non-repudiation, availability, and auditability (or accountability).

Under paragraph 3.17(5)(a) of the Rule, the clearing agency is required to ensure that it has scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives. Capacity management requires that the clearing agency monitor, review, and test (including stress test) the actual capacity and performance of the system on an ongoing basis. Accordingly, under paragraph 3.17(5)(d) of the Rule, the clearing agency is required to meet certain systems capacity, performance and disaster recovery standards for testing. These standards are consistent with prudent business practice. The activities and tests required in this paragraph are to be carried out at least once a year. In practice, continuing changes in technology, risk management requirements and competitive pressures will often result in these activities being carried out or tested more frequently.

As part of its activities and test, the clearing agency should carefully forecast demand and make appropriate plans to adapt to any plausible change in the volume of business or technical requirements. These plans should be based on a sound, comprehensive methodology so that the required service levels and performance can be achieved and maintained. Further, the clearing agency should determine a required level of redundant capacity, taking into account its level of importance and interconnectedness, so that if an operational outage occurs, the system is able to resume operations and process all remaining transactions before the end of the day.

Paragraph 3.17(5)(e) of the Rule requires the clearing agency to notify the Commission of any material system failure, malfunction or delay or other incident disruptive to the clearing agency's operations, or any breach of data security, integrity or confidentiality. A failure, malfunction or delay or other disruptive incident is considered to be "material" if the clearing agency would in the normal course of operations escalate the matter to or inform its senior management ultimately accountable for technology. It is also expected that, as part of this notification, the clearing agency will provide updates on the status of the failure and the resumption of service. Further, the clearing agency should have comprehensive and well-documented procedures in place to record, report, analyze, and resolve all operational incidents. In this regard, the clearing agency should undertake a "post-incident" review to identify the causes and any required improvement to the normal operations or business

continuity arrangements, as further discussed within section 3.17. Such reviews should, where relevant, include the clearing agency's participants. The results of such internal reviews are required to be communicated to the Commission as soon as practicable.

(6) Subsection 3.17(6) of the Rule requires the clearing agency to engage a qualified party to conduct an annual independent assessment of its systems and related internal controls and information technology general controls and prepare a report in accordance with established audit standards. A qualified party is a person or company or a group of persons or companies with relevant experience in both information technology and in the evaluation of related internal systems or controls in a complex information technology environment. Qualified persons may include external auditors or third party information system consultants, as well as employees of the clearing agency, but may not be persons responsible for the development or operation of the systems or capabilities being tested.

(11) Subsection 3.17(11) of the Rule holds that if the clearing agency must make a change to its technology requirements regarding interfacing with or accessing the clearing agency to immediately address a failure, malfunction or material delay of its systems or equipment, it will immediately notify the Commission. We expect the amended technology requirements to be made publicly available as soon as practicable, either while the changes are being made or immediately after.

– ***Business continuity plan***

(12) Business continuity management is a key component of a clearing agency's operational risk-management framework. Under subsection 3.17(12), the clearing agency is required to have a business continuity plan, with clearly stated objectives. Paragraph 3.17(12)(a) of the Rule specifies that this plan must address events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. Both internal and external threats should be considered in the business continuity plan, and the impact of each threat should be identified and assessed. In addition to reactive measures, the clearing agency's business continuity plan may need to include measures that prevent disruptions of critical operations. All aspects of the business continuity plan should be clearly and fully documented. The clearing agency should explicitly assign responsibility for business continuity planning and devote adequate resources to this planning.

As part of its business continuity plan, under paragraph 3.17(12)(b), the clearing agency is required to set up a secondary site with sufficient resources, capabilities, and functionalities and appropriate staffing arrangements that would not be affected by a wide-scale disruption and would allow the secondary site to take over operations if needed. The secondary site should provide the level of critical services necessary to perform the functions consistent with the recovery time objective and should be located at a geographical distance from the primary site that is sufficient to have a distinct risk profile. A comparative risk analysis should be conducted on a selected secondary site. The need and possibility of a third site could be considered, in particular to provide sufficient confidence that the clearing agency's business continuity objectives will be met in all scenarios. The clearing agency should also consider alternative arrangements (for example, manual paper-based procedures) to allow for the processing of time-critical transactions in extreme circumstances.

The objectives of the business continuity plan should include a system's recovery time and recovery point. Under subparagraph 3.17(12)(c)(i), the clearing agency's business continuity plan, including its disaster recovery plan, must be designed to ensure that critical information technology systems can resume operations within two hours following disruptive events. Ideally, backup systems should commence processing immediately. Under subparagraph 3.17(12)(c)(ii), the plan must also be designed to enable the clearing agency to complete settlement by the end of the day even in case of extreme circumstances. Depending on their recovery-time objectives and designs, some clearing agencies may be able to resume operations with some data loss; however, contingency plans should ensure that the status of all transactions at the time of the disruption can be identified with certainty in a timely manner.

The clearing agency's business continuity plan should also include clearly defined procedures for crisis and event management. The plan, for example, should address the need for rapid deployment of a multi-skilled crisis and event-management team as well as procedures to consult and inform participants, interdependent clearing agencies, authorities, and others (such as service providers and, where relevant, the media) quickly. Communication with regulators, supervisors, and overseers is critical in case of a major disruption to the clearing agency's operations or a wider market distress that affects the clearing agency, particularly where relevant authorities might rely on data held by the clearing agency for crisis management. Depending on the nature of the problem, communication channels with local civil authorities (for physical attacks or natural disasters) or computer experts (for software malfunctions or cyber-attacks) may also need to be activated. If the clearing agency has global importance or critical linkages to one or more interdependent clearing agencies, it should set up, test, and review appropriate cross-system or cross-border crisis-management arrangements.

The clearing agency's business continuity plan and its associated arrangements should be subject to frequent review and testing. At a minimum, under paragraph 3.17(12)(d), such tests must be conducted annually. Tests should address various scenarios that simulate wide-scale disasters and inter-site switchovers. The clearing agency's employees should be thoroughly trained to execute the business continuity plan and participants, critical service providers, and linked clearing agencies should be regularly involved in the testing and be provided with a general summary of the testing results. The Commission expects that the clearing agency will also facilitate and participate in industry-wide testing of the business continuity plan. The clearing

agency should make appropriate adjustments to its business continuity plan and associated arrangements based on the results of the testing exercises.

(13) A single point of failure is any point in a system, whether a service, activity, or process, that, if it fails to work correctly, leads to the failure of the entire system.

– ***Interdependencies, including outsourcing***

(14) As a clearing agency may be connected directly and indirectly to its participants, other clearing agencies, and service and utility providers, it is incumbent on the clearing agency to identify, monitor, and manage any risks that may be posed to its operations. Subsection 3.17(14) of the Rule sets out the requirements for identifying, monitoring and managing the risks of the interdependencies of any of the key services or systems of the clearing agency.

The clearing agency should identify both direct and indirect effects on its ability to process and settle transactions in the normal course of business and manage risks that stem from an external operational failure of connected entities. These effects include those transmitted through its participants, which may participate in multiple clearing agencies. In addition, the clearing agency should also identify, monitor, and manage the risks it faces from and poses to other clearing agencies (refer also to section 3.20). To the extent possible, interdependent clearing agencies should coordinate business continuity arrangements. The clearing agency also should consider the risks associated with its service and utility providers and the operational effect on the clearing agency if service or utility providers fail to perform as expected. The clearing agency should provide reliable service, not only for the benefit of its direct participants, but also for all entities that would be affected by its ability to process transactions.

To manage the operational risks associated with its participants, the clearing agency should consider establishing minimum operational requirements for its participants (see also section 3.18 on access, participation and process requirements). For example, the clearing agency may want to define operational and business continuity requirements for participants in accordance with the participant's role and importance to the system. In some cases, the clearing agency may want to identify critical participants based on the consideration of transaction volumes and values, services provided to the clearing agency and other interdependent systems, and, more generally, the potential impact on other participants and the system as a whole in the event of a significant operational problem. Critical participants may need to meet some of the same operational risk-management requirements as the clearing agency itself. The clearing agency should have clear and transparent criteria, methodologies, or standards for critical participants to ensure that their operational risks are managed appropriately.

(15) Where a clearing agency relies upon or outsources some of its operations to a service provider, it should generally ensure that those operations meet the same requirements they would need to meet if they were provided internally. Under subsection 3.17(15) of the Rule, the clearing agency must meet various requirements in respect of the outsourcing of critical services or systems to a service provider. The requirements under the subsection 3.17(15) apply regardless of whether the outsourcing arrangements are with third-party service providers, or with affiliates of the clearing agency.

Generally, the clearing agency is required to establish, implement, maintain and enforce policies and procedures to evaluate and approve outsourcing agreements to critical service providers. Such policies and procedures should include assessing the suitability of potential service providers and the ability of the clearing agency to continue to comply with Ontario securities law in the event of the service provider's bankruptcy, insolvency or termination of business. The clearing agency is also required to monitor and evaluate the on-going performance of the service provider to which they outsourced critical services, systems or facilities. Further, the clearing agency should have robust arrangements for the substitution of such providers, timely access to all necessary information, and the proper controls and monitoring tools.

Under subsection 3.17(15) of the Rule, a contractual relationship should be in place between the clearing agency and the critical service provider allowing it and relevant authorities to have full access to necessary information. The contract should ensure that the clearing agency's approval is mandatory before the critical service provider can itself outsource material elements of the service provided to the clearing agency, and that in the event of such an arrangement, full access to the necessary information is preserved. Clear lines of communication should be established between the outsourcing clearing agency and the critical service provider to facilitate the flow of functions and information between parties in both ordinary and exceptional circumstances.

Where the clearing agency outsources operations to critical service providers, it should disclose the nature and scope of this dependency to its participants. It should also identify the risks from its outsourcing and take appropriate actions to manage these dependencies through appropriate contractual and organisational arrangements. The clearing agency should inform the Commission about any such dependencies and the performance of these critical service providers. To that end, the clearing agency can contractually provide for direct contacts between the critical service provider and the Commission, contractually ensure that the Commission can obtain specific reports from the critical service provider, or the clearing agency may provide full information to the Commission.

Access, participation and due process requirements

– *General principle*

3.18 (1) Access refers to the ability to use a clearing agency's services and includes the direct use of the services by participants, including other market infrastructures and, where relevant, service providers. In some cases, access also includes indirect participation. Under subsection 3.18(1) of the Rule, a recognized clearing agency is required to allow for fair and open access to its services, while also having objective, risk-based and publicly disclosed criteria for participation. Fair and open access to the clearing agency's services encourages competition among market participants and promotes efficient and low-cost clearing and settlement.

– *Basic access standards*

(2) A clearing agency should always consider the risks that an actual or prospective participant may pose to itself and other participants. Accordingly, subsection 3.18(2) specifically requires the clearing agency to control the risks to which it is exposed by its participants by setting out risk-related requirements for participation in its services. The clearing agency should ensure that its participants and any linked clearing agency have the requisite operational capacity, financial resources, legal powers, and risk-management expertise to prevent unacceptable risk exposure for the clearing agency and other participants. Where participants act for other entities (indirect participants), it may be appropriate for the clearing agency to impose additional requirements to ensure that the direct participants have the capacity to do so. Operational requirements may include reasonable criteria relating to the participant's ability and readiness (for example, its IT capabilities) to use the clearing agency's services. Financial requirements may include reasonable risk-related capital requirements, contributions to prefunded default arrangements, and appropriate indicators of creditworthiness. Legal requirements may include appropriate licences and authorisations to conduct relevant activities as well as legal opinions or other arrangements that demonstrate that possible conflict of laws issues would not impede the ability of an applicant (for example, a foreign entity) to meet its obligations to the clearing agency. The clearing agency also may require participants to have appropriate risk-management expertise. If the clearing agency admits non-regulated entities, it should take into account any additional risks that may arise from their participation and design its participation requirements and risk-management controls accordingly.

The clearing agency's participation requirements must be clearly stated and publicly disclosed on its Website so as to eliminate ambiguity and promote transparency. In addition, the clearing agency's participation requirements should be justified in terms of its safety and efficiency as well as that of the markets it serves, be tailored to the clearing agency's specific risks, and be imposed in a manner commensurate with such risks.

Subject to maintaining acceptable risk control standards, the clearing agency should endeavour to set requirements that have the least-restrictive impact on access that circumstances permit. While restrictions on access should generally be based on reasonable risk-related criteria, such restrictions may also be subject to the constraints of local laws and policies of the jurisdiction in which the clearing agency operates. Requirements should also reflect the risk profile of the activity; the clearing agency may have different categories of participation based on the type of activity. For example, a participant in the clearing services of a CCP may be subject to a different set of requirements than a participant in the auctioning process of the same CCP.

To help address the balance between open access and risk, the clearing agency should manage its participant-related risks through the use of risk-management controls, risk-sharing arrangements, and other operational arrangements that have the least-restrictive impact on access and competition that circumstances permit. For example, the clearing agency can use credit limits or collateral requirements to help it manage its credit exposure to a particular participant. The permitted level of participation may be different for participants maintaining different levels of capital. Where other factors are equal, participants holding greater levels of capital may be permitted less-restrictive risk limits or be able to participate in more functions within the clearing agency. The effectiveness of such risk-management controls may mitigate the need for the clearing agency to impose onerous participation requirements that limit access. The clearing agency could also differentiate its services to provide different levels of access at varying levels of cost and complexity. For example, the clearing agency may want to limit direct participation to certain types of entities and provide indirect access to others. Participation requirements (and other risk controls) can be tailored to each tier of participants based on the risks each tier poses to the clearing agency and its participants.

(3) Under subsection 3.18(3) of the Rule, the clearing agency is prohibited from unreasonably limiting access to its services, permitting unreasonable discrimination among its participants or the customers of its participants, or introducing competitive distortions. For example, requirements based solely on a participant's size are typically insufficiently related to risk and deserve careful scrutiny. In addition, the clearing agency is prohibited from unreasonably requiring the use or purchase of another service to utilize the clearing agency's functions, or impose unfair or inequitable fees or material costs. For instance, the clearing agency should not develop closed, proprietary interfaces that result in vendor lock-in or barriers to entry with respect to competing service providers. Also, the Commission is of the view that a requirement on participants of a CCP serving the derivatives markets to use an affiliated trade repository to report derivatives trades would be unreasonable.

– ***Participant monitoring***

(6) Under subsection 3.18(5), the clearing agency is required to monitor compliance with its participation requirements on an ongoing basis through the receipt of timely and accurate information. Participants should be obligated to report any developments that may affect their ability to comply with the clearing agency's participation requirements. The clearing agency should also have the authority to impose more-stringent restrictions or other risk controls on a participant in situations where it is determined that the participant poses heightened risk to the clearing agency. For example, if a participant's creditworthiness declines, the clearing agency may require the participant to provide additional collateral or reduce the participant's credit limit. Finally, the clearing agency should have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements. The methodology of monitoring compliance and non-compliance should be fully documented.

Tiered participation arrangements

– ***General principle***

3.19 (1) (a) Section 19 of the Rule discusses a recognized clearing agency's requirements in respect of tiered participation arrangements. Tiered participation arrangements occur when firms (indirect participants) rely on the services provided by other firms (direct participants) to use a clearing agency's facilities. In such arrangements, tiered participants may not be bound by the rules of the clearing agency, even though its transactions are cleared or settled by or through the clearing agency. The dependencies and risk exposures (including credit, liquidity, and operational risks) inherent in these tiered arrangements can present risks to the clearing agency and its smooth functioning as well as to the participants themselves and the broader financial markets. Under paragraph 3.19(1)(a) of the Rule, the clearing agency must identify, monitor, and manage any material risks to the clearing agency arising from such tiered participation arrangements.

The nature of the risks posed by tiered participation arrangements is such that they are most likely to be material where there are indirect participants whose business through a clearing agency is a significant proportion of the clearing agency's overall business or is large relative to that of the direct participant through which they access the clearing agency's services. A clearing agency should therefore identify indirect participants responsible for a significant proportion of transactions processed by the clearing agency and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants, through which they access the clearing agency, in order to manage the risks arising from these transactions.

Normally, the identification, monitoring, and management of risks from tiered participation will be focused on financial institutions that are the immediate customers of direct participants and depend on the direct participant for access to a clearing agency's services. In exceptional cases, however, tiered participation arrangements may involve a complex series of financial intermediaries or agents, which may require the clearing agency to look beyond the direct participant and its immediate customer. The clearing agency should therefore identify all material dependencies between direct and indirect participants that might affect the clearing agency.

There are limits on the extent to which the clearing agency can, in practice, observe or influence direct participants' commercial relationships with their customers. However, a clearing agency will often have access to information on transactions undertaken on behalf of indirect participants and can set direct participation requirements that may include criteria relating to how direct participants manage relationships with their customers in-so-far as these criteria are relevant for the safe and efficient operation of the clearing agency. At a minimum, the clearing agency should identify the types of risk that could arise from tiered participation and should monitor concentrations of such risk. If the clearing agency or its smooth operation is exposed to material risk from tiered participation arrangements, it should seek to manage and limit such risk.

(b) The clearing agency should regularly review risks to which it may be exposed as a result of tiered participation arrangements. If material risks exist, the clearing agency should take mitigating action when appropriate. The results of the review process should be reported to the Board of Directors and updated periodically and after substantial amendments to the clearing agency's rules.

– ***Gathering and assessing information on risks arising from tiered participation arrangements***

(2) The clearing agency may be able to obtain information relating to tiered participation through its own systems or by collecting it from direct participants. Under subsection 3.19(2) of the Rule, the clearing agency must therefore ensure that its procedures, rules, and agreements with direct participants allow it the ability to gather basic information about indirect participants in order to identify, monitor, and manage any material risks to the clearing agency arising from such tiered participation arrangements. This information should, when collected, enable the clearing agency, at a minimum, to identify (i) the proportion of activity that direct participants conduct on behalf of indirect participants, (ii) direct participants that act on behalf of a material number of indirect participants, (iii) indirect participants with significant volumes or values of transactions in the system, and (iv) indirect participants whose transaction volumes or values are large relative to those of the direct participants through which they access the clearing agency.

– ***Understanding material dependencies in tiered participation arrangements***

(3) Under subsection 3.19(3), the clearing agency is required to identify material dependencies between direct and indirect participants that may adversely affect the clearing agency, and in particular, have policies and procedures that enable it to identify certain indirect participants, as identified in paragraphs (a) and (b). Indirect participants will often have some degree of dependency on the direct participant through which they access the clearing agency. In the case of a clearing agency with few direct participants but many indirect participants, it is likely that a large proportion of the transactions processed by the clearing agency would depend on the operational performance of those few direct participants. Disruption to the services provided by the direct participants – whether for operational reasons or because of a participant's default – could therefore present a risk to the smooth functioning of the system as a whole. The clearing agency should identify and monitor material dependencies of indirect participants on direct participants so that the clearing agency has readily available information on which significant indirect participants may be affected by problems at a particular direct participant.

In some cases, issues at an indirect participant could also affect the clearing agency. This is most likely to occur where a large indirect participant accesses the clearing agency's facilities through a relatively small direct participant. Failure of this significant indirect participant to perform as expected, such as by failing to meet its payment obligations, or stress at the indirect participant, such as that which causes others to delay payments to the indirect participant, may affect the direct participant's ability to meet its obligations to the clearing agency. Clearing agencies should therefore identify and monitor the material dependencies of direct participants on indirect participants so that the clearing agency has readily available information on how it may be affected by problems at an indirect participant, including which direct participants may be affected.

Tiered participation arrangements typically create credit and liquidity exposures between direct and indirect participants. The management of these exposures is the responsibility of the participants and, where appropriate, subject to supervision by their regulators. The clearing agency is not expected to manage the credit and liquidity exposures between direct and indirect participants, although the clearing agency may have a role in applying credit or position limits in agreement with the direct participant. The clearing agency should, however, have access to information on concentrations of risk arising from tiered participation arrangements that may affect the clearing agency, allowing it to identify indirect participants responsible for a significant proportion of the clearing agency's transactions or whose transaction volumes or values are large relative to those of the direct participants through which they access the clearing agency. The clearing agency should identify and monitor such risk concentrations.

In a CCP, direct participants are responsible for the performance of their customers' financial obligations to the CCP. The CCP may, however, face an exposure to indirect participants (or arising from indirect participants' positions) if a direct participant defaults, at least until such time as the defaulting participant's customers' positions are ported to another participant or closed out. If a participant default would leave a clearing agency that acts as a CCP with a potential credit exposure related to an indirect participant's positions, it should ensure it understands and manages the exposure it would face. For example, it may set participation requirements that require the direct participant, on request, to demonstrate that it is adequately managing relationships with its customers to the extent that they may affect the CCP. The clearing agency should also consider establishing concentration limits on exposures to indirect participants, where appropriate.

Default scenarios can create uncertainty about whether indirect participants' transactions have been settled or will be settled and whether any settled transactions will be unwound. Default scenarios can also raise legal and operational risks for the clearing agency if there is uncertainty about whether the indirect or direct participant is liable for completing the transaction. The clearing agency should ensure that a default, whether by a direct participant or by an indirect participant, does not affect the finality of indirect participants' transactions that have been processed and settled by the clearing agency. The clearing agency should ensure that its rules and procedures are clear regarding the status of indirect participants' transactions at each point in the settlement process (including the point at which they become subject to the rules of the system and the point after which the rules of the system no longer apply) and whether such transactions would be settled in the event of an indirect or direct participant default. The clearing agency should also ensure that it adequately understands its direct participants' processes and procedures for managing an indirect participant's default. For example, the clearing agency should know whether the indirect participant's queued payments can be removed or future-dated transactions rescinded and whether such processes and procedures would expose the clearing agency to operational, reputational, or other risks.

Direct participation in a clearing agency usually provides a number of benefits, some of which may not be available to indirect participants, such as real-time gross settlement, exchange-of-value settlement, or settlement in central bank money. Moreover, indirect participants are vulnerable to the risk that their access to a clearing agency, their ability to make and receive payments and their ability to undertake and settle other transactions is lost if the direct participant on whom these indirect participants rely defaults or declines to continue their business relationship. If these indirect participants have large values or volumes of business through the clearing agency, this may affect its smooth functioning. For these reasons, where an indirect participant accounts for a large proportion of the transactions processed by the clearing agency, it may be appropriate to encourage direct participation. For example, the clearing agency may in some cases establish objective thresholds above which direct participation would normally be encouraged (provided that the firm satisfies the clearing agency's access criteria). Setting such thresholds and encouraging direct participation should be based on risk considerations rather than commercial advantage.

Links with other financial market infrastructures

– ***General principle***

3.20 (1) For the purposes of the Rule and this CP, a link is to be understood as a set of contractual and operational arrangements between a recognized clearing agency and one or more other clearing agencies or trade repositories that connect these entities directly or through an intermediary. The clearing agency may establish a link for the primary purpose of expanding its services to additional financial instruments, markets, or institutions.

– ***Identifying and managing link-related arrangements***

(2) Before entering into a link arrangement, and on an ongoing basis once the link is established, the clearing agency is required to identify and assess, and subsequently monitor and manage all potential sources of risk arising from the link, including legal, operational, credit, and liquidity risks.

The type and degree of risk varies according to the design and complexity of the entities and the nature of the relationship between them. In a simple case of a vertical link, for example, the clearing agency may provide basic services to another clearing agency, such as a CSD that provides securities transfer services to an SSS. Such links typically pose only operational and custody risks. Other links, such as an arrangement in which a CCP provides clearing services to another CCP, may be more complex and may pose additional risk, such as credit and liquidity risk. Cross-margining by two or more CCPs may also pose additional risk because the CCPs may rely on each other's risk-management systems to measure, monitor, and manage credit and liquidity risk. In addition, links between different types of clearing agencies may pose specific risks to one or all of the entities in the link arrangement. For example, a CCP may have a link with a CSD that performs the services of an SSS for the delivery of securities and settlement of margins. If the CCP poses risks to the CSD, the CSD should manage those risks.

In respect of managing legal risks, a link is required to have a well-founded legal basis, as further required by paragraph 3.20(3)(a) of the Rule.

In respect of managing operational risks, the clearing agency should ensure that linked entities provide an appropriate level of information about their operations to each other in order for each to perform effective periodic assessments of the operational risk associated with the link. In particular, the clearing agency should ensure that each entity's risk-management arrangements and processing capacity are sufficiently scalable and reliable to operate the link safely for both the current and projected peak volumes of activity processed over the link. Systems and communication arrangements between linked entities also should be reliable and secure so that the link does not pose significant operational risk. Any reliance by a linked entity on a critical service provider should be disclosed as appropriate to the other entities. In addition, a linked entity should be obligated to identify, monitor, and manage operational risks due to complexities or inefficiencies associated with differences in time zones, particularly as these affect staff availability. Governance arrangements and change-management processes should ensure that changes in one entity will not inhibit the smooth functioning of the link, related risk-management arrangements, or non-discriminatory access to the link.

In respect of managing financial risks, the clearing agency should ensure that each entity in a link is able to effectively measure, monitor, and manage their financial risk, including custody risk, arising from the link. Moreover, the entities and their participants should be obligated to ensure they have adequate protection of assets in the event of the insolvency of another linked entity or a participant default in a linked entity.

Specific guidance on mitigating and managing risks for CSD-CSD links and CCP-CCP links is provided in subsections 3.20(4) and (5).

(3) (a) As is required under paragraph 3.20(3)(a) of the Rule, a link should have a well-founded legal basis that supports its design and provides adequate protection to the entities involved in the link. Cross-border links may present legal risk arising from differences between the laws and contractual rules governing the linked entities and their participants, including those relating to rights and interests, collateral arrangements, settlement finality, and netting arrangements. For example, differences in law and rules governing settlement finality may lead to a scenario where a transfer is regarded as final in one entity, but not in the linked one(s). In some jurisdictions, differences in laws may create uncertainties regarding the enforceability of CCP obligations assumed by novation, open offer, or other similar legal device. Differences in insolvency laws may unintentionally give a participant in one CCP a claim on the assets or other resources of a linked CCP in the event of the first's default. To limit these uncertainties, the respective rights and obligations of the linked entities and, where necessary, their participants should be clearly defined in the link agreement. The terms of the link agreement should also set out, in cross-jurisdictional contexts, an unambiguous choice of law that will govern each aspect of the link.

(b) In all cases, links are required to be designed such that the clearing agency is able to properly observe the Rule. Further, the link should not hinder the ability of each of the other linked entities to observe Ontario securities law, including the Rule, as well as the ability of the their regulators to monitor compliance with Ontario securities law, where applicable.

– ***CSD-CSD links***

(4) Under subsection 3.20(4), if the clearing agency acts a CSD and is linked to another CSD(s), it is required to meet various standards, arising from various potential risks. Namely, as part of its activities, a CSD (the 'investor CSD), or a third party acting on behalf of the investor CSD, may choose to establish a link with another CSD (the 'issuer CSD', in which securities are issued or immobilized), for example by opening an account with the issuer CSD, so as to enable the cross-system settlement of securities transactions. If such a link is improperly designed, the settlement of transactions across the link could subject participants to new or increased risks. In addition to legal and operational risks, linked CSDs and their participants could also face credit and liquidity risks. For example, an operational failure or default in one CSD may cause settlement failures or defaults in a linked CSD and expose participants in the linked CSD, including participants that did not settle transactions across the link, to unexpected liquidity pressures or outright losses. A CSD's default procedures, for example, could affect a linked CSD through loss-sharing arrangements. Linked CSDs are therefore required under paragraph 3.20(4)(a) of the Rule to identify, monitor, and manage the credit and liquidity risks arising from the linked entity. In addition, under paragraph 3.20(4)(b) of the Rule, any credit extensions between CSDs must be covered fully by high-quality collateral and be subject to limits. Further, some practices deserve particularly rigorous attention and controls. In particular, under paragraph 3.20(4)(c) of the Rule, provisional transfers of securities between linked CSDs must be prohibited or, at a minimum, the retransfer of provisionally transferred securities should be prohibited prior to the transfer becoming final.

Under paragraph 3.20(4)(d) of the Rule, an investor CSD must only establish links with an issuer CSD if the link arrangement provides a high level of protection for the rights of the investor CSD's participants. In particular, the investor CSD should use issuer CSDs that provide adequate protection of assets in the event that the issuer CSD becomes insolvent. In some cases, securities held by an investor CSD can be subject to attachment by the creditors of the CSD or its participants and, as such, can also be subject to freezing or blocking instructions from local courts or other authorities. Further, if an investor CSD maintains securities in an omnibus account at an issuer CSD and a participant at the investor CSD defaults, the investor CSD should not use the securities belonging to other participants to settle subsequent local deliveries of the defaulting participant. The investor CSD should have adequate measures and procedures to avoid effects on the use of securities belonging to non-defaulting participants in a participant-default scenario.

Furthermore, linked CSDs should have robust reconciliation procedures to ensure that their respective records are accurate and current. Reconciliation is a procedure to verify that the records held by the linked CSDs match for transactions processed across the link. This process is particularly important when three or more CSDs are involved in settling transactions (that is, the securities are held in safekeeping by one CSD or custodian while the seller and the buyer participate in one or more of the linked CSDs).

Pursuant to paragraph 3.20(4)(e) of the Rule, if an investor CSD uses an intermediary to operate a link with an issuer CSD, the investor CSD must measure, monitor, and manage the additional risks (including custody, credit, legal, and operational risks) arising from the use of the intermediary. In an indirect CSD-CSD link, an investor CSD uses an intermediary (such as a custodian bank) to access the issuer CSD. In such cases, the investor CSD faces the risk that the custodian bank may become insolvent, act negligently, or commit fraud. Although an investor CSD may not face a loss on the value of the securities, the ability of the investor CSD to use its securities might temporarily be impaired. The investor CSD should measure, monitor, and manage on an ongoing basis its custody risk and provide evidence to the relevant authorities that adequate measures have been adopted to mitigate this custody risk. In addition, the investor CSD should ensure that it has adequate legal, contractual, and operational protections to ensure that its assets held in custody are segregated and transferable. Similarly, an investor CSD should ensure that its settlement banks or cash correspondents can perform as expected. In that context, the investor CSD should have adequate information on the business continuity plans of its intermediary and the issuer CSD to achieve a high degree of confidence that both entities will perform as expected during a disruptive event.

– ***CCP-CCP links***

(5) A clearing agency that acts as a CCP may establish links with one or more other CCPs. In this regard, if the clearing agency operating as a CCP is linked to another CCP, subsection 3.20(5) of the Rule requires it to meet various standards, arising from various potential risks.

Although the details of individual link arrangements among CCPs differ significantly because of the varied designs of CCPs and the markets they serve, there are currently two basic types of CCP links: peer-to-peer links and participant links. In a peer-to-peer link, a CCP maintains special arrangements with another CCP and is not subject to normal participant rules. Typically, however, the CCPs exchange margin and other financial resources on a reciprocal basis. The linked CCPs face current and potential future exposures to each other as a result of the process whereby they each net the trades cleared between their participants so as to create novated (net) positions between the CCPs. Risk management between the CCPs is based on a bilaterally approved framework, which is different from that applied to a normal participant.

In a participant link, one CCP (the participant CCP) is a participant in another CCP (the host CCP) and is subject to the host CCP's normal participant rules. In such cases, the host CCP maintains an account for the participant CCP and would typically

require the participant CCP to provide margin, as would be the case for a participant that is not a CCP. A participant CCP should mitigate and manage its risk from the link separately from the risks in its core clearing and settlement activities. For example, if the host CCP defaults, the participant CCP may not have adequate protection because the participant CCP does not hold collateral from the host CCP to mitigate the counterparty risk posed to it by the host CCP. Risk protection in a participant link is one-way, unlike in a peer-to-peer link. The participant CCP that provides margin but does not collect margin from another linked CCP should therefore hold additional financial resources to protect itself against the default of the host CCP.

Both types of links – peer-to-peer and participant links – may present new or increased risks that should be measured, monitored, and managed by the CCPs involved in the link. The most challenging issue with respect to CCP links is the risk management of the financial exposures that potentially arise from the link arrangement. Under paragraphs 3.20(5)(a) and (b) of the Rule, before entering into a link with another CCP, the CCP must identify and assess the potential spill-over effects from the default of the linked CCP, as well as identify, assess and manage the potential spill-over effects on an ongoing basis thereafter. Under paragraph 3.20(5)(c) of the Rule, if a link has three or more CCPs, each CCP must identify and assess the risks of the collective link arrangement. A network of links between CCPs that does not properly acknowledge and address the inherent complexity of multi-CCP links could have significant implications for systemic risk.

Exposures faced by one CCP from a linked CCP should be identified, monitored, and managed with the same rigour as exposures from a CCP's participants to prevent a default at one CCP from triggering a default at a linked CCP. Such exposures should be covered fully, primarily through the use of margin or other equivalent financial resources. In particular, under paragraph 3.20(5)(d) of the Rule, each CCP in a CCP link arrangement must be able to cover, at least on a daily basis, its current and potential future exposures to the linked CCP and its participants, if any, fully with a high degree of confidence without reducing the CCP's ability to fulfil its obligations to its own participants at any time. Financial resources used to cover inter-CCP current exposures should be prefunded with highly liquid assets that exhibit low credit risk. Best practice is for CCPs to have near real time inter-CCP risk management. However, at a minimum, financial exposures among linked CCPs should be marked to market and covered on a daily basis. CCPs also need to consider and address the risks arising from links in designing their stress tests and calibrating their prefunded default arrangements. Linked CCPs should also take into account the effects that possible contributions to each other's prefunded default arrangements, exchange of margin, common participants, major differences in their risk-management tools, and other relevant features may have on their risk-management frameworks, especially in relation to the legal, credit, liquidity, and operational risks they face.

Because of the different possible types of links, different types of CCPs, and differences in the legal and regulatory frameworks in which CCPs may operate, different combinations of risk-management tools may be used by the CCP. When linked CCPs have materially different risk-management frameworks, the risks stemming from the link are more complex. In this case, the linked CCPs should carefully assess the effectiveness of their risk-management models and methodologies, including their default procedures, in order to determine whether and to what extent their inter-CCP risk-management frameworks should be harmonised or whether additional risk-mitigation measures would be sufficient to mitigate risks arising from the link.

A CCP (the first CCP) will usually have to provide margin to a linked CCP for open positions. In some cases, the first CCP may not be able to provide margin that it has collected from its participants to the linked CCP because the first CCP's rules may prohibit the use of its participants' margin for any purpose other than to cover losses from a default of a participant in the first CCP, or the first CCP's legal or regulatory requirements may not permit such reuse of its participants' collateral. As such, the CCP would need to use alternative financial resources to cover its counterparty risk to the linked CCP, which is normally covered by margin. If a CCP is allowed to reuse its participants' collateral to meet an inter-CCP margin requirement, such collateral provided by the first CCP must be unencumbered and its use by the linked CCP in the event of the default of the first CCP must not be constrainable by actions taken by the participants of the first CCP. The credit and liquidity risk arising from the reuse of margin should be adequately mitigated by the CCPs. This can be achieved through segregation, protection, and custody of margin exchanged between CCPs in a manner that allows for its swift and timely return to the CCP in case of a decrease in the exposures and that allows for supplemental margin (and, if necessary, supplemental default fund contributions) needed to cover the counterparty risk between the linked CCPs to be charged directly to the participants who use the link service, if applicable.

Linked CCPs should maintain arrangements that are effective in managing the risks arising from the link; such arrangements often involve a separate default fund to cover that risk. In principle, the risk-management measures related to the link should not reduce the resources that a CCP holds to address other risks. The most direct way to achieve this outcome is for CCPs not to participate in each other's default funds, which may in turn mean that the CCP will need to provide additional margin. However, in arrangements in which CCPs have agreed, consistent with their regulatory framework, to contribute to each other's default funds, the linked CCPs should assess and mitigate the risks of making such contributions via specific conditions. In particular, funds used by a CCP to contribute to another CCP's default fund must represent prefunded additional financial resources and must not include resources used by the CCP to satisfy its regulatory requirements to hold sufficient capital or participant margin funds (or any other funds, including independent default fund resources) held by the CCP to mitigate the counterparty risk presented by its participants. The contributing CCP should further ensure that any consequent exposure of its own participants to the risk of a participant default in the linked CCP is fully transparent to and understood by its participants. The contributing CCPs may, for example, consider it appropriate to ensure the default fund contribution is made only by those of its participants

that use the link, if applicable. Moreover, the resources provided by one CCP to another should be held in such a way that they are ring fenced from other resources provided to that CCP. For example, securities could be held in a separate account at a custodian. Cash would need to be held in segregated accounts to be considered as acceptable collateral in this case. Finally, in case of a participant default in the first CCP, the use of the linked CCP's contribution to the default fund of the first CCP could be restricted or limited. For example, the linked CCP's contribution to the default fund could be put at the bottom of the first CCP's default waterfall.

Link arrangements between CCPs will expose each CCP to sharing in potentially uncovered credit losses if the linked CCP's default waterfall has been exhausted. For example, a CCP may be exposed to loss mutualisation from defaults of a linked CCP's participants. This risk will be greater to the extent that the first CCP is unable directly to monitor or control the other CCP's participants. Such contagion risks can be even more serious in cases where more than two CCPs are linked, directly or indirectly, and a CCP considering such a link should satisfy itself that it can manage such risks adequately. Each CCP should ensure that the consequent exposure of its own participants to a share in these uncovered losses is fully understood and disclosed to its participants. CCPs may consider it appropriate to devise arrangements to avoid sharing in losses that occur in products other than those cleared through the link and to confine any loss sharing to only participants that clear products through the link. Depending on how losses would be shared, CCPs may need to increase financial resources to address this risk.

Any default fund contributions or allocation of uncovered losses should be structured to ensure that (i) no linked CCP is treated less favourably than the participants of the other CCP and (ii) each CCP's contribution to the loss sharing arrangements of the other is no more than proportionate to the risk the first CCP poses to the linked CCP.

Efficiency and effectiveness

– ***General principle***

3.21 (1) Under subsection 3.21(1) of the Rule, a recognized clearing agency is required to efficiently and effectively meet the needs of its participants and the markets it serves. In particular, the clearing agency should have regard for choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures. In the context of this section, and as further operationalized in subsection 3.21(2) of the Rule, "efficiency" refers generally to the resources required by the clearing agency to perform its functions, while "effectiveness" refers to whether the clearing agency is meeting its intended goals and objectives.

Efficiency is a broad concept that encompasses what the clearing agency chooses to do, how it does it, and the resources required. Fundamentally, the clearing agency should be designed and operated to meet the needs of its participants and the markets it serves. The clearing agency's efficiency will ultimately affect its use by its participants and their customers as well as these entities' ability to conduct robust risk management, which may affect the broader efficiency of financial markets.

The clearing agency is effective when it reliably meets its obligations in a timely manner and achieves the public policy goals of safety and efficiency for participants and the markets it serves. In the context of oversight and auditing, the clearing agency's effectiveness may also involve meeting service and security requirements.

A clearing agency that operates inefficiently or functions ineffectively may distort financial activity and the market structure, increasing not only the financial and other risks of a clearing agency's participants, but also the risks of their customers and end users. If the clearing agency is inefficient, a participant may choose to use an alternate arrangement that poses increased risks to the financial system and the broader economy. The primary responsibility for promoting the efficiency and effectiveness of the clearing agency belongs to its owners and operators.

– ***Presumption***

(2) (a) The clearing agency's efficiency and effectiveness depends partly on its choice of, and its reliability in meeting its intended goals and objectives related to a clearing and settlement arrangement (for example, gross, net, or hybrid settlement; real time or batch processing; and novation or guarantee scheme); operating structure (for example, links with multiple trading venues or service providers); scope of products cleared, settled, or recorded; and use of technology and procedures (for example, communication procedures and standards). Under paragraph 3.21(2)(a) to (c) of the Rule, it will be presumed that the clearing agency is operating efficiently and effectively if it can demonstrate all the items listed in the paragraphs. Under paragraph 3.21(2)(a) of the Rule, the clearing agency must demonstrate that it meets the needs of its participants and the markets it serves, with particular regard to items (i) to (iv) listed in the Rule.

In designing an efficient system, the clearing agency should also consider the practicality and costs for participants, their customers, and other relevant parties (including other clearing agencies and service providers). Furthermore, the clearing agency's technical arrangements should be sufficiently flexible to respond to changing demand and new technologies.

(b) To further demonstrate its efficient and effective operation, the clearing agency should have clearly defined goals and objectives that are measureable and achievable. Under paragraph 3.21(2)(b), the clearing agency is required to set minimum service-level targets (such as the time it takes to process a transaction and the availability of its IT system), risk-management expectations (such as the level of financial resources it should hold), and business priorities (such as the development of new services), in order to establish that it is operating efficiently and effectively.

(c) Finally, in establishing that the clearing agency is operating efficiently and effectively, paragraph 3.21(2)(c) of the Rule requires that the clearing agency demonstrate that it has mechanisms for the regular review of its efficiency and effectiveness. Such reviews should include periodic measurement of progress against the clearing agency's goals and objectives. As well, since efficiency can involve cost control, the clearing agency's reviews should include regular review of its costs and pricing structure.

Communication procedures and standards

– ***General principle***

3.22 (1) The ability of participants to communicate with a clearing agency in a timely, reliable, and accurate manner is key to achieving efficient clearing, settlement, depository, recording and payment processes. A clearing agency's adoption of internationally accepted communication procedures and standards for its core functions – i.e. standardized communication procedures (or protocols) which provide a common set of rules across systems for exchanging messages – can facilitate the elimination of manual intervention in clearing and settlement processing, reduce risks and transaction costs, improve efficiency, and reduce barriers to entry into a market. Reducing the need for intervention and technical complexity when processing transactions can also help to reduce the number of errors, avoid information losses, and ultimately reduce the resources needed for data processing by a clearing agency, its participants, and markets generally. In this regard, subsection 3.22(1) of the Rule requires a recognized clearing agency to use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards to ensure effective communication between the clearing agency and its participants, their customers, and others that connect to the clearing agency (such as third-party service providers and other clearing agencies). The clearing agency is encouraged but not required to use or accommodate internationally accepted communication procedures and standards for purely domestic transactions.

If the clearing agency conducts activities across borders, it should also use internationally accepted communication procedures and standards or, at a minimum, accommodate them. A clearing agency that, for example, settles a chain of transactions processed through multiple clearing agencies or provides services to users in multiple jurisdictions should strongly consider using internationally accepted communication procedures and standards to achieve efficient and effective cross-border financial communication. Furthermore, adopting these communication procedures can facilitate interoperability between the information systems or operating platforms of clearing agencies in different jurisdictions, which allows market participants to obtain access to multiple clearing agencies without facing technical hurdles (such as having to implement or support multiple local networks with different characteristics). A clearing agency that operates across borders also should be able to support and use well-established communication procedures, messaging standards, and reference data standards relating to counterparty identification and securities numbering processes. For example, relevant standards promulgated by the International Organization for Standardization should be carefully considered and adopted by the clearing agency.

– ***Systems that translate or convert data***

(2) While the use of internationally accepted standards for message formats and data representation (whether used domestically or across borders) will generally improve the quality and efficiency of the clearing and settlement of financial transactions, where the clearing agency does not itself fully adopt internationally accepted communication standards, it can still potentially interoperate with the information systems or operating platforms of other clearing agencies by developing systems to translate or convert international procedures and standards into the domestic equivalent, and vice versa.

Transparency

– ***General principle***

3.23 (1) Under subsection 3.23(1) of the Rule, a recognized clearing agency is required to provide sufficient information to its participants and prospective participants to enable them to identify clearly and understand fully the risks and responsibilities of participating in the system. To achieve this objective, and as part of the requirements under subsection 3.1(2) of the Rule, the clearing agency should adopt and disclose written rules and procedures that are clear and comprehensive and that include explanatory material written in plain language so that participants can fully understand the system's design and operations, their rights and obligations, and the risks of participating in the system. The clearing agency's rules, procedures, and explanatory material need to be accurate, up-to-date, and readily available to all current and prospective participants. Under subsections 3.23(1) and (2) of the Rule, the relevant rules and procedures of the clearing agency must be fully disclosed to participants and the public on its Website.

– ***Understanding risks***

(3) The clearing agency's rules and procedures are typically the foundation of the clearing agency and provide the basis for participants' understanding of the risks they incur by participating in the clearing agency. In this regard, and further to subsections 3.23(1) and (2) of the Rule, which requires the clearing agency to adopt clear and comprehensive rules and procedures that are fully disclosed to participants and to the public, subsection 3.23(3) of the Rule requires the clearing agency's relevant rules and procedures to include clear descriptions of the system's design and operations, as well as the clearing agency and its participants' rights and obligations, so that participants can assess the risk they would incur by participating in the clearing agency. They should clearly outline the respective roles of participants and the clearing agency as well as the rules and procedures that will be followed in routine operations and non-routine, though foreseeable, events, such as a participant default. In particular, the clearing agency should have clear and comprehensive rules and procedures for addressing financial and operational problems within the system.

(4) Participants bear primary responsibility for understanding the rules, procedures, and risks of participating in a clearing agency as well as the risks they may incur when the clearing agency has links with other clearing agencies. However, subsection 3.23(4) of the Rule requires the clearing agency to provide all documentation, training, and information necessary to facilitate participants' understanding of the clearing agency's rules and procedures and the risks they face from participating in the clearing agency. New participants should receive training before using the system, and existing participants should receive, as needed, additional periodic training. The clearing agency should disclose to each individual participant stress test scenarios used, individual results of stress tests, and other data to help each participant understand and manage the potential financial risks stemming from participation in the clearing agency. Other relevant information that should be disclosed to participants, but typically not to the public, includes key highlights of the clearing agency's business continuity arrangements.

As the clearing agency is well placed to observe the performance of its participants, it should promptly identify those participants whose behaviour demonstrates a lack of understanding of, or compliance with, applicable rules, procedures, and risks of participation. In such cases, the clearing agency should take steps to rectify any perceived lack of understanding by the participant and take other remedial action necessary to protect the clearing agency and its participants. This may include notifying senior management within the participant institution. In cases in which the participant's actions present significant risk or present cause for the participant's suspension, the clearing agency should notify the appropriate regulatory, supervisory, and oversight authorities.

– ***Changes to rules and procedures***

(5) Further to subsections 3.23(1) and (2) of the Rule which require the disclosure of all relevant rules and key procedures, subsection 3.23(5) requires that the clearing agency have a clear and fully disclosed process for proposing and implementing changes to its rules and procedures. The clearing agency is also required to have rules and procedures for informing participants and the Commission of such changes. Similarly, the rules and procedures should clearly disclose the degree of discretion that the clearing agency can exercise over key decisions that directly affect the operation of the system, including in crises and emergencies. For example, the clearing agency's procedures may provide for discretion regarding the extension of operating hours to accommodate unforeseen market or operational problems. The clearing agency also should have appropriate procedures to minimize any conflict-of-interest issues that may arise when authorized to exercise its discretion.

– ***Disclosure of fees***

(6) Subsections 3.23 (6) and (7) of the Rule require the public disclosure of fees for individual services and policies on discounts, as well as clear descriptions of priced services for comparability purposes on its Website. In addition, the clearing agency should disclose information on the system design, as well as technology and communication procedures, that affect the costs of operating the clearing agency. These disclosures collectively help participants evaluate the total cost of using a particular service, compare these costs to those of alternative arrangements, and select only the services that they wish to use. The clearing agency's design will influence not only how much liquidity participants need to hold in order to process payments but also opportunity costs of holding such liquidity. The clearing agency should provide timely notice to participants and the public of any changes to services and fees.

– ***Disclosure framework and basic data***

(8) Under subsection 3.23(8), the clearing agency should provide to the public comprehensive and appropriately detailed responses to the CPSS-IOSCO FMI Disclosure Framework Document to improve the overall transparency of the clearing agency, its governance, operations, and risk-management framework. In order for the disclosures to reflect correctly the clearing agency's current rules, procedures, and operations, the clearing agency should update its responses following material changes to the system or its environment. At a minimum, the clearing agency should review its responses to the CPSS-IOSCO FMI Disclosure Framework Document every two years to ensure continued accuracy and usefulness.

Other relevant information for participants and, more generally, the public could include general information on the clearing agency's full range of activities and operations, such as the names of direct participants in the clearing agency, key times and dates in clearing agency operations, and its overall risk-management framework (including its margin methodology and assumptions). The clearing agency also should disclose its financial condition, financial resources to withstand potential losses, timeliness of settlements, and other performance statistics. The clearing agency is required to disclose, at a minimum, basic data on transaction volumes and values under subsection 3.23(9) of the Rule. The Commission is of the view that such minimum basic data on transaction volumes and values are those that are set forth in the CPSS-IOSCO report *Public quantitative disclosure standards for central counterparties* for a clearing agency that acts as a CCP.[14]

The clearing agency should make the relevant information and data it discloses available to the public through generally accessible media, including its Website. The data should be accompanied by robust explanatory documentation that enables users to understand and interpret the data correctly.

[14] See the consultative CPSS-IOSCO report *Public quantitative disclosure standards for central counterparties*, published in October 2013, available at the Bank for International Settlements' website (www.bis.org) and IOSCO website (www.iosco.org).

Chapter 7

Insider Reporting

This chapter is available in the print version of the OSC Bulletin, as well as as in Carswell's internet service SecuritiesSource (see www.carswell.com).

This chapter contains a weekly summary of insider transactions of Ontario reporting issuers in the System for Electronic Disclosure by Insiders (SEDI). The weekly summary contains insider transactions reported during the seven days ending Sunday at 11:59 pm.

To obtain Insider Reporting information, please visit the SEDI website (www.sedi.ca).

Chapter 8

Notice of Exempt Financings

REPORTS OF TRADES SUBMITTED ON FORMS 45-16F1 AND 45-501F1

Transaction Date	No of Purchasers	Issuer/Security	Total Purchase Price ($)	No of Securities Distributed
11/11/2013	25	7262591 Canada Limited - Preferred Shares	3,630,000.00	363,000.00
11/13/2013	9	9109 Manager LP - Limited Partnership Units	651,900.00	N/A
11/20/2013	16	Asher Resources Corporation - Units	491,200.00	2,456,000.00
11/28/2013	11	Aston Bay Holdings Ltd. - Flow-Through Units	71,500.00	26.00
11/08/2013	27	Auryn Resources Inc. - Common Shares	2,196,500.00	4,393,000.00
10/30/2013	1	Barclays Bank PLC - Notes	284,316.75	2,500.00
10/30/2013	1	Barclays Bank PLC - Notes	284,316.75	2,500.00
11/06/2013 to 11/07/2013	7	Barclays Bank PLC - Notes	765,000.00	N/A
11/12/2013	5	Barracuda Networks, Inc. - Common Shares	671,077.80	35,500.00
11/13/2013	18	BlackBerry Limited - Debentures	1,046,800,000.00	1,000,000.00
11/07/2013	88	Blackbird Energy Inc. - Common Shares	3,087,361.67	33,488,463.00
11/20/2013	27	Blackspur Oil Corp. - Common Shares	867,940.20	1,446,567.00
11/20/2013	2	Booz Allen Hamilton Holding Corporation - Common Shares	36,275,346.64	2,051,773.00
11/28/2013	3	Brant Park Phase 2 Inc. - Bonds	140,000.00	140.00
11/15/2013	25	Canadian First Financial Group Inc. - Common Shares	2,655,203.15	N/A
10/16/2013 to 10/24/2013	137	Canadian First Financial Group Inc. (amended) - Common Shares	26,906,163.61	N/A
11/04/2013	6	Caribbean Diversified Investments, Inc. - Units	197,082.00	1,970,829.00
04/01/2013	1	Chalkstream Investment Fund (International) Ltd. - Common Shares	3,050,100.00	N/A
11/01/2013	4	Champion Diversified Bond Inc. - Debentures	950,000.00	950.00
11/18/2013	37	Daimler Canada Finance Inc. - Notes	400,000,000.00	4,000,000.00
11/18/2013	17	Daimler Canada Finance Inc. - Notes	200,000,000.00	2,000,000.00
05/01/2011	1	Defiance Fund Ltd. - Common Shares	300,000.00	300.00
11/08/2013	10	Diablo Technologies Inc. - Preferred Shares	8,308,696.07	7,523,267.00
11/25/2013	3	Duncastle Gold Corp. - Common Shares	55,000.00	200,000.00
11/15/2013	30	Espial Group Inc. - Units	4,000,000.20	5,714,286.00

Transaction Date	No of Purchasers	Issuer/Security	Total Purchase Price ($)	No of Securities Distributed
11/18/2013	3	Extended Stay America, Inc. - Common Shares	13,555,100.00	650,000.00
11/08/2013 to 11/15/2013	7	Feronia Inc. - Common Shares	26,119,505.00	261,195,050.00
11/13/2013	2	Firesteel Resources Inc. - Common Shares	47,500.00	708,333.00
10/15/2013	55	First Mountain Exploration Ltd. - Common Shares	609,000.00	609,000.00
11/18/2013 to 11/26/2013	29	First Point Minerals Corp. - Units	1,583,789.95	9,316,406.00
10/04/2013	1	Fortress Brant Park - 2011 Ltd. - Notes	50,000.00	N/A
09/24/2012	1	Fortress Brant Park - 2011 Ltd. - Notes	75,000.00	N/A
11/01/2013	2	Fortress Calgary 2011 Ltd. - Loan Agreements	92,900.00	N/A
09/27/2013	1	Fortress Calgary 2011 Ltd. - Loan Agreements	50,000.00	N/A
05/15/2013	1	Fortress Calgary 2011 Ltd. - Notes	50,000.00	N/A
04/09/2013 to 04/18/2013	4	Fortress Calgary 2011 Ltd. - Notes	405,000.00	N/A
04/22/2013 to 04/29/2013	2	Fortress Calgary 2011 Ltd. - Notes	100,000.00	N/A
09/04/2013	1	Fortress Capital Pointe 2013 Inc. - Loan Agreements	75,000.00	N/A
11/13/2013	1	Fortress Capital Pointe 2013 Inc. - Loan Agreements	25,000.00	N/A
08/21/2013	1	Fortress Gotham 2011 Limited - Loan Agreements	50,000.00	N/A
09/03/2013	2	Fortress Gotham 2011 Limited - Loan Agreements	76,762.50	N/A
11/16/2013	1	Fortress Gotham 2011 Limited - Loan Agreements	54,000.00	N/A
04/29/2013	1	Fortress Gotham 2011 Limited - Notes	100,000.00	N/A
05/15/2013	1	Fortress Gotham 2011 Limited - Notes	50,000.00	N/A
07/17/2013	1	Fortress Gotham 2011 Limited - Notes	50,000.00	N/A
02/20/2013 to 02/26/2013	2	Fortress Gotham 2011 Limited - Notes	75,000.00	N/A
10/04/2013	1	Fortress King Charlotte 2010 Limited - Loan Agreements	64,000.00	N/A
04/19/2013	1	Fortress King Charlotte 2010 Limited - Notes	50,000.00	N/A
09/19/2013	1	Fortress Munir 2013 Ltd. - Loan Agreements	50,000.00	N/A
10/11/2013	1	Fortress Munir 2013 Ltd. - Loan Agreements	50,475.00	N/A
11/07/2013	1	Fortress Munir 2013 Ltd. - Loan Agreements	75,000.00	N/A

Transaction Date	No of Purchasers	Issuer/Security	Total Purchase Price ($)	No of Securities Distributed
10/11/2013	1	Fortress Munir 2013 Ltd. - Loan Agreements	25,000.00	N/A
11/01/2013	1	Fortress Munir 2013 Ltd. - Loan Agreements	25,000.00	N/A
09/04/2013 to 09/06/2013	3	Fortress Munir 2013 Ltd. - Loan Agreements	225,000.00	N/A
08/21/2013	1	Fortress SoBa 2011 Ltd. - Loan Agreements	130,000.00	N/A
11/14/2013	9	Gedex Inc. - Common Shares	1.05	14,829,998.00
11/11/2013	30	Goldstar Acquisitionco Inc. - Common Shares	916,250.00	366,500.00
01/01/2005 to 12/31/2005	42	Greystone Money Market Fund (amended) - Units	161,104,352.51	16,110,435.00
01/01/2006 to 12/31/2006	4	Greystone Socially Responsible Canadian Equity Fund - Units	42,951.87	4,468.30
01/01/2005 to 12/31/2005	4	Greystone Socially Responsible Canadian Equity Fund - Units	1,716,830.10	132,254.74
01/01/2006 to 12/31/2006	38	Greystone US Equity Fund - Units	72,502,200.34	6,421,711.50
11/04/2013	5	Helix BioPharma Corp. - Units	5,292,300.00	4,602,000.00
11/07/2013	9	Highbank Resources Ltd. - Common Shares	164,000.00	2,050,000.00
11/19/2013	1	iStar Financial Inc. - Notes	4,145,200.00	N/A
11/14/2013	1	JGWPT Holdings Inc. - Common Shares	1,470,000.00	100,000.00
11/06/2013	6	JVL LABS INC., JVL GAMING INC., JVL MOBI INC. AND JVL MUSIC INC. (THE CORPORATIONS) - Units	2,100,000.00	2,100.00
07/31/2013	1	Kensington Capital Partners Limited - Debentures	2,500,000.00	N/A
11/26/2013	1	KeyBank National Association - Notes	12,656,400.00	12,000.00
11/07/2013	7	Lachlan Star Limited - Common Shares	3,752,160.20	18,760,801.00
11/27/2013	125	LX Ventures Inc. - Units	3,045,000.00	8,700,000.00
11/01/2013	6	Mady Brookdale 2013 Inc. - Loan Agreements	750,000.00	N/A
11/18/2013	5	Mag Copper Limited - Units	64,000.00	1,280,000.00
11/05/2013	10	Makena Resources Inc. - Common Shares	115,600.00	963,333.00
11/29/2013	1	Mill Road Capital II, L.P. - Limited Partnership Units	500,000.00	N/A
11/07/2013	1	NanoStruck Technologies Inc. - Common Shares	13,404.72	111,706.00
11/18/2013	1	New Gold Inc. - Common Shares	30,640.00	4,000.00
11/08/2013	4	Newfoundland Power Inc. - Bonds	70,000,000.00	70,000,000.00
11/21/2013	1	Norfolk Southern Corporation - Notes	472,500.52	N/A
11/08/2013	1	Parta Dialogue Inc. - Loans	200,000.00	200,000.00

Transaction Date	No of Purchasers	Issuer/Security	Total Purchase Price ($)	No of Securities Distributed
11/12/2013	4	Pittsburgh Glass Works, LLC - Notes	7,087,500.00	6,750.00
11/18/2013	6	Post Holdings, Inc. - Notes	11,047,406.50	N/A
04/26/2013	12	Q-Gold Resources ltd. - Common Shares	265,000.00	4,416,666.00
11/01/2013	3	Quantum Leap Mortgage Investments Fund - Units	89,974.62	8,900.00
11/15/2013	13	Quinsam Capital Corporation - Common Shares	600,000.00	10,000,000.00
11/12/2013	23	Redstone Capital Corporation - Bonds	446,700.00	N/A
11/12/2013	17	Redstone Investment Corporation - Notes	1,075,000.00	N/A
11/25/2013	12	Rockex Mining Corporation - Units	1,030,163.32	25,754,083.00
11/13/2013	33	Romarco Minerals Inc. - Common Shares	25,087,509.65	71,678,599.00
11/26/2013	1	SimpliFlow International Inc. - Common Shares	800,000.00	80.00
11/20/2013	1	SINA Corporation - Notes	522,250.00	N/A
12/01/2013	74	Skyline Commercial Real Estate Investment Trust - Units	9,023,750.00	902,375,000.00
11/14/2013	1	Smart Employee Benefits Inc. - Units	500,000.00	1,250,000.00
11/21/2013	17	Southeast Asia Mining Corp. - Debentures	180,105.00	183,780.00
11/06/2013	1	Star Team, LLC - Units	10,002.24	10,000.00
11/19/2013	4	State Street Corporation - Notes	7,308,617.12	7,000.00
11/27/2013	2	Sungy Mobile Limited - American Depository Shares	439,930.00	37,000.00
08/30/2013	2	Timbercreek Senior Mortgage Investment Corporation - Common Shares	300,000.00	N/A
10/18/2013	3	TOMAGOLD CORPORATION - Common Shares	47,500.00	500,000.00
09/26/2013	3	Trez Capital Finance Fund IV Limited Partnership - Limited Partnership Units	55,000,000.00	N/A
11/13/2013	4	True North Commercial Real Estate Investment Trust - Units	2,550,002.40	386,364.00
10/30/2013	1	UBS AG, London Branch - Notes	568,633.50	5,000.00
11/06/2013	17	UBS AG, London Branch - Notes	3,150,000.00	N/A
11/04/2013	15	UMC Financial Management Inc. - Units	6,700,000.00	N/A
08/15/2013	1	United Airlines 2013-1 Pass Through Trusts (Class A Trust and Class B Trust) - Certificates	13,442,000.00	N/A
11/14/2013	1	Vida Ventures Ltd. - Receipts	240,000.00	800,000.00
11/29/2013	2	Zadar Ventures Ltd. - Common Shares	12,400.00	40,000.00

Chapter 11

IPOs, New Issues and Secondary Financings

Issuer Name:
Castle Mountain Mining Company Limited
Principal Regulator - Ontario
Type and Date:
Preliminary Short Form Prospectus dated December 11, 2013
NP 11-202 Receipt dated December 11, 2013
Offering Price and Description:
$5,000,050 - 9,091,000 Common Shares
Price: $0.55 per Offered Share
Underwriter(s) or Distributor(s):
Cormark Securities Inc.
GMP Securities L.P.
Dundee Securities Ltd.
MacQuarie Capital Markets Canada Ltd.
MGI Securities Inc.
Promoter(s):
-
Project #2145894

Issuer Name:
Alliance Grain Traders Inc.
Principal Regulator - Saskatchewan
Type and Date:
Preliminary Short Form Prospectus dated December 16, 2013
NP 11-202 Receipt dated December 16, 2013
Offering Price and Description:
$25,500,000.00 - 1,700,000 Common Shares
Price: $15.00 per Common Share
Underwriter(s) or Distributor(s):
GMP Securities L.P.
Cormark Securities Inc.
Canacorrd Genuity Corp.
CIBC World Markets Inc.
Scotia Capital Inc.
Altacorp Capital Inc.
National Bank Financial Inc.
Raymond James Ltd.
Promoter(s):
-
Project #2147092

Issuer Name:
Chrysalis Capital IX Corporation
Principal Regulator - Ontario
Type and Date:
Preliminary CPC Prospectus dated December 12, 2013
NP 11-202 Receipt dated December 12, 2013
Offering Price and Description:
Maximum Offering: $1,000,000.00 - 10,000,000 Common Shares
Minimum Offering: $200,000.00 - 2,000,000 Common Shares
Price: $0.10 per Common Share
Underwriter(s) or Distributor(s):
PI Financial Corp.
Promoter(s):
Robert Munro
Project #2146356

Issuer Name:
FÉRIQUE BALANCED GROWTH Fund
Principal Regulator - Quebec
Type and Date:
Preliminary Simplified Prospectus dated December 12, 2013
NP 11-202 Receipt dated December 13, 2013
Offering Price and Description:
Mutual Fund Trust Units
Underwriter(s) or Distributor(s):
Services D'Investissement Ferique
Services d'investissement FÉRIQUE
Promoter(s):
Jacques Lapare
Lisa Bourassa
Project #2146615

Issuer Name:
Fortis Inc.
Principal Regulator - Ontario
Type and Date:
Preliminary Short Form Prospectus dated December 13, 2013
NP 11-202 Receipt dated December 16, 2013
Offering Price and Description:
$1,594,000,000.00 - 4.00% Convertible Unsecured Subordinated Debentures represented by Instalment Receipts
Price: $1,000 per Debenture to yield 4.00% per annum (each Debenture is convertible into Common Shares at a Conversion Price of $30.72)
Underwriter(s) or Distributor(s):
Scotia Capital Inc.
RBC Dominion Securities Inc.
TD Securities Inc.
CIBC World Markets Inc.
BMO Nesbitt Burns Inc.
National Bank Financial Inc.
Desjardins Securities Inc.
Promoter(s):
-
Project #2146051

Issuer Name:
MD Strategic Opportunities Fund
MD Strategic Yield Fund
Principal Regulator - Ontario
Type and Date:
Preliminary Simplified Prospectuses dated December 9, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
Series A and Series I units
Underwriter(s) or Distributor(s):
MD Management Limited
MD Management Limited
Promoter(s):
MD Physician Services Inc.
Project #2145236

Issuer Name:
Royal Bank of Canada
Principal Regulator - Quebec
Type and Date:
Preliminary Base Shelf Prospectus dated December 9, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
$15,000,000,000
Debt Securities (Unsubordinated Indebtedness)
Debt Securities (Subordinated Indebtedness)
First Preferred Shares
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2145362

Issuer Name:
Terrace Energy Corp.
Principal Regulator - British Columbia
Type and Date:
Preliminary Short Form Prospectus dated December 16, 2013
NP 11-202 Receipt dated December 16, 2013
Offering Price and Description:
$* - * Common Shares at a Price of $* per Share
Price: $* per Offered Share
Underwriter(s) or Distributor(s):
Canaccord Genuity Corp.
Promoter(s):
-
Project #2147048

Issuer Name:
Trilogy Energy Corp.
Principal Regulator - Alberta
Type and Date:
Preliminary Base Shelf Prospectus dated December 12, 2013
NP 11-202 Receipt dated December 12, 2013
Offering Price and Description:
$300,000,000.00
Debt Securities
Common Shares
Subscription Receipts
Warrants
Units
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2146441

Issuer Name:
Ag Growth International Inc.
Principal Regulator - Manitoba
Type and Date:
Final Short Form Prospectus dated December 10, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
$75,000,000.00
5.25% Convertible Unsecured Subordinated Debentures
Price: $1,000 per Debenture
Underwriter(s) or Distributor(s):
TD Securities Inc.
National Bank Financial Inc.
CIBC World Markets Inc.
Scotia Capital Inc.
Cormark Securities Inc.
Altacorp Capital Inc.
Cantor Fitzgerald Canada Corporation
Laurentian Bank Securities Inc.
Paradigm Capital Inc.
Promoter(s):
-
Project #2139217

Issuer Name:
Big 8 Split Inc.
Principal Regulator - Ontario
Type and Date:
Final Short Form Prospectus dated December 5, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
$32,000,000.00 Maximum - 3,200,000 Preferred Shares @ $10.00 per share
$40,000,000.00 Maximum - 3,200,000 Capital Shares @ $12.50 per share
$16,000,000.00 Minimum - 1,600,000 Preferred Shares @ $10.00
$20,000,000.00 Minimum - 1,600,000 Capital Shares @ $12.50 per share
Underwriter(s) or Distributor(s):
TD Securities Inc.
CIBC World Markets Inc.
Scotia Capital Inc.
BMO Nesbitt Burns Inc.
National Bank Financial Inc.
Canaccord Genuity Corp.
GMP Securities L.P.
Raymond James Ltd.
Desjardins Securities Inc.
Mackie Research Capital Corporation
Manulife Securities Incorporated
Promoter(s):
TD Sponsored Companies Inc.
Project #2123547

Issuer Name:
BIOTEQ ENVIRONMENTAL TECHNOLOGIES INC.
Principal Regulator - British Columbia
Type and Date:
Final Short Form Prospectus dated December 10, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
$1,200,000.00
Rights to purchase 24,000,000 Common Shares at a purchase price of $0.05 per
Common Share
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2143651

Issuer Name:
BlackRock Balanced Portfolio
BlackRock Conservative Portfolio
BlackRock Defensive Portfolio
BlackRock Diversified Monthly Income Portfolio
BlackRock Growth Portfolio
BlackRock MaxGrowth Portfolio
BlackRock All Bond Portfolio
Principal Regulator - Ontario
Type and Date:
Amended and Restated Simplified Prospectuses and Annual Information Form dated November 28, 2013 (the amended prospectus) amending and restating the Simplified Prospectuses and Annual Information Form dated October 1, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:

Series A, Series D, Series F and Series I units
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2092555

Issuer Name:
Bri-Chem Corp.
Principal Regulator - Alberta
Type and Date:
Final Short Form Prospectus dated December 12, 2013
NP 11-202 Receipt dated December 12, 2013
Offering Price and Description:
$10,000,500.00
6,667,000 Common Shares
Price: $1.50 Per Offered Share
Underwriter(s) or Distributor(s):
Cormark Securities Inc.
Beacon Securities Limited
Paradigm Capital Inc.
Promoter(s):
-
Project #2144262

Issuer Name:
Brigata Diversified Portfolio
Principal Regulator - Ontario
Type and Date:
Amendment #3 dated December 6, 2013 to the Simplified Prospectus and Annual Information Form dated June 21, 2013
NP 11-202 Receipt dated December 11, 2013
Offering Price and Description:
Series A and Series F units
Underwriter(s) or Distributor(s):
Independent Planning Group Inc.
Promoter(s):
Brigata Capital Management Inc.
Project #2064404

Issuer Name:
Cardinal Energy Ltd.
Principal Regulator - Alberta
Type and Date:
Final Long Form Prospectus dated December 10, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
$225,000,000.00
21,428,571 Common Shares
Price: $10.50 per Common Share
Underwriter(s) or Distributor(s):
RBC Dominion Securities Inc.
CIBC World Markets Inc.
GMP Securities L.P.
Macquarie Capital Markets Canada Ltd.
FirstEnergy Capital Corp.
Promoter(s):
-
Project #2134553

Issuer Name:
CatchMark Timber Trust, Inc.
Principal Regulator - Ontario
Type and Date:
Final MJDS Prospectus dated December 11, 2013
NP 11-202 Receipt dated December 11, 2013
Offering Price and Description:
-
Underwriter(s) or Distributor(s):
Raymond James Ltd.
Promoter(s):
-
Project #2134363

Issuer Name:
Cleantech Capital Inc.
Type and Date:
Final CPC Prospectus dated December 11, 2013
Receipted on December 11, 2013
Offering Price and Description:
A minimum of 4,250,000 Common Shares ($425,000.00) and
a maximum of 8,500,000 Common Shares ($850,000.00)
PRICE: $0.10 PER COMMON SHARE
Underwriter(s) or Distributor(s):
M Partners Inc.
Promoter(s):
James Sbrolla
Project #2131777

Issuer Name:
DiaMedica Inc.
Principal Regulator - Ontario
Type and Date:
Final Short Form Prospectus dated December 13, 2013
NP 11-202 Receipt dated December 16, 2013
Offering Price and Description:
$2,500,200.00
2,778,000 Units
Price: $0.90 per Unit
Underwriter(s) or Distributor(s):
Jordan Capital Markets Inc.
Promoter(s):
-
Project #2143932

Issuer Name:
IG Putnam Low Volatility U.S. Equity Class
Investors Dividend Class
Principal Regulator - Manitoba
Type and Date:
Final Simplified Prospectus, Annual Information Form and Fund Facts dated December 6, 2013
NP 11-202 Receipt dated December 13, 2013
Offering Price and Description:
Series A Shares, Series B Shares, Series JDSC Shares, Series JNL Shares, Series U Shares, Series TDSC Shares, Series TNL Shares, Series TJDSC Shares, Series TJNL Shares, and Series TU Shares @ Net Asset Value
Underwriter(s) or Distributor(s):
Investors Group Finanical Services Inc.
Investors Group Securities Inc.
Investors Group Financial Services Inc. & Investors Group Securities Inc.
Promoter(s):
I.G. Investment Management Ltd.
Project #2123743

Issuer Name:
Mackenzie Income Fund (Series LB)
Mackenzie Strategic Income Class* (Series LB and LX)
Mackenzie Strategic Income Fund (Series LB and LX)
(*A class of Mackenzie Financial Capital Corporation)
Principal Regulator - Ontario
Type and Date:
Amendment #1 dated December 12, 2013 to the Annual Information Form dated November 28, 2013
NP 11-202 Receipt dated December 16, 2013
Offering Price and Description:
Series LB and LX
Underwriter(s) or Distributor(s):
LBC Financial Services Inc
LBC Financial Services Inc.
Promoter(s):
-
Project #2122654

Issuer Name:
Marquest Money Market Fund
(formerly Matrix Money Market Fund)
(Class A Units)
Marquest Short Term Income Fund (Corporate Class*)
(formerly Matrix Short Term Income Fund (Corporate Class*)
(Series A Shares)
Marquest Canadian Balanced Fund (Corporate Class*)
(formerly Matrix Canadian Balanced Fund (Corporate Class*)
(Series A, F, I, O and T8 Shares)
Marquest Canadian Bond Fund
(formerly Matrix Canadian Bond Fund)
(Class A, F, I and O Units)
Marquest Monthly Pay Fund
(formerly Matrix Monthly Pay Fund)
(Class A, F, I, O, T8, AA and F-AA Units)
Marquest Monthly Pay Fund (Corporate Class*)
(formerly Matrix Monthly Pay Fund (Corporate Class*)
(Series A, F, I, O, T-F8 and T8 Shares)
Marquest Dow Jones Canada High Dividend 50 Fund (Corporate Class*)
(formerly Matrix Dow Jones Canada High Dividend 50 Fund (Corporate Class*)
(Series A, F, I and T8 Shares)
Marquest S&P/TSX Canadian Dividend Aristocrats Fund (Corporate Class*)
(formerly Matrix S&P/TSX Canadian Dividend Aristocrats Fund (Corporate Class*)
(Series A, F, I and T8 Shares)
Marquest International Income Balanced Fund
(formerly Matrix International Income Balanced Fund)
(Class A, F, I, O and T8 Units)
Marquest International Balanced Fund
(formerly Matrix International Balanced Fund)
(Class A, F, I and O Units)
Marquest Tax Deferred Income Fund
(formerly Matrix Tax Deferred Income Fund)
(Class A, F, I, O and T8 Units)
Marquest American Dividend Growth Fund (Corporate Class*)
(formerly Matrix American Dividend Growth Fund (Corporate Class*)
(Series A, F, I, O and T8 Shares)
Marquest Covered Call Canadian Banks Plus Fund (Corporate Class*)
(formerly Matrix Covered Call Canadian Banks Plus Fund (Corporate Class*)
(Series A, F and I Shares)
Marquest Small Companies Fund
(Formerly Matrix Small Companies Fund)
(Class A, F, I and O Units)
Marquest Canadian Resource Fund
(Formerly Matrix Canadian Resource Fund)
(Class A, F, I and O Units)
Marquest Canadian Resource Fund (Corporate Class*)
(Formerly Matrix Canadian Resource Fund (Corporate Class*)
(Series A, F, I and O Shares)
(* All “Corporate Class” Funds are a series of shares of Marquest Corporate Class Funds Ltd.)
Principal Regulator - Ontario

Type and Date:
Amendment #1 dated November 11, 2013 to the Simplified Prospectuses and Annual Information Form dated July 9, 2013
NP 11-202 Receipt dated December 11, 2013
Offering Price and Description:
A, F, I, O, T8, AA, F-AA and T-F8 @ Net Asset Value
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2130868 & 2068714

Issuer Name:
Marquest Tax Deferred Income Trust Pool
Principal Regulator - Ontario
Type and Date:
Amendment #1 dated November 11, 2013 to the Simplified Prospectus and Annual Information Form dated September 12, 2013
NP 11-202 Receipt dated December 11, 2013
Offering Price and Description:
-
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2130918

Issuer Name:
Northern Frontier Corp.
Principal Regulator - Alberta
Type and Date:
Final Short Form Prospectus dated December 10, 2013
NP 11-202 Receipt dated December 10, 2013
Offering Price and Description:
$10,759,000.00
3,074,000 Units
Price: $3.50 per Unit
Underwriter(s) or Distributor(s):
Acumen Capital Finance Partners Limited
GMP Securities L.P.
Promoter(s):
-
Project #2143921

Issuer Name:
NorthWest International Healthcare Properties Real Estate Investment Trust
Principal Regulator - Ontario
Type and Date:
Final Short Form Prospectus dated December 12, 2013
NP 11-202 Receipt dated December 12, 2013
Offering Price and Description:
$18,000,000.00
9,000,000 Units
Price: $2.00 per Unit
Underwriter(s) or Distributor(s):
GMP Securities L.P.
National Bank Financial, Inc.
Canaccord Genuity Corp.
Dundee Securities Ltd.
Scotia Capital Inc.
Desjardins Securities Inc.
Manulife Securities Incorporated
Promoter(s):
-
Project #2141734

Issuer Name:
PNI Digital Media Inc.
Principal Regulator - British Columbia
Type and Date:
Final Short Form Prospectus dated December 13, 2013
NP 11-202 Receipt dated December 13, 2013
Offering Price and Description:
$6,500,550.00
6,191,000 Common Shares
Price: $1.05 per Offered Share
Underwriter(s) or Distributor(s):
Paradigm Capital Inc.
TD Securities Inc.
Promoter(s):
-
Project #2143514

Issuer Name:
The Manufacturers Life Insurance Company
Principal Regulator - Ontario
Type and Date:
Final Base Shelf Prospectus dated December 13, 2013
NP 11-202 Receipt dated December 13, 2013
Offering Price and Description:
$2,000,000,000.00
Debt Securities
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #2144552

Issuer Name:
True North Commercial Real Estate Investment Trust
Principal Regulator - Ontario
Type and Date:
Final Base Shelf Prospectus dated December 16, 2013
NP 11-202 Receipt dated December 16, 2013
Offering Price and Description:
$200,000,000.00
Trust Units
Debt Securities
Subscription Receipts
Warrants
Units
Underwriter(s) or Distributor(s):
-
Promoter(s):
Starlight Investment Ltd.
Project #2144849

This page intentionally left blank

Chapter 12

Registrations

12.1.1 Registrants

THERE IS NOTHING TO REPORT THIS WEEK.

This page intentionally left blank

Chapter 13

SROs, Marketplaces and Clearing Agencies

13.2 Marketplaces

13.2.1 LatAm SEF LLC – Notice of Commission Order – Application for Interim Exemption Order

LatAm SEF LLC (LatAm)

APPLICATION FOR INTERIM EXEMPTION ORDER

NOTICE OF COMMISSION ORDER

On December 10, 2013, the Commission issued an interim order under section 147 of the *Securities Act* (Ontario) (Act) exempting LatAm from the requirement in subsection 21 (1) of the Act to be recognized as an exchange (Order). LatAm is exempted from the requirement until the earlier of (i) December 10, 2014, and (ii) the effective date of the Subsequent Order (as defined in the Order).

A copy of the Order is published in Chapter 2 of this Bulletin.

13.3 Clearing Agencies

13.3.1 CDS – Notice of Withdrawal – Material Amendments to CDS Rules – Delegation of Board Authority to Management

CDS CLEARING AND DEPOSITORY SERVICES INC.

MATERIAL AMENDMENTS TO CDS RULES

DELEGATION OF BOARD AUTHORITY TO MANAGEMENT

NOTICE OF WITHDRAWAL OF MATERIAL AMENDMENTS TO CDS RULES

In accordance with the provisions of the rule protocol between the Ontario Securities Commission ("OSC") and CDS Clearing and Depository Services Inc. ("CDS®"), CDS hereby officially withdraws its submission of the proposed Material Amendments to CDS Rules concerning Delegation of Board Authority to Management. The proposed Rule amendments were submitted for regulatory approval on June 26, 2012.

A copy and description of the amendments were published for comment on July 5, 2012 in the OSC Bulletin, Volume 35, issue 27.

Cheryl Graden
Interim Chief Legal Officer
CDS Clearing and Depository Services Inc.

Chapter 25

Other Information

25.1 Exemptions

25.1.1 Front Street Global Balanced Income Class and Front Street Tactical Bond Class

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – exemption from ss. 2.1(2) of NI 81-101 to file a prospectus more than 90 days after the date of the receipt for the preliminary prospectus – National Instrument 81-101 Mutual Fund Prospectus Disclosure.

Applicable Legislative Provisions

National Instrument 81-101 Mutual Fund Prospectus Disclosure, ss. 2.1(2), 6.1.

December 10, 2013

Blake, Cassels & Graydon LLP

Attention: Stacy McLean

Dear Sirs/Mesdames:

Re: Front Street Global Balanced Income Class and Front Street Tactical Bond Class (the Funds)

Combined Preliminary and Amended and Restated Simplified Prospectus, Annual Information Form and Fund Facts dated September 3, 2013

Exemptive Relief Application under Part 6 of National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (NI 81-101)

Application No. 2013/0817; SEDAR Project Number 2110691

By letter dated December 5, 2013 (the **Application**), Front Street Capital 2004, the manager of the Funds, applied to the Director of the Ontario Securities Commission (the **Director**) under section 6.1 of NI 81-101 for relief from the operation of subsection 2.1(2) of NI 81-101, which prohibits an issuer from filing a prospectus more than 90 days after the date of the receipt for the preliminary prospectus.

This letter confirms that, based on the information and representations made in the Application, and for the purposes described in the Application, the Director intends to grant the requested exemption to be evidenced by the issuance of a receipt for the Funds' prospectus, subject to the condition that the prospectus be filed no later than December 16, 2013.

Yours very truly,

"Vera Nunes"
Manager, Investment Funds Branch
Ontario Securities Commission

25.1.2 Horizons ETFs Management (Canada) Inc. et al.

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – exemption from s. 2.3(1.1) of NI 41-101 to file a prospectus more than 90 days after the date of the receipt for the preliminary prospectus.

Applicable Legislative Provisions

National Instrument 41-101 General Prospectus Requirements, s. 2.3(1.1).

December 9, 2013

Horizons ETFs Management (Canada) Inc.

Attention: Greg Sainsbury

Dear Sir:

Re: Horizons ETFS Management (Canada) Inc., Horizons Betapro ETFS III (the Filer)

Preliminary Long Form Prospectus dated August 16, 2013

Horizons BetaPro MSCI Japan Bull Plus ETF and Horizons BetaPro MSCI Japan Bear Plus ETF (collectively, the Funds)

Exemptive Relief Application under Part 19 of National Instrument 41-101 General Prospectus Requirements (NI 41-101)

Application No. 2013/0791; SEDAR Project Number 2098709

By letter dated November 26, 2013 (the Application), the Filer, as manager of the Funds, applied on behalf of the Funds to the Director of the Ontario Securities Commission (the Director) under section 19.1 of NI 41-101 for relief from the operation of subsection 2.3(1.1) of NI 41-101, which prohibits an issuer from filing a final prospectus more than 90 days after the date of the receipt for the preliminary prospectus which relates to the final prospectus.

This letter confirms that, based on the information and representations made in the Application, and for the purposes described in the Application, the Director intends to grant the requested exemption to be evidenced by the issuance of a receipt for the Funds' final prospectus, subject to the condition that the final prospectus be filed by no later than January 31, 2014.

Yours very truly,

"Vera Nunes"
Manager, Investment Funds Branch
Ontario Securities Commission

25.2 Approvals

25.2.1 Ewing Morris & Co. Investment Partners Ltd. – s. 213(3)(b) of the LTCA

Headnote

Clause 213(3)(b) of the Loan and Trust Corporations Act – application by manager for approval to act as trustee of pooled funds and future pooled funds to be established and managed by the applicant and offered pursuant to a prospectus exemption.

Statutes Cited

Loan and Trust Corporations Act, R.S.O. 1990, c. L.25, as am., s. 213(3)(b).

December 10, 2013

Borden Ladner Gervais LLP
Scotia Plaza
40 King Street West
Toronto, Ontario
M5H 3Y4

Attention: Sarah Gardiner

Dear Sirs/Mesdames:

Re: Ewing Morris & Co. Investment Partners Ltd. (the "Applicant")

Application under clause 213(3)(b) of the Loan and Trust Corporations Act (Ontario) for approval to act as trustee

Application 2013/0611

Further to your application dated September 20, 2013 (the "Application") filed on behalf of the Applicant, and based on the facts set out in the Application and the representation by the Applicant that the assets of Ewing Morris Opportunities Trust Fund and any other future mutual fund trusts that the Applicant may establish and manage from time to time, will be held in the custody of a trust company incorporated and licensed or registered under the laws of Canada or a jurisdiction, or a bank listed in Schedule I, II or III of the *Bank Act* (Canada), or an affiliate of such bank or trust company, the Ontario Securities Commission (the "Commission") makes the following order:

Pursuant to the authority conferred on the Commission in clause 213(3)(b) of the *Loan and Trust Corporations Act* (Ontario), the Commission approves the proposal that the Applicant act as trustee of Ewing Morris Opportunities Trust Fund and any other future mutual fund trusts which may be established and managed by the Applicant from time to time, the securities of which will be offered pursuant to prospectus exemptions.

Yours truly,

"James Turner"
Vice-Chair
Ontario Securities Commission

"Judith Robertson"
Commissioner
Ontario Securities Commission

This page intentionally left blank

Index

Agueci, Eda Marie
Notice from the Office of the Secretary ... 12048
OSC Reasons ... 12133

Arconti, Alexander Flavio
Notice from the Office of the Secretary ... 12045
Order – ss. 127, 127.1 ... 12080
OSC Reasons – s. 127 ... 12095

Arconti, Luigino
Notice from the Office of the Secretary ... 12045
Order – ss. 127, 127.1 ... 12080
OSC Reasons – s. 127 ... 12095

Aston Hill Asset Management Inc.
Decision ... 12060
Decision ... 12073

Aston Hill Oil & Gas Income Fund
Decision ... 12060

Aston Hill VIP Income Fund
Decision ... 12060

Bajovski, Nikola
Notice from the Office of the Secretary ... 12048
Order – ss. 37, 127, 127.1 ... 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 ... 12153

Bell Canada
Decision ... 12065

BioExx Specialty Proteins Ltd.
Cease Trading Order ... 12171

Bradon Technologies Ltd.
Notice from the Office of the Secretary ... 12044
Order – s. 127 ... 12075

Brikman, Vyacheslav
Notice from the Office of the Secretary ... 12048
Order – ss. 37, 127, 127.1 ... 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 ... 12153

CDS Rules – Delegation of Board Authority to Management
Clearing Agencies ... 12410

Cohen, Bruce
Notice from the Office of the Secretary ... 12048
Order – ss. 37, 127, 127.1 ... 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 ... 12153

Companion Policy 24-503CP Clearing Agency Requirements
News Release ... 12043
Request for Comments ... 12209

Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations
Rules and Policies ... 12173

Companion Policy 81-101CP Mutual Fund Prospectus Disclosure
Notice ... 12014
Rules and Policies ... 12205

Companion Policy 81-106CP Investment Fund Continuous Disclosure
Notice ... 12014
Rules and Policies ... 12197

Compta, Joseph
Notice from the Office of the Secretary ... 12044
Order – s. 127 ... 12075

Crown Hill Capital Corporation
Notice from the Office of the Secretary ... 12047
Order ... 12083

CSA Notice 81-324 and Request for Comments – Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts
News Release ... 12038

CSA Staff Notice 33-316 Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients
Notice ... 11998
News Release ... 12041

CSA Staff Notice 81-323 – Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees
Notice ... 11989
News Release ... 12041

CSA Staff Notice 91-303 – Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives
Notice ... 12015

CT Real Estate Investment Trust
Decision ... 12063

Ensign Corporate Communications Inc.
Notice from the Office of the Secretary 12044
Order – s. 127 12075

Ernst & Young LLP
Notice from the Office of the Secretary 12044
Order – ss. 127, 127.1 12075

Ewing Morris & Co. Investment Partners Ltd.
Approval – s. 213(3)(b) ofo the LTCA 12413

Feder, Elliot
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

Fiorillo, Henry
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Fiorini, Giuseppe (Joseph)
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Form 41-101F2 Information Required in an Investment Fund Prospectus
Notice 12014
Rules and Policies 12203

Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance
Notice 12014
Rules and Policies 12189

Front Street Global Balanced Income Class
Exemptions 12411

Front Street Tactical Bond Class
Exemptions 12411

German, Timothy
Notice from the Office of the Secretary 12044
Order – s. 127 12075

Global Energy Group, Ltd.
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

Gornitzki, Jacob
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Groberman, Herbert
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

Harper, Christina
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

Heritage Education Funds Inc.
Notice from the Office of the Secretary 12046
Order 12081

Hillsdale Investment Management Inc.
Decision 12068

Horizons BetaPro ETFS III
Exemption 12412

Horizons BetaPro MSCI Japan Bear Plus ETF
Exemption 12412

Horizons BetaPro MSCI Japan Bull Plus ETF
Exemption 12412

Horizons ETFS Management (Canada) Inc.
Exemption 12412

Iacono, Santo
Notice from the Office of the Secretary 12048
OSC Reasons 12133

LatAm SEF LLC
Order – s. 147 12085
Marketplaces 12409

Lipari Energy, Inc.
Decision 12049

Manulife Asset Management Limited
Decision 12056

Marlatt, Frederick Lawrence
Notice of Hearing – ss. 127(1), 127(10) 12033
Notice from the Office of the Secretary 12046

Minor, Michael Wallace
Notice of Hearing – ss. 127(1), 127(10) 12033
Notice from the Office of the Secretary 12046

Mirabela Nickel Limited
Cease Trading Order 12171

Mitschele, Frederick Lawrence
Notice of Hearing – ss. 127(1), 127(10) 12033
Notice from the Office of the Secretary 12046

New Gold Limited Partnerships
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations
Rules and Policies 12173

NI 41-101 General Prospectus Requirements
Notice 12014
Rules and Policies 12203

NI 81-101 Mutual Fund Prospectus Disclosure
Notice 12014
Rules and Policies 12204

NI 81-102 Mutual Funds
Notice 12014
Rules and Policies 12206

NI 81-104 Commodity Pools
Notice 12014
Rules and Policies 12207

NI 81-106 Investment Fund Continuous Disclosure
Notice 12014
Rules and Policies 12189

North American Capital Inc.
Notice from the Office of the Secretary 12045
Order – ss. 127, 127.1 12080
OSC Reasons – s. 127 12095

North American Financial Group Inc.
Notice from the Office of the Secretary 12045
Order – ss. 127, 127.1 12080
OSC Reasons – s. 127 12095

O'Brien, David M.
Notice from the Office of the Secretary 12045
Order – s. 9(1) of the SPPA and Rules 8.1, 5.2(1) of the OSC Rules of Procedure 12076

OSC Rule 24-503 Clearing Agency Requirements
News Release 12043
Request for Comments 12209

OSC Rule 81-801 Implementing National Instrument 81-106 Investment Fund Continuous Disclosure
Notice 12014
Rules and Policies 12208

OSC Staff Notice 23-702 – Electronic Trading Risk Analysis Update
News Release 12040

Pasternak, Oded
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs) – ss. 37, 127, 127.1 12153

Platmin Limited
Cease Trading Order 12171

Pollen Services Limited
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Pushka, Wayne Lawrence
Notice from the Office of the Secretary 12047
Order 12083

Raponi, Josephine
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Redwood Asset Management Inc.
Decision 12073

Redwood Energy Growth Class
Decision 12073

Robinson, Peter
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs) – ss. 37, 127, 127.1 12153

Schaumer, Michael
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs) – ss. 37, 127, 127.1 12153

Serpa, John
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Shiff, Andrew
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs) – ss. 37, 127, 127.1 12153

Silverstein, Alan
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs) – ss. 37, 127, 127.1 12153

St. Jean, Dale Joseph Edgar
Notice from the Office of the Secretary 12047
Order – ss. 127(1), 127(10) 12082

Stans Energy Corp.
Cease Trading Order 12171

Stephany, Kimberley
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Strata-Trade Corporation
Notice from the Office of the Secretary 12047
Order – ss. 127(1), 127(10) 12082

Strike Minerals Inc.
Cease Trading Order 12171

Telfer, Ian
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Timelo Investment Management Inc.
Decision 12051

Timelo Strategic Opportunities Fund LP
Decision 12051

Timelo Strategic Opportunities Fund
Decision 12051

Tindall, Gregory Dennis
Notice from the Office of the Secretary 12047
Order – ss. 127(1), 127(10).......... 12082

TransCap Corporation
Notice from the Office of the Secretary 12047
Order – ss. 127(1), 127(10).......... 12082

Tsatskin, Vadim
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

Walker, Allan
Notice from the Office of the Secretary 12048
Order – ss. 37, 127, 127.1 12090
OSC Reasons (Sanctions and Costs)
– ss. 37, 127, 127.1 12153

Wing, Dennis
Notice from the Office of the Secretary 12048
OSC Reasons 12133

Zungui Haixi Corporation
Notice from the Office of the Secretary 12044
Order – ss. 127, 127.1 12075