

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

**THE BY-LAWS OF THE
INVESTMENT DEALERS ASSOCIATION OF CANADA**

AND

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

AND

OPTIONSXPRESS CANADA CORP.

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and optionsXpress Canada Corp. (the "**Respondent**"), consent and agree to the settlement of this matter by way of this settlement agreement (the "**Settlement Agreement**").
2. The Enforcement Department of IIROC has conducted an investigation (the "**Investigation**") into the conduct of the Respondent.
3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. Pursuant to the *Administrative and Regulatory Services Agreement* between IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for IDA to carry out its regulatory functions.
4. The Respondent consents to be subject to the jurisdiction of IIROC.
5. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No. 1, Schedule C.1, Part C (the "**Hearing Panel**").

II. JOINT SETTLEMENT RECOMMENDATION

6. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.
7. The Respondent admits to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

Between April 2008 and January 2012, the Respondent failed to correct deficiencies identified during a Business Conduct Compliance Examination despite representing that it would do so and in so doing:

- i. Failed to maintain a proper supervisory system, contrary to IIROC Dealer Member Rules 29.27 and 38.1; and
- ii. Failed to observe high standards of ethics and conduct in the transaction of its business and engaging in any business conduct or practice which is unbecoming or detrimental to the public interest, contrary to IIROC Dealer Member Rule 29.1 (IDA By-Law 29.1 or to June 1, 2008).

8. Staff and the Respondent agree to the following terms of settlement:

1) A fine in the amount of \$65,000.

9. The Respondent agrees to pay costs to IIROC in the sum of \$2,500.

III. STATEMENT OF FACTS

(i) Acknowledgment

10. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

Overview

11. IIROC Rules require that all Dealer Members establish and maintain a system of internal controls that is reasonably designed to ensure compliance with regulatory requirements. IIROC's Business Conduct Compliance ("**BCC**", formerly known as "**Sales Conduct Compliance**") department is tasked with regularly examining and testing these systems to identify any problems or concerns related to a Dealer Member's business conduct compliance systems or the implementation or operation of those systems. When deficiencies are noted, Dealer Members are required to address these concerns and to propose a course of action to correct the deficiencies.

12. Following a BCC examination in 2007, both the Respondent's Ultimate Designated Person and Chief Compliance Officer represented, on behalf of the Respondent, that it would take corrective measures to address certain deficiencies noted during such exam. Despite these representations, when a subsequent examination was conducted in late 2011 and 2012, it was discovered that many of the procedures proposed following the 2007 examination had not been properly implemented. As a result, several deficiencies continued to exist and others increased in significance.

Registration History

13. The Respondent has been registered as an Investment Dealer since December 1, 2005. The Respondent offers online stock, options and futures brokerage service, on a self-directed basis to Canadian investors.
14. Between December 1, 2005 and January 11, 2012, Thomas Stern ("**Stern**") was the Respondent's President and Ultimate Designated Person. On December 22, 2008, he also became the Respondent's Chief Compliance Officer.
15. On January 11, 2012, Stern was terminated by the Respondent due, in part, to the conduct outlined below.

The 2007 Review

16. In 2007, BCC Staff conducted a Sales Compliance Review of the Respondent (the "**2007 Review**"). The 2007 Review identified several deficiencies, including two items that were noted by BCC Staff as "significant", relating to:
 - 1) **Supervision of account activity** – there was no evidence of whether a supervisory review took place or that the reviewers made inquiries, received responses or took action to address concerns noted on the supervisory reviews; and
 - 2) **Canadian Orders Accepted by U.S. Registrants** - registrants of the Respondent's US affiliate would accept verbal orders from Canadian clients. Although the Respondent had represented that these trades would be subsequently approved by a Canadian registrant, there was no evidence of the Canadian-registered CCO's or ADP's approval of these trades.
17. In response to the 2007 Review, both the Respondent's Ultimate Designated Person and Chief Compliance Officer, on behalf of the Respondent, undertook to address the deficiencies identified by BCC and outlined the steps to correct these issues.
18. Specifically, in response to the first deficiency, the Respondent advised that, for all reports containing accounts of the Respondent, it would implement a process to maintain supervisory review logs for exception reports containing the name of the report and the date reviewed.
19. In response to the second deficiency, the Respondent advised that it would:
 - 1) Establish a change in the system processes to assure that telephone orders from Canadian clients would be routed to Canadian licensed representatives;
 - 2) Implement new procedures for U.S. licensed representatives that come in contact with Canadian clients. The U.S. licensed representatives would guide and offer assistance to Canadian clients for placing trades on their own, but if any such client insisted on such representative placing trades on such client's behalf, then that client would be routed to a Canadian licensed representative.
20. Satisfied with the response, BCC closed the 2007 Review.

The 2012 Examination

21. In late 2011, BCC Staff began preparations for another Business Conduct Examination of the Respondent (the "**2012 Examination**").
22. On November 16, 2011, BCC Staff held an entrance meeting (the "**Entrance Meeting**") with Stern as well as Katherine Gory ("**Gory**"), at the time an Investment Representative and the Alternate Designated Person of the Respondent.
23. During the Entrance Meeting, BCC Staff inquired as to the steps taken by the Respondent to address the items identified during the 2007 Review. Specifically, BCC Staff asked Stern about the Canadian-resident orders which were processed by non-Canadian registered employees of the Respondent. Stern advised that he approved all orders that were accepted verbally by registrants of the Respondent's U.S. affiliate from Canadian resident clients. When asked how he maintained such evidence, he advised that it was evidenced electronically.
24. Stern did not advise whether the Respondent had corrected the deficiency related to the supervision of account activity as identified during the 2007 Review.
25. BCC Staff continued the 2012 Examination and identified several deficiencies, including items that were noted by BCC Staff as "significant repeat" deficiencies. The items identified were:
 - 1) **Daily, Weekly and Monthly Account Supervision** - there was no evidence of supervisory review for daily, weekly, and monthly account supervisory reports;
 - 2) **Material Changes to Know-Your-Client ("KYC") Information** - there was no evidence of supervisory review and approval for changes to KYC updates;
 - 3) **Supervision of Non-Client Accounts** - no evidence of a timely review of employee accounts held outside the firm;
 - 4) **Delegation of Duties** - no evidence of written delegation of duties to multiple employees of an affiliated U.S. registrant;
 - 5) **Documentation Deficiencies** - lack of supervisory approval of New Client Application Forms; and inadequate personal identity verification;
 - 6) **Canadian Orders Accepted by U.S. Registrants** - verbal trade orders from Canadian residents were accepted by registrants of the U.S. affiliate. The Respondent was not able to provide evidence that it had taken any of the steps outlined in its response to the 2007 Examination with respect to Canadian orders.
26. In addition to these items, the 2012 Examination also identified a new item, the Chief Compliance Officer's (Stern) annual report to the Respondent's Board of Directors failed to accurately reflect the status of compliance at the firm.
27. Despite undertaking to address the deficiencies identified in the 2007 Report and despite Stern's representations that he approved all Canadian-resident orders which were processed by non-Canadian registered personnel, BCC Staff determined that these deficiencies had not in fact been properly addressed.

Stern

28. During the Entrance Meeting, the Respondent became aware that Stern's representations regarding the Canadian resident orders were not accurate. Following the meeting, senior personnel at the Respondent were made aware of Stern's misrepresentations.
29. The Respondent retained outside counsel to conduct an internal investigation into the allegations and determined that Stern had provided false and misleading information to BCC Staff. Stern was terminated by Respondent.
30. Stern has been recently disciplined by the Chicago Board Options Exchange Inc. ("CBOE"). During a review in October 2011 of OX Trading LLC, a related company of the Respondent, the CBOE found that Stern violated several CBOE Rules, including:
 - 1) Stern failed to create and maintain a record to evidence the calculation of margin;
 - 2) Stern failed to adequately supervise OX's Anti Money Laundering Program;
 - 3) Stern made false statements or misrepresentations to the CBOE.
31. In August 2012, Stern submitted a letter of consent and was permanently barred from acting as a Trading Permit Holder or from association with a Trading Permit Holder or TPH organization.
32. Stern is not currently registered in any capacity with an IROC regulated firm.
33. Pursuant to Dealer Member Rule 29.1, the Respondent acknowledges that it is responsible for the acts and omissions of Stern, the UDP, President, and later CCO of the firm during the relevant time.

Actions Taken by the Respondent

34. Since Stern's termination, the Respondent has undertaken steps to remedy the deficiencies outlined in the 2012 Examination.
35. In September 2012, the Respondent advised IROC Staff of its intention withdraw its business operations in Canada.

IV. TERMS OF SETTLEMENT

36. This settlement is agreed upon in accordance with IROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.
37. The Settlement Agreement is subject to acceptance by the Hearing Panel.
38. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
39. The Settlement Agreement will be presented to the Hearing Panel at a hearing (the "**Settlement Hearing**") for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.
40. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its right

under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

41. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to disciplinary hearing in relation to the matters disclosed in the Investigation.
42. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
43. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.
44. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
45. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Toronto, in the Province of Ontario, this 19th day of December, 2012.

Terence Doherty

WITNESS
NAME: Terence Doherty

Katherine Gory

RESPONDENT

AGREED TO by the Staff at the City of Toronto in the Province of Ontario, this 19th day of December, 2012.

Terence Doherty

WITNESS
NAME: Terence Doherty

Rob DelFrate

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

ACCEPTED at the City of Toronto, in the Province of Ontario, this 19th day of December, 2012.

Per: The Honourable Patrick
 Galligan
 Panel Chair

Per: Mr. Guenther Kleberg
 Panel Member

Per: Ms. Colleen Wright
 Panel Member