INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

THE RULES OF THE INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (IIROC)

AND

THE BY-LAWS OF THE INVESTMENT DEALERS ASSOCIATION OF CANADA (IDA)

AND

CANACCORD GENUITY CORP.

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and Canaccord Genuity Corp. **(the "Respondent")** each 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 **("IDA")** and Market Regulation Services Inc. Pursuant to the Administrative and Regulatory Services Agreement between the IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for the IDA to carry out its regulatory functions.

4. The Respondent is 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 the following contraventions of IIROC Rules:

8. Canaccord failed to adequately supervise retail client account activity contrary to IIROC Dealer Member Rules 2500 and 1300.2 (prior to June 2008 IDA Policy 2 and IDA Regulation 1300.2)

    (i) From 2005 through 2010, by failing to monitor adequately first level supervision and by failing to have effective second tier supervision.

    (ii) From June 2009 to February 2011, by refusing to adopt procedures to reasonably assure itself that its clients who purchased private placements were "accredited investors".

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

    a) The Respondent shall pay a fine of $750,000 plus an additional $310,000 for disgorged commissions.
    b) The Respondent will contribute an additional $50,000 towards IIROC's investigation costs.

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. As a result of a number of concurrent investigations involving its registered representatives, IIROC conducted an extensive review of Canaccord's supervisory practices. That review identified a number of supervisory failures by Canaccord's branch managers and head office personnel responsible for conducting tier two supervisory reviews of retail account activity.

12. From 2005 through 2010 Canaccord failed to ensure that certain of its branch managers properly carried out their responsibility to supervise retail account activity at the branch level. At the same time Canaccord's head office tier two supervision of retail account activity failed to detect various instances of unsuitable holdings and excessive trading.

13. These branch managers also failed to question and head office practices also failed to detect or address other red flags indicative of suspicious or potentially manipulative trading related to clients with retail accounts in Prince George, British Columbia and Vancouver, British Columbia. This failure allowed clients to make transactions which were potentially unfair to other market participants.

14. Separately, Canaccord, for more than a year, from June 2009 to February 2011, resisted IIROC's interpretation of a Dealer Member Firm's responsibility when facilitating purchases of securities in non-brokered private placements by its clients. Despite being clearly advised by IIROC that a Dealer Member Firm must have procedures in place to reasonably assure itself that its clients are qualified for any exemptions they claim which allow them to purchase private placements, Canaccord resisted IIROC's directions and refused to change its procedures. It has since done so.

15. This Settlement Agreement orders a global penalty against Canaccord for its failure to supervise in accordance with IIROC rules.

Montreal

16. Nicholas Budnik **("Budnik")** was an RR at the Montreal branch. He joined Canaccord in 2001 and worked there until he was dismissed by Canaccord in February 2008.

17. In 2011, pursuant to a settlement agreement between IIROC staff and Budnik, an IIROC hearing panel disciplined Budnik for engaging in excessive trading for the purpose of generating commissions and without regard to the investment objectives of an 87 year old client with limited investment knowledge and account objectives of 50% income and 50% moderate growth. Budnik paid back the approximately $42,500 his client was charged in commissions and there were no trading losses in the client account.

18. The average annual turn rate for the client's account was more than 6 which meant the entire portfolio value had been bought and sold more than an average of 6 times each year.

19. Melkom Melkonian **("Melkonian")** was another RR at Canaccord's Montreal branch. He joined Canaccord in 1998 and worked there until September 2009.

20. In 2011 an IIROC hearing panel, pursuant to a settlement agreement between IIROC staff and Melkonian, disciplined Melkonian for engaging in excessive and unsuitable trading in the joint account of clients whose primary account objective was capital preservation by excessively trading without proper consideration of the clients' best interest. The clients deposited $280,000 as part of the Immigrant Investor Program. The average annual turn rate for the clients' account was more than 6. Melkonian personally compensated the clients in an amount exceeding their losses.

Kelowna (Phillips)

21. Melaney Phillips **("Phillips")** was an RR at Canaccord's Kelowna Branch. She joined Canaccord in January 2006 and worked there until August 2008.

22. In 2011 an IIROC hearing panel disciplined Phillips for making unsuitable recommendations in the account of two different clients who were 82 and 57 years old respectively. Combined losses in the accounts of these clients exceeded $235,000.

23. Canaccord made the clients whole for the financial losses in their accounts.

Kelowna (Options)

24. Two other RRs at the Kelowna Branch were TM and RH **("M&H")**, who worked as partners. They transferred to Canaccord from another Dealer Member Firm in the fall of 2005 and brought clients with them. In these clients' accounts M&H employed a specific trading strategy **(the "Option Strategy")** that required selling of calls and puts simultaneously on various indexes. The success of the Option Strategy was market neutral.

25. The Option Strategy was high risk. Accordingly it required Level 4 options approval, the highest risk category for options trading. Moreover, Canaccord initially required M&H to purchase offsetting long puts, which would contain potential losses.

26. The offsetting long puts stopped being purchased in May 2007 and when market volatility increased in the summer of 2008 so did the risk to clients. M&H continued to sell calls and puts for their clients into the fall of 2008. With the continuing sharp falls in the markets in the fall of 2008, many clients were unable or unwilling to meet margin calls required to prevent unrealized losses from being crystallized, and so suffered large losses. Canaccord has compensated many of these clients.

Prince George

27. Marco Myatovic **("Myatovic")** was an RR at Canaccord's Prince George branch. He joined Canaccord in 1992 and worked there until he was dismissed in 2011.

28. In 2012 an IIROC hearing panel found that Myatovic facilitated manipulative or suspicious trading activity in several client accounts by prearranging trades and taking instructions from an individual who was not the account holder.

29. The trading in question related to accounts opened at the direction of **("TP")** who was an officer and director of two junior resource companies. Throughout the life of the accounts, certain red flags suggested that the accounts may have been used for improper purposes. These red flags were concentration in a limited number of securities, for which TP was an officer, large volumes of trades in two such securities, and re-aging debits by selling one security to buy the other.

30. In 2009, the accounts were ultimately suspended by Canaccord after TP failed to settle a number of outstanding trades. Combined debit balances of approximately $335,000 were left in the accounts.

Vancouver

31. DS was an RR at Canaccord's head office in Vancouver. He was the RR responsible for client accounts for six different Panamanian corporations that were beneficially owned by individual Europeans. The New Client Application Form **("NCAF")** for each account indicated that the clients shared the same address which was the Panamanian address of a corporate trust services firm which managed each of the corporate entities. Four of the six accounts were opened on the same day in March, 2008. Each also had a bank account at the same bank in Hungary.

32. The accounts were almost exclusively used for the deposit of OTCBB share certificates and subsequent sale of those shares into the market.

33. Between April and September 2009, these six Canaccord clients received in share certificates for a total of 194 million shares of an OTCBB company, Spongetech Delivery Systems Inc. **("Spongetech")**. There were 12 deposits that accounted for all 194 million shares. Almost immediately after they were deposited to the accounts at Canaccord, these shares were then sold for proceeds of just over $15 million (USD). The sale proceeds were then wired to bank accounts in Hungary. Canaccord approved the deposit of the share certificates and the outgoing wire transfers.

34. In May 2008, the BC Securities Commission published BC Instrument 33-705 – Conditions of Registration for Investment Dealers that Trade in the US Over-the-Counter Markets **(the "Instrument")**. Among other things, it described the risks associated with trading in the over-the-counter markets. To mitigate these risks, the Instrument detailed the role of dealers as gatekeepers of the markets and their related responsibilities to know the true identity of each beneficial owner of OTC issuer securities.

35. Enforcement Staff requested documentation from Canaccord to verify that Canaccord satisfied these requirements under the Instrument. For a majority of the deposits, Canaccord was unable to produce records as to how the clients obtained the shares. For the remainder of the deposits, Canaccord produced unexecuted share purchase agreements which indicated that the shares had been purchased only days prior to their deposit at Canaccord, and, where a price was indicated, at a substantial discount to the market price.

36. Canaccord's review of these deposits was inadequate, as it failed to adequately scrutinize the accompanying documentation for completeness and the reasonableness of the representations contained therein. The absence of sufficient scrutiny of these deposits

violated Canaccord's internal controls in relation to OTCBB deposits and its requirements under the Instrument.

37. In 2010, the US Securities and Exchange Commission filed a Civil Complaint against certain parties alleging that they participated in a scheme to "pump" Spongetech's share price and then "dump" shares by illegally selling them to the public through affiliated entities in unregistered transactions. The alleged scheme included lawyer opinion letters which induced Spongetech's transfer agent to remove restrictive legends from share certificates that were transferred to at least two of the six Canaccord clients. Five individuals have since pled guilty in related criminal proceedings. No allegations of wrong-doing were made in any civil, criminal or regulatory proceeding against any of Canaccord's clients.

Supervisory failures

38. In each of the above examples, the first tier supervisors – the branch managers, or a senior compliance officer in the Spongetech example – in Canaccord's two tier supervisory structure failed to effectively carry out their responsibility to identify or question transactions or trading which, on its face, appeared suspicious or potentially unsuitable for the client.

39. Canaccord did not sufficiently monitor the performance of its first tier supervisors. It did not check or audit their performance as supervisors in any meaningful way to ensure that the first level supervision was being adequately conducted. Canaccord only required monthly checklists from its Branch Managers requiring them to make written representations that they had performed their supervisory duties.

40. Canaccord's second tier supervisors – its compliance staff at its head office – were responsible for identifying account problems that may have been missed by the first level supervision. In the examples of Phillips, Budnik and Melkonian, although compliance staff at Canaccord's head office did detect the excessive and unsuitable transactions, they failed to effectively ensure that the red flags were addresses by first tier supervisors.

41. The result of this dual failure was that significant losses or activity that was potentially unfair to other market participants went undetected.

42. Had Canaccord properly monitored the performance of its first tier supervisors and conducted effective second tier supervision it would have identified the unsuitable recommendations made by Phillips and the excessive and unsuitable transactions made by Budnik and Melkonian at an early stage and prevented their recurrence. It would have ensured that the conditions attached to M&H's Option Strategy were actually being adhered to and enabled Canaccord to more closely monitor the risk in client accounts as markets became more volatile in the summer of 2008. It would have sought reasonable answers to questions raised by the red flags related to the trading by Melkonian and to the deposit of Spongetech share certificates and subsequent sale of those shares.

Accredited Investor Exemptions

43. Apart from its supervisory failures, Canaccord, for more than a year from June 2009 to February 2011, resisted IIROC's interpretation of a Dealer Member Firm's responsibility when facilitating purchases of private placements by its clients.

44. There are various exemptions set out in securities legislation which permit the sale of securities for which no formal prospectus has been filed. Such exempt sales or distributions are commonly known as private placements.

45. One such exemption allows the purchase of a private placement by an individual if their net financial assets[1] exceed $1,000,000 or if their net assets[2] exceed $5,000,000 **(the "Accredited Investor Exemption")**.

46. Many Dealer Member firms, including Canaccord, facilitate the sale of private placements to their clients as part of their business model.

47. In a January 2009 IIROC Business Conduct Compliance report, IIROC noted it had found examples where Canaccord clients whose Account Information Forms showed that they did not have the financial assets necessary to claim exemption were nevertheless doing so in subscription agreements in order to purchase private placements. The report, however, did not require Canaccord to report what action they took to remedy the finding.

48. In a subsequent letter dated June 10, 2009 **(the "June Letter")** IIROC advised Canaccord that it had received a referred investigation from the British Columbia Securities Commission **(the "Commission")**. The Commission was concerned Canaccord clients had relied on the Accredited Investor Exemption to purchase private placements, when the account information at Canaccord did not support their qualification for the exemption.

49. Because Canaccord had, in previous communication with the Commission, indicated that it was the issuing company's responsibility to ensure purchasers qualified for any claimed exemptions, IIROC's June Letter advised Canaccord this position was incorrect.

50. Canaccord's 2010 IIROC Business Conduct Compliance Report, delivered in October 2010, contained a repeat finding that Canaccord clients claimed exemptions to purchase private placements that were not supported by the account information on file at Canaccord. Canaccord was required to report what action they were taking to address this finding.

51. In November 2010 Canaccord replied and indicated that it relied on representations made by the purchasers in subscription agreements, unless it had reason not to. Canaccord further indicated it was preparing a reminder to its RRs about updating NCAFs and was

[1] Real estate is not included in the calculation of "financial assets".

[2] Real estate is included in the calculation of "assets".

considering sanctions against RRs who did not update NCAFs where information on subscription agreements represented a material change for the client.

52. On January 25, 2011 IIROC wrote Canaccord about its proposed action and indicated a more substantial response was required with details about procedures Canaccord would take to meet their responsibilities in establishing client accreditation and prevent non accredited clients from participating in private placements. The letter also indicated the matter would be referred to IIROC's Enforcement department for review.

53. On February 25, 2011 Canaccord indicated they were establishing new procedures which would include a compliance staff member validating accredited investor status by reviewing the clients' NCAF.

54. Despite being clearly advised by IIROC that a Dealer Member Firm must have procedures in place to reasonably assure itself that its clients are qualified for any exemptions they claim which allow them to purchase private placements, Canaccord resisted IIROC's directions and refused to adopt said procedures in a timely way.

55. IIROC reviewed ten different private placements purchased through Canaccord's Whitehorse branch for the period between June 2010 and January 2011. During the period reviewed, 79 clients at the Whitehorse branch purchased 10 different private placements. Each purchase was effected by a written claim the client was eligible to purchase private placements because they fit within the Accredited Investor definition in that they had more than $1,000,000 financial assets. However, the account documentation for 71 out of the 79 clients indicated that they did not have more than $1,000,000 financial assets and did not fit within the definition of Accredited Investor. The total value of the private placements purchased by the 71 clients was approximately $800,000.

56. None of the clients who purchased the private placements complained despite being contacted by both IIROC and Canaccord.

Commissions

57. In the examples of Budnik, Melkonian, M&H, Myatovic, Spongetech, and the Accredited Investors, Canaccord earned commission on transactions that should not have been made. The total of these commissions paid to Canaccord was $310,000.

Mitigating Factors

58. Canaccord has replaced its branch managers in Montreal, Kelowna and Prince George, and RRs Budnik, Melkonian, Phillips, Myatovic, DS, TM & RH.

59. Since 2008 Canaccord has spent approximately $1,000,000 implementing and maintaining a new electronic supervisory system to supplement their current supervisory practices.

60. Canaccord currently conducts more frequent audits of its front line supervisors and has tied their compensation to the frequency and effectiveness of their supervisory efforts.

61. In 2011 Canaccord retained independent compliance consultants to review its compliance and supervisory systems and assess the efficacy of some of the changes undertaken by the firm. The independent report was generally positive and where it made recommendations, Canaccord has taken action to address them.

IV. TERMS OF SETTLEMENT

62. This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.

63. The Settlement Agreement is subject to acceptance by the Hearing Panel.

64. The Settlement Agreement shall become effective and binding upon the Respondents and Staff as of the date of its acceptance by the Hearing Panel.

65. 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.

66. If the Hearing Panel accepts the Settlement Agreement, the Respondents waive their rights under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

67. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondents may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.

68. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.

69. Staff and the Respondents 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.

70. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondents are payable immediately upon the effective date of the Settlement Agreement.

71. 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 Vancouver, British Columbia this 30th day of October, 2013.

"David Mitchell"_____
WITNESS

"Bruce Maranda"_____
RESPONDENT

AGREED TO by IIROC Staff at Vancouver, British Columbia this 30th day of October, 2013.

"Chris Perkins"_____
WITNESS

"Paul Smith"_____
PAUL SMITH
Senior Enforcement Counsel on behalf of Staff of the Investment Industry Regulatory Organization of Canada

ACCEPTED at the City of Vancouver in the Province of British Columbia, this 29th day of November, 2013, by the following Hearing Panel:

Per: "Benjamin Casson"_____
Panel Chair

Per: "William Welton"_____
Panel Member

Per: "Peter McWilliams"_____
Panel Member