The Ontario Securities Commission

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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)

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JULY 11, 2003

CURRENT PROCEEDINGS

BEFORE

ONTARIO SECURITIES COMMISSION

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

The Harry S. Bray Hearing Room
Ontario Securities Commission
Cadillac Fairview Tower
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20 Queen Street West
Toronto, Ontario
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Robert L. Shirriff, Q.C.	—	RLS
Suresh Thakrar	—	ST
Wendell S. Wigle, Q. C.	—	WSW

SCHEDULED OSC HEARINGS

DATE: TBA	**ATI Technologies Inc., Kwok Yuen Ho, Betty Ho, JoAnne Chang, David Stone, Mary de La Torre, Alan Rae and Sally Daub**
	s. 127
	M. Britton in attendance for Staff
	Panel: TBA
DATE: TBA	**Teodosio Vincent Pangia, Agostino Capista and Dallas/North Group Inc.**
	s. 127
	Y. Chisholm in attendance for Staff
	Panel: TBA
July 11, 2003	**Brian Anderson, Leslie Brown, Douglas Brown, David Sloan and flat Electronic Data Interchange (a.k.a. F.E.D.I.)**
10:00 a.m.	
	s. 127
	K. Daniels in attendance for Staff
	Panel: HLM/WSW/RLS
July 21, 2003	**Robert Davies**
10:00 a.m.	s. 127
	T. Pratt in attendance for Staff
	Panel: HLM/RWD
October 7 to 10, 2003	**Gregory Hyrniw and Walter Hyrniw**
	s. 127
	Y. Chisholm in attendance for Staff
	Panel: TBA

October 20 to 31, 2003	**Ricardo Molinari, Ashley Cooper, Thomas Stevenson, Marshall Sone, Fred Elliott, Elliott Management Inc. and Amber Coast Resort Corporation**
	s. 127
	I. Smith in attendance for Staff
	Panel: TBA
November 3 to 21, 2003	**Patrick Fraser Kenyon Pierrepont Lett, Milehouse Investment Management Limited, Pierrepont**
10:00 a.m.	**Trading Inc., BMO Nesbitt Burns Inc.*, John Steven Hawkyard+ and John Craig Dunn**
	s. 127
	K. Manarin in attendance for Staff
	Panel: TBA
	* BMO settled Sept. 23/02
	+ April 29, 2003

ADJOURNED SINE DIE

Buckingham Securities Corporation, Lloyd Bruce, David Bromberg, Harold Seidel, Rampart Securities Inc., W.D. Latimer Co. Limited, Canaccord Capital Corporation, BMO Nesbitt Burns Inc., Bear, Stearns & Co. Inc., Dundee Securities Corporation, Caldwell Securities Limited and B2B Trust

Global Privacy Management Trust and Robert Cranston

M.C.J.C. Holdings Inc. and Michael Cowpland

Philip Services Corporation

S. B. McLaughlin

Livent Inc., Garth H. Drabinsky, Myron I. Gottlieb, Gordon Eckstein, Robert Topol

1.1.2 OSC Compliance Team, Capital Markets Branch 2003 Annual Report

2003 ANNUAL REPORT
COMPLIANCE TEAM,
CAPITAL MARKETS BRANCH, OSC

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2003 ANNUAL REPORT COMPLIANCE TEAM, CAPITAL MARKETS BRANCH, OSC

Introduction

The Compliance team of the Capital Markets branch of the Ontario Securities Commission has prepared this report to provide guidance to investment counsel and portfolio managers ("ICPMs") in complying with Ontario securities laws.

The report on our activities from April 1, 2002 to March 31, 2003 is divided into two parts. The first part of the report describes various compliance initiatives and issues relating to ICPMs. The second part of the report deals with common deficiencies identified during field reviews of ICPMs. We also include some suggested guidelines to assist market participants in improving their existing procedures, establishing procedures where they are lacking, and to give general guidance that can help in improving the overall compliance environment. Our intent is to educate ICPMs about compliance practices and to encourage strong compliance and internal control environments.

We issued a similar report covering our activities from April 1, 2001 to March 31, 2002 and note that seven of the deficiencies included in this year's report were also included in last year's report.

A major focus of the Compliance team is the execution of compliance examinations. At the beginning of any examination, staff requests that the market participant compile various books and records that will be reviewed as part of the fieldwork. Many ICPMs have indicated that they could benefit from knowing more specifically what books and records they are required to compile for staff. We have included, in Appendix A, the listing of books and records that we request prior to the commencement of an examination and encourage you to review it. This is a generic listing and depending on the nature of your business some of the items may not be applicable.

In the past year the team has been very involved with mutual fund dealers and the Mutual Fund Dealers Association's membership process. As a result of our continued involvement with mutual fund dealers, we were not able to focus our resources on fund managers and, therefore, the most common fund manager deficiencies have not been included.

While the major focus of the Compliance team is to conduct field reviews, Compliance staff is also involved in other initiatives. Some initiatives and issues of relevance to ICPMs are highlighted in the first part of the report.

Part I. Initiatives and Other Issues

ICPM Roundtable Meetings

The ICPM roundtable meetings, a Compliance initiative that started in fiscal 2001/2002, have continued in the past year. The roundtable meeting is a forum for advisers to discuss issues and share ideas. It is a forum for advisers to provide their perspective on issues.

A variety of topics are discussed at the meetings. Some of the topics that have been discussed include: Rule 31-502 – Proficiency Requirements for Registrants, the Risk Assessment Project, proxy voting, Rule 13-502 – Fees and the capital formula for advisers.

Participation is voluntary and advisers are invited on a random basis. We encourage anyone that is interested in attending a future meeting to contact one of the authors of this report listed at the end of the report.

Update on the Risk Assessment Project[1]

In fiscal 2001, Compliance initiated a project to develop a risk-based selection model for routine compliance examinations. The model is intended to focus the Compliance group's staffing resources on those market participants and the specific areas of their operations considered to be high risk. The model is used to calculate a risk "score" for each market participant based on staff's analysis of specific factors concerning the market participant's operations, nature of their products and client base. A numerical risk score is then assigned to each factor under analysis, and the cumulative result of these factors results in an overall risk rating for the firm. Each market participant is then ranked based on its overall resulting risk ranking. This overall ranking will be used to determine the frequency and extent of compliance field reviews for each market participant.

The last phase of the implementation of the model is now completed. Compliance staff achieved a 100% response rate from the population of ICPMs and fund managers to whom risk assessment questionnaires were distributed. The risk assessment project team spent several months analyzing the responses provided by all market participants and assigning appropriate risk scores to each. Commencing in fiscal 2003/2004, OSC staff will meet with senior management of high risk market participants to communicate their overall risk ranking to them and to discuss those areas of their operations which have been identified as contributing to their high risk rating. The timing of the next compliance field review for these market participants will also be considered. As an interim measure, some market participants may be asked to develop appropriate action plans to address the high risk areas of their operations until such time as a compliance field review is scheduled. For those market participants that have been categorized as lower risk, the risk ranking assessment will be provided to them at the completion of their next scheduled compliance review. Information relating to each market participant's risk ranking will be provided on a confidential basis.

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[1] For more detailed information refer to OSC Staff Notice 11-719 – A Risk-Based Approach for More Effective Regulation.

Monitoring of Subadvisers

Compliance staff has seen a variety of methods used by ICPMs to monitor the activities of subadvisers where they have delegated all or a portion of their investment advisory and management duties. These methods range from the periodic receipt of attestation statements from subadvisers to detailed testing of the subadvisers' trading and portfolio management activities.

In order to ensure the adequate discharge of their obligations under securities laws, ICPMs have a responsibility to monitor the duties delegated to others contractually or otherwise. The execution of a contract stipulating the terms by which a subadviser is expected to perform its duties to the ICPM cannot replace the regulatory obligations of the ICPM nor the fiduciary duty it owes to its clients. As a result, ICPMs should actively monitor subadvisers' trading activities for adherence to the investment mandates of the ICPMs' clients and for adherence to all applicable securities legislation. Active monitoring goes beyond the receipt of periodic statements from the subadviser attesting to their compliance with relevant securities laws and/or the terms of their contractual arrangement with the ICPM.

Market participants must determine what procedures they should adopt to ensure that subadvisers are being adequately monitored. Some procedures that can be adopted are:

- The performance of due diligence prior to the selection of a subadviser
- Due diligence includes assessing the adequacy of the subadviser's internal policies in the areas of personal trading, fair allocation of investment opportunities among clients, cross trading and soft dollar arrangements
- At least annually, ICPMs should request a signed acknowledgement from senior management of the subadviser confirming adherence to their policies and procedures
- Periodic comparison of the securities held in client accounts against the clients' stated investment objectives should be done to ensure client portfolios are suitable
- Periodic price testing and variance analysis for a sample of client portfolios should be done to ensure the proper valuations of portfolios

Regulation 113(3) requires registrants to retain books and records necessary to properly record their business transactions and financial affairs. For that reason, ICPMs are expected to retain sufficient evidence of their monitoring activities, including the resolution of any issues identified with regard to the performance of subadvisers.

Mutual Funds – Securities Lending

2001 amendments to National Instrument 81-102 ("NI 81-102") allow mutual funds to engage in securities lending. Part 2.12 of NI 81-102 sets out the conditions that must be met if the mutual fund intends to engage in securities lending. One of the conditions is that the arrangement is a securities lending arrangement as defined in section 260 of the Income Tax Act ("ITA").

Securities lending arrangements involve the transfer, sale, or purchase of securities for a period of time, in order to generate income. These arrangements include securities loans (where securities are loaned out for a period of time in return for collateral), repurchase transactions (where securities are sold and subject to repurchase at a later date) and reverse repurchase transactions (where securities are purchased and subject to resale at a later date). Part 2 of NI 81-102 permits mutual funds to enter into securities lending arrangements with other parties provided certain conditions are met. This includes the requirement that only securities defined in section 260 of the ITA as "qualified securities" may be lent. Over the past year several mutual funds in Ontario have lent trust units under these arrangements. These are not qualified securities under section 260 of the ITA. As a result, these securities were deemed to have been disposed for tax purposes, exposing the funds to potentially adverse tax consequences.

Staff reminds market participants that only qualified securities as defined in section 260 of the ITA are permitted in securities lending arrangements. Market participants must ensure that the custodian or sub-custodian whom they have appointed as agent to administer these transactions is aware of and abides by the requirements of Part 2 of NI 81-102 and section 260 of the ITA.

Proficiency Requirements for Registrants

Representatives of the investment adviser industry have raised concerns about the proficiency requirements for compliance officers of firms registered as advisers under Rule 31-502 – Proficiency Requirements for Registrants ("Rule 31-502") and also with respect to the requirements for designated compliance officers and their delegates under Rule 31-505 – Conditions of Registration ("Rule 31-505"). The proposed amendments are intended to provide alternative proficiency requirements for compliance officers of advisers and to clarify the roles assigned to individuals involved in the supervision of advisers' regulatory compliance.

The proposed Rule 31-502 amendments will provide alternatives which recognize practical expertise in compliance matters. The current requirement under Rule 31-505 requires an adviser to designate a compliance officer who will be responsible for certain duties and is permitted to delegate some of those duties to another individual who has the same proficiency as the designated individual. The amendments to Rule 31-505 propose a system whereby a senior officer assumes ultimate responsibility for the compliance functions, while day-to-day

supervision of the compliance function is undertaken by an operating officer whose proficiency is determined in accordance with the amended requirements under Rule 31-502.

The proposed amendments can be read in their entirety on the OSC website. The comment period ended on March 31, 2003, however, the amendments are not yet final.

The Capital Formula for Advisers

The Compliance team began an initiative on the capital formula for advisers to determine whether, based on the risks in the adviser environment, changes were warranted to the minimum capital requirements.

An analysis of what the requirements are in other jurisdictions has been done and a focus group meeting was held with representatives from the adviser population to obtain their views on the issue. We are currently in the process of analyzing alternatives to determine what our next steps should be.

Part II. Common ICPM deficiencies

This part of the report discusses those deficiencies that occurred with the most frequency based on Compliance examinations conducted from April 1, 2002 to March 31, 2003. A necessary element of a market participant's business is a compliance program that effectively addresses the inherent risks in the business of advising and helps the firm meet its compliance obligations. An effective compliance program increases the firm's compliance with regulatory requirements. This report is meant to provide guidance and help ICPMs review their compliance programs, supervisory and internal control procedures and to establish a stronger compliance environment.

The ten most common deficiencies noted in our reviews of ICPMs are:[2]

1. Policy for fairness in allocation of investment opportunities
2. Maintenance of books and records
3. Statement of policies
4. Policies and procedures manual
5. Capital calculations
6. Portfolio management
7. Marketing
8. Know your client and suitability information
9. Personal trading
10. Registration issues

The noted deficiencies are followed by some suggested guidelines that may assist you in improving your compliance procedures. These suggested guidelines are not mandated or required, and there may be others that may be just as effective. They may provide you with some guidance on what would work best at your firm.

1. *Policy for fairness in allocation of investment opportunities*

Every investment counsel must have standards to ensure fairness in the allocation of investment opportunities among its clients. ICPMs are required to prepare a written fairness policy dealing with the allocation of investment opportunities among clients. The policy must be filed with the Commission as well as distributed to all clients. The policy should specify the method used by the ICPM to allocate securities purchased in block trades and/or initial public offerings (IPOs) to client accounts, including their in-house pools. The policy should also include the method used by the ICPM to allocate price and commissions on these trades among client accounts. Advisers have a fiduciary duty to clients to allocate trades equitably among client accounts.

During our reviews, staff observed the following:

- The ICPM had not prepared a fairness policy
- The ICPM did not provide clients with a copy of the fairness policy
- The ICPM did not file a copy of the fairness policy with the Commission
- The fairness policy did not include a methodology for allocating block trades or IPOs
- The ICPM did not follow the allocation practices set out in its fairness policy
- The fairness policy contained wording that was very generic and was not tailored to the ICPM's business
- The allocation of shares to client accounts was done on a "best judgement" basis instead of being done using a more independent method such as, pro-rata basis

[2] While this report focuses on those deficiencies most commonly noted, Compliance staff also identified issues in numerous other areas at ICPMs. Deficiencies were also identified in the following areas: cross transactions, disclosure issues, proxy voting, management fee calculation errors, dealing with clients in other jurisdictions, late filing of audited annual financial statements, expired insurance, trust account issues, subordinated loan issues, trade name issues, monitoring of subadvisers, advertising of registration, soft dollar issues, conflicts of interest, best price and execution, non-compliance with clients' investment restrictions and guidelines, registration issues, unregistered trading activity, contract issues, and statements of portfolio.

- The policy does not describe how security prices and commissions will be determined when trades are blocked

Suggested practices

Each ICPM should tailor its fairness policy to address all relevant areas of its business. At a minimum, it should state:

- How price and commissions are allocated among client accounts when trades are blocked
- How block trades are allocated among client accounts when there is only a partial fill
- The process for determining which clients will participate in "hot issues" and IPOs
- The process for the allocation of prices and commissions for block trades that are filled in different lots and/or at different prices

2. *Maintenance of books and records*

ICPMs are required to maintain books and records necessary to properly record their business transactions and financial affairs. Regulation 113(1) requires them to maintain the books and records that are necessary to properly record their business transactions.

During our reviews, staff observed the following:

- Trade instructions were provided verbally from the portfolio manager to the trader/executing broker with no record of the instruction kept
- The ICPM could not locate certain client management agreements
- The ICPM did not maintain a trade blotter or the blotter maintained was incomplete
- The ICPM did not maintain copies of each trade order or instruction
- Trade orders were not time-stamped
- A complaints log recording the nature of complaints and their resolution was not maintained
- A log of failed trades and trading errors was not maintained
- There was no documentation in client files regarding a client's directed brokerage arrangement
- No record of monthly capital calculations was maintained
- Client files do not contain the most current documentation such as advisory agreements
- Monthly trial balances and financial statements are not prepared
- Cash and security reconciliations are not prepared

Suggested practices

A list of books and records that ICPMs are required to maintain is contained in Regulation 113(3). ICPMs should also retain any other books and records necessary to properly record their business transactions and financial affairs.

3. *Statement of policies*

ICPMs who provide advice with respect to their own securities or securities of certain issuers who are connected or related to them are required to disclose these relationships. Every registrant is required to include this disclosure in a statement of policies which is to be filed with the Commission, as well as distributed to each client. Regulation 223 requires that registrants prepare and file a statement of policies with the Commission as well as provide a copy to their clients.

During our reviews, staff observed some the following deficiencies:

- The ICPM had not prepared a statement of policies
- The ICPM had not filed the most current statement of policies with the Commission and/or did not provide all clients with a copy
- The ICPM had not updated its statement of policies to include all related issuers
- The ICPM did not list its own pooled funds as related issuers
- The ICPM did not describe the nature of its relationship with related and connected issuers
- The ICPM distributed a statement of policies to clients that differed from the one filed with the Commission

Suggested practices

- A current statement of policies should be prepared and filed with the Commission
- If a significant change occurs, a revised statement of policies must be filed with the Commission and distributed to all clients
- A copy of the statement of policies should be provided to all clients

- The statement of policies should include a complete listing of related issuers along with a concise description of the nature of the relationship with each of the related issuers
- The statement should include the disclosure required in Regulation 223(1)(d)

4. *Policies and procedures manual*

ICPMs are required to establish and enforce written policies and procedures that will enable them to serve their clients adequately. ICPMs should prepare a policies and procedures manual (Manual). They should ensure that the Manual is in sufficient detail, is updated on a periodic basis, and is made available to all relevant staff. The relevant regulatory requirements should be outlined in the Manual. Written procedures contribute to a strong compliance environment.

During our reviews, staff observed the following:

- The Manual contained out-dated references to rules and regulations of the Act
- The Manual did not contain procedures covering all major areas of the business
- The Manual was not sufficiently detailed
- The Manual was not made available to all staff
- The procedures used in practice were not consistent with the procedures outlined in the Manual

Suggested practices

Each ICPM should establish and enforce a written Manual that is sufficiently detailed, up to date, and which covers all relevant areas of its business. The following list of topics should be considered for inclusion in a standard Manual:

- Trading and Brokerage
  - Guidelines on the selection of brokers
  - Fairness in allocation of investment opportunities among client accounts
  - Obtaining best price and best execution for clients
  - Executing trades in a timely manner and in accordance with the portfolio manager's instructions
  - Monitoring and resolving failed trades and trading errors
  - Guidelines on soft dollar arrangements with brokers
- Portfolio Management
  - Guidance on proxy voting
  - Performance of sufficient research to support investment decisions
  - Collection, documentation and timely updating of KYC and suitability information for clients
  - Compliance with clients' specified investment restrictions or other instructions, such as directed brokerage
  - Compliance with regulatory requirements
  - Supervision of sub-advisers
  - Suitability of investments for each client
- Administration
  - Handling of client complaints
  - Opening and closing of client accounts
  - Insider and early warning reporting
- Financial Condition
  - Preparation, review and monitoring of monthly capital calculations
- Money Laundering Prevention
  - Definition of "money laundering" and examples of suspicious transactions
  - Handling of prescribed and suspicious transactions
  - Procedures to report prescribed and suspicious transactions to the Financial Transactions and Reports Analysis Centre of Canada
  - Documenting the records which should be maintained under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act and Regulations*

5. *Capital calculations*

ICPMs are required to prepare a monthly calculation of minimum free capital and capital required (capital calculation) within a reasonable period of time after each month end. The capital calculation is to be prepared based on monthly financial statements prepared in accordance with generally accepted accounting principles (GAAP). All market participants are required to inform the Commission

immediately should they be become capital deficient. They are required to rectify the capital deficiency within 48 hours.

During our reviews, staff observed the following:

- Capital calculations were not prepared or were not prepared on a timely basis and, therefore, monitoring of the firm's capital was not done
- Capital calculations were not prepared in accordance with GAAP
- Monthly accruals for expenses such as rent payable, utilities payable, and other monthly operating expenses were not recorded
- Management fee revenue was not properly recorded
- The insurance deductible on the financial institution bond was not included in the calculation or an incorrect amount was included
- There was no evidence that a review of the calculation was performed by someone other than the preparer
- The ICPM did not inform the Commission of a capital deficiency
- Copies of the monthly capital calculations were not maintained, therefore eliminating the audit trail
- The market participant was capital deficient
- Capital calculations were performed on a quarterly basis

Suggested practices

- The ICPM's capital position should be calculated on a monthly basis within 2 weeks of month end and should be based on financial statements prepared in accordance with GAAP
- Copies of the calculations should be maintained for purposes of an audit trail
- A person other than the preparer should review the calculations to ensure they are accurate
- Evidence of the review should be documented
- The Commission should be informed immediately should the ICPM's capital position become deficient

6. *Portfolio management*

Portfolio management is the provision of investment advice to clients based on their stated investment objectives. Advisers have a significant degree of discretion in the management of client assets and a fiduciary duty to their clients. Investments must always be consistent with clients' objectives and any client restrictions must be adhered to. Advisory contracts, which govern the activities of the adviser, should contain adequate disclosure of all material facts.

During our reviews, staff observed the following:

- The advisory fee being charged to clients was not consistent with the rate stated in the advisory agreement
- Clients' portfolio holdings were not in compliance with their investment restrictions.
- Terms of the advising contract had changed, however, the contract was never updated to reflect the changes.
- Management of client accounts was not in accordance with the terms of the advising agreement. For example, subadvisers were used, the fee was performance based instead of as a percentage of assets under management, asset allocation percentages were not adhered to, established limits were not adhered to, etc.
- Written notice to terminate the advising agreement was not always obtained
- Accounts are managed prior to the execution of an advisory agreement
- Accounts are managed without an investment management agreement

Suggested practices

- A review of clients' holdings should be done on a frequent enough basis to ensure that holdings are consistent with the investment restrictions
- The correct advisory fee should be charged to clients
- Contracts should be updated whenever any terms have changed
- Written notice should always be obtained prior to terminating any advising agreement
- The advisory agreement should be executed prior to the management of the account beginning

7. *Marketing*

In order to deal fairly, honestly and in good faith with clients it is necessary to ensure that all marketing material include accurate information that is not misleading to clients.

When marketing mutual funds, the requirements of Part 15 of NI 81-102 must be adhered to.

During our reviews, staff observed the following:

- Performance data of mutual funds was not disclosed for the required time periods
- Internal marketing requirements were not being adhered to
- The disclosure and warning language required by 15.2(2) of NI 81-102 was not always present
- Performance figures used to compare fund performance were for funds that did not have similar fundamental investment objectives, were not under common management or an index
- Marketing materials contained information that was incorrect
- Marketing materials being used were outdated
- Composites, used in marketing materials, did not include all the required client accounts and were, therefore, improperly constructed
- References to the Association for Investment Management and Research ("AIMR") were used when the firm was not AIMR compliant
- Performance data was not provided for the required time periods
- No evidence was maintained of any review of marketing material

Suggested practices

- Sales communications pertaining to a mutual fund must be made in accordance with Part 15 of NI 81-102.
- Marketing material should be regularly updated to ensure all information is complete and accurate and not misleading to clients
- Establish and enforce procedures with respect to the preparation, review and approval of marketing materials
- Establish guidelines on the preparation of performance data and the construction of composites
- Require the approval of all marketing material from someone independent of its preparation

8. *Know your client and suitability information*

ICPMs are required to collect and maintain current "know your client" (KYC) information that would allow the ICPM to ascertain general investment needs of its clients, as well as the suitability of a proposed transaction. ICPMs should collect client information such as investment objectives, risk tolerance, investment restrictions, investment time frame, annual income, and net worth.

During our reviews, staff observed the following:

- KYC information was not collected for all clients
- KYC information that had been collected was not complete
- KYC information had not been updated periodically or since the opening of the account
- KYC information was not formally documented
- KYC forms were not signed by clients
- A standard KYC form was not used to collect and document KYC information and suitability information

Suggested practices

- Complete KYC information must be collected for all clients
- KYC information should be periodically updated
- Clients must sign the KYC information form
- If possible, maintain KYC information in an electronic format which can be used to generate exception reports
- Maintain a pending file when a KYC form is incomplete
- The pending file should be cleared on a timely basis and prior to any trade execution

9. *Personal trading*

ICPMs are required to establish and enforce written procedures for dealing with clients that conform to prudent business practice. The establishment and enforcement of a detailed policy on the personal trading of responsible persons is a prudent business practice. It will ensure that conflicts of interest and abusive practices are avoided. A responsible person is defined in subsection 118(1) of the Act.

During our reviews, staff observed the following:

- There was no policy in place to monitor personal trading by responsible persons
- A personal trading policy was in place but was not being enforced by the ICPM
- The compliance officer's personal trades were not pre-approved by an independent person

- Employees' trade confirmations and statements of accounts were missing from some employees' files
- Pre-approval forms were not always matched against employees' statements to ensure all personal trades were pre-approved
- A log of all instances of non-compliance and their resolution was not maintained
- No formal process in place to pre-approve personal trades, maintain or review personal brokerage statements
- No review of personal trading was being done
- The registrant's policies and procedures for the monitoring of personal trading were not being adhered to
- Requirement for employees to complete and submit an annual certification is not being adhered to
- Pre-approval for personal trades was verbal, written documentation was not required

Suggested practices

- Designate a compliance officer who is responsible for reviewing and maintaining personal trading records
- Distribute clear personal trading restrictions and reporting obligations to all responsible persons
- Personal trading procedures should include blackout periods, the requirement for pre-approval of all personal trades and a review of portfolio statements
- Require all responsible persons, on an annual basis, to acknowledge in writing that they understand and will abide by the firm's personal trading policies
- Maintain a record of personal trade approvals as documentary evidence that personal trading is being monitored
- Employees should direct their brokers to send statements of their accounts directly to their employer
- On a monthly or quarterly basis, review employee statements and reconcile all trades to the approvals granted
- All personal trades should be pre-cleared
- Put a process in place to deal with personal trading violations
- Establish an independent review committee to review personal trading

10. *Registration issues*

Every registered adviser is required to notify the Director, within 5 business days, of any changes in address and any change in the status of directors and/ or officers.

During our reviews, staff observed the following:

- Individuals that were officers were not registered with the OSC
- Individuals that were directors were not registered with the OSC
- Branch offices of the company were not registered with the OSC

Suggested practices

- Notify the Director, on a timely basis, of all changes.

APPENDIX A

ADVISER COMPLIANCE FIELD REVIEW LIST OF BOOKS AND RECORDS REQUESTED FOR REVIEW

A. Planning -Field

1. A copy of the Registrant's Statement of Policies as required by Regulation 223

2. A copy of the Registrant's standards to ensure fairness in the allocation of investment opportunities among its clients as required by Regulation 115

3. A copy of the Registrant's disclosure of its related registrants and the policies and procedures adopted to minimize the potential for conflict of interest resulting from these relationships as required by OSC Rule 31-501

4. A copy of the Registrant's current organizational chart and a listing of employees with telephone numbers

5. A list of individuals responsible for providing investment advice to clients during the review period, and the name of the compliance officer

6. A list of all individuals that are subject to "close supervision" terms and conditions imposed by the Commission

7. A list of all branch offices, including those that were closed during the review period

8. A list of all affiliated parties to the Registrant and the nature of the relationship

9. A copy of any reports issued during the review period by the Registrant's internal audit department, including a copy of management's response

10. A copy of any management letters issued during the review period by the Registrant's external auditor, including a copy of management's response

11. A copy of all minutes of meetings of the Board of Directors, Audit Committee, Investment Committee or other committees of the Registrant, during the review period

B. Financial Condition

12. A copy of the Registrant's financial statements as at the end of the most recent fiscal year and as at the end of the review period

13. A copy of the monthly capital calculations for the entire review period

14. A copy of the insurance certificate of renewal

C. Contracts

15. A list of clients as at the end of the review period. For each client, identify the custodian, type of account (e.g. equity, balanced, fixed income), whether or not the Registrant has discretionary authority, and the total amount of assets under management

16. A list of clients whose contract provides for performance based compensation

17. A copy of each of the Registrant's standard advisory contracts or agreements

18. A copy of powers of attorney or letters of authorization that confer discretionary authority, if not incorporated directly in the contracts specified in item 17

19. A copy of the Registrant's fee schedule, if not included in the contracts specified in item 17

D. Portfolio Management

20. A list of any joint ventures or any other businesses in which the Registrant or any officer, director, portfolio manager or trader of the Registrant participates or has any interest in

21. Total assets under management as at the end of the review period

22. A copy of any sub-advisory agreements with other investment advisers

23. Client files, including access to former clients' files

E. Trading & Brokerage

24. A list of clients who have instructed the Registrant to direct a portion or the entirety of their brokerage to particular broker-dealers, including the name of the brokerage firm and the client's reason for such direction, if known

25. A list of all initial public offerings that the Registrant participated in during the review period

26. A list of all brokerage firms where client transactions were effected during the review period, identifying the name of the firm, amount of agency commissions paid and the volume of transactions

27. A list of all soft-dollar arrangements. This list should include the name of the broker or other entity involved, the nature of the goods or services received by the Registrant and the approximate annual amount of commissions on securities transactions needed to satisfy each arrangement

28. A listing of all cross transactions which took place during the review period

29. If the Registrant, its related persons or affiliates have custody of client funds or securities, a list which includes the names of all such clients, the current market value of all assets in their possession or to which the Registrant has access, and the location(s) where such assets are held

30. A list of all proprietary trading or investment accounts of the Registrant or of any "associated persons". "Associate" is defined in the *Ontario Securities Act* ("Act")

31. A list of accounts of individuals who are directly or indirectly related to the Registrant or any of its related persons, the account number, and the person to whom he/she is related

32. A list of all persons required to report personal securities transactions to the Registrant during the review period, including any officer or employee of Registrant's affiliates deemed as associated persons

33. Records of employee personal securities transactions including those for any person deemed to be associated persons during the review period

34. Listing of all securities held in all client portfolios (aggregate position totals for all securities) as of the beginning and end of the review period. This list should show the name of each security and the aggregate number of shares or principal amount held for total client portfolios.

35. Registrant's trading blotter for the review period. If possible, provide the information in chronological order with the following fields of data:

    a. Trade date

    b. Type of transaction (i.e. buy/sell)

    c. Number of shares or principal amount

    d. Security name

    e. Identifying number (e.g. cusip number)

    f. Price

    g. Total commission

    h. Commission in cents per share

    i. Fees

    j. Accrued interest

    k. Net amount to/from client

    l. Client name

    m. Client account number

    n. Broker or dealer name

    If possible, please provide the trading blotter in Microsoft Excel compatible format on 3.5inch diskette

36. A copy of the Registrant's written policies and procedures manual

F. Custody

37. General ledger, trial balance, cash receipts and disbursements journals and bank reconciliations for all trust accounts for the review period

38. Bank statements, deposit books and cancelled cheques for the review period for all trust accounts

G. Marketing

39. A copy of any promotional brochures, pamphlets, or other materials routinely furnished to prospective clients (e.g. proposals); and a copy of any marketing materials (e.g. newspaper or magazine ads, radio scripts, reprints, seminar materials etc.) used to inform or solicit clients. If the Registrant makes information about its services available on the INTERNET, provide the address.

40. A copy of any composite or representative performance reports, data, or graphs currently disseminated to clients or prospective clients

41. The criteria the Registrant employs in the construction of any composite or performance data included in the records described above

42. A list of all parties that received any referral fees during the review period

H. Administration

43. Complaint log and complaint files for the review period

I. Conflicts of Interest

44. A copy of written policies and procedures and any Code of Ethics governing the personal securities transactions of the Registrant's employees and those of participating affiliates.

45. Access to a log of all instances of non-compliance with the Registrant's Code of Ethics for the review period including resolutions to the non-compliance

J. Money Laundering

46. A copy of the policies and procedures for money laundering

Contact Information

For further information, please contact:

Marrianne Bridge
Manager Compliance, Capital Markets Branch
mbridge@osc.gov.on.ca
phone – (416) 595-8907

Felicia Tedesco
Assistant Manager Compliance, Capital Markets Branch
ftedesco@osc.gov.on.ca
phone – (416) 593-8273

1.1.3 OSC Comments on British Columbia Securities Commission's Proposed Model for Securities Regulation in B.C.

June 27, 2003

Mr. Doug Hyndman
Chair
British Columbia Securities Commission
PO Box 10142, Pacific Centre
701 West Georgia Street
Vancouver, BC V7Y 1L2

Dear Mr. Hyndman:

The Ontario Securities Commission welcomes the opportunity to comment on the proposed BCSC model. We agree with your assessment that Canadian securities regulation is under intense scrutiny and there is need for reform.

As you point out in the *Commentary on Draft Legislation*, there are a number of processes underway to respond to the challenge for reform. These include:

- the federal Wise Persons' Committee which is seeking direction on what is the best securities regulatory system for Canada,
- the provincial ministers' process which is focusing on a passport system and harmonized securities regulation,
- the CSA Uniform Securities Legislation (USL) project which aims to streamline and harmonize securities legislation through a uniform securities act and rules,
- the report of the Ontario Five Year Review Committee which supports a national securities regulator among its recommendations for reform, and
- the Ontario Fair Dealing Model which proposes an innovative way to regulate financial services providers.

We are encouraged by the renewed interest and commitment on the part of governments and regulators to reform securities regulation. Over the past four decades, there have been attempts to reform our fragmented regulatory system to more adequately respond to the evolving and competitive challenges facing our small Canadian market. To be successful, we need to be innovative, timely, and we need to work together.

We applaud your Commission's immense effort and the extensive and transparent consultation process in developing a concept paper and draft legislation within a short period of time. As part of the dialogue on reform, your focus on the effectiveness, efficiency and complexity of the current system is an important component of the debate.

We share your objectives to streamline securities regulation, make the rules simple and clear, and reduce costs and inefficiency for market participants. We are supportive of the goal to establish a regulatory system that imposes minimum regulatory burden on industry as long as it does not compromise investor protection and market efficiency.

In reviewing your proposals, we assessed whether the BCSC model adequately ensures market efficiency and investor protection. We also measured your proposals against their compatibility with the initiatives of the CSA and other major jurisdictions.

Overall, we are concerned that the BCSC has chosen to pursue a significant shift in policy direction that will undermine the progress the CSA has achieved to harmonize securities regulation across Canada. If your proposals are implemented, it will further fragment securities regulation in Canada and open a significant gap in securities regulation between BC, the rest of Canada, the U.S. and other major world markets.

To be effective, reform needs to be accomplished on a harmonized and national basis. The BCSC proposals need to be considered in context with CSA initiatives aimed at regulatory harmonization and uniform securities legislation. In this regard, the BCSC proposals are not consistent with the direction of the Uniform Securities Legislation project to harmonize and streamline regulation across Canada. Your criticism of USL as a missed opportunity for regulatory reform undermines the importance of the project and the significant progress that has been achieved with the release of the concept paper, *Blueprint for Uniform Securities Laws for Canada*.

Although the primary focus of the USL project is to achieve harmonization of securities legislation, a complementary goal is to simplify and streamline the regulatory system. The resulting uniform Act, regulations and national rules will be simplified and less voluminous. Uniform registration, prospectus and exemption requirements, a streamlined registration system (passport) and delegation of powers are important components of the project. Given the aggressive time lines of the USL project, it has not been possible to achieve consensus in incorporating further policy changes. Where consensus can be achieved in a timely fashion, more reforms can be accommodated.

As you note in the *Commentary*, your proposals are driven by the BC government's agenda to reduce regulation across all government sectors by one third. To facilitate compliance with this direction, you have chosen to focus exclusively on the volume and complexity of rules. The analysis does not give sufficient weight to the more serious problems involving differences in regulatory requirements among jurisdictions and the multitude of decision-makers. A significant number of commentators on your proposals have identified the need for a national securities regulator as the most pressing issue that needs to be addressed by regulators and governments.

Your objective is to reduce the volume of regulation by requiring market participants to adopt principles and codes of conduct. Compliance with the principles and codes will be encouraged through enhanced enforcement powers and new remedies for investors. We are concerned that the proposed shift in focus to enforcement and new civil remedies as the counterweight to relaxing requirements will not provide sufficient protection for investors.

We are concerned that you may have gone too far in removing prescriptive requirements and relaxing requirements on market participants. Commissions have a responsibility to proactively enforce clear standards to protect investors and foster a fair and efficient marketplace. Market participants also expect clear guidance on appropriate behaviour.

In reforming our securities regulatory system, we need to go beyond the debate on the relative merits of principles-based versus rules-based regulation. There is no question that we must have clearly articulated principles. The interpretive flexibility inherent in principles provides adaptability and allows our regulatory system to evolve.

The problem is that principles alone are rarely sufficient. They do not provide sufficient clarity for market participants or for regulators unless they are supplemented with rules. The application of principles could be open to widely differing interpretations unless they are supported by sufficient guidance to ensure that they will be applied consistently in similar circumstances. To force market participants to determine what is expected of them is to shift the regulatory burden down to those participants. To force investors to interpret a set of principles and to make a judgement as to whether their application by an issuer or registrant is adequate is neither efficient nor would it inspire confidence. We believe that rules are necessary to amplify and clarify clearly articulated principles.

The use of both principles and rules is necessary in the formulation of effective securities regulation.

Costs

We are concerned that your proposals will not reduce costs or increase efficiency for market participants. Your analysis is focused on a reduced role for the regulator, but overlooks the increased costs of compliance for market participants and the increased burden of enforcement that will be borne by investors. Your model does not take into account the duplication, inefficiency and increased costs for market participants complying with the requirements of different securities regulatory regimes.

A principles-based approach results in decision-making by the courts and administrative tribunals thereby adding to the complexity and costs for market participants. It also increases the uncertainty of future regulation by letting the courts, rather than the securities commission, interpret the rules going forward, potentially changing the direction of regulation in ways not anticipated, nor possibly desired, by the BCSC.

Registration: Principles and Code of Conduct

Registrants are currently required to maintain high standards of integrity in all aspects of their dealings with investors. The current rules prescribing a registrant's qualifications, proficiency and ethical conduct are detailed and prescriptive. In place of the existing set of detailed regulatory requirements that determine who can participate in our markets, and govern the conduct of market participants, the BCSC model proposes the following changes:

- the substitution of eight broadly-worded principles for most of the existing detailed rules that must be satisfied in order to obtain registration and that govern the ongoing operation of registrants,
- new civil remedies which are intended to expand the ability of investors to sue market participants who break the rules as the counterweight to the relaxation of detailed requirements, and
- elimination of the existing requirements for representatives of registered dealers and advisers to be registered, and hence the current screening by regulators of these market participants for fitness or suitability (the "firm-only registration proposal").

We do not agree that Principles, a Code of Conduct and Guidelines should serve as a replacement for existing prescriptive legislative or SRO requirements. Our existing requirements have been developed over many years, based on the experience of industry and regulators. We disagree with the premise that replacing prescriptive requirements with general principles to be applied ad hoc by registered firms results in reduced regulatory burdens and more efficient capital markets. We believe that a combination of principles and clear prescriptive requirements reduces the regulatory burden for market participants and promotes efficiencies.

We are concerned that the ability of regulators and investors to take remedial action for breach of these requirements could be substantially impaired, due to the generalized language of the principles (and the recognition in the principles that firms can determine their own requirements). We believe that the substitution of a set of *subjective* principles for an existing comprehensive set of *objective* regulations will necessitate substantial costs – as the regulators, registrants, and their clients must determine, through costly administrative and civil litigation, what conduct constitutes compliance with the Code. This will inevitability add significantly to the regulatory burden and cost for market participants and investors.

Both investors and market participants expect clear guidance on the expected conduct of market participants. Clear and unambiguous rules serve to promote investor protection and market efficiency as fewer resources need to be expended on interpretative issues and the pursuit of legal remedies.

The permissive language contained in the Code and the flexibility in the Code's direction that firms need only adopt policies and procedures that suit their situation will invite divergent standards of conduct that will place burdens on clients seeking redress.

Investor redress will be further compromised by your proposed elimination of specific minimum capital requirements for participating firms (although investment dealers and mutual fund dealers that are members of an SRO will be required to satisfy the SRO's capital requirements). Owners of adviser or restricted dealer firms may choose to address the risk of remedial action by maintaining minimal capital in the enterprise, thereby reducing the assets available to satisfy client claims.

Registration: Firm-Only Registration

The BCSC model proposes that only firms be required to obtain registration, and that the present requirement to register the individual representatives of the firms be eliminated. The firm, not the regulator, would have the responsibility of determining an individual's "fitness" or "suitability" to participate in the industry.

The effect of the BCSC proposals is to shift the regulatory burden onto the employer, raising the question whether firms have the same duty to protect investors as regulators do. The shift also raises concerns regarding increased costs for the employer. A significant number of industry participants have flagged the cost implications of this proposal.

You argue that the registration of individuals creates a large paper burden on firms because they have to submit detailed applications in each jurisdiction where they wish individuals to be registered. This argument is no longer relevant because, as you acknowledge, the National Registration Database (NRD) addresses these concerns. Redesigning NRD to accommodate firm-only registration would involve significant costs.

Investor protection is enhanced by the requirement for the individual representatives who trade and advise on behalf of a registered firm to also apply for registration (including a reinstatement, or transfer to another firm) and renewal of registration. In connection with the firm only registration model, an important issue that arises is the ability to appropriately deal with individual registrants who have been disciplined or terminated by their employers, but who resurface with another registered dealer. The process of individual registration assists in monitoring the movement of such individuals.

The *Commentary on the Draft Legislation* suggests that, while regulators would no longer be in a position to prevent an individual from trading or advising on behalf of a firm (by the regulator satisfying itself on the suitability or fitness for registration of the individual representative), the regulator would still retain the power to suspend or prohibit inappropriate or unqualified individuals after the inappropriate activity has come to the regulator's attention. We believe that investor protection is better served by not

permitting participation in the industry by undesirable individuals in the first place, rather than by trying to remove them after they have harmed investors.

The premises that underlie the BCSC model have not been tested nor have they been subjected to a cost-benefit analysis. While the proposed changes may stimulate a useful discussion of the objectives and efficacy of existing registration requirements, we are concerned that they will not produce the intended results with respect to market efficiency, investor protection and streamlining. Additional information is needed to better assess the merits of a Code of Conduct. We would like to see more discussion on the enforceability of principles, a cost-benefit analysis of the implications of this proposal and some discussion of how SROs fit into your proposals.

Continuous Market Access System

Your Continuous Market Access System (CMA) appears to be a refinement of the streamlined offering system outlined in the Integrated Disclosure System (IDS) proposal published by the CSA in January 2000.

As you know, the CSA has been actively working on the development of IDS in recognition that more efficient access to capital with minimum regulatory delays will benefit all market participants. IDS will permit faster and less costly access to capital markets by allowing eligible issuers to use their continuous disclosure and streamlined offering process and disclosure for new distributions.

In order to facilitate the implementation of IDS and given that the vast majority of trading takes place in the secondary markets, the CSA has been focussing its efforts on improving the quality of continuous disclosure in Canada. In developing National Instrument 51-102 *Continuous Disclosure Obligations,* important steps are being taken to harmonize continuous disclosure requirements and to introduce new requirements which will greatly enhance the quality of continuous disclosure provided to the marketplace by Canadian issuers. A strong system of continuous disclosure will pave the way for an eventual implementation of an integrated disclosure system.

The significant differences between the CMA and IDS and the areas where we have concerns are as follows:

Prospectus remedies

The CMA proposal eliminates the prospectus and the consequent requirement for issuers to be responsible to investors who buy shares from the issuer for the completeness and accuracy of the information that is provided. Under a prospectus regime, purchasers of treasury securities have the right to get their money back if they have been misled. Even if the misrepresentation is an innocent one, the issuer cannot keep the money. The CSA's proposed IDS system preserves this right for investors by keeping in place a streamlined prospectus.

The BCSC approach eliminates this right, providing a more limited right to recover limited damages and only if the issuer failed to be properly diligent. We cannot agree with an approach that takes away a fundamental right for investors.

Other major jurisdictions such as the United States, the United Kingdom, Australia and the European Union have retained the prospectus-based system for the distribution of securities.

We note that the BCSC model contains a "harmonized interface" that would entitle BC purchasers to the prospectus remedies available in other jurisdictions if they purchase securities under a prospectus offering. Given that many issuers seek financing in BC and other Canadian jurisdictions at the same time, we expect that most issuers and BC investors would be subject to and benefit from existing prospectus rights regardless of your changes.

Timely disclosure - Material information standard vs. Material Fact and Material Change

The BCSC model proposes to change the trigger for timely disclosure to a material information standard. Under this approach, an issuer must ensure its continuous disclosure record contains all material information about the issuer and its securities all the time. Any new material information must be disclosed in a news release as soon as practicable.

Comments in the *Issuers Guide* indicate that the material information trigger used in the BCSC model results in the disclosure of the same information as would be disclosed under the current regime of "material fact" used in the prospectus context and "material change" used in the continuous disclosure context. We disagree with this assertion and would like more analysis to understand the basis for this proposal. The Ontario Five Year Review Committee considered whether the disclosure standard should be changed to a material information standard, but rejected the idea because of the difficulties that issuers would face in trying to comply with that standard.

While the concept of changing the timely disclosure trigger to material information has some appeal because more information would be available to the marketplace, we believe it would be onerous for issuers to comply with this standard. To address this concern, we note that you included in your draft legislation a safe harbour for issuers that are subject to timely disclosure obligations in another Canadian jurisdiction. So long as these issuers comply with the material change disclosure requirements, they will be exempt from the BCSC draft legislation news release requirement. The practical effect of the proposed safe harbour is no change from the current timely disclosure trigger for the majority of issuers in Canada, thus raising the question whether it makes sense to make the change.

We question whether the merits of adopting a material information trigger outweigh the confusion that we believe will be created in the marketplace, both from the change itself as well as the existence of a safe harbour provision.

As an alternative approach, Ontario's Five Year Legislative Review Committee reaffirmed the existing material change approach, but with a recommended modification to the definition to replace the market impact test with a reasonable investor standard. We suggest this would be a preferable approach.

Fewer requirements – increased "guidance"

While we understand the approach taken by the BCSC to reduce regulation, we disagree with the replacement of existing requirements with only general guidance. Again, we believe this to be an extreme approach. We believe that the approach taken by the BCSC pushes the cost of regulation onto issuers and investors because there is less certainty as to what is expected of issuers to be in full compliance with the law. By allowing companies the flexibility to determine what disclosure is relevant for the market, comparability between issuers will be reduced.

We also note the ability of the BCSC to issue a cease trade order against the issuer in circumstances where it is determined by the regulator that the issuer has failed to provide material information to the marketplace. We believe that it would be difficult to evaluate when information is missing from the market and that the use of the cease trade tool against an issuer in these circumstances inappropriately penalizes investors.

An additional concern with the substitution of guidance for specific requirements is how a regulator uses the guidance. We are particularly concerned where "requirements" are disguised as "guidance". It remains to be seen how the BCSC will view issuers that do not follow the guidance given. Again, this raises the issue of providing certainty for issuers to know they are doing what is expected of them to comply with the law.

We are concerned about the ability of regulators to enforce compliance under the CMA system, given the lack of specificity in requirements and the fact that disclosure decisions are largely left to the "reasonable business judgement" of issuers. We believe that it is critical to deal quickly with non-compliance matters to maintain the integrity of the system and the reputation of Canada's markets and to protect investors.

We are concerned about how our regulatory system will be regarded internationally if the prospectus and continuous disclosure regimes are perceived to be less onerous than they currently are and especially if they vary widely among our jurisdictions.

The cross-border and international implications of adopting a CMA system need to be carefully assessed. The implications of shifting to a CMA system while the U.S. and other jurisdictions and investors continue to rely on a prospectus disclosure regime must be assessed.

Investor Remedies

The BCSC model proposes to provide investors with a right of action for damages for material contraventions of the Act or the Rules. This single right of action is intended to replace all of the existing rights of action under BC securities law and expand statutory remedies beyond where they are today. We are not aware of any deficiencies or gaps in existing common law remedies (other than in the context of secondary market investors who are injured by misleading disclosure) which would dictate such an expansion of the current statutory civil remedies regime. Your proposals are silent on this point. We believe that your proposed new civil remedies regime warrants a much more thorough review to better understand its impact on Canada's capital markets.

The balance of our comments relating to investor remedies focus on your proposed changes to the CSA's draft November 2000 statutory civil liability regime for secondary market investors. As you know, the Ontario Government recently passed amendments based on the CSA's draft legislation. We expect that these amendments will be proclaimed in force soon.

Ontario's Bill 198 civil remedies regime is a culmination of more than two decades of government and industry reports studying civil liability in the secondary market, including the report by the blue ribbon Allen Committee. Following the release of the Allen Committee's Final Report in March 1997, the CSA determined that it was a top priority to respond to the Committee's recommendations. The BCSC participated on the CSA Committee that developed the legislation and was supportive of the initiative. At the outset, the CSA decided to follow in principle the Allen Committee's recommendations as they pertained to the design of the proposed civil liability regime for continuous disclosure. We carefully considered and relied upon the Allen Committee's extensive research, analysis, and consultations with market participants and their advisers and engaged in extensive additional consultations and public comment processes.

We are concerned that the BCSC proposes significant changes from the CSA's statutory civil liability regime. For example, the BCSC is proposing to:

- impose a more rigorous liability standard on directors and officers for misrepresentations in public oral statements,
- impose a more rigorous liability standard on outside directors for misrepresentations in documents not required to be filed under securities law and for failure to make timely disclosure,
- shift the burden of proof onto potential defendants under all circumstances,
- eliminate several defences available to defendants including the "whistleblower" defence,
- eliminate the automatic intervenor status of a securities regulatory authority in any civil action launched under the legislation, and

- eliminate the damages calculation section which was intended to provide a roadmap for courts to ensure consistency among awards.

These changes are troubling. As you know, many commenters on the CSA's draft legislation were concerned about the potential for multiple class actions being initiated in different CSA jurisdictions based on the same disclosure violation. Indeed, multiple class actions could undermine the ceilings on liability envisioned under the CSA's draft legislation and ultimately Ontario's Bill 198. These issues may be addressed by the courts through the exercise of powers given to them to manage class actions and to stay or consolidate actions. The difficulties of coordinating class actions intraprovincially, however, will be exacerbated by differences in provincial liability regimes. Such differences with respect to standards of liability, defences or burden of proof may also result in forum shopping by plaintiffs. None of these results is desirable. It is for this reason that the CSA was and remains committed to creating a uniform statutory liability regime for disclosure violations.

The issues relevant to creating an effective deterrent civil liability regime for secondary market investors have been considered in Canada on numerous occasions. Most recently, the CSA engaged in a robust and comprehensive study of the Allen Committee proposals, developed draft legislation for public consultation and considered comments received on the legislation. We need to proceed with the CSA's proposals – not reopen them to a further round of debate. We hope that other jurisdictions including BC will follow the Ontario Government's lead in enacting this landmark legislation.

Conclusion

Staff is reviewing your proposals in detail to determine where there are opportunities for harmonization. We agree that more can be done to streamline securities regulation.

We are pleased that, in some areas, such as mutual funds and take-over and issuer bids, the BCSC has decided to work within the CSA to implement reform. In developing their proposals for mutual fund governance, for example, staff has tried to achieve a more balanced approach to regulation by avoiding unduly prescriptive and detailed provisions, while including prescriptive rules where a consistent industry standard is necessary to achieve a regulatory result.

Mutual fund governance is an example of how we can work together to achieve a better balance between principles and prescriptive rules.

Overall, we are concerned that your proposals:

- increase the regulatory burden and costs for market participants,
- raise significant investor protection concerns, and
- are not compatible with the direction of CSA and other major international jurisdictions.

We are concerned that, if your proposals are adopted unilaterally, securities regulation in Canada will be further fragmented and the efficiencies that we have accomplished to date through the CSA would be seriously undermined.

I welcome the opportunity to further discuss my comments with you and to engage in a meaningful dialogue on how we can work together within the CSA to achieve a harmonized, effective and efficient regulatory regime.

Sincerely,

David Brown
Chair

1.3 News Releases

1.3.1 OSC Continues the Cease Trade Order in the Matter of Discovery Biotech Inc. and Graycliff Resources Inc.

FOR IMMEDIATE RELEASE
July 2, 2003

OSC CONTINUES THE CEASE TRADE ORDER IN THE MATTER OF DISCOVERY BIOTECH INC. AND GRAYCLIFF RESOURCES INC.

TORONTO – On June 26, 2003, the Ontario Securities Commission continued the temporary cease trade order against Discovery Biotech Inc. and Graycliff Resources Inc. until further order of the Commission.

For Media Inquiries: Eric Pelletier
Manager, Media Relations
416-595-8913

For Investor Inquiries: OSC Contact Centre
416-593-8314
1-877-785-1555 (Toll Free)

1.3.2 OSC Comments on British Columbia Securities Commission's Proposed Model

FOR IMMEDIATE RELEASE
July 9, 2003

OSC COMMENTS ON BRITISH COLUMBIA SECURITIES COMMISSION'S PROPOSED MODEL

TORONTO – The Ontario Securities Commission's comments on the British Columbia Securities Commission's proposed model for securities regulation in B.C. are available on the "What's New" section of the OSC's website at **www.osc.gov.on.ca**.

For Media Inquiries: Eric Pelletier
Manager, Media Relations
416-595-8913

For Investor Inquiries: OSC Contact Centre
416-593-8314
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Chapter 2

Decisions, Orders and Rulings

2.1 Decisions

2.1.1 Mellon Bank, N.A.

Headnote

Prospectus and registration relief for Schedule III Bank – revocation of original MRRS Decision in Ontario and re-issuance of Ontario only decision to clarify advising business to be carried on by Schedule III Bank in Ontario.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25(1)(a) and (e), 35(1)(3)(i), 35(2), 53(i), 72(1)(a)(i), 73(1)(a), 74(1), 144, 147.

Regulations Cited

Regulation made under the Securities Act, R.R.O. 1990, Reg. 1015, as amended, Schedule I, section 28.

Policies Cited

OSC Policy 45-501.

IN THE MATTER OF
THE SECURITIES ACT, R.S.O. 1990,
CHAPTER S.5, AS AMENDED (the "Act")

AND

IN THE MATTER OF
MELLON BANK, N.A.

REVOCATION AND DECISION

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker") in each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Northwest Territories, Nunavut Territory and Yukon Territory (the "Jurisdictions") made decisions on December 4, 2000 under the Mutual Reliance Review System for Exemptive Relief Applications ("MRRS") pursuant to the securities legislation of the Jurisdictions (the "Legislation") that Mellon Bank, N.A. ("Mellon Bank") is exempt from various registration, prospectus and filing requirements of the Legislation in connection with the banking activities to be carried on by Mellon Bank in Canada through its Schedule III Bank (the "Original Decision");

AND WHEREAS the Ontario Securities Commission (the "Commission") has received an application (the "Application") from Mellon Bank for a decision pursuant to the *Securities Act* (Ontario) (the "Act") to revoke the Original Decision with respect to the relief granted by Ontario and to restate the Original Decision to clarify the business of Mellon Bank to be carried on in Ontario;

AND WHEREAS it has been represented by Mellon Bank to the Commission that:

1. Mellon Bank is a United States bank and is the principal bank subsidiary of Mellon Financial Corporation in the United States.

2. Mellon Financial Corporation is a multi-bank holding company whose principal wholly-owned subsidiaries are Mellon Bank, The Boston Company Inc., Boston Safe Deposit and Trust Company, Mellon Capital Management Corporation, Mellon Bank (DE) National Association and Buck Consultants Inc. The Dreyfus Corporation, a major mutual fund management company in the United States, is a wholly-owned subsidiary of Mellon Bank.

3. In June 1999, amendments to the *Bank Act* (Canada) (the "*Bank Act*") were proclaimed that permit foreign commercial banks to establish direct branches in Canada. These amendments have created a new Schedule III, which lists foreign banks permitted to carry on banking activities through branches in Canada.

4. On November 10, 2000, Mellon Bank received an order under the *Bank Act* permitting it to establish a full service branch under the *Bank Act* and designating it on Schedule III to the *Bank Act*.

5. Mellon Bank's principal business is banking including investment counselling and portfolio management activities. Mellon Bank provides portfolio management services for equity, fixed income, asset allocation, foreign currency and overlay portfolios. As part of these services, Mellon Bank engages in foreign exchange, options, over-the-counter derivative products, financial futures, commodity futures contracts and commodity futures options. Additional banking activities include commercial loans, foreign exchange, current accounts, lock-box and cash management services to companies operating in Canada. Treasury operations of Mellon Bank provide funding and liquidity for commercial lending activity of Mellon Bank and deal in foreign exchange. Mellon Bank is a provider of trust and custody and related services, such as securities lending, investment accounting, trade processing,

performance measurement, investment-related foreign exchange, risk management and fiduciary monitoring in sub-custodian relationships with banks. Mellon Bank is a participant in the interbank market and accepts term deposits from major Canadian and multi-national corporations.

6. The only advising activities which Mellon Bank undertakes are either part of its principal business in accordance with the *Bank Act* or are incidental to its principal business.

7. Mellon Bank only accepts deposits from the following:

(a) Her Majesty in right of Canada or in right of a province or territory, an agent of Her Majesty in either of those rights and includes a municipal or public body empowered to perform a function of government in Canada, or an entity controlled by Her Majesty in either of those rights;

(b) the government of a foreign country or any political subdivision thereof, an agency of the government of a foreign country or any political subdivision thereof, or an entity that is controlled by the government of a foreign country or any political subdivision thereof;

(c) an international agency of which Canada is a member, including an international agency that is a member of the World Bank Group, the Inter- American Development Bank, the Asian Development Bank, the Caribbean Development Bank and the European Bank for Reconstruction and Development and any other international regional bank;

(d) a financial institution (i.e.: (a) a bank or an authorized foreign bank under the Bank Act; (b) a body corporate to which the *Trust and Loan Companies Act* (Canada) applies; (c) an association to which the *Cooperative Credit Association Act* (Canada) applies; (d) an insurance company or a fraternal benefit society to which the *Insurance Companies Act* (Canada) applies; (e) a trust, loan or insurance corporation incorporated by or under an Act of the legislature of a province or territory in Canada; (f) a cooperative credit society incorporated and regulated by or under an Act of the legislature of a province or territory in Canada (g) an entity that is incorporated or formed by or under an Act of Parliament or of the legislature of a province or territory in Canada and that is primarily engaged in dealing in securities, including portfolio management and investment counselling, and is registered to act in such capacity under the applicable legislation; and (h) a foreign institution that is (i) engaged in the banking, trust, loan or insurance business, the business of a cooperative credit society or the business of dealing in securities or is otherwise engaged primarily in the business of providing financial services, and (ii) is incorporated or formed otherwise than by or under an Act of Parliament or of the legislature of a province or territory in Canada);

(e) a pension fund sponsored by an employer for the benefit of its employees or employees of an affiliate that is registered and has total plan assets under administration of greater than $100 million;

(f) a mutual fund corporation that is regulated under an Act of the legislature of a province or territory in Canada or under the laws of any other jurisdiction and has total assets under administration of greater than $10 million;

(g) an entity (other than an individual) that has, for the fiscal year immediately preceding the initial deposit, gross revenues on its own books and records of greater than $5 million;

(h) any other entity, where the deposit facilitates the provision of the following services by the authorized foreign bank to the entity, namely,

(i) lending money,

(ii) dealing in foreign exchange, or

(iii) dealing in securities, other than debt obligations of the authorized foreign bank; or

(i) any other person if the deposit is in an aggregate amount of greater than $150,000;

collectively referred to for purposes of this Decision as "Authorized Purchasers".

8. Portfolio management and investment counselling are included in the definition of the "business of banking" under the *Bank Act* which is the principal business of banks in Schedule I, II and III to the *Bank Act*.

9. The Act refers to "Schedule I and Schedule II banks" in connection with certain exemptions, however, no reference is made in the Act to entities listed on Schedule III to the *Bank Act*.

10. In order to ensure that Mellon Bank, as an entity listed on Schedule III to the *Bank Act*, is able to provide banking services to persons in the Jurisdictions, it requires similar exemptions enjoyed by banking institutions incorporated under the *Bank Act* to the extent that the current exemptions applicable to such banking institutions are relevant to the banking business being undertaken by Mellon Bank in the Jurisdictions.

AND WHEREAS the Commission is satisfied that the tests contained in the Act that provides the Commission with the jurisdiction to make the Decision has been met;

IT IS THE DECISION of the Commission pursuant to the Act that the Original Decision is revoked and replaced by the following decision (the "Decision").

THE DECISION of the Commission pursuant to the Act is that in connection with the banking business to be carried on by Mellon Bank in Ontario:

1. Mellon Bank is exempt from the requirement under the Act to be registered as an underwriter with respect to trading in the same types of securities that an entity listed on Schedule I or II to the *Bank Act* may act as an underwriter in respect of without being required to be registered under the Act as an underwriter.

2. Mellon Bank is exempt from the requirements under the Act to be registered as an adviser for the purpose of providing investment counsel services and portfolio management services in accordance with the *Bank Act* or where the performance of the service as an adviser is solely incidental to its principal business.

3. A trade of a security to Mellon Bank, where Mellon Bank purchases the security as principal, shall be exempt from the registration and prospectus requirements of the Act provided that:

   (i) the forms that would have been filed and the fees that would have been paid under the Act if the trade had been made, on an exempt basis, to an entity listed on Schedule I or II to the *Bank Act* purchasing as principal are filed and paid in respect of the trade to Mellon Bank, and

   (ii) the first trade in a security acquired by Mellon Bank pursuant to this Decision is deemed a distribution under the Act unless the conditions in subsections 2 or 3, as applicable, of section 2.5 of Multilateral Instrument 45-102 - *Resale of Securities* are satisfied.

4. Provided Mellon Bank only trades the types of securities referred to in this paragraph 4 with Authorized Purchasers, trades of bonds, debentures or other evidences of indebtedness of or guaranteed by Mellon Bank shall be exempt from the registration and prospectus requirements of the Act.

5. Evidences of deposit issued by Mellon Bank to Authorized Purchasers shall be exempt from the registration and prospectus requirements of the Act.

6. Subsection 25(1)(a) of the Act does not apply to a trade by Mellon Bank:

   (i) of a type described in subsection 35(1) of the Act or section 151 of the Regulations made under the Act; or

   (ii) in securities described in subsection 35(2) of the Act.

7. Except as provided for in paragraph 3 of this Decision. section 28 of Schedule I to Ontario Regulation 1015 made under the Act shall not apply to trades made by Mellon Bank in reliance on this Decision.

December 31, 2002.

"Howard I. Wetston" "Theresa McLeod"

2.1.2 Fastrak Systems Inc. - MRRS Decision

Headnote

MRRS – exemption from the requirement contained in the securities legislation of the Jurisdictions to be registered to trade in a security in connection with Fastrak's activities as an administrator of employee share incentive plans for client companies, subject to conditions.

Applicable Ontario Statute

Ontario Securities Act, R.S.O. 1990, c. S.5, s. 25(1), 147.

Applicable Ontario Rules

OSC Rule 45-503.
OSC Rule 32-501.

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ALBERTA, BRITISH COLUMBIA, MANITOBA,
ONTARIO AND SASKATCHEWAN

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM
FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
FASTRAK SYSTEMS INC.

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "**Decision Makers**") in each of Alberta, British Columbia, Manitoba, Ontario and Saskatchewan (the "**Jurisdictions**") has received an application from Fastrak Systems Inc. ("**Fastrak**") for a decision pursuant to the securities legislation of the Jurisdictions (the "**Legislation**") that the requirement contained in the Legislation to be registered to trade in a security (the "**Registration Requirement**") shall not apply to Fastrak's activities as administrator of employee share incentive plans ("**ESPs**") of client companies which permit employees, officers and directors resident in any of the Jurisdictions ("**Plan Participants**") to purchase securities, as more fully described below;

AND WHEREAS pursuant to the Mutual Reliance Review System for Exemptive Relief Applications (the "**MRRS**"), the Ontario Securities Commission is the principal regulator for this application;

AND WHEREAS Fastrak has represented to the Decision Maker that:

1. Fastrak is a corporation incorporated under the laws of Ontario, with its head office in Ontario. It is not registered to trade in securities in any capacity under the laws of any jurisdiction.

2. Fastrak is in the business of administering ESPs. Fastrak enters into administration agreements ("**Administration Agreements**") with companies that have previously established, or will hereafter establish, ESPs (individually a "**Company**" and collectively the "**Companies**"). The distribution of securities under ESPs, and the first trade of such securities, will be exempt from the registration and prospectus requirements of the Legislation, as applicable, pursuant to available exemptions or, where required, exemption orders granted under applicable Legislation in the Jurisdictions.

3. ESPs may include:

   (i) share purchase plans, share bonus plans, restricted share plans, share award plans and similar plans, each of which involve, or may potentially involve, the issuance of shares of a Company to a Plan Participant; and

   (ii) share option plans which involve, or may potentially involve, the issuance of options to purchase shares of a Company to a Plan Participant and, on exercise of such options, the issuance of shares of the Company to the Plan Participant.

4. Plan Participants may include registered retirement savings plans, registered retirement income funds and registered education savings plans of which employees, officers and directors of a Company or its affiliates are beneficiaries.

5. Under an ESP, only employees, directors and officers of the relevant Company and its affiliates will be eligible to acquire securities pursuant to the ESP. Participation in the ESP is voluntary and employees are not required to purchase securities nor are they induced to purchase securities by expectation of employment with the Company or its affiliates.

6. Fastrak's services as administrator of ESPs will principally involve:

   (a) maintaining accounts for Plan Participants which will provide information on holdings, purchases, sales, option values and vesting schedules, option exercises, dividends and asset values;

(b) maintaining an Internet website, interactive voice response facilities and a "1-800" call centre;

(c) distributing annual reports, quarterly financial statements and management proxy circulars of the applicable Company to Plan Participants;

(d) facilitating option exercises;

(e) facilitating sales of shares; and

(f) reporting to Companies and Plan Participants on a periodic basis.

7. Each Company (or its Canadian affiliate) will establish and maintain a trading account ("**ESP Account**") for and on behalf of Plan Participants with a dealer who is registered under applicable Legislation (the "**Plan Broker**"). Fastrak will have access and authority to deal with the Plan Broker regarding the ESP Account so as to permit Fastrak to perform its duties under the Administration Agreements.

8. Each Company (or its Canadian affiliate) will arrange with the Plan Broker to have payroll deductions and additional Company contributions, if applicable, delivered directly from the Company to the Plan Broker. Alternatively, Plan Participants may contribute funds directly to the Plan Broker.

9. Upon receipt of the contributed funds from the Company and/or Plan Participants, the Plan Broker will aggregate the amounts from such contributions for each designated investment period and will purchase shares in the secondary markets for and on behalf of the Plan Participants.

10. Options and shares (through option exercises or otherwise) may be issued directly by the Company from treasury to Plan Participants if the ESP so provides.

11. Shares will be registered in the name of the Company, as nominee for the Plan Participants, and will be held in the ESP Account. Plan Participants who have personal investment accounts with a broker may request, at any time, to have their ESP securities moved from the ESP Account to their personal brokerage account. Thereafter, the Plan Participant will deal directly with his or her personal broker.

12. The Company and/or the Plan Broker will communicate the number of securities issued from treasury or acquired in the secondary markets to Fastrak. Fastrak will then record these acquisitions on a *pro rata* basis for each contributing Plan Participant.

13. If and when they so desire, Plan Participants may communicate sell orders and cashless option exercises with respect to ESP securities to Fastrak by means of the Internet, interactive voice response facilities ("**IVR**") or facsimile. In addition, Fastrak will maintain a "1-800" call centre (the "**Call Centre**") to assist Plan Participants with general inquiries concerning Plan Participants' account information. Fastrak has established a policy prohibiting its customer service representatives from accepting oral sell orders from Plan Participants over the telephone. No advice will be offered or available from Fastrak to Plan Participants concerning the purchase or sale of ESP securities.

14. In respect of each Company, Fastrak will aggregate sell orders received from Plan Participants (other than Plan Participants who have elected to execute transactions through a personal broker) over a time period designated by the Company (a business day or days). At the end of the time period, Fastrak will place a single aggregate sell order with the Plan Broker for each Company. The Plan Broker will then execute sales of shares in the secondary markets for and on behalf of the Plan Participants.

15. The Plan Broker will remit the aggregate proceeds of sales (net of brokerage commissions) directly to the Plan Participants or directly into a segregated bank account maintained by Fastrak with a Canadian financial institution for each ESP, whereupon Fastrak will then remit the proceeds (net of administration fees with respect to the sale which may be charged by Fastrak to the Plan Participant or the Company in accordance with the fee arrangement between Fastrak and the Company) to each Plan Participant that placed a sell order on a *pro rata* basis.

16. Cash and non-cash dividends paid on shares acquired under ESPs will be credited to the applicable ESP Account. Subject to the terms of the Plan, cash dividends will be automatically reinvested by the Plan Broker in additional securities in the manner described above. Similarly, stock dividends and/or stock splits are deposited into each ESP account and allocated *pro rata* to each Plan Participant, where applicable. Stock rights cannot be exercised, and may be sold and the proceeds reinvested by the Plan Broker in the manner described above. An administration fee may be charged to the Company on reinvestment purchases in accordance with the fee arrangement between Fastrak and the Company.

17. If a Plan Participant ceases to be qualified to participate in an ESP, by reason of termination of employment with the Company or otherwise, such person shall cease to be a Plan Participant. Upon the occurrence of such an event and upon the

Company's instructions, Fastrak will direct the Plan Broker to transfer the former Plan Participant's securities, sell the securities, or deliver share certificates representing the securities together with a cheque for the former Plan Participant's fractional interest, if any. Administration fees and commissions, where applicable with respect to sales and/or withdrawals are typically borne by the Plan Participant.

18. Plan Participants may at all times review the real-time status of their holdings of ESP securities through Fastrak's Internet website, IVR or the Call Centre.

AND WHEREAS pursuant to the system, this MRRS Decision Document evidences the decision of each of the Decision Makers (collectively, the "**Decision**");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides each Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers pursuant to the Legislation is that the Registration Requirement shall not apply in respect of the services provided by Fastrak as administrator of ESPs and the activities of Plan Participants in connection with the provision of such services by Fastrak provided that:

(a) in connection with the administration of ESPs pursuant to an Administration Agreement, Fastrak limits its activities to those described in the representations above as being undertaken by it;

(b) the sale of securities by a Plan Participant under each ESP is made through the Plan Broker;

(c) Fastrak does not provide any advice to any Plan Participant concerning the decision to purchase or sell securities;

(d) all funds received by Fastrak from the sale of securities by a Plan Participant under an ESP are deposited promptly into a segregated bank account with a Canadian financial institution and then promptly remitted to the applicable Plan Participants net of Fastrak's fees as set out in the applicable Administration Agreement;

(e) Fastrak maintains bonding or insurance with respect to its activities in an amount of not less than $200,000;

(f) Fastrak sends to each Plan Participant a statement of account showing any debit or credit balance and the details of any securities held, purchases, sales, option values and vesting schedules, option exercises, dividends and asset values, not less than once every three months;

(g) Fastrak, in respect of each ESP for which it has entered into an Administration Agreement, maintains books and records necessary to record properly all transactions for which it is responsible pursuant to the Administration Agreement; and

(h) Fastrak provides to each Plan Participant who uses Fastrak's services in connection with an ESP a written statement which states that the Plan Participant is receiving no investment advice from Fastrak with respect to the purchase or sale of securities under the ESP and that if the Plan Participant wishes to receive investment advice in connection with the ESP then the Plan Participant should contact a broker or dealer.

February 24, 2003.

"H. Lorne Morphy" "Robert L. Shirriff"

2.1.3 Montrusco Bolton Investments Inc. - MRRS Decision

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – relief from requirement to obtain specific and informed written consent from clients once in each twelve-month period with respect to certain funds – subject to conditions.

Applicable Ontario Legislation

Ontario Regulation 1015, R.R.O. 1990, sec. 227(2)(b)(ii), 233.

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO AND NOVA SCOTIA

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM
FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
MONTRUSCO BOLTON INVESTMENTS INC.

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the **Decision Maker**) in each of Ontario and Nova Scotia (the **Jurisdictions**) has received an application from Montrusco Bolton Investments Inc. (**MBII**, the **Filer**) for a decision, pursuant to the securities legislation of the Jurisdictions (the **Legislation**), that the requirement contained in the Legislation to secure the specific and informed written consent of each of MBII's clients to the exercise of MBII's discretionary authority as portfolio manager once in each twelve-month period following the initial grant of specific and informed written consent (the **Additional Consent Requirement**) shall not apply to MBII.

AND WHEREAS under to the Mutual Reliance System for Exemptive Relief Applications (the **System**), the Ontario Securities Commission is the principal regulator for this application;

AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 Definitions;

AND WHEREAS the Filer has represented to the Decision Makers that:

1. MBII, a company incorporated under the laws of Canada having its head office at 1250 René-Lévesque West, Suite 4600, Montreal, Québec, H3B 5J5, is registered in Ontario as investment counsel, portfolio manager and limited market dealer, and in Nova Scotia as investment counsel and portfolio manager. MBII is also registered as an adviser with an unrestricted practice and a mutual fund dealer in Québec, as a portfolio manager (securities) in British Columbia, as investment counsel and portfolio manager in Alberta and New Brunswick, as investment counsel (institutional clients) in Saskatchewan, and as a broker dealer and investment counsel in Manitoba.

2. MBII manages mutual funds established under the laws of the Province of Ontario and offered by prospectus or private placement to its clients (the **Funds**). The Funds and other mutual funds or pooled fund trusts to be established by MBII or an affiliate of MBII and managed by MBII (collectively, the **Other Funds**) are considered a related issuer of MBII as defined in National Instrument 33-105 *Underwriting Conflicts*.

3. MBII currently acts as an adviser in securities of the Funds for discretionary accounts.

4. Units of each of the Funds and the Other Funds may be offered on a continuous basis and will be acquired by residents of the Jurisdictions either under a prospectus filed by the Fund or Other Fund or on an exempt distribution basis.

5. Discretionary account clients of MBII (**clients**) are provided with a Statement of Policies concerning Securities of Related and Connected Issuers when MBII begins to act as their adviser and every twelve months thereafter, which states the relationship and connection between MBII and the Funds and includes the information required by Section 223 of the Regulation. In the event of a significant change in its Statement of Policies, MBII will provide to each of its clients a copy of the revised version of, or amendment to, the Statement of Policies.

6. Clients provide MBII with their specific and informed written consent to the exercise of discretionary authority in respect of the securities of the Funds to address this potential conflict of interest when they sign a discretionary account management agreement.

7. Each client has given its specific and informed written consent to the exercise of the discretionary authority in respect of the securities upon entering into the discretionary management agreement.

8. Clients are provided by MBII with a statement of policies once within each twelve-month period after giving their specific and informed written consent.

AND WHEREAS under the System, this MRRS Decision Document evidences the decision of each of the Decision Makers (collectively, the **Decision**);

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Makers with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers pursuant to the Legislation is that MBII is exempt from the Additional Consent Requirement under the Legislation in respect of the exercise of discretionary management authority to invest in the securities of the Funds or the Other Funds set out in MBII Statement of Policies, provided MBII has secured the specific and informed consent of the client in advance of the initial exercise of discretionary authority in respect of the Funds or the Other Funds, as the case may be.

June 25, 2003.

"Paul M. Moore" "Harold P. Hands"

2.1.4 RBC Global Investment Management Inc. - MRRS Decision

Headnote

Mutual reliance review system for exemptive relief applications – Portfolio manager registrant exempted (subject to conditions) from the dealer registration requirement, in clause 25(1)(a) of the Act, for trades in shares or units of mutual funds, where: the mutual fund is managed by the registrant (or an affiliate of the registrant), the registrant is the portfolio adviser to the fund, and the trade is made to an account that is fully managed by the registrant, or an affiliate of the registrant – Portfolio manager registrant also exempted (subject to conditions) from the dealer registration requirement, in clause 25(1)(a) of the Act, for trades that consist of any act, advertisement or solicitation, directly or indirectly, in furtherance of another trade in shares or units of such mutual funds, where the other trade is a purchase or sale that is made by or through another dealer that is registered under the Act in the appropriate category of registration.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25, 74(1).

Applicable Ontario Rules

National Instrument 14-101 Definitions.
National Instrument 81-102 Mutual Funds.
Ontario Securities Commission Rule 31-506 SRO Membership - Mutual Fund Dealers.
Ontario Securities Commission Rule 45-501 Exempt Distributions.

Documents Cited

Letter Sent to The Investment Funds Institute of Canada and the Investment Counsel Association of Canada, December 6, 2000, (2000), 23 OSCB 8467.

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, ONTARIO, QUÉBEC, NEW BRUNSWICK, NOVA SCOTIA, PRINCE EDWARD ISLAND, NEWFOUNDLAND AND LABRADOR, YUKON TERRITORY, NORTHWEST TERRITORIES AND NUNAVUT

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
RBC GLOBAL INVESTMENT MANAGEMENT INC.

MRRS DECISION DOCUMENT

WHEREAS the Canadian securities regulatory authority or regulator (the "Decision Maker") in each of the Provinces of British Columbia, Alberta, Saskatchewan, Ontario, Québec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Yukon Territory, Northwest Territories and Nunavut (the "Jurisdictions") has received an application (the "Application") from RBC Global Investment Management Inc. ("RBC Global") for a decision, pursuant to the securities legislation (the "Legislation") of each Jurisdiction, that the "dealer registration requirement" (the "Dealer Registration Requirement"), as such term is defined in National Instrument 14-101 *Definitions* ("NI 14-101"), shall not apply to RBC Global, or to any officers or employees (each an "RBC Global Representative") of RBC Global acting on its behalf, in respect of any trades, in shares or units of a mutual fund (an "RBC Global Portfolio Managed Fund") that is managed by RBC Global, or an affiliate of RBC Global, and in respect of which RBC Global acts as portfolio adviser, as such term is defined in National Instrument 81-102 ("NI 81-102"), where:

(i) the trade is made by RBC Global to an RBC Global Managed Account (as defined below);

(ii) the trade is made by RBC Global to an RBC Affiliate Managed Account (as defined below); or

(iii) the trade consists of Marketing or Wholesaling Activities (as defined below);

AND WHEREAS under the Mutual Reliance Review System for Exemptive Relief Applications (the "System"), the Ontario Securities Commission is the principal regulator for this Application.

AND WHEREAS RBC Global has represented to the Decision Makers that:

1. RBC Global is registered under the Legislation of each Jurisdiction, other than Nunavut where it is pursuing registration, as an adviser in the categories of "investment counsel" and "portfolio manager" (or the equivalent) and RBC Global is registered under the Legislation of Ontario and Newfoundland as a dealer in the category of "limited market dealer".

2. RBC Global carries on business primarily as an investment counsel and portfolio manager and offers portfolio management services to persons and companies (each, an "RBC Global Portfolio Managed Client") through investment portfolio accounts (each, an "RBC Global Managed Account") under which RBC Global, pursuant to a written agreement made between RBC Global and the RBC Global Portfolio Managed Client, makes investment decisions for the account and has full discretionary authority to trade in securities for the account without obtaining the specific consent of the RBC Global Portfolio Managed Client.

3. RBC Global has certain affiliates (an "RBC Affiliate"), including RBC Private Counsel Inc. ("RBC Private Counsel"), that also carry on business as an investment counsel and portfolio manager and offer portfolio management services to persons and companies (each, an "RBC Affiliate Portfolio Managed Client") through investment portfolio accounts (each, an "RBC Affiliate Managed Account") under which the RBC Affiliate, pursuant to a written agreement made between the RBC Affiliate and the RBC Affiliate Portfolio Managed Client, makes investment decisions for the account and has full discretionary authority to trade in securities for the account without obtaining the specific consent of the RBC Affiliate Portfolio Managed Client.

4. RBC Private Counsel is registered under the Legislation of each Jurisdiction as an adviser in the categories of "investment counsel" and "portfolio manager" (or the equivalent).

5. Incidental to its principal business of portfolio management, RBC Global proposes to distribute shares or units of RBC Global Portfolio Managed Funds to RBC Global Managed Accounts and to RBC Affiliate Managed Accounts.

6. RBC Global also proposes to engage in Marketing and Wholesaling Activities in respect of RBC Global Portfolio Managed Funds. "Marketing and Wholesaling Activities" means for, RBC Global, a trade by RBC Global that consists of any act, advertisement or solicitation, directly or indirectly, in furtherance of another trade in shares or units of an RBC Global Managed Fund, and the other trade is a purchase or sale of shares or units of the RBC Global Managed Fund, that is, in each case, made by or through another dealer that is registered under the Legislation of the Jurisdiction in a category that permits that other dealer to act as a dealer for such trade.

7. In the absence of this Decision, RBC Global would have to be registered under the Legislation of each Jurisdiction as a dealer in the category of "mutual fund dealer" or "investment dealer" (or the equivalent) in order to carry out the trading activities permitted by this Decision;

8. In order to obtain registration under the Legislation of all of the Jurisdictions as a mutual fund dealer, RBC Global would be required to be a member of the Mutual Fund Dealers Association of Canada (the "MFDA").

9. The MFDA has rules that govern its membership which would have the effect of precluding RBC Global from being a member of the MFDA if it continues to conduct its principle business of acting as an investment counsel and accepting discretionary portfolio management mandates.

AND WHEREAS under the System, this MRRS Decision Document evidences the decisions of each Decision Maker (collectively, the "Decision").

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met.

THE DECISION of the Decision Makers under the Legislation is that the Dealer Registration Requirement in the Legislation shall not apply to any trades by RBC Global, in shares or units of an RBC Global Portfolio Managed Fund, made through an RBC Global Representative, to an RBC Global Managed Account,

PROVIDED THAT:

(A) RBC Global is, at the time of the trade, registered under the Legislation as an adviser in the category of "portfolio manager" (or the equivalent);

(B) if the trade is made in a Jurisdiction other than Ontario or Newfoundland, the trade is made by or at the direction of an RBC Global Representative who is, at the time of the trade, registered under the Legislation to act on behalf of RBC Global as an adviser in the category of "portfolio manager" (or the equivalent);

(C) if the trade is made in the Jurisdictions of either Ontario or Newfoundland and Labrador, RBC Global is, at the time of the trade, registered under the Legislation of the Jurisdiction as a dealer in the category of "limited market dealer", and the trade is made on behalf of RBC Global by a RBC Global Representative who is, at the time of the trade, either: (i) registered under the Legislation to act on behalf of RBC Global as an adviser in the category of "portfolio manager" (or the equivalent), or (ii) acting under the direction of such a person and is himself or herself registered under the Legislation to trade on behalf of RBC Global pursuant to its registration as a limited market dealer; and

(D) for each Jurisdiction, this Decision shall terminate one year after the coming into force, subsequent to the date of this Decision, of a rule or other regulation under the Legislation of the Jurisdiction that relates, in whole or part, to any trading by persons or companies that are registered under the Legislation as portfolio managers (or the equivalent), in securities of a mutual fund, to an account of a client, in respect of which the person or company has full discretionary authority to trade in securities for the account, without obtaining the specific consent of the client to the trade, but does not include any rule or regulation that is specifically identified by the Decision Maker for the Jurisdiction as not applicable for these purposes.

AND, IT IS THE DECISION of the Decision Makers under the Legislation of each Jurisdiction that the Dealer Registration Requirement in the Legislation shall not apply to any trades by RBC Global, in shares or units of an RBC Global Managed Fund, made through an RBC Global Representative, where:

(i) the trade is made to an RBC Affiliate Managed Account, or

(ii) the trade consists of Marketing or Wholesaling Activities,

PROVIDED THAT:

(E) in the case of each such trade referred to in paragraph (i), the corresponding RBC Affiliate having full discretionary trading authority in respect of the RBC Affiliate Managed Account is either:

(i) registered under the Legislation as an adviser in the category of "portfolio manager" (or the equivalent); or

(ii) registered under the Legislation as a dealer in the category of "investment dealer" (or the equivalent), and is authorized to act as a portfolio manager in respect of the RBC Affiliate Managed Account, pursuant to an exemption from the "adviser registration requirement", as such term as defined in National Instrument 14-101 *Definitions*, that is made available under the Legislation to dealers who are members of the Investment Dealers Association of Canada; and

(F) in the case of each trade referred to in paragraphs E (i) and (ii), if the trade is made in the Jurisdictions of either Ontario or Newfoundland and Labrador, RBC Global is, at the time of the trade, registered under the Legislation of the corresponding Jurisdiction, as a dealer in the category of "limited market dealer" and the RBC Global Representative that makes the trade on behalf of RBC Global is, at the time of the trade, registered under the Legislation of the

corresponding Jurisdiction to trade on behalf of RBC Global pursuant to its registration as a "limited market dealer".

June 11, 2003.

"Paul M. Moore" "Harold P. Hands"

2.1.5 MAXIN *Income Fund* - MRRS Decision

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – closed-ended investment trust exempt from prospectus and registration requirements in connection with the sale of units repurchased from existing unit holders pursuant to market purchase program - first trade in repurchased units deemed a distribution unless made in compliance with MI 45-102.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25, 53 and 74(1).

Multilateral Instrument Cited

Multilateral Instrument 45-102 Resale of Securities (2001), 24 OSCB 5522.

IN THE MATTER OF
SECURITIES LEGISLATION OF
BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, ONTARIO, NOVA SCOTIA, NEW BRUNSWICK, PRINCE EDWARD ISLAND, NEWFOUNDLAND AND LABRADOR AND YUKON

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
MAXIN INCOME FUND

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker") in each of British Columbia, Alberta, Saskatchewan, Ontario, Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland and Yukon (the "Jurisdictions") has received an application from MAXIN *Income Fund* (the "Trust") for a decision, pursuant to the securities legislation of the Jurisdictions (the "Legislation"), that the requirement contained in the Legislation to be registered to trade in a security and to file and obtain a receipt for a preliminary prospectus and a final prospectus (the "Registration and Prospectus Requirements") shall not apply to the distribution of units of the Trust (the "Units") which have been repurchased by the Trust pursuant to the mandatory market purchase program, the discretionary market purchase program, or by way of redemption of Units at the request of holders thereof, nor to the resale of such repurchased Units (the "Repurchased Units") which have been distributed by the Trust;

AND WHEREAS under the Mutual Reliance Review System for Exemptive Relief Applications (the "System"), the Ontario Securities Commission is the principal regulator for this application;

AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 Definitions;

AND WHEREAS the Trust has represented to the Decision Makers that:

1. The Trust is an unincorporated closed-end investment trust established under the laws of the Province of Ontario by a declaration of trust dated as of March 28, 2003 (the "Declaration of Trust").

2. The Trust is not considered to be a "mutual fund" as defined in the Legislation because the holders of Units ("Unitholders") are not entitled to receive on demand an amount computed by reference to the value of a proportionate interest in the whole or in part of the net assets of the Trust as contemplated in the definition of "mutual fund" in the Legislation.

3. The Trust became a reporting issuer or the equivalent thereof in the Jurisdictions on March 28, 2003 upon obtaining a receipt for its final prospectus dated March 28, 2003 (the "Prospectus").

4. Each Unit represents an equal, undivided beneficial interest in the net assets of the Trust and is redeemable at net asset value of the Trust ("Net Asset Value") per Unit on November 30th of each calendar year.

5. Each whole Unit is entitled to one vote at all meetings of Unitholders and is entitled to participate equally with all other Units with respect to any and all distributions made by the Trust.

6. Middlefield MAXIN Management Limited (the "Manager"), which was incorporated pursuant to the *Business Corporations Act* (Ontario) on January 29, 2003, is the manager and the trustee of the Trust.

7. The Units are listed and posted for trading on the Toronto Stock Exchange (the "TSX") under the trading symbol "MXZ.UN". As at April 15, 2003, 8,000,000 Units were issued and outstanding.

8. In order to enhance liquidity and to provide market support for the Units, pursuant to the Declaration of Trust and the terms and conditions that attach to the Units, the Trust shall, subject to compliance with any applicable regulatory requirements, be obligated to purchase (the "Mandatory Purchase Program") any Units offered in the market on a business day at the then prevailing market price if, at any time after the closing of the Trust's initial public offering pursuant to the Prospectus, the price at which Units are then offered for sale is less than 95% of the Net Asset Value per Unit determined as at the close of business in Toronto, Ontario on the immediately preceding business day, provided that:

   (a) the maximum number of Units that the Trust shall purchase in any three month period (commencing with the three month period that begins on the first day of the month following the month in which the closing of the Trust's initial public offering occurs) will be 2.50% of the number of Units outstanding at the beginning of each such three month period; and

   (b) the Trust shall not be required to purchase Units pursuant to the Mandatory Purchase Program if:

      (i) in the opinion of the Manager, the Trust lacks the cash, debt capacity or resources in general to make such purchases; or

      (ii) in the opinion of the Manager, the making of any such purchases by the Trust would adversely affect the ongoing activities of the Trust or the remaining Unitholders.

9. In addition, the Declaration of Trust provides that the Trust, subject to applicable regulatory requirements and limitations, shall have the right, but not the obligation, exercisable in its sole discretion, at any time, to purchase outstanding Units in the market at prevailing market prices (the "**Discretionary Purchase Program**"). Such discretionary purchases may be made through the facilities and under the rules of any exchange or market on which the Trust Units are listed (including the TSX) or as otherwise permitted by applicable securities laws.

10. Pursuant to the Declaration of Trust and subject to the Trust's right to suspend redemptions, Units may be surrendered for redemption (the "**Redemption Program**" and, together with the Mandatory Purchase Program and Discretionary Purchase Program, the "**Programs**") by a Unitholder at any time in the month of November of each year to the Trust's registrar and transfer agent, and each Unit properly surrendered for redemption by a Unitholder not later than 5:00 p.m. (Toronto time) on the fifth business day prior to November 30th of such year (the "**Redemption Valuation Date**") will, subject to an investment dealer finding purchasers for Units properly surrendered for redemption upon the authorization of the Unitholder and at the direction of the Trust, be redeemed by the Trust pursuant to the

Redemption Program for a price (the "**Redemption Price**") equal to the Net Asset Value of the Trust divided by the number of Units then outstanding determined as of the applicable Redemption Valuation Date.

11. A Unitholder who has surrendered Units for redemption will be paid the Redemption Price for such Units by the tenth business day following the Redemption Valuation Date.

12. Purchases of Units made by the Trust under the Programs are exempt from the issuer bid requirements of the Legislation pursuant to exemptions contained therein.

13. The Trust desires to, and the Declaration of Trust provides that the Trust shall, have the ability to sell through one or more securities dealers Repurchased Units, in lieu of cancelling such Repurchased Units and subject to obtaining all necessary regulatory approvals.

14. In order to effect sales of Repurchased Units by the Trust, the Trust intends to sell, in its sole discretion and at its option, any Repurchased Units purchased by it under the Programs primarily through one or more securities dealers and through the facilities of the TSX (or such other exchange on which the Units are then listed).

15. Repurchased Units which the Trust does not sell within ten months of the purchase of such Repurchased Units will be cancelled by the Trust.

16. Prospective Purchasers who subsequently acquire Repurchased Units will have equal access to all of the continuous disclosure documents of the Trust, which will be filed on SEDAR, commencing with the Prospectus.

17. Legislation in some of the Jurisdictions provides that a trade by or on behalf of an issuer in previously issued securities of that issuer that have been purchased by that issuer is a distribution subject to the Registration and Prospectus Requirements.

18. Legislation in some of the Jurisdictions provides that the first trade or resale of Repurchased Units acquired by a purchaser will be a distribution subject to the Registration and Prospectus Requirements unless such first trade is made in reliance on an exemption therefrom.

19. The Prospectus disclosed that the Trust may repurchase and redeem, as the case may be, Units under the Mandatory Purchase Program, the Discretionary Purchase Program and the Redemption Program and that, subject to receiving all necessary regulatory approvals, the Trust may arrange for one or more dealers to find purchasers for any Units repurchased or redeemed by the Trust.

AND WHEREAS under the System, this MRRS Decision Document evidences the decision of each of the Decision Makers (collectively, the "**Decision**");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Makers with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers pursuant to the Legislation is that the trades of Repurchased Units pursuant to the Programs shall not be subject to the Registration and Prospectus Requirements of the Legislation provided that:

(a) the Repurchased Units are sold by the Trust through the facilities of and in accordance with the regulations and policies of the TSX or the market on which the Units are then listed;

(b) the Trust complies with the insider trading restrictions imposed by securities legislation with respect to the trades of Repurchased Units;

(c) the Trust complies with the conditions of paragraphs 1 through 5 of subsection 2.8(2) of Multilateral Instrument 45-102 with respect to the sale of the Repurchased Units, other than the requirement to file interim financial statements for the period ended March 31, 2003 in the Province of British Columbia in respect of complying with the requirement contained in subsection 2.8(2)5 of Multilateral Instrument 45-102; and

(d) the first trade or resale of Repurchased Units acquired by a purchaser from the Trust in a Jurisdiction shall be deemed a distribution or primary distribution to the public under the Legislation unless the conditions of paragraphs 2 through 5 of subsection 2.6(3) of Multilateral Instrument 45-102 are satisfied, other than the requirement to file interim financial statements for the period ended March 31, 2003 in the Province of British Columbia in respect of complying with the requirement contained in subsection 2.6(3)5 of Multilateral Instrument 45-102.

July 2, 2003.

"Robert L. Shirriff" "Robert W. Korthals"

2.1.6 RBC Dominion Securities Inc. - MRRS Decision

Headnote

Mutual reliance review system for exemptive relief applications – Registered dealer exempted from the requirements of section 36 of the Act to send trade confirmations for trades that the dealer executes on behalf of customer accounts that are fully managed by the dealer, where: the customer has informed the dealer that they do not want to receive the trade confirmation for such managed account trades, the managed account trades are included in the services for which the customer pays a "wrap fee", and the dealer sends to the customer a statement of account (not less than once a month) that includes certain of the information that would be otherwise be required to be included in the trade confirmation.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 36 and 147.

Applicable Ontario Regulations

Regulation made under the Securities Act, R.R.O. 1990, Reg. 1015, as amended, s. 123.

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA, QUEBEC, ONTARIO, NEW BRUNSWICK, NOVA SCOTIA, NEWFOUNDLAND AND LABRADOR, YUKON TERRITORY, NORTHWEST TERRITORIES, AND NUNAVUT

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
RBC DOMINION SECURITIES INC., RBC GLOBAL INVESTMENT MANAGEMENT INC. AND RBC PARAMETERS PORTFOLIOS PROGRAM

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker"), in each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia, Newfoundland and Labrador, the Yukon Territory, Northwest Territories and Nunavut (collectively, the "Jurisdictions") has received an application (the "Application") from RBC Dominion Securities Inc. ("RDC DS") for a decision under the securities legislation (the "Legislation") of each Jurisdiction that the provisions (the "Trade Confirmation Requirement") contained in the Legislation that require a registered dealer, who has acted as principal or agent in connection with a trade in a security, to promptly send or deliver to the customer a written confirmation (a "Trade Confirmation") of the transaction, setting forth certain information specified in the Legislation, shall not apply to RBC DS in respect of trades (a "Managed Account Trade") where the customer (a "Customer") has a Managed Account (as defined below) with RBC DS under a portfolio management program (the "Program") operated by RBC DS and known as the "RBC Parameters Portfolio Program" and the trade is made for the Managed Account;

AND WHEREAS pursuant to the Mutual Reliance Review System for Exemptive Relief Applications (the "System"), the Ontario Securities Commission is the principal regulator for this application;

AND WHEREAS RBC DS has represented to the Decision Makers that:

1. RBC DS is a corporation incorporated under the laws of Canada and has its head office in Toronto, Ontario.

2. RBC DS is registered under the legislation of each Jurisdiction as a dealer in the category of "investment dealer" (or the equivalent), and is authorized to act as an adviser, pursuant to an exemption from the "adviser registration requirement" (as defined in National Instrument 14-101 – Definitions) that is made available under the Legislation of each Jurisdiction to dealers who are members of the Investment Dealers Association of Canada (the "IDA").

3. RBC DS provides both discretionary managed and non-discretionary advisory services to individuals, corporations and other entities seeking wealth management or related services.

4. RBC DS intends to offer the Program through its network of branches across Canada. Under the Program, RBC DS will act as portfolio manager for Customers who desire certain discretionary managed services ("Managed Services") from RBC DS through an investment portfolio account ("a Managed Account") under which RBC DS, pursuant to a written agreement ("Customer Agreement") made between RBC DS and the Customer, makes investment decisions for the account and has full discretionary authority to trade in securities for the account without obtaining the specific consent of the Customer to the trade.

5. The Program is subject to Investment Dealers Association Regulation 1300 "Supervision of Accounts" and, in each Jurisdiction, all adviser activities in respect of the Managed Account will be provided by employees of RBC DS who meet the proficiency requirements of a portfolio manager or associate portfolio manager under the Legislation of the Jurisdiction.

6. For each Customer, the Managed Services will be described in the Customer Agreement and will include the following services (the "Wrap Services") for which the Customer will pay to RBC DS a fixed percentage "wrap" fee (the "Wrap Fee"): investment research, portfolio selection and management with respect to all securities or other assets in the Managed Account, custody, reporting, and trade execution. The Wrap Fee will be calculated on the basis of assets under administration in the Managed Account and will not depend upon the number of transactions effected on behalf the Managed Account (i.e., no trading commission will be charged to the Managed Account).

7. Each Managed Account will hold a portfolio (the "Managed Account Portfolio") that will typically consist of a basket of securities (the "RBC Parameters Portfolio") that will, from time to time, be selected by RBC DS using one or more Guided Portfolio Lists prepared for internal use by RBC DS. Each Managed Account Portfolio will be determined on the basis of an RBC Parameters Portfolio, unless the Customer has instructed RBC DS to exclude from their Managed Account securities of a specific industry classification or other specific securities, or, RBC DS otherwise determines, in its discretion, that the content of the Managed Account Portfolio should differ from that suggested by the corresponding RBC Parameters Portfolio.

8. Under the Program:

   (a) RBC DS will identify the investment objective and risk tolerance for each Customer and determine the appropriate RBC Parameters Portfolio to be used by RBC DS in connection with its selection of securities or other assets to comprise the Managed Account Portfolio of the Customer;

   (b) RBC DS will be authorized by the Customer in the Customer Agreement to retain RBC Global Investment Management Inc. (as "RBC GIM") to determine which securities will be held in a particular RBC Parameters Portfolio and to act as the agent for RBC DS in respect of the Managed Account by performing investment research, security selection and portfolio management functions in respect of all securities or other assets in the Managed Account; and

   (c) the Customer will have no contractual relationship with RBC GIM, but RBC DS will be responsible to the Customer for all activities of RBC GIM in respect of the Managed Account of the Customer.

9. Except for Nunavut where it is pursuing such registration, RBC GIM is registered under the Legislation of each Jurisdiction as an adviser in the category of "investment counsel" and "portfolio manager" (or the equivalent).

10. Under the Program, RBC DS will send to the Customer of each Managed Account:

   (a) not less than once every three months, a performance report for the Managed Account; and

   (b) not less than once a month, a statement of account (a "Statement of Account") for the Managed Account which identifies the assets of the Customer being managed on behalf of the Customer through the Managed Account, and includes, for each Managed Account Trade made during the period, the information which RBC DS would otherwise have been required to include in a written confirmation of the Managed Account Trade that was sent or delivered in accordance with the Trade Confirmation Requirement, except for the following information (which will be maintained by RBC DS in its books and records and made available to the Customer upon request):

      (i) where RBC DS acted as agent, the name of the person or company from, to or through whom the security was bought or sold;

      (ii) the date name of the stock exchange, if any, upon which the transaction took place; and

      (iii) the name of the salesperson, if any, in the transaction.

11. Customers paying a fixed percentage fee for a discretionary managed service, such as the Program, have advised RBC DS that they would prefer not to receive Trade Confirmations for Managed Account Trades.

12. There will be no impact on fees or expenses to be paid by a Customer resulting from the Customer instructing RBC DS that the Customer does not wish to receive Trade Confirmations for Managed Account Trades.

AND WHEREAS pursuant to the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the "Decision");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that

provides the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers pursuant to the Legislation is that RBC DS shall not be subject to the Trade Confirmation Requirement for any Managed Account Trade, provided that:

(A) the Customer has previously informed RBC DS that the Customer does not wish to receive Trade Confirmations for Managed Account Trades; and

(B) in the case of each such Managed Account Trade, RBC DS sends to the Customer the corresponding Statement of Account, that includes the information for the Managed Account Trade, referred to in paragraph 10(b), above.

May 21, 2003.

"Harold P. Hands" "Robert W. Korthals"

2.1.7 Mansfield Trust/Fiducie Mansfield - MRRS Decision

Headnote

Mutual Reliance Review System – previous order provided that issuer of asset-backed securities exempt from the requirement to prepare, file and deliver interim and annual financial statements and annual information circulars or, where applicable, annual reports in lieu of an information circular subject to conditions, including the requirement to prepare, file and deliver monthly and annual reports regarding performance of pools of securities assets – previous order revoked and replaced.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 77, 78, 79, 80(b)(iii), 81(2), and 144.

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA, ONTARIO, QUEBEC, NOVA SCOTIA AND NEWFOUNDLAND AND LABRADOR

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
MANSFIELD TRUST/FIDUCIE MANSFIELD

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the Decision Maker) in each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia and Newfoundland and Labrador (collectively, the Jurisdictions) issued on November 28, 2001 a decision (the Previous Decision) pursuant to the securities legislation of the Jurisdictions (the Legislation) that Mansfield Trust/Fiducie Mansfield (the Issuer) is exempted, on certain terms and conditions, from the requirements of the Legislation concerning the preparation, filing and delivery of interim and annual financial statements and the annual filing of an information circular or, where applicable, a report in prescribed form in lieu thereof, and the preparation of an information circular, where management of the Issuer solicits proxies of holders of "voting securities" (the Disclosure Requirements) in connection with certain commercial mortgage pass-through certificates;

AND WHEREAS each Decision Maker has received an application from the Issuer for a decision under the Legislation that the Previous Decision be varied to not require that the Issuer on a quarterly basis, publish in newspapers a notice setting forth certain reporting

requirements in respect of the Certificates, where such reports are located and that upon request paper copies will be delivered by ordinary mail, as described in paragraph 17 of the Previous Decision;

AND WHEREAS pursuant to the Mutual Reliance Review System for Exemptive Relief Applications (the System), the Ontario Securities Commission is the Principal Regulator for this application;

AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 — Definitions or in Quebec Commission Notice 14-101;

AND WHEREAS the Issuer has represented to the Decision Makers that:

1. The Issuer is a special purpose trust which was established by The Trust Company of Bank of Montreal (the Issuer Trustee) under the laws of Ontario pursuant to a declaration of trust dated as of May 24, 2001, the beneficiary of which is a registered charity. The only security holders of the Issuer will be holders of its asset-backed securities (the Certificateholders).

2. The Issuer Trustee is located in Toronto, Ontario and the head office of Sun Life Assurance Company of Canada, the administrative agent of the Trust, is located in Toronto, Ontario.

3. The Issuer filed a short form prospectus (the Prospectus) dated July 17, 2001 with each of the Canadian provincial securities regulatory authorities for the issuance of approximately $253,300,000 aggregate principal amount of Commercial Mortgage Pass-Through Certificates Series 2001-1 (the Certificates) and received receipts for such prospectus from each of the Canadian provincial securities regulatory authorities.

4. The Issuer is a reporting issuer, or the equivalent, in each of the provinces and territories of Canada that provides for a reporting issuer regime and to its knowledge is currently not in default of any applicable requirements under the securities legislation thereunder.

5. The Issuer is a special-purpose trust and does not carry on any activities other than issuing asset-backed securities and purchasing assets in connection thereto (the Assets).

6. The Issuer has no material assets or liabilities other than its rights and obligations arising from acquiring Assets and in respect of the Certificates.

7. On November 28, 2001, the Decision Makers issued the Previous Decision.

8. To the knowledge of the Trust's Administrative Agent, no Certificateholder has requested paper copies of the reports referenced in paragraph 17 of the Previous Decision.

9. In the past few years, the Canadian market for asset-backed securities has matured and investors have become familiar with the types of reports to which holders of such securities are entitled and where such reports are available.

10. The Prospectus advises investors that certain reports will be available on the website of the reporting agent appointed by the Issuer in connection with the Certificates and on SEDAR, and provides the web address in respect of both, and that upon request paper copies will be delivered by ordinary mail.

11. Except as otherwise stated in this application, all of the factual statements concerning the Issuer contained in the Previous Decision remain true as of, and as if made on, the date hereof.

AND WHEREAS pursuant to the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the Decision);

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers pursuant to the Legislation is that the Previous Decision be varied by:

(a) deleting in its entirety paragraph 17 of the Previous Decision and substituting therefor the following:

"The Issuer will advise investors in the relevant short form prospectus under which any Additional Certificates are offered, that the monthly information prescribed in paragraph 13 hereof, the quarterly information prescribed in paragraph 18 hereof and the annual information prescribed in paragraph 19 hereof is available on the Reporting Agent's website and on SEDAR, and provide the website address in respect of both, and that Certificateholders may request that paper copies of such reports be provided to them by ordinary mail."

(b) deleting in its entirety paragraph 21 of the Previous Decision and substituting therefor the following:

"The provision of information to Certificateholders on a monthly, quarterly and annual basis as described in

paragraphs 13, 18 and 19 hereof, as well as the annual notices to be given by the Issuer as to availability of such information given pursuant to paragraph 16 hereof, will meet the objectives of allowing the Certificateholders to monitor and make informed decisions about their investments"; and

(c) deleting in its entirety the Decision of the Previous Decision and substituting therefor the following:

"*THE DECISION* of the Decision Makers pursuant to the Legislation is that the Issuer is exempted from the requirements of the Legislation concerning the preparation, filing and delivery of interim and annual financial statements and annual report, where applicable, and the annual filing of an information circular or, where applicable, a report in prescribed form in lieu thereof, and the preparation of an information circular, where management of the Issuer solicits proxies of holders of "voting securities" in respect of a meeting of which notice has or will be given, in connection with the Certificates and Additional Certificates, provided that:

(i) the Issuer complies with paragraphs 13, 16, 17, 18, 19 and 20 hereof; and

(ii) the exemption from the requirements of the Legislation concerning the annual filing of an information circular or, where applicable, a report in lieu thereof, shall terminate sixty days after the occurrence of a material change in any of the representations of the Issuer contained in paragraphs 5 through 9 inclusive, unless the Issuer satisfies the Decision Makers that the exemption should continue."

June 7, 2003.

"Paul M. Moore" "H. Lorne Morphy"

2.1.8 Great-West Lifeco Inc. - MRRS Decision

Headnote

Mutual reliance review system for exemptive relief application – Exemptions from dealer registration requirement in clause 25(1)(a) of the Act to permit the operation by a trust company of an assisted sales program, whereby program participants transmit sales orders for shares to trust company for subsequent execution through appropriately registered dealers – Shares are replacement securities to be received by participants in substitution for shares of another issuer that were previously received by the participants on the demutualization of a life insurance company and covered by a similar assisted sales program.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25, 74(1).

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA, ONTARIO, QUÉBEC, NEW BRUNSWICK, PRINCE EDWARD ISLAND, NOVA SCOTIA, NEWFOUNDLAND AND LABRADOR, THE YUKON TERRITORY, THE NORTHWEST TERRITORIES AND THE NUNAVUT TERRITORY

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
GREAT-WEST LIFECO INC.

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker") in each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, Prince Edward Island, Nova Scotia, Newfoundland and Labrador, the Yukon Territory, the Northwest Territories and the Nunavut Territory (collectively, the "Jurisdictions") has received an application from Great-West Lifeco Inc. ("Lifeco") for a decision pursuant to the securities legislation of the Jurisdictions (the "Legislation") that the requirement (the "Dealer Registration Requirement") contained in the Legislation, that prohibits a person or company from trading in a security unless the person or company is registered in the appropriate category of registration under the Legislation, shall not apply to Lifeco, Computershare Trust Company of Canada ("Computershare"), as administrator to the Lifeco Program (as hereinafter defined) or Program Participants (as hereinafter defined) in respect of any trades of Lifeco Common Shares or Lifeco Preferred Shares (each, as hereinafter defined) through

Computershare and the Lifeco Assisting Dealers (as hereinafter defined) under the Lifeco Program;

AND WHEREAS pursuant to the Mutual Reliance Review System for Exemptive Relief Applications (the "System"), the Manitoba Securities Commission is the principal regulator for this application;

AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 Definitions or in Québec Commission Notice 14-101;

AND WHEREAS Lifeco has represented to the Decision Makers that:

1. Lifeco and Canada Life Financial Corporation ("CLFC") entered into a transaction agreement made as of February 14, 2003 (the "Transaction Agreement") providing for the acquisition of all of the common shares of CLFC ("CLFC Common Shares") by Lifeco (the "Transaction") to be effected by way of a reorganization of CLFC's capital involving the change of the CLFC Common Shares into a new class of exchangeable shares of CLFC (the "Exchangeable Shares") and the automatic transfer of the Exchangeable Shares to Lifeco for a combination of up to 24,000,000 4.80% Non-Cumulative First Preferred Shares, Series E of Lifeco ("Lifeco Series E Shares"), up to 8,000,000 5.90% Non-Cumulative First Preferred Shares, Series F of Lifeco ("Lifeco Series F Shares" and together with the Lifeco Series E shares, the "Lifeco Preferred Shares") and up to 55,958,505 common shares of Lifeco ("Lifeco Common Shares") to be issued by Lifeco, as well as cash, through a series of transactions to holders of CLFC Common Shares all as more particularly described in paragraph 7.

2. Lifeco is a company incorporated under the *Canada Business Corporations Act* and is a reporting issuer under the Legislation. To its knowledge, Lifeco is not in default of any applicable requirement of the Legislation. Lifeco's registered office is located at 100 Osborne Street North, Winnipeg, Manitoba R3C 3A5.

3. The authorized share capital of Lifeco consists of an unlimited number of Lifeco Common Shares, an unlimited number of first preferred shares, issuable in series ("First Preferred Shares"), an unlimited number of Class A preferred shares, issuable in series ("Class A Preferred Shares"), and an unlimited number of second preferred shares, issuable in series. As at May 31, 2003, there were outstanding, (a) 365,249,883 Lifeco Common Shares; (b) 4,000,000 First Preferred Shares, Series C; (c) 8,000,000 First Preferred Shares, Series D; and (d) 5,192,242 Class A Preferred Shares, Series 1. The Lifeco Common Shares, First Preferred Shares, Series C, First Preferred Shares, Series D and Class A Preferred Shares, Series 1 are traded on the Toronto Stock Exchange (the "TSX").

4. CLFC is an insurance company incorporated under the *Insurance Companies Act* (Canada) and is a reporting issuer under the Legislation. To its knowledge, CLFC is not in default of any applicable requirement of the Legislation. CLFC's registered office is located at 330 University Avenue, Toronto, Ontario M5G 1R8.

5. The authorized share capital of CLFC consists of an unlimited number of CLFC Common Shares and an unlimited number of non-voting preferred shares, issuable in series ("CLFC Preferred Shares"). As of May 31, 2003, there were 160,402,435 CLFC Common Shares and 6,000,000 CLFC Preferred Shares issued and outstanding. The CLFC Preferred Shares are currently listed and posted for trading on the TSX and the CLFC Common Shares are currently listed and posted for trading on the TSX and the New York Stock Exchange.

6. Computershare is the registrar and transfer agent for the Lifeco Common Shares, First Preferred Shares, Series C, First Preferred Shares, Series D, Class A Preferred Shares, Series I, CLFC Common Shares and CLFC Preferred Shares. Computershare will also be the registrar and transfer agent for the Lifeco Preferred Shares to be issued under the Transaction.

7. The reorganization of CLFC's capital will consist of the following:

   (a) an amendment to the by-laws of CLFC to create the Exchangeable Shares, which will rank junior to the CLFC Preferred Shares and equal to the CLFC Common Shares;

   (b) an amendment to the by-laws of CLFC to change the CLFC Common Shares, other than those beneficially owned by Lifeco or its subsidiaries that have not been allocated to a segregated or other investment fund established and maintained by any of such subsidiaries, into Exchangeable Shares at the closing date on the basis of one Exchangeable Share for each CLFC Common Share; and

   (c) each Exchangeable Share, other than those held by CLFC shareholders who validly exercise their dissent rights, will be automatically transferred to Lifeco at the closing date in exchange for any of $44.50 in cash, 1.78 Lifeco Series E Shares, 1.78 Lifeco Series F Shares, 1.1849 Lifeco Common Shares or a combination of the foregoing (subject in

each case to election and proration based on a specified maximum number of shares and amount of cash to be issued or paid) and subject to customary anti-dilution provisions.

8. The Transaction has been voted on and approved by holders of CLFC Common Shares at a special meeting held on May 5, 2003. Subject to the satisfaction or waiver of all closing conditions and obtaining all applicable regulatory approvals, it is anticipated that the Transaction will close on July 10, 2003.

9. In connection with the demutualization ("Demutualization") of Canada Life Assurance Company ("Canada Life"), CLFC established an assisted sales program (the "Program") to be administered by Montreal Trust Company of Canada ("Montreal Trust" now operating as Computershare) to facilitate the ownership and transfer of CLFC Common Shares received by certain insurance policyholders of Canada Life on completion of Demutualization.

10. Under the Program, participating eligible policyholders who received CLFC Common Shares on Demutualization ("Program Participants") hold their shares through Computershare as nominee and are able to sell those shares on the TSX simply by contacting Computershare, the administrator of the Program, through written instructions or by telephone. Computershare established an account with a registered dealer (the "Assisting Dealer") and, through the Assisting Dealer, arranges to sell Program Participants' CLFC Common Shares and remit the proceeds, less applicable fees, to Program Participants. The Program was only offered to Program Participants and only in respect of CLFC Common Shares received by them on Demutualization.

11. Under the Program, only sell orders at the market price are accepted by Computershare and no advice regarding the decision to sell or hold the CLFC Common Shares is offered to any Program Participant. Program Participants may not sell less than all of their CLFC Common Shares held under the Program, but any Program Participant who wishes to sell their CLFC Common Shares in another manner (for example, by transferring their holdings to another dealer with whom they have a brokerage relationship) is free to do so. Material distributed to Program Participants regarding the Program does not contain any advice as to the desirability of selling or holding the CLFC Common Shares. Neither Canada Life nor CLFC subsidizes the costs of selling CLFC Common Shares under the Program. Program Participants are not required to pay commissions on the sale of their shares through the Program, but are required to pay a flat fee (currently CDN$25.00) to Computershare for each sale of CLFC Common Shares under the Program. The Assisting Dealer does not open individual accounts or engage in "know your client" procedures with respect to individual Program Participants using the Program.

12. In connection with the establishment of the Program, CLFC, Canada Life, Montreal Trust and the Program Participants applied for and were granted relief pursuant to a decision dated July 8, 1999 by the Decision Makers in each Jurisdiction (other than Québec) from the registration requirements in respect of trades in CLFC Common Shares under the Program.

13. Canada Life, CLFC and Montreal Trust also obtained a decision document dated October 27, 1999 containing an extract of the minutes of a meeting held by the Commission des valeurs mobilières du Québec on July 12, 1999, pursuant to which the Commission des valeurs mobilières du Québec under Section 263 of *Securities Act* (Québec), granted relief from the registration requirements in connection with the establishment and administration of the Program.

14. Upon completion of the Transaction, Program Participants will no longer hold any CLFC Common Shares and the Program will, as a result, terminate. However, pursuant to the Transaction, Program Participants may receive Lifeco Common Shares and/or Lifeco Preferred Shares.

15. It is proposed that Lifeco continue to offer an assisted sales program (the "Lifeco Program"). It is proposed that Program Particpants, upon receiving Lifeco Common Shares and/or Lifeco Preferred Shares pursuant to the Transaction, have their Lifeco Common Shares and/or Lifeco Preferred Shares registered in the name of Computershare and be automatically enrolled in the Lifeco Program on substantially the same terms as under the Program.

16. Under the Lifeco Program, Program Participants who receive Lifeco Common Shares and/or Lifeco Preferred Shares pursuant to the Transaction will be able to sell such shares by contacting Computershare, the administrator of the Lifeco Program. Computershare will establish an account with one or more registered dealers (the "Lifeco Assisting Dealers") and will, through the Lifeco Assisting Dealers, arrange to sell Program Participants' Lifeco Common Shares and/or Lifeco Preferred Shares obtained as a result of the Transaction and remit the proceeds to the Program Participants, less applicable fees. The Lifeco Program will only be extended to Program Participants and only in respect of Lifeco Common Shares and/or Lifeco Preferred Shares received pursuant to the Transaction in substitution for

CLFC Common Shares received upon Demutualization.

17. Under the Lifeco Program, only sell orders will be accepted by Computershare and no advice regarding the decision to sell or hold the Lifeco Common Shares and/or Lifeco Preferred Shares will be offered to a Program Participant. Program Participants wishing to sell their Lifeco Common Shares will not be able to sell less than all of their Lifeco Common Shares held under the Lifeco Program and Program Participants wishing to sell either series of Lifeco Preferred Shares will not be able to sell less than all of the applicable series of Lifeco Preferred Shares held under the Lifeco Program. However, any Program Participant who wishes to sell its Lifeco Common Shares and/or Lifeco Preferred Shares in another manner (for example, by transferring its holdings to another dealer with whom it has a brokerage relationship) will be free to do so. Any material distributed to Program Participants regarding the Lifeco Program will not contain any advice as to the desirability of selling or holding the Lifeco Common Shares and/or the Lifeco Preferred Shares. Lifeco will not subsidize the cost of selling Lifeco Common Shares and/or Lifeco Preferred Shares under the Lifeco Program. Program Participants will not be required to pay commissions on the sale of their shares through the Lifeco Program, but will be required to pay a flat fee to Computershare for each sale of Lifeco Common Shares and/or Lifeco Preferred Shares under the Lifeco Program (expected to be approximately $35.00). The Assisting Dealers will not open individual accounts or engage in "know your client" procedures with respect to individual Program Participants using the Lifeco Program. At any time a Program Participant in the Lifeco Program may transfer their Lifeco Common Shares and/or Lifeco Preferred Shares to a stock broker or obtain share certificates representing such shares at no cost to such Program Participant.

AND WHEREAS pursuant to the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the "Decision");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers under the Legislation is that the Dealer Registration Requirement shall not apply to Lifeco, Computershare, as administrator under the Lifeco Program, or Program Participants in respect of:

(a) the placing of unsolicited orders ("Sale Orders") with Computershare by Program Participants to sell Lifeco Common Shares and/or Lifeco Preferred Shares in accordance with the Lifeco Program; or

(b) the execution by Computershare of the Sale Orders through the Lifeco Assisting Dealers, in accordance with the Lifeco Program,

PROVIDED THAT:

(i) Computershare is, at the relevant time, appropriately licensed or otherwise legally authorized to carry on the business of a trust company in the Jurisdiction; and

(ii) for the purposes of this MRRS Decision Document, Sale Order shall not be considered "solicited" by reason of Lifeco or Computershare, on behalf of Lifeco, distributing to Program Participants disclosure documents, notices, brochures, or similar documents advising of the availability of Computershare to facilitate sales of Lifeco Common Shares and/or Lifeco Preferred Shares or by reason of Lifeco and/or Computershare advising Program Participants of the availability, and informing Program Participants of the details of the operation, of the Lifeco Program in response to enquiries from Program Participants by telephone or otherwise.

July 4, 2003.

"Doug Brown"

2.1.9 Counsel Corporation - MRRS Decision

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – issuer bids – convertible debentures – debentures convertible into common shares at a conversion price far in excess of current value of common shares – conversion feature of no material value – debentures trade like non-convertible, subordinated, unsecured debt – convertible debentures are out-of-the-money – circular to include summary of opinion letter on convertibility feature – applicant exempt from valuation requirement.

Applicable Rule

61-501 – Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions, ss. 3.3, 3.4, and 9.1.

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO, ALBERTA, BRITISH COLUMBIA, MANITOBA, NEWFOUNDLAND AND LABRADOR, NOVA SCOTIA, QUEBEC AND SASKATCHEWAN

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM
FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
COUNSEL CORPORATION

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker") in each of Ontario, Alberta, British Columbia, Manitoba, Newfoundland and Labrador, Nova Scotia, Quebec and Saskatchewan (the "Jurisdictions") has received an application (the "Application") from Counsel Corporation ("Counsel") for a decision under the securities legislation of the Jurisdictions (the "Legislation") that the requirement contained in the Legislation to obtain a formal valuation (the "Formal Valuation Requirement") of the 6% Convertible Subordinated Debentures due October 31, 2003 (the "Debentures") shall not apply to Counsel in connection with its proposed offer (the "Offer") to acquire its outstanding Debentures;

AND WHEREAS under the Mutual Reliance Review System for Exemptive Relief Applications (the "System"), the Ontario Securities Commission is the principal regulator for this Application;

AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 Definitions or in Quebec Commission Notice 14-101;

AND WHEREAS Counsel has represented to the Decision Makers that:

1. Counsel is governed by the *Business Corporations Act* (Ontario). Its head office is located in Toronto, Ontario.

2. Counsel is a reporting issuer or the equivalent in each Jurisdiction and is not in default of any requirements of the Legislation in the Jurisdictions.

3. Counsel's authorized capital consists of an unlimited number of preferred shares and an unlimited number of common shares (the "Common Shares"). As at June 2, 2003 there were no preferred shares outstanding and 20,965,972 Common Shares were issued and outstanding.

4. The Common Shares are listed for trading on The Toronto Stock Exchange (the "TSX") and The Nasdaq SmallCap Market and the Debentures are listed for trading on the TSX.

5. As at June 2, 2003, Counsel had outstanding US$41,566,000 of the Debentures.

6. The Debentures were issued under a trust indenture (the "Indenture") dated as of October 31, 1996.

7. The Debentures are unsecured and are convertible at the holder's option into Common Shares at any time prior to the earlier of October 31, 2003 and the last business day immediately preceding the date specified for redemption. Originally, the Debentures were convertible at a price of US$13.875 per Common Share. On June 8, 1999, Counsel declared a special dividend of C$1.50 per Common Share (the "Special Dividend") to holders of Common Shares of record as at July 12, 1999. As a result of the Special Dividend, the conversion price for the Debentures was adjusted from US$13.875 to US$11.726 effective July 20, 1999 (the "First Adjustment Date").

8. On April 30, 2000, Counsel paid a dividend in kind which resulted in a further reduction of the conversion price for the Debentures to US$11.472, effective April 30, 2000 (the "Second Adjustment Date"). All other attributes of the Debentures remain unchanged.

9. Over the twelve-month period immediately preceding June 2, 2003, the Common Shares have traded on the TSX in a range between C$2.15 and C$3.70 per Common Share.

10. On July 19, 1999, the last trading day before the First Adjustment Date on which the Debentures were traded, the closing price of the Debentures on the TSX was US$780.00 per US$1,000 principal amount.

11. On April 20, 2000 the last trading day before the Second Adjustment Date on which the Debentures were traded, the closing price of the Debentures on the TSX was US$680.00 per US$1,000 principal amount.

12. On June 2, 2003, the closing price of the Debentures on the TSX was US$620.00 per US$1,000 principal amount of Debentures.

13. Over the twelve-month period immediately preceding June 2, 2003, the Debentures traded on the TSX on only 108 out of the 252 trading days, with an average daily trading price of US$679.86 on the days traded, and a price range per US$1,000 principal amount of US$610.00 to US$795.00.

14. Since November 1, 2001, Counsel has been entitled to redeem the Debentures at any time at par plus accrued and unpaid interest.

15. The Indenture provides that Counsel may purchase any or all of the Debentures at any time when Counsel is not in default under the Indenture. Counsel is not in default under the Indenture.

16. On December 12, 2002, Counsel filed and the TSX accepted a Notice of Intention to Make a Normal Course Issuer Bid (the "Notice"). Pursuant to the Notice, Counsel may acquire through the TSX's facilities up to a maximum of US$2,128,050 of the outstanding Debentures, representing approximately 5% of the principal amount of Debentures outstanding as at December 9, 2002. Pursuant to the Notice, as of June 2, 2003, the Applicant has acquired through the TSX's facilities:

    (a) Between February 26, 2003 and April 9, 2003 US$109,000 principal amount of the Debentures at a price of US$692.00 per US$1,000 principal amount.

    (b) Between April 16, 2003 and April 23, 2003 US$100,000 principal amount of the Debentures at a price of US$682.40 per US$1,000 principal amount.

    (c) Between May 14, 2003 and May 16, 2003 US$14,000 principal amount of the Debentures at a price of US$620.00 per US$1,000 principal amount.

    (d) On May 26, 2003 US$772,000 principal amount of the Debentures at a price of US$625.00 per US$1,000 principal amount.

17. Counsel proposes to make the Offer for its outstanding Debentures. The Offer will be an "issuer bid" within the meaning of the Legislation in the Jurisdictions because the Debentures are convertible debt securities. No purchases will be made under the Notice from the date the intention to make the Offer is publicly announced to the completion of the Offer.

18. In a letter (the "Opinion Letter") dated May 22, 2003, BMO Nesbitt Burns ("BMO NB") advised Counsel that, in BMO NB's opinion:

    (i) the Debenture holders' conversion option is of no material value, and

    (ii) the Debentures trade on the TSX like non-convertible, subordinated, unsecured debt.

19. The Offer will be made in compliance with the requirements in the Legislation applicable to formal bids made by issuers, except to the extent exemptive relief is granted by the Decision Makers.

20. The issuer bid circular provided to holders of the Debentures in connection with the Offer will include a summary of the Opinion Letter.

AND WHEREAS under the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the "Decision");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers under the Legislation is that the requirement contained in the Legislation to comply with the Formal Valuation Requirement shall not apply to Counsel provided that Counsel complies with the other requirements in the Legislation applicable to formal bids made by issuers.

July 4, 2003.

"Ralph Shay"

2.2 Orders

2.2.1 YBM Magnex International Inc. et al. - ss. 127 and 127.1

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

AND

IN THE MATTER OF
YBM MAGNEX INTERNATIONAL INC.
HARRY W. ANTES
JACOB G. BOGATIN
KENNETH E. DAVIES
IGOR FISHERMAN
DANIEL E. GATTI
FRANK S. GREENWALD
R. OWEN MITCHELL
DAVID R. PETERSON
MICHAEL D. SCHMIDT
LAWRENCE D. WILDER
GRIFFITHS MCBURNEY & PARTNERS
NATIONAL BANK FINANCIAL CORP.
(formerly known as First Marathon Securities Limited)

ORDER
(Sections 127 and 127.1)

WHEREAS on November 1, 1999, the Commission issued a Notice of Hearing pursuant to section 127 of the *Securities Act* (the Act) in respect of YBM Magnex International Inc., Harry W. Antes, Jacob G. Bogatin, Kenneth E. Davies, Igor Fisherman, Daniel E. Gatti, Frank S. Greenwald, R. Owen Mitchell, David R. Peterson, Michael D. Schmidt, Lawrence D. Wilder, Griffiths McBurney & Partners and National Bank Financial Corp. (formerly known as First Marathon Securities Limited) (collectively the Respondents);

AND WHEREAS staff of the Commission advised the Respondents and the Commission that they would be seeking costs in this matter pursuant to section 127.1 of the Act;

AND WHEREAS the Commission conducted a hearing into this matter on: May 7-11 and 16-17, 2001; June 11, 18 and 20, 2001; July 9-12, 16-19, 23-26 and 30-31, 2001; August 1-2, 13-15 and 27-30, 2001; October 29-30, 2001; November 2, 6-8 and 13-16, 2001; December 4, 6-7 and 13-14, 2001; January 8, 10-11, 15 and 25, 2002; February 5, 8, 12 and 14-15, 2002; March 5, 7, 8, 19, 21-22, 25-26 and 28, 2002; April 1-5, 8-9, 12, 16-17, 22-26 and 29-30, 2002; May 1-3, 6-7 and 28-30, 2002; June 10, 17, 19, 24 and 26, 2002; August 6-8, 12-14, 19, 21-22, 27 and 29, 2002; and November 18-22 and 25, 2002;

AND WHEREAS on May 28, 2002, the Commission considered and approved a settlement agreement between staff of the Commission and Lawrence D. Wilder;

AND WHEREAS the Commission is satisfied that YBM Magnex International Inc., Jacob G. Bogatin, Igor Fisherman, R. Owen Mitchell, Kenneth E. Davies, Harry W. Antes, National Bank Financial Corp. and Griffiths McBurney & Partners have not complied with Ontario securities law and have not acted in the public interest;

AND WHEREAS the Commission is of the opinion that it is in the public interest to make this order;

AND WHEREAS the Commission is of the opinion that orders for costs pursuant to section 127.1 of the Act are appropriate;

IT IS HEREBY ORDERED, effective July 2, 2003, that:

1. in respect of **YBM Magnex International Inc.**, pursuant to paragraph 2 of subsection 127(1) of the Act, trading in any securities of YBM Magnex International Inc. cease permanently;

2. in respect of **Jacob G. Bogatin**, pursuant to paragraph 8 of subsection 127(1) of the Act, Bogatin be permanently prohibited from becoming or acting as a director or officer of any issuer;

3. in respect of **Igor Fisherman**, pursuant to paragraph 8 of subsection 127(1) of the Act, Fisherman be permanently prohibited from becoming or acting as a director or officer of any issuer;

4. in respect of **R. Owen Mitchell**:

   (a) pursuant to paragraph 7 of subsection 127(1) of the Act, Mitchell resign any positions that he holds as a director or officer of a reporting issuer;

   (b) pursuant to paragraph 8 of subsection 127(1) of the Act, Mitchell be prohibited from becoming or acting as a director or officer of any reporting issuer for five years from the date this order takes effect; and

   (c) pursuant to subsections 1 and 2 of section 127.1 of the Act, Mitchell pay investigation and hearing costs in the amount of $250,000;

5. in respect of **Kenneth E. Davies:**

   (a) pursuant to paragraph 7 of subsection 127(1) of the Act, Davies resign any positions that he holds as a director or officer of a reporting issuer;

   (b) pursuant to paragraph 8 of subsection 127(1) of the Act, Davies be prohibited from becoming or acting as a director or officer of any reporting issuer for three

years from the date this order takes effect; and

(c) pursuant to subsections 1 and 2 of section 127.1 of the Act, Davies pay investigation and hearing costs in the amount of $75,000;

6. in respect of **Harry W. Antes:**

(a) pursuant to paragraph 7 of subsection 127(1) of the Act, Antes resign any positions that he holds as a director or officer of a reporting issuer;

(b) pursuant to paragraph 8 of subsection 127(1) of the Act, Antes be prohibited from becoming or acting as a director or officer of any reporting issuer for three years from the date this order takes effect; and

(c) pursuant to subsections 1 and 2 of section 127.1 of the Act, Antes pay investigation and hearing costs in the amount of $75,000;

7. in respect of **National Bank Financial Corp.**, pursuant to subsections 1 and 2 of section 127.1 of the Act, National Bank Financial Corp. pay investigation and hearings costs in the amount of $400,000; and

8. in respect of **Griffiths McBurney & Partners**:

(a) pursuant to paragraph 4 of subsection 127(1) of the Act, Griffiths McBurney & Partners submit to a review of its practices and procedures as an underwriter by an independent person approved by staff of the Commission and institute any changes recommended by that person; and

(b) pursuant to subsections 1 and 2 of section 127.1 of the Act, Griffiths McBurney & Partners pay investigation and hearing costs in the amount of $400,000.

June 27, 2003.

"Howard I. Wetston" "Derek Brown" "Robert W. Davis"

2.2.2 Avotus Corporation - cl. 104(2)(c)

Headnote

Relief from issuer bid requirements – Applicant issued its employees, senior officers and directors 2,818,286 options to purchase its common shares pursuant to its stock option plan – the exercise price of each of the outstanding options is significantly higher than the current trading price of the common shares – under the rules of the TSX Venture Exchange, Applicant unable to issue additional options under stock option plan – Applicant intending to reduce exercise price of options by issuing replacement options with a lower exercise price – exchange of options approved by board of directors and conditionally approved by TSX Venture Exchange – exchange of options to be put to a vote of disinterested shareholders of the Applicant – relief granted from issuer bid requirements.

Applicable Ontario Statutory Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 95-98, 100 and 104(2)(c).

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, Chapter S.5, AS AMENDED (the "Act")

AND

IN THE MATTER OF
AVOTUS CORPORATION

ORDER
(Clause 104(2)(c))

UPON the application of Avotus Corporation ("Avotus") to the Ontario Securities Commission (the "Commission") for an order pursuant to clause 104(2)(c) of the Act exempting Avotus from the issuer bid requirements of sections 95, 96, 97, 98 and 100 of the Act (the "Issuer Bid Requirements") in connection with an Option Exchange Program (as defined below);

AND UPON considering the application and the recommendation of the staff of the Commission;

AND UPON Avotus having represented to the Commission as follows:

1. Avotus is a corporation existing under the laws of Canada.

2. Avotus is a communications management company offering software, products and services that monitor, analyze and control communications information travelling over voice and data networks.

3. Avotus has been a reporting issuer under the Act since its formation by way of amalgamation on February 20, 2001 and is not in default of any

requirements of the Act or the regulation made thereunder.

4. The common shares in the capital of Avotus (the "Common Shares") are listed on the TSX Venture Exchange (the "TSXV"). As of June 16, 2003, Avotus had 15,799,826 Common Shares issued and outstanding.

5. Avotus has in place a Stock Option Plan (the "Plan"), pursuant to which 2,818,284 options ("Options") to purchase Common Shares are outstanding. Each Option entitles the holder to purchase one Common Share, upon payment of an exercise price that ranges from $0.22 to $6.75, with a weighted average exercise price of $1.02.

6. The closing price of the Common Shares from January 1, 2003 to June 15, 2003 ranged from $0.12 to $0.46. Therefore, the exercise price of each of the outstanding Options is significantly higher than the current trading price of the Common Shares.

7. Avotus is not permitted to issue additional Options under the Plan because under applicable TSXV policies, listed companies may not, under any circumstances, grant options to purchase listed securities in excess of 20% of the total number of listed securities issued and outstanding.

8. Applicable TSXV rules, however, permit Avotus to reduce the exercise price of the Options by (i) amending the terms of the Options to lower their exercise price (a "Repricing"); or (ii) issuing replacements options with a lower exercise price. Either course of action requires the prior approval of the TSXV and, as required by the TSXV, shareholders of Avotus.

9. On May 6, 2003, the board of directors of Avotus determined that it is in the best interests of Avotus to approve (and did approve) an option exchange program (the "Option Exchange Program") that will be offered to current employees (including senior officers) and directors of Avotus (the "Eligible Participants") who hold 2,418,882 Options (the "Old Options"). The Option Exchange Program will not apply to Old Options issued after December 31, 2002. Board approval was subject to obtaining approval from the TSXV and, as required by the TSXV (and described in paragraph 1.14), the disinterested shareholders of Avotus.

10. The board approved the Option Exchange Program as opposed to a Repricing because it was advised that a Repricing may give rise to adverse accounting treatment for Avotus.

11. Under the Option Exchange Program, Eligible Participants will be given the opportunity to exchange Old Options for an equal number of new options to purchase Common Shares to be issued under the Plan (the "New Options"). There are a maximum of 2,418,882 Old Options subject to the Option Exchange.

12. The New Options will be granted no earlier than six months and one day from the date an Eligible Employee notifies the Corporation of its desire to participate in the Option Exchange Program. The New Options will have an exercise price equal to the weighted average of the closing price per Common Share on the TSXV on the 20 trading days ending on the last trading day preceding the date of grant. Each New Option will be exercisable for the remainder of the term of its corresponding Old Option (not exceeding 10 years from the date of grant of the Old Option) and will vest in accordance with the terms of the Plan.

13. The TSXV has conditionally approved the Option Exchange Program, subject to: *(a)* Avotus obtaining disinterested shareholder approval for the Option Exchange Program (as described in paragraph 14 below); *(b)* Avotus not permitting Old Options granted within the last 6 months to be exchanged; and *(c)* the restriction that if the exercise price of the New Options is equal to the Discounted Market Price (as defined in the TSXV Policies) of the Common Shares, a new TSXV hold period will apply to the New Options.

14. At its annual and special meeting scheduled for June 24, 2003, Avotus will seek shareholder approval to the issuance of New Options under the Option Exchange Program in respect of the exchange of up to 1,798,205 Old Options by Eligible Participants who are directors and senior officers of Avotus who, along with their Associates (as defined in the TSXV Policies), will not be permitted to vote on the matter.

15. The exchange of Old Options by Avotus constitutes an issuer bid under the Act. No exemptions from the requirements of Part XX of the Act are fully available, because (i) the maximum number of Old Options that could be exchanged exceeds 5% of Avotus' outstanding Options, contrary to the requirements of subsection 93(3)(d) of the Act; and (ii) the exemption in subsection 93(3)(d) does not apply to directors.

AND UPON the Commission being satisfied that to do so would not be prejudicial to the public interest:

IT IS ORDERED pursuant to clause 104(2)(c) of the Act that the purchase by Avotus of up to 2,418,882 Options to purchase Common Shares from the Eligible Participants be exempt from the Issuer Bid Requirements.

June 27, 2003.

"Paul M. Moore" "H. Lorne Morphy"

2.2.3 Franklin Templeton Investments Corp. - s. 147

Headnote

Exemption for pooled funds from the requirement to file with the Commission interim financial statements under section 77(2) of the Act and comparative financial statements under section 78(1) of the Act, subject to conditions.

Statutes Cited

Securities Act, R.S.O. 1990, c. S.5 as am., ss. 74(1).
Ontario Securities Commission Rule 45-501 – Exempt Distributions, s. 1.1 and s. 2.12.
National Instrument 13-101 – System for Electronic Document Analysis and Retrieval (SEDAR), s. 2.1(1)1.

Regulations Cited

Regulation made under the Securities Act, R.R.O. 1990, Reg. 1015, as am.

IN THE MATTER OF
THE SECURITIES ACT (ONTARIO),
R.S.O. 1990, CHAPTER S.5 AS AMENDED (THE "ACT")

AND

IN THE MATTER OF
FRANKLIN TEMPLETON INVESTMENTS CORP.

AND

TEMPLETON MASTER TRUST-SERIES I,
TEMPLETON MASTER TRUST-SERIES 2,
TEMPLETON RETIREMENT EQUITY TRUST,
TEMPLETON INTERNATIONAL
EQUITY PENSION TRUST,
BISSETT CANADIAN LARGE CAP TRUST,
TEMPLETON INTERNATIONAL STOCK TRUST,
TEMPLETON CANADIAN EQUITY TRUST,
TEMPLETON GLOBAL STOCK TRUST,
TEMPLETON GLOBAL EQUITY TRUST AND
TEMPLETON INTERNATIONAL EQUITY TRUST
(The "Existing Pooled Funds")

ORDER
(Subsection 147 of the Act)

UPON the application (the "Application") of Franklin Templeton Investments Corp. ("FTIC"), the manager of the Existing Pooled Funds and other pooled funds established and managed by FTIC from time to time (collectively, the "Pooled funds"), to the Ontario Securities Commission (the "Commission") for an order pursuant to subsection 147 of the Act exempting the Pooled Funds from filing with the Commission the interim and comparative financial statements prescribed by sections 77(2) and 78(1), respectively, of the Act;

AND UPON considering the Application and the recommendation of the staff of the Commission;

AND UPON FTIC having represented to the Commission that:

1. FTIC is a corporation existing under the laws of Ontario with its head office in Toronto, Ontario. FTIC is, or will be, the manager of the Pooled Funds. FTIC is registered with the Commission as a mutual fund dealer and adviser in the categories of investment counsel and portfolio manager.

2. The Pooled Funds are, or will be, open-end mutual fund trusts established under the laws of the Province of Ontario. The Pooled Funds will not be reporting issuers in any province or territory of Canada. Units of the Pooled Funds are, or will be, distributed in each of the provinces and territories of Canada without a prospectus pursuant to exemptions from the registration and prospectus delivery requirements of applicable securities legislation.

3. The Pooled Funds are an administratively efficient construction that is designed to permit FTIC to build larger investment models rather than reproduce those same models in individual segregated accounts.

4. The Pooled Funds fit within the definition of "mutual fund in Ontario" in section 1(1) of the Act and are thus required to file with the Commission interim financial statements under section 77(2) of the Act and comparative financial statements under section 78(1) of the Act (collectively, the "Financial Statements").

5. Unitholders of the Pooled Funds receive the Financial Statements for the Pooled Funds they hold. The Financial Statements are prepared and delivered to unitholders in the form and for the periods required under the Act and the regulation or rules made thereunder (the "Regulation").

6. Section 2.1(1)1 of National Instrument 13-101 – System for Electronic Document Analysis and Retrieval (SEDAR) ("Rule 13-101") requires that every issuer required to file a document under securities legislation make its filing through SEDAR. The Financial Statements filed with the Commission thus become publicly available.

AND UPON the Commission being satisfied that to do so would not be prejudicial to the public interest,

IT IS ORDERED by the Commission pursuant to subsection 147 of the Act that the Pooled Funds be exempted from the requirements in sections 77(2) and 78(1) of the Act to file the Financial Statements with the Commission provided:

(a) The Pooled Funds will prepare and deliver to the unitholders of the Pooled Funds the Financial Statements, in the form and for the periods required under

the Act and the Regulation, as if the Financial Statements are required to be filed with the Commission;

(b) The Pooled Funds will retain the Financial Statements indefinitely;

(c) The Pooled Funds will provide the Financial Statements to the Commission or any member, employee or agent of the Commission immediately upon request of the Commission or any member, employee or agent of the Commission;

(d) The Pooled Funds will provide a list of the Pooled Funds relying on this Order to the Investment Funds Branch of the Commission on an annual basis;

(e) Unitholders of the Pooled Funds will be notified that the Pooled Funds are exempted from the requirements in sections 77(2) and 78(1) of the Act to file the Financial Statements with the Commission; and

(f) In all other aspects, the Pooled Funds will comply with the requirements in Ontario securities law for financial statements.

July 4, 2003.

"Robert W. Korthals" "H. Lorne Morphy"

2.2.4 Bourse de Montréal Inc. - s. 147, s. 80 of the CFA and s. 6.1 of OSC Rule 91-502

Headnote

Extension to the order temporarily exempting the Bourse de Montréal from recognition as a stock exchange pursuant to section 21 of the Securities Act (Ontario) and registration as a commodity futures exchange pursuant to section 15 of the Commodity Futures Act (Ontario) and order granting an exemption from Part 4 of OSC Rule 91-502 until October 14, 2003.

Provisions Cited

Securities Act, R.S.O. 1990, c. S.5, as amended, section 21, 147.
Commodity Futures Act, R.S.O 1990, Chapter 20, as amended, sections 15, 80.
OSC Rule 91-502 Trades in Recognized Options, Part 4 and section 6.1.

IN THE MATTER OF
THE SECURITIES ACT, R.S.O. 1990
CHAPTER S.5, AS AMENDED (the Act)

AND

IN THE MATTER OF
THE COMMODITY FUTURES ACT
R.S.O 1990, CHAPTER 20, AS AMENDED
(the CFA)

AND

IN THE MATTER OF
OSC RULE 91-502 TRADES IN RECOGNIZED OPTIONS
(Rule 91-502)

AND

IN THE MATTER OF
BOURSE DE MONTRÉAL INC.

ORDER
(Section 147 of the Act, section 80 of the CFA and section 6.1 of Rule 91-502)

WHEREAS the Bourse de Montréal Inc., previously known as the Montreal Exchange and the Montréal Exchange Inc. (collectively referred to as the Bourse), has filed an application pursuant to section 147 of the Act and section 80 of the CFA for an order exempting the Bourse from the requirement to be recognized as a stock exchange under section 21 of the Act and registered as a commodity futures exchange under section 15 of the CFA;

AND WHEREAS the Bourse has filed an application for an order by the Director pursuant to section 6.1 of OSC Rule 91-502 that the Bourse is exempt from Part 4 of Rule 91-502 of the Commission;

AND WHEREAS the Bourse represented that the Bourse carries on business as a stock exchange and a derivatives exchange in Québec and is recognized under the Securities Act (Québec) as a self-regulatory organization;

AND WHEREAS the Bourse represented that the contracts traded or to be traded on the Bourse are approved by the Commission des valeurs mobilières du Québec (the CVMQ) and are filed with the Commission;

AND WHEREAS the Bourse is exempt from section 25 and section 53 of the Act pursuant to Ontario Securities Commission Rule 91-503 Trades of Commodity Futures Contracts and Commodity Futures Options Entered into on Commodity Futures Exchanges Situate Outside of Ontario;

AND WHEREAS an Order was granted by the Commission dated October 3, 2000 (the October 2000 Order) exempting the Bourse on an interim basis from the requirement to be recognized as a stock exchange under section 21 of the Act and registered as a commodity futures exchange under section 15 of the CFA;

AND WHEREAS Orders were granted by the Commission extending the October 2000 Order exempting the Bourse on an interim basis from the requirement to be recognized as a stock exchange under section 21 of the Act and registered as a commodity futures exchange under section 15 of the CFA until July 8, 2003;

AND WHEREAS the Commission is satisfied that granting the Bourse an extension of the October 2000 Order pursuant to section 147 of the Act and section 80 of the CFA on an interim basis would not be contrary to the public interest;

AND WHEREAS the Director is satisfied that an exemption from Part 4 of Rule 91-502 would not be contrary to the public interest;

IT IS ORDERED by the Commission pursuant to section 147 of the Act and section 80 of the CFA, that the Bourse be exempt from the requirement to be recognized as a stock exchange under section 21 of the Act and registered as a commodity futures exchange under section 15 of the CFA; and

IT IS FURTHER ORDERED by the Director pursuant to section 6.1 of Rule 91-502 that the Bourse is exempt from Part 4 of Rule 91-502;

PROVIDED THAT the Bourse continues to be recognized as a self-regulatory organization under the Securities Act (Québec) and that the exemptions pursuant to section 147 of the Act, section 80 of the CFA and section 6.1 of Rule 91-502 shall terminate at the earlier of:

(i) the date that the Bourse is granted an order by the Commission recognizing it as a stock exchange and registering it as a commodity futures exchange or exempting it from the requirement to be recognized as a stock exchange and registered as a commodity futures exchange; and

(ii) October 14, 2003.

July 8, 2003.

"Randee B. Pavalow" "Robin W. Korthals"
"H. Lorne Morphy"

2.3 Rulings

2.3.1 Intrawest Corporation - ss. 74(1) and 144(1)

Headnote

Previously granted order varied and restated to provide that trades by a developer or licensed real estate agents of the developer of Condohotel units not subject to section 25 or 53 provided that purchasers receive certain disclosure prior to entering into an agreement of purchase and sale.

Ontario Statutes

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25, 53, 74(1), 77, 78, 79, 144.
Condominium Act, 1998, S.O. 1998, c. 19, as am.
Real Estate and Business Brokers Act, S.O. 2002, c. R.4, as am.

IN THE MATTER OF
THE SECURITIES ACT
R.S.O. 1990, CHAPTER S.5, AS AMENDED (the "Act")

AND

IN THE MATTER OF
INTRAWEST CORPORATION

RULING AND ORDER
(Subsections 74(1) and 144(1))

WHEREAS on May 7, 1999, the Ontario Securities Commission (the "Commission") made a ruling pursuant to subsection 74(1) of the Act (the "Original Ruling") that the sale by Intrawest Corporation (the "Applicant") and agents of the Applicant ("Applicant Agents") licensed under the *Real Estate and Business Brokers Act* , S.O. 2002, Chapter R.4 (the "REBB Act") of condominium units ("Condohotel Units") within certain condohotels (the "Condohotels") to be built by the Applicant on land known as the "Village Core" (the "Village Core Lands") located next to Blue Mountain Resort near Collingwood, Ontario is exempt from sections 25 and 53 of the Act;

AND WHEREAS on May 19, 2000, the Commission made an order pursuant to subsection 144(1) of the Act (the "Variation Order") which varied certain representations contained in the Original Ruling that had become inaccurate as the result of, among other things, amendments to Zoning By-Law 1983-40 described in the Original Ruling;

AND WHEREAS the Applicant wishes to vary the Original Ruling, as amended by the Variation Order, to permit Condohotel project specific limited partnerships ("Project LPs") and agents of Project LPs licensed under the REBB Act ("Project LP Agents"), as well as the Applicant and Applicant Agents, to sell Condohotel Units within Condohotels built by either the Applicant or a Project LP;

AND WHEREAS in order to so vary the Original Ruling, as amended by the Variation Order, the Applicant has made an application to the Commission pursuant to subsections 144(1) and 74(1) of the Act (the "Application") for an order revoking the Original Ruling and the Variation Order and restating them as set out below;

AND UPON considering the Application and the recommendation of the staff of the Commission;

AND UPON the Applicant having represented to the Commission as follows:

1. The Applicant is a leading developer and operator of village-centered resorts which owns or controls 10 mountain resorts, including Whistler Blackcomb, North America's most popular mountain resort, as well as Sandestin Golf and Beach Resort in Florida.

2. The Applicant is developing the Village Core Lands by constructing, either directly or through a Project LP, a number of multi-family dwellings which will consist primarily of Condohotels and a limited number of townhome units (the "Village Core Project") which are intended to both support and enhance the Resort by establishing a resort village environment that will be attractive to both frequent and infrequent users of the Resort's facilities.

3. Project LPs will be used by the Applicant from time to time for the purpose of implementing its strategy of separating the bulk of its production – phase real estate business into independent limited partnerships. Each Project LP will be established by the Applicant to develop all, or part only, of a Condohotel or a Condohotel project consisting of two or more Condohotels. The Applicant will supervise the development, construction and marketing of each Project LP's Condohotel or Condohotel project, and will also provide administrative services to each Project LP.

4. A Condohotel is a condominium complex which consists of a number of self-contained Condohotel Units and common areas and common facilities that are available for use by the owners and other occupants of Condohotel Units.

5. Each Condohotel Unit has a living area, a kitchen and at least one bathroom and a sleeping area/bedroom, and it is sold fully furnished.

6. The common areas and common facilities of a Condohotel will generally consist of central interior hallways and may also include one or more of underground parking, a lounge area, a pool and spa facility and additional space that may be required to support the rental management operation of the Condohotel as more particularly described in paragraph 13 below.

7. In addition to his or her own Condohotel Unit, each owner of a Condohotel Unit will be entitled to a proportionate share of the relevant Condohotel's common property and the common facilities and other assets of the condominium corporation (the "Condohotel Corporation") that will be created pursuant to the *Condominium Act, 1998* S.O. 1998, Chapter 19 (the "Condominium Act").

8. Each owner of a Condohotel Unit will be responsible for expenses, such as heat, light, power, cable television, telephone line charges and real property taxes, that are directly attributable to the Condohotel Unit, and will also be responsible for his or her proportionate share of certain utilities and other expenses related to the common property of the Condohotel.

9. The Applicant or Project LP, as the case may be, will cause the Condohotel Corporation to enter into a property management agreement with a qualified property manager, which shall be one of Blue Mountain Resorts Limited ("BMRL"), the Applicant or a qualified third party, and the property manager shall manage and administer the Condohotel's common property and shall be paid a management fee for its services.

10. BMRL owns and operates the Resort.

11. The Village Core Project is subject to a comprehensive scheme of land use regulation pursuant to Zoning By-Law 1983-40, as amended by Zoning By-Law 99-71 (the "By-Law"), which establishes certain criteria that must be met by multi-unit developments, such as a Condohotel, that are to be established on the Village Core Lands.

12. For purposes of the By-Law, a Condohotel will be structured and operated as a "Village Commercial Resort Unit" which is defined by the By-Law to mean one room or a group of rooms forming a single commercial accommodation unit within a Village Commercial Resort Unit Complex in which:

    (a) culinary and sanitary facilities are provided for the exclusive use of the unit; and

    (b) access to the unit is provided by a private entrance from a common hallway inside the building; and

    (c) is not used or designated as a principal residence;

    but does not mean or include a residential dwelling unit, hotel unit, a motel unit, an inn unit, a lodge unit, a dormitory unit, a hostel unit, or any other use defined in the By-Law. The term "Village Commercial Resort Unit Complex" is defined as a building or group of buildings containing ten or more Village Commercial Resort Units which:

    (i) is serviced by a central lobby facility; and

    (ii) is part of a rental or lease management program, including housekeeping services, with a minimum of 80% of the Village Commercial Resort Units restricted to occupancy by any one individual person for one or more periods of time not to cumulatively exceed a total of 120 days per year; and

    (iii) the remaining 20% may be exempt from the 120 day per year occupancy limitation; and

    (iv) contain accessory recreational and/or commercial uses; and

    (v) the maximum number of Village Commercial Resort Units that may be exempted under subsection (iii) above shall be 256.

13. Every owner of a Condohotel Unit will be required to enter into either a rental management agreement (the "Rental Management Agreement") or rental pooling agreement (the "Rental Pooling Agreement") with either BMRL, the Applicant, or a qualified third party, in order to (i) permit the establishment and operation of a Condohotel rental or lease arrangement program (the "Rental Program") either by way of a rental management arrangement or a rental pooling arrangement; and (ii) ensure that the terms of this Ruling and Order (the "Ruling and Order") are complied with. If the Rental Program is designed as a rental management arrangement, each owner of a Condohotel Unit will be required to enter into a Rental Management Agreement with either BMRL, the Applicant or a qualified third party, as the case may be (the "Unit Manager"). If the Rental Program is designed as a rental pooling arrangement, each owner of a Condohotel Unit will be required to enter into a Rental Pooling Agreement with either BMRL, the Applicant or a qualified third party, as the case may be (the "Rental Pool Manager"). While all owners of Condohotel Units must enter into either a Rental Management Agreement or Rental Pooling Agreement, up to 20% of such owners may be permitted, on a first-come first-served basis, to opt out of participation in the Rental Program for periods of one or more years so long as at least 80% of owners of Condohotel Units continue to participate in the Rental Program ("Rental

Program Participants"). Owners of Condohotel Units who have opted out of the Rental Program may subsequently become Rental Program Participants by opting into the Rental Program in accordance with the terms thereof.

14. A Rental Management Agreement would require the Unit Manager so retained by a Rental Program Participant to generate revenue for the Rental Program Participant by renting the Rental Program Participant's Condohotel Unit to third parties and generally maintaining the Condohotel Unit for such purpose.

15. A Rental Pooling Agreement would require a Rental Program Participant to participate in an arrangement whereby revenues derived from, and/or expenses relating to, the rental of the Rental Program Participant's Condohotel Unit by the Rental Pool Manager would be pooled with revenues derived from, and/or expenses relating to, the rental of all other Condohotel Units located in the same Condohotel that are owned by Rental Program Participants and all such pooled revenues and expenses would be shared by such Rental Program Participants in accordance with their proportionate interests in the Condohotel (a "Rental Pool").

16. The Unit Manager or Rental Pool Manager, as the case may be, will be entitled to receive a fee for managing the Rental Program that is based upon the rental revenue generated by the Rental Program.

17. Each Rental Management Agreement or Rental Pooling Agreement would have an initial term of not more than seven years and four subsequent terms of not more than three years each and it would renew automatically at the end of each term unless terminated in accordance with its terms which may permit each Condohotel Unit owner to provide the Unit Manager or Rental Pool Manager, as the case may be, with written notice of termination no less than 90 days prior to the end of the relevant term or may require termination only with the approval of a prescribed majority of the Condohotel Unit owners within a Condohotel or within a group of Condohotels that is serviced by a common check-in facility.

18. Rental Program Participants will be provided with the right to occupy their Condohotel Units for no more, and no less, than 120 days per calendar year without restriction save and except for restrictions on use that are reasonably required to facilitate the orderly management and administration of a Condohotel by a qualified Unit Manager or Rental Pool Manager which may include advanced notice of use requirements and peak period minimum use commitments.

19. Condohotel Units will be offered for sale in Ontario through one or more of the Applicant, an Applicant Agent, a Project LP and a Project LP Agent.

20. The offering of Condohotel Units will be made in compliance with the Condominium Act.

21. The Applicant, an Applicant Agent, a Project LP or a Project LP Agent will deliver to an initial purchaser of a Condohotel Unit, before an agreement of purchase and sale is entered into, an offering memorandum (the "Disclosure Document") in the form of a disclosure statement required under the Condominium Act which will also include additional information in the body of the disclosure statement relating to the real estate securities aspects of the offering prepared substantially in accordance with the form and content requirements of B.C. Form 45-906F under the *Securities Act* (British Columbia) R.S.B.C. 1996, c. 418, as amended ("Form 45-906F"), including, but not limited to:

(a) a description of the Village Core Project and the offering of Condohotel Units;

(b) a summary of the material features of the Rental Pooling Agreement and/or Rental Management Agreement;

(c) a description of the continuous reporting obligations of the Applicant or Project LP and the Rental Pool Manager or Unit Manager, as the case may be, to owners of Condohotel Units as more particularly described in paragraphs 26 and 27 below;

(d) a description of the risk factors that make the offering of Condohotel Units a risk or speculation;

(e) a description of the contractual right of action available to purchasers of Condohotel Units as more particularly described in paragraph 23 below; and

(f) a certificate signed by the president or chief executive officer and chief financial officer of the Applicant or the general partner of the Project LP, as the case may be, in the following form:

"The foregoing contains no untrue statement of a material fact and does not omit to state a material fact that is required to be stated or that is necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made".

22. An initial purchaser of a Condohotel Unit will have a statutory right under the Condominium Act to

rescind an agreement to purchase a Condohotel Unit within ten days of receiving the Disclosure Document or a material amendment to the Disclosure Document.

23. Purchasers of Condohotel Units will be provided with a contractual right of action as defined in Commission Rule 14-501 - "Definitions". The Disclosure Document will describe the contractual right of action, including any defences available to the Applicant or Project LP, as the case may be, the limitation periods applicable to the exercise of the contractual right of action, and will indicate that the rights are in addition to any other right or remedy available to the purchaser.

24. Prospective purchasers of Condohotel Units will not be provided with rental or cash flow guarantees or any other form of financial projection or commitment on the part of the Applicant or Project LP, as the case may be, BMRL, the Unit Manager or the Rental Pool Manager, save and except for the budget that must be delivered to an initial purchaser of a Condohotel Unit pursuant to the Condominium Act.

25. The economic value of a Condohotel will be attributable primarily to its real estate component because Condohotel Units will be advertised and marketed as resort properties and will not be advertised or marketed with reference to the expected economic benefits of the Rental Pooling Agreement or Rental Management Agreement.

26. A Rental Pooling Agreement will impose an irrevocable obligation on the Applicant, Project LP or Rental Pool Manager to send to each owner of a Condohotel Unit:

(a) audited annual financial statements for the Rental Pool that have been prepared and delivered in accordance with sections 78 and 79 of the Act as if the Rental Pool was a reporting issuer for purposes of the Act; and

(b) interim unaudited financial statements for the Rental Pool that have been prepared and delivered in accordance with sections 77 and 79 of the Act as if the Rental Pool was a reporting issuer for purposes of the Act.

27. A Rental Management Agreement will impose an irrevocable obligation on the Applicant, Project LP or Unit Manager to send to each Rental Program Participant quarterly statements of revenues and expenses for his, her or its Condohotel Unit on or before the 60th day after the date to which they are made up.

28. A Rental Pooling Agreement or Rental Management Agreement, as the case may be, will impose an irrevocable obligation on the Applicant, Project LP, Rental Pool Manager or Unit Manager, as applicable, to deliver to a subsequent prospective purchaser, upon reasonable notice of an intended sale by the owner of a Condohotel Unit, and before an agreement of purchase and sale is entered into:

(a) the most recent audited annual financial statements (which include financial statements for the prior comparative year) and, if applicable, interim unaudited financial statements for the Rental Pool (collectively "Financial Statements"); and

(b) quarterly statements of revenues and expenses for the Condohotel Unit for the two-year period preceding the entering into of the agreement of purchase and sale for the Condohotel Unit but only to the extent that the Condohotel Unit was subject to the Rental Management Agreement during such two-year period (the "Two Year Quarterly Statements"),

("Financial Statements" and "Two Year Quarterly Statements" are collectively referred to as "Financial Information").

29. A Rental Pooling Agreement or Rental Management Agreement, as the case may be, will impose an irrevocable obligation on:

(a) the Applicant, Project LP, Rental Pool Manager or Unit Manager, as the case may be, to deliver the Disclosure Document to a subsequent prospective purchaser of a Condohotel Unit upon receiving reasonable notice of a proposed sale of the Condohotel Unit that is to take place either prior to, or within 12 months of, the issuance of permission to occupy the relevant Condohotel Unit; and

(b) the Applicant, Project LP, Rental Pool Manager or Unit Manager, as the case may be, to deliver a summary of the Disclosure Document (the "Disclosure Document Summary") to a subsequent prospective purchaser of a Condohotel Unit upon receiving reasonable notice of a proposed sale of the Condohotel Unit that is to take place any time following the expiration of a period of 12 months from the date of issuance of permission to occupy the relevant Condohotel Unit.

30. A Disclosure Document Summary that is delivered to a prospective purchaser of a Condohotel Unit

which is subject to a Rental Pooling Agreement will include:

(i) items 1, 3(1), 6,7, 9(1), (2), (3) and (4), 10(b) and 16 of Form 45-906F with respect to the proposed sale, modified as necessary to reflect the operation of the Rental Pool and the form of disclosure, and

(ii) items 12(2), (3) and (4) of Form 45-906F with respect to the Rental Pool Manager under the Rental Pooling Agreement modified so that the period of disclosure runs from the date of the certificate attached to the Disclosure Document Summary,

and will be certified by the Rental Pool Manager in the form of the certificate required pursuant to item 19 of Form 45-906F.

31. A Disclosure Document Summary that is delivered to a prospective purchaser of a Condohotel Unit which is subject to a Rental Management Agreement will include,

(i) the Rental Management Agreement; and

(ii) a summary of the Unit Manager's past experience that includes items 12(2), (3) and (4) of Form 45-906F with respect to the Unit Manager modified so that the period of disclosure runs from the date of the certificate attached to the Disclosure Document Summary,

and will be certified by the Unit Manager in the form of the certificate required pursuant to item 19 of Form 45-906F.

32. A Rental Pooling Agreement or Rental Management Agreement will impose an irrevocable obligation on each owner of a Condohotel Unit to provide:

(a) the Applicant, Project LP, Rental Pool Manager or Unit Manager, as the case may be, with reasonable notice of a proposed sale of the Condohotel Unit; and

(b) a subsequent prospective purchaser of a Condohotel Unit with notice of his, her or its right to obtain from the Applicant, Project LP, Rental Pool Manager or Unit Manager, as the case may be, Financial Information and the Disclosure Document or Disclosure Document Summary, as the case may be.

33. A Rental Pooling Agreement and Rental Management Agreement will not require purchasers of Condohotel Units to give any person any assignment of their right to vote in accordance with the Condominium Act or condominium bylaws, or to waive notice of meetings of the condominium corporation in respect of the Village Core Project and the Condohotel.

AND UPON the Commission being satisfied that to do so would not be prejudicial to the public interest;

IT IS ORDERED, pursuant to subsection 144(1) of the Act, that the Original Ruling and the Variation Order are revoked except in respect of any subsequent trade of a Condohotel Unit acquired pursuant to either the Original Ruling or the Original Ruling, as amended by the Variation Order; and

IT IS RULED, pursuant to subsections 74(1) and 144(1) of the Act, that the distribution of a Condohotel Unit by the Applicant, Project LP or a Licensed Agent is exempt from sections 25 and 53 of the Act, provided that:

(i) every purchaser of a Condohotel Unit receives prior to the completion of the purchase transaction all of the documents and information referred to in paragraph 21 as well as a copy of this Ruling and Order;

(ii) any subsequent trade of a Condohotel Unit acquired pursuant to this Ruling and Order shall be a distribution unless:

A. notice is given by the seller to the Applicant, Project LP, Rental Pool Manager or Unit Manager, as the case may be, of the seller's intent to sell his or her Condohotel Unit;

B. the prospective purchaser of the Condohotel Unit receives, before an agreement of purchase and sale is entered into, all of the documents and information referred to in paragraphs 28 and 29 above; and

C. the seller, or an agent acting on the seller's behalf, does not advertise or market the expected economic benefits of the Rental Pool Agreement or Rental Management Agreement to the prospective purchaser.

June 27, 2003.

"Paul M. Moore" "H. Lorne Morphy"

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Chapter 3

Reasons: Decisions, Orders and Rulings

3.1 Reasons for Decision

3.1.1 YBM Magnex International Inc. et al.

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

AND

YBM MAGNEX INTERNATIONAL INC.
HARRY W. ANTES
JACOB G. BOGATIN
KENNETH E. DAVIES
IGOR FISHERMAN
DANIEL E. GATTI
FRANK S. GREENWALD
R. OWEN MITCHELL
DAVID R. PETERSON
MICHAEL D. SCHMIDT
LAWRENCE D. WILDER
GRIFFITHS MCBURNEY & PARTNERS
NATIONAL BANK FINANCIAL CORP.
(formerly known as First Marathon Securities Limited)

Hearing: November 29, 1999
December 21, 22, 1999
January 27, 2000
January 23, 26, 2001
February 22, 23, 2001
March 7, 2001
May 7, 8, 9, 10, 11, 16, 17, 2001
June 11, 18, 20, 2001
July 9, 10, 11, 12, 16, 17, 18, 19, 23, 24, 25, 26, 30, 31, 2001
August 1, 2, 13, 15, 27, 28, 29, 30, 2001
October 29, 30, 2001
November 2, 6, 7, 8, 13, 14, 15, 16, 2001
December 4, 6, 7, 13, 14, 2001
January 8, 10, 11, 15, 25, 2002
February 5, 8, 12, 14, 15, 2002
March 5, 7, 8, 19, 21, 22, 25, 26, 28, 2002
April 1, 2, 3, 4, 5, 8, 9, 12, 16, 17, 22, 23, 24, 25, 26, 29, 30, 2002
May 1, 2, 3, 6, 7, 28, 29, 30, 2002
June 10, 17, 19, 24, 26, 2002
August 6, 7, 8, 12, 13, 14, 19, 21, 22, 27, 29, 2002
November 18, 19, 20, 21, 22, 25, 27, 28, 2002

Panel:

Howard I. Wetston, Q.C.	-	Vice-Chair (Chair of the Panel)
Derek Brown	-	Commissioner
Robert W. Davis, FCA	-	Commissioner

Counsel:

Michael Code Jay Naster Ian Smith Kathryn J. Daniels	-	For the Staff of the Ontario Securities Commission

Counsel:	Peter Howard	- For YBM Magnex International Inc.
	Paul Le Vay Donna E. Campbell	- For Harry W. Antes and Frank S. Greenwald
	Bryan Finlay, Q.C. Michael Statham	- For Jacob Bogatin
	Michael W. Kerr Derek Ferris Kelly A. Charlebois	- For Kenneth E. Davies
	Brian P. Bellmore Karen M. Mitchell	- For Daniel E. Gatti
	James D.G. Douglas David Di Paolo	- For R. Owen Mitchell
	Alan J. Lenczner, Q.C. Monique Jilesen	- For David R. Peterson
	Harry Underwood Gregory W. MacKenzie	- For Michael D. Schmidt
	Linda L. Fuerst L. David Roebuck	- For Lawrence D. Wilder
	John A. Keefe Julie Rosenthal Elizabeth Moore	- For Griffiths McBurney & Partners
	James A. Hodgson Bonnie A. Tough Julia A. Evans Michael Petrocco	- For National Bank Financial Corp.

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INTRODUCTION

[1] This case raises serious questions with respect to the meaning of materiality in the prospectus and timely disclosure provisions of the *Securities Act* (the "Act"). A basic tenet of securities law is that disclosure is generally limited to *material* matters. Confronted by the dilemma of what should be disclosed to the public, the respondents relied on the concept of materiality as the cornerstone for disclosure. YBM's key disclosure documents did not, we find, contain full, true and plain disclosure of all material facts. YBM also failed to disclose a material change in its affairs forthwith. While disclosing good news with little hesitation, its practice was to restrict the disclosure of bad news.

[2] YBM's disclosure leads the reader to believe that the risks faced by YBM were no greater than the inherent risks faced by any company operating in Eastern Europe at that time. We find this to be incorrect. YBM was subject to company-specific risks. An investor in YBM's securities had the right to know what specific risks were presently threatening the issuer. Disclosure continues as the main principle for protecting investors, ensuring fairness in the trading markets and enhancing investor trust.

[3] Despite a hearing which took over 124 hearing days to complete, this case is not about organized crime, money laundering or whether the respondents believed YBM was not a real company. It is about the disclosure of risk. Materiality is reinforced as the standard for such disclosure in securities markets by taking into account the considerations associated with the exercise of judgement and reasonable diligence.

THE ALLEGATIONS

[4] Staff's first allegation is that YBM Magnex International Inc. ("YBM") filed a preliminary prospectus dated May 30, 1997 and a final prospectus dated November 17, 1997 that failed to contain full, true and plain disclosure of all material facts relating to the securities offered. Specifically, staff allege that YBM failed to disclose the mandate, information obtained by, and findings of a special committee (the "Special Committee") of its board of directors (the "Board of Directors", "Board" or "Directors"). The respondent directors and officers are alleged to have authorized, permitted or acquiesced in YBM's failure to make full, true, and plain disclosure. The respondent underwriters are alleged to have signed certificates to prospectuses which, to the best of their knowledge, information, and belief did not contain full, true, and plain disclosure.

[5] Staff's second allegation is that YBM failed to comply with its continuous disclosure obligations by not issuing forthwith a press release that disclosed the substance of a material change in the affairs of the company. Specifically, YBM should have disclosed that Deloitte & Touche LLP (U.S.) ("D&T") had advised YBM on or before April 20, 1998 that it would not perform any further services for the company, including the rendering of an audit opinion in respect of the company's 1997 financial statements, until YBM had completed an in-depth forensic investigation that addressed specific concerns to D&T's satisfaction. The members of YBM's audit committee (the "Audit Committee"), its Chief Executive Officer, Chief Financial Officer and Chief Operating Officer are alleged to have authorized, permitted or acquiesced in YBM's failure to comply with those continuous disclosure obligations.

[6] Staff's third allegation, against Lawrence D. Wilder, was settled in May 2002. Staff alleged that during the prospectus review process in July 1997, Wilder made misleading, untrue or incomplete statements to the Commission. Pursuant to the settlement agreement approved on consent by this panel on May 28, 2002, Wilder acknowledged that he acted in a manner that was contrary to the public interest by employing the language he did in his July 4, 1997 letter to staff. Wilder did not, however, admit to an intention to mislead. He offered, and staff accepted, an apology to staff. Wilder made voluntary payments of (a) $150,000 in respect of the costs awarded in connection with Wilder's application for judicial review to the Divisional Court and the subsequent appeal, and (b) $250,000 in respect of the costs of the investigation and hearing in this matter. Staff discontinued the allegation against Wilder.

THE RESPONDENTS

[7] YBM was incorporated under Alberta's *Business Corporations Act*, S.A. 1981, c. B-15, on March 16, 1994 under the name Pratecs Technologies Inc. ("Pratecs"). Pratecs changed its name to YBM Magnex International Inc. effective November 3, 1995. YBM became a reporting issuer in Ontario on January 22, 1996, and its shares began trading on the Toronto Stock Exchange on March 7, 1996. On May 13, 1998, the Commission issued a temporary cease trade order in respect of YBM shares; this order remains in effect. On December 8, 1998, pursuant to an order of the Court of Queen's Bench of Alberta, a receiver was appointed respecting the present and future assets, property and undertakings of YBM. The receiver did not defend the allegations in this matter. YBM controlled a United States subsidiary, YBM Magnex Inc. ("YBM Magnex") that had its head office in Newtown, Pennsylvania. As at May 13, 1998, YBM Magnex was either the sole or majority owner of:

(a) United Trade Limited ("United Trade"): a Cayman Islands corporation and wholly-owned subsidiary of YBM Magnex, with its head office and operations located in Budapest, Hungary;

(b) Magnex RT: a Hungarian corporation and majority-owned subsidiary of United Trade. Its offices and operations were located on Csepel Island in Budapest, Hungary;

(c) Schwinn-Csepel: a Hungarian corporation having offices and operations on Csepel Island in Budapest, Hungary; and

(d) Crumax Magnetics: operations consisting of companies that YBM acquired in 1997 and 1998: Crucible Magnetics ("Crucible") in Kentucky and Crusteel in the United Kingdom, acquired by YBM in August 1997, and the former magnetics division of Philips Electronics in the U.K., acquired by YBM in March 1998.

[8] During the period May 1, 1996 to May 13, 1998 (the "material time"), there were eight directors of the Board, two of whom were also officers of the Company:

(a) Harry W. Antes, Chairman of the Board and a member of the Audit Committee, appointed a director on April 29, 1996;

(b) Jacob G. Bogatin, President and Chief Executive Officer, appointed a director on April 4, 1994;

(c) Kenneth Davies, member of the Special Committee, appointed a director on April 4, 1994;

(d) Igor Fisherman, Chief Operating Officer of YBM, appointed a director on April 29, 1996;

(e) Frank S. Greenwald, Chair of the Audit Committee, appointed a director on April 29, 1996;

(f) R. Owen Mitchell, Chair of the Special Committee and member of the Audit Committee, appointed a director on January 26, 1996, and also a Vice President and director of First Marathon Securities Limited ("First Marathon") during the material time.

(g) David R. Peterson, appointed a director on April 29, 1996. Peterson is a partner and the Chair of the law firm Cassels, Brock & Blackwell LLP ("Cassels Brock") which was Canadian general counsel to YBM during the material time; and

(h) Michael D. Schmidt, member of the Special Committee, appointed director on April 4, 1994.

[9] Daniel E. Gatti was the Vice President of Finance and Chief Financial Officer of YBM during the material time. He was appointed an officer on January 26, 1996.

[10] In May 1997, two Canadian securities dealers agreed to act as co-lead underwriters for a financing being contemplated by YBM:

(a) National Bank Financial Corp. ("National Bank"), which acquired in August 1999, First Marathon. During the material time First Marathon was, and National Bank continues to be, registered under the Act as a broker and investment dealer; and

(b) Griffiths McBurney & Partners ("GMP"), which during the material time was, and continues to be, registered under the Act as a broker and investment dealer.

[11] Wilder is a partner at Cassels Brock, and during the material time was counsel to YBM and counsel to the Special Committee.

BACKGROUND – FIRST ALLEGATION

Corporate History

From Eastern Europe in 1990 to the Ontario Capital Markets in 1996

[12] YBM was the product of a series of incorporations, acquisitions and reverse-takeovers that transformed a closely-held company based in Eastern Europe into an international corporation, and traded in Canada on the Toronto Stock Exchange ("TSE" or "TSX").

[13] Arigon Company Limited ("Arigon") was incorporated in the Channel Islands, U.K. in May 1990. The founding shareholders recorded in the share register of Arigon were: Semeon Mogilevich, Alexei Alexandrov, Anatoly Kulachenko, Vitaly

Leiba, Alexandr Alexandrov, and Semeon Ifraimov (the "founding shareholders"). In January 1991, Arigon formed Arbat International Inc. ("Arbat") in Russia as a joint venture company that conducted trading activity in Russia.

[14] In November 1991, the founding shareholders purchased magnet manufacturing equipment from a Russian company. In February 1992, Arigon acquired the equipment from them in exchange for preferred shares valued at approximately U.S. $14 million (the "Original Equipment Transaction").

[15] Arigon incorporated Magnex RT in Hungary in September 1992. Arigon held 99% of the shares; Mogilevich and Dr. Sandorne Bodonyi held the remaining 1%. The board of directors and supervisory board of Magnex RT were composed of the founding shareholders and Dr. Bodonyi. Mogilevich became chairman of the board and Kulachenko, CEO. Fisherman was appointed president.

[16] On September 15, 1992, Arigon and Magnex RT entered into three agreements which structured their relationship in the magnetics business. Arigon transferred the equipment acquired from the founding shareholders to Magnex RT and Magnex RT became responsible for all magnet manufacturing. Arigon became responsible for obtaining patents and raw materials for the manufacture of magnets, and for marketing and selling all magnets manufactured by Magnex RT. In September 1993, the scope of Magnex RT's business activity was expanded to include the "commerce of oil and fuel." Oil sales would account for 22-27% of YBM's sales in the coming years.

[17] Meanwhile, in Pennsylvania, Jacob Bogatin incorporated two private magnetics companies in April 1993: YBM Magnetics Inc. and YBM Technologies Inc. The former acted as a consultant and agent in magnet manufacturing and sales; the latter licensed magnet manufacturing patents. From April 1994, the companies provided their services exclusively to Arigon/YBM Magnex.

[18] Bogatin was invited to attend a meeting of the board of directors of Magnex RT in Budapest on January 23, 1994. He was identified in the minutes as "Assistant Director" of YBM Magnex Inc., although that company had yet to be incorporated. The minutes recorded the following:

> [Mogilevich] deems imperative to adopt strategic measures, appropriate for the business goals of Magnex RT. It would be beneficial for the introduction of industrial magnets manufactured by the Company, to the largest possible market ... the United States, if the production and distribution of the product would be realized through a company incorporated under US law. For this reason the Company has engaged in negotiations with YBM Magnex Inc., willing to play an important role in this business project ... He proposes that the Board of Directors authorize Director for Development Igor Fisherman to represent the Company in these negotiations...

Magnex RT's Board authorized Fisherman to conclude the required contracts.

[19] YBM Magnex Inc. was incorporated in Pennsylvania on February 10, 1994. Bogatin was appointed its sole director and president. By the end of the month, YBM Magnex's new board of directors included members of the founding shareholders and officers of Magnex RT. Kulachenko was appointed CEO; Fisherman, President; and Bogatin, Group Vice-President and Chairman of Finance. By December 1994, YBM Magnex completed a reverse take-over of Arigon: the Arigon shareholders exchanged 100% of the common shares in Arigon for 85% of the common shares in YBM Magnex.

[20] Pratecs was incorporated in Alberta in March 1994 and issued two million shares to 15 individuals: one million shares to Bogatin and one million shares, in aggregate, to 14 others, including Davies and Schmidt. Four directors of YBM Magnex were elected directors of Pratecs, including Bogatin, Davies and Schmidt.

[21] In May 1994, Pratecs filed a preliminary prospectus in Alberta under the Junior Capital Pool Program ("the JCP program"). The JCP program required Pratecs to enter into a major transaction within 18 months of the offering. Pratecs disclosed that its major transaction would be the acquisition of Canadian distribution rights for the magnetic products of YBM Magnex. Upon filing its final prospectus on July 18, 1994, Pratecs issued four million common shares to the public and became a JCP corporation. On July 27, 1994, Pratecs applied for a listing on the Alberta Stock Exchange, which was approved one week later.

[22] Also on July 27, 1994, Pratecs entered into two letters of intent with YBM Magnex. The first dealt with the JCP major transaction and the second dealt with Pratecs' merger with YBM Magnex by way of a share exchange. Pratecs would acquire all of the shares in YBM Magnex in exchange for US$22 million in the form of 110 million shares of Pratecs. This reverse take-over was contingent on a Pratecs offering.

[23] The pending offering was threatened by court proceedings in the UK (the "UK proceedings") in the summer of 1995. On June 22, 1995, Pratecs voluntarily halted trading in its common shares on the Alberta Stock Exchange. On July 19, 1995, Pratecs explained that the halt in trading was a result of allegations concerning money laundering and fraud made in London against Arigon and two individual shareholders of YBM Magnex, Mogilevich and Konstantin Karat. Pratecs later announced that,

at a hearing in the UK court on July 10, 1995, the prosecution had submitted an affidavit that withdrew all language attempting to connect the matter with Arigon or any of its officers or directors. A consent order dated July 19, 1995 dismissed all legal proceedings against the two YBM Magnex shareholders. Trading in Pratecs shares resumed on the Alberta Stock Exchange on July 24, 1995.

[24] First Marathon and GMP first became involved with Pratecs/YBM in the summer of 1995. The firms acted as co-lead underwriters for the January 1996 prospectus offering. The law firm Fogler, Rubinoff LLP ("Fogler Rubinoff") acted as underwriters' counsel. Cassels Brock acted as YBM's counsel. On October 5, 1995, Pratecs completed a private placement of approximately seven million special warrants for aggregate gross proceeds of approximately US$14 million. On October 26, 1995, Pratecs/YBM filed a preliminary prospectus to qualify the shares and the purchase warrants issuable on the exercise of the outstanding special warrants. All conditions for the reverse take-over were now satisfied. On November 3, 1995, Pratecs/YBM announced the completion of its acquisition of YBM Magnex.

[25] The company, now known as YBM Magnex International Inc., filed its final prospectus on January 19, 1996. On March 10, 1996 the common shares of YBM were listed and posted for trading on the TSE.

Corporate Activity in 1996: The Sale of Arbat and the Reorganization of Arigon

[26] YBM sold Arbat pursuant to an agreement dated April 1, 1996, between Arigon, Arbat, and two individual purchasers, Girin and Titelman. The purchasers agreed to assume Arbat's past and future liabilities.

[27] YBM then liquidated Arigon. YBM had been advised that it could achieve a tax-free reorganization by incorporating a company in the Cayman Islands and then transferring the assets and business of Arigon to this new company. Accordingly, United Trade was incorporated in the Cayman Islands in March 1996 as a wholly-owned subsidiary of YBM Magnex and as the successor company to Arigon.

[28] YBM, Arigon, United Trade and the preferred shareholders of Arigon (the founding shareholders) entered into an agreement dated April 1, 1996. The business, assets, goodwill and debts of Arigon were assigned to United Trade in exchange for United Trade assuming the debts and future liabilities of Arigon. The founding shareholders surrendered their preferred shares in Arigon in exchange for the same number of preferred shares in United Trade. The former officers, directors and employees of Arigon assumed the same positions in United Trade.

[29] Bogatin presented the sale of Arbat and the liquidation of Arigon to YBM's Board of Directors at their meeting on April 29, 1996. The minutes of the meeting record:

> The Chairman updated the board as to various other matters including the Company's plans to sell Arbat International Inc. to a group of arm's length purchasers for consideration equal to approximately (US)$250,000. The Chairman indicated that the rationale for the sale was that the Company's operations in Eastern Europe were difficult to supervise and exposed it to certain potential liability. The Chairman confirmed that Arbat will continue to render services to the Company but only on a contractual basis.
>
> The Chairman also advised the board of a proposal to relocate the Company's wholly-owned subsidiary, Arigon Co. Ltd. from the Channel Islands, U.K. to the Cayman Islands. The Chairman explained that the rationale for such move was to bring Arigon's operations closer to the Company's North American headquarters. The Chairman advised that the Royal Bank of Canada was assisting the Company and Arigon in this move. The Chairman also advised that upon completion of such move, Arigon's name will most likely be changed to United Trade Limited. The Chairman advised that this move would be accomplished by way of a tax free reorganization of assets.

[30] In July 1996, YBM acquired over 77% of the outstanding common shares in Hungarian bicycle manufacturer Schwinn-Csepel RT. The remaining minority interests were acquired in one consolidated block on October 1, 1996.

The Crucible Acquisition and the Public Offering of 1997

[31] The public offering by YBM in 1997 is at the heart of the first and principal allegation in this matter. On April 2, 1997, YBM entered into an Asset Purchase Agreement for the acquisition of the magnetics division of Crucible Materials Corporation, which included the operations of Crucible in Kentucky and Crusteel Magnetics in London, England. The Board of Directors had authorized management to enter into discussions with Crucible at the meeting of August 15, 1996. The acquisition of Crucible was to have been financed by the proceeds of the 1997 offering. By May 1997, the underwriting syndicate was in place. Repeating their roles from the January 1996 offering, First Marathon and GMP acted as co-lead underwriters, each with 35% of the offering. Fogler Rubinoff again acted as the underwriters' counsel and Cassels Brock as YBM's counsel.

[32] The offering proceeded under the Prompt Offering Qualification System (the "POP system"); National Policy 47, "Prompt Offering Qualification System" (1993), 16 O.S.C.B. 675 ("NP47") [now National Instrument 44-101, "Short Form

Prospectus Distributions" (2000), 23 O.S.C.B. (Supp.) 867 ("NI44-101")]. Under the POP system, a short form prospectus is filed that incorporates other disclosure documents by reference, one of which is the company's Annual Information Form. On May 2, 1997, YBM filed its AIF dated May 1, 1997 (the "AIF") and on June 2, 1997, filed its preliminary short form prospectus dated May 30, 1997 (the "Preliminary Prospectus"). The POP system is meant to facilitate a quick prospectus review by the Commission, usually in three days. Due to circumstances that will be discussed later in these reasons, the prospectus review concluded in November 1997, over five months later.

[33] Because of the delay in the prospectus review process, YBM sought alternative means of financing. On August 21, 1997, YBM completed a private placement of subordinated convertible notes in the amount of CDN $48 million. These proceeds funded the Crucible acquisition, which was completed the following day. The common shares underlying the convertible notes would be qualified for issuance with the final prospectus. On November 18, 1997, YBM filed its final short form prospectus dated November 17, 1997 (the "Final Prospectus"). The Commission issued a receipt for the Final Prospectus on November 20, 1997.

Visa Issues and Investigation by YBM Management in 1996

[34] In January 1996, YBM management became concerned when the U.S. embassy in Budapest denied return visas to two YBM employees. Bogatin and Gatti began an informal investigation. They made inquiries in person and through their Member of Congress (Rep. Greenwood), approaching consular officials and the State Department in the United States. YBM, through its management, retained U.S. lawyer Richard Rossman and the law firm of Pepper Hamilton to determine the U.S. Government's concerns. In August 1996, Pepper Hamilton learned that the U.S. Attorney's Office in Philadelphia was conducting an investigation into YBM.

[35] At Rossman's insistence, YBM held a special meeting of its Board of Directors on August 15, 1996. Every Director was present, as were representatives of management, YBM's auditors and various legal advisors. Following routine business matters, the Directors heard presentations from Bogatin, Gatti and Rossman about the history and results of management's inquiries to date.

[36] Gatti prepared the following document entitled "Approximate Chronology of Significant Events Leading to Notice of Investigation," which he presented at the meeting:

Approximate Chronology of Significant Events Leading to Notice of Investigation

Fall 1995:	YBM requests resignation of founding shareholders from management of YBM;
December 21, 1996:	Chris Vitanov travels to Hungary;
January 15, 1996:	Chris Vitanov delayed in getting visa from U.S. Embassy in Hungary (first indication of a problem);
January 20, 1996:	Tami Vitanov travels to Hungary;
January 22, 1996:	YBM/Vitanov's become concerned that there is some problem because visa request is taking too long;
February 7, 1996	Gabor Varga contacts U.S. embassy in regards to visa problem. Embassy implies that the company is not doing real business;
February 9, 1996:	Jacob Bogatin and Dan Gatti meet with Vice Consul Scott Boswell in Budapest to understand the reasons for the delay in getting the Vitanov's back to the U.S. Boswell states that the embassy is waiting for some response from State Department or INS. No indication that there is a problem with the company. Discussion concludes with YBM stating it will contact local congressman to try to speed things up the process;
February 12, 1996:	Jacob Bogatin contacts State Department and speaks with Katherine Gelner who says visas will not be issued because the sponsor, YBM Magnex, is conducting some illegal activity;
February 12, 1996:	YBM contacts Representative Greenwood's office requesting assistance;

Approximate Chronology of Significant Events Leading to Notice of Investigation

February 13, 1996:	Immigration attorney, John Hykel, contacts Katherine Gelner at the State Department and is told that YBM Magnex is conducting some illegal activity;
February 26, 1996:	YBM meets with Representative Greenwood;
February 29, 1996:	Representative Greenwood writes letter to State Department requesting briefing on issue regarding YBM;
March 4, 1996:	YBM retains Pepper, Hamilton & Sheetz based upon reference from David Kirk, YBM's U.K. attorney;
March 1996:	YBM, through Jacob Bogatin, performs an internal investigation including a review of all its customer and sales representative contracts – results of investigation results in implementation of new customer acceptance procedures and the termination of one sales representative contract;
March 20, 1996:	Michael Bellows, Office of Public and Diplomatic Liaison, writes letter stating that Tami and Chris Vitanov have been found ineligible under the Immigration and Nationality Act and the reasons for ineligibility are classified;
April 1, 1996:	YBM divests itself from Arbat International, transfers net assets of Arigon to United Trade and begins process of liquidation of Arigon;
May 7, 1996:	Congressman James Greenwood briefed by State Department – staff contacts YBM to indicate that the Congressman felt the decision was justified and that he could no longer help us;
May 8, 1996:	Jacob Bogatin and Dan Gatti write Congressman Greenwood letter asking for any advice he could give and also request a meeting. Request was denied and suggestion to pursue through our attorneys was recommended;
May 21, 1996:	U.S. embassy in Russia acknowledges YBM's sale of Arbat International via letter from Minister Counsel;
June 6, 1996:	Peter Hearn retained at the advice of Pepper Hamilton for the purpose of approaching Senator Arlen Specter for assistance;
July 1996:	Peter Hearn meets with Specter aides who inform him that it would not be appropriate for a U.S. Senator to meet with YBM because of ongoing investigation...aides refer Peter Hearn to U.S. Attorney's office in Philadelphia;
August 2, 1996:	Peter Hearn and Richard Rossman (Pepper Hamilton) inform Jacob Bogatin that the U.S. Attorneys office confirmed to Peter Hearn that a highly sensitive investigation of YBM was in progress;
August 6, 1996:	YBM informs United States corporate attorney, Wolf Block, of notice; and
August 15, 1996	With the advice of Pepper, Hamilton, YBM management informs board of investigation.

[37] Gatti also told the Board that management had recently come across European press articles that linked alleged organized crime figures to YBM. One of these was a November 1995 article in *Izvestia* concerning a Mr. Mikhaylov, a reputed Russian organized crime figure who was seeking to become Honorary Consul for Costa Rica. Mikhaylov claimed to be the owner of several businesses, two of which were "Arigon" and "Magnex".

[38] Rossman presented the Board with the same information regarding an investigation of YBM that he had told Bogatin leading up to the meeting. He advised the Board to form a committee of outside Directors, advised by independent counsel, to investigate the matter. Following the presentations, the Board discussed its disclosure obligations.

[39] The Special Committee, chaired by Mitchell, was formed at a special meeting of the outside Directors on August 29, 1996. YBM management continued to play a role by providing information to the Committee and by following up issues on their own and through Rossman.

[40] In November 1996, Bogatin and Gatti brought a discrepancy in Arigon's 1994 commission payments to Mitchell's attention. One payment schedule listed a Viktor Averin as a recipient; the other listed a corporation instead, on the same date and for the same amount as the Averin commission on the other sheet. Management had no explanation for the discrepancy.

[41] Later that month, Bogatin and Gatti became aware of a new article in a Russian magazine that echoed the *Izvestia* article about Sergei Mikhaylov. They instructed Rossman to seek a retraction.

[42] On November 26, 1996, Bogatin and Gatti wrote to Ernst & Young, asking the firm to reconsider its decision not to pursue a relationship with YBM. They addressed the articles linking Russian organized crime figures to YBM, the U.K. proceedings, and the U.S. Government's monitoring of the company. They also advised that an independent committee of the Board was investigating these matters.

[43] In mid-December 1996, management became aware of an affidavit in support of an application for a wiretap on the telephone of one Ivankov, a Russian organized crime figure (the "FBI Affidavit"). It named Arbat as a vehicle for transmitting large sums of money from Moscow "to a company in Budapest, Hungary overseen by 'Seva' Mogielevich, one of Ivankov's closest associates." It also referred to Sergei Mikhaylov, Viktor Averin and Arnold Tamm as founders and leaders of a Russian organized crime group. Management shared the FBI Affidavit with Rossman and Mitchell. They confirmed to Rossman that the Mogielevich named in the FBI Affidavit was a shareholder of YBM and that Mikhaylov, Averin and Tamm had received commission payments from Arigon and United Trade.

[44] On December 18, 1996, management acted on the information in the FBI Affidavit by sending a letter and questionnaire to each of the founding shareholders and the other former shareholders of Arigon (the "December 1996 Questionnaire Letter"). They wrote:

> Our job is simple. We must determine whether there is any truth to the statements made by the FBI. To begin this process, we would like each of you and each officer of our company, including United States management, to complete the enclosed questionnaire for internal purposes only. Subsequently, the board of directors will evaluate the need to do a full scale internal investigation of our activities which will ultimately determine if any criminal activity exists in our companies and whether the questionnaires you submit are complete and accurate.
>
> Our western securities lawyers tell us that we are very close to having an obligation to disclose these allegations to the general public. If this were to happen, our stock would be worthless in a short period of time. Since you are now informed about these allegations, we encourage you to avoid selling any YBM stock until these issues are resolved or risk prosecution under insider trading laws.

[45] In early 1997, management dealt with two issues regarding United Trade that had been uncovered by the Special Committee's investigation. The first issue was United Trade's operation of two bank accounts ostensibly owned by other entities, Technology Distribution and Mogilevich, respectively. Gatti reviewed the accounts independently and with YBM's auditors, Parente Randolph Orlando & Carey ("Parente"). He found that United Trade was operating them legitimately, notwithstanding the names of the account holders. Parente concluded that the accounts were correctly indicated as cash on YBM's financial statements. These accounts were nonetheless closed, and new accounts were opened in the name of United Trade. The second issue concerned United Trade's offices being located in the same building as Mogilevich's office. United Trade's offices were moved to Csepel Island, near the operations of Magnex RT.

[46] In early February 1997, management received a letter from the editor of *Izvestia* with respect to the November 1995 article on Mikhaylov, more or less retracting the article:

> We hope that the publication has not inflicted any loss to the reputation and commercial interests of your firm, particularly since the law enforcement agencies of Russia and the newspaper *Izvestia* have not received any data which would support the version cited.

The Work of the Special Committee and Fairfax: 1996-97

[47] The outside Directors of YBM met by conference call on August 29, 1996. Wilder also participated, as did Rossman and Scott Godshall of Pepper Hamilton. Mitchell, Davies and Schmidt were appointed to the Special Committee, and Wilder was retained as the Committee's counsel.

[48] The Special Committee's initial work was a review of available documentation. Mitchell asked Schmidt to summarize information about the shareholders, directors and officers of YBM, Pratecs, Arigon, Magnex RT and Arbat. Mitchell himself

reviewed the results of Rossman's Lexis-Nexis search, articles on YBM's public filings in Canada, articles on the U.K. proceedings, and the November 1995 *Izvestia* article.

[49] Mitchell then sought information from YBM's European operations via two letters faxed to Gatti on September 20, 1996. The first letter, addressed to Antes, stated the Special Committee's focus and proposed plan of investigation:

> Our focus has been to attempt to identify any clear correlation (including share ownership) between YBM or its subsidiaries and individuals of criminal background as has been suggested by articles in the European press and allegations in the London Court Case. We believe that these areas are the most likely sources of any pending investigation of the Company by US authorities.

[50] The attached letter to Bogatin requested:

(a) backgrounds of the shareholders of YBM and subsidiaries, and any business relationships that Bogatin or the senior managers may have with the shareholders;

(b) material commissions of greater than $10,000 paid by YBM and its subsidiaries, and a similar background analysis of the recipients of these payments;

(c) detailed background of the oil contract and contact persons at the counterparties; and

(d) access to Parente by the Special Committee.

Gatti responded by letter dated October 8, 1996, attaching documents compiled by management in Hungary. He informed Mitchell that there was no information from Arbat because it had been sold.

[51] On November 1, 1996, Mitchell presented the interim report of the Special Committee to a meeting of the Board of Directors held via conference call. The Board decided that the Fairfax Group ("Fairfax") would be retained to assist the Special Committee.

[52] Fairfax was retained on November 8, 1996. The Fairfax team was led by Senior Managing Director Philip Stern, a former prosecutor in New York State. The other members of the team were Clayton McManaway, a former State Department official and diplomat, and William Larkin, a forensic accountant. Fairfax's mandate was to "determine the exact nature of YBM's difficulties with the State Department and/or the U.S. Attorney's Office". Fairfax was also asked to conduct background checks on several individuals, including Mogilevich, Averin, Karat and "Mihalkov".

[53] Fairfax briefed Mitchell regularly between November 1996 and April 1997. After making initial inquiries in December 1996, Fairfax advised Mitchell that the State Department's investigation of YBM involved national security and organized crime issues. In January 1997, Fairfax was asked to conduct a broader review. McManaway and Larkin travelled to Hungary, where they reviewed United Trade and Magnex RT records and operations, and interviewed several of the founding shareholders and United Trade management. They briefed Mitchell on February 6, 1997. Fairfax's primary concern was the potential for money laundering in the Hungarian operations.

[54] Mitchell authorized Fairfax to conduct further background investigations into corporations and individuals. McManaway and Larkin briefed him on March 3, 1997. Fairfax had traced YBM's corporate evolution from Arigon and noted the involvement of the founding shareholders at each step. Fairfax's sources reported that Mogilevich, Kulachenko, Averin, Tamm and Mikhaylov were all linked to organized crime in Eastern Europe.

[55] Fairfax's major briefing took place during two meetings, on March 21 and 22, 1997. The first meeting was held in the offices of First Marathon in Toronto, attended by Stern, Larkin, McManaway, Mitchell, Antes, Wilder and Schmidt. McManaway and Larkin presented Fairfax's consolidated findings and recommendations, summarized as follows:

(a) the founding shareholders were all linked to a Russian organized crime group called "Solntzevskaia". Some of them had links to, or were former members of, the KGB;

(b) the founding shareholders retained significant ownership of YBM and exerted considerable influence over the company;

(c) although there was no evidence of money laundering found, indicia of money laundering were present in the Eastern European operations; and

(d) there were difficulties tracing significant customers and vendors.

[56] Going forward, Fairfax recommended that further work be done, including:

(a) the verification of customers, vendors, shipments, inventory and assets;

(b) interviews of the accountants and a review of their work papers and reports;

(c) further interviews of management of YBM, United Trade and Magnex RT;

(d) a review of cash management and banking arrangements; and

(e) an approach to the U.S. Government, disclosing findings and offering co-operation.

[57] Fairfax repeated the briefing in Philadelphia the following day. This time Bogatin, Gatti and Rossman were present, in addition to Mitchell, Antes and Wilder.

[58] Mitchell authorized Fairfax to verify YBM's customers and vendors. At the end of the March 22 meeting, Larkin and Gatti began assembling a customer list for this purpose. Fairfax later received a 16-page list of U.S. customers compiled by Fisherman (the "Fisherman List") and used this as a basis for its work. In June 1998, the Fisherman List was determined to have been a complete fabrication. On April 13, 1997, during a meeting with Fairfax convened by YBM management, Bogatin questioned findings that Fairfax had presented at the March 22nd meeting. Fairfax completed its engagement in April 1997 and was not asked to perform the further work that it had recommended.

[59] Mitchell and Wilder began drafting the report of the Special Committee (the "Report") in early April 1997. On April 8, Mitchell delivered a draft of the Report to Fairfax for comment. Stern, Larkin and McManaway provided feedback to Mitchell in a conference call. Mitchell incorporated Fairfax's comments into the Report, but Fairfax did not review the ensuing draft. On or around April 11, 1997, Mitchell gave copies of the draft Report (the "April 11 draft") to Lawrence Bloomberg, President and CEO of First Marathon, and Lloyd Fogler, senior partner of Fogler Rubinoff.

[60] Mitchell presented the Report, reading it verbatim, at the meeting of the YBM Board of Directors on April 25, 1997. Every Director was present, as were Gatti and Wilder. Unlike the presentation of the interim report on November 1, 1996, the Board was not provided with copies of the Report. The key points of the Report can be summarized as follows:

(a) U.S. counsel for YBM was advised "off the record" by the U.S. Attorney's Office that there was an "ongoing investigation" involving YBM; while unable to uncover further particulars counsel confirmed that U.S. law enforcement agencies had placed a priority on uncovering infiltration of organized crime from the former Soviet Union into U.S. business; on August 15, 1996 YBM management informed the Board of Directors of their discussions, through counsel, with the U.S. Attorney's Office;

(b) on August 29, 1996 the Special Committee was formed to investigate the situation; counsel for YBM advised that due to a lack of clarity surrounding the matter, public disclosure should not be made at that time;

(c) the mandate of the Special Committee was to independently investigate possible areas of concern arising out of the company's business operations to attempt to determine the basis for any investigation and to recommend further action to address any problems or potential problems uncovered;

(d) the initial review of the Special Committee focused on shareholder and employees/commissioned salespeople, and on contractual arrangements with customers; these two areas were chosen as a focus "as they relate to the legitimacy of YBM's core business";

(e) the Special Committee reviewed the original shareholders list; this review did not raise any concerns, nevertheless the Special Committee undertook a further review;

(f) the initial review of the Special Committee identified very substantial commission payments paid by Arbat which seemed inconsistent with Arbat's business. "In particular, the Committee was concerned about one set of parallel records which showed substantial payments to a Victor Averin on one set and the exact same payments to a corporate entity with a different name on another. Later a third version had different amounts and payees. Management had no explanation for this and, in general, accepted that their direct knowledge of Arbat activities was limited. This was one of the major reasons Arbat had been sold. The Committee noted that Arbat was not a material portion of the Company's sales or earnings."

(g) through Cassels Brock, the Special Committee retained Fairfax, "a large U.S. consulting organization operated by former senior Justice Department, State Department and F.B.I. officials; Fairfax came highly recommended and exhibited a strong track record with respect to dealings in Eastern Europe";

(h) Fairfax was requested by the Special Committee to: discover more details respecting the "ongoing investigation"; do background checks on management, salespeople, and the original shareholders; randomly examine business transactions recorded in the records of the Company to ascertain if bona fide; and review YBM operations and make recommendations regarding improved controls;

(i) the results of the Fairfax review included the following:

i) initial background checks on management showed no concerns regarding Bogatin or other managers located in the United States. In Eastern Europe, however, a number of concerns arose; recipients of Arbat commissions in 1993-95 had clear ties to Russian organized crime. Another recipient of commissions from Arbat was incarcerated in Switzerland. Even though Arbat was sold, it was under the operating control of Kulachenko, one of the original shareholders. Arbat was rumoured to have been a vehicle for criminal acts;

ii) the original transaction respecting the acquisition of the equipment "may not have been as originally described". The price paid by original shareholders for the equipment "was substantially below that booked at the time Magnex [RT] was formed. Management has indicated that the value of the preferred shares issued in consideration for the equipment was based on an independent appraisal of the equipment";

iii) "A second area of concern raised by Fairfax was the possible commingling of the business activities of Magnex RT, United Trade (the offshore sales arm of YBM) and those of the original shareholders resident in Budapest. The same office building was being used to transact activities for all the businesses and shareholder Simon Mogilevich in particular had taken an active interest in the activities of United Trade and Magnex RT despite not being an officer or employee of either company. There was a bank account (since terminated) through which Company business was transacted to which Simon Mogielvich was a signing officer. Management has already taken steps to relocate office activities and ensure proper separation";

iv) there were a substantial number of cash transactions, in particular payment of salaries and commissions. There was a large volume of cash on hand. Management has already taken steps to severely restrict the use of cash payments; and

v) the customer lists were reviewed and it was very difficult to establish end users for the products because of the use of intermediate agents for most sales. Where end users were specified, these proved to be business that used magnets in their production. "Management has begun to improve their client approval process and has agreed to use Fairfax in the future to check out potential customers";

(j) the Special Committee noted that its "most significant concern" was the series of payments made by Arbat "to individuals who had seemingly no tie to the Company's business." There seems to have been no basis for these payments. Management was unable to determine whether these payments were legitimate or some sort of "protection". Despite the fact that Arbat was sold, ties remained. "Simon Mogilevich and the founding shareholders have a long history of business and personal involvement extending back many years. Averin is also from the same area of the Soviet Union as many of the shareholders. Simon Mogilevich admitted that he has known Victor Averin since his youth. Simon Mogilevich and Igor Fisherman... are long standing friends. Anatoly Kulachenko, a founding shareholder, operated and may continue to operate Arbat."

(k) the conclusions of the Special Committee included the following:

i) there is no evidence that "senior management of YBM is in any way involved in any illegal or improper activities";

ii) that in respect of the questions surrounding the original shareholders, it is "not surprising that allegations should be made at successful businessmen of Russian origin trading between the Former Soviet Union and the West";

iii) YBM cannot be expected to control its shareholders and their actions. There is no tangible evidence to tie the original shareholders to any wrongdoing. The Committee directed management to eliminate any ties to the original shareholders in the "day-to-day operations of the Company";

iv) the original shareholders control in aggregate over 40% of YBM common stock; to the knowledge of the Committee there existed no formal agreements among the original shareholders governing their

activities vis-à-vis YBM, but "the existence of this block of shareholders is of concern to the Committee";

v) "the Company's auditors have produced consecutive unqualified audits while clearly understanding the background of the Company and its shareholders. The Fairfax review has evidenced an active business with legitimate customers and suppliers. ... [N]o forensic audit has been undertaken to attempt to track all material flow from supplier to end user as such a task would be extremely difficult in Eastern Europe";

vi) "As regards potential investigation by US regulatory agencies, the visas that prompted the whole issue have been provided without comment. Two immigration agents spent extensive time in the Newtown office attempting, it appears, to ensure that an actual business is taking place. Management believes they left completely satisfied that this was the case. Discussions with counsel have concluded that it is unlikely that any purpose would be served by approaching the FBI or the US Attorney with our conclusions and that it is unlikely that we would ever know if and when any investigation had been concluded."

(l) the recommendations of the Special Committee were as follows:

"a) Provide the Board with an action plan to address each of the following areas:

- Elimination of commingling of business activity with that of Company shareholders in Europe;
- Establish operational controls to ensure that management remains operationally independent from the founding shareholders;
- Establishment of improved cash controls in Hungary;
- The setting of more detailed customer and agent approval criteria;
- The establishment of an accurate data base on these customers and agents;
- Consolidation of accounting control in Newtown; and
- Engage a major accounting firm for the completion of future audits.

b) Establish a permanent subcommittee of the Board or the Audit Committee to supervise compliance with these recommendations and other issues surrounding corporate ethics in the future.

c) Advise the underwriters financing the acquisition of Crucible as to the background and results of this investigation."

[61] Following Mitchell's presentation, the Board and counsel discussed YBM's disclosure obligations. Counsel advised that the existence of the Special Committee should be disclosed in the AIF, to be filed in furtherance of the forthcoming public offering.

The 1997 Offering

[62] YBM filed its AIF on SEDAR on May 2, 1997. The AIF contained disclosure relating to the work of the Special Committee under the heading "Business Risks, Risks Associated with Activities in Eastern Europe". This disclosure was drafted by Wilder with input from Mitchell, Gatti and Bogatin.

[63] By early May 1997, three junior underwriters had joined co-leads First Marathon and GMP in the underwriting syndicate: ScotiaMcLeod, with 20% of the offering, and Canaccord Capital and Gordon Capital, with 5% each. The co-leads had earlier invited Nesbitt Burns to join the syndicate. On May 2, 1997, representatives of First Marathon and GMP met with Jeff Orr of Nesbitt Burns. Mitchell presented the background, formation, findings and recommendations of the Special Committee and Fairfax. Nesbitt Burns declined to join.

[64] In mid-May, First Marathon assigned its head of investment banking, Peter Jones, to lead its due diligence in the offering and sign the underwriter certificates to the preliminary and final prospectuses. On counsel's advice, First Marathon brought in Jones to offset any perception of conflict of interest in Mitchell's role as a Director of YBM and an employee of First Marathon. McBurney continued to lead GMP's due diligence in respect of the underwriting.

[65] First Marathon, later joined by GMP, engaged Price Waterhouse in May 1997 to assist in the underwriters' due diligence. Price Waterhouse reviewed Parente's audit work papers and prepared follow-up questions for First Marathon to ask Parente. In early June, following the filing of the Preliminary Prospectus, First Marathon asked PriceWaterhouse to review customer and vendor companies in Eastern Europe and obtain a valuation of the Magnex RT equipment.

[66] YBM filed the Preliminary Prospectus on SEDAR on June 2, 1997. It incorporated the AIF by reference but did not contain further disclosure about the work of Special Committee. Cassels Brock had drafted the prospectus with input from Bogatin, Gatti, Mitchell, Jones, McBurney and Gary Litwack of Fogler, Rubinoff.

[67] On June 3, 1997, staff from the Commission's Market Operations Branch ("Market Operations") commenced the prospectus review process at a meeting at the Commission attended by Jones, McBurney and Litwack on behalf of the underwriters and their counsel, and Wilder and other members of Cassels Brock for YBM. Market Operations expressed concerns regarding YBM's financial statements and the fact that Price Waterhouse had been retained. They also discussed stories on the Internet that linked YBM to organized crime.

[68] In conjunction with the meetings, staff's prospectus review was conducted through comment letters to YBM counsel. In their first comment letter, staff raised questions respecting the AIF, one of which was about the review of the company's operations and recommendations that were being implemented:

> 10. On page 6 [of the AIF], under the heading "Risks Associated with Activities In Eastern Europe", reference is made to new standards for business practices being implemented by the Board. Please describe the circumstances surrounding the review of the Company's operations. What recommendations are being implemented? Describe the "Standards Applicable to Canadian Companies".

[69] YBM's counsel responded, without indicating the existence of the Report of the Special Committee:

> **Circumstances Surrounding the Review of the Company's Operations**
>
> Over the past year, the Company has had some difficulty in being issued certain business visas for employees. As a result, the Company decided to investigate this further in order to resolve this problem. The Company's efforts confirmed that U.S. law enforcement agencies had placed a priority on uncovering infiltration of organized crime from the former Soviet Union into U.S. businesses. Given the roots of the Company and its affiliates in Russia, and the involvement of former Russian nationals as shareholders and managers of the Company, the Company believes that it may have been examined as part of any such investigation. The visas which prompted the concerns were subsequently issued by the U.S. Government without comment.
>
> As noted in the AIF, the Company took a number of steps to address any possible concerns, including the divestiture in the first quarter of 1996 of Arbat International, Inc., the Company's Russian trading company, and the establishment of a special committee of the board to review the operations of the Company in Eastern Europe.
>
> **Special Committee Recommendations**
>
> The special Committee made the following recommendations which have been or are being implemented by the Company's management:
>
> - Establishment of improved cash controls at the Company's Hungarian facilities;
> - Establishment of more detailed customer and agent approval criteria;
> - Establishment of a more accurate data base on these customers and agents;
> - Establishment of new management information systems; and
> - Consolidation of accounting control at the Company's Newtown, Pennsylvania, head office through establishment of integrated information systems at each site of the Company's operations.

[70] On June 11, 1997, Market Operations alerted YBM's counsel to an anonymous tip suggesting that YBM may be involved in money laundering. Staff from the Commission's Enforcement Branch ("Enforcement") became involved. At the meeting of July 7, 1997, Enforcement advised the underwriters and counsel that Enforcement had "soft information" which questioned the veracity of YBM's sales, but stated that this information would not be the basis for a decision as to the prospectus receipt. In a conference call on September 24, 1997, company and underwriters' counsel were advised that Enforcement was investigating discrepancies in YBM's historical disclosure of magnet and oil sales.

[71] Numerous meetings and conference calls were held throughout the months of June and July 1997. Staff met with Price Waterhouse and reviewed various matters with them. By the end of June, staff advised the underwriters' and company's counsel that they were not prepared to issue a receipt for a final prospectus until YBM's income statement was confirmed by a "Big Six" accounting firm. Staff were not pursuing the rumours and innuendo surrounding YBM, but wanted to confirm issues of related-party transactions. In early July, staff was insisting on seeing actual customer lists for magnets and oil products, classified by location and type of customer (end user versus distributor).

[72] With some reluctance, on July 23, 1997, YBM advised staff that D&T had been retained and had commenced work on a full audit. Staff met with counsel and D&T the next day to discuss the procedures to be undertaken by D&T and staff's requirement of a clean audit opinion. Staff expressed its concerns as to (a) the existence and identity of customers and end users; (b) the tracing of cash receipts and revenue; and (c) the geographic location of customers, which could not be verified to date.

[73] D&T rendered an unqualified audit opinion on YBM's 1996 financial statements on October 13, 1997. On November 4, D&T, Peterson, Gatti, and YBM's and underwriters' counsel met with senior members of staff to discuss the audit. During a discussion on the timing of the receipt for the Final Prospectus, Wilder informed staff that YBM faced an $8 million penalty pursuant to the subordinate convertible notes in the event that a receipt was not issued by November 17. Staff then asked D&T and Gatti over 70 detailed questions about the audit. Peterson responded to questions about the Board's involvement in the audit process.

[74] On November 12, YBM's Board of Directors approved the final prospectus by written resolution. The next day, YBM filed a material change report in respect of D&T's audit and the restated financial statements, particularly the adjustments to geographic sales information. The underwriters held their "bring down" due diligence session soon thereafter. On November 17, the certificates were signed and the Final Prospectus was filed.

[75] The Commission issued a receipt for the Final Prospectus on November 20, after five months of review by Market Operations. During the course of the prospectus review, Enforcement advised YBM that they had opened an investigation file on YBM. The final prospectus disclosed that as part of its continuing review, staff of the Commission requested certain source documentation underlying YBM's disclosure record in connection with the 1996 financial statements. The final prospectus disclosed most but not all of the recommendations made in the Report of the Special Committee. Apart from the AIF, this was the only additional disclosure relating to the Special Committee.

[76] On May 13, the United States organized crime task force headed by the U.S. Attorney's Office for the Eastern District of Pennsylvania executed a search warrant on YBM's offices in Newtown. That same day, the Commission issued a temporary cease trade order in respect of the securities of YBM, which remains in effect.

Settlement of the Civil Proceedings

[77] On May 10, 2002, five civil proceedings before the Ontario Superior Court of Justice were settled, including two class action suits by shareholders who purchased YBM shares pursuant to the Final Prospectus and on the secondary market, respectively. The actions had not proceeded to trial and there were no findings nor admissions of liability. The class action plaintiffs alleged negligent misrepresentations and negligence not only against the respondents in the matter before us, but also the auditors, junior underwriters, lawyers, and officers who were involved in the public offering of shares of YBM. In the reasons for approving the settlement agreement [*CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman* (2002), 26 B.L.R. (3d) 281 at para. 13 (Ont. S.C.J.)], Cumming J. wrote:

> The plaintiffs' pleadings alleged that there was a very sophisticated, multi-layered conspiracy and massive fraud perpetrated upon the public through the utilization of YBM by organized crime. Indeed, the level of complexity and fraud of the alleged overall scheme seems unparalleled in Canadian experience and may well rival any such scheme seen on the international scene.

Cumming J. estimated the loss to purchasers under the Final Prospectus at more than $100 million, and to persons who purchased shares in the secondary market at $250 million. The total settlement through contributions by some of the defendants and third parties was $85 million. Shareholders also received $33.5 million from the YBM estate in bankruptcy.

[78] Two other civil proceedings settled that day involved actions by YBM, through its receiver and litigation supervisor, against the respondents and D&T, Parente, Cassels Brock and former YBM management. The fifth settled civil proceeding involved an action by D&T against YBM, Bogatin, Gatti, Mitchell, Cassels Brock, and First Marathon. On June 7, 1999, YBM pleaded guilty to a charge of conspiracy to commit fraud in the United States.

THE FAILURE TO MAKE FULL, TRUE AND PLAIN DISCLOSURE OF ALL MATERIAL FACTS

[79] Staff have alleged violations contrary to subsections 54(1), 56(1), 58(1) and 59(1) of the Act. They are more fully described above.

Risk-Related Disclosure in the Preliminary Prospectus and Final Prospectus

[80] YBM tended to disclose both the existence of a risk and the factual reason for it. For example:

a) because YBM depends on a small number of key employees, losing one or more of the key employees could have a material adverse effect on YBM's performance;

b) because YBM's manufacturing process is highly automated and YBM is unable to rapidly scale down its cost structure over the short to medium term, a significant reduction in orders for YBM's products would harm YBM; and

c) because the market prices of certain key raw materials are extremely volatile, a dramatic rise in those prices may have a material adverse effect on YBM's profitability.

[81] In contrast, the section on Risks Associated with Activities in Eastern Europe did not clearly state both the risks and the factual reason for those risks. The sum total of the company's disclosure respecting the mandate, information obtained by and findings of the Special Committee, is found in two paragraphs. One paragraph was in the AIF, and the other in the Final Prospectus. In the AIF the company made the following disclosure at page 6:

> **BUSINESS IN GENERAL**
>
> **Business Risks**
>
> *Risks Associated with Activities in Eastern Europe*
>
> The Company's manufacturing operations are located in Hungary. Additionally, 47% of consolidated net sales are concentrated in Eastern Europe. Economic, political and general business conditions in these regions are highly inflationary and are potentially unstable.
>
> The evolving market economies in Eastern Europe are characterized by a high level of cash transactions as well as less rigorous financial controls. The Company has and continues to implement recommendations made by independent public accountants and others with expertise in these regions to improve the Company's operations in these regions.
>
> Over the last two years the Company became aware of concerns that had been expressed in the media and by government authorities generally concerning companies doing business in Eastern Europe and, particularly, in Russia. To this end, the Company has taken a number of steps to address these concerns, including:
>
> 1. the divestiture in the first quarter of 1996 of Arbat International, Inc. ("Arbat"), the Company's Russian trading company which distributed a variety of consumer goods and materials through Eastern Europe and Russia. Upon a review of Arbat's operations, management was not satisfied that adequate customer and sales representative acceptance procedures could be implemented, including monitoring the propriety of sales commissions paid to sales representatives; and
>
> 2. the establishment of an independent committee of the board of Directors who retained experts knowledgeable with political, social and economic issues in Eastern Europe to review the Company's operations to ensure that they are consistent with the standards applicable to Canadian public companies. Recommendations resulting from such review are being implemented by the Company. The board of Directors, through the Audit Committee, will monitor ongoing compliance by the Company with such recommendations.

[82] The only additional disclosure made by YBM pertaining to the mandate, information obtained by and findings of the Special Committee, was in the Final Prospectus, under a general heading "Business of YBM", wherein the company disclosed the following at page 5:

> In order to address the special risks inherent in carrying on business in Hungary in particular and Eastern Europe in general, YBM:
>
> (a) has established improved cash controls at its Hungarian facilities;

(b) has developed more detailed end user and distributor approval criteria;

(c) is in the process of establishing a more accurate database respecting its distributors and end-users;

(d) is in the process of implementing new management information systems; and

(e) is in the process of improving and centralizing controls over all of its international accounting activities at its Newtown, Pennsylvania head office.

The intent of the foregoing initiatives is to ensure that despite the fact that YBM carries on a substantial portion of its activities in Eastern Europe, its internal controls and financial reporting standards will be in accordance with those otherwise generally applicable to Canadian public companies...

[83] The final prospectus also stated that except for certain non-cash restatements and reclassifications to YBM's existing 1996 financial statements, "a major international accounting firm" had rendered an unqualified audit opinion regarding those financial statements.

To summarise, the parts of the AIF and the rest of the prospectus that dealt with risks other than the "special" risks connected with Eastern Europe plainly disclosed both the existence of a risk and the factual basis for the risk. The sections on Eastern Europe were considerably more opaque in describing the precise risks facing YBM and the factual basis for those risks.

Material Facts

[84] The Act defines a "material fact" for disclosure purposes, where used in relation to securities issued or proposed to be issued, as "a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of such securities." Normally, materiality, which is fact-intensive, invites considerable debate, but, in this case, so did the meaning of a fact within subsection 1(1) of the Act. For instance, it was submitted that the information Fairfax provided regarding links between the founding shareholders and organized crime was not factual and therefore not a material fact.

[85] What is "a fact" within the meaning of the Act? A fact, in and of itself, is not defined in the Act. Staff submit that the disclosure engaged herein involves the disclosure of risk which is by definition uncertain. The meaning of "a fact" should not be read supercritically; *Re Royal Trustco Ltd. and Ontario Securities Commission* (1983), 42 O.R. (2d) 147 at 152 (Div. Ct.); NP47, Appendix A, AIF Guidelines 1 and 4 [now NI 44-101 and the accompanying forms 44-101F1 and F3]. Dictionaries were drawn in support of positions that facts must be verifiable by reference to existing objective or external sources.

[86] The respondents argue that a risk cannot be an uncertainty built upon an uncertainty. Stated somewhat differently, risk is the antithesis of fact or risks are a product of a set of underlying facts without which the probability of an outcome is not assessable. Furthermore rumour is uncertain, unverifiable and therefore is not a fact within the meaning of the Act. In *R. v. Fingold* (1999), 45 B.L.R. (2d) 261 (Ont. S.C.J.) (*Fingold*), an insider trading case, Keenan J. stated at para. 56:

> "facts" must mean more than mere rumour or gossip on the street or even an "overpowering suspicion". It must be information obtained from an identifiable source which might reasonably be expected to have such information and obtained in circumstances which would tend to support the accuracy and reliability of the information given.

Keenan J.'s approach is both normative and pragmatic.

[87] Staff submit that facts that give rise to a material risk are material facts. The facts, from a professional and reliable source, are not uncertain, only the risk. In that sense, both are facts and must be assessed for materiality. We agree with this approach, that is, that risks are facts within the meaning of the Act. Risk factor disclosure is common in prospectuses and specifically addressed in the prospectus rules under the Act. There can be little doubt that risks are facts that must be disclosed if they are material. NP47 made this clear; Item 3(2)(e) to Appendix A and Item 18 to Appendix B [now Item 3.3 of Form 44-101F1 and Item 18.1 of Form 44-101F3]. In most circumstances not only should the risk be disclosed, if material, but also the underlying facts, as YBM did in parts of the AIF.

[88] The essence of what is engaged in this case is the disclosure of risk. Were the risks faced by YBM fully, truly and plainly disclosed as simply general business risks associated with activities in Eastern Europe? Were the concerns simply those expressed by the media and government authorities generally concerning companies doing business in Eastern Europe and, particularly, Russia? If not, was YBM uniquely subject to material risks that were not disclosed?

The Materiality Assessment

[89] Disclosure in securities markets encourages investing and therefore growth. Disclosure protects investors, aids in ensuring that securities markets operate in a free and open manner and ensures that a security will nearly correspond to its

actual value. Too much disclosure or information overload can be counter-productive. The boundaries are identified by the concept of "material facts". The definition appears straightforward but its assessment is nuanced.

[90] Assessments of materiality are not to be judged against the standard of perfection or with the benefit of hindsight. It is not a science and involves the exercise of judgement and common sense; *Core Mark International Inc. v. 162093 Canada Ltd.* (8 June 1989) Toronto 1220/89 at 4-5 (Ont. H.C.)

[91] The test for materiality in the Act is objective and is one of market impact. An investor wants to know facts that would reasonably be expected to significantly affect the market price or value of the securities. The investor is an economic being and materiality must be viewed from the perspective of the trading markets, that is, the buying, selling or holding of securities. Price in an open market normally reflects all available information. YBM was not a thinly traded stock. As such, its price more likely reflected the information disclosed to the public market. Full disclosure of adverse information may lower the price but it does not shut out a security from the market.

[92] There was extensive reference to the U.S. law on materiality. The reasonable investor test or substantial likelihood test is found in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) (*TSC Industries*). Generally, for historic information like past financial results or completed business transactions this test frames the materiality assessment. When facts point to a future event, the U.S. courts have applied the probability/magnitude test; *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). This test analyses the current value of information as it effects the price of securities discounted by the chances of it occurring. This test has been applied by the Commission in *Re Sheridan* (1993), 16 O.S.C.B. 6345, and in *Re Donnini* (2002), 25 O.S.C.B. 6225 (*Donnini*).

[93] Disclosure is contextual. In the U.S. this has been identified as the total mix of information test; *TSC Industries* at 449. It seems sensible that the respondents must take into account the import of all extant disclosures, positive or negative, in order to assess whether a fact is material.

[94] Materiality is a question of mixed law and fact, i.e. do the facts satisfy the legal test? Some facts are material on their own. When one or more facts do not appear to be material on their own, materiality must also be considered in light of all the facts available to the persons responsible for the assessment.

[95] The materiality assessment in this case involves a consideration of whether material facts respecting the mandate, information obtained by and findings of the Special Committee were omitted from the disclosure documents. Would the disclosure of such information translate into market gains or losses? In our opinion, the critical question is whether certain undisclosed facts contained in the Special Committee Report would have revealed that YBM was, at the time, exposed to risks that would reasonably be expected to have a significant effect on the value of YBM's securities if disclosed.

[96] Peterson refers to U.S. law for the principle that uncharged criminal conduct or unadjudicated violations of the law generally need not be disclosed. *U.S. v. Mathews*, 787 F.2d 38 (2d Cir. 1986); *SEC v. Chicago Helicopter Industries*, 1980 U.S. Dist. Lexis 17214 (N.D. Ill. 1980). This is in reference to the allegation that the company had confirmed it was the subject/target of an ongoing highly sensitive criminal investigation by U.S. law enforcement authorities.

[97] According to John M. Fedders, "Qualitative Materiality: The Birth, Struggles, and Demise of an Unworkable Standard" (1988) 48 Cath. U. L. Rev. 41 at 89:

> The rule is that corporations need not disclose unadjudicated violations of law or antisocial or unethical conduct unless the information is quantitatively significant to investors and alters the total mix of information made available. The compelled disclosure of uncharged and unadjudicated criminal conduct would violate the Fifth Amendment.

[98] The allegation in this case is not whether YBM was engaged in money laundering or some other criminal activity. There is also no allegation that any of the respondents believed the company was a fraud or was not a real company. The evidence regarding the U.S. investigation and possible criminal associations of the founding shareholders and board knowledge is relevant, according to staff, because it demonstrates that the risks facing YBM were real and were readily identifiable through reasonable investigation and diligence.

[99] The U.S. case law with respect to such disclosure is caught up in Fifth Amendment issues related to self-incrimination and testimonial compulsion. There were no such arguments in this case.

[100] In our opinion, the events in this case are extraordinary in nature, the disclosure of which would likely have a significant effect on the market price or value of the securities. The cases referred to by staff and the respondents generally involved insider trading, credible merger negotiations, proxy statements or uncharged and unadjudicated violations of the law. These cases present discrete events in which the materiality analysis is quite straightforward. Such is not the case herein. Would the disclosure of these facts likely affect the market price or value of its securities?

[101] In this regard, we agree with the respondents that the application of the probability/magnitude test to the investigation by U.S. law enforcement agencies as a discrete event is problematic. In essence, the fact of the investigation was incapable of the application of the probability/magnitude test. Probability could not be determined with perfect certainty. However, this does not mean that a fact cannot meet the test for materiality set out in the Act. One should not lose sight of the forest for the trees by assessing the materiality of individual facts piecemeal when the broader factual context suggests a risk faced by an issuer. Some facts may be material on their own, while others may only be material in the context of other facts. The probability/magnitude test is useful in assessing the occurrence of a future event, but common sense must prevail. The broader factual context, or total mix, must not be overlooked when the risk facing the company is a current one.

The Omitted Material Facts

[102] Did the Preliminary Prospectus or Final Prospectus contain any misrepresentations or omissions respecting the facts particularised in the allegations made by staff with respect to the mandate, information obtained by and findings of the Special Committee? If yes, the Commission must consider whether the misrepresentations or the omissions are material.

[103] Staff and the respondents address the alleged deficiencies in somewhat different ways. Basically, staff submit that there are 14 items of information that related to the work of the Special Committee that were omitted. National Bank compresses these items into three essential questions:

1) Was YBM the target of an investigation and, if so, what was the unlawful conduct alleged to be taking place and who was conducting the investigation?

2) Were the founding shareholders engaged in organized criminal activities and, if so, what criminal activities?

3) If the shareholders were engaged in criminal activities were those criminal activities being co-mingled with the business of YBM?

[104] The respondents' general response to the information which was not disclosed is two-fold:

a) The information was rumour or merely speculation – i.e. the information was not fact, or

b) the issues had been resolved no longer making the facts material.

[105] Staff submit that, with the exception of the actual violations underpinning the U.S. investigation, the respondents had knowledge of material facts when the AIF and the preliminary and final prospectuses were filed. It is submitted that comparing these facts with the facts that the respondents chose to disclose demonstrates the extent to which the public was denied the benefit of full, true and plain disclosure. In short, staff's position is that investors were unaware of the specific risks facing YBM.

The U.S. Investigation

[106] Was YBM the target of an investigation? What was the unlawful conduct at issue and who was conducting the investigation? The respondents do not take the position that the findings of the Special Committee as recorded in its Report are all rumours, speculation, or give rise to concerns or suspicions. Mitchell agrees that:

a. In August 1996 there was a U.S. Government investigation involving YBM and as subsequently uncovered by the Special Committee or Fairfax;

b. prior to its divestiture by YBM, Arbat had made substantial commission payments to agents that seemed inconsistent with a trade goods business and there were two records of these payments which showed inconsistent payees;

c. background checks on Bogatin and other YBM managers located in the United States revealed no concerns; Fisherman, YBM's head of European operations, was a longstanding friend of Mogilevich, one of the founding shareholders; overall, there was no evidence that management of YBM was involved in any illegal or improper activities;

d. the founding shareholders purchased the founding equipment, which they transferred to YBM for an amount substantially less than what YBM paid for it;

e. one of YBM's business offices in Budapest was in the same building as the office of Mogilevich; Mogilevich had held signing authority on a bank account through which YBM business was transacted;

f. YBM engaged in a significant number of cash transactions, in particular payment of salaries and commissions;

g. there was a substantial production volume and level of activity at YBM's magnet manufacturing facility in Budapest;

h. end users of YBM's magnets both in Eastern Europe and North America were identified as *bona fide* businesses that utilised magnets in their production; and

i. none of the founding shareholders had been convicted of any crime.

[107] Mitchell describes these as the business operational facts. Some are disclosed in the Final Prospectus along with the existence of the Special Committee and some of the recommendations that were being implemented. However the real issue is whether any of the omitted facts were material and required disclosure.

[108] The materiality of the facts regarding the investigation, unless they are material in and of themselves, must be assessed contextually, i.e., in accordance with the other findings of the Special Committee. Staff contend that the investigation was confirmed by Rossman and Fairfax. It was generally agreed that U.S. law enforcement agencies had placed a priority on uncovering infiltration of organized crime from the Soviet Union into U.S. business. Rossman ultimately received information from the U.S. Attorney in Philadelphia that YBM was under an investigation of an unspecified nature. YBM did not specifically know the specific subject matter of the investigation. Indeed, Rossman did not know what the outcome of the investigation might be. It was unclear whether the US investigation involved issues of national security and/or organized crime. It is clear that no charges had been laid or any search warrants or target letters issued. There was no evidence that any officer or director of YBM was the target or subject of an investigation. There was no evidence that any of its employees were violating any laws. The rumoured involvement of the founding shareholders in organized crime provided a potential reason for the U.S. Government's investigation into YBM. Rossman had provided his views to the Board on August 15, 1996. The final prospectus was receipted on November 20, 1997. No action had been taken by U.S. government law enforcement authorities during this period.

[109] Rossman wrote Bogatin on August 2, 1996 and met with the Board on August 15 and August 29. In an effort to obtain information with respect to the denial of the employee visas (or the investigation), Rossman confirmed to Bogatin in his August 2 letter as follows:

> Peter Hearn was told that the Senator could not meet with us based upon information received from a staff member of the Senate Intelligence Committee...the US attorney returned Peter's call and said he could not meet with us. He confirmed that the Department of Justice was conducting a "highly sensitive" criminal investigation of YBM Magnex and that it would be inappropriate to meet with us...he said he could not discuss the nature of the investigation because it is "especially sensitive"...in view of the fact that for the first time we have a confirmation that YBM Magnex is the target of a federal criminal investigation, we must advise that this information be immediately made known to the board of directors...we have no idea how long this cloud may continue to linger over the company. We do know, however, that the situation is serious.

[110] Mike Rotko, an attorney, also advised Godshall (Rossman's partner) that he spoke with the Chief of the Criminal Division at the US Attorney's Office and confirmed that it was a Philadelphia case with undercover work going on. Following the meeting of outside Directors held on August 29, 1996, Wilder's notes of that meeting record Rotko's confirmation of the investigation as being out of Philadelphia. His notes also state "is it official – has been confirmed by individuals formally" and "probably initiated by FBI." The fact that YBM was advised that the U.S. Attorney's Office confirmed a highly sensitive investigation of YBM was in progress is also confirmed in the chronology prepared by Gatti, which he read aloud at the August 15, 1996 meeting.

[111] The respondents generally challenged this information as being multiple hearsay. Despite section 15 of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22 (the "SPPA"), the respondents argue that hearsay, even if admissible, is not reliable and in any event is not clear and convincing evidence because it is too imprecise to be considered a fact within the meaning of subsection 56(1) of the Act.

[112] There was much discussion around whether or not Rossman had indicated that YBM was the target or the subject of a criminal investigation. It is clear that they mean different things. The U.S. Attorney's Manual of the Department of Justice states as follows at section 9-11.151:

> A "target" is a person as to whom the prosecutor or the grand jury has substantial evidence linking him or her to the commission of a crime and who, in the judgment of the prosecutor, is a putative defendant. ... A "subject" of an investigation is a person whose conduct is within the scope of the grand jury's investigation.

[113] Rossman conceded that he might have used the word target after speaking with Hearn even though Hearn may not have used it. What may be more significant than YBM being the subject or target of an investigation was the information that Rossman had that led him to use the word target.

[114] McManaway of Fairfax testified that he advised Mitchell in December 1996 that the concerns of the State Department were national security, organized crime or both. McManaway further testified, consistent with the March 21, 1997 Fairfax speaking notes, that he advised Mitchell and others that the FBI was investigating YBM. Fairfax provided little more information regarding the investigation. Fairfax also testified with respect to links between the founding shareholders and organized crime as well as the issue of commingling. A broad-based attack is mounted against McManaway with respect to his credibility for two principal reasons. First, it is argued that McManaway contradicted portions of his deposition given in a U.S. civil proceeding. Second, it is argued that McManaway inappropriately spoke to his own counsel during his cross-examination. We accept that the discussions with counsel were not with respect to his evidence in this proceeding. We do not find that McManaway was inappropriately influenced. Moreover, we see no reason to doubt his explanation for the alleged contradiction in his testimony as between the U.S. civil proceeding and this hearing. His preparation for this hearing was extensive. While he was to be generously paid for his evidence herein, this does not detract from the reliability of his testimony. Witnesses cannot be expected to not have any inconsistencies nor can they be expected to have perfect recall.

[115] Mitchell confirmed that Fairfax advised him that the investigation concerned national security or organized crime. Mitchell did not regard this as new information and that it independently confirmed Rossman's information. It is clear that Mitchell did not question the reliability of the information provided by Fairfax at that time. Rather than causing his antennae to go up, he treated the facts as nothing new.

[116] Rossman and Fairfax were independently retained to assist YBM and the board in attempting to ascertain the facts with respect to the investigation. Prior to this the U.K. proceedings were ultimately withdrawn in July 1995. It would not be unreasonable to regard these proceedings together with the information contained in the pleadings and correspondence as somewhat ominous.

[117] Earlier on we asked, was YBM the target of an investigation and if so what was the unlawful conduct alleged to be taking place and who was conducting the investigation?

[118] The evidence of Mitchell, Gatti and Peterson is instructive as to whether or not there was a U.S. criminal investigation into YBM. The November 1, 1996 interim report of the Special Committee states that in August 1996, "the management of YBM ... were made aware of a pending investigation of the Company and its activities through the U.S. Attorney's Office in Philadelphia." Mitchell stated that he did not view this information as rumour. He was not certain whether it was an investigation of YBM or its shareholders. Mitchell knew it was a sensitive matter which was serious in nature but not the actual subject matter. Gatti had also indicated that he knew there was a highly sensitive investigation involving the company. This was in part due to the FBI Affidavit, which identifies Arbat as a front to transmit large sums of money from Moscow to a Budapest company overseen by one Seva Mogielevich. No explicit reference to YBM was made but Gatti drafted the December 1996 Questionnaire Letter for the founding shareholders. Gatti suggested that this affidavit "most assuredly is the root of their problems." Mitchell testified that Bogatin advised him of the relevant sections of the FBI Affidavit and that it appeared consistent with the information that Fairfax was providing to him.

[119] Peterson acknowledged that while Rossman's letter of August 2, 1996 used different language than that discussed at the August 15, 1996 board meeting, the essence of what was conveyed was the same. He acknowledged that the word criminal was used but not in any particular context. Moreover, Davies testified that he was not shocked by what he heard on August 15, since he had been visited by several FBI agents in Florida in April 1996. The agents possessed a folder with Davies' and YBM's names on it. They advised him that there was an investigation but did not refer specifically to YBM. They solicited his assistance in this investigation but he declined. The information which he heard on August 15, 1996 should have confirmed Davies' view as to materiality rather than simply doing nothing.

[120] The Report notes that Rossman was unable to uncover further particulars about the investigation and that YBM had not been formally contacted by authorities with regard to it. The Report further confirms that U.S. law enforcement agencies had placed a priority on uncovering infiltration of organized crime from the former Soviet Union into U.S. business. Consequently it was reasonable to expect given YBM's operations in Eastern Europe that they would be examined in connection with such an investigation. While the employee visas were eventually issued there was no suggestion that the investigation was not ongoing. Rossman also testified, consistent with his notes, that Bogatin advised him on March 26, 1997 that YBM was visited by an INS field worker seeking for a three-year period, a list of customers and vendors for YBM and its subsidiaries. Rossman further testified that it did not appear to be a normal immigration investigation. YBM would subsequently learn from its immigration counsel in the fall of 1997 that the INS investigation was a fraud investigation.

[121] Mitchell contends that the facts obtained as a result of the Special Committee investigation were considered in assessing the materiality of the U.S. investigation and militated against a finding of materiality and therefore disclosure. Neither Rossman nor Fairfax could bring any greater specificity to the U.S. investigation than that provided on August 15, 1996. Moreover, the Board was continuing to receive information that YBM was a legitimate business, run by honest managers with legitimate customers. The Directors never learned despite their efforts what was being investigated; what specific law or laws were engaged; how long the investigation had gone on; how long it might continue; what was the likelihood of a charge being laid; or if it would be charged with something the magnitude of which would threaten the very existence of the company? In the

period from August 15, 1996 to November 20, 1997, other than the interest shown by the INS, YBM learned nothing more from the U.S. Government with respect to the investigation. Mitchell contends that the fact of the investigation was incapable of the application of the probability/magnitude test. This approach was reinforced by legal advice regarding disclosure.

[122] Staff take a different approach to materiality. It is staff's view that the assessment of materiality with respect to the investigation and the role of further inquiries was to assess whether there were overall serious risks to the company, while the reason for the further investigation by the respondents was to determine the exact nature of the investigation.

[123] It is important to note that Rossman informed YBM of two matters – (a) U.S. law enforcement agencies had placed a priority on uncovering infiltration of organized crime from the former Soviet Union into U.S. business and (b) YBM was the target (subject) of a criminal investigation. Fairfax separately and independently confirmed an FBI investigation into YBM. Neither Rossman nor Stern believed the investigation would be quietly closed although that was always a possibility.

[124] Stern testified that a problem with the company was the antecedent people involved, i.e. the founding shareholders. He was confident that the information that the investigation involved organized crime or national security was from reliable sources. It is uncontradicted that the founding shareholders and others related to them owned at least 40% of the common shares of YBM and that they were shrouded by the spectre of organized crime.

[125] We are of the opinion that there was sufficient confirmation of the aspects of the investigation to assess whether these facts are material within the meaning of the Act. In addition to the Rossman and Fairfax evidence there is: the FBI visit to Davies; the FBI Affidavit; the U.K. proceeding, the information provided to YBM by the State Department that YBM was conducting some illegal activity; Rep. Greenwood's refusal to meet with YBM given the sensitivity of the State Department information; information from Sean Slack, Rep. Greenwood's aide, that the Senate Select Committee on Intelligence was briefed about the employee visas; and the interest shown by the INS field worker in YBM's customers, which all provide sufficient evidence to conclude that the company had confirmed that a highly sensitive criminal investigation was being conducted by the U.S. law enforcement authorities including the U.S. Department of Justice and FBI involving either national security or organized crime or both.

[126] Staff do not criticize YBM's efforts to ascertain whether or not there was an investigation by U.S. Government authorities. The further efforts provided little comfort however and should have in staff's submission triggered disclosure obligations. In essence the Board and underwriters exercised their judgement but did not do so prudently in the circumstances of the case.

[127] In our view, if the facts regarding the investigation were not material in and of themselves, they were unquestionably material as part of the broader factual context.

The Mandate of the Special Committee

[128] Staff have alleged that there was not full, true and plain disclosure of the mandate of the Special Committee. At the April 25, 1997 Board meeting, Wilder advised that YBM should disclose the existence of the Special Committee. According to the Report, the Special Committee's mandate was to independently investigate possible areas of concern arising out of the company's business operations, determine the basis for any investigation and recommend further action to address any potential problems uncovered. In a letter to Antes, Mitchell noted that the mandate of the Special Committee was to identify any correlation (including share ownership) between YBM (or its subsidiaries) and individuals of criminal background as had been suggested by articles in the European press and allegations in the U.K. court case. Mitchell believed that these areas were the most likely sources of any pending investigation of the company by U.S. authorities. The disclosure of the Special Committee is found in the AIF disclosure reproduced in the Risk Related Disclosure section above.

[129] The Special Committee requested counsel to advise it on its legal obligations with respect to disclosure and any potential legal action. There is no question that the Special Committee and the Board were alive to the issue of disclosure. We find that the disclosure leads the reader to believe that the risk faced by YBM was nothing more than the inherent risk faced by any company doing business in Eastern Europe at that time. This is not accurate. Once it was decided to disclose the existence of the Special Committee, it follows that disclosure of its mandate was also required. In this case, the disclosure was completely inadequate. In our view, if the mandate of the Special Committee was not material in and of itself, it was unquestionably material as part of the broader factual context.

Shareholder Links to Organized Crime

[130] Staff further submit that information supplied by Fairfax and senior management of YBM confirmed that there was ample justification for the criminal investigation because one or more of YBM's founding shareholders, which as a group controlled over 40% of the company's shares, were, according to Fairfax, linked to an Eastern European organized crime group. As indicated previously, the respondents took the position that the information supplied by Fairfax was riddled with hearsay and multiple hearsay and was not reliable. Mitchell, at the time, accepted Fairfax's information and testified he had no reason to

challenge it. National Bank vigorously challenges much of the Fairfax information as rumour. As indicated above, this case is not about organized crime or money laundering. However, we agree that if the quality of the information underpinning the conclusion that there were undesirable ties to YBM is the only basis for a materiality assessment, then we might agree with the respondents. However, that is clearly not the case in these circumstances.

[131] There was no information disclosed in the AIF, the Preliminary Prospectus or the Final Prospectus regarding organized crime. We take no issue with that in and of itself. However, it would appear that staff's allegations with respect to this disclosure is narrower than that argued by the respondents. Staff submit that this evidence suggests there was something percolating beneath the surface.

[132] The founding shareholders in YBM had historically been involved directly or indirectly in the business and affairs of the company. They were involved in various capacities with Magnex RT, Pratecs, United Trade, Arbat and YBM.

[133] Mitchell testified that the contents of the FBI Affidavit, which he was aware of but did not obtain a copy of, were consistent with the information being provided by Fairfax. At the very least this information corroborated some of the information from Fairfax, for example, that Mogilevich had ties to Eastern European crime. While the FBI Affidavit predated the U.K. proceedings, which were withdrawn, its significance did not disappear. For example, YBM had recently been informed of the U.S. investigation.

[134] Mitchell was of the opinion that in 1995, there were doubts about the merits of the allegations in the U.K. proceedings with respect to wrongdoing of any of its shareholders. This may also have been the view of the Alberta Stock Exchange. However, we prefer Rossman's approach to this event:

> In addition, the FBI's allegations are quite similar to those allegations of British law enforcement authorities which were withdrawn when their evidence could not stand the light of day....
>
> So – here we sit representing a company under federal criminal investigation for unspecified charges probably related to activities outlined in the FBI affidavit.

[135] Rossman testified that at his meeting with management, they did not refute that Mogilevich was linked to organized crime. This information could not be discounted despite Sergeant Wanless withdrawing the allegations in the U.K. proceedings.

[136] There remains the Izvestia article. This article is not relied upon as evidence of the founding shareholders' involvement in organized crime. It does refer to Mogilevich and Mikhailov. It was retracted privately but not publicly and not completely. The respondents placed considerable reliance on the retraction.

[137] What is the significance of all this evidence regarding the founding shareholders? In summary, it is relevant to a consideration of whether there was a US criminal investigation into YBM and that YBM faced serious undisclosed risks. Does this information contribute to deciding whether or not there was a disclosable event? Mitchell's testimony is that he did not attribute much importance to the FBI Affidavit on the basis that the information was similar to that he was receiving from Fairfax and also because it predated the U.K. proceedings, which were withdrawn.

[138] Whether or not all of the sources were believable, much of the information was hearsay and some of the information could not be confirmed, whether or not you could disprove a negative, it was clear that Fairfax's investigation was starting to portray a more coherent picture of what was taking place around YBM. While such things as the divestiture of Arbat appeased the board to some extent, the various events in the past, in our opinion, had not rendered the concern of the U.S. Government simply historical.

[139] Mitchell indicated that he could do nothing about the founding shareholders. His idea was to put "a box around the company", to keep them out of the business. He concluded that YBM was a legitimate business. However, the Special Committee Report discussed several concerns. Rumoured involvement of shareholders in organized crime was noted from a variety of sources. Ties remained between Mogilevich and the founding shareholders. Questionable commission payments were made to Victor Averin who had known Simon Mogilevich since their youth. Fisherman and Mogilevich were friends. Kulachenko, a founding shareholder, operated and may have continued to operate Arbat. As is evident, the Committee noted that a second lingering concern was the continued substantial founding shareholder ownership of YBM. This clearly concerned the Committee on a going forward basis. Mitchell dealt with what he had, i.e., a relatively new Eastern European business with which he is inexperienced. Even if the facts regarding the founding shareholders are not material in and of themselves, they were material as part of the broader factual context. They support the likely basis of the investigation flowing from the Rossman/Fairfax evidence. They support the nature of the risks facing the company presently and specifically. They support greater disclosure, which would have significantly altered the market's perception of YBM's state of affairs.

Commingling of the Founding Shareholders in YBM's Business

[140] There was considerable evidence and argument with respect to commingling. If shareholders were engaged in criminal activities, were those activities being co-mingled with the business of YBM? The allegation around commingling involves Mogilevich, who had signing authority over a bank account through which YBM was transacting business. There was nothing in the AIF, the Preliminary Prospectus or the Final Prospectus with respect to commingling. There were two cash accounts, the Technology Distribution account and a Visa account in the name of Mogilevich. The Technology Distribution account served as United Trade's main operating account for a limited period of time. Gatti testified that United Trade began using this account in the summer of 1995 after the U.K. proceedings. Gatti and Mitchell stated that no unusual transactions went through the Technology Distribution account and any problems related to it had been resolved by closing the accounts prior to the Final Prospectus. Fairfax appeared to agree that the transactions or the cash did appear to belong to United Trade and not Mogilevich. The Mogilevich Visa account was also subsequently closed and no evidence had been found that Mogilevich was using the corporate Visa card. These efforts were part of Mitchell's desire to "box out" the founding shareholders.

[141] The Special Committee Report acknowledges that the same office building was being used to transact activities for all the businesses and Mogilevich in particular was actively involved in activities related to United Trade and Magnex RT, despite not being an officer or employee of either company. Nevertheless YBM moved United Trade's office out of the shared space by the time of the Final Prospectus. As such, despite the somewhat technical nature of the arguments associated with commingling and any inferences therefrom, the respondents deny materiality since the issues associated with them were resolved prior to the filing of the Final Prospectus. Fairfax's concern with Mogilevich's involvement and the use of these accounts was that this could be a sign of money laundering and as such another red flag for YBM.

[142] Staff contend that there was ample justification for concern because Arbat had made commission payments which management could not explain involving hundreds of thousands of dollars to persons with clear ties to Eastern European organized crime. The AIF stated that the "evolving market economies in Eastern Europe are characterised by a high level of cash transactions as well as less rigorous financial controls." This issue roughly corresponds with Mitchell's business operational fact wherein prior to its divestiture by YBM, Arbat had made substantial commission payments to agents that seemed inconsistent with the trade goods business. Mitchell testified that these commissions were paid to agents, whereas staff submit that they were paid to persons with clear ties to Eastern European organized crime.

[143] The Special Committee Report notes that Fairfax found that the commission payments were to Victor Averin and Arnold Tamm in 1993-1995. They had ties to Russian organized crime. The Report further notes that "management have been unable to establish whether these payments might have been some form of 'protection' or whether these individuals were actually active in the Company's business during this period." While the respondents agree the payments were questionable, they viewed them as not significant because Arbat paid the commissions, not YBM, and YBM sold Arbat before the Final Prospectus. Mitchell relies upon the following evidence to establish that Arbat paid the commissions: (1) Bogatin advised Mitchell that certain commission payments were indeed Arbat payments; (2) Rossman appears to confirm that in a memo to Godshall; and (3) Gatti also testified that Bogatin advised him that United Trade paid some commissions for sales that went through Arbat

[144] Staff take the position that it was unreasonable for YBM to conclude that the commission payments were paid by Arbat and consequently that these issues were resolved with the sale of Arbat. We agree for a number of reasons: (1) the payments are recorded in United Trade's ledger; (2) some of the payments post-date the sale of Arbat on April 1, 1996; and (3) Fisherman remained in charge of YBM's Eastern European operations after the sale. Staff also suggest that the Arbat sale was not at arm's length. The Special Committee Report states that Arbat was sold to a company formed by the founding shareholders and was under the operating control of one of them.

[145] It is clear that the divestiture of Arbat did not resolve all the problems associated with inappropriate commission payments. It is difficult to rationalise why there were commission payments from Arbat to Averin in the United Trade ledger after the divestiture of Arbat. Either the commission payments were actually from United Trade to Averin, or the divestiture of Arbat was not at arm's length. The AIF states that Arbat was divested due to concerns regarding Eastern European companies. This is incorrect. Arbat was divested due to company-specific concerns not general ones surrounding companies in this region.

[146] Furthermore, the existence of a set of parallel records showing substantial payments to Averin on one set and the exact same payments to a corporate entity with a different name on another concerned both Mitchell and Gatti. It would appear that the general ledger of the company had been altered and Mitchell agreed that he never received a satisfactory explanation as to why and how it had been altered. He thought the commission payments were serious. Basically there was no satisfactory explanation for the parallel records. The argument of the respondents and in particular Mitchell was that it was not material as it was historical, having ended with the divestiture of Arbat. For the reasons indicated above, this explanation is insufficient as an answer to the concerns raised by these payments and records.

[147] We question YBM's conclusion that the commingling issues were not material as they were merely historical, and we question whether they were sufficiently historical. The shared office space and bank account issues were addressed in the months leading up to the offering. Arbat had been sold just over a year before the Preliminary Prospectus was filed. Taken together with the other facts and information of which YBM was aware, in our view, these events were still sufficiently recent such that they could reasonably be expected to have a significant impact on YBM's market price.

Equipment

[148] Staff submit that YBM faced further risks as indicated by false records of the Original Equipment Transaction (the equipment being purchased from the founding shareholders). Generally the respondents submit that any concerns regarding the false records or the value of the equipment were adequately addressed by independent valuations of the equipment. There were three valuations of the equipment – Coopers & Lybrand, Real Partners and Dr. Keverian as part of the D&T audit. Mitchell in particular noted that the valuations supported the value of the founding equipment recorded on YBM's books. While Mitchell admitted that the falsification of the equipment records always concerned him, in that they were created after the fact, his attitude with respect to them was somewhat fatalistic, i.e. "it concerned me...to this day, but it was what it was." Mitchell never received a satisfactory explanation regarding the false records. In the context of the other facts, the equipment-related facts were material. They further revealed that YBM was exposed to risks that would reasonably be expected to have a significant effect on the value of YBM's securities if disclosed.

Customers and End Users

[149] The respondents attempted to verify customers and end users on three separate occasions. Staff submit that the Special Committee's measures to address these concerns were inadequate. Moreover, Bogatin took over the process with respect to customers since Gatti was focused on the Crucible acquisition. It is not clear whether Bogatin had some role in the creation of the false Fisherman List but it is clear that Fisherman did. Fairfax had received the 16-page list, did not know it was false, confirmed the existence of at least 51 of the companies on the list and made actual telephone calls to these customers. It is submitted that Fairfax confirmed the existence of U.S. end users through electronic searches which were adequate. Stern confirmed that YBM's North American end users were real companies. However, we believe there was a misunderstanding between Fairfax and Mitchell as indicated by Fairfax's mark-up of "? % looked @" on the draft of the Special Committee Report provided to them. They were real companies, i.e. incorporated companies but not necessarily real customers or end users of magnets. The Special Committee was concerned about confirming the existence of a customer called Diamond in Israel based upon Fairfax's work. D&T later reclassified most of YBM's U.S. sales from the U.S. to Eastern Europe. Staff submit this should have alerted the Special Committee to another risk. In addition, Fairfax had recommended a complete investigation of customers including knocking on doors and checking all invoices. This work was not pursued.

[150] First Marathon and later GMP retained Price Waterhouse on May 22, 1997 to assist with its due diligence. Price Waterhouse had reviewed Parente's working papers and reported that Parente was unable to find two U.S.-based customers. However, Price Waterhouse seemed satisfied with Eastern European customers. Jones of First Marathon called customers, which he acknowledged would not be proof of very much if a fraud was being perpetrated and Price Waterhouse visited another company, TooFsh, in Russia. Finally, First Marathon contacted Diamond's office in Israel wherein Diamond advised they were an end user of neodymium magnets, purchasing approximately $250,000 annually. Diamond was allegedly a top-five customer and later D&T reclassified sales to the Middle East as 0 during the 1996 re-audit. Moreover, Diamond was nowhere to be found in the YBM's list of 19 major customers supplied to staff and D&T. This suggested an inconsistency that is hard to miss.

[151] Customers and end users became the preoccupation of staff in June of 1997. This led to Staff's request for a re-audit of YBM's 1996 financial statements. The D&T audit was significant from a number of perspectives. YBM took the position that in many cases it had no knowledge of the actual end user. Staff's key concerns were the identity of customers, the tracing of sales and the specific identity of cash receipts to ensure that the revenue was properly recorded. No receipt would issue without further audit work. A full audit was conducted and a clean audit opinion rendered on October 13, 1997. With respect to sales, a key result was the reclassification of geographic sales. YBM did release a press release on October 22, 1997 with respect to the reclassification to reflect the ultimate end user of the company's products. These changes resulted in sales to North America being reduced from 13.6 million to 1.8 million; sales to the Middle East being reduced from 3.3 million to 0; and sales to Russia being increased from 21.8 million to 50.2 million. Of course, in this matter, Fisherman reappeared and provided the information as the basis for the reclassification. Fisherman indicated to D&T that sales recorded as being made to distributors in the United States did not necessarily mean in this instance goods being shipped to the United States. However, it was through Fisherman's insistence that the reclassification of the geographic segmentation resulted. Fisherman did not testify and did not defend the allegations in any manner whatsoever. D&T was completely unaware of the false customer list which he prepared.

[152] Despite unanswered questions raised by the reclassification, it would appear that the respondents were satisfied and took great comfort in the D&T audit.

[153] In the context of the other facts, the customer and end user facts were material. They further revealed that YBM was exposed to risks that would reasonably be expected to have a significant effect on the value of YBM's securities if disclosed.

Conclusion

[154] In our opinion, YBM's prospectus did not contain full, true, and plain disclosure of all material facts by failing to disclose that YBM was subject to unique risks. When each alleged omission is analysed in isolation, a technical argument can be made that some of them may not be material. We do not believe that is the appropriate approach to this case. The factual context cannot be ignored.

[155] In our view, when the omissions which are material on their own and the omissions which in isolation may not appear to be material are considered together, the evidence indicates that YBM was subject to a set of risks specific to itself. These risks were not disclosed. The AIF told the investing public that the mandate, information obtained by and findings of the Special Committee were connected to only general concerns expressed in the media and by government authorities that related to all companies doing business in Eastern Europe.

[156] No doubt, the facts and information unearthed by the Special Committee presented YBM with very difficult disclosure decisions. Having chosen to proceed with a public offering, which required full, true and plain disclosure of all material facts, the obscure disclosure contained in the AIF was unsatisfactory. It did not provide investors with the opportunity to adequately inform themselves regarding the specific risks facing YBM.

[157] At a minimum, we believe some disclosure regarding what YBM knew about the U.S. investigation and less muddled disclosure regarding the purpose of the Special Committee would have better informed investors about the risks facing YBM. To this end, Gatti produced draft disclosure for the AIF that was headed in the right direction, as it disclosed that YBM was aware of an unofficial inquiry by the U.S. Government into YBM's operations and that this led to the creation of the Special Committee. The following disclosure was contained in a draft response letter to staff's comment regarding YBM's operational review. In our view, the disclosure would have made the AIF less obscure. Unfortunately, the items which we have noted in bold were deleted in the final version of the response letter sent to staff:

> Circumstances Surrounding the Review of the Company's Operations
>
> Over the past year, the Company has had some difficulty in being issued certain business visas for some of its employees. As a result, the Company decided to investigate this further in order to try to gain a resolution to this problem. The Company's efforts confirmed that U.S. law enforcement agencies had placed a priority on uncovering infiltration of organized crime from the former Soviet Union into U.S. businesses. Given the roots of the Company and its affiliates in Russia, and the involvement of former Russian nationals as shareholders and managers of the Company, it was considered to be a reasonable expectation that the Company may have been examined as part of any such investigation. **Subsequent off-the-record discussions with the U.S. Attorney's Office confirmed that the Company had been examined as part of the investigation. However, the Company has never been formally contacted by authorities with regard to any investigation**, and the visas which prompted the concerns were subsequently issued by the U.S. Government without comment...
>
> In addition, concerns were raised in media reports regarding companies doing business in Eastern Europe
>
> **As a result, the Board formed a special committee to independently investigate possible areas of concern arising from the Company's business operations, and recommended further action in order to address any problems or potential problems which are uncovered as a result of the investigation.**
>
> Special Committee Recommendations
>
> The special Committee made the following recommendations which have been or are being implemented by the Company's management:
>
> - **Elimination of commingling of business activity with that of its founding shareholders in Eastern Europe;**
> - **Establish operational controls to ensure that management remains operationally independent from its founding shareholders;**
> - Establishment of improved cash controls at the Company's Hungarian facilities;
> - The establishment of more detailed customer and agent approval criteria;
> - The establishment of an accurate data base on these customers and agents;
> - Consolidation of accounting control at the Company's Newtown, Pennylvania, head office ...

[158] In our opinion there can be no doubt that disclosure of the factual deficiencies alleged by staff would have reasonably been expected to significantly impact the market price or value of YBM's securities.

[159] A good indicator of the materiality of the deficiencies in this case is the conduct of the underwriters. One of Mitchell's first instincts as Special Committee Chair and YBM's underwriter was to disclose the Special Committee information to the other underwriters beginning with his employer, First Marathon. Moreover when Lawrence Bloomberg at First Marathon read the April 11 draft of the Report, he told Mitchell that the initial approval given by the Investment Banking Steering Committee was no longer valid.

[160] When Jones at First Marathon was made aware of the Special Committee information, he proceeded to conduct additional due diligence on behalf of First Marathon in response to the concerns raised by the information. His instinct was also that they should personally brief Jeff Orr of Nesbitt Burns as a professional courtesy before he decided whether Nesbitt should become a member of the underwriting syndicate. Nesbitt Burns did not participate and Mitchell believed it was because of the information imparted at this briefing. It was acknowledged that Nesbitt Burns had been involved in Bre-X and as such their risk profile was certainly different than the others.

[161] When McBurney eventually got the report from staff in 1999, he reacted with hostility to Mitchell for not having provided him a copy of it earlier. Counsel to the underwriters, Litwack, testified that the concerns expressed by the Special Committee in the April 11 draft were material concerns.

[162] In addition to the conduct of the underwriters, we believe there is other evidence of the materiality of the Special Committee information. As noted, management's December 1996 questionnaire to the founding shareholders advising them of the FBI Affidavit indicated that disclosure could result in YBM's stock being worthless in a short period of time. Gatti also testified that Mitchell was angry at a meeting on or about December 21, 1996 upon discovering that the questionnaire was sent to the founding shareholders. Gatti recalled there was some concern over whether "these people would start selling their stock or something." Mitchell does not recall attending this meeting. We see no reason not to accept Gatti's evidence in this regard.

[163] In conclusion, the respondents failed to make full, true and plain disclosure of all material facts contrary to the Act.

THE AVAILABILITY OF A DEFENCE FOR DIRECTORS, OFFICERS AND UNDERWRITERS

[164] We have found a breach of subsections 54(1), 56(1), 58(1) and 59(1) of the Act. Staff submit that because each respondent had knowledge of material facts which were not disclosed, only a limited due diligence defence is available to them; *Escott v. BarChris Construction Corp.*, 283 F.Supp. 643 at 684 (S.D.N.Y. 1968) (*Escott*). Staff qualify this position as follows. If a respondent has knowledge of facts, but is mistakenly of the view that they are not material, i.e., if he or she was diligent in ascertaining their materiality but was nevertheless honestly and reasonably mistaken in this respect, the due diligence defence is available. However, Staff further assert that the application of the due diligence defence to materiality is quite remote; *Fingold* at para. 82. Staff's final argument did not specifically analyze the evidence as it relates to each individual respondent except GMP. As such, staff reviewed the facts sequentially and did not analyze their individual due diligence defences except to a limited extent in reply.

[165] Due diligence procedures "are intended to ascertain risk factors and to ferret out in advance and deal with potential problems, and to cause appropriate disclosure in this and other material respects to be made"; George R.D. Goulet, *Public Share Offerings and Stock Exchange Listings in Canada: Going Public, Staying Public, Getting Listed, Staying Listed* (Toronto: CCH Canadian, 1994) at 231.

[166] The approach to a due diligence defence has varied to some extent. In *Re Cartaway Resources Corp.* (2000), 9 A.S.C.S. 3092 (*Cartaway*), the Alberta Securities Commission considered prudence and due diligence but only in the context of whether an order in the public interest was warranted. This is identified as a regulatory test. In *Re Banco Resources Ltd.*, [1987] 51 B.C.S.C.W.S. 1, a prospectus disclosure case, the British Columbia Securities Commission adopted a due diligence defence in a public interest hearing. In *Gordon Capital Corp. v. Ontario Securities Commission* (1991), 1 Admin. L.R. (2d) 199 (Ont. Div. Ct.) (*Gordon Capital*), which was not a prospectus disclosure case, the court held that a due diligence defence was not automatically available to a registrant in a hearing under R.S.O. 1980, c. 466, subs. 26(1). That subsection became subsection 27(1) in R.S.O. 1990, was repealed under the *Financial Services Statute Law Reform Amendment Act, 1994*, and was taken up in paragraph 1 of subsection 127(1) of the Act; S.O. 1994, c. 11, ss. 360, 375.

[167] In *Gordon Capital*, the issue involved the suspension or imposition of terms upon the registration of a registrant "where in [the Commission's] opinion such action is in the public interest." The court characterized proceedings under subsection 26(1) as regulatory, protective or corrective and not quasi-criminal or punitive in nature. In deciding that these types of proceedings do not automatically provide for a due diligence defence for a registrant, the court stated:

> The fact that Gordon may have acted without malevolent motive and inadvertently is not determinative of the right of the OSC to exercise its regulatory and discretionary powers to impose a sanction upon Gordon.

[168] In this case we are dealing with the conduct of an issuer, various directors and officers of the issuer and two registered investment dealers. Public interest hearings lend themselves to a number of different approaches. Regardless of which approach is taken, we recognize that the Commission maintains the discretion to impose a sanction on the respondents under section 127 of the Act.

[169] YBM's rapid growth was out-pacing its systems and controls. Business practices in its major manufacturing and sales markets differed from North American ones due, in part, to the early development of Eastern European economies. Moreover, its management was separated. It was a company nominally in Canada, with a minimal head office in Pennsylvania, and its operations and sales were primarily in Eastern Europe.

[170] Before any disclosure documents were drafted, Parente spelled out the deficiencies in YBM's financial control systems and reporting. The Special Committee Report detailed serious lapses in supervision, record keeping and decisions in Europe. The recommendations in the Report were fundamental and revealed an operation with a somewhat shaky foundation.

[171] The respondents were aware of these risks. There was also a very strong awareness, flowing from the Report, that disclosure of the information would be detrimental. It could adversely impact the Crucible acquisition. As such, this case boils down to the incentives to disclose or not disclose bad news.

[172] In *Escott*, there was little doubt that the false and misleading information was material. The case turned on the various defendants' due diligence defences. *Fingold* was an insider trading case in which the court found a reasonable mistake of fact in relation to materiality. In that case, there was little need to investigate the facts. The only defence was an honest and mistaken belief in the materiality of the known facts.

[173] We find staff's approach limiting. It is not desirable, in this case, to limit the application of a due diligence defence in the manner proposed by staff, as their approach approximates absolute liability for directors, officers and underwriters. Moreover, these are not criminal provisions and often involve difficult questions of judgement. Knowledge of the information may make it more difficult to establish a reasonable investigation or reasonable grounds, but that is a matter of evidence. Moreover, knowledge of facts, even material facts, is different from believing that a prospectus fails to contain full, true and plain disclosure.

[174] As indicated previously, this is an extraordinary case. Our review of the case law suggests that in past cases, either the material facts were known and ignored or they were capable of being ascertained and were not. This is not this case here. There were considerable efforts undertaken by the Board and underwriters to investigate the facts, ascertain their materiality and decide what constituted full, true and plain disclosure of these facts.

[175] Normally, if an issuer breaches the Act, an order in the public interest is warranted. No one argued that a defence should be available to YBM. An order in the public interest may not be justified against a director, officer or underwriter if the investigation and belief were reasonable. In some cases, the investigation or belief may have been unreasonable but the facts will not otherwise call for an order in the public interest. In other cases, an order may be justified on the facts even if the investigation and belief were reasonable, because such considerations are not determinative of the public interest question; *Cartaway* and *Gordon Capital*. We are confident about this approach because the maintenance of high standards of fitness and business conduct is intended to ensure honest and responsible conduct by market participants; para. 2.1(2)(iii) of the Act.

[176] We recognize that in fostering high standards of fitness and business conduct we must not overly constrain the ability of the officers and directors to make rational business decisions and take measured risks. Risk taking is in the spirit of commercial activity and in the hope of greater economic reward. Risk taking is accommodated, not hampered, by care and diligence.

The Prudent Person as the Measurement of Reasonableness

[177] The corporate statutes require every director and officer of a corporation in exercising his or her duties to exercise them with the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances; *Business Corporations Act*, S.A. 1981, c. B-15, s. 117(1) [now R.S.A. 2000, c. B-9, s. 122(1)]; *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 134(1); *Soper v. Canada*, [1998] 1 F.C. 124 (C.A.) (*Soper*); and generally C. Hansell, *Directors and Officers in Canada: Law and Practice* (Toronto: Carswell, 1999), c. 9. Section 132 of the Act, which applies to civil liability, notes that in determining what constitutes reasonable investigation or reasonable grounds for belief for the purposes of sections 130 and 131, "the standard of reasonableness shall be that required of a prudent person in the circumstances of the particular case."

[178] This case is not a civil action but rather a section 127 hearing. Public interest proceedings under section 127 prescribe no specific standard of due diligence or reasonable investigation. In *Soper* at para. 34, Robertson J. defined diligence as follows: "Upon reflection, it seems arguable to me that the term 'diligence' is synonymous with the term 'care'. That is, diligence is simply the degree of attention or care expected of a person in a given situation." However, this means that the determination of due diligence should differ depending on one's function; Goulet at 236.

[179] We think it best to consider the reasonableness of the respondents' diligence and their belief from the perspective of a prudent person in the circumstances. This necessarily entails both objective and subjective considerations including their degree of participation, access to the information and skill.

[180] A few additional points are worth noting about reasonableness in this regard.

Directors and Officers

[181] The standard of care for directors and officers is not a professional standard nor is it the negligence standard; *Soper* at para. 41. Each director and officer owes a duty to take reasonable care in the performance of the office and in some circumstances that duty will require a director or officer to take action. That action may in some circumstances even call for a resignation.

[182] Directors are not obliged to give continuous attention to the company's affairs; *Soper* at para. 26. However, their duties are awakened when information and events that require further investigation become known to them. The standard of care encourages responsibility not passivity; *Soper* at para. 26.

[183] Directors act collectively as a board in the supervision of a company. Directors, however, are not a homogenous group. Their conduct is not to be governed by a single objective standard but rather one that embraces elements of personal knowledge and background, as well as board processes. More may be expected of persons with superior qualifications, such as experienced businesspersons. As such, not all directors stand in the same position. *Soper* at para. 40.

[184] In addition, more may be expected of inside directors than outside directors; *Soper* at para. 44. Similarly, a CFO who is on the board may be held to a higher standard than one who is not, particularly if he or she is involved in the public offering.

[185] When dealing with legal matters, more may be expected of a director who is a lawyer. A lawyer-director may be in a better position to assess the materiality of certain facts. Due to improved access to information, more may sometimes be expected of directors depending on the function they are performing, for example those who sit on board committees, such as a special committee or audit committee. An outside director who takes on committee duties may be treated like an inside director with respect to matters that are covered by the committee's work; Victor P. Alboini, *Securities Law and Practice*, loose-leaf (Toronto: Carswell, 1984) at s. 23.4.1.

[186] Directors may rely on the members of a special committee if the committee is comprised of disinterested directors in a position to base their decisions on the merits of the issue free of extraneous considerations and influences so that the committee's integrity and processes are beyond challenge; Stephen H. Halperin & Robert A. Vaux, "The Role of the Target's Directors in Unsolicited Control Transactions" in *Critical Issues in Mergers and Acquisitions: Domestic and International Views* (Kingston: Queen's Annual Business Law Symposium, 1999) 109 at 120. In the absence of grounds for suspicion, it is not improper for a director to rely on management to honestly perform their duties; *Re Standard Trustco Ltd.* (1992), 15 O.S.C.B. 4322 at 4364-4365 (*Standard Trustco*). Directors are entitled to rely on professional outside advisers, including legal counsel and underwriters; *Standard Trustco* at 4364-4365. Reliance would be unreasonable if the director was aware of facts or circumstances of such character that a prudent person would not rely on the professional advice.

Underwriters

[187] An issuer's certificate under subsection 58(1) of the Act must be signed by the CEO, CFO and any other two directors. It must certify that the prospectus contains full, true and plain disclosure of all material facts. The underwriter's certificate under subsection 59(1) of the Act must certify that the prospectus constitutes full, true and plain disclosure of all material facts, but only "to the best of our knowledge, information and belief". In general terms, the certificates are different due to the underwriter's access to information. Directors and officers are generally in a better position to obtain information and data that may be unavailable to the underwriter.

[188] The phrase "to the best of our knowledge, information and belief" carries with it a requirement to obtain information before an underwriter can make that affirmation; *Re A.E. Ames & Co. Ltd.*, [1972] O.S.C.B. 98 at 112 (*Ames*). Although that phrase acknowledges that an underwriter may not have the same access to corporate information that the officers and directors have, the underwriter is a gatekeeper of the public interest with professional expertise in the capital markets; Goulet at 238. An underwriter must go beyond the statements of the issuer's directors, officers and counsel and must avoid automatic reliance. In *Ames*, the Commission noted at 112:

> The underwriter stands between the issuer and the public as an independent, expert party in bringing new securities to the market. In a sense the underwriter and the issuer are joint-venturers, but in another and more important sense they must be adversaries. That is the underwriter must seek out and question all relevant and material facts concerning the issuer and reasonably ensure himself that these facts are fully and truly set before the investing public.

[189] While underwriters may be at an informational disadvantage, the essence of their role was captured in a poignant paragraph in *Feit v. Leasco Data Processing Equipment Corp.*, 332 F.Supp. 544 at 582 (E.D.N.Y. 1971), where Weinstein J. stated:

> [The duty of dealer-managers] to investigate should be considered in light of their more limited access. Nevertheless they are expected to exercise a high degree of care in investigation and independent verification of the company's representations ... the underwriters must play devil's advocate.

[190] In this regard, an underwriter must challenge the disclosure the issuer proposes to make to the investing public. Otherwise, the underwriter cannot be said to have met the standard to the best of its knowledge, information and belief.

[191] Lead underwriters must be adversarial and more so in some circumstances. Reliance on counsel cannot be an excuse for failing to make an adequate examination of the facts. While legal advice will be a factor that affects an underwriter's belief that there were no omissions of material facts, if counsel did not make an adequate examination, the underwriter must bear the consequences; *Escott* at 697.

WHAT DID YBM'S DIRECTORS AND OFFICERS DO TO ENSURE FULL, TRUE AND PLAIN DISCLOSURE?

[192] Staff allege that YBM's directors and officers authorized, permitted, or acquiesced in YBM's failure to make full, true and plain disclosure. The board of directors of a company is ultimately responsible for making prospectus disclosure.

[193] Actions initiated by the Directors upon being advised about the visa problems and the U.S. investigation in August 1996 can be summarized as follows:

1. The YBM directors struck the Special Committee.
2. The Special Committee, principally through Mitchell, conducted a preliminary investigation.
3. Mitchell prepared the interim report of the Special Committee, which he delivered to a meeting of the Directors on November 1, 1996 and in which he recommended hiring professional investigators.
4. The Special Committee hired Fairfax and authorized it to travel to Hungary to review YBM's operations.
5. Mitchell received Fairfax's oral report on its findings in Hungary on February 6, 1997, and authorized it to proceed with further investigations, including investigations of customers.
6. Mitchell reported on the status of Fairfax's investigation at a meeting of the Directors on February 19, 1997.
7. Mitchell, Antes and Schmidt received a further oral report from Fairfax on March 21, 1997 in which concerns were raised about, among other things, the legitimacy of some of YBM's customers.
8. Mitchell, Antes and Schmidt invited Fairfax to repeat its March 21 report on the following day to YBM's management, at which time Mitchell made it clear to management that they must satisfy Fairfax as to the legitimacy of YBM's customers.
9. Mitchell received Fairfax's confirmation of the satisfactory results of its searches of YBM's customers and proceeded to prepare the Special Committee Report with input from Fairfax.
10. Mitchell delivered the Special Committee Report to the Board on April 25, 1997.

[194] The Directors submit that the above steps constituted both an investigation into the facts and an assessment of materiality for disclosure purposes. While they were aware of an investigation by the U.S. Attorney, the Special Committee was unable to verify sufficient particulars for disclosure. Similarly, they were aware of rumours regarding the founding shareholders, but the Special Committee could find no evidence that the founding shareholders were presently exerting undue influence over YBM. The Directors submit that the above investigation, in conjunction with their reliance upon legal advice and the D&T re-audit of the 1996 financial statements, establishes that their belief regarding materiality and disclosure was reasonable.

The Special Committee

[195] The Directors responded to the information provided by Rossman and management regarding the U.S. investigation on August 15, 1996 by creating the Special Committee. U.S. and Canadian counsel advised the Board that disclosure was not required. The directors also authorized management to continue discussions to acquire Crucible.

[196] Contrary to Rossman's advice, the Special Committee did not retain independent counsel but turned to company counsel, Wilder. Schmidt did some early work for the Committee and Davies had no involvement whatsoever. Basically, the Special Committee was Mitchell with Wilder in aid.

[197] The Committee was independent of management, but was not without a manifest conflict of interest. Mitchell chaired the Special Committee and was very active as YBM's co-lead underwriter. The Special Committee was not created as a disclosure committee, but shortly after its formation the board discussed the possibility of the Crucible acquisition. Mitchell wanted to complete the investigation before the financing. As a result, the Directors relied on the work of the Special Committee as the basis for their conclusion regarding both materiality and disclosure. Mitchell had divided loyalties. The degree of care required to secure full, true and plain disclosure leaves little room for risk.

Initial Work of the Special Committee

[198] Following Rossman's advice, the Special Committee focused on YBM itself and on any areas which might cause the U.S. investigation. An inherent shortcoming of the Special Committee was that even after its investigation, YBM still did not know if the information obtained was at the root of the U.S. investigation. The initial work of the Special Committee is described above, and demonstrates a willingness to make inquiries and obtain further information.

[199] Gatti advised Mitchell of the parallel records and, in particular, concerns regarding payments to Averin. Mitchell became aware of potential links between Averin and organized crime through the FBI Affidavit and information provided by Fairfax. As indicated earlier, we do not find that the divestiture of Arbat resolved the issues associated with commission payments. Mitchell acknowledged that he never received a satisfactory explanation for the existence of the parallel records. His explanation that they were historical is more consistent with passivity than diligence.

Retention of Fairfax

[200] The Special Committee retained Fairfax to assist with its investigation. All of Fairfax's investigation was to be co-ordinated through Mitchell.

[201] While Fairfax received much information from YBM it did not initially receive: (i) the interim report of the Special Committee dated November 1, 1996; (ii) the Arigon/United Trade sales commission schedules delivered by Gatti to Mitchell in October, 1996; (iii) the FBI Affidavit; and (iv) Bogatin's letter to the founding shareholders, enclosing the questionnaire.

[202] During the course of Fairfax's investigation, Mitchell became aware of the FBI Affidavit on or around January 1997. It required serious attention. Mitchell had no explanation for why he did not request a copy or why he never asked if Fairfax had a copy. The Special Committee Report does not even refer to it and only Davies, Mitchell, Bogatin and Gatti were aware of it.

[203] During the course of Fairfax's retainer, Mitchell approved the expansion of its inquiry as more information became available. A summary of some of the work conducted by Fairfax is found above. Fairfax found a business that manufactured magnets and found no illegal activity or evidence of money laundering. However, Fairfax concluded that the indicia of money laundering existed and expressed serious concern regarding YBM's customers. Mitchell permitted McManaway to brief the U.S. State Department on the information Fairfax was discovering about YBM.

[204] Mitchell updated the Board regarding the Special Committee's investigation at the February 19, 1997 board meeting. They discussed disclosure to the underwriters due to the Crucible deal. Mitchell was actively involved in the discussions with Crucible. In early March, he advised Fairfax that the Crucible acquisition could not proceed unless Fairfax provided favourable customer information.

[205] The most significant briefing by Fairfax occurred on March 21, 1997 in Toronto at First Marathon. Mitchell, Wilder, Antes and Schmidt were present. Fairfax's key findings and recommendations of further work are described above. Fairfax did not complete its recommended work. According to Fairfax, during the course of the meeting, a copy of their speaking notes was not requested, no one asked a substantive question and there was no request that the report be shared with third parties. Fairfax found no evidence of illegal activity but reported that there were indicia of money laundering.

[206] The directors who attended the March 21, 1997 briefing were comfortable that several of the issues Fairfax raised were already resolved. For instance: Arbat had been sold; they were already in possession of a valuation of the equipment purchased by the founding shareholders for 1/10 the value it was sold to YBM; and management was dealing with the bank account and shared office space commingling issues.

[207] Mitchell continued to have concerns regarding customers based upon the information that Fairfax provided. This was noted at the Fairfax briefing with management the following day. In attendance were Mitchell, Antes, Bogatin, Gatti and Rossman. Mitchell advised that the Crucible acquisition would not proceed unless management satisfied Fairfax as to the legitimacy of YBM's customers. Consequently, customer confirmation was critical.

[208] Fairfax recommended a complete investigation of customers (knocking on doors and checking all invoices) – a significant undertaking. However, Bogatin became involved, which resulted in Fairfax conducting only electronic searches.

[209] On April 13, 1997, the final meeting between Fairfax and YBM occurred. YBM was represented by Bogatin, Gatti, Mitchell and Antes. There are disputed accounts regarding what Fairfax reported to Mitchell between March 22 and April 13.

[210] Mitchell testified that Fairfax verified customers and end users of magnets. He relies largely upon Stern's failure to significantly mark up the draft of the Special Committee Report which he was provided. Mitchell appeared unaware that Fairfax only conducted electronic searches. Our examination of the evidence suggests that Fairfax continued to express concerns regarding YBM's customers throughout this period. This is consistent with Fairfax's recommendations as recorded in its speaking notes from the March 21 briefing as well as Larkin's notes from the April 13 meeting. It appears that the flow of information between Mitchell and Fairfax was also unsatisfactory and created the opportunity for misunderstanding.

[211] Rossman was not contacted again by the Special Committee after March 22, 1997. Moreover, Rossman was concerned that the March 26 visit to YBM by an INS field worker did not appear to be a normal immigration investigation given the request for YBM customer lists. As such, one month before YBM would contemplate disclosure for the offering, the U.S. Government continued to express specific interest in YBM.

[212] However, the Special Committee Report states, "Discussions with counsel have concluded that it is unlikely that any purpose would be served by approaching the FBI or the U.S. Attorney's Office with our conclusions and that it is unlikely that we would know if and when any investigation had been concluded". The Report further appears to overstate the INS's satisfaction with the business of YBM given the circumstances. The Special Committee's conclusion may not have been unreasonable in and of itself but is more consistent with a desire to get on with the transaction than further investigation.

The Special Committee Report

[213] Mitchell prepared the first draft of the Special Committee Report (dated April 2, 1997) from memory and without notes. Wilder commented on it as well as Fairfax. Stern's view was that Mitchell had understated Fairfax's concerns about the founding shareholders. Mitchell did a revision but Fairfax did not see the final draft. Mitchell read the Report verbatim at the critical April 25, 1997 board meeting. Neither Fairfax nor Rossman were invited to attend. A summary of the Report is found above. The minutes of this meeting are, to say the least, sketchy and uninformative. It was a poorly documented process.

[214] Mitchell expanded on the content contained in the Report to some extent. He discussed the connection of other founding shareholders to organized crime in addition to Mogilevich. Notes from this meeting suggest that YBM's segmented information was correct, that Fairfax was satisfied with YBM's U.S. customers and that an active investigation was confirmed by Fairfax. Gatti testified that Greenwald wanted to know the bottom line, to which Mitchell responded that Fairfax "was satisfied."

[215] Copies of the Report were not distributed based upon the previous advice of U.S. counsel citing concerns over libel and slander. As a result, Peterson did not ask for a copy and he understood that Fairfax signed off on the report. This is not entirely accurate as Fairfax provided initial comments, but did not see a subsequent draft of the Report.

[216] Despite the extent of the concerns expressed in the Report, the board continued to press ahead with the Crucible deal. The board did not believe that management was involved in any illegal activity or that the founding shareholders were actively involved in the business. A noted benefit of the Crucible acquisition was that operational control would be steadily centralized at the head office and reliance on Eastern European activities would be diluted. We cannot say that the Board was oblivious to the concerns, but can it be said that it acted prudently in the face of those matters?

The Crucible Acquisition and Proposed Financing

[217] Despite not having completed the Special Committee's investigation, Mitchell wrote to Bogatin outlining certain matters regarding a proposed special warrant offering. Bogatin required the letter for the Crucible negotiations. Mitchell described First Marathon as "lead underwriter". Mitchell did not intend to proceed with this transaction until the issues raised in the Special Committee's investigation could be dealt with to the satisfaction of the underwriters. Nevertheless, on April 3, 1997, YBM announced it had agreed to purchase the magnetics division of Crucible Materials Corporation located in Kentucky.

[218] Mitchell met with Bloomberg on April 11 to discuss the underwriting, and gave him a copy of the draft Report. As such, First Marathon was given the Report before YBM's Directors.

The AIF Disclosure

[219] Disclosure was extensively discussed at the April 25, 1997 board meeting. There is no question that the board placed considerable reliance on Wilder's legal advice. Peterson testified, "We had turned it over to our lawyers to capture our intentions

in words and they did that." Gatti testified that the process was not so much one of people working together as "people were funnelling information to our securities counsel." Mitchell testified that "counsel drove the bus on the AIF."

[220] Gatti provided his version of the AIF and testified that Wilder and Mitchell determined that it was inappropriate. Gatti's draft AIF flagged the recent INS inquiry into foreign nationals working at the company's headquarters in Newtown.

[221] Mitchell testified that subject to some minor editorial comments, he approved the following draft that Wilder prepared. He did not review any subsequent drafts prior to the filing of the AIF. The final disclosure in the AIF changed substantially from this draft.

> As a result of difficulties experienced by the Company in obtaining U.S. business visas for certain of its foreign employees, the board of directors constituted a Special Committee thereof consisting of Owen Mitchell, Michael Schmidt and Ken Davies, each of whom is independent of management. The mandate of the Committee was to:
>
> (i) independently investigate all possible areas of regulatory concern arising out of the Company's business operations, in particular, business operations in Eastern Europe; and
>
> (ii) recommended further actions in order to improve, where necessary, the Company's internal financial controls.
>
> The Committee retained independent experts to assist it in its investigations and examine the business and activities of the Company with a particular emphasis on its Eastern European operations. Each of the concerns raised by the Committee that were within the control of the Company, have been or are being, addressed by management including increased internal financial controls at Magnex RT. The business visas which precipitated the Company's original review were ultimately issued by the United States immigration authorities after an examination by such authorities of the Company's U.S. business operations which concluded without comment. On a go forward basis, the board has established the sub-committee of the Audit Committee to monitor ongoing compliance by the Company with the Committee's recommendations and to advise management with respect to any additional operational areas of concern.

[222] Gatti testified that Bogatin participated in the draft which formed the basis for the Special Committee disclosure contained in the AIF. The AIF disclosure is reproduced in the Risk Related Disclosure section above.

[223] Jones' notes of an April 29, 1997 meeting contain a reference to "nothing to disclose – no facts". Mitchell testified that management concluded that the Special Committee had developed no factual information that should be disclosed. There is no evidence that the directors questioned the disclosure. Mitchell took the position that he had a minimal role in the disclosure and understood that Wilder and Gatti were largely responsible for it. There was no subsequent review by the Board prior to filing the AIF or the Preliminary Prospectus.

[224] We have already determined the AIF was deficient. At a minimum, Gatti's draft more accurately conveyed that YBM was subject to specific risks since it reflected that the U.S. Government had expressed specific interest in YBM. Meanwhile, First Marathon received a copy of the Special Committee Report, Mitchell briefed the other underwriters regarding some of the Special Committee information, and the investing public got what it got. This is confirmed by Mitchell when he stated:

> Company's disclosure record was a subject which was often discussed by the board of directors and by company counsel. Company took guidance from its counsel, and after full and fair discussion of issues regarding disclosure, the company's disclosure record is as it is.

Offering Process and Prospectus Review

[225] Mitchell attended the May 28, 1997 due diligence session between the underwriters and Bogatin in preparation for the filing of the Preliminary Prospectus. Counsel were also present. In response to a question from counsel to the underwriters regarding whether the company was aware of any current, pending or contemplated investigation against the company by any regulatory authority or other body, the response recorded from counsel is "to the best of his knowledge, no" and "no, other than as disclosed". Mitchell testified that he did not attend this session as a director of YBM, but rather as an underwriter.

[226] The preliminary prospectus was filed on June 2, 1997 with no additional disclosure regarding the work of the Special Committee. The first meeting with staff occurred on June 3, when staff was tipped off that the underwriters were still conducting due diligence with the assistance of Price Waterhouse.

[227] On June 11, staff contacted counsel to YBM and the underwriters and advised that they had received allegations from international sources that YBM was involved in money laundering. Staff advised that they had requested the assistance of Enforcement, that there were questions regarding the integrity of YBM's sales and that staff wanted to speak to Price Waterhouse.

[228] Mitchell attended two meetings with staff on June 13 and 16, during which the Special Committee came up. Jones of First Marathon had previously advised Mitchell that staff had been told of the rumours regarding YBM, the *Izvestia* article, the formation of the Special Committee, the engagement of Fairfax and Fairfax's conclusion that there was no reason to believe that YBM was engaged in illegal or illegitimate activities. Mitchell testified that staff was uncomfortable with the disclosure and was not focusing on money laundering. Mitchell testified as to why he did not provide a copy of the Special Committee Report to staff:

> Q. Did you think, sir, at that point in time, that the contents of the report or the report itself of the Special Committee would be information that Staff would find of any value?
>
> A. I thought that the company had made disclosure consistent with what was advised by experienced securities counsel regarding the Special Committee and the work that it had done.
>
> Q. We are not talking disclosure right now. We are talking about the process of a prospectus review where there's an interchange going between Staff and the issuer and the underwriters. The question to you is did you think that the report would have been of any interest to staff? Did that thought cross your mind when you were telling them about this independent committee?
>
> A. The interchange that took place between staff on the prospectus review process, that being the comment process, is one that is fundamentally done by the company, Mr. Bogatin, Mr. Gatti who were both intimately aware of the contents of the report; by counsel, Mr. Wilder, who was certainly aware intimately of the contents of the report and those were the people who were dealing with Staff.
>
> Q. So when you get to these meetings at this point in time, for example, on the 13th you are wearing your First Marathon hat and not your director's hat?
>
> A. That's correct, yes. I didn't see any other directors at the meeting other than Mr. Bogatin, I guess, who is not even at this meeting. There's only underwriters so clearly I would be attending as an underwriter rather than as a director.

[229] At the June 16 meeting, when the Special Committee was referred to again, staff did not pursue the work of the Special Committee. Mitchell testified that he never attempted to hide the Special Committee and its work from staff. If asked for a copy of the Report, he would have asked counsel since he did not make the company's disclosure. He further stated, "The company makes its disclosure. Company counsel and the company would decide whether that report was going to be disclosed, but I would not oppose the disclosure of that report, no."

[230] Mitchell acknowledged that, to his knowledge, neither he nor anyone on behalf of the underwriters advised staff that the U.S. Attorney had confirmed the existence of an investigation into the company.

[231] Staff issued the first comment letter on June 16. It raised a general comment regarding the Special Committee disclosure contained in the AIF. The comment and YBM's response are reproduced above. An initial draft response letter from YBM included the following items reproduced from the Special Committee Report:

> Subsequent off-the-record discussions with the U.S. Attorney's Office confirmed that the Company had been examined as part of the investigation.
>
> As a result, the board formed a Special Committee to independently investigate possible areas of concern arising from the Company's business operations, and recommend further action in order to address any problems or potential problems which are uncovered as a result of the investigation.
>
> Special Committee Recommendations
>
> Elimination of commingling of business activity with that of its founding shareholders in Eastern Europe.
>
> Establish operational controls to ensure that management remains operationally independent from its founding shareholders.

[232] Unfortunately, these items were deleted in the final draft response sent to staff on June 18. A fax cover sheet confirms that the initial draft was sent to Mitchell, but he does not recall receiving it or discussing the response with the possible exception of the commingling issue. Litwack testified that he recalled having some discussions with Mitchell with respect to this response.

[233] Staff requested that the Special Committee recommendations that were disclosed in the response letter be disclosed in the Final Prospectus. We have no doubt what staff's response would have been to the information deleted from the draft response letter - disclosure. In our opinion, this was a serious omission in response to staff's general comment.

[234] On June 12, the Directors held a conference call. There are no minutes of this meeting. Greenwald's notes indicate the purpose of the meeting was "to price the new stock offering":

> At a price between $12.50 and $13, they have firm commitments totalling $150 million.
>
> Since we can sell only $100 million from treasury stock, Owen would like to approach the original shareholders who now control 30% of YBM shares to convince them that it is to their advantage to sell off $50 million of their holdings.
>
> Jacob has talked to the original shareholders and is convinced that they will not sell. They did not think that they have done anything wrong even though all the allegation against the company concern their activities.
>
> Jacob reported that the Ontario securities commission had received a call about the report against us. Lawry Wilder went to see them immediately, armed with the Fairfax information. He believes that the commission will approve the prospectus next Monday.

[235] The prospectus receipt was delayed. On June 24, staff advised YBM that they would not issue a receipt for the prospectus unless additional work was done by Enforcement or a Big Six accounting firm. YBM decided to have a re-audit of YBM's 1996 financial statements around July 25. The directors and underwriters became increasingly concerned that a delayed receipt for the prospectus would postpone the closing date of the Crucible deal, thereby triggering an $8 million payment.

[236] Another board meeting was held on July 17, and all the Directors were present except Fisherman. Gatti, Scala, Wilder, Silfen and Kottcamp were also present. The minutes record the following amongst other items:

> Questions were presented by the underwriters May 29th. On June 2, 1997 the preliminary prospectus was filed. The road show followed. The board Special Committee lead to the underwriters doing extra due diligence (using Price Waterhouse ("PW"))...
>
> Mr. Wilder says he has never seen anything like the situation that has occurred. Re: Segment Information 1996 (the OSC is concerned with): (1) whether the product has been delivered to end users; and 2) billing addresses of invoices. The OSC is looking for other companies and the auditor's opinion. The OSC is looking to see whether the Company has real customers, and whether it is selling to missile producers. D&T will dispel all concerns.

[237] With the delay in closing the offering, on August 21, 1997, YBM announced that it had completed a private placement of subordinated convertible notes in the amount of CDN $48 million, which notes were purchased by institutional investors. The following day YBM announced the closing of the Crucible deal. Despite the concerns expressed by staff, YBM proceeded with closing the Crucible acquisition.

Deloitte & Touche Audit

[238] D&T were not provided with a copy of the Special Committee Report. Coulter and Purcell testified that had D&T been informed of the mandate, information obtained by and findings of the Special Committee, it likely would not have accepted the engagement. Furthermore, if it had accepted the engagement, they testified that the information would have been relevant to the nature of the procedures undertaken in conducting the audit.

[239] In response to whether Mitchell felt he had an obligation to provide a copy of the Special Committee Report to D&T, his testimony was as follows:

> I had no reason at the time to believe it had not been brought to their attention in a completely satisfactory manner. If I had believed it had not been brought to their attention in a satisfactory manner, I may have taken steps to bring it to their attention. However, and again, this – I am a director of the company. I'm not the company, not an employee of the company. I worked for First Marathon. I don't work for YBM Magnex International. To the extent that amongst the, let's say it's 20 people or 30 people that know about the contents of the Special Committee report, let's say that amongst that group of people, if it is entirely incumbent upon me to ensure that every potential person who might be interested in that report receives a copy, then I am remiss, but you know something, Mr. Naster, I'm a busy guy. I was a busy guy at that time...I worked very hard, made lots of trips back and forth to Philadelphia...I have an employer that's paying me good money not to sit on Special Committees and...expects me to make that firm money.

[240] It is clear that Mitchell's duties as a director were not free of extraneous considerations and influences and in fact were compromised by his dual role in this case.

[241] D&T understood that its audit was being relied upon as part of a public financing, that there was a risk that YBM could be involved in money laundering, that its customers may not exist and that its reported sales may be bogus. D&T had been provided with documents that contained some references to YBM employees being denied visas, the existence of an investigation and the existence of the Special Committee.

[242] Procedures conducted by D&T included site visits to brokers who accounted for $32 million of YBM's sales of $61 million, representing 52% of YBM's total magnet sales. Coulter agreed that this was a "very high sample" for a financial statement audit and explained, "...we were not relying on controls. We were performing extended procedures." D&T did extensive work in respect of 75% of YBM's consolidated net sales as well as extensive procedures in verifying sales to end users.

[243] On October 13, 1997, D&T issued an unqualified opinion in respect of the 1996 YBM financial statements. On October 22, YBM issued a press release announcing receipt of the unqualified audit report (dated October 17) on its December 31, 1996 financial statements from D&T. One non-cash adjustment made to the company's financial results pertained to a reclassification of the company's North American sales of $13.6 million (as previously reported) to $1.8 million; sales to the Middle East being reduced from $3.3 million to nil; sales to Russia being increased from $21.8 million to $50.2 million. On November 4, D&T met with staff. At staff's request, D&T's audit opinion was ultimately incorporated by reference into the Final Prospectus. Peterson attended this meeting and portrayed a serious board that wanted a high comfort level and did not want to be associated with "anything that isn't up and up."

The Final Prospectus

[244] By November 6, staff had advised YBM and the underwriters that the final prospectus could be filed. The board discussed pricing for the offering and the payment of an additional commission to First Marathon and GMP for their work on the Crucible acquisition at a November 11 meeting. The board approved the final prospectus by written resolution on November 12.

[245] YBM entered into the underwriting agreement on November 17. The offering was priced at $16.50 for 3,200,000 common shares. The syndicate consisted of 35% First Marathon, 35% GMP, 20% Scotia McLeod, 5% Canaccord and 5% Gordon Capital. In addition, the underwriters were granted an over-allotment option of up to an additional 320,000 common shares at $16.50 for up to 60 days after closing. The over-allotment option was exercised by the dealers.

WERE YBM'S DIRECTORS AND OFFICERS DILIGENT?

YBM's Process to Ensure Full, True and Plain Disclosure

[246] Did the directors exercise their judgement reasonably in concluding that the Final Prospectus contained full, true and plain disclosure? Was the Special Committee investigation, bolstered by reliance on legal advice and the D&T audit, consistent with diligence sufficient to ground a reasonable judgement or belief that full, true and plain disclosure had been made?

[247] The directors exerted significant efforts through the creation and work of the Special Committee, including the retention of Fairfax, to ascertain further information regarding the concerns of the U.S. authorities and the company. However, there were serious weaknesses in connection with the Special Committee's investigation. Most notably, it was not independent. We indicated earlier that the degree of care required in ensuring full, true and plain disclosure leaves little room for risk.

[248] We are most concerned about Mitchell's dual role as Special Committee Chair and YBM's underwriter, particularly given that the Special Committee conducted its investigation contemporaneously with the Crucible negotiations and while planning the financing. Mitchell was active in all three of these initiatives. Despite suggestions to the contrary, his loyalties were divided.

[249] As YBM's underwriter, Mitchell's influences were clear. The underwriter's fee exclusive of any over-allotment option was $2,376,000. In addition, YBM paid $600,000 to First Marathon for advisory services on the Crucible acquisition. We further note that First Marathon together with GMP dominated trading in YBM's shares on the secondary market including approximately U.S. $12,000,000 in trades effected by the founding shareholders through an account for which Mitchell was investment advisor.

[250] If the independence of one's mandate is threatened, then the reasonableness of one's judgement becomes questionable. While this case does not engage the business judgement rule, even that rule requires directors to act reasonably, in good faith and without any conflicts of interest. Basically, it was hard to determine who was going to show up during the prospectus review – the director, the Chair of the Special Committee or the underwriter. Moreover, Mitchell provided no reasonable response as to why he did not provide a copy of the Report to staff and D&T.

[251] Other weaknesses of the Special Committee investigation are as follows:

1. The Arbat sale did not resolve the issue of questionable commission payments. The United Trade ledger contained payments to Averin after Arbat's sale. This discrepancy was not pursued even in the face of the existence of the parallel records and Fairfax's information regarding Arbat's sale that suggested the sale did not occur at arm's length. More investigation was required.

2. The Special Committee failed to follow up or obtain a copy of the FBI Wiretap Affidavit or advise the other directors of its existence in the Report. The Report merely states, "Rumoured involvement of shareholders in organized crime was noted from a variety of sources including print articles." The FBI Affidavit provided exceptional information potentially relevant to assessing the materiality of the U.S. investigation and the rumoured involvement of shareholders in organized crime. It should have been brought to the attention of all the Directors, staff of the Commission and D&T. Moreover, Davies remained silent regarding his interview with the FBI.

3. The resolution of customer and end user identification was critical. The Special Committee relied extensively on management to satisfy Fairfax. We find that management restricted Fairfax to electronic searches and required the searches to be completed in ten days. There was no reasonable basis to conclude that the issues had been resolved. The Special Committee also left the Board with the impression that Fairfax was satisfied when, in fact, it continued to express concerns and recommend further work.

4. Gatti's draft AIF noted that the INS had begun an informal inquiry into foreign nationals working at the company's headquarters in Newtown. Mitchell and Wilder reviewed this and thus knew the U.S. authorities continued to be interested in YBM. Rossman testified that the INS's investigation was unusual given the request for customer information. YBM would subsequently learn from its immigration counsel in the fall of 1997 that the investigation was a fraud investigation. The Special Committee Report, however, stated that management believes that the INS is satisfied that there is an actual business in place.

[252] The Board relied on the Special Committee to assist with disclosure. While not created as a disclosure committee, by the April 25 board meeting at which the AIF disclosure was discussed, to some extent that is what the Special Committee had become. Indeed, YBM was now relying on the information reported by the Special Committee as the basis for its decision regarding disclosure of the U.S. investigation.

[253] Generally speaking, a board is entitled to rely on special committees. However, as indicated above, Mitchell's independence and the non-participation of the other two members were questionable. The absence of Schmidt and Davies from meetings with Fairfax or Mitchell rendered them ill-suited to discharge their role. The failure to participate, particularly given Davies' information, seriously limited the exchange of ideas and prevented the Special Committee from being a committee upon which the Board could fully rely. In addition, we note the serious nature of information conveyed to the Board by the Special Committee. This should have resulted in a call to action in light of the pending acquisition of Crucible and the public financing. Instead, we note some additional weaknesses in the process followed by the board:

1. Relying on U.S. legal advice provided months before regarding potential defamation concerns, the Directors did not even get a copy of the Report. This could have aided the questioning and decision around disclosure. More than a one shot briefing from Mitchell was required.

2. The entire Board should have requested a meeting with Fairfax to discuss Fairfax's unfiltered continuing concerns regarding YBM's end users or money laundering. Fairfax wanted to do more work including interviewing the auditors, reviewing their work papers, conducting a complete investigation of customers and vendors including knocking on doors and checking all invoices, and explaining the actions taken by the Board to the U.S. Government. Fairfax's services were not inexpensive, but, in relative terms, the financing raised $106 million. Fairfax's additional services were not called upon.

3. Wilder was counsel to the Special Committee and YBM. Rossman advised the Board that the Special Committee should retain its own independent counsel. The Board declined this advice based upon Peterson's suggestion that "lawyers were not going to solve this problem." This advice was improvident. Despite Fairfax's expertise, the nature of the issues confronting YBM required independent legal counsel.

[254] The board relied on legal advice throughout. Good faith reliance upon legal advice that is fully informed, ostensibly credible and within the lawyer's area of expertise is consistent with the exercise of reasonable care; *Blair v. Consolidated Enfield Corp.* (1993), 15 O.R. (3d) 783 at 796-801, aff'd [1995] 4 S.C.R. 5. The board, however, cannot have it both ways. It relied on legal advice, but on the other hand, minimized the value of retaining inherently independent legal advice.

[255] Wilder's advice was to disclose the existence of the Special Committee. The approach adopted in this case was to "turn it over to counsel to capture our intentions in words and they did that." Moreover, the disclosure is based upon a draft prepared by Bogatin and the evidence indicates that management was of the view that there were no facts to disclose.

[256] The Board knew that the purpose of the Special Committee was to independently investigate concerns arising out of the company's business specifically as a consequence of the investigation of YBM by the U.S. Attorney. The Board authorized Mitchell to disclose the full details of the Special Committee to the underwriters. The Board subsequently became aware that the underwriters were conducting extra due diligence specifically as a result of the Special Committee information provided. The Board was later reminded, during its June 12, 1997 conference call, of the continued concerns regarding the founding shareholders as Mitchell attempted, through Bogatin, to persuade the founding shareholders to add their shares to the offering. Wilder also advised the Board of staff's position that YBM's sales needed to be audited and that this request was exceptional. We further note that staff requested additional disclosure based upon the minimal details of the Special Committee Report shared with them in YBM's response to their comment letter.

[257] The description of the Special Committee and its mandate was obscure. This was a less than stirring effort given the information that had been received. Given the foregoing, we question whether the Board's reliance on legal advice was reasonable in the circumstances.

[258] Lastly, we note that despite the efforts put forth and the seriousness of the information unearthed by the Special Committee, no one assumed custodianship over the Special Committee Report subsequent to the April 25, 1997 meeting. Staff and D&T should have received copies of the Report.

Reliance on D&T

[259] The respondents relied upon the clean audit opinion provided by D&T as further justification for not disclosing the mandate, information obtained by and findings of the Special Committee in the final prospectus. The Directors derived significant additional comfort regarding the legitimacy of YBM's business due to the D&T audit.

[260] The respondents submit that a reasonable and measured response to the unique risks faced by YBM was to examine YBM's financial reporting, because the information, if true, would necessarily manifest itself in some misstatement of the financial records. If, on the other hand, it could be determined that the financial reporting of sales and costs had integrity, i.e. if it was a real business and its sales as reported were real, then the information would be simply unfounded rumours and innuendo, which are not disclosable as they are not material facts. In a nutshell, the issue is whether it was a reasonable response to the information to believe that, if they were able to "harden the balance sheet", then the concerns raised by the information would be eliminated or overridden.

[261] Several efforts were made to "harden the balance sheet", but the audit undertaken by D&T was the most comprehensive and while not forensic it utilized extended procedures. D&T was fully aware of the context in which the audit was occurring, including the extent to which it would be relied upon by staff and the underwriters. Both Coulter and Purcell testified that the information contained in the Special Committee Report would have been relevant to the procedures conducted, including whether D&T would have even accepted the retainer. Their evidence was that a "high risk" audit does not entail the kind of enquiry which is intended to ferret out criminal activity. That kind of inquiry is to be made by forensic accountants.

[262] The respondents argue that the D&T audit provided a reasonable basis for their belief that the prospectus contained full, true and plain disclosure. We take issue with that for at least three reasons: (1) it was not a forensic audit; (2) even if the respondents could rely on the audit to conclude that the business was legitimate, that does not necessarily mean that the respondents were not in possession of facts that required disclosure; and (3) D&T did not have important information contained in the Report which should have affected their reliance.

[263] We further note that YBM was required to amend the geographic segmentation of sales as a consequence of the audit. This resulted in North American sales being reduced from $13.6 million to $1.8 million and sales to Russia being increased from $21.8 million to $50.2 million. Given what Mitchell had previously advised the Board regarding the work done by Fairfax in connection with YBM's North American end users and YBM's segment information, another inconsistency was evident. The Board did not pursue it.

[264] Overall, we are satisfied that significant efforts were made by the Directors to ascertain the facts and assess their materiality. However, we find that the process adopted by the Directors to support their judgement and belief that the mandate, information obtained by and findings of the Special Committee were not material, and that the disclosure provided was full, true and plain, was deficient. YBM's Directors are not a homogenous group and therefore we must consider each director according to his degree of participation, access to information and skill.

Mitchell

[265] It is clear by now that Mitchell, despite being an outside director, had a fundamental role in the affairs of YBM and was involved in the most significant issues facing the corporation. He testified for 12 days. He was assertive, confident and forthright. We take no issue with his integrity, only his judgement in these circumstances.

[266] Mitchell was an experienced investment banker. He was well versed in public financings. He was a vice-president and director of First Marathon during the material time, and until his departure in April 2001, he was a managing director of National Bank Financial. Mitchell's involvement in YBM began in mid-1994. By June 1995, First Marathon and GMP were both preparing a financing for YBM. In September 1995, First Marathon and GMP entered into an engagement agreement with Pratecs/YBM to act as agents in the raising of funds through the sale of special warrants convertible into common shares.

[267] Through the due diligence performed for the 1995 financing, Mitchell became familiar with YBM's background, including the significant role played by the founding shareholders. The underwriters specifically put an escrow agreement in place with respect to the shares of the founding shareholders. A trading account was subsequently opened by the original six founding shareholders through which they sold YBM shares. Mitchell was the investment advisor for this account. Further, Mitchell acknowledged in his testimony that from the earliest stages of his involvement with YBM, he understood that "long-distance management" of YBM was risky.

[268] Following the completion of the special warrants financing in January 1996, Mitchell agreed to join YBM's Board. First Marathon's written policy was that its employees were not to sit on the boards of its clients without the written consent of First Marathon. The policy offered no guidance regarding the factors First Marathon considered relevant to providing its consent. Mitchell obtained First Marathon's written consent in February 1996.

[269] Mitchell attended his first Board meeting on April 29, 1996. Mitchell was later appointed Chair of the Special Committee on August 29, 1996, and was appointed to the Audit Committee on April 25, 1997. Peterson testified that he was confident that Mitchell would have the time, energy and commitment to act as Chair of the Special Committee due to his background as an investment banker and the fact that "he had known this company better than anyone else."

[270] As indicated previously, the reasonableness of an investigation and belief in the completeness and accuracy of disclosure will vary with an individual's skill, access to information and degree of participation.

[271] Mitchell possessed the greatest knowledge, along with Wilder, of the mandate, information obtained by and findings of the Special Committee. He was the Chair, directed the investigation and principally drafted both the interim report and the Report presented to the board on April 25, 1997. His extensive involvement makes it difficult, though not impossible, to establish his belief that there were no material facts omitted. He was familiar with and experienced in the performance of his responsibilities regarding disclosure. Mitchell was an experienced director, analogous to an inside director in these circumstances.

[272] There are risks associated with an underwriter being a director of a public company. YBM was encountering unique risks. Mitchell's responsibility was to investigate and make recommendations. The Special Committee played a prominent role in the Board's decision to proceed with the Crucible acquisition as well as its decision regarding disclosure. Mitchell exclusively conducted the Special Committee's investigation and authored, with the assistance of counsel, the Report. While the Special Committee may not have been created as a disclosure committee, to a large extent by April 25, that is what it had become. The Board discussed disclosure in preparation for the offering at the April 25 meeting. It is clear that the Board relied upon the findings and recommendations in the Report in deciding to proceed with the offering and in fulfilling its disclosure obligations.

[273] Mitchell, as an underwriter, was largely compensated based upon a direct drive compensation scheme. Clearly, First Marathon and Mitchell would benefit if YBM completed the Crucible acquisition and the offering. Simply put, Mitchell was in a conflict of interest. We do not view the conflict of interest as a matter of intention or lack of good faith on his part. Rather, it compromised both his time and judgement. As previously discussed, a special committee must be comprised of disinterested directors in a position to base their decisions on the merits of the issue free of extraneous considerations and influences.

[274] As an experienced director and underwriter, Mitchell ought to have known better. If Mitchell was not alert to this issue on August 29, 1996 when the Special Committee was created, he should have been on November 1, 1996 when the financing for the Crucible acquisition was first discussed by the Board. Mitchell submitted that he addressed the conflict by not advising First Marathon about the Special Committee without first obtaining Board approval. Unfortunately, the Board's approval came late in the Special Committee process. In any event, it did not address the essential problem. The Board's approval did little to protect investors because the basis for Mitchell's conflict remained and the Board proceeded with its decision regarding disclosure based upon the Report. The potential for divided loyalties makes it more difficult for Mitchell to justify the reasonableness of his belief that YBM made full, true, and plain disclosure.

[275] The evidence indicates that Mitchell's conflict adversely impacted his judgement. Why would he provide a copy of the Special Committee Report to First Marathon but not to the Board? It is clear that the Board had no process for the Report's distribution (not even to itself in light of the legal advice with which it was provided), however, the Report was, in our opinion, critical to issues of disclosure as well as to the 1996 re-audit and the 1997 audit. Mitchell explained that he did not ensure that staff and D&T received a copy of the Report because he was a "busy guy" and he had an employer that was "paying [him] good money not to sit on special committees." YBM and its shareholders, however, expected Mitchell to fulfill his duty to ensure that full, true and plain disclosure was made. We note further that Mitchell did not provide the Report to First Marathon's co-lead underwriter, GMP.

[276] We have previously discussed the details of the Special Committee's investigation. Matters were brought to Mitchell's attention, which required further investigation. The United Trade commission payments, the FBI Affidavit, YBM's customers and end users, the falsification of the original equipment invoices and the continued INS interest were not pursued. With regard to the false equipment invoices Mitchell testified, "I had no reason to doubt that the invoices had been created after the fact.... So it concerned me, concerned me to this day, but it was what it was". The failure to pursue these matters affected the reasonableness of his belief in the materiality of the facts that were omitted.

[277] As indicated previously, Mitchell failed to provide much of this information to the Board. The Board, except Bogatin and Davies, was unaware of the FBI Affidavit. The Board was not informed of the continued interest of the INS despite its being marginalized in the report. The Board was under the impression that the sale of Arbat resolved any issues associated with the commission payments. We are also dissatisfied with the fact that the Board was not informed about a number of Fairfax details. While Fairfax found no evidence of money laundering, it did find indicia of it and recommended further investigation, which was not pursued. Despite its work on end users in March and April of 1997, Fairfax continued to have concerns with North American end users.

[278] Fairfax viewed the draft report provided to it as Mitchell "attempting to portray some bad facts as well as he could, given the circumstances." We view the final Report in the same light. For instance, the Report states that the Original Equipment Transaction "may not have been as originally described," when Mitchell knew that the documentation surrounding the transaction was likely false and testified that this continued to cause him concern. Similarly, the Report states that "rumoured involvement of shareholders in organized crime was noted from a variety of sources including print articles." Mitchell had been specifically briefed about the FBI Affidavit.

[279] Similarly, Mitchell was not completely forthcoming with the public. The AIF is a critical disclosure document in a POP offering. He let Wilder and management "[drive] the bus on the AIF". We take no issue with counsel being involved in the preparation of the AIF, but the work of the Special Committee was not typical and Mitchell was the most informed. He reviewed Wilder's initial draft of the AIF but not the final draft, which was revised largely by Bogatin. He reviewed the changes to the AIF after it had been filed, but expressed no concerns.

[280] Mitchell testified that YBM took guidance from its counsel regarding disclosure and that as a result the company's disclosure record "is as it is". Despite this, Mitchell knew the Special Committee information was important. He wanted First Marathon and the underwriters briefed about it. Mitchell was unhappy with Gatti's letter to the founding shareholders regarding the FBI Affidavit because it could have caused them to trade their securities. Mitchell knew what the AIF said and what it did not say.

[281] As part of the offering process, Mitchell attended the May 28, 1997 due diligence session on behalf of First Marathon. He did not respond to a question regarding whether there were any current, pending or contemplated investigations, despite his being the Chair of the Special Committee. He had obviously switched hats. Similarly, at the June 13 and 16 meetings with staff, he testified that his role was that of underwriter not director.

[282] Mitchell took a number of positive steps towards uncovering facts that could have had an adverse economic impact on the business. However, the risks at issue left little margin for error. Mitchell had considerable skill, access to the most information and extensive participation in the offering, the investigation of the facts, their materiality and their disclosure. He developed a belief in the legitimacy of the business. However, that did not in our view justify a reasonable basis for his belief that YBM made full, true and plain disclosure of all material facts. Consequently, a defence of due diligence is unavailable to him.

Davies

[283] Davies is a semi-retired business consultant residing in British Columbia. He has raised venture capital on at least 24 occasions. He became a director of Pratecs in April 1994. He has served on the board of four public companies. Two were on the former Vancouver Stock Exchange and two were shell companies. He was on the Pratecs board when the U.K. proceedings were initiated into money laundering involving Arigon, Karat and Mogilevich and later dismissed on consent. Davies looked on this result as a form of immunization of YBM.

[284] Davies submits that he was relatively inexperienced, that he did not bring to the board the expertise and business prominence associated with TSE 300 public companies and that he did not have a leadership role, enjoying no influence or control over the affairs of YBM or the Board. He had little experience with TSE 300 companies but he had considerable experience with other public companies. Whether the issues facing a board involve a TSE 300 company, a smaller public company or an unlisted company, a director's attention to his or her obligations is still the essence of diligence; *Soper* at para. 34. Davies may have been unfamiliar with large public boards but he has no shortage of experience with respect to raising capital for public companies.

[285] Davies was a member of the Special Committee, which he submits did not place him in a better position to make disclosure because he knew no more than other directors. Davies' role on the Special Committee was limited and virtually non-existent after Fairfax was retained. He submits that living in British Columbia, a different time zone, impaired his ability to serve effectively on the Special Committee. With respect to this latter suggestion, we disagree for the most obvious reasons.

[286] As a member of the Special Committee, the Board relied on him. While the evidence establishes that Mitchell conducted the Special Committee's investigation almost single handedly, that did not relieve Davies of his responsibilities as a member of that committee. In *Soper* at para. 26, Robertson J. stated that the law does not permit directors to "adhere to a standard of total passivity and irresponsibility." Furthermore, the law cannot "embrace the principle that the less a director does or knows or cares, the less likely it is that he or she will be held liable"; *Soper* at para. 26.

[287] Davies knew, or ought to have known, that Mitchell was in a compromised position because of his dual role as underwriter as well as Chair of the Special Committee. This fact alone should have required him to take on more responsibility. Simply put, it is irresponsible to do virtually nothing when your responsibility suggests otherwise. Davies' reasons for not taking on a greater role appear more like excuses rather than reasonable explanations consistent with care. It is not a question of honesty but rather skill and diligence.

[288] Despite what would otherwise appear, Davies had a close relationship with Bogatin. Davies was very familiar with the business of the company. They often spoke, and obviously, we take no issue with that. However, Bogatin did inform Davies of the visa difficulties before telling the rest of the board and of the FBI affidavit.

[289] Davies was the only outside director who had a personal visit from the FBI in April 1996. While the FBI only disclosed that there was an investigation and asked no specific questions about YBM's business, it is clear that their visit related to YBM. The FBI wanted Davies to work in a somewhat clandestine manner on its behalf but he declined. Davies did not discuss this visit or the likely subject matter with the Board or its counsel, only with his daughter. He explained that the FBI advised him to keep the interview in confidence. He compared his decision to do so with staff's responsibility with respect to their public law duties. We have some difficulty understanding Davies' motivation in this situation. Having heard his testimony, we are of the opinion that having regard to his skill and business experience, he failed to act prudently. A director has a positive duty to act when he or she obtains information, or becomes aware of facts, which might lead one to conclude that there may be an issue that may adversely affect the company; *Soper* at para. 53. We must consider his belief that there were no material facts omitted. A director's belief cannot be considered reasonable when he is aware of circumstances of such a character, so plain, so manifest, that a person with any degree of prudence would not have acted in this manner.

[290] Davies was present at the August 15, 1996 meeting where Rossman recommended to the board that it form an independent committee with independent counsel. Davies supported that recommendation. It is apparent that the Board decided not to retain independent counsel. We also have considerable difficulty accepting his suggestion that retaining Fairfax was in some way the equivalent of retaining independent outside counsel. That was clearly not its role or responsibility.

[291] Davies had virtually no involvement in the work of the Special Committee. No processes were put in place to achieve that outcome. He took no part in the preparation of the interim report. It is submitted that that he had no information and therefore could not contribute. We agree to some extent but not entirely. Despite his suggestions, we do not accept that he could not have made himself available to meet with Fairfax or at least get more information. We agree that Fairfax could have and probably should have prepared a more comprehensible report but that is not an excuse for Davies' inaction. Moreover, Davies did have views and even important facts to contribute. How would counsel or the Board have reacted if they had known that he had been visited by the FBI? His knowledge of the FBI affidavit, the FBI request for assistance and earlier knowledge of the U.K. proceedings were a call to action. Even if Davies had become more involved, as we suggested above, it is possible that the disclosure would have remained the same; however, what would have changed would have been our view of his diligence and his belief. His conduct is more consistent with sophisticated inexperience than reasonable care. Once again, we find his submissions regarding distance and time unconvincing.

[292] There are no stringent prerequisites for becoming a director of a public company and the nature of that office involves the exercise of business judgement; *Soper* at para. 28. What Davies did not get by way of information, he could have asked for. The standard of care is intended to encourage responsibility not passivity. It is said that an obvious characteristic of a reasonable director is one who is prepared to ask tough questions not only of management but also of other directors. Davies'

unique knowledge and role on the Special Committee presented him with an opportunity to do so. It is apparent that he declined.

[293] As a final comment, we would like to comment on Davies' decision to provide all of his YBM documents to the Financial Post. Apparently, he was worried that the police would seize them and they would disappear. He did this because he has little faith in law enforcement in Canada because, somehow or another, documents disappear. He obtained legal advice as to what to do with these documents from a non-North American lawyer. Staff describe this as a complete absence of good judgement. We agree.

[294] Counsel for Davies, in a most persuasive and insightful manner attempted to persuade us of the reasonableness of this action. However, we are not persuaded as to its prudence. While this issue may be collateral to the essential question of full, true and plain disclosure, this conduct is inconsistent with the care and diligence expected of directors in general and Davies specifically.

[295] Mitchell did not consult with him with respect to the report of the Special Committee and Davies did not take part in drafting it nor did he receive a copy of it, although he testified that through discussions with Mitchell he was aware of its basic content. Davies concluded he had no information to provide and that the Special Committee had answered all of the major questions of concern. In addition, he was not consulted nor did he view that he had any role in preparing the AIF. He relied, as he was entitled to do, in his opinion, on the expertise of professionals and management. As such, he took no issue with the disclosure. Obviously, he took no steps to determine who should receive a copy of the Report.

[296] Davies did not fully inform himself as a member of the Special Committee regarding the investigation and the details of the Report and did not share all relevant facts of which he was aware with other Directors or counsel. These facts could have, in our opinion, had some influence on the Board's investigation and belief as to the accuracy of its disclosure.

[297] We find that Davies' belief that there was full, true and plain disclosure of all material facts was not reasonable in the circumstances and therefore a defence of due diligence is unavailable to him.

Schmidt

[298] Schmidt was a land surveyor and real estate agent with limited experience raising capital. He was the least experienced board member. He first became a director of Pratecs in March 1994. Pratecs was his first public directorship. In 1995, he learned of the U.K. proceedings and participated in the decision that resulted in the cease trade of Pratecs' shares. He remained involved and monitored documents related to the proceedings. He clearly took an active interest in the issues and was not passive in these responsibilities. Somewhat to his surprise, Schmidt continued on the YBM Board as it evolved from a shell company to a more sophisticated organization.

[299] Schmidt attended the August 15, 1996 board meeting. He was an outside director but was a member of the Special Committee. He was appointed to the Special Committee primarily because he was an early director and had information with respect to YBM's background. Schmidt provided this background information regarding YBM to the Special Committee. He actually provided a written report to Mitchell on September 9, 1996 wherein he noted a discrepancy in Mogilevich's shareholding in Arigon. Beyond providing this written report, Schmidt was not asked to provide any further assistance in the investigation and there were no meetings of the Special Committee.

[300] Schmidt attended the November 1, 1996 meeting in Philadelphia where concerns relating to Russian organized crime were discussed. Following this meeting, Fairfax was retained and Fairfax's sole point of contact was Mitchell. At this point, Schmidt viewed his Special Committee work to be at an end. He was not advised of this. He simply concluded that he had nothing further to offer. He was, however, not asked to do anything further. In essence, he shared the same knowledge as other Board members who were updated at Board meetings. He did participate in the February 19, 1997 meeting and the March 21, 1997 meeting with Antes and Mitchell by way of a conference call wherein Fairfax made its presentation.

[301] By now, we are well aware of the concerns presented by Fairfax at this meeting. Afterwards, the outside Directors discussed their concerns as well as the fact that there were factors mitigating them.

[302] It seems that despite his passive role on the Special Committee, Schmidt did remain in contact with Mitchell during the investigation, particularly with respect to Fairfax's efforts to confirm customers. Schmidt was of the opinion that the board would walk away from the Crucible deal and pay the $8 million penalty if Fairfax's concerns were not resolved.

[303] Schmidt attended the April 25, 1997 board meeting in Toronto. Neither Bogatin, Mitchell or Davies disclosed the existence of the FBI Affidavit to the rest of the Board. Schmidt was not aware of the FBI Affidavit.

[304] Schmidt was not involved in the drafting of the AIF, but he did review it. His reasons for being satisfied conform to reasons already discussed herein. He participated in the board resolutions approving the Preliminary Prospectus and the Final

Prospectus. He had no involvement in the events after April 25, including no contact with the underwriters, Price Waterhouse, staff or D&T.

[305] Generally, we do not accept Schmidt's reasons for not being more proactive on the Special Committee. This is particularly the case since he participated by phone in the briefing by Fairfax on March 21, 1997. It would also appear that he remained in contact with Mitchell despite not being active on the Special Committee. For the reasons outlined with respect to Davies' inactivity on the Special Committee, we are of a similar opinion with respect to Schmidt. Similar to Davies, we do not question Schmidt's honesty and integrity. We do question certain aspects of his diligence and care. We agree that one can exercise a reasonable degree of care and yet be wrong. However, in these circumstances it is a question of being reasonably informed. Was Schmidt's belief justified in the circumstances? It is clear that he relied on legal advice. It is also clear that he was inexperienced. While Schmidt relied on such advice, and despite his lack of experience, he also applied his own judgement to the issue of disclosure. He also relied on the underwriters, in particular on Mitchell. His reliance was not unreasonable in this case. As others were, Schmidt was relieved at the uniformly positive D&T audit opinion.

[306] At the time, despite his passive role on the Special Committee, and given his relative age and inexperience, we would not put him in the same position as Davies. It was more reasonable for him to rely on experienced counsel and financial advisors since his level of experience would make it more difficult for him to judge the advice as being right or wrong. Schmidt considered the information, relied on other professionals with more experience in disclosure and materiality and applied his own judgement. That belief was reasonable in the circumstances for the reasons discussed earlier.

[307] Schmidt, unlike Mitchell and Davies, did not have any information that other Directors did not have or did not share with the Board. His belief in the legitimacy of the business and no managerial improprieties was not unreasonable. He admittedly gave more weight to these factors than to other risks that YBM might face. He clearly could have done more on the Special Committee and he should have. Nevertheless, he had no knowledge of any facts not known to the Directors generally and to Mitchell and Davies more specifically.

[308] As a result, we have concluded that a due diligence defence is available to Schmidt.

Peterson

[309] Peterson is the Chair of the partnership at Cassels Brock and was the Premier of Ontario from 1985 to 1990. He was called to the Bar of Ontario in 1969. He is Wilder's partner. Peterson gives strategic advice but does not have a traditional law practice. He is an experienced corporate director who serves on many public boards. He has served on special committees and signed a number of prospectus certificates on behalf of other issuers.

[310] Peterson was an outside director who had been on the Board for four months at the time of the August 15, 1996 meeting. While he was a Director of YBM he invested $50,000 in shares of the company at $6.00 per share in the beginning and later at $15.00 per share. He never traded the stock. As such, he lost his investment along with other investors. He was not on the Special Committee. He signed the prospectus certificate on behalf of the Board, but was not substantially involved in the offering process. He attended only one meeting with staff on November 4, 1997. He did attend all of the relevant board meetings and was fully aware of the mandate of the Special Committee. He also met with First Marathon on one occasion on May 12, 1997 to discuss the report of the Special Committee. At that time, he expressed his confidence in the management of YBM.

[311] The board specifically discussed disclosure on two occasions: August 15, 1996 and April 25, 1997. On both occasions, even after receiving the Special Committee Report, the legal advisors opined that no further disclosure was required. Peterson was actively involved in the decision to create the Special Committee but he was not a member. While he understood Rossman's advice that the Committee should retain independent counsel, he was of the view that "lawyers were not going to solve this problem." Independent investigators were required to "drill down" and "get the facts". The Committee could have retained independent counsel, but it decided to carry on with Wilder, his partner. While we understand his reasons for not retaining independent counsel, we do not accept his rationale and believe that that decision was inconsistent with good process.

[312] Peterson relied on the work of the Special Committee but did not request a copy of the Report. He understood from Mitchell's presentation at the April 25 board meeting that there was an ongoing investigation but was not aware of the subject matter. He acknowledged that the Special Committee information could have provided a possible explanation why the U.S. authorities might be investigating YBM. He understood that the rumoured involvement of shareholders and organized crime was noted from a variety of sources including print articles. He also realized that ties existed between Fisherman and the founding shareholders, Mogilevich in particular. However, he concluded that no undue influence was being exerted on YBM by the founding shareholders and that the Special Committee had found no evidence of illegality. Further, there were internal controls and processes in YBM that had to be improved, but based on legal advice, no further disclosure was required.

[313] Peterson took great comfort from the Committee's conclusion that neither Fairfax nor the Committee had discovered any evidence that senior management of YBM was in any way involved in any illegal or improper activity. He thought the Report's findings and conclusions provided a reasonable response to the issues raised therein.

[314] Peterson was not as informed as Mitchell or Davies, both of whom had a longer history with YBM and were on the Special Committee. He was unaware, for example, that the Arbat commissions discussed in the Report were actually recorded in the United Trade ledger and in some cases post-dated Arbat's divestiture. He was unaware of Gatti's AIF draft disclosing that the INS had recently begun an informal inquiry into foreign nationals working at YBM. He was unaware of the FBI Affidavit and that Davies had met with the FBI. He did not attend any briefings by Fairfax and was under the impression that Fairfax had approved the Report.

[315] We have expressed concerns regarding Mitchell's dual role and reliance by the Board on the Special Committee to provide a report that would inform, in part, their obligations. Peterson's legal background and his professional board experience suggests that he should have been attuned to the potential conflicts of interest in this case. The Board nevertheless pressed ahead and decided to proceed with the offering at the April 25 meeting. It would appear that the board weighed the information and, in particular, was relieved that Fairfax found no evidence of illegality or improper activity by management.

[316] Peterson understood, based upon Wilder's advice, that there should be disclosure of the fact of the Special Committee in the AIF. He relied upon counsel and management to prepare that disclosure, as he is obviously entitled to do. He understood the delicate balance between too little disclosure and what was described as inappropriate disclosure. He realized that the Special Committee information was to be disclosed to the underwriters on the basis that "if he [an underwriter] thought there was anything unsavoury or improper, he could have withdrawn easily", while investors received less information. Peterson subsequently relied upon the D&T high-risk audit as reducing any concerns and further justifying YBM's disclosure. He did not consider whether D&T or staff received a copy of the Report.

[317] Although Peterson was an outside director, he was experienced with respect to TSE/TSX public companies. Peterson was not passive in his role. He questioned management and recommended outside assistance. Neither disclosure, nor an understanding of his duties with respect to full, true and plain disclosure were new to him. We take no issue with Mr. Peterson's integrity, his truthfulness or his motives. But, that is not the issue with respect to diligence. Our review of the evidence suggests some areas where Peterson should have not accepted the facts at face value because they required more scrutiny and analysis.

[318] First, he fell down on the process of the Special Committee particularly with respect to Mitchell's roles. Second, at the February 19, 1997 board meeting, Peterson first became aware of Mogilevich, whom he agreed was a man of unsavoury character. Peterson was less concerned because his focus was on whether there was any improper activity in the business or any undue influence by Mogilevich on the company. He came to the conclusion that this issue, as exemplified by the commingling matter, was solved by the time of the final Report. Third, on April 3, 1997, Peterson knew that despite not completing the Special Committee investigation, YBM agreed to purchase Crucible risking an $8 million fee if the deal was not completed. Peterson thought this was a reasonable risk to take.

[319] Finally, we question the manner in which Peterson considered the AIF disclosure. He agreed that it did not touch on the investigation issue. He testified that the Committee found no crime and no improprieties by management. It was discussed thoroughly and a group of well- intentioned people tried to present the truth. Peterson distinguishes between inaccuracy and incompleteness in the disclosure of the mandate of the Committee. We remind him that the duty is to make full, true and plain disclosure. Peterson was an outside director. The report raised issues, but from his perspective, it also provided answers to those concerns. He was comforted by the Special Committee's conclusions that there was no evidence of undue influence by the founding shareholders and no evidence that management was involved in any illegal or improper activities.

[320] Peterson's belief that the prospectus contained full, true, and plain disclosure must be assessed in the context of his reliance on the Special Committee, legal advice, management of YBM and the D&T audit. As indicated previously, the Special Committee process was flawed. Nevertheless, the disclosure decision was further justified, in his view, by the results of the D&T audit. While he did not inquire into whether D&T was provided with a copy of the Report, he was entitled to assume that management or the Special Committee would fulfil that task.

[321] While we believe Peterson could have done more, we have concluded that Peterson acted reasonably based on his involvement in the matter, his skill and his access to information in the circumstances. Accordingly, his due diligence defence is available to him, but just barely. We are of the view that Peterson brought a unique perspective to the board. His professional reputation as testified to by Mr. Michael Wilson, Mr. David Beatty and Mr. John Tory, and his experience in many other public company boards, was not in any way equalled by any other Director. He had unique access to counsel to the Special Committee, whom he supported as counsel both to YBM and the Special Committee. He was appointed to add to the prestige and status of YBM. While Peterson meets the legal test of due diligence, the panel remains disappointed that he did not offer more insight and leadership to the board in these circumstances.

Antes & Greenwald

[322] Antes and Greenwald are both retired scientists living in the United States. Antes is 72 and Greenwald is 77.

[323] In 1986, when the company which Antes for worked acquired the company which Greenwald worked for, they met and began working together. Soon after the acquisition, Antes hired Bogatin as the Director of Research of the magnetics division of the merged company. Bogatin had impressive credentials and experience. Antes and Greenwald considered him a brilliant scientist and both forged solid personal relationships with him, which would later bolster their belief in management's integrity and in the legitimacy of the company.

[324] In April of 1993, Bogatin approached Greenwald to join Bogatin's new company, which aimed to sell Eastern European magnets in the U.S. market. Greenwald declined, but did work as a magnet sales consultant from 1993 to 1994. In March of 1995, Greenwald joined the board of YBM Magnex. Antes joined the board three months later. It was still a private company at that time. On April 29, 1996, Antes and Greenwald became directors of the new public YBM, at which time Mitchell and Peterson also became directors. Antes became the Chair of the Board four months later.

[325] Antes and Greenwald had difficulty recalling certain meetings, conference calls and documents. Antes had much more difficulty than Greenwald. Antes' poor recollection seemed inconsistent with his excellent recall of scientific matters and his participation in the Crucible acquisition. However, we do not infer any improper motives. We found Antes and Greenwald generally to be credible witnesses. The documentary record and the evidence of other witnesses were able to fill the gaps in their recollections.

[326] Antes and Greenwald were on YBM's board because of their scientific expertise, experience, connections and standing within the magnetics industry. Although both of them had been on the boards of private companies and non-profit organizations, this was the first public company board on which either of them had ever served. While they had business experience, they were essentially scientists and knew little, if anything, about securities law. They each had a general understanding of their obligations as a Director and took comfort from the fact that Mitchell and Peterson had extensive experience with respect to public companies.

[327] Antes and Greenwald took their duties as directors seriously, and attended every general and special board meeting that occurred during the relevant period. Antes also sought advice from friends with public company experience. Antes and Greenwald did the job expected of them. They identified and recommended Crucible as a desirable acquisition target, and conducted negotiations with Crucible in Kentucky and with neodymium magnet licensors in Japan.

[328] Similar to Peterson, Antes and Greenwald were not members of the Special Committee. They were not involved in the drafting of the Report and their knowledge of its contents came from Mitchell's oral presentations. They were not aware of the FBI Affidavit or Davies' visit from the FBI.

[329] We recognize that, together with Peterson, Antes signed the Preliminary Prospectus and the Final Prospectus on behalf of all the Directors, and that Antes was more involved in YBM's affairs than Greenwald was. In 1997, Antes worked 140 days as a part-time consultant to the company and shared an office at the Newtown headquarters. He also acted as an official conduit for the Special Committee's early information requests to management, but did not see or discuss management's responses. Unlike the other non-Special Committee directors – or, for that matter, Davies – Antes heard Fairfax's findings directly. He participated in the preliminary briefing with Stern in Newtown in November 1996, the Fairfax briefings on March 21 and 22 , 1997, and the Philadelphia meeting on April 13, 1997. However, he did not play a passive role at these meetings and questioned the pertinence of Fairfax's findings and conclusions.

[330] Through his consulting work and his knowledge of Fairfax's work, Antes was more informed than Greenwald. However, Antes was not akin to an inside director for due diligence purposes. Antes worked with management in respect of acquisitions, but he did not have a meaningful involvement in YBM's day-to-day affairs in the way that management did.

[331] Greenwald had no direct exposure to the Special Committee's work, other than attending Mitchell's briefings on November 1, 1996, February 13, 1997 and April 25, 1997. He never met any of the Fairfax representatives. He often asked Antes for updates on Fairfax's progress. Greenwald stated that the content of Antes' updates essentially reflected what Mitchell reported to the whole board on April 25, 1997: "[Fairfax] haven't found anything of sufficient seriousness to explain the investigation by the U.S. Attorney's office, 'but we're finding a lot of things that we've got to do something about.'" Furthermore, in Greenwald's opinion, the Report largely repeated information that the Directors already knew from previous briefings. Still, Greenwald was not passive at the April 25 meeting, and asked Mitchell to clarify Fairfax's "bottom line". Mitchell replied that Fairfax was satisfied with the legitimacy of the business.

[332] Antes and Greenwald brought different skills to the Board than the other YBM directors. Skill is that proficiency that comes from training and experience. They did not have the public company or business experience of other YBM directors. They relied on the members of the Special Committee to fulfill the duties assigned to them. For all their involvement in

identifying and recommending the acquisition of Crucible, Antes and Greenwald had no material role in the financing. They relied on counsel for the drafting of disclosure that was to comply with Ontario securities law. Legal advice must be considered in the context in which it was given, and in this context, given their level of experience and skill, it was reasonable for Antes and Greenwald to rely on counsel. They did not participate in the drafting of the AIF, the Preliminary Prospectus or the Final Prospectus, and did not participate in any of the meetings with staff. Despite the reasonableness of their reliance on counsel and even with their limited knowledge, they should have been alive to the muddled nature of the disclosure in the prospectuses when those two documents were presented for Board approval. Even without public board expertise, their knowledge of the mandate, information obtained by and findings of the Special Committee should have put them on notice.

[333] Antes and Greenwald, although members of the Audit Committee, were not involved in selecting or instructing D&T. Their knowledge of staff's concerns and the D&T engagement came from board meetings in the summer of 1997. Antes believed that the high-risk audit being performed by D&T was akin to a forensic investigation and would unearth wrongdoing. Greenwald had no specific understanding of the investigation. When D&T's clean audit opinion emerged, they both viewed it as confirmation of their long-standing belief that YBM was a legitimate business. Their reliance on the D&T clean audit opinion was reasonable.

[334] Accordingly, their belief as to full, true and plain disclosure is justified in the circumstances of the case. Therefore, a due diligence defence is available to both Antes and Greenwald.

Gatti

[335] Gatti faces the same allegation as the directors of YBM. Did Gatti, as an officer and the CFO, authorize, permit or acquiesce in the failure of YBM to make full, true and plain disclosure of all material facts? At the relevant time he was the CFO and Vice-President of Finance. He was not a member of the Board and as such not on the Special Committee. He did attend some Board meetings but only upon invitation. His superiors, Bogatin (CEO) and Fisherman (COO), were both Directors of YBM.

[336] As an officer of the company he is deemed to have an in-depth knowledge of the affairs of the company. Thus, as stated in *Soper*, as a senior officer, he will have a higher duty to react diligently to events based on that knowledge.

[337] Gatti first became involved with YBM in 1995 when he was its audit manager at Parente. At that time he became aware of YBM's substandard accounting systems and financial reporting. In 1995, he left Parente for Ernst & Young but joined YBM shortly thereafter in January 1996 because it was an opportunity for his career "to take a bit of a quantum leap." He was relatively inexperienced in January 1996 when he became CFO of YBM, his first appointment as an officer of a public company. In addition, the Crucible transaction and the public offering were his first involvement.

[338] Gatti played a significant role at YBM. His responsibilities touched on virtually all aspects of its business – strategic planning, financings, financial reporting, accounting and control systems in Philadelphia. Staff posed the question – what would the reasonable person have done in Gatti's circumstances?

[339] As an officer, Gatti's knowledge and ability to influence the company were different and lesser than Bogatin's and Fisherman's because he was not a director and he did not regularly attend Board meetings. As suggested in *Standard Trustco* at page 4375, his role was relatively subordinate to those members of management who were also directors. However, his knowledge of the affairs of YBM was clearly greater than that of the outside directors with the exception of Mitchell. We agree that "inside directors will face a significant hurdle when arguing that the subjective element of the standard of care should predominate over its objective aspect"; *Soper* at para. 44.

[340] Staff assert an expansive view of the role of the modern CFO. It encompasses more than finance and embraces broader responsibilities including corporate governance, risk management and maintenance of effective systems of internal control. The CFO must take on the important responsibility of being a conduit of information between the board and its auditors. Further, the CFO has an important responsibility regarding timely and accurate public disclosure.

[341] Staff contend that Gatti was an ineffective CFO. For the most part we disagree. Gatti tackled many of the issues that were within his skills as a reasonably experienced auditor and novice CFO. He did a sound job with respect to matters within his control and skills. By the end of 1997 he had gone a considerable way towards addressing the material deficiencies identified in Parente's management letters. He recruited a controller, improved internal financial reporting and records and worked with D&T to implement a proper computerized accounting system. He was also responsible for the financial disclosure that was not in issue in this case. At the same time, Gatti was somewhat overwhelmed by the demands of a company that had most of its operations in Eastern Europe. It was also growing by acquisition. He was understaffed in North America and a number of his attempts to centralize control in Newton were thwarted by Bogatin and Fisherman. It was clear that Gatti was in a subordinate role. Nevertheless, Staff submit that he should have gone directly to the Board with his concerns. In general terms we agree with this submission.

[342] Staff submit that Gatti knew all the relevant facts or should have known them. He knew YBM's corporate history since he had previously been an auditor at Parente assigned to YBM. He should have been aware of the materiality of the relevant facts since he drafted documents which clearly stated that the disclosure of the investigation, commission payments to alleged members of organized crime and founding shareholder ties to criminal activity all would have a devastating impact on YBM's share price.

[343] As an officer Gatti derives responsibility from the Act. His belief regarding the completeness and accuracy of disclosure must be dependent on a reasonable investigation, which depends in turn on the degree of his involvement, his access to pertinent information and his skill. The manner in which he arrives at an informed decision regarding disclosure is germane to his defence of due diligence. In this case, Gatti believed that there were no omissions and that the disclosure was accurate.

[344] There is no need to apply a higher standard of care to Gatti. He was not a director, nor was he on the Special Committee. Staff's allegations did not concern the expertised portions of the Preliminary Prospectus and Final Prospectus. While Gatti was the CFO, he was not called upon to use his accounting training and skills to certify the type of disclosure at issue in this proceeding. However, he was involved, as would be expected of senior management, in the preparation of the AIF along with others.

[345] Did Gatti sign a certificate that, given his knowledge of the facts, simply could not support a belief that the associated disclosure was true and that facts were neither omitted nor misstated?

[346] Gatti had considerable knowledge of the corporate history of YBM including the fact that the original shareholders had a significant role in the formation of the company but were, in his belief, not active in the company. He knew there were material weaknesses in internal controls in the accounting systems. He also was aware of the details of the U.K. proceedings. He agreed that one reason for the reorganization of Arigon and the establishment of United Trade was to dispose of the lingering effect of the U.K. proceedings that had been dismissed. Gatti recommended Arbat's sale but left the details to Fisherman and Bogatin. We accept his evidence that he did not know the value of the continuing services that Arbat would render on a contractual basis after its sale.

[347] There can be little doubt that Gatti had considerable awareness of the facts which staff submit were material and should have been disclosed. Gatti and Bogatin initiated a management investigation into the visas that had been denied to the Vitanovs. They retained Rossman and Gatti briefed him on the investigation. They also took other steps. They contacted and co-operated with government officials, contacted Congressman Greenwood, invited and spoke to the FBI in Newtown, agreed to approach Senator Specter and hired Hearn for that purpose.

[348] Bogatin appeared to resist bringing Rossman's findings to the board but did so on August 15, 1996, on threat of Rossman's withdrawal. Gatti prepared and presented a detailed chronology as discussed above. He was aware of the highly sensitive investigation but not its scope or magnitude.

[349] Gatti knew of the State Department's interest and that there was a "large Justice Department file on YBM." He had concerns and understood the potential impact on YBM as a public company. Management agreed to send a letter detailing these concerns and the potential impact, drafted by Gatti, to U.S. Attorney Stiles. Ultimately, the board did not approve its being sent. The contents of this letter clearly demonstrate the likely materiality of this information.

[350] Rossman felt that Gatti was sincere, co-operative and forthcoming with information. We took a similar view during this hearing. We were satisfied as to his integrity. We find that he honestly believed that there were no material facts omitted. However, that does not necessarily mean that his belief was reasonable in the circumstances.

[351] Gatti assisted the Special Committee in collecting information and did so extensively. We do not attribute any negative inferences with respect to the Arbat information. His effort to provide information is evidence of his due diligence. He drew to the Special Committee's attention the issues associated with the discrepancies in the Averin sales commission statement. Management discovered the FBI Affidavit. Bogatin made Mitchell aware of its contents. Gatti prepared the letter and questionnaire to the original shareholders in December 1996 in which management tried to identify the problem. In this letter, Gatti recognized that "our western securities lawyers tell us that we are very close to having an obligation to disclose these allegations to the general public. If this were to happen our stock could be worthless in a short period of time." This letter was written on December 19, 1996. At that time Gatti was unwilling to sign off on the 1996 audit due to his concerns.

[352] Gatti was obviously not a member of the Special Committee. He forwarded information to Fairfax, including concerns regarding individuals with ties to organized crime. Neither Gatti nor the Special Committee informed Fairfax about the FBI Affidavit. After the Special Committee retained Fairfax, Gatti became more reactive. This was not unreasonable given the role of the Special Committee and Fairfax.

[353] Gatti attended with Fairfax in Hungary during their review of operations. He also highlighted for Fairfax the commission payments made to Averin. Staff submit that Gatti destroyed a commission statement. He testified that he did not do so but rather that he declined to give Larkin a copy. We accept Gatti's evidence on this matter. The conduct alleged by staff would be inconsistent with our view of his overall testimony.

[354] Gatti was briefed on March 22, 1997 by Fairfax. He provided further information regarding customers at that time. He also provided information regarding the Technology Distribution and Mogilevich bank accounts. He attended the Fairfax/YBM final meeting on April 13, 1997 and was present at the April 25 board meeting.

[355] Gatti was part of the working group that prepared the AIF and preliminary prospectus. The working group consisted of Wilder, Jordan Jacobs of Cassels Brock, Mitchell, Jones, McBurney, Litwack, Bogatin and Gatti. It would appear that the working group funnelled information to Wilder.

[356] Gatti submitted a draft AIF, which while not entirely sufficient, was more detailed than the final version. Gatti's draft demonstrates his belief in the materiality of the formation of the Special Committee, its mandate and a number of its findings. Wilder and Mitchell decided that Gatti's draft was not appropriate. Bogatin became involved and the May 1, 1997 draft was then finalized. The final version of the AIF substantially reflected Bogatin's input. Gatti clearly relied on the advice of the working group of lawyers, underwriters and Mitchell as Chair of the Special Committee.

[357] Gatti had no experience in such matters. He relied on the Special Committee. He relied on the experience of underwriters and securities lawyers for the issuer and underwriters. While Gatti knew a great deal, the Special Committee knew more. The disclosure at issue was not financial disclosure. The Special Committee was independent of management. As such, his reliance was in good faith and honest in the circumstances. As indicated previously, a material fact is a question of fact and law. The assessment of and reliance on legal advice is most pertinent to the reasonableness of the investigation. Gatti was influenced by the fact that while the investigation may have existed, counsel advised that it was not disclosable. Indeed Gatti received correspondence with regard to a Parente audit inquiry letter with a marginal note that reads: "no required disclosure – per CBB". Finally on May 28, 1997, Gatti, Bogatin and James Held of YBM participated in a due diligence conference call with the underwriters, auditors and lawyers in which it was concluded that no material fact, including the fact of any pending investigation, was omitted from the preliminary prospectus. The prospectus was signed two days later. The question is, did he reasonably believe that the disclosure was adequate and that it was true?

[358] Gatti relied on the D&T audit as verification of the legitimacy of the business. As indicated previously, appropriate reliance is a factor in due diligence. Was reliance on D&T's audit reasonable for Gatti, who was an experienced auditor? Gatti supplied considerable information to D&T. The nature of the high-risk audit has been discussed previously. We agree with staff that D&T should have been, but were not provided with, the Report, Rossman's August 2, 1996 letter to Bogatin, Mitchell's September 15, 1996 letter to Antes, Gatti's October 8, 1996 letter to Mitchell, the November 1 interim report of the Special Committee and notes pertaining to the two Fairfax briefings. While Gatti did provide considerable information to D&T, clearly it should have been provided with more. Gatti, however, was not the only member of management who had this responsibility. Moreover, Mitchell and the entire Board were aware of the significance of the D&T audit and should have provided the above mentioned information.

[359] It was clear that Gatti was subordinate to Bogatin and to the decisions of Mitchell and Wilder. What should he have done? In our opinion, as mentioned above, in such circumstances an engaged CFO should communicate directly with the board of directors of the company.

[360] In conclusion, we find that, at the relevant time, Gatti had a reasonable belief that the prospectus disclosure was true and that no material facts were omitted. In the circumstances of this case, we find that Gatti has proved his due diligence, but just barely.

WHAT DID FIRST MARATHON AND GRIFFITHS MCBURNEY DO TO ENSURE FULL, TRUE AND PLAIN DISCLOSURE?

[361] Staff allege that First Marathon and GMP signed certificates to preliminary and final prospectuses which they knew or ought to have known failed to contain full, true and plain disclosure of all material facts. In particular, they knew or ought to have known that the prospectuses failed to disclose material facts relating to the mandate, information obtained by and findings of the Special Committee.

[362] Staff submit that the underwriters used the due diligence process selectively as a means to justify a pre-determined position by rejecting the results of due diligence that reflected adversely on the issuer and accepting the results of due diligence which supported the issuer. The underwriters submit that they conducted extensive due diligence procedures and did not merely rely on the statements and opinions of YBM's directors, officers and counsel.

[363] The actions taken by the co-lead underwriters and their counsel from April 11, 1997 (the date Mitchell gave Bloomberg the April 11 draft of the Report) to November 18, 1997 (the date the final prospectus was filed) can be summarized as follows:

1. Jones and McBurney were designated to oversee their firms' due diligence and sign the underwriter certificates to the preliminary and final prospectuses.

2. Without having a copy of the April 11 draft of the Report, Jones discussed disclosure regarding the Special Committee and its findings in the AIF.

3. Having received a copy of the April 11 draft, Litwack reviewed and commented on at least two drafts of the AIF sent to him by Wilder.

4. Based on the advice Fogler gave after reviewing the April 11 draft, Bloomberg and Jones met with Peterson on May 12 to obtain a moral reference on the quality of YBM's management.

5. Based on Fogler's advice that the balance sheet be 'hardened', the underwriters retained Price Waterhouse and Real Partners to ascertain the legitimacy of the business.

6. Steps were taken from May onwards to confirm sales, customers and both the existence of and value of equipment. These steps included document reviews, site visits in Hungary and conversations with Bogatin and Fisherman.

7. Just before the preliminary prospectus was filed, a set of 'bring down' due diligence questions was put to the company, and answers given. Mitchell and Jones participated on behalf of First Marathon. McBurney attended on behalf of GMP. Litwack was also present.

8. Starting on June 3, a variety of individuals from First Marathon, GMP, Fogler Rubinoff and Price Waterhouse participated in a series of meetings with staff regarding the sufficiency of YBM's disclosure.

9. After D&T was retained to re-audit YBM's 1996 financial statements, the underwriters ceased their efforts to harden the balance sheet because they believed that such efforts would be redundant given D&T's work.

10. After receiving the April 11 draft of the Report in July, Jones asked Mitchell about items in the Report that seemed inconsistent with the oral briefing Mitchell had provided previously. In particular, they discussed the Special Committee's stated concern about the role that the founding shareholders had with respect to the company.

11. In the wake of a clean audit opinion from D&T on October 13, bring down sessions for the Final Prospectus were held on November 14 and 18. Questions were again asked and answers given.

1995 Due Diligence and GMP/First Marathon Trading Accounts

[364] Mitchell and McBurney had conducted due diligence on behalf of First Marathon and GMP previously in connection with the 1995 offering. Litwack and Wilder had acted as counsel to the underwriters and YBM, respectively. At that time, McBurney asked who the principal shareholders were.

[365] Upon incorporation, the shares of Arigon were held in the names of nominees resident in the Channel Islands. The Arigon share register identifies the beneficial owners of these common shares as Semeon Mogilevich (40%), Alexei Alexandrov (12%), Anatoly Kulachenko (12%), Vitaly Leiyba (12%), Alexander Alexandrov (12%), and Semeon Ifraimov (12%). As consideration for the sale of equipment to Arigon, Arigon also issued preferred shares to these individuals in the same proportions.

[366] Sixteen new Arigon shareholders, together with the six founding shareholders, appear in connection with the reverse take-over of YBM Magnex Inc. by the Arigon shareholders. In February 1994, in connection with that transaction, the shareholders of YBM Magnex Inc. consented to issue shares to a total of 22 Arigon shareholders. It appears that no one shareholder beneficially owned more than 10% of YBM Magnex Inc. after the introduction of the additional 16 shareholders.

[367] The only Arigon shareholders recorded in the minutes as having participated at the May 14, 1994 meeting to ratify the share exchange agreement with YBM Magnex Inc. are the six founding shareholders. Bogatin was appointed as their agent and attorney to execute documents in connection with the reverse take-over of Pratecs. Only the six founding shareholders of Arigon executed the authorization. The additional 16 shareholders did, however, execute the shareholders' consent dated September 28, 1994 approving the letter of intent in connection with the reverse take-over of Pratecs.

[368] The relationship between the new 16 shareholders and the original six shareholders of Arigon was explained in 2 letters from Adrian Churchward, counsel to the "founders of Arigon" in March 1995. Churchward confirmed that each of the original shareholders were holding their shares on behalf of themselves and various other unknown parties. Later, Churchward

clarified that the shares in Arigon were initially issued to seven residents of the Channel Islands, who executed Declarations of Trust in favour of the true beneficial owners. Declarations of Trust were issued in favour of a Galina Grigorieva, who held the shares on behalf of the six original founding shareholders, who in turn held them on behalf of themselves plus the additional 16 shareholders. Churchward supplied a schedule breaking down the holders of 17,000 shares of YBM Magnex Inc. into six groups. Each of the six groups included one of the original six shareholders. Five of the six groups held 12% of the shares and the group with Semeon Mogilevitch held the remaining 40%. Included within the Mogilevitch group was Fisherman.

[369] In the course of the 1995 prospectus review, staff asked YBM to comply with the prospectus form disclosure requirements for principal shareholders. Wilder advised staff that "to the best of our knowledge, the disclosure contemplated by Form 12 Item 26 is not required." At the time, Mitchell and McBurney understood from management that the shareholders were separate and distinct.

[370] After the 1995 offering, a number of trading accounts were opened by the original shareholders through which they sold YBM shares between May 1996 and April 1998. Approximately 7,958,764 shares were sold through GMP accounts and proceeds of approximately CDN $90,000,000 withdrawn. Approximately 2,108,800 shares were sold through a First Marathon account and proceeds of approximately U.S. $12,148,329 withdrawn.

[371] The GMP accounts included one opened by Karat, the founding shareholder named with Mogilevich in the initial allegations in the U.K. proceedings. The new client application form directed that confirmations be sent to Bogatin. Other documentation in the account included a power of attorney executed by Mogilevich in favour of Karat and a letter from Bogatin to McBurney forwarding five share certificates, including one in Mogilevitch's name. An account called Poseidon controlled by a V. Alexandroff was opened at GMP with instructions that confirmations be sent to YBM's address. An account was also opened in the name of an Alexander Benkovich, a name that appears in various capacities, including as a former shareholder of Schwinn Csepel, a representative of Amadeus (a YBM customer) and a director of Technology Distribution.

[372] Karat also opened the Arion Investment Club cash account at First Marathon for which Mitchell is recorded as the investment advisor. The six founding shareholders of Arigon are the six partners in the Arion Investment Club. Mitchell testified that the rationale for such an account is to provide an orderly means for original shareholders to dispose of their shares while minimizing disruption in the market. Mitchell was aware that there was significant over-demand for YBM shares and that institutional buyers were available.

[373] After the 1995 offering, GMP and First Marathon dominated secondary trading in YBM shares. Until January 1998, First Marathon and GMP issued consistently favourable research reports with buy and strong buy recommendations.

The Special Committee Report

[374] Mitchell provided Bloomberg with a copy of the April 11 draft of the Report after the April 11, 1997 Investment Banking Screening Committee meeting at which First Marathon approved the proposed offering with YBM. Bloomberg sought Fogler's advice. As a result of their discussions, the following key decisions were made by First Marathon between mid-April and early May 1997:

(1) First Marathon would not proceed with the financing until it had conducted further due diligence.

(2) In order to avoid any suggestion of a conflict of interest, an additional senior investment banker would be involved in the due diligence process and would sign the prospectus on behalf of First Marathon.

(3) Bloomberg would contact Peterson to make sure that he was aware of the issues surrounding the Special Committee and to obtain Peterson's views on YBM and in particular its management.

(4) First Marathon would take steps to ensure that it was reasonable to rely on YBM's financial statements that had been audited by the firm of Parente.

[375] On or about April 14, Jones met with Mitchell to discuss YBM. Mitchell informed him of the visa problems, the Special Committee and Fairfax. Jones understood the possibility that YBM was being investigated as part of a larger investigation involving organized crime infiltrating U.S. businesses. Mitchell summarized Fairfax's findings and explained that its key conclusion was that there had been no evidence of improper activity on the part of the YBM or its management. Mitchell indicated that there were some suspicions with respect to one or more of the founding shareholders having some involvement with organized crime in the former Soviet Union.

[376] Jones was not provided with a copy of the Report at this time. He did not receive a copy until July 1997, well after the Preliminary Prospectus had been filed. Litwack, who had received a copy as underwriter's counsel, did not provide a copy of the Report to either Jones or McBurney, as he understood that they were aware of the relevant details.

[377] Bloomberg and Jones advised Mitchell that First Marathon's approval of the financing was withdrawn because they did not have all of the relevant facts at the time the approval was granted. Jones confirmed that in his view, the information regarding the Special Committee was "crucial" information for those people who were making the investment banking decisions.

[378] Some time after April 22, 1997 Mitchell spoke with McBurney in Newtown about the Special Committee. He did not provide McBurney with a copy of the Report, but he did talk to McBurney about its contents. Mitchell did not know whether McBurney was aware that a report existed. Mitchell testified that he did not recall McBurney ever asking if the Special Committee prepared a report.

[379] McBurney understood that certain YBM employees had been denied visas. Mitchell told him that YBM had made inquiries and had discovered that certain U.S. Government organizations were concerned about the infiltration of legitimate American businesses by Russian organized crime. Mitchell further explained that it was believed that YBM had likely been examined as part of that investigation. McBurney understood that the foregoing led to the creation of the Special Committee and that its mandate was to review YBM's operations.

[380] McBurney understood that Fairfax was an internationally recognized investigative firm. McBurney understood that Fairfax had reported a rumour that one of the founding shareholders had links to organized crime, but had been unable to substantiate the rumour. Further, McBurney understood that Fairfax viewed YBM as a legitimate business and that its management was not involved in any illegal or improper activity. McBurney asked if Fairfax had prepared a written report. He did not ask if the Special Committee had produced one too.

[381] Mitchell told McBurney that Fairfax had found that, with two exceptions, there was no connection between the founding shareholders and YBM's ongoing business. The two exceptions were that YBM and Mogilevich had offices in the same building and that Mogilevich had signing authority over a dormant bank account. These issues, however, had already been addressed by management. Mitchell also told him about certain unexplained commission payments made by Arbat, but McBurney understood that Arbat had been sold.

[382] McBurney testified that he understood Mitchell's joint role had the potential for conflict, but saw no reason to doubt Mitchell. GMP's practice, however, was not to sit on the boards of its clients. His personal relationship and past business experience with Mitchell may have been partially responsible for this belief.

The AIF Disclosure

[383] Jones discussed the AIF disclosure with Mitchell before the AIF was filed and he reviewed it afterwards. Jones believed that the disclosure was accurate and that it conveyed that there were clearly risks in investing in YBM. Similarly, McBurney was comfortable with the language used in the AIF.

[384] Litwack reviewed the final draft of the AIF before it was filed. He marked up page six of the AIF, dealing with "Business Risks". Next to the section about Arbat, Litwack noted "Is this why it was sold?". He further underlined the section dealing with the establishment of the "Independent Committee" and noted a question mark. The reason for this was to "make sure they [YBM] were comfortable that there was an adequate description of Fairfax". This version of the AIF did not change again and Litwack did not advise his clients that the AIF was deficient.

Due Diligence – Preliminary Prospectus

[385] On May 2, the Orr briefing took place at the offices of Nesbitt Burns. We have already referred to this meeting and its implications in our discussion of material facts above. Mitchell believed that Nesbitt declined to participate in the syndicate based on this briefing.

[386] Jones spoke with Barry Rowland, who was the audit partner at Ernst & Young responsible for First Marathon's audit. On May 9, Rowland informed Jones that YBM's auditor, Parente, was a reputable firm. Rowland also informed him that Ernst & Young had been offered the audit of YBM but had declined after doing some due diligence work in Hungary. Rowland advised Jones to contact Ernst & Young's security people, who might be able to provide more information on a privileged basis.

[387] On May 13, Litwack reported to Jones that he had contacted Larry Bastocky at Ernst & Young and informed him that there was nothing that Bastocky said that they did not already know. He made reference to a letter that Bogatin sent to Ernst & Young on November 26, 1996 addressing the concerns of Ernst & Young. Jones received a copy of the letter on May 13. He testified that after reading the letter, he felt more comfortable.

[388] Jones and Bloomberg met with Peterson on May 12. Peterson expressed confidence in the company and its management.

[389] At some point in May, McBurney asked Litwack "whether or not we should be talking to Fairfax." Litwack replied that Fairfax does not "talk to anybody else but their client" due to privilege concerns. Litwack also advised Jones, based upon discussions with Wilder, that Fairfax would not speak to them. Stern testifed that Fairfax had advised Mitchell on April 13 that they would speak to the underwriters if contacted.

[390] On or about May 15, Jones briefed Diana Chant, the audit partner from Price Waterhouse, who were also auditors of First Marathon. Jones told her what he knew about YBM and the Special Committee and retained Price Waterhouse to visit YBM in Hungary and review Parente's working papers with respect to the audited financial statements. Jones testified that he wanted to be comfortable that he could rely heavily on the financial statements. He engaged Price Waterhouse because he was not familiar with Parente and because the existence of the rumours and the creation of the Special Committee raised unusual concerns.

[391] On May 28, Jones and Mitchell attended a due diligence session with the YBM and its auditors. McBurney and Litwack also attended.

[392] Also on May 28, Chant raised some concerns with Jones regarding the identity of YBM's customers. In particular, there were two U.S. customers that could not be found in Dun & Bradstreet listings. She also questioned whether some of the magnets could be used in missiles and noted that one third of the sample documentation to support certain sales was missing. She also indicated that certain business practices in Eastern Europe were often intended to create confusion because companies were trying to hide things from former Communist authorities. She explained that these practices were well ingrained and that it did not necessarily mean there was any deception.

[393] Jones was concerned and decided that it would be inappropriate to file the Preliminary Prospectus until they reviewed these issues. McBurney and Mitchell travelled to London around this time in preparation for YBM's road show. McBurney left a signed certificate for the Preliminary Prospectus in escrow with Litwack pending favourable resolution of the issues raised by Price Waterhouse.

[394] First Marathon met with Price Waterhouse on May 29 and Jones concluded that they should speak with Parente. A conference call with Parente occurred the following day. As a result of the call, Jones became comfortable with Parente's work, as did Chant, but she indicated that Price Waterhouse would have checked customers differently. Jones requested that Price Waterhouse conduct further customer checks. Despite the request for additional work, Jones asked Chant and Litwack if they had any reservations about filing the Preliminary Prospectus. Chant would not provide an opinion regarding filing the Preliminary Prospectus, whereas Litwack was unreserved. The prospectus was filed on June 2.

[395] Litwack advised Jones that rumours are inappropriate prospectus disclosure. Meanwhile, the collective view was that the founding shareholders were not involved in the operations of the company and that management had integrity. Jones was impressed with Bogatin after meeting and questioning him, but indicated to management that First Marathon would not complete the financing until all due diligence was completed.

[396] Jones testified that it would have been better to complete the due diligence before the Preliminary Prospectus was filed. McBurney testified that due diligence is always ongoing, right up until the final prospectus is filed. Litwack testified that the Preliminary Prospectus was filed in order to start the process of the offering and that there could have been problems with the Crucible acquisition if the "clock didn't start ticking". Jones spoke with McBurney later and gave no indication of any discomfort with filing the Preliminary Prospectus.

[397] As part of First Marathon's continuing work, Jones wanted another equipment valuation. Dan Nowlan of First Marathon and Mike Middleton, an analyst at GMP, went to Hungary.

Prospectus Review and Due Diligence for the Final Prospectus

[398] On June 3, Jones attended a meeting at the Commission with staff, Litwack, McBurney and counsel to YBM. Staff had learned about Price Waterhouse's engagement, but not from the respondents. According to McBurney, when staff indicated that they were concerned about "the integrity of the company," this got his antennae up.

[399] Notes from the meeting indicate that staff was made aware that:

- YBM was co-founded by Russian immigrants;
- there were rumours about the shareholders' links to organized crime; staff was already aware of this.
- the Fairfax group, was hired to look into the rumours and innuendo but could not find any evidence to substantiate the rumours.

- Cassels Brock did not look into whether U.S. authorities had concerns with the YBM – (didn't know where to start) - "we due diligence [everything] and have found nothing".

[400] On June 5, Nowlan reported to Jones from Hungary that he had talked to a number of customers, visited YBM's plants and observed a real magnet business in operation. McBurney indicated that Middleton reported that he had confronted Fisherman as follows: "Come on, Igor, is this a Russian mobster company?" Fisherman was taken aback and replied, "No, there's no connection whatsoever."

[401] In an effort to confirm sales, Bloomberg requested that someone visit YBM's largest customer notwithstanding Nowlan's telephone contact. Meanwhile, on June 9, Jones received a letter from Real Partners that provided an opinion on the quality of the equipment and operations at YBM's Budapest facilities. It was favourable, but Jones nevertheless requested a valuation of the equipment by Real Partners.

[402] On or about June 12, both First Marathon and GMP contemplated withdrawing from the offering because staff advised them that they had heard from international sources that YBM was involved in money laundering.

[403] On June 13, Jones attended a meeting at the Commission with Mitchell, Litwack, Wilder, McBurney and staff. Jones informed staff that First Marathon continued to make calls to YBM's customers and had conducted more due diligence than they ordinarily would have. Naster specifically advised that staff's concerns were with respect to disclosure and not money laundering.

[404] Staff was advised about articles in the media, the establishment of the Special Committee and, according to notes from the meeting:

- the Russian shareholders not being involved in the management of the company;
- control weaknesses at YBM;
- "individual mentioned in article never been shareholder or employee of the company".

[405] On June 16, representatives of First Marathon, GMP, Fogler Rubinoff and Price Waterhouse again met with staff. At staff's request, Chant provided a copy of the Price Waterhouse engagement letter, the Price Waterhouse draft report dated May 29, and notes of the Price Waterhouse manager's review of Parente's working papers.

[406] On June 18, staff received the response to its first comment letter. Litwack acknowledged that the first draft of the response letter included more information regarding the U.S. investigation and the Special Committee. McBurney saw the drafts but did not participate in the wording of the letter. We have already discussed Mitchell's involvement in the preparation of the response letter above.

[407] Meanwhile, the report from Real Partners providing an appraisal for certain of YBM's equipment valued it at U.S. $2.2 million less than the value recorded on YBM's books. This created more concerns for Jones, who took steps to investigate. Jones spoke to Fisherman, who was confident that the equipment valuation was accurate. Like Nowlan, Jones gained a positive impression of Fisherman.

[408] Mitchell and McBurney travelled to Budapest to assess the Real Partners valuation. McBurney testified that the invoices he reviewed on this trip for YBM's equipment purchases in 1997 bothered him. He was not completely satisfied with Gatti's answer, which was that YBM was in the process of improving its controls, but McBurney eventually concluded that an appraisal would give him additional comfort.

[409] On June 24, staff advised YBM of their position that a re-audit of YBM's financial statements was required. First Marathon continued its customer verification work, including doing some site visits, until D&T's re-audit. In First Marathon's view, further investigation would be redundant given the D&T audit. McBurney testified that in June, GMP was either going to walk away from the deal or wait for the process to play itself through, i.e. wait for the completion of the re-audit.

[410] In July, Jones finally received a copy of the April 11 draft of the Report from Mitchell. Overall, Jones understood it to be consistent with the oral briefing that he had received. There were some discrepancies, but Mitchell advised him that the Report was an overstatement of the facts and would subsequently be revised. Jones understood that the revisions would constitute more than mere wordsmithing. Litwack testified that Mitchell previously advised him that significant changes to the April 11 draft were not expected.

[411] Jones inquired about the commingling concerns expressed in the Report. Jones also inquired about the "ties remain" reference to Arbat despite YBM having sold it. Jones gained comfort that the only ties that remained were social and historical. However, the Report stated that Kulachenko, a founding shareholder, operated and may continue to operate Arbat. Jones was

not informed before the Preliminary Prospectus was signed that Rossman had been advised "off the record" by the U.S. Attorney's Office that there was an ongoing investigation involving YBM, as contained in the Report. It did not occur to Jones to speak with Rossman, although he understood that an investigation may have been going on in the manner previously described to him.

[412] McBurney testified that he did not learn of the existence of the Report until the fall of 1999. He was upset at not receiving the Report earlier. He testified that he said to Mitchell that it is pretty clear in the Report that there is an investigation. Neither First Marathon or Fogler Rubinoff provided a copy of the Report to staff or D&T.

[413] McBurney did not examine the GMP accounts through which Mogilevich and the other founding shareholders sold YBM shares. McBurney was aware that the six original founding shareholders had "a commonality of interest" in the Arigon/United Trade preferred shares that were subsequently exchanged for YBM common shares. Before he received the Report, Jones was aware that the founding shareholders collectively owned approximately 40% of the securities, and that one of the benefits of the offering would be to dilute the founding shareholders' ownership in YBM. Jones specifically inquired and was advised that the founding shareholders did not represent a control block and that none of them held more than 10%.

[414] Jones was unaware of the Arion Investment Club account at First Marathon. He testified that if he had been aware of this, he would have insisted that there be some disclosure of the principal shareholders or would have sought legal advice on this issue. Litwack understood that the founding shareholders were not joint actors, but when presented with the Arion Investment Club account documentation at the hearing, he testified that it might suggest that the original six founding shareholders were investing together.

[415] Litwack did report to Jones about the soft information obtained from staff on July 7. Staff had advised Wilder and Litwack of a lawsuit commenced by a disgruntled ex-employee of YBM and a concern expressed by a Paris bank employee regarding YBM's sales based upon rumour and innuendo.

[416] On July 8, a further meeting with staff was held. Jones understood that staff was concerned about the validity of the sales and the identity of the end users. He understood that staff "suspected there was the possibility of fraud." Jones recalled McBurney asking Naster if there was a staff investigation going on. Naster replied that if it were an investigation, Enforcement would want a forensic audit, not merely an audit opinion.

[417] In July 1997, Wilder sought to restructure the financing by doing a special warrant private placement in order to avoid the difficulties with the prospectus review and to ensure that the Crucible acquisition could close. Jones was not prepared to participate in the private placement because he was not yet satisfied that they had sufficient answers to various issues and did not wish to be viewed as circumventing the regulator. On August 21, due to the delay in closing the offering, YBM entered into the $48 million private placement with CC&L. Counsel to CC&L was Fogler Rubinoff, also counsel to the underwriters on the offering. CC&L acknowledged that it was relying exclusively upon its own due diligence when it retained Fogler Rubinoff. The information respecting the Special Committee was not disclosed to CC&L.

Deloitte & Touch Clean Audit

[418] Jones testified that he was pleased to learn that D&T had issued a clean audit opinion of YBM's financial statements in October, 1997. He believed that the opinion eliminated concerns with respect to fraud because he believed that D&T had been given very specific instructions on the procedures they were to follow and that those procedures were designed to detect a fraud, if one existed. Jones understood that D&T had been provided with all of the correspondence between YBM and the Commission and had also been provided with all of the documents prepared by PriceWaterhouse. McBurney was similarly comforted by the results of the D&T audit.

[419] Litwack advised Jones that, at the November 4 meeting, staff satisfied themselves that D&T had done very extensive work, that they had followed all of the agreed procedures, and that staff appeared to have no concerns with respect to the quality of D&T's work.

[420] On November 14 and 18, the underwriters held bring down due diligence sessions. The Final Prospectus was filed on November 18.

[421] The foregoing indicates that the underwriters tried to investigate YBM in response to the information provided to them regarding the Report. We are unable to accept staff's submission that the underwriters conducted their due diligence selectively. We must still consider whether the investigation conducted by First Marathon and GMP was sufficient to provide a reasonable basis for their belief that the prospectus contained full, true, and plain disclosure.

First Marathon/National Bank Financial Corp.

[422] First Marathon was at all relevant times an investment dealer registered under the Act. First Marathon was acquired by the National Bank of Canada through a concurrent merger of First Marathon and Levesque Beaubien Geoffrion Inc., then owned by the National Bank of Canada to form National Bank Financial Corp. Neither Mitchell nor Jones are currently employed at National Bank.

[423] We must consider whether First Marathon, given its knowledge, access to information, involvement and expertise, reasonably formed the view that YBM's prospectus contained full, true and plain disclosure. Did First Marathon adequately question, challenge and investigate the information put before them?

[424] First Marathon submits that there are two ways to conclude that it signed a prospectus which, to the best of its knowledge, information and belief failed to contain full, true and plain disclosure of all material facts:

1. Mitchell was aware of information and/or material facts which, though not disclosed to his colleagues at First Marathon, First Marathon is deemed to have known; and

2. the due diligence conducted by First Marathon as a result of the information contained in the draft Report was inadequate.

Mitchell's Knowledge

[425] First Marathon had already established a relationship with YBM at the time of the 1997 offering by acting as a co-lead underwriter in the 1995 offering. Mitchell, with the consent of First Marathon, subsequently accepted a position on YBM's board in early 1996 and, of course, chaired the committee whose report and investigation are at issue in these proceedings.

[426] Staff submit that Mitchell was a "directing mind" of First Marathon and, consequently, First Marathon had perfect knowledge of the alleged material facts respecting the Special Committee. National Bank submits that Mitchell was not the "governing executive authority" nor the "directing mind" with respect to the filing and certification of YBM's prospectus on behalf of First Marathon, but rather Jones was. We prefer staff's position on this matter. First, it would be untenable to conclude that only the person signing the certificate can establish liability. Second, there may be more than one directing mind in a company; *Rhône (The) v. Peter A.B. Widener (The)*, [1993] 1 S.C.R. 497. Third, despite Jones signing the certificate, Mitchell remained an integral part of First Marathon's underwriting team.

[427] National Bank acknowledges that Mitchell should not have been involved in investment banking functions in this financing. We agree, but would add that the issue is not only one of Mitchell's involvement in the financing, but also First Marathon's reliance upon him. First Marathon was required to be adversarial with Mitchell given his position as a YBM Director and Special Committee Chair.

[428] National Bank further acknowledges that Mitchell's knowledge can be imputed to First Marathon given that there was no "Chinese wall". However, National Bank submits that imputing Mitchell's knowledge to First Marathon is more relevant to issues of civil liability than regulatory liability. While we appreciate the distinction, we do not accept it, particularly in this case, and indeed view it as imperative in a public interest proceeding.

[429] The allegation before us is with respect to the conduct of First Marathon. Consequently, we must assess the reasonableness of First Marathon's belief regarding disclosure for the purpose of determining its regulatory liability. The reasonableness of First Marathon's belief can only be assessed in the context of the collective knowledge of First Marathon, not just that of Jones.

[430] First Marathon consented to Mitchell sitting on YBM's board. It was well aware that he had chaired the Special Committee. First Marathon took no issue with this and relied upon Mitchell throughout the offering process. In this case, however, Mitchell chaired the committee whose information was the focal point of the underwriters' due diligence. First Marathon was well aware that the potential for conflict existed. Indeed, as indicated above, National Bank acknowledges that Mitchell "should not have been permitted to have been involved in investment banking functions in this financing."

[431] We believe that Mitchell's knowledge is relevant in assessing First Marathon's due diligence in this case, particularly in light of his conflict and the reliance placed upon him by First Marathon.

First Marathon's Investigation

[432] Based upon legal advice provided, First Marathon attempted to address Mitchell's conflict by getting Jones involved. Jones testified on behalf of First Marathon.

[433] At that time, Jones was the Executive Vice-President and Head of Investment Banking at First Marathon. Jones was a highly experienced and respected investment banker, having joined First Marathon from Salomon Brothers Canada Inc., where he had been President and Chief Executive Officer. Prior to Salomon Brothers, Jones had been the worldwide head of corporate finance for Wood Gundy. Jones was forthcoming, thoughtful, well prepared and we take no issue with his integrity as a witness.

[434] Significant efforts were initiated by Jones on behalf of First Marathon in an attempt to ascertain further facts regarding YBM and assess the materiality of some of the Special Committee information provided to him. Indeed, the investigation undertaken by the underwriters in this case was extensive. A significant shortcoming of Jones' investigation, however, was that he was unaware of all the facts relevant to First Marathon's investigation.

[435] For instance, Jones wanted to speak with Fairfax, but counsel advised him that Fairfax would not speak with him. Mitchell knew differently. Jones understood there were suspicions with respect to one or more founding shareholders having some involvement with organized crime. Meanwhile, Mitchell was fully aware of the FBI Affidavit and the confidence that Fairfax had expressed in its intelligence sources. It did not occur to Jones to speak with Rossman regarding the U.S. investigation as he did not believe that Rossman had any particular knowledge on the subject. Mitchell, of course, had attended Rossman's August 15, 1996 briefing. Jones was unaware that as recently as March 1997, the INS continued to demonstrate a specific interest in YBM and had requested lists of its customers. Mitchell, however, had received Gatti's AIF draft disclosing that the INS had begun an informal inquiry. Jones was unaware of the Arion Investment Club account, which would have led him to question whether disclosure of the principal shareholders was required. Mitchell was the account's investment advisor. Bloomberg, Mitchell and Litwack each had a copy of the Report. Jones did not receive a copy until well after the Preliminary Prospectus had been filed, despite being responsible for First Marathon's due diligence.

[436] Mitchell was a senior investment banker, officer and colleague. Jones testified that he was less sceptical of the information obtained from Mitchell for this reason. However, as indicated previously, in the context of their division of the corporate brain, there was clearly an issue with respect to the sharing of important facts which make it unclear how First Marathon could conduct reasonable due diligence and form a reasonable belief that full, true and plain disclosure of all material facts had been made.

[437] In addition to these failures to communicate, the evidence suggests other shortcomings in First Marathon's due diligence process. Most notably, the process was not complete at the time First Marathon agreed that the Preliminary Prospectus could be filed. The items that remained were not routine 'tying up loose ends' type due diligence. First Marathon had not completed its 'hardening of the balance sheet' in response to the concerns raised by the Special Committee information. It was still in the process of 'legitimating the business'. It is unclear how First Marathon could certify to the best of its knowledge, information and belief given the circumstances. We recognize the commercial reason for proceeding in this manner, but the desire to get on with the Crucible acquisition was simply too high-risk at this stage. This is particularly the case since the Preliminary Prospectus was filed under the POP system, which provides for an abridged prospectus review process by the Commission and an expedited closing of the financing.

[438] We have already discussed Mitchell's role in connection with the AIF disclosure and the work of the Special Committee. Indeed, Bloomberg and Jones quite correctly withdrew First Marathon's initial approval of the offering in response to the Special Committee information. Jones also felt that the information was sufficiently important that they should brief Nesbitt Burns personally before it decided to participate in the syndicate. First Marathon proceeded to conduct an exceptional amount of due diligence. In short, First Marathon and the other underwriters had an opportunity to become comfortable with the risks associated with YBM while investors only received the disclosure provided in the prospectus.

[439] Given First Marathon's knowledge of the Special Committee, its awareness of the risks associated with YBM, and its expertise with respect to public offerings generally, we are less inclined to accept its reliance on counsel's advice regarding disclosure as being reasonable in the circumstances. We note further that while counsel expressed some concern to YBM regarding the adequacy of the description of Fairfax in the AIF disclosure, the issue was not pressed. Counsel was aware that staff had broadly questioned the Special Committee disclosure. Nevertheless, counsel appears to have allowed the watered-down version of the response letter to be filed without much resistance.

[440] Similar to the other respondents, First Marathon also places great weight on the results of the D&T audit to support the reasonableness of its belief that the Final Prospectus contained full, true, and plain disclosure. But this reasonableness is compromised by the failure to provide D&T with all information relevant to the audit. Most notably, First Marathon failed to provide the Report. We do not say that the failure to provide D&T the report was deliberate. Nor was it necessarily First Marathon's responsibility, but a more reasonable process with fewer communication failures would have been prudent in the circumstances.

[441] First Marathon was a sophisticated and experienced underwriting firm. Unlike the officers and directors of YBM, conducting public offerings was First Marathon's lifeblood. Moreover, First Marathon, through Mitchell's involvement with YBM, was more knowledgeable than the typical underwriter. As such, its obligation to investigate should be considered in the context

of its greater access to information. In short, First Marathon was alerted to the specific risks associated with YBM. The expectations of an underwriter by the public cannot be taken lightly. While clearly not the guarantor of full, true and plain disclosure, the underwriter is a gatekeeper.

[442] There can be little doubt that First Marathon exerted significant efforts to investigate YBM. We do not believe it sought to deliberately mislead investors. However, given its knowledge, access to information, involvement and skill, we do not find that National Bank has established that the belief that the prospectus contained full, true and plain disclosure was justified. Accordingly a defence of due diligence is unavailable.

Griffiths McBurney & Partners (GMP)

[443] GMP is an investment dealer registered under the Act. McBurney was the directing mind of GMP. At the relevant time, McBurney was the head of investing banking in Toronto and Montreal and a member of his firm's executive committee. McBurney was called to the Ontario bar in 1979 and practised securities law for many years. He worked at Fogler Rubinoff from 1985 to 1995, at which time he left to set up GMP. At Fogler Rubinoff, McBurney was involved in approximately 200 public financings. At times he worked with Wilder and Litwack. Some time in 1990, McBurney started doing legal work for Mitchell. McBurney worked with Mitchell on approximately 16 to 20 deals as a lawyer. At the time of the 1997 offering, McBurney regarded Mitchell as one of his best friends. McBurney had also worked with Mitchell as a co-lead underwriter in connection with the 1995 offering and was already familiar with YBM as a result. This financing would have been one of GMP's early deals.

[444] GMP submits that it was in a unique position relative to the other respondents because it was not provided with a copy of the Report. The evidence does not support a finding that GMP had a copy of the Report. While GMP was less knowledgeable regarding the mandate, information obtained by and findings of the Special Committee, it was not completely uninformed. GMP argues that underwriters are not guarantors of the content of a prospectus and submits that it was reasonably diligent based on its more limited knowledge of the Special Committee. They made some inquiries on their own and relied substantially on legal advice, the due diligence conducted by First Marathon, and most importantly, the D&T audit. We must assess whether the foregoing measures provide a reasonable basis for GMP's belief, in the circumstances, that the Preliminary Prospectus and Final Prospectus each contained full, true and plain disclosure.

[445] Staff argue that if GMP did not know the facts which staff allege were material, it was because it failed to conduct reasonable diligence. Staff argue that GMP conducted almost no due diligence before the Preliminary Prospectus was filed, and that the diligence conducted afterwards cannot be described as good faith due diligence, as negative information about YBM was ignored or explained away while positive information was accepted without adequate inquiry.

[446] GMP argues that what it knew about the U.S. investigation was neither specific or certain enough to require disclosure, and what it knew about the Special Committee was not discloseable because to the best of its knowledge, information and belief, no criminal activity involving financial impropriety was taking place. GMP knew less about the U.S. investigation, Arbat and the founding shareholders than First Marathon did. Regarding the U.S. investigation, GMP understood that YBM may have been examined as part of an investigation by U.S. government authorities like the State Department and Justice Department, who were concerned about Russian organized crime infiltrating legitimate U.S. businesses. As for Arbat, GMP knew that the Special Committee had discovered certain irregularities in Arbat's records, including some questionable commission payments, but understood that these irregularities did not give rise to any concerns, as Arbat was not part of YBM's core business and had been sold off in early 1996. As for the founding shareholders, GMP understood that all that existed were rumours of ties to organized crime.

[447] The cornerstone of GMP's belief that the Final Prospectus contained full, true and plain disclosure was its reliance on the D&T audit. McBurney's impression was that there would be a complete cradle-to-grave examination. As part of this examination, D&T would be contacting end users and obtaining an independent appraisal of YBM's equipment. Minimal reliance would be put on Parente's work. D&T's work would be done at a high-risk level using procedures which were acceptable to staff, who had advised D&T of their concerns. GMP never received a copy of the Report and believed that D&T had been given access to everything. GMP submits that, based upon its knowledge, it was reasonable to conclude that D&T's work had resolved the question of the risk of money laundering by the founding shareholders.

[448] However, we question whether GMP, as a co-lead underwriter, should have known more or made more inquiries than it did in the circumstances. While not a guarantor of YBM's disclosure, McBurney understood that a diligent investment banker would be expected to "drill down" on sensitive issues and agreed that his experience as both a securities lawyer and investment banker would help him in identifying sensitive areas of a company's business. Why did GMP possess the limited knowledge that it did? It is clear that GMP relied upon Mitchell and First Marathon. McBurney knew that Mitchell's dual roles had the potential for conflict. McBurney relied on Mitchell even though GMP's own policy prohibited its investment bankers from acting as directors of public companies that are GMP clients. McBurney did not think that there would be a reason to doubt what Mitchell was telling him or be suspicious that Mitchell's interest as a director would compromise his role as an investment banker. That may have been because of previous experience or because of his close personal relationship.

[449] GMP's reliance on Mitchell was problematic. In Newtown, McBurney assumed that Mitchell would tell him everything he needed to know. He asked Mitchell if Fairfax had prepared a report, but never inquired as to whether the Special Committee had prepared a report. Even if, as McBurney testified, Mitchell did not read from any notes or a script of any kind at the Newtown meeting, we are troubled by this lapse in diligence. When he eventually saw the Report, McBurney believed that "it's pretty clear in the report there's an investigation." We are aware that Jones did not ask about a report, nor did GMP's own legal counsel provide its client with a copy. In our opinion, this failure is inconsistent with a process that encourages reasonable diligence.

[450] We discussed earlier some of the shortcomings of First Marathon's due diligence based upon its failure to share information internally. This affected the investigation conducted by Jones on behalf of First Marathon and the reasonableness of First Marathon's belief that the prospectus contained full, true and plain disclosure. To the extent that GMP was relying upon First Marathon as part of its due diligence, we believe that GMP was relying upon a flawed investigation. In principle, we see no reason why one member of an underwriting syndicate cannot or should not rely on another, but where a co-lead underwriter falls down in the conduct of its due diligence, the other co-lead may have to bear the risk of its reliance. We note that a similar approach was taken in *Escott*. The underwriters who relied on Drexel in that case were bound by its failure to conduct a reasonable investigation. We believe that GMP understood that its reliance on First Marathon was subject to certain risks given Mitchell's roles.

[451] GMP also relied on its counsel, Fogler Rubinoff, and in particular the work done by Litwack on the AIF. As discussed earlier, Litwack, who was counsel to both First Marathon and GMP, was insufficiently adversarial in failing to pursue his comments on the draft AIF. It is not unreasonable for an underwriter to rely on its counsel to scrutinize the issuer's proposed disclosure. However, such reliance does not automatically mean the underwriter's belief is reasonable. If counsel knows more than its client but is not sufficiently diligent, then any shortcomings of counsel may be visited upon GMP.

[452] McBurney attended the bring down session for the Preliminary Prospectus and a number of meetings with staff. It was the first of these meetings with staff that raised McBurney's antennae. Amid staff's concern about the integrity of the company, GMP sent Middleton, "an in-your-face guy," to try to resolve customer and equipment issues. In connection with the work of Price Waterhouse, McBurney met with Jones on June 2, and on June 16 he met with Chant, who viewed him as being well acquainted with Price Waterhouse's work. Despite this, no thought was given by McBurney to providing a copy of Price Waterhouse's May 29 report to staff at the June 16 meeting until staff specifically asked for it.

[453] When doubts swirled around Real Partners' equipment valuation, he went to Hungary personally and spoke to Fisherman during his visit. It was during this visit that McBurney became concerned regarding the invoices documenting YBM's 1997 equipment purchases. McBurney testified with respect to the invoices that "I don't think you could characterize them in any way but false", "I was concerned as well with kickbacks", and "I didn't like it. I didn't like it. You know, I didn't like it at all". McBurney questioned Gatti regarding the invoices and was not satisfied with the answer provided, but concluded that an appraisal of the equipment would give him additional comfort. While D&T conducted an appraisal of the equipment as part of its audit, McBurney did not inquire of D&T about the invoices or take steps to ensure D&T was aware of them.

[454] GMP was presented with other opportunities to improve its knowledge and conduct further inquiries, which it did not fully pursue. McBurney asked Litwack about speaking to Fairfax. That was sensible. Despite Litwack's negative response GMP should have pressed harder. We question why McBurney did not read all of the fax he received from Jones on June 18, 1997 enclosing drafts of the response to staff's comment letter. McBurney wrote "file YBM due dilig" on the document and had it filed. It goes without saying that a prudent co-lead underwriter would review all materials received from its underwriting partner, especially when a document comes from the person overseeing the due diligence process. As it turned out, the drafts of the response letter stated that "subsequent off the record discussions with the U.S. Attorney's Office confirmed that the Company had been examined as part of the investigation." McBurney testified, "If I had read this, I would have -- I may have asked, 'What about the off-the-record discussions?'"

[455] Faced with the spectre of organized crime and money laundering, we are concerned that it did not occur to McBurney to investigate on whose behalf GMP had been selling YBM shares in 1996 and 1997. During the 1995 offering, McBurney had raised a question regarding the identity of the principal shareholders. Despite what was in Arigon's share register and some of YBM's material agreements, McBurney accepted the explanation that the principal shareholders were 22 individuals acting independent of one another. McBurney was aware that the six original founding shareholders were involved in the business at the time of the 1995 offering.

[456] McBurney testified that he knew that GMP had sold shares of YBM, but did not know who the sellers were. He knew that the six founding shareholders who held the Arigon preferred shares that were subsequently exchanged for common shares of YBM had a commonality of interest in those shares. He also admitted that he may have been aware that certain founding shareholders had opened accounts at GMP, but did not know the details of any accounts. He knew that during the 1996-97 period, GMP had tried to get the founding shareholders to open accounts and that some of them did. McBurney admitted that he did not examine any trading activity at GMP in which Mogilevitch may have had involvement. A review of GMP's own documentation would have revealed, for example, that Mogilevitch had granted a power of attorney to Karat, that YBM was the

recipient of trade confirmations for the Poseidon account, and that the letter Bogatin sent to McBurney in 1996 indicated that shares were being pooled for subsequent sale from the Karat account on behalf of five individuals: Karat, Mila Mogilevitch, Titana Mogilevitch, Mogilevitch himself, and Vitaliy Leibya.

[457] Similar to First Marathon, in this case, we are concerned that GMP signed the certificate to the Preliminary Prospectus and allowed it to be filed while due diligence was still ongoing. McBurney's position was that due diligence is always ongoing, right up until the final prospectus. We would agree with that statement if the remaining work only consists of tying up loose ends, but to the extent that further significant investigations would be required after a preliminary prospectus is filed, we cannot agree. McBurney and First Marathon engaged Price Waterhouse, but McBurney did not speak to Price Waterhouse or obtain a report of its findings until after the Preliminary Prospectus was signed. Nor was Price Waterhouse's work completed prior to signing the Preliminary Prospectus. As stated in *Ames*, a course of conduct must be completed before an underwriter can affirm that to the best of its knowledge, information and belief, the document contains full, true and plain disclosure.

[458] We believe that McBurney was alive to the importance and materiality of the information which he did possess. He attended the Orr briefing with Mitchell on May 2, 1997 and acknowledged that the purpose of the meeting was to advise Orr of the issues that he should be aware of in deciding whether to participate in the syndicate. Like Mitchell and First Marathon, GMP was aware that the underwriters were being told more about YBM than investors.

[459] GMP primarily relied upon the D&T audit as the basis for its belief that the Final Prospectus contained full, true and plain disclosure. This reliance is premised upon GMP's limited knowledge of the mandate, information obtained by and findings of the Special Committee. We believe that GMP must bear some responsibility for its limited knowledge based on its reliance on Mitchell and First Marathon. We find that McBurney was alert to the potential conflict associated with Mitchell's roles. As a co-lead underwriter, GMP could have been more adversarial in the circumstances. This was an error which a prudent underwriter with GMP's access to information, participation and skill would have avoided. GMP chose to rely on Mitchell and First Marathon. This implicates the reasonableness of GMP's investigation and its belief that the disclosure was sufficient.

[460] There is no doubt that GMP, along with the other respondents, drew great comfort from the D&T audit which, by all accounts, was an exceptional measure to institute in the midst of a prospectus offering. However, GMP also relied on First Marathon's flawed investigation. GMP was fully aware of those risks. If it was not it should have been. GMP should have taken certain steps that would have been consistent with its role as a co-lead underwriter. Accordingly, we find that a defence of due diligence is unavailable to GMP.

Abuse of Process Motion

[461] Mr. Edward L. Greenspan, Q.C., on behalf of GMP, seeks a stay of these proceedings pursuant to subsection 23(1) of the SPPA, wherein a tribunal may make an order to prevent an abuse of process. The allegation is one of misconduct against staff counsel. In essence it is contended that: staff have no legal basis for their attack on McBurney; Mr. Naster (staff counsel) has put his own credibility at issue; and staff's written submissions are "immoderate and intemperate" in tone.

[462] Counsel submits that because of the manner in which Mr. Naster conducted his cross-examination of McBurney, he compromised the integrity of the hearing sufficient to amount to an abuse of process. Earlier efforts by GMP to stay these proceedings on the basis of an abuse of process were unsuccessful. (OSC, February 6, 2001; Div. Ct. April 20, 2001)

[463] The standard of behaviour imposed on staff of the Commission is no higher than that of a prosecutor in criminal proceedings; *Glendale Securities Inc. v. Ontario (Securities Commission)* (1996), 11 C.C.L.S. 216 (Ont. Div. Ct.); *R. v. Felderhof*, [2002] O.J. No. 4103 (S.C.J.).

[464] Despite the adversarial nature of this proceeding, it is submitted that Commission counsel's conduct fell below the standard so that this panel is unable to assess McBurney's credibility fairly and objectively. Simply put, Mr. Greenspan says Mr. Naster was too close to it. It is argued that the panel is unable to assess McBurney's credibility where the prosecutor is at odds with him. Furthermore, it is argued that the problem, in part, flows from Mr. Naster being the senior investigator and later taking on the lead prosecutor role for the Commission. The risk is that, in Mr. Greenspan's words, the prosecutor gets pitted against the witness.

[465] Counsel further notes that staff's written submission contains little moderation and impartiality with respect to McBurney's testimony and credibility. Staff argue in various places that his testimony or conduct may be described as follows: "strains belief"; "it reveals his true colours"; "his stated belief ... is absurd"; "he wanted to bury the report"; "his modus operandi"; "it defies belief" and "it was a lame excuse". Mr. Greenspan notes that these comments are not impartial and were completely unnecessary and unwarranted.

[466] He further contends that Mr. Naster's approach to this prosecution suggests that the panel should "believe me" over the witness because "I was there".

[467] Mr. Code submits on behalf of staff, and we agree, that it would be an error if a witness denies knowledge of a fact, and the panel disbelieves the witness, that disbelief results in a finding of actual knowledge of the facts. Mr. Code asserts that Mr. Naster at no time crossed the line and did not allow himself to be "baited". It is submitted that if questions appeared close, which was not admitted, Mr. Naster was attempting to establish whether or not there was a defence of reliance on staff in accordance with the Commission's previous ruling. McBurney suggested that staff lied and that issue goes to staff conduct. We have already ruled that staff conduct is not an issue in this hearing.

[468] While the case opening slip and the investigation seem to have been delayed until September 24, 1997, we agree with Mr. Code that the examination by Mr. Naster does not in any way suggest inappropriate use of personal knowledge or that he "pitted" himself against or "baited" McBurney. Moreover, while we find that GMP was not misled by that fact, it was not until September 24, 1997 that the Commission's investigation was commenced, almost two months before the receipt of the Final Prospectus on November 20, 1997.

[469] A second series of questions is also emphasised by Mr. Greenspan as revealing that Mr. Naster suggests "believe me" not McBurney because "I was there".

[470] Mr. Code submits there is no basis for that whatsoever and we agree with him. The cross-examination raises no issue as to Mr. Naster's credibility as Commission counsel. Unlike *R. v. Logiacco* (1984), 11 C.C.C. (3d) 374 at 379 (Ont. C.A.), the cross-examination of Mr. McBurney in this case was not irrelevant, distracting, repeatedly abusive or insulting. Indeed Mr. Naster was not provoked even when he was called a "liar" by McBurney.

[471] Finally, Mr. Code discusses the attack with respect to the tone of the staff's submissions, that is, were they immoderate and not impartial? We agree with Mr. Code that less colourful language could have been used. It does not advance the case nor does it assist the panel. Moreover, when the senior staff investigator also assumes the role of senior prosecutor, the risk of the appearance of being too close or giving evidence becomes even more likely. As such, in fact-intensive cases where credibility findings may be imperative, and where there is considerable interaction between staff and the issuer, we would discourage this practice. Another staff litigator should take on the prosecution role. Indeed in this case Ms. Daniels and Mr. Smith along with Mr. Code assumed significant responsibilities for the prosecution of the case. Nevertheless, we do not find Mr. Naster acted improperly or impartially.

[472] GMP submits that because staff's attack on McBurney's credibility and good faith underpins their submissions, and because Commission counsel's conduct and credibility have been put directly in issue in attacking his credibility, it is submitted that there is no remedy reasonably capable of removing the prejudice to GMP at this stage. Furthermore, the proceedings are unfair, and the administration of justice and the integrity of the Commission's hearing process require an order permanently staying these proceedings against GMP under section 23 of the SPPA.

[473] As is evident from the above, we do not accept GMP's argument that there are sufficient grounds to stay these proceedings against GMP. We would prefer that such proceedings not take 124 hearing days and be so vigorously prosecuted and defended. These are, after all, public welfare offences and not criminal matters. No doubt, there is a lot at stake for both staff and the respondents. A tribunal is expected to provide a more efficient and less adversarial alternative to the courts particularly in this specialised field; *Everyday Justice: Report of the Agency Reform Commission on Ontario's Regulatory & Adjudicative Agencies* (Toronto: Queen's Printer, 1998). However, as is evident in this case, considerable time was consumed by motions, evidentiary objections, procedural points, document productions, examination and cross-examination of witnesses, and finally, lengthy and complex submissions. As the Agency Reform Commission of Ontario has observed, "This is not an alternative to the court but an alternative court." (September 1997 at 8)

[474] Staff prosecutors do not seek convictions before the Commission. However they must meet the intermediate standard of proof and must advocate their case in a robust and at times adversarial manner. We agree with Mr. Code that in this case staff counsel have engaged in legitimate advocacy in the pursuit of a just result in an adversarial process. We do not find that the respondents were misled by the investigation. Staff conduct is not in issue in this proceeding. In any event, as indicated above, they formally notified YBM of the investigation on September 24, 1997.

[475] In conclusion, the facts herein fall short of the high standard for a finding of an abusive process and a stay of proceedings. It is not the clearest of cases in which the fairness of this hearing or its integrity has been impaired. The request to stay is denied.

THE FAILURE TO DISCLOSE A MATERIAL CHANGE FORTHWITH

[476] This second allegation is fully set out above and concerns a failure on the part of YBM, its senior officers (Bogatin, Fisherman and Gatti) and its Audit Committee (Mitchell, Antes and Greenwald) to comply with YBM's continuous disclosure obligations – specifically the requirement that material changes in the affairs of a reporting issuer be disclosed forthwith. The alleged violation is contrary to subsection 75(1) of the Act.

[477] The material change that staff allege the respondents failed to disclose was that by April 20, 1998 at the latest, D&T had notified YBM that it would not perform any further services for YBM, including the rendering of an audit opinion in respect of YBM's 1997 financial statements, until YBM had completed an in-depth forensic investigation into specific concerns to D&T's satisfaction.

[478] Pursuant to subsection 75(1) of the Act, "where a material change occurs in the affairs of a reporting issuer, it shall forthwith issue and file a news release authorized by a senior officer disclosing the nature and substance of the change." Subsection 1(1) of the Act defines a material change, where used in relation to the affairs of an issuer, as "a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer." YBM's liability is as principal. The liability of the individual directors and officers is based on having authorized, permitted or acquiesced in the company's failure to comply with subsection 75(1) of the Act.

[479] Staff urge the Commission to answer the following questions:

1) Was the audit suspension a change in the business, operations or capital of YBM?

2) If yes, was the audit suspension material?

3) If material, did YBM and the respondents make the disclosure forthwith?

The Facts

[480] On December 1, 1997, Fisherman, on behalf of United Trade, entered into a series of escrow agreements. The agreements required that United Trade place U.S. $32.2 million in escrow with the Swiss Union Bank Corporation. These contracts were not approved by the Board or Gatti. In February and March of 1998, D&T was not only completing the 1997 audit, but also had accepted a number of additional non-audit engagements on behalf of YBM. D&T was aware that YBM was the subject of an investigation by Enforcement. D&T noted, as a pervasive audit risk factor, that the company's operations were concentrated in Eastern Europe, specifically Russia and the Ukraine.

[481] Gatti learned of the escrow agreements in January, 1998 from YBM's controller. Gatti was troubled and brought the transactions to the attention of Bogatin, who then spoke to Fisherman. Gatti requested that Parker of D&T inquire into the details of the escrow arrangements. Gatti met with Bogatin and Purcell of D&T to discuss the escrow arrangements. After Parker returned from Budapest and Moscow, Purcell became concerned with the escrow arrangements and spoke to management again. D&T also sent a memo to Fisherman requesting information about the escrow arrangements.

[482] At first, Fisherman was opposed to breaking the escrow arrangements and returning the money to North America. Mitchell advised Gatti that the money should immediately be transferred back under YBM's control. In accordance with Mitchell's instructions, the vast majority of the funds, U.S. $28,499,970, were transferred to a YBM bank account at the Royal Bank of Canada between March 19 and 27, 1998. The balance of the funds, U.S. $3,720,000, had already been paid in connection with a licensing agreement entered into by YBM that was approved by the board.

[483] Purcell confirmed that during the weeks following the initial January meeting with Bogatin and Gatti, significant efforts were made to address D&T's concerns respecting the escrow transactions. However, in addition to the escrow agreements, a series of technology contracts also became a matter of concern for D&T, and on February 25, 1998, D&T sent a memo to Gatti raising a series of questions relating to them. D&T sent another memo regarding this issue on February 28. Gatti wanted D&T's questions to be answered because D&T was trying to accommodate YBM's desire to issue a press release regarding the company's 1997 earnings. On March 2, Antes responded on behalf of YBM.

[484] During this period, D&T had also been inquiring about YBM's oil business, which in 1996 accounted for U.S. $20.3 million in sales. D&T initially made inquiries of Fisherman in December 1997. No response was provided. In February 1998, Gatti forwarded the questions to Fisherman again. On February 19, Fisherman replied. YBM terminated its oil business as of January 1, 1998.

[485] Coulter remained concerned about the escrow agreements and the technology contracts. He was dissatisfied with the explanation Antes provided on March 2. He was also concerned because YBM had issued a press release on March 9 announcing the financial results for the year ended December 31, 1997. YBM reported that net income, sales and earnings per share were significantly up compared to 1996.

[486] By the middle of March of 1998, D&T had been unable to resolve its concerns with management and brought its concerns to the Audit Committee. Before a March 23 meeting with the Audit Committee, Bogatin provided copies of a change in policies and procedures to be immediately instituted by United Trade. Much of the problem was laid at the feet of Fisherman. Bogatin was upset with Fisherman, thinking he was reckless and unprofessional.

[487] YBM management were trying to introduce better controls and procedures with respect to Eastern European activities. D&T, meanwhile, unbeknownst to YBM, obtained legal advice concerning YBM, performed background checks with respect to a number of Eastern European companies with which YBM did business, and made certain inquiries into the presence of organized crime.

[488] On March 23, D&T (Coulter, Purcell and Parker) met with the Audit Committee (Mitchell, Antes and Greenwald), along with YBM's U.S. counsel Richard Silfen. At this meeting, D&T requested that YBM conduct an independent investigation into the escrow arrangements, the technology contracts, certain equipment transactions and certain resale magnet purchase contracts with a company called SKS.

[489] Transactions in the amount of U.S. $68 million were identified by D&T as problematic. A forensic investigation was not requested at this time. The members of the Audit Committee decided that Mitchell would be best suited to develop the Audit Committee's investigation plan and communicate with Coulter. Coulter confirmed that there was no discussion at that meeting with respect to suspending work on the audit. The Audit Committee believed that the audit was substantially complete as of March 23, with the exception of addressing the issues raised by D&T. At the February 20 board meeting, Gatti had indicated that the D&T audit was 80% complete.

[490] Other than attending the March 23 meeting, Greenwald had no involvement in the Audit Committee investigation.

[491] YBM continued to disclose positive changes. On March 31, YBM issued a press release announcing the acquisition of the magnetic division of Phillips. No reference was made to any problems with respect to the 1997 audit or the independent investigation by the Audit Committee.

[492] On or about April 7, Gatti provided a memo to the Audit Committee and generally remained concerned about the relevant transactions. On April 7, Mitchell sent Coulter the Audit Committee's draft investigation plan. The purpose of the investigation was to confirm that the transactions were consistent with sound business practices for a public company. They intended to complete the review over the next two weeks. The plan was extensive and was prepared with the assistance of U.S. counsel (Silfen).

[493] On April 9, the Board met and discussed D&T's concerns. The entire Board, including Fisherman, was present along with Gatti, Silfen and Wilder. At some point during the meeting, the Directors discussed matters without Gatti present. Silfen and Wilder discussed the Board's legal duties and responsibilities. Mitchell did not find the explanation that Fisherman provided at this meeting regarding the escrow arrangements to be satisfactory. The Board authorized the Audit Committee to fully investigate D&T's concerns.

[494] Around April 15, Gatti was interviewed regarding the transactions. Even as late as April 16, Gatti was still trying to obtain information from Fisherman regarding geographic segmented disclosure and oil sales. Surprisingly, even at that point, there were still unanswered financial and sales contract questions with respect to the company.

[495] On April 19, D&T by phone advised Mitchell, Antes and Abbe Fletman of Wolf, Block (who had been retained as counsel to the Audit Committee) that D&T would not perform any further audit procedures in connection with the 1997 audit. D&T had reached a high level of anxiety. It was concerned that: (1) entities involved in the forementioned transactions may not exist as legal entities; (2) certain individuals associated with these entities may have ties to organized crime; and (3) the transactions may be bogus and were being used to cover the flow of money between these companies for other purposes. It rejected the Audit Committee's extensive investigation plan as insufficient, requested that an in-depth forensic investigation be performed by outside counsel and an experienced forensic investigation firm, and that YBM management not be involved in the investigation.

[496] D&T further advised the Audit Committee that it would not perform any further audit procedures or services for YBM until the Audit Committee completed its investigation and all matters were resolved to D&T's satisfaction. Upon completion of the investigation, D&T would determine whether it would continue to be associated with YBM, whether it would be able to issue an opinion on YBM's 1997 financial statements, and whether it would continue to be associated with YBM's 1996 financial statements. D&T believed it unlikely that these issues could be resolved by YBM's filing deadline with the securities commissions, which D&T understood to be April 30. In fact, the deadline was May 20.

[497] On April 20, Coulter faxed Mitchell a letter confirming the telephone discussion. It is at this time that staff submit a press release should have been issued disclosing the audit suspension. Mitchell discussed with counsel that if YBM did not get its audit opinion, YBM's shares could be cease-traded. Mitchell relied on counsel's advice that no disclosure was required at this time.

[498] D&T gave Mitchell and Fletman additional information to investigate, including information respecting certain individuals and companies whose legal status could not be confirmed. On April 27, Mitchell updated Coulter on the Audit Committee's

investigation, including the fact that Pinkerton had been retained to do a forensic investigation. Interviews were being conducted with management and with individuals in Hungary.

[499] On April 27, YBM issued a press release announcing extremely positive results from its operations for the three months ended March 31, 1998. There was no mention of D&T suspending its 1997 audit pending the completion of an in-depth forensic investigation. Mitchell testified that he was annoyed that management issued the release, but Coulter testified that Mitchell commented that YBM was not aware of any actual inaccuracy in the financial records at this point, so they decided to go ahead and release the results.

[500] Gatti had prepared the quarterly statements and left them with Bogatin before departing on vacation. He thought Bogatin would consult with the Audit Committee as they were best suited to authorize the release.

[501] D&T was concerned that YBM released its first quarter 1998 results when the 1997 financial statements had still not been finalized and significant concerns still existed. On April 28, D&T wrote the Audit Committee expressing these concerns and recommended that YBM consult with counsel to address YBM's need to disclose the audit suspension to the Commission and the public.

[502] It is apparent that there were some discussions regarding "Semeon Mogilevitch" during a call between Coulter and Mitchell on April 28. Mitchell continued to receive advice from counsel that disclosure was not required. As indicated above, D&T was mistaken that the audited statements needed to be filed on April 30.

[503] On May 3, Coulter left Mitchell a voicemail message and advised him that if disclosure was not made within the next few days, D&T would likely resign. Mitchell testified that he was in Russia at that time and did not receive this message from Coulter. On May 4, Coulter phoned Antes and Wilder. Coulter testified that Wilder "believed the company had an obligation not to disclose the suspension of the audit." Wilder indicated that the company was conducting an extensive investigation and had not found a problem with a single company. Antes was prepared to work with D&T regarding the appropriate disclosure. Wilder provided legal advice as to the meaning of a material change under Ontario securities law. Coulter learned at this time that the filing date was May 20. Nevertheless, Coulter advised that D&T expected that the audit suspension and investigation would be disclosed.

[504] On May 7, Antes called Coulter and informed him that the company intended to file an application seeking an extension of the time to file the 1997 financial statements and that YBM would be making disclosure. He also advised that a preliminary report on the investigation was expected on May 11 and a final report on May 13.

[505] On May 8, Coulter wrote the Audit Committee reiterating D&T's concerns that YBM had released financial results but had not disclosed the audit suspension.

[506] That same day, the Board held an emergency meeting by conference call. Peterson, Davies and Fisherman were absent. Mitchell participated from hospital where he was being treated for a medical problem. The board was updated on the results of the investigation. Antes advised that Pinkerton, on a preliminary basis, had not found any material adverse information that would be likely to affect the business or operations of the company or have any significant affect on the company's historical financial statements. Antes had spoken with Fletman, who provided a similar report. Gatti did not participate in the emergency meeting of the Board, but Wilder did. Wilder advised that he was in the process of applying to the Commission for an exemption to extend the filing deadline, but that such applications were rarely granted. A draft press release was reviewed by the Board at that time.

[507] On May 8, YBM issued the news release announcing that it was in the process of filing an application with securities regulators seeking a 45-day extension from the May 20 deadline for filing and mailing its 1997 audited financial statements to shareholders. YBM disclosed that the reason for the application was that "it is possible that [YBM] will not receive an audit report on its 1997 financial statements from its auditors, Deloitte & Touche LLP, in time to meet the required filing and mailing deadline." YBM also disclosed, "As part of concluding its audit, Deloitte & Touche LLP has requested that the Board of Directors conduct an independent review of certain aspects of the Company's business and operations in Eastern Europe. The Board, through an independent committee, is in the process of concluding an extensive review and expects to report its final findings to Deloitte & Touche LLP shortly." The release goes on to state, "Management attributes the extensiveness of the audit and the requirement for this review to the fact that business practices in the Company's major market, Eastern Europe, differ from those in North America due to the relatively early stage of development of the Eastern European market economies."

[508] The release did not indicate that D&T had suspended its audit engagement or that the investigation requested was a forensic one. The actual application for the extension was filed with the Commission on May 8. On May 13, the U.S. organized crime task force headed by the U.S. Attorney's Office for the Eastern District of Pennsylvania executed a search warrant on YBM's offices in Newtown. That same day, the Commission issued a temporary cease trade order in respect of the securities of YBM, which remains in effect.

[509] On June 2, the report of the Audit Committee was issued, and on June 24, D&T informed YBM that it was not able to report on YBM's 1997 financial statements and resigned as YBM's auditor, effective immediately.

Submissions

[510] The Act requires prompt disclosure of material changes in the affairs of an issuer. Staff submit that the audit suspension constituted a "material change" in the affairs of YBM and as such triggered a reporting obligation.

[511] Staff submit that the audit suspension constituted a change in the business, operations or capital of YBM for three reasons:

1) In light of the role played by auditors of public companies, the suspension of the audit constituted a change in the business and operations of the company.

2) The demand for an in-depth forensic examination into material aspects of YBM's business cast suspicion on the business, operations and capital of the company.

3) The suspension of the audit occurred at a date close to the due date for the financial statements and created a risk that YBM would not be able to satisfy its regulatory requirements and that its securities would cease trading.

[512] Staff further submit that the issuance of the May 8 press release, 18 days after learning of the material change on April 20, cannot be "forthwith" as required by subsection 75(1) of the Act. They also refer to subsection 75(2) of the Act, which requires the filing of a material change report "as soon as practicable and in any event within ten days of the date on which the change occurs."

[513] The respondents advance a series of alternative arguments. They submit that the audit suspension was not a change in the business, operations or capital of YBM. Furthermore, even if it was, it was not material. Moreover, if it was material, then they acted in a timely fashion and issued a release forthwith.

[514] With respect to staff's three reasons why the audit suspension is a material change, the respondents submit that the first two reasons do not by their nature constitute changes in the business, operations or capital of YBM. Mitchell submits that, intuitively, it is difficult to understand how the audit suspension, in and of itself, had any impact on YBM's commercial activity (business), its organization (operations) or its overall wealth (capital). Coulter suggested during cross-examination that the audit suspension effected no change in the business, operations or capital of YBM.

[515] The respondents generally acknowledge that staff's third reason could have constituted a material change and that the probability/magnitude test discussed above must be applied. Mitchell does not dispute the importance of the role played by D&T in the affairs of YBM, but submits that his assessment of the materiality of the audit suspension was consistent with the proper application of the probability/magnitude test.

[516] Antes and Greenwald submit that it is the risk of two contingent events based upon the audit suspension (not obtaining an audit opinion by the filing deadline and the stock not trading) which potentially constituted the material change. Materiality must therefore be measured by the probability/magnitude test. Greenwald and Antes also argue that the ripeness of the future event must be interpreted in a manner that avoids undesirable and premature disclosure. This was recognized by Antes in a letter to Coulter on May 12, the day before the U.S. search warrant was executed, in which Antes stated that "any public disclosure before ascertaining the facts was premature and could have misled the public marketplace." Obviously, if the Audit Committee had been able to satisfy D&T before the filing date and obtain an audit opinion, premature disclosure of the audit suspension would have had unnecessary consequences to YBM shareholders. Antes and Greenwald further contend that the Audit Committee was diligent in examining the facts and made disclosure on May 8 which was timely, in these circumstances.

Analysis

[517] Energy levels were becoming depleted by this time in the hearing. This was likely a function of the length of the proceedings and not the importance of the issue.

[518] An issuer is obliged to disclose material changes. That enhances the fairness of the market. The definition of material change acts as a brake on premature and undesirable disclosure. The concept of material change, like that of material fact, requires an exercise of judgement. If the decision is borderline, then the information should be considered material and disclosed. In our opinion, a supercritical interpretation of the meaning of material change does not support the goal of promoting disclosure or protecting the investing public; sections 1.1 and 2.1 of the Act.

[519] The requirement for an annual audit by an independent auditor is intended to provide the public with an independent and objective check on the fairness of the presentation of the company's financial position at fiscal year end. That information is not only crucial to investors in the secondary market but also to an issuer's ability to raise capital. An auditor, while not a guarantor of financial statement accuracy, assumes a special role vis-à-vis the public. There was no disagreement with respect to the crucial role of auditors in public companies.

[520] There was also no disagreement that YBM faced a serious risk if it did not file its audited financial statements by May 20, or obtain an exemption from the filing deadline. Failure to file on time or obtain an exemption would result in the issuance of a cease trade order against YBM's securities.

[521] Was the audit suspension a change in the business, operations or capital of YBM that would reasonably be expected to have a significant effect on the market price or value of its securities? "Business, operations or capital" is not defined in the Act. In *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 at 561-562 (*Pezim*), Iacobucci J. noted that:

> [t]hree elements emerge from [the definition of a material change in the B.C. legislation]: the change must be
>
> a) in relation to the affairs of an issuer,
>
> b) in the business, operations, assets or ownership of the issuer and
>
> c) material, i.e., would reasonably be expected to have a significant effect on the market price or value of the securities of the issuer.
>
> [...]
>
> This case also turns on the meaning of the words 'as soon as practicable' ... as to when a material change should be disclosed to the public. The timeliness of disclosure also falls within the [B.C.] Commission's regulatory jurisdiction.

[522] It should now be obvious that a material change is a question of both fact and law. The Act is similar to the B.C. legislation except that the Act uses "capital" instead of "assets" and also does not include ownership of the issuer in the definition. Most notably, the Act also uses "forthwith" instead of "as soon as practicable".

[523] There was little evidence as to whether the audit suspension could be considered a change in the business, operations or capital of YBM. Opinion evidence on this issue would have been most helpful. Staff submit that it is implicit given the crucial role of auditors in public companies. However, Coulter testified that the audit suspension did not alter or affect the day-to-day business or operations of YBM.

[524] While Coulter testified that the suspension of the audit, in and of itself, did not alter or change any line item in the balance sheet, he did agree that if the audit opinion was not provided that would affect the business, operations or capital of YBM since YBM would fail to meet its regulatory obligations. This leads us to a critical issue associated with the audit suspension, namely its timing.

[525] We agree with the respondents that the probability/magnitude test is a useful tool in this context, as the issue is the materiality of a discrete event, namely YBM missing its filing deadline and having its securities cease-traded. We believe the potential magnitude of a publicly traded company missing its filing deadline and having its securities cease-traded is self-evident. We are left with the question of what the probability was of not obtaining an audit opinion by May 20 based upon the audit suspension on April 20. Alternatively, even if probability was difficult to determine herein, was the emergence of the present risk regarding the filing deadline and ensuing cease trade order material based on the events of April 19 and 20 as informed by earlier events?

[526] After becoming aware of D&T's concerns on March 23 and of the intended audit suspension on April 20, the Audit Committee and Gatti took the following steps:

1. They agreed to conduct a review of the transactions being questioned by D&T.
2. They obtained Board approval to proceed with a review.
3. The Audit Committee retained independent counsel (Wolf, Block), approved by D&T.
4. The Audit Committee reviewed numerous transactions and interviewed management and third parties.
5. They retained the expert forensic investigation firm Pinkerton, approved by D&T.

6. The escrow monies were recovered and deposited at the Royal Bank of Canada.

7. They specifically sought legal advice regarding their disclosure obligations with respect to the risk associated with the audit suspension. The advice was that disclosure was not required.

[527] It would appear that the audit was substantially complete by mid-March except for D&T's concerns. It is submitted that the materiality of the audit suspension could only be assessed after the Audit Committee was given a reasonable opportunity to satisfy D&T's concerns. On the one hand, the Audit Committee investigation appeared to have addressed some concerns, but on the other hand, D&T continued to insist that they be provided with auditable evidence respecting the legitimacy of the transactions.

[528] We do not accept Mitchell's explanation that the only reason that the escrow and technology contracts troubled D&T was due to the inadequate controls within the company. D&T's evidence was to the contrary and is more consistent with the documentary record.

[529] D&T's March 23 meeting with the Audit Committee was a turning point, but it was not until April 9 that the board authorized the Audit Committee to examine D&T's concerns extensively. The Board tried to address the issues, but to a certain extent ignored the impact of the information they were receiving. They continued to search for explanations rather than accept the facts provided to them. Only a year before, Fairfax had advised the Special Committee that while Fairfax found no evidence of actual wrongdoing, the founding shareholders were rumoured to have ties to organized crime and there were indicia of money laundering. Although D&T's audit opinion from October 1997 may have provided some comfort on the money laundering question, the common talk regarding organized crime continued in 1998. In addition, it was D&T, the very firm that had provided the clean opinion, that now had these concerns.

[530] The concerns presented to Mitchell and Antes on April 19 which led to the audit suspension and the request for a forensic investigation were extraordinary in nature. This was much more than a disagreement between D&T and management over the application of accounting principles, for example. D&T was concerned about (a) the validity of transactions, (b) whether counterparties to YBM's agreements were legal entities, and (c) organized crime and the possible cover-up of the flow of money.

[531] While the Audit Committee did not ignore D&T's concerns, it did not provide D&T with any indication that a number of these issues had already been examined by the Special Committee. The Audit Committee not only did not provide information to D&T, but it also did not make it available to the public.

[532] We note that during this period, YBM continued to make good news disclosure announcements. YBM had already issued its unaudited 1997 financial results on March 9, before the Audit Committee was first notified of D&T's concerns on March 23. After being notified of D&T's concerns, YBM issued a press release on March 31 announcing the Phillips acquisition. There was no mention of any problems with the audit.

[533] On April 27, YBM issued a press release announcing its results from operations for the first quarter ended March 31, 1998. These were extremely positive; for example, earnings per share increased by 53.8%. At that time, YBM shares were trading in the $18 to $19 range with significant volumes being traded. Once again nothing was said about the audit. Coulter was concerned with this release and Mitchell was displeased. In our opinion YBM's shares continued to trade well, but on an unaware and unsuspecting public.

[534] The absence of any disclosure regarding the audit suspension was a matter of increasing concern to D&T. Although D&T was mistaken as to the filing deadline (April 30 vs. May 20), it nevertheless was anxious about disclosure, among other things. In our opinion, that anxiety was well-placed.

[535] On May 8, YBM issued a press release announcing that it was seeking a 45-day extension from the May 20 deadline. It did not disclose the audit suspension, but did state it might not receive an audit opinion on the 1997 financials in time. It disclosed that D&T requested that the Board conduct an independent review of certain aspects of the company's business and operations in Eastern Europe, but did not disclose that the review consisted largely of a forensic investigation.

[536] Staff submit that this disclosure was deficient but do not press the point since this was not the allegation. We agree that the press release omitted certain key information.

[537] We have indicated that the respondents who defended these allegations did not profit directly from any trading with the exception of commissions earned by the investment dealers. Nevertheless, the public was unaware and unsuspecting. While YBM continued to try to resolve D&T's concerns, there was an essential detail missing – disclosure.

[538] In our opinion, given: (1) the extraordinary nature of the concerns expressed by D&T on April 20; (2) D&T's request for a forensic investigation on April 20; and (3) the fact that D&T advised that it would need to consider whether it was willing to continue being associated with YBM and able to issue an opinion on YBM's 1997 financial statements upon completion of the

Audit Committee's investigation, it was probable as of April 20 that YBM would be unable to obtain an audit opinion and make its May 20 filing deadline. Given the events of April 19 and 20, as informed by earlier events, the emergence by April 20 of the risk regarding the filing deadline and likely cease trade order constituted a material change.

[539] The press release was issued approximately 18 days after notice of the audit suspension was provided. Staff contend this was not "forthwith", particularly in light of the ten-day period set out in subsection 75(2) of the Act. We agree with this submission.

[540] For the foregoing reasons, we find that YBM breached subsection 75(1) of the Act by failing to disclose the audit suspension forthwith.

Directors' and Officers' Role in the Failure to Make Timely Disclosure

[541] We have found that YBM failed to disclose the audit suspension forthwith and therefore failed to comply with its continuous disclosure obligations under the Act. The press release was issued approximately 18 days after notice of the audit suspension was provided.

[542] As mentioned previously, Gatti and Greenwald submitted that they did not know and could not reasonably have been expected to know the facts which staff allege constituted a material change. Meanwhile, Antes and Mitchell contend that they held an honest and reasonable belief that the audit suspension was not a change in the business, operations or capital of YBM and that they took care to ascertain the materiality of that change.

[543] Antes and Mitchell both knew about the audit suspension. They relied on the advice of counsel as to what constitutes a change in the business, operations or capital of YBM. That advice appears to have been that the audit suspension, in and of itself, was not a material change, although we have no report or written opinion to that effect. We have found, despite the argument to the contrary, that a material change occurred.

Mitchell

[544] D&T recommended to Mitchell, as a member of the Audit Committee, that the Committee consult with counsel regarding the audit suspension and disclosure to the public, given that YBM had already issued its earnings releases. This occurred more than once. Mitchell was a party to the April 19 call advising of the audit suspension. He received D&T's written confirmation on April 20 and D&T's April 28 letter expressing concern at YBM's release of the first quarter financials without disclosing the audit suspension. He also received Coulter's voicemail of May 3 telling him that the company should inform the public. While Mitchell testified that he has no recollection of this last occasion, and surmised that he may have been in Russia at the time, we prefer Coulter's evidence. It is commonplace for an honest witness to give evidence of facts as he or she believes them to be but which the panel does not accept. Coulter was pressing very hard during this period as he believed that YBM had an obligation to disclose the suspension.

[545] Mitchell testified that he had discussions with and relied on the advice of counsel regarding disclosure of the suspension. He testified that counsel consistently advised that disclosure of the audit suspension was not required unless the Audit Committee found some evidence of inaccuracy or error. We find, however, that as of April 20, Mitchell ought to have known that YBM likely would not get its audit opinion in time and that, as a consequence, the shares of the company would be cease-traded.

[546] Disclosure in this instance could not be resolved by simply relying on legal advice. This advice may be gleaned from a May 12 memo in which counsel stated that "no thought was given to a press release or material change report on April 20, 1998 because the D&T letter contained no facts, and therefore, we did not want to issue a press release based on concerns or supposition." Following that, counsel's advice with regard to D&T's April 28 letter reinforced the fact that the filing date was clearly at risk and that this was an important consideration vis-à-vis disclosure. Mitchell testified that upon learning about that letter, and the status of the investigation, Wilder asked him if the Audit Committee believed that it could complete the investigation within sufficient time to permit D&T to review the results of the investigation and meet the May 20 filing deadline.

[547] Mitchell believed that it could for a number of reasons. First, as at April 20, Mitchell believed that D&T had effectively completed its audit procedures, although his evidence does not confirm that he specifically asked D&T whether it completed its audit procedures. Second, when D&T was asked if it had identified any inaccuracies in the 1997 unaudited financials, it responded that it had not. Third, he felt that the audit opinion for 1996 was done on a high-risk basis and would serve as a useful proxy for the 1997 financials. Fourth, Mitchell had no reason to believe that the results of the investigation would be unsatisfactory to D&T as the transactions involved were similar to the ones that were audited in 1996. D&T had not indicated that it was withdrawing or altering its audit opinion for 1996. Finally, Coulter had testified that the possibility of rendering an audit opinion was not foreclosed.

[548] Although it was technically possible that D&T would still render an audit opinion, this was highly improbable. D&T expressed doubt that the necessary investigation could be completed in time for the filing deadline. It was persistent in its requests that YBM make disclosure of the audit suspension, despite the ongoing Audit Committee investigation. Its concerns were fundamental in nature and involved the validity of millions of dollars in transactions and the legal existence of counterparties to the transactions. It had asked the Audit Committee to hire forensic investigators. Given Mitchell's background, he would have been well aware of the difference between a high-risk and forensic audit. His belief in these circumstances, including his reliance on legal advice, was not reasonable. He bears direct responsibility for the delay in issuing the press release. He was the most involved in the Audit Committee investigation along with Antes and counsel.

Antes

[549] Antes had little or no recollection of the important events associated with disclosure here. As before, for the first allegation, the documentary record and the evidence of Coulter help fill the gaps in his recollection.

[550] As was the case with Mitchell, D&T recommended to Antes, as a member of the Audit Committee, that the Committee consult with counsel regarding the audit suspension and disclosure to the public, given that YBM had already issued its earnings releases. Antes participated on the April 19 telephone call, was copied on D&T's April 20 letter and on May 4 spoke with Coulter and Wilder regarding disclosure issues. Wilder advised Coulter that YBM had an obligation not to disclose, but Coulter continued to press for disclosure of the audit suspension and forensic investigation. Although Antes testified that he did not recall this telephone conversation, he was nevertheless aware that D&T was anxious that the audit suspension and forensic investigation be disclosed. Coulter's letter of May 8 to Antes is illustrative of this. In it, Coulter stated:

> As we have indicated on several occasions and as we discussed yesterday, we are extremely concerned that the Company has issued its earnings release for 1997 and for the first quarter 1998 but has failed to disclose that our audit has been suspended until the Company completed its investigation into the validity of certain significant transactions which took place in 1997 and which may impact those earnings. (emphasis added)

[551] Antes also testified that counsel advised that "any public disclosure before ascertaining the facts was premature and could have misled the public marketplace," and that he relied on that advice. As with Mitchell, we find that as of April 20, Antes ought to have known that YBM likely would not get its audit opinion in time and that, as a consequence, the shares of the company would be cease-traded. Although his understanding of this issue came from the advice of counsel and not from any personal knowledge or experience in the capital markets, we find that he did understand the nature of the risk. Moreover, he saw D&T's April 28 letter, which should have reinforced the fact that the filing date was at risk and that this was an important consideration regarding disclosure. Regardless of his relative lack of experience in the capital markets, he was an active member of the Audit Committee, was knowledgeable of the issues and had reason to challenge the legal advice.

[552] Antes submits that he believed that the Audit Committee would be able to satisfy D&T's concerns in time for the filing deadline, and that this belief was reasonable for several reasons. YBM and D&T had faced similar issues in the 1996 re-audit with regard to finding evidence that transactions were as recorded and that counterparties existed. YBM had received a clean audit opinion, with the audit conducted on a high-risk basis, under difficult circumstances. He did not know, and could not be expected to know, the differences between an audit, a high-risk audit and a forensic investigation. Finally, Coulter had testified that the possibility of rendering an audit opinion was not foreclosed.

[553] We agree that Antes could not be expected to know the nuances between an audit, a high risk audit and a forensic investigation. But that is not the issue. The issue is one of prudence and common sense, particularly where D&T did not want to deal with management. His belief had to be reasonable, and as with Mitchell, the basis for that belief was too slim. We find that Antes did not have a reasonable basis for believing on April 20 that a material change had not occurred.

Greenwald

[554] Although Greenwald chaired the Audit Committee, he was in a different position than Mitchell and Antes. Greenwald testified that he did not recall knowing that D&T said it was in a stop position on April 19. He testified that he was not present for the April 19 telephone call with D&T and that no one called to advise him of what had happened during the call. Similarly, Greenwald did not receive D&T's April 20 letter and did not recall having a conversation with either Mitchell or Antes about the letter.

[555] We find that Greenwald did not have any direct contact with D&T after March 23 until May 13. Similarly, he did not receive the Audit Committee/D&T correspondence from April 20 to May 8 until May 11. Staff does not dispute this. Simply put, Greenwald was not presented with the risk that YBM would miss the May 20 deadline and did not have the background and experience to appreciate the emergence and probable consequences of this risk.

[556] We would have expected more from the Chair of the Audit Committee, but Mitchell was selected to oversee this process given his background and experience, and Antes, the Chair of the Board, was directly involved. Greenwald's inaction is

certainly troubling, but on balance, we are unable to conclude that Greenwald should be held responsible for the delay in the press release.

Gatti

[557] There is no evidence to suggest that Gatti took part in the April 19 call with D&T. Nor is there any evidence that Gatti received D&T's April 20 letter or participated in the April 20 disclosure discussion with counsel. Gatti testified that he was unaware of the audit suspension. Staff suggest otherwise and point to certain documentary evidence in support of its position, such as Gatti's memos to Fisherman and Tsoura (of United Trade) dated April 19 to 21, 1998, and the fax from Lait (of D&T's Moscow office) to Gatti on April 21 informing him that due diligence work on the Novocherkaask transaction was suspended. In our opinion, the memos from Gatti to Fisherman and Tsoura do not demonstrate that Gatti was aware of the audit suspension. They are consistent with his being asked by the Audit Committee for further particulars with regard to transactions that, for the most part, were brought up at the March 23 meeting with D&T. Furthermore, we find that Gatti's inference that Lait's fax referred to what had happened on March 23 was reasonable. Even if Gatti knew of the audit suspension, he was unaware that Coulter had been pressing for its disclosure.

[558] Although Gatti prepared the first quarter results, he left them with Bogatin who, according to Gatti, "was going to interact with the audit committee." Similarly, we find that as Gatti was away on April 28, he would not have been aware of the communications between Coulter and Mitchell regarding D&T's concerns about the release of the first quarter results in the circumstances. He would also not have been privy to any discussions with counsel regarding disclosure. There is no evidence that Gatti was aware of or participated in any of the telephone calls or meetings leading up to the disclosure. D&T wanted to deal with the Audit Committee, not management. Gatti did participate in the drafting of the press release, but was unaware of much of the information possessed by Mitchell and Antes. As such, we cannot find that Gatti was responsible for the delay in filing the press release.

SANCTIONS

[559] We have concluded that YBM, Bogatin, Fisherman, Mitchell, Davies, First Marathon and GMP breached the prospectus disclosure provisions of the Act by failing to make full, true and plain disclosure of all material facts. There is no due diligence defence available for YBM. The other respondents have not persuaded us as to the availability of their due diligence defences. Moreover we have found that YBM, Bogatin, Fisherman, Mitchell and Antes have breached the timely disclosure provisions of the Act and that they have no defence to their failure to file forthwith. Normally, if a respondent has breached the Act and has not made out a due diligence defence, an order in the public interest is warranted. However, the respondents further submit that even if they have breached the Act, an order in the public interest is unwarranted.

[560] Section 127 is a regulatory provision, the purpose of which is neither remedial nor punitive. It is protective and preventative, intended to be exercised to prevent likely future harm to Ontario's capital markets; *Committee for the Equal Treatment of Asbestos Minority Shareholders*, [2001] 2 S.C.R. 132 at para. 42 (*Asbestos*).

[561] As stated by Iacobucci J., the Commission's role under section 127 "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* at para. 43, citing *Re Mithras Management Ltd.* (1990) 13 O.S.C.B. 1600 at 1610 ["We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing, we must, of necessity, look to the past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all."]. Iacobucci J. noted that section 127 of the Act gives the Commission "an unrestricted discretion" to attach terms and conditions to any order made under subsection 127(1); *Asbestos* at para. 40.

[562] Participation in Ontario's capital markets is a privilege, not a right; *Manning v. Ontario Securities Commission* (1996), 12 C.C.L.S. 106 (Ont. Div. Ct.). In *Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743 at 7746, the Commission outlined various factors for consideration in a public interest violation: (1) the seriousness of the allegations proved; (2) the respondent's experience in the marketplace; (3) the level of a respondent's activity in the marketplace; (4) whether there has been recognition of the seriousness of the improprieties; and (5) whether the sanctions imposed may serve to deter not only those involved in the case being considered but also any like-minded people from engaging in similar abuses of the capital markets. These factors were expressly approved recently in *Erikson v. Ontario (Securities Commission)* (2003), 26 O.S.C.B. 1622 (Div. Ct.) (*Erikson*).

[563] In addition to the above factors, we would also consider whether the violations were isolated or recurrent, the degree of participation in the violations and the likelihood that a respondent's occupation will present opportunities for future violations.

[564] *Erikson* confirms the principle of both specific and general deterrence in section 127 public interest cases. General deterrence should deter others from similar misconduct and hopefully improve business standards. The sanction imposed should reflect the Commission's assessment of the measures necessary to achieve these objectives. Moreover, there must be an appropriate relationship between the seriousness of the violation and the sanctions selected to achieve compliance with the

law. Sanctions should invariably be fair, proportional to the degree of participation and should have regard to any mitigating factors which may be present. In this sense, sanctions are custom-made to fit the circumstances of the particular case or to sanction a precise problem or breach.

[565] The Supreme Court has stated that the primary goal of securities law is investor protection; *Pezim* at 589, 592; section 1.1 of the Act. Moreover, the Act provides that one of the primary means for achieving its purposes is timely, accurate and efficient disclosure of information; para. 2.1(2)(i) of the Act. Sanctions derive their importance from the principles and purposes they are invoked to support.

[566] We do not view the conduct of the individual respondents who answered the allegations as deceitful. However, while not deceitful, we have found that certain respondents, in the circumstances, failed to satisfy prospectus and timely disclosure duties under the Act. Moreover, with the exception of Greenwald, in which the trade was reversed, the Directors did not profit financially from their misconduct in this case. Finally, as part of our considerations, it is clear the respondents relied on legal advice throughout with respect to both allegations. It is also evident that the respondents believed in the legitimacy of the business as a result of the D&T audit. Generally we do not view the advice as unscrupulous because there are few concepts in securities law as vague and imprecise as materiality as the standard for disclosure.

[567] Staff seek orders as follows from the Commission:

(a) YBM: an order pursuant to paragraph 2 of subsection 127(1) of the Act that trading in any securities of YBM Magnex International Inc. cease permanently;

(b) Bogatin and Fisherman: an order pursuant to paragraph 8 of subsection 127(1) that Bogatin and Fisherman permanently be prohibited from acting as a director or officer of an issuer;

(c) Mitchell: an order pursuant to paragraph 7 of subsection 127(1) that he resign any position that he holds as director or officer of an issuer; an order pursuant to paragraph 8 of subsection 127(1) that he be permanently prohibited from becoming or acting as a director or officer of any issuer; an order that he be permanently prohibited from seeking registration since he is not currently a registrant; and an order pursuant to section 127.1 for the payment of costs;

(d) Davies: an order pursuant to paragraph 7 of subsection 127(1) that he to resign any position that he holds as a director or officer of an issuer; an order pursuant to paragraph 8 of subsection 127(1) that he be prohibited from acting as a director or officer of any issuer for a period of at least ten years; and an order pursuant to section 127.1 for the payment of costs;

(e) Antes: an order pursuant to paragraph 8 of subsection 127(1) that he be prohibited from acting as a director or officer of any issuer for a period of between five and ten years; and an order pursuant to section 127.1 for the payment of costs; and

(f) National Bank and GMP: orders pursuant to paragraph 1 of subsection 127(1), imposing a term and condition on National Bank's and GMP's registrations that each not be permitted to act as underwriter in any public financing for a period between six months to one year; orders pursuant to paragraph 4 of subsection 127(1), requiring that a person approved by staff conduct a review of National Bank's and GMP's practices and procedures, and that any recommendations made be implemented; and an order pursuant to section 127.1 against each for the payment of costs;

Analysis

Bogatin and Fisherman

[568] During the course of opening statements, counsel for Bogatin appeared in order to advise that Bogatin was unable to participate in the hearing because he could not make full answer and defence to the allegations without significantly prejudicing his Constitutional right against self-incrimination in the United States. Although neither Bogatin nor Fisherman provided any answer or defence to the allegations in this matter, there was extensive evidence of their involvement and conduct during the hearing. They were both inside directors and senior officers. Both were involved in YBM from its inception, and they each had some involvement in YBM's antecedent companies and some relationship with the founding shareholders. At all times Bogatin was the President and CEO and Fisherman was the COO of YBM. We find that they had thorough knowledge of the company and its operations, the Fairfax investigation, and the mandate, findings and recommendations of the Special Committee.

[569] Evidence relating to Bogatin went both ways. On the one hand, he did take positive steps during management's investigation of the visa issues, and he did share the FBI Affidavit with management and Rossman. On the other hand, his later steps overshadow his positive initiatives. Bogatin rejected Fairfax's findings on organized crime but did not give Fairfax the FBI

Affidavit, which corroborated Fairfax's findings. He asserted some control over the Fairfax investigation and confined Fairfax to electronic searches by prohibiting direct approaches to customers. He revised Gatti's draft AIF disclosure relating to the Special Committee, making it less than full, true and plain. In 1998, continuing his pattern of releasing only positive news in light of negative facts, he authorized the release of the unaudited first quarter financial statements in the midst of D&T's concerns. On balance, we find that Bogatin has no defence of due diligence available to him.

[570] The evidence relating to Fisherman was less ambiguous. There is no doubt that he fabricated the Fisherman List "to make Fairfax go away". Fisherman's conduct was deceitful. On this basis alone, we find that Fisherman has no defence of due diligence available to him.

Mitchell

[571] Mitchell contends that, if the Commission finds a breach, nevertheless an order in the public interest should not be made against him. He also contends that if the Commission concludes that he made one or more errors in judgement which led to a breach or breaches of the Act, the Commission should take the following into account when considering whether he poses a prospective threat to investors or the integrity of the Ontario capital markets:

(a) his previously unblemished record as a registrant;

(b) his due diligence efforts as Chair of the Special Committee;

(c) his due diligence efforts in the spring of 1998 as a member of the Audit Committee;

(d) his efforts in the summer and fall of 1998 to assist the shareholders in replacing the Board and ultimately appointing a receiver;

(e) the fact that he did not personally sell a single share of YBM stock;

(f) his genuine remorse for the losses suffered by his clients and the other shareholders of YBM; and

(g) the confidence expressed by the witnesses Gary Drummond and Rebecca MacDonald in his business acumen and integrity.

[572] These are serious allegations. Mitchell has considerable experience and was actively involved throughout. With respect to Mitchell, we find no evidence of dishonesty, deceit or a cover-up. However, his approach to this financing was high-risk and the evidence clearly establishes serious lapses in judgement with respect to the disclosure in this case. These facts should have awakened his suspicions and would have put a prudent person on alert.

[573] Moreover, he was not prudent in failing to provide the Special Committee Report to staff as well as D&T. He failed to request a copy of the FBI Affidavit which was imprudent and the result of poor judgement. He failed to provide GMP with the Report. In this case, Mitchell's reliance on legal advice was good faith but he was aware of circumstances which made his reliance on legal advice imprudent and therefore unreasonable. In the most simple of terms, Mitchell may not have known better but he should have known better, given his background and expertise. Shareholders and investors have natural expectations and rely on the experience and skill of directors like Mitchell. Despite the testimony of Mr. Drummond and Ms. MacDonald, we believe an order in the public interest is warranted, as well as a costs order.

Davies

[574] Davies submits that the sanction sought by staff is punitive rather than prophylactic. He also argues that the sanctions are disproportional to those sought against many of the outside directors. He submits that the sanctions staff seek against him are harsher due to his role on the Special Committee, his interactions with the FBI and his safeguarding of documents. We have dealt with these matters earlier.

[575] Davies argues that the sanctions requested amount to a lifetime ban given that he is 60 years of age. Davies has no prior infractions. He argues that he dealt with the issues facing YBM in good faith, professionally and with a view to the best interests of shareholders and potential investors, and that having lived through the events of 1996 through 1998, the ensuing civil litigation and this hearing, he is better able to fulfil his duties as a director in the future.

[576] In conclusion, Davies submits that given all of the circumstances, including the massive notoriety of this case, the discipline of the marketplace for the selection of directors should be sufficient to address any public policy concerns.

[577] We have taken the above considerations into account but nevertheless we are of the opinion that Davies demonstrated a serious lapse in judgement which requires an order in the public interest, as well as a costs order.

Antes

[578] Antes submits that the evidence does not warrant making an order in the public interest against him. Furthermore, he submits that if he is wrong, that it would be difficult to anticipate the exact basis upon which the panel would decide that an order is warranted. As such, he seeks leave to make further submissions should the panel decide that a sanction in the public interest is warranted. We have found that Antes has made out a defence of due diligence regarding the first allegation. We need only consider the second allegation and see no reason for further submissions.

[579] Antes submits that the orders requested against him constitute a harsh penalty. He argues that regardless of the fact that it is unlikely that he would ever become a director of an Ontario public issuer (given his age and the fact that he is retired and a U.S. resident), the order requested by staff amounts to its seeking a life ban. This would have an enormous impact on Antes' reputation.

[580] Moreover, it is submitted that on the evidence it cannot be found that Antes breached Ontario securities law wilfully, deliberately or recklessly.

[581] Antes submits that the best and most useful measure of an appropriate sanction is that made against Wilder: a reprimand. In addition, Wilder also paid costs in the amount of $250,000.

[582] It is clear that Antes had a significant role with respect to the decision as to when and if to issue a press release. He was the Chairman of the Board and a member of the Audit Committee. We are persuaded that an order in the public interest is warranted, as well as a costs order.

National Bank (First Marathon)

[583] National Bank submits that any restriction on its ability to carry on business would be an unwarranted and disproportionate punishment since it poses no present threat to the integrity of the capital markets for three reasons:

(1) It is a fundamentally different organization than First Marathon, which it acquired in August, 1999. Key personnel have changed. Jones has retired and Mitchell has left National Bank. National Bank has instituted a variety of changes in its compliance policies and corporate governance. It has set up a Compliance Committee composed entirely of outside directors. It has revised its investment banking screening procedures, guidelines for business conduct and compensation system. Notably, under these new policies, an employee can no longer act as a director of a public company and participate in an investment banking function relating to that company. In simple terms, the conflict issue in this case has already been effectively addressed.

(2) Even if the Commission chooses to take the principle of general deterrence into account, the evidence does not warrant the sanction requested. In this case, if there were errors, they were good faith errors in judgement and not wilful misconduct by First Marathon.

(3) Should the Commission find that Mitchell acted contrary to the public interest, it does not follow that the full measure of any regulatory sanction against him also be visited on National Bank. In the regulatory context, vicarious liability is based in fault and not the pure operation of law.

[584] In general terms we agree with the above submissions and that sanctions requested by staff against National Bank are unnecessary and inappropriate in this case to protect the public interest given that National Bank is a different organization today. However, we are of the opinion that a costs order is appropriate under section 127.1.

GMP

[585] GMP submits that the order prohibiting it from acting as an underwriter for public financings for a period of six months to one year is unprecedented, unwarranted and unduly punitive in the circumstances.

[586] GMP contends that its conduct was not "so abusive as to give rise to a fear of future misconduct." GMP approached this offering with a high degree of seriousness. If its due diligence is found to be insufficient, it was only in the circumstances of this particular case and does not display a course of conduct from which the public needs to be protected. GMP further submits that any error made on the 1997 offering is not indicative of any general compliance problems at GMP. Staff called no evidence to prove that a culture of deceit or non-compliance exists in the organization.

[587] GMP is an experienced investment dealer and its participation throughout was extensive. McBurney's experience and skill was considerable. While GMP did not have as much information as Mitchell and First Marathon, GMP's role was not

sufficiently adversarial in the circumstances. GMP's reliance and diligence were questionable in the circumstances. Accordingly, we believe that an order in the public interest is warranted, as well as a costs order.

Reliance on Commission Staff

[588] Mitchell submits that the Commission should take into account, as part of the sanction, the role of staff in relation to the Final Prospectus when considering whether any order in the public interest is appropriate as against him. Other respondents made a similar argument. In particular, it is contended that the Commission should not ignore the fact that Naster misrepresented to the respondents in July 1997 the state of staff's knowledge about YBM and that he was not truthful with them about the Enforcement investigation that had been opened in June 1997. Mitchell, McBurney, Litwack and Peterson all testified that the truth would have altered their course of conduct. It is contended that if the truth had been revealed, the financing may not have proceeded. This possibility makes Naster's alleged misrepresentations and the respondent's reliance upon them a factor which the Commission should take into account when considering sanctions.

[589] Staff's reliance submission varies from respondent to respondent. National Bank submits that the relevance of staff conduct to its defence is in assessing the reasonableness of its reliance on D&T's re-audit. Peterson, in contrast, submits that while staff were in possession of more knowledge, they exercised the same judgement with respect to disclosure. It is suggested that the problem facing staff flowed from additional information provided to staff on or about November 14 before the prospectus receipt.

[590] In an evidentiary ruling on March 5, 2002, the Commission stated as follows with respect to staff knowledge:

> We believe however, that this evidence may not form the basis of an excuse, nor be used to examine the appropriateness of staff conduct....
>
> We conclude that the evidence is relevant to our consideration of whether or not it is appropriate to issue an order under section 127 of the Act, and it is relevant to our consideration of whether the respondents, despite the information they may have had, and irrespective of whether the allegations are made out, nonetheless acted reasonably and in good faith in relying on the Deloitte & Touche audit.
>
> Accordingly, the evidence is admissible insofar as it is relevant to the respondent's reliance defence and section 127 considerations, but it is not admissible as a basis for an assessment of materiality, an examination of staff conduct or to disclosure of informer identity.

[591] The decision with respect to the admissibility of evidence in this matter was informed by the ruling of the Divisional Court with respect to an institutional bias application made by Peterson in 2001; *Peterson v. Ontario (Securities Commission)*, [2001] O.J. No. 1495. The court noted as follows at paras. 1 and 4:

> The principal submission, ably advanced by Mr. Lenczner, was that the Commission had knowledge of the facts which Mr. Peterson failed to disclose. In our judgment, the knowledge of the Commission, as a general rule and certainly in the circumstances of this case, cannot excuse the failure to make full, true and plain disclosure of all material facts in a prospectus. In saying this, we express no opinion as to whether there was in fact sufficient disclosure in this case.
>
> Although aware in November 1997 of rumours casting doubts on the accuracy of the financial statements of YBM, Commission staff did not consider it had the necessary ground to deny a receipt for the prospectus. It would not have been appropriate in these circumstances for Commission staff to have attempted to delay the receipt, as suggested by Mr. Lenczner, by informal requests to those seeking to conclude the filing.

[592] Staff's role in receipting a prospectus must be considered in the context of the statutory framework. As such, it is not staff's duty to perform due diligence or duplicate the parties' due diligence in issuing a receipt. If anything, given the concerns around historical disclosure, money laundering, sales, customers and geographic segmentation, this might have been, on these grounds, sufficient to deny the receipt in the public interest. Nevertheless, despite the submissions by the respondents, we have found no evidence of any misrepresentation by staff or any lack of good faith. Staff did not want to impede a legitimate financing. They had considerable pressure from the issuer, the issuer's counsel and the underwriters to issue the receipt. This is evident because had the Crucible deal not proceeded, an $8 million fee would have to have been paid by YBM. On the other hand, staff wanted to ensure disclosure that was full, true and plain.

[593] As indicated previously, the respondents felt misled because they were not informed that staff had commenced an investigation earlier than September 24, 1997. A case assessment file was opened on June 6, 1997. At this time Enforcement was providing advice to Market Operations. On June 26, 1997, an e-mail was sent asking that the file be upgraded to an investigation. It is unclear what transpired after that, except that Mr. Lubic replaced Mr. Butler on the file on July 23, 1997.

[594] YBM was informed of the investigation on September 24, almost two months before the November 20 receipt. As such, it is entirely speculative as to what the Board may have done upon receiving that information earlier. Indeed, what they did after September 24 is a good indication of what they might have done in that previous period. Nevertheless the respondents knew of Enforcement's involvement in the prospectus review process, including following up on information regarding money laundering and the soft information provided to them by Enforcement on July 7, 1997.

[595] What is clear from this evidence is that if staff had confirmed a criminal investigation, they would have advised YBM. If that had been the case, they likely would have insisted on its disclosure. This is clear from Kathy Soden's November 20 memo to file when she receipted the prospectus, in that she continued to harbour serious concerns regarding the company. What was more likely is that no receipt would have been issued.

[596] As indicated previously, this is a highly exceptional case. Staff submit that, if the director of the Commission had denied a receipt to YBM for its 1997 prospectus, the issuer and other affected parties would have had a right to a hearing, to which all the rules of procedural fairness and natural justice would apply, and at which staff would have had to justify their decision to deny the receipt on the basis of certain evidence. In order to endorse the decision to deny a receipt, the Commission would have had to find that there was sufficient evidence upon which the decision to deny could be made.

[597] In the circumstances of this case, staff submit that they would have been unable to present any evidence in support of the denial of a receipt in November 1997 because that evidence could not be used by staff. That evidence could not be disclosed, either because it came from a confidential informant (who enjoys an absolute privilege which cannot be waived by law enforcement officials) or because it may have jeopardized ongoing activities by other law enforcement agencies (a result protected against by virtue of the operation of the law of public interest immunity). In other words, in declining to use the evidence in question, again, staff was honouring its public law duties.

[598] There is little doubt that Ms. Soden was confronted by a difficult legal issue at the time. In her own words:

> In discussions with Enforcement, it seems to me that the only way to get the witness testimony to a Commission panel was through an in camera, ex-parte proceeding since the witness needed to maintain confidentiality.

[599] The advice given to Ms. Soden, at the most senior level of the Commission, was that this approach was untenable on fairness principles. Indeed it appears that Enforcement was more concerned with the company's historical disclosure record and certain correspondence than with the recent confidential information received by staff.

[600] We do not intend to review the decision to receipt the prospectus. That is not the purpose of this hearing. However, we have some comments with respect to the process.

[601] The fundamental concern was one of fairness. How could the issuer persuade the Commission to make a favourable decision when it would not have access to the confidential information? Subsection 61(4) provides that where a prospectus raises a material question involving the public interest that might result in the director refusing a receipt, the director may refer the question to the Commission for determination. This hearing is *inter partes* and as such can be utilized in appropriate cases. Subsection 61(1) provides for no receipt if it is not in the public interest to issue a receipt.

[602] The denial of a receipt does not invoke the same broad principles as the right to make full answer and defence in a section 127 case. Both require devotion to the principles of fairness, but the statutory framework within which fairness is to operate must be considered, and while rare, a limit must necessarily be implied. What is essential is substantial fairness to the company which may be accomplished by providing as much information as possible without necessarily disclosing the precise information or sources. This balances the requirements to the company of fairness without adversely affecting the scheme of the Act, which has as a paramount objective investor protection. In this regard, staff's concerns could be disclosed without necessarily revealing confidential sources or putting informants in peril and therefore providing the issuer with an opportunity to contradict the information. Not unlike the public interest, there can be no rigid rules as to the meaning, scope or extent of fairness in a particular context; *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817 at para. 21. That normally depends on the subject matter. There must be provided that measure of fairness which Lord Reid described in *Ridge v. Baldwin*, [1964] A.C. 40 at 65, as "insusceptible of exact definition, but what a reasonable [person] would regard as fair procedure in particular circumstances." In summary, the clear and cogent evidence required to make a finding that a respondent has breached the Act is not the same as the evidence required on a review of a decision to deny a receipt for a prospectus. In either case there is nothing to prevent the decisions from being appealed under subsection 9(1) of the Act to the courts.

Costs

[603] The Commission has clear statutory authority to order costs under section 127.1 of the Act. These costs may include the costs of the investigation and the costs of or related to the hearing that are incurred by or on behalf of the Commission. For greater certainty the costs the Commission may order a person or company to pay include, but are not limited to: costs incurred

in respect of services provided under sections 5, 11 and 12 of the Act; costs of matters preliminary to the hearing; costs for time spent by the Commission or staff of the Commission; any fee paid to a witness; and costs of legal services provided to the Commission. Costs may be ordered when a person or company has not complied with Ontario securities law or has not acted in the public interest.

[604] It appears that the Act allows for the payment of costs to a full indemnity. Staff are asking for $2,454,874.93. While they submit that this is not full indemnity, it is a substantial amount. While staff have allocated costs to each respondent in this proceeding with the exception of YBM, Bogatin and Fisherman, the amounts requested are very similar, ranging from $242,229.90 to $307,599.93. The difference flows primarily from costs associated with preliminary matters.

[605] It is clear that costs are not intended to be punitive but rather are intended to indemnify the Commission for fees and expenses incurred. Mitchell submits that the Commission does not have jurisdiction to order costs of the proceeding and costs of the investigation because the facts at issue in the hearing took place before the amendment to the Act, and that the Notice of Hearing was issued before the amendment to the Act. In our opinion, the application of section 127.1 does not attract the presumption against retrospectivity. In general terms, costs are procedural in nature and the respondents were provided with notice. *Shea v. Miller*, [1971] 1 O.R. 199 at 203 (C.A.); *Re Tindall* (2000), 23 O.S.C.B. 6889.

[606] Staff have provided the Commission with sufficient quantifiable information to serve as a useful basis to assess costs. We are mindful that to defend oneself is not reprehensible and unless that defence is in some way or another abusive of the hearing process it should not be a factor in the costs award. Secondly, we do not believe that a costs order should vary according to the degree of misconduct of a party. However, in the costs order it may be appropriate to reflect the greater investigative/hearing costs that the specific conduct of a respondent tends to require in the case.

[607] Mitchell contends that staff's allegations are akin to allegations of fraud. There would be costs consequences if that was the case. We are of the opinion that there are no allegations akin to fraud in this matter. While there are forceful submissions regarding credibility, that does not mean that fraud is alleged.

[608] There is no question, as indicated previously, that this hearing was adversarial and virtually indistinguishable from a trial. We are most concerned with respect to the amount of time that this hearing took. We recognize its complexity and the number of respondents in the case. It is unfortunate that there appeared to be few agreements or concessions by either staff or the respondents to reduce the length of the hearing. Finally, we agree that "[i]n addition to success or failure, a discipline committee awarding costs must consider such factors as the seriousness of the charges, the conduct of the parties and the reasonableness of the amounts"; *K.C. v. College of Physical Therapists (Alta.)* (1999), 214 A.R. 28 at para. 94 (C.A.).

[609] The Commission has recently adopted a schedule of hourly rates for various members of Enforcement in respect of costs awards to be made under section 127.1. The schedule is: $175 for case assessment employees; $185 for investigation employees; and $205 for litigation employees. These figures are designed to capture fixed costs, staff salaries and a portion of corporate services. The Commission considered and approved this new costs grid in *Donnini*.

[610] Given the number of respondents in this proceeding, staff apply the following principles in calculating costs. They submit that they are not seeking full indemnity but are seeking reasonable and conservative expenses. The following principles are used: costs are calculated on an eight-hour day; no costs for non-counsel members of staff; an estimated contribution for each respondent on the preliminary motions depending on participation; costs of the investigation are calculated on a 1/13 share; costs of the hearing are calculated on a 1/10 share before the Wilder settlement and 1/9 after the Wilder settlement; and disbursements are calculated on a 1/10 share. Moreover costs are sought for five time periods, discussed below.

[611] Staff have requested costs relative to the following time periods and categories:

(a) The Investigation – September 1997 to November 1, 1999

Staff seek costs related to document gathering and review, interviewing witnesses, drafting the Notice of Hearing and allegations and making disclosure. The amount sought is $563,750 with each respondent paying $43,365.39.

(b) Preliminary Matters – November 1, 1999 to May 6, 2001

The total costs of these matters are in the order of $42,100. Some of these matters were argued before the Commission and some before the Divisional Court. Staff contend that the costs of the attendances before the Divisional Court are in the interests of finality and efficiency. While we believe their objective is laudable, we have decided not to assess these costs herein.

(c) The Hearing – May 7, 2001 to August 31, 2002

This period covers the hearing on the merits. Staff seek more than $1.7 million for these costs including costs to outside counsel.

(d) The Written Submissions – September 1, 2002 to November 15, 2002

Staff request $172,200 in this regard including reply.

(e) Final Argument – November 18, 2002 – November 29, 2002

This figure has been calculated as simply the per diem share of $4,920 for closing argument by staff in attendance.

[612] The final area requested is disbursements in the amount of $302,355.36. This is a large number because over $213,000 was paid as witness costs associated with the Fairfax evidence. About half of that was paid to Fairfax's outside counsel and the other to fees and expenses paid in respect of Ginsburg of Fairfax. We will consider these amounts due to the unusual circumstances of this case. We would not, in the normal course, expect to recover legal fees from the respondents paid to a firm acting for a witness in proceedings before the Commission. It should be noted that in the Wilder settlement, Wilder paid $250,000 for Commission investigation and hearing costs.

ORDERS IN THE PUBLIC INTEREST

[613] In our opinion, it is in the public interest to make the following orders, effective July 2, 2003, under sections 127 and 127.1 of the Act.

YBM Magnex International Inc.

[614] An order pursuant to paragraph 2 of subsection 127(1) that trading in any securities of YBM Magnex International Inc. cease permanently.

Bogatin

[615] An order pursuant to paragraph 8 of subsection 127(1) that Bogatin be permanently prohibited from becoming or acting as director or officer of any issuer.

Fisherman

[616] An order pursuant to paragraph 8 of subsection 127(1) that Fisherman be permanently prohibited from becoming or acting as director or officer of any issuer.

Mitchell

[617] An order that:

(a) pursuant to paragraph 7 of subsection 127(1), Mitchell resign any positions that he holds as a director or officer of a reporting issuer;

(b) pursuant to paragraph 8 of subsection 127(1), Mitchell be prohibited from becoming or acting as a director or officer of any reporting issuer for five years from the date the order takes effect; and

(c) pursuant to subsections 1 and 2 of section 127.1, Mitchell pay investigation and hearing costs in the amount of $250,000.

Davies

[618] An order that:

(a) pursuant to paragraph 7 of subsection 127(1), Davies resign any positions that he holds as a director or officer of a reporting issuer;

(b) pursuant to paragraph 8 of subsection 127(1), Davies be prohibited from becoming or acting as a director or officer of any reporting issuer for three years from the date the order takes effect; and

(c) pursuant to subsections 1 and 2 of section 127.1, Davies pay investigation and hearing costs in the amount of $75,000.

Antes

[619] An order that:

(a) pursuant to paragraph 7 of subsection 127(1), Antes resign any positions that he holds as a director or officer of a reporting issuer;

(b) pursuant to paragraph 8 of subsection 127(1), Antes be prohibited from becoming or acting as a director or officer of any reporting issuer for three years from the date the order takes effect; and

(c) pursuant to subsections 1 and 2 of section 127.1, Antes pay investigation and hearing costs in the amount of $75,000.

National Bank Financial Corp.

[620] An order pursuant to subsections 1 and 2 of section 127.1 that National Bank Financial Corp. pay investigation and hearing costs in the amount of $400,000.

Griffiths McBurney & Partners

[621] An order that:

(a) pursuant to paragraph 4 of subsection 127(1), Griffiths McBurney & Partners submit to a review of its practices and procedures as an underwriter by an independent person approved by staff of the Commission and institute any changes recommended by that person; and

(b) pursuant to subsections 1 and 2 of section 127.1, Griffiths McBurney & Partners pay investigation and hearing costs in the amount of $400,000.

June 27, 2003.

"Howard I. Wetston" "Derek Brown" "Robert W. Davis"

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

AND

YBM MAGNEX INTERNATIONAL INC.
HARRY W. ANTES
JACOB G. BOGATIN
KENNETH E. DAVIES
IGOR FISHERMAN
DANIEL E. GATTI
FRANK S. GREENWALD
R. OWEN MITCHELL
DAVID R. PETERSON
MICHAEL D. SCHMIDT
LAWRENCE D. WILDER
GRIFFITHS MCBURNEY & PARTNERS
NATIONAL BANK FINANCIAL CORP.
(formerly known as First Marathon Securities Limited)

Panel: Howard I. Wetston, Q.C. - Vice-Chair (Chair of the Panel)
Derek Brown - Commissioner
Robert W. Davis, FCA - Commissioner

[1] This case raises serious questions with respect to the meaning of materiality in the prospectus and timely disclosure provisions of the *Securities Act* (the "Act"). A basic tenet of securities law is that disclosure is generally limited to *material* matters. Confronted by the dilemma of what should be disclosed to the public, the respondents relied on the concept of materiality as the cornerstone for disclosure. YBM's key disclosure documents did not, we find, contain full, true and plain disclosure of all material facts. YBM also failed to disclose a material change in its affairs forthwith. While disclosing good news with little hesitation, its practice was to restrict the disclosure of bad news.

[2] YBM's disclosure leads the reader to believe that the risks faced by YBM were no greater than the inherent risks faced by any company operating in Eastern Europe at that time. We find this to be incorrect. YBM was subject to company-specific risks. An investor in YBM's securities had the right to know what specific risks were presently threatening the issuer. Disclosure continues as the main principle for protecting investors, ensuring fairness in the trading markets and enhancing investor trust.

[3] Despite a hearing which took over 124 hearing days to complete, this case is not about organized crime, money laundering or whether the respondents believed YBM was not a real company. It is about the disclosure of risk. Materiality is reinforced as the standard for such disclosure in securities markets by taking into account the considerations associated with the exercise of judgement and reasonable diligence.

First Allegation

[4] Staff's first allegation is that YBM Magnex International Inc. ("YBM") filed a preliminary prospectus dated May 30, 1997 and a final prospectus dated November 17, 1997 that failed to contain full, true and plain disclosure of all material facts relating to the securities offered. Specifically, staff allege that YBM failed to disclose the mandate, information obtained by and findings of a special committee of its board of directors (the "Special Committee"). The respondent directors and officers are alleged to have authorized, permitted or acquiesced in YBM's failure to make full, true and plain disclosure. The respondent underwriters are alleged to have signed certificates to prospectuses which, to the best of their knowledge, information, and belief did not contain full, true and plain disclosure.

[5] The essence of what is engaged in this case is the disclosure of risk. Were the risks faced by YBM fully, truly and plainly disclosed as simply general business risks associated with activities in Eastern Europe? Were the concerns simply those expressed by the media and government authorities generally concerning companies doing business in Eastern Europe and, particularly, Russia? If not, was YBM uniquely subject to material risks that were not disclosed?

[6] Disclosure in securities markets encourages investing and therefore growth. Disclosure protects investors, aids in ensuring that securities markets operate in a free and open manner and ensures a security will nearly correspond to its actual value. Too much disclosure or information overload can be counter-productive. The boundaries are identified by the concept of "material facts". The definition appears straightforward but its assessment is nuanced.

[7] The materiality assessment in this case involves a consideration of whether material facts respecting the mandate, information obtained by and findings of the Special Committee were omitted from the disclosure documents. Would the disclosure of such information translate into market gains or losses? In our opinion, the critical question is whether certain undisclosed facts contained in the Special Committee Report would have revealed that YBM was, at the time, exposed to risks that would reasonably be expected to have a significant effect on the value of YBM's securities if disclosed.

[8] One should not lose sight of the forest for the trees by assessing the materiality of individual facts piecemeal when the broader factual context suggests a risk faced by an issuer. Some facts may be material on their own, while others may only be material in the context of other facts. Common sense must prevail; the broader factual context, or total mix, must not be overlooked when the risk facing the company is a current one.

[9] To summarise, the parts of the AIF and the rest of the prospectus that dealt with risks other than the "special" risks connected with Eastern Europe plainly disclosed both the existence of a risk and the factual basis for the risk. The sections on Eastern Europe were considerably more opaque in describing the precise risks facing YBM and the factual basis for those risks.

[10] We are of the opinion that, when taken together with other facts, there was sufficient confirmation of the aspects of the U.S. Government's investigation into YBM to assess whether these facts are material within the meaning of the Act.

[11] In our view, when the omissions which are material on their own and the omissions which in isolation may not appear to be material are considered together, the evidence indicates that YBM was subject to a set of risks specific to itself. These risks were not disclosed. The AIF told the investing public that the mandate, information obtained by and findings of the Special Committee were connected to only general concerns expressed in the media and by government authorities that related to all companies doing business in Eastern Europe.

[12] No doubt, the facts and information unearthed by the Special Committee presented YBM with very difficult disclosure decisions. Having chosen to proceed with a public offering, which required full, true and plain disclosure of all material facts, the obscure disclosure contained in the AIF was unsatisfactory. It did not provide investors with the opportunity to adequately inform themselves regarding the specific risks facing YBM.

[13] At a minimum, we believe some disclosure regarding what YBM knew about the U.S. investigation and less muddled disclosure regarding the purpose of the Special Committee would have better informed investors about the risks facing YBM.

[14] We recognize that in fostering high standards of fitness and business conduct we must not overly constrain the ability of the officers and directors to make rational business decisions and take measured risks. Risk taking is in the spirit of commercial activity and in the hope of greater economic reward. Risk taking is accommodated, not hampered, by care and diligence.

[15] We think it best to consider the reasonableness of the respondents' diligence and their belief from the perspective of a prudent person in the circumstances. This necessarily entails both objective and subjective considerations including their degree of participation, access to the information and skill.

[16] The Special Committee was independent of management, but was not without a manifest conflict of interest. Mitchell chaired the Special Committee and was very active as YBM's co-lead underwriter. Mitchell took a number of positive steps through his work as Chair of the Special Committee towards uncovering facts that could have had an adverse economic impact on the business. However, the risks at issue left little margin for error. Mitchell had considerable skill, access to the most information and extensive participation in the offering, the investigation of the facts, their materiality and their disclosure. He developed a belief in the legitimacy of the business. However, that did not in our view justify a reasonable basis for his belief that YBM made full, true and plain disclosure of all material facts. Consequently, a defence of due diligence is unavailable to him.

[17] Mitchell, as an underwriter, was largely compensated based upon a direct drive compensation scheme. Clearly, First Marathon and Mitchell would benefit if YBM completed the Crucible acquisition and the offering. Simply put, Mitchell was in a conflict of interest. We do not view the conflict of interest as a matter of intention or lack of good faith on his part. Rather, it compromised both his time and judgement.

[18] Davies was the only outside director who had a personal visit from the FBI in April 1996. Davies did not discuss this visit or the likely subject matter with the board or its counsel. Having heard his testimony, we are of the opinion that having regard to his skill and business experience, he failed to act prudently. We must consider his belief that there were no material facts omitted. A director's belief cannot be considered reasonable when he is aware of circumstances of such a character, so plain, so manifest, that a person with any degree of prudence would not have acted in this manner.

[19] Schmidt, unlike Mitchell and Davies, did not have any information that other directors did not have or did not share with the board. His belief in the legitimacy of the business and no managerial improprieties was not unreasonable. He admittedly

gave more weight to these factors than to other risks that YBM might face. He clearly could have done more on the Special Committee and he should have. Nevertheless, he had no knowledge of any facts not known to the directors generally and to Mitchell and Davies more specifically.

[20] While we believe Peterson could have done more, we have concluded that Peterson acted reasonably based on his involvement in the matter, his skill and his access to information in the circumstances. Accordingly, his due diligence defence is available to him, but just barely. We are of the view that Peterson brought a unique perspective to the board. His professional reputation as testified to by Mr. Michael Wilson, Mr. David Beatty and Mr. John Tory, and his experience in many other public company boards, was not in any way equalled by any other director. He had unique access to counsel to the Special Committee, whom he supported as counsel both to YBM and the Special Committee. He was appointed to add to the prestige and status of YBM. While Peterson meets the legal test of due diligence, the panel remains disappointed that he did not offer more insight and leadership to the board in these circumstances.

[21] Antes and Greenwald brought different skills to the YBM board than the other directors. Skill is that proficiency that comes from training and experience. They did not have the public company or business experience of other YBM directors. They relied on the members of the Special Committee to fulfill the duties assigned to them. For all their involvement in identifying and recommending the acquisition of Crucible, Antes and Greenwald had no material role in the financing. They relied on counsel for the drafting of disclosure that was to comply with Ontario securities law. Legal advice must be considered in the context in which it was given, and in this context, given their level of experience and skill, it was reasonable for Antes and Greenwald to rely on counsel. They did not participate in the drafting of the AIF, the preliminary prospectus or the final prospectus, and did not participate in any of the meetings with staff. Accordingly, their belief as to full, true and plain disclosure is justified in the circumstances of the case. Therefore, a due diligence defence is available to both Antes and Greenwald.

[22] Gatti had no experience in such matters. He relied on the Special Committee. He relied on the experience of underwriters and securities lawyers for the issuer and underwriters. While Gatti knew a great deal, the Special Committee knew more. The disclosure at issue was not financial disclosure. The Special Committee was independent of management. As such, his reliance was in good faith and honest in the circumstances. It was clear that Gatti was subordinate to Bogatin and to the decisions of Mitchell and Wilder. What should he have done? In our opinion, in such circumstances an engaged CFO should communicate directly with the board of directors of the company. In conclusion, we find that, at the relevant time, Gatti had a reasonable belief that the prospectus disclosure was true and that no material facts were omitted. In the circumstances of this case, we find that Gatti has proved his due diligence, but just barely.

[23] The reasonableness of First Marathon's belief can only be assessed in the context of the collective knowledge of First Marathon. National Bank acknowledges that Mitchell should not have been permitted to have been involved in investment banking functions in this financing. The investigation undertaken by the underwriters in this case was extensive. A significant shortcoming of Jones' investigation on behalf of First Marathon, however, was that he was unaware of all the facts that Mitchell was.

[24] In addition to these failures to communicate, the evidence suggests other shortcomings in First Marathon's due diligence process. Most notably, the process was not complete at the time First Marathon agreed that the preliminary prospectus could be filed. It is unclear how First Marathon could certify to the best of its knowledge, information and belief given the circumstances. We recognize the commercial reason for proceeding in this manner, but the desire to get on with the Crucible acquisition was simply too high-risk at this stage. First Marathon was a sophisticated and experienced underwriting firm. Unlike the officers and directors of YBM, conducting public offerings was First Marathon's lifeblood. Moreover, First Marathon, through Mitchell's involvement with YBM, was more knowledgeable than the typical underwriter. While clearly not the guarantor of full, true and plain disclosure, the underwriter is a gatekeeper. There can be little doubt that First Marathon exerted significant efforts to investigate YBM. We do not believe it sought to deliberately mislead investors. However, given its knowledge, access to information, involvement and skill, we do not find that National Bank has established that the belief that the prospectus contained full, true and plain disclosure was justified. Accordingly a defence of due diligence is unavailable.

[25] While GMP was less knowledgeable regarding the mandate, information obtained by and findings of the Special Committee, it was not completely uninformed. While not a guarantor of YBM's disclosure, McBurney understood that a diligent investment banker would be expected to "drill down" on sensitive issues and agreed that his experience as both a securities lawyer and investment banker would help him in identifying sensitive areas of a company's business. Why did GMP possess the limited knowledge that it did? It is clear that GMP relied upon Mitchell and First Marathon. McBurney knew that Mitchell's dual role had the potential for conflict. In principle, we see no reason why one member of an underwriting syndicate cannot or should not rely on another, but where a co-lead underwriter falls down in the conduct of its due diligence, the other co-lead may have to bear the risk of its reliance. We believe that GMP understood that its reliance on First Marathon was subject to certain risks given Mitchell's roles.

[26] There is no doubt that GMP, along with the other respondents, drew great comfort from the audit by Deloitte & Touche LLP (U.S.) ("D&T") which, by all accounts, was an exceptional measure to institute in the midst of a prospectus offering. However, GMP also relied on First Marathon's flawed investigation. GMP was fully aware of those risks. If it was not, it should

have been. GMP should have taken certain steps that would have been consistent with its role as a co-lead underwriter. Accordingly, we find that a defence of due diligence is unavailable to GMP.

[27] Mr. Greenspan, on behalf of GMP, seeks a stay of these proceedings pursuant to subsection 23(1) of the *Statutory Powers Procedure Act*, wherein a tribunal may make an order to prevent an abuse of process. The allegation is one of misconduct against staff counsel of the Commission. The facts herein fall short of the high standard for a finding of an abuse of process and a stay of proceedings. It is not the clearest of cases in which the fairness of this hearing or its integrity has been impaired. The request to stay is denied.

Second Allegation

[28] Staff's second allegation is that YBM failed to comply with its continuous disclosure obligations by not issuing forthwith a press release that disclosed the substance of a material change in the affairs of the company. Specifically, YBM should have disclosed that D&T had advised YBM on or before April 20, 1998 that it would not perform any further services for the company, including the rendering of an audit opinion in respect of the company's 1997 financial statements, until YBM had completed an in-depth forensic investigation that addressed specific concerns to D&T's satisfaction. The members of YBM's audit committee, its Chief Executive Officer, Chief Financial Officer and Chief Operating Officer are alleged to have authorized, permitted or acquiesced in YBM's failure to comply with those continuous disclosure obligations.

[29] An issuer is obliged to disclose material changes. That enhances the fairness of the market. The definition of material change acts as a brake on premature and undesirable disclosure. The concept of material change, like that of material fact, requires an exercise of judgement. If the decision is borderline, then the information should be considered material and disclosed. In our opinion, a supercritical interpretation of the meaning of material change does not support the goal of promoting disclosure or protecting the investing public; sections 1.1 and 2.1 of the Act.

[30] The requirement for an annual audit by an independent auditor is intended to provide the public with an independent and objective check on the fairness of the presentation of the company's financial position at fiscal year end. That information is not only crucial to investors in the secondary market but also to an issuer's ability to raise capital. An auditor, while not a guarantor of financial statement accuracy, assumes a special role vis-à-vis the public. There was no disagreement with respect to the crucial role of auditors in public companies.

[31] There was also no disagreement that YBM faced a serious risk if it did not file its audited financial statements by May 20, 1998 or obtain an exemption from the filing deadline. Failure to file on time or obtain an exemption would result in the issuance of a cease trade order against YBM's securities.

[32] The concerns presented to Mitchell and Antes on April 19 which led to the audit suspension and the request for a forensic investigation were extraordinary in nature. D&T was concerned about (a) the validity of transactions, (b) whether counterparties to YBM's agreements were legal entities, and (c) organized crime and the possible cover-up of the flow of money. Given the events of April 19 and 20, as informed by earlier events, the emergence by April 20 of the risk regarding the filing deadline and likely cease trade order constituted a material change. The press release was issued approximately 18 days after notice of the audit suspension was provided. This was not forthwith, particularly in light of the ten day period set out in subsection 75(2) of the Act.

[33] Although Mitchell believed it was possible that D&T would still render an audit opinion, this was highly improbable. D&T expressed doubt that the necessary investigation could be completed in time for the filing deadline. Its concerns were fundamental in nature and involved the validity of millions of dollars in transactions and the legal existence of counterparties to the transactions. His belief in these circumstances, including his reliance on legal advice, was not reasonable.

[34] As with Mitchell, we find that as of April 20, Antes ought to have known that YBM likely would not get its audit opinion in time and that, as a consequence, the shares of the company would be cease-traded. Regardless of his relative lack of experience in the capital markets, he was an active member of the Audit Committee, was knowledgeable of the issues and had reason to challenge the legal advice.

[35] We agree that Antes could not be expected to know the nuances between an audit, a high-risk audit and a forensic investigation. But that is not the issue. The issue is one of prudence and common sense, particularly where D&T did not want to deal with management. His belief had to be reasonable, and as with Mitchell, the basis for that belief was too slim. We find that Antes did not have a reasonable basis for believing on April 20 that a material change had not occurred.

Sanctions

[36] Section 127 is a regulatory provision, the purpose of which is neither remedial nor punitive. It is protective and preventative, intended to be exercised to prevent likely future harm to Ontario's capital markets. *Erikson* confirms the principle of both specific and general deterrence in section 127 public interest cases. General deterrence should deter others from similar

misconduct and hopefully improve business standards. The sanction imposed should reflect the Commission's assessment of the measures necessary to achieve these objectives. Moreover, there must be an appropriate relationship between the seriousness of the violation and the sanctions selected to achieve compliance with the law. We do not view the conduct of the individual respondents who answered the allegation as deceitful. However, while not deceitful, we have found that certain respondents, in the circumstances, failed to satisfy prospectus and timely disclosure duties under the Act.

[37] Sanctions are contained in the Commission's order dated June 27, 2003 effective July 2, 2003.

Chapter 4

Cease Trading Orders

4.1.1 Temporary, Extending & Rescinding Cease Trading Orders

Company Name	Date of Temporary Order	Date of Hearing	Date of Extending Order	Date of Lapse/Revoke
CA-Network Inc.	09 Jul 03	21 Jul 03		
Cardinal Factor Corporation	27 Jun 03	09 Jul 03	09 Jul 03	
Crystallex International Corporation	09 Jul 03	21 Jul 03		
Goran Capital Inc.	08 Jul 03	18 Jul 03		
Mobile Knowledge Inc.	03 Jul 03	15 Jul 03		
Namibian Minerals Corporation	27 Jun 03	09 Jul 03	09 Jul 03	
Neotel Inc.	23 Jun 03	04 Jul 03	04 Jul 03	
Pangeo Pharma Inc.	24 Jun 03	04 Jul 03	04 Jul 03	
Perial Ltd.	30 Jun 03	11 Jul 03		
Qnetix Inc.	26 Jun 03	08 Jul 03	08 Jul 03	
Spyn Corporation	09 Jul 03	21 Jul 03		
Telepanel Systems	25 Jun 03	07 Jul 03	07 Jul 03	
Westfort Energy Ltd.	08 Jul 03	18 Jul 03		
Windy Mountain Explorations Ltd.	26 Jun 03	08 Jul 03	08 Jul 03	
Zamora Gold Corp.	07 Jul 03	18 Jul 03		

4.2.1 Management & Insider Cease Trading Orders

Company Name	Date of Order or Temporary Order	Date of Hearing	Date of Extending Order	Date of Lapse/ Expire	Date of Issuer Temporary Order
Afton Food Group Ltd.	21 May 03	03 Jun 03	03 Jun 03		
Aspen Group Resources Corporation	21 May 03	03 Jun 03	03 Jun 03		
Devine Entertainment Corporation	22 May 03	04 Jun 03	04 Jun 03		
Finline Technologies Ltd.	21 May 03	03 Jun 03	03 Jun 03		
Hydromet Environmental Recovery Ltd.	21 May 03	03 Jun 03	03 Jun 03		

Company Name	Date of Order or Temporary Order	Date of Hearing	Date of Extending Order	Date of Lapse/ Expire	Date of Issuer Temporary Order
Polyphalt Inc.	21 May 03	03 Jun 03	03 Jun 03		
Ivernia West Inc.	22 May 03	04 Jun 03	04 Jun 03		

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 SecuritiesScource (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

Exempt Financings

The Ontario Securities Commission reminds issuers and other parties relying on exemptions that they are responsible for the completeness, accuracy, and timely filing of Forms 45-501F1 and 45-501F2, and any other relevant form, pursuant to section 27 of the *Securities Act* and OSC Rule 45-501 ("Exempt Distributions").

REPORTS OF TRADES SUBMITTED ON FORM 45-501F1

Transaction Date	Purchaser	Security	Total Purchase Price ($)	Number of Securities
18-Jun-2003 20-Jun-2003	Albert Richard;Lucinda Williams	Acuity Pooled Balanced Fund - Trust Units	305,000.00	20,124.00
20-Jun-2003	Julie Shams	Acuity Pooled Canadian Small Cap Fund - Trust Units	50,000.00	3,728.00
17-Jun-2003 26-Jun-2003	14 Purchasers	Acuity Pooled High Income Fund - Trust Units	1,860,355.06	119,775.00
23-Jun-2003	6 Purchasers	Adherex Technologies Inc. - Notes	260,000.00	408,879.00
26-Jun-2003	11 Purchasers	ADB Systems International Ltd. - Units	315,500.00	1,314,582.00
25-Jun-2003	N/A	Alta BioPharma Partners III, L.P. - N/A	15,000,000.00	0.00
18-Jul-2003 23-Jun-2003	11 Purchasers	Amerigo Resources Ltd. - Units	6,609,999.60	11,016,666.00
13-Jun-2003	3 Purchasers	Andromeda Media Capital Corporation - Units	7,000.00	7,000.00
01-Jun-2003	3 Purchasers	Ascendant Volatility Fund Limited Partnership - Limited Partnership Units	452,910.00	465.00
01-Mar-2003	Arrow Global Multi-Strategy Fund;Arrow Global Long/Short Fund	Ascendant Volatility Fund Limited Partnership - Limited Partnership Units	130,000.00	134.00
01-Feb-2003	KBSH Arrow Multi-Strategy Fund;KBSH Global Long/Short Fund	Ascendant Volatility Fund Limited Partnership - Limited Partnership Units	37,500.00	39.00
02-Jun-2003	3 Purchasers	Bactech Enviromet Corporation - Common Shares	168,000.00	420,000.00
20-Jun-2003	3 Purchasers	Bio-Diagnostics Inc. - Common Shares	35,250.00	11,750.00

25-Jun-2003	Jon Morda	Biogan International, Inc. - Special Warrants	10,000.00	333,333.00
01-Jul-2003	Silvercreek Mgmt Inc.	Cable Design Technologies, Corp - Convertible Debentures	1,352,600.00	4.00
23-Jun-2003	Ken Kukkee	Canadian Golden Dragon Resources Ltd. - Common Shares	2,800.00	20,000.00
12-Jun-2003	Leo J. Thibodeau	Cangold Limited - Common Shares	30,000.00	200,000.00
26-Jun-2003	20 Purchasers	Choice Resources Corp. - Special Warrants	1,793,556.00	1,793,556.00
26-Jun-2003	Allister P. Graham	CHX Technologies Inc. - Common Shares	10,000.00	2,500.00
02-Jul-2003	Credit Risk Advisors	Cincinnati Bell, Inc. - Notes	1,325,600.00	7.00
07-Jul-2003	11 Purchasers	Cranston, Gaskin, O'Reilly & Vernon - Units	339,865.07	29,037.00
07-Jul-2003	16 Purchasers	Cranston, Gaskin, O'Reilly & Vernon - Units	144,710.06	12,673.00
07-Jul-2003	40 Purchasers	Cranston, Gaskin, O'Reilly & Vernon - Units	587,623.44	51,419.00
20-Jun-2003	Jayvee & Co.;Frank A. Archibald	Crystallex International Corporation - Special Warrants	725,000.00	580,000.00
12-Jun-2003	5 Purchasers	Dexit Inc. - Common Shares	230,000.00	115,000.00
15-May-2003 16-May-2003	Guskan Inc.;MBHD Holdings Ltd.	Dynex Capital Limited Partnership - Units	400,000.00	400.00
25-Jun-2003	5 Purchasers	E3 Energy Inc. - Flow-Through Shares	3,948,000.00	3,760,000.00
19-Jun-2003	GWD Ventures Inc.;AIC Investment Services Inc.	Ecosynthetix Inc. - Common Shares	4,520,548.00	3,300,000.00
12-Jun-2003	6 Purchasers	Electra Gold Ltd. - Common Shares	144,364.00	144,364.00
26-Jun-2003	James Gutmann Limited	Etruscan Enterprises Ltd. - Common Shares	200,000.00	200,000.00
27-Jun-2003	6 Purchasers	Euston Capital Corp. - Common Shares	36,000.00	12,000.00
27-Jun-2003	Marc Freeman	Excalibur Limited Partnership - Limited Partnership Units	67,695.00	0.00
02-Jul-2003	3 Purchasers	Exploration Loubel Inc. - Common Shares	18,750.00	375,000.00
30-Jun-2003	Canadian Imperial Bank of Commerce	Falls Management Company - Notes	270,000,000.00	1.00

26-Jun-2003	38 Purchasers	First Capital Realty Inc. - Common Shares	48,137,500.00	3,414,000.00
27-Jun-2003	MFC Global Investments	FPL Energy American Wind, LLC - Bonds	26,926,000.00	7.00
28-Aug-2002	MacKinnon Transport Inc.	F.R. Insurance Ltd. - Common Shares	54,561.50	1.00
25-Jun-2003	Front Street Investment Management	General Minerals Corporation - Units	85,800.00	78,000.00
23-Jun-2003	Griffiths McBurney & Partners	Geomaque Explorations Ltd. - Option	0.00	2,611,806.00
13-Jun-2003	GGOF Canadian Value Fund	GGOF Canadian Large Cap Fund - Units	927,611.93	94,078.00
04-Jul-2003	3 Purchasers	Golden Goliath Resources Ltd. - Units	12,600.00	84,000.00
27-Jun-2003	27 Purchasers	Great Northern Exploration Ltd. - Common Shares	6,770,000.00	1,692,500.00
30-Jun-2003	Ian McKinnon	Gulf International Minerals Ltd. - Units	100,000.00	250,000.00
27-Jun-2003	4 Purchasers	Heritage Explorations Ltd. - Units	362,500.00	670,000.00
24-Jun-2003	5 Purchasers	High Point Resources Inc. - Common Shares	7,900,000.00	4,000,000.00
24-Jun-2003	24 Purchasers	High Point Resources Inc. - Subscription Receipts	11,872,000.00	7,420,000.00
18-Jun-2003	Lawrence & Co.	Highpine Oil & Gas Limited - Common Shares	612,765.96	200,000.00
24-Jul-2003	Cinram International Inc.	HSBC Short Term Investment Fund - Shares	3,000,000.00	298,864.00
30-Jun-2003	5 Purchasers	Jacuzzi Brands, Inc. - Notes	3,705,625.00	5.00
03-Jan-2001 31-Mar-2003	273 Purchasers	Janus American Equity Fund - Units	14,686,916.32	1,428,235.00
03-Jan-2001 31-Mar-2003	239 Purchasers	Janus Global Equity Fund - Units	7,103,709.05	731,643.00
26-Jun-2003	Canadian Medical Protective Association	J.P. Morgan European Pooled Corporate Finance Institutional Investors II LLC and J.P. Morgan European Direct Corporate Finance Institutional Investors II LLC - Limited Liability Interest	5,372,800.00	4,000,000.00
26-Jun-2003	Canadian Medical Protective Association	J.P. Morgan U.S. Pooled Corporate Finance Institutional Investors II LLC and J.P. Morgan U.S. Direct Corporate Finance Institutional Investors II LLC - Limited Liability Interest	29,550,400.00	22,000,000.00

24-Jun-2003	Menashy & McLean Partnership	Laurence Development LP - Limited Partnership Units	450,000.00	450,000.00
18-Jun-2003	CPP Investment Board Private Holdings Inc.	Lexington Capital Partners V, L.P. - Limited Partnership Units	25,000,000.00	25,000,000.00
03-Jan-2001 31-Mar.2001	441 Purchasers	Mackenzie Maxxum Canadian Balanced Fund - Units	99,609,570.01	10,013,291.00
03-Jan-2001 31-Mar-2003	383 Purchasers	Mackenzie Maxxum Canadian Equity Growth Fund - Units	37,694,262.74	3,389,977.00
03-Jan-2001 31-Mar-2003	495 Purchasers	Mackenzie Maxxum Dividend Fund - Units	105,518,931.59	8,189,481.00
04-Jan-2001 31-Mar-2003	412 Purchasers	Mackenzie Maxxum Income Fund - Units	174,728,313.29	31,446,183.00
04-Jan-2001 31-Mar-2001	356 Purchasers	Mackenzie Universal Canadian Resource Fund - Units	50,481,563.70	5,191,423.00
09-Jan-2001 31-Mar-2003	325 Purchasers	Mackenzie Universal Precious Metals Fund - Units	32,405,242.89	3,642,466.00
20-Jun-2003	Der Haroutiounian Manuel	Market Neutral Preservation Fund - Units	25,000.00	2,487.00
27-Jun-2003	23 Purchasers	McWatters Mining Inc. - Flow-Through Shares	14,020,000.00	82,750,000.00
19-Mar-2003	AGF Management Limited	Medicines Company, The - Common Shares	784,560.00	30,000.00
26-Jul-2003	24 Purchasers	Medicure Inc. - Common Shares	5,060,571.20	9,627,466.00
27-Jun-2003	3 Purchasers	Merisant Company, Inc. - Notes	1,357,400.00	29.00
27-Jun-2003	Sandra J. Romer	Microsource Online, Inc. - Common Shares	24,000.00	4,000.00
27-Jun-2003	John Haddath	Microsource Online, Inc. - Common Shares	1,800.00	300.00
27-Jun-2003	Erwin Speckert	Microsource Online, Inc. - Common Shares	18,000.00	3,000.00
02-Jul-2003	Sam Lombardo	Microsource Online, Inc. - Common Shares	1,200.00	200.00
02-Jul-2003	Christopher Gilbert Bowes	Microsource Online, Inc. - Common Shares	1,200.00	200.00
02-Jul-2003	Hon Wing Kam	Microsource Online, Inc. - Common Shares	3,000.00	500.00
23-Jun-2003	5 Purchasers	Milano Investments Limited Partnership - Limited Partnership Units	297,575.85	5.00
25-Jun-2003	5 Purchasers	Miramar Mining Corporation - Flow-Through Shares	7,297,499.00	3,683,500.00

12-Mar-2003	Beutel Goodman & Co.	Mitsubishi Tokyo Financial Group, Inc. - Shares	748,386.00	138,600.00
01-Jul-2003	Kilmer Sports Inc.;TD Capital Group Limited	MLG Holdings Limited - Common Shares	0.00	15.00
17-Jun-2003	9 Purchasers	Mustang Resoures Inc. - Common Shares	2,678,325.00	1,373,500.00
24-Jun-2003	Cesar Cesaratto	N-able Technologies Inc. - Shares	30,003.00	60,000.00
26-Jun-2003	Bob Donaldson	Navaho Networks Inc. - Common Shares	200,000.00	200,000.00
16-Jun-2003	Royal Bank Capital Partners Ltd. and Skypoint II;G.P. Co. Inc.	Nimcat Networks Incorporated - Convertible Debentures	500,000.00	500,000.00
16-Jun-2003	Royal Bank Capital Partners Ltd. and Skypoint II;G.P. Co. Inc.	Nimcat Networks Incorporated - Warrants	2.00	2.00
18-Jun-2003	Georgia Pacific Securities Corporation	Northern Financial Corporation - Common Shares	450,000.00	30,000,000.00
24-Jun-2003	Bobby Floros	Northern Orion Explorations Ltd. - Special Warrants	26,500.11	203,847.00
20-Jun-2003	Ennio D'Angela	Northern Orion Resources Inc. - Special Warrants	130,000.00	1,000,000.00
24-Jun-2003	Maxium Financial Services Inc.	OB Golf Management LP - Debentures	125,000.00	3.00
24-Jun-2003	3 Purchasers	Oleum West Capital L.P. - Units	112,000.00	112.00
19-Jun-2003	6 Purchasers	Oncolytics Biotech Inc. - Units	880,800.00	293,600.00
23-Jun-2003	21 Purchasers	Online Hearing.com Inc. - Convertible Debentures	101,500.00	101,500.00
24-Jun-2003	3 Purchasers	Pargas Enterprises Ltd - Special Warrants	60,000.00	600,000.00
04-Jun-2003	William G. Redman	Peritec BioSciences, Ltd. - Notes	100,000.00	100,000.00
27-Jun-2003	Gordon Reid	Photon Control Inc. - Common Shares	51,000.00	340,000.00
15-Apr-2003	BMO Nesbitt Burns Inc. and Polar Capital	Phototronics, Inc. - Notes	500,000.00	500,000.00
28-Apr-2003	Polar Securities and Salida Capital Corp.	Pride International, Inc. - Notes	3,000,000.00	3,000,000.00
30-Jun-2003	4 Purchasers	Promittere Asset Backed Securities Fund - Units	99,086.18	19,827.00
26-Jun-2003	MacKenzie Financial Corp.	PT Bank Mandiri (Persero) - Common Shares	108,736.00	1,000,000.00

25-Jun-2003	58 Purchasers	Queenstake Resources Ltd. - Units	40,683,100.00	81,017,524.00
28-Mar-2003	Credit Risk Advisors	Raytheon - Notes	732,443.00	500,000.00
30-May-2003	Absolute Return Concepts Fund	RBC Global Investment Management Inc. - Units	255,800.00	2,359.00
24-Jun-2003	Amir Shalaby	Recognia Inc. - Notes	10,000.00	1.00
25-Jun-2003	Denzil Doyle	Recognia Inc. - Notes	10,000.00	1.00
09-Apr-2003	Manufacturers Life Insurance and Credit Risk Advisors	Resolution Performance Products - Notes	500,000.00	500,000.00
04-Jun-2003	38 Purchasers	Second World Trader Inc. - Units	74,582.00	520.00
28-May-2003	Gary Clark	Solitaire Minerals Corp. - Units	4,000.00	40,000.00
30-May-2003	Dundee Securities Corporation	Supratek Pharma Inc. - Common Shares	0.00	30,000.00
26-Jun-2003	10 Purchasers	Systems Xcellence - Common Shares	3,989,999.60	3,069,231.00
18-Feb-2003	3 Purchasers	Teekay Shipping Corporation - Units	2,490,150.00	65,000.00
26-Jun-2003	28 Purchasers	Tm Bioscience Corporation - Units	5,054,544.00	22,975,200.00
01-Jul-2003	5 Purchasers	Toronto Maple Leafs Network Ltd. - Shares	1,000.00	1,000.00
01-Jul-2003	5 Purchasers	Toronto Raptors Network Ltd. - Shares	1,000.00	1,000.00
24-Jun-2003	12 Purchasers	Transition Therapeutics Inc. - Units	3,707,280.00	9,756,000.00
25-Jun-2003	William F. White	Tribute Minerals Inc. - Flow-Through Shares	132,000.00	440,000.00
26-Jun-2003	8 Purchasers	Trigence Corp. - Convertible Debentures	1,100,000.00	1,319,978.00
02-Jul-2003	Brad Wilson	True North Gems Inc. - Common Shares	92,000.00	25,000.00
26-Jun-2003	Canadian Dominion Resources LP XI	Twin Mining Corporation - Flow-Through Shares	999,999.84	3,571,428.00
02-May-2003	Trilon Bancorp Inc.	Viewest Corporation - N/A	35,000,000.00	35,000,000.00
18-Jun-2003	43 Purchasers	Viracocha Energy Inc. - Common Shares	11,999,997.10	5,578,394.00
27-Jun-2003	Export Development Canada;Acuity Investment Management Inc.	ViXS Systems Inc. - Preferred Shares	3,102,468.78	3,285,713.00

07-Mar-2003	4 Purchasers	Watson Pharmaceuticals, Inc. - Debentures	7,229,460.00	4,900,000.00
25-May-2003	Independent Order of Foresters and IOF Foesters	Wells Fargo & Company - Notes	24,516,085.00	16,500,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	45,043.20	16,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	600,482.16	213,300.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	140,760.00	50,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	281,520.00	100,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	281,520.00	100,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	84,456.00	30,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Common Shares	281,520.00	100,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Preferred Shares	232,980.32	82,758.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Preferred Shares	112,608.00	40,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Preferred Shares	57,711.60	20,500.00
24-Jun-2003	EdgStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Preferred Shares	232,980.32	82,758.00
24-Jun-2003	8 Purchasers	Workbrain Corporation - Preferred Shares	534,888.00	190,000.00
24-Jun-2003	EdgeStone Capital Venture Fund Nominee;Inc.	Workbrain Corporation - Preferred Shares	70,380.00	25,000.00
19-Jun-2003	Felicia Ross	ZI Corporation - Units	536,000.00	200,000.00

RESALE OF SECURITIES - (FORM 45-501F2)

Transaction Date	Seller	Security	Total Selling Price	Number of Securities
20-Jun-2003 20-Jun-2003	Investors Group Trust C., Ltd.	Pangeo Pharma Inc. - Common Shares		995,000.00
01-Apr-2003	Investors Group Trust Co. Ltd.	Stratos Global Corporation - Special Warrants		25,000.00

NOTICE OF INTENTION TO DISTRIBUTE SECURITIES AND ACCOMPANYING DECLARATION UNDER SECTION 2.8 OF MULTILATERAL INSTRUMENT 45-102 RESALE OF SECURITIES - FORM 45-102F3

Seller	Security	Number of Securities
Patrick A. Gouveia	Atlas Cold Storage Income Trust - Trust Units	604,972.00
Boston Pizza International Inc.	Boston Pizza Royalties Income Fund - Units	378,052.00
John Buhler	Buhler Industries Inc. - Common Shares	267,591.00
The Catherine and Maxwell Meighen Foundation	Canadian General Investments, Limited - Common Shares	0.00
Bernard C. Sherman	Cangene Corporation - Common Shares	3,564,800.00
Larry Melnick	Champion Natural Health.com Inc. - Shares	100,000.00
Larry Melnick	Champion Natural Health.com Inc. - Shares	19,765.00
CMG Reservoir Simulation Foundation	Computer Modelling Group Ltd. - Common Shares	235,600.00
CMG Reservoir Simulation Foundation	Computer Modelling Group Ltd. - Common Shares	251,500.00
James A. Estill	EMJ Data Systems Ltd. - Common Shares	59,200.00
Riad Chahayeb	Intelpro Media Group Inc. - Common Shares	925,000.00
Xenolith Gold Limited	Kookaburra Resources Ltd. - Common Shares	1,113,700.00
Susan M. S. Gastle	Microbix Biosystems Inc. - Common Shares	7,548.00
William J. Gastle	Microbix Biosystems Inc. - Common Shares	477,133.00
Steven Hulaj	Nextair Inc. - Common Shares	2,304,000.00
Michael R. Faye	Spectra Inc. - Common Shares	450,000.00
Michael A. Jenkins	The Jenex Corporation - Common Shares	330,000.00
The Catherine and Maxwell Meighen Foundation	Third Canadian General Investment Trust Limited - Common Shares	0.00

Chapter 11

IPOs, New Issues and Secondary Financings

Issuer Name:
Caisse centrale Desjardins
Principal Regulator - Quebec
Type and Date:
Preliminary Shelf Prospectus dated July 8, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
$2,000,000,000.00 - Medium Term Deposit Notes
Underwriter(s) or Distributor(s):
BMO Nesbitt Burns Inc.
Desjardins Securities Inc.
Scotia Capital Inc.
TD Securities Inc.
CIBC World Markets Inc.
RBC Dominion Securities Inc.
Merrill Lynch Canada Inc.
National Bank Financial Inc.
Laurentian Bank Securities Inc.
Casgrain & Company Ltd.
Deutsch Bank Securities Ltd.
Societe Generale Securities Inc.
Promoter(s):
-
Project #556075

Issuer Name:
Dynamic Canadian High Yield Bond Fund II
Principal Regulator - Ontario
Type and Date:
Preliminary Simplified Prospectus dated July 3, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
Series A and F Units
Underwriter(s) or Distributor(s):
Dynamic Mutual Funds Ltd.
Dynamic Mutual Funds Ltd.
Promoter(s):
Dynamic Mutual Funds Ltd.
Project #555896

Issuer Name:
Marquis RSP All Equity Portfolio
Marquis All Equity Portfolio
Marquis Growth Portfolio
Marquis Balanced Portfolio
Marquis Conservative Portfolio
Principal Regulator - Ontario
Type and Date:
Preliminary Simplified Prospectus dated July 3, 2003
Mutual Reliance Review System Receipt dated July 7, 2003
Offering Price and Description:
Series A Units
Underwriter(s) or Distributor(s):
Dynamic Mutual Funds Ltd.
Dynamic Mutual Funds Ltd.
Promoter(s):
Dynamic Mutual Funds Ltd.
Project #555589

Issuer Name:
MI Developments Inc.
Principal Regulator - Ontario
Type and Date:
Preliminary Prospectus dated July 8, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
Class A Subordinate Voting Shares and Class B Shares
Underwriter(s) or Distributor(s):
-
Promoter(s):
Magna International Inc.
Project #555965

Issuer Name:
Northern Orion Resources Inc.
Principal Regulator - British Columbia
Type and Date:
Preliminary Prospectus dated July 2, 2003
Mutual Reliance Review System Receipt dated July 3, 2003
Offering Price and Description:
$105,352,403.13 - 81,040,310 Common Shares and 40,520,155 Common Share Purchase Warrants issuable upon the exercise of 810,403,101 previously issued Special Warrants Price: $0.13 per Special Warrant
Underwriter(s) or Distributor(s):
Griffiths McBurney & Partners
BMO Nesbitt Burns Inc.
Canaccord Capital Corporation
Pacific International Securities Inc.
Yorkton Securities Inc.
Salman Partners Inc.
McFarlane Gordon Inc.
Promoter(s):
David Cohen
Robert Cross
Project #555136

Issuer Name:
Pan American Silver Corp.
Principal Regulator - British Columbia
Type and Date:
Preliminary Shelf Prospectus dated July 7, 2003
Mutual Reliance Review System Receipt dated July 7, 2003
Offering Price and Description:
US$100,000,000.00 - Common Shares Debt Securities Warrants
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #555834

Issuer Name:
Phoenix Matachewan Mines Inc.
Principal Regulator - Ontario
Type and Date:
Preliminary Prospectus dated July 2, 2003
Mutual Reliance Review System Receipt dated July 3, 2003
Offering Price and Description:
$595,000.00 - 4,125,000 Special Warrant Units and 1,825,000 Flow Through Special Warrants Price: $0.10 Per Special Warrant Unit and Flow-Through Special Warrant
Underwriter(s) or Distributor(s):
-
Promoter(s):
Robin B. Dow
Project #555147

Issuer Name:
Royal LePage Franchise Services Fund
Principal Regulator - Ontario
Type and Date:
Preliminary Prospectus dated July 7, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
$ * - * Units Price: $10.00 per Unit
Underwriter(s) or Distributor(s):
CIBC World Markets Inc.
RBC Dominion Securities Inc.
Trilon Securities Corporation
BMO Nesbitt Burns Inc.
Scotia Capital Inc.
TD Securities Inc.
Promoter(s):
Royal LePage Limited
Project #555961

Issuer Name:
Select 50 S-1 Income Trust
Principal Regulator - Ontario
Type and Date:
Amended Preliminary Prospectus dated July 3, 2003
Mutual Reliance Review System Receipt dated July 4, 2003
Offering Price and Description:
Maximum: $ * (* Units) Price: $10.00 per Unit
Minimum Purchase: 100 Units
Underwriter(s) or Distributor(s):
National Bank Financial Inc.
CIBC World Markets Inc.
RBC Dominion Securities Inc.
BMO Nesbitt Burns Inc.
Scotia Capital Inc.
TD Securities Inc.
Canaccord Capital Corporation
Dundee Securities Corporation
First Associates Investments Inc.
HSBC Securities (Canada) Inc.
Raymond James Ltd.
Promoter(s):
Sentry Select Capital Corp.
Project #554194

Issuer Name:
Trimark U.S. Small Companies Class
AIM American Mid Cap Growth Class
Trimark U.S. Companies Fund
Trimark Global Balanced Fund
Trimark Canadian Resources Fund
AIM AMERICAN AGGRESSIVE GROWTH FUND
AIM Canadian Premier Class
AIM CANADIAN PREMIER FUND
AIM CANADIAN BALANCED FUND
Trimark Select Canadian Growth Fund
Trimark Select Balanced Fund
Trimark Canadian Fund
Trimark Global Endeavour Fund
Principal Regulator - Ontario
Type and Date:
Preliminary Simplified Prospectus dated July 4, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
Series D Shares, Series D Units, Series I Shares and Series I Units
Underwriter(s) or Distributor(s):
AIM Funds Management Inc.
AIM Funds Management Inc.
AIM Funds Group Canada Inc.
Promoter(s):
AIM Funds Management Inc.
Project #555579

Issuer Name:
Ultima Energy Trust
Principal Regulator - Alberta
Type and Date:
Preliminary Short Form Prospectus dated July 7, 2003
Mutual Reliance Review System Receipt dated July 7, 2003
Offering Price and Description:
$52,000,000.00 - (10,000,000 Trust Units) Price: $5.20 per Trust Unit
Underwriter(s) or Distributor(s):
BMO Nesbitt Burns Inc.
National Bank Financial Inc.
CIBC World Markets Inc.
Scotia Capital Inc.
TD Securities Inc.
Promoter(s):
-
Project #555912

Issuer Name:
Acclaim Energy Trust
Principal Regulator - Alberta
Type and Date:
Final Short Form Prospectus dated July 7, 2003
Mutual Reliance Review System Receipt dated July 7, 2003
Offering Price and Description:
$65,043,000 .00 - 5,940,000 Trust Units @$10.95 per Unit
Underwriter(s) or Distributor(s):
CIBC World Markets Inc.
BMO Nesbitt Burns Inc.
Scotia Capital Inc.
TD Securities Inc.
National Bank Financial Inc.
FirstEnergy Capital Corp.
Promoter(s):
-
Project #553561

Issuer Name:
AGF American Tactical Asset Allocation Fund
AGF Canadian Tactical Asset Allocation Fund
AGF Canadian Value Fund
AGF RSP American Tactical Asset Allocation Fund
AGF RSP World Balanced Fund
AGF World Balanced Fund
Principal Regulator - Ontario
Type and Date:
Amendment #2 dated June 30, 2003 to the Simplified Prospectus and Annual Information Form dated March 28, 2003
Mutual Reliance Review System Receipt dated July 4, 2003
Offering Price and Description:
-
Underwriter(s) or Distributor(s):
AGF Funds Inc.
Promoter(s):
-
Project #515043

Issuer Name:
Caldwell Balanced Fund
Caldwell Income Fund
Caldwell Canada Fund
Caldwell America Fund
Principal Regulator - Ontario
Type and Date:
Final Simplified Prospectus dated June 27, 2003
Mutual Reliance Review System Receipt dated July 2, 2003
Offering Price and Description:
Units @ Net Asset Value per Unit
Underwriter(s) or Distributor(s):
Caldwell Securities Ltd.
Caldwell Securities Ltd.
Promoter(s):
-
Project #543051

Issuer Name:
CHUM LIMITED
Principal Regulator - Ontario
Type and Date:
Final Short Form Prospectus dated July 8, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
$109,049,700.00 - 2,159,400 Non-Voting Class B Shares @ $50.50/Non-Voting Class B Share
Underwriter(s) or Distributor(s):
TD Securities Inc.
RBC Dominion Securities Inc.
BMO Nesbitt Burns Inc.
CIBC World Markets Inc.
National Bank Financial Inc.
Scotia Capital Inc.
Promoter(s):
-
Project #554193

Issuer Name:
FNX Mining Company Inc.
Principal Regulator - Ontario
Type and Date:
Final Short Form Prospectus dated July 2, 2003
Mutual Reliance Review System Receipt dated July 2, 2003
Offering Price and Description:
$40,054,500.00 - 6,210,000 Common Shares @ $6.45/Common Share
Underwriter(s) or Distributor(s):
BMO Nesbitt Burns Inc.
Griffiths McBurney & Partners
Dundee Securities Corporation
CIBC World Markets Inc.
Promoter(s):
-
Project #552259

Issuer Name:
Heritage Plans (formerly Heritage Scholarship Trust Plans)
Principal Regulator - Ontario
Type and Date:
Final Prospectus dated June 25, 2003
Mutual Reliance Review System Receipt dated July 2, 2003
Offering Price and Description:
-
Underwriter(s) or Distributor(s):
-
Promoter(s):
-
Project #543211

Issuer Name:
Noranda Income Fund
Principal Regulator - Ontario
Type and Date:
Final Short Form Prospectus dated July 7, 2003
Mutual Reliance Review System Receipt dated July 8, 2003
Offering Price and Description:
$118,051,265.00 - 11,984,900 Class A Priority Units @ $9.85/Unit
Underwriter(s) or Distributor(s):
CIBC World Markets Inc.
Scotia Capital Inc.
RBC Dominion Securities Inc.
TD Securities Inc.
BMO Nesbitt Burns Inc.
National Bank Financial Inc.
Trilon Securities Corporation
HSBC Securities (Canada) Inc.
Promoter(s):
Noranda Inc.
Project #554213

Issuer Name:
Rogers Sugar Income Fund
Principal Regulator - British Columbia
Type and Date:
Final Short Form Prospectus dated July 4, 2003
Mutual Reliance Review System Receipt dated July 4, 2003
Offering Price and Description:
$111,698,022.00 - 27,243,240 Trust Units @ $4.10/Trust Unit
Underwriter(s) or Distributor(s):
Scotia Capital Inc.
RBC Dominion Securities Inc.
National Bank Financial Inc.
TD Securities Inc.
Griffiths McBurney & Partners
Promoter(s):
-
Project #554332

Issuer Name:
TD Private International Equity Fund
Principal Regulator - Ontario
Type and Date:
Amendment #1 dated June 26, 2003 to the Simplified Prospectus and Annual Information Form dated April 4, 2003
Mutual Reliance Review System Receipt dated July 7, 2003
Offering Price and Description:
-
Underwriter(s) or Distributor(s):
-
Promoter(s):
TD Asset Management Inc.
Project #512419

Issuer Name:
The Newport Fixed Income Fund
The Newport Canadian Equity Fund
The Newport U.S. Equity Fund
The Newport International Equity Fund
The Newport Yield Fund
Principal Regulator - Ontario
Type and Date:
Final Simplified Prospectus dated June 30, 2003
Mutual Reliance Review System Receipt dated July 3, 2003
Offering Price and Description:
Trust Units
Underwriter(s) or Distributor(s):
The Newport Investment Counsel Inc.
Newport Investment Counsel Inc.
Promoter(s):
The Newport Investment Counsel Inc.
Project #546748

Issuer Name:
Transborder Capital Inc.
Principal Regulator - Alberta
Type and Date:
Final CPC Prospectus dated June 23, 2003
Mutual Reliance Review System Receipt dated July 4, 2003
Offering Price and Description:
$450,000.00 - 1,500,000 Common Shares
@$.30/Common Share
Underwriter(s) or Distributor(s):
Northern Securities Inc.
Promoter(s):
Richard W. DeVries
Byron M. Takaoka
Raymond P. Mack
Ralph G. Zielsdorf
Project #519369

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Chapter 12

Registrations

12.1.1 Registrants

Type	Company	Category of Registration	Effective Date
New Registration	Harris Alternatives LLC Attention: Roxanne Mary Martino Two N Lasalle Street Suite 500 Chicago IL 60602 USA	International Adviser	Jul 03/03
Change of Name	Worldsource Financial Management Inc./ Gestion Financiere Worldsource Inc. 625 Cochrane Drive Suite 700 Markham ON L3R 9R9	Mutual Fund Dealer Limited Market Dealer	Jul 07/03
Change of Name	Children's Education Funds Inc./ Fonds d'Etudes Pour Les Enfants Inc. 414 North Service Rd E Oakville ON L6H 5R2	Scholarship Plan Dealer	Jul 07/03
Suspension of Registration	The Delphi Corporation 22 St. Clair Avenue East Suite 1700 Toronto ON M4T 2S3	Limited Market Dealer	Jun 25/03
Suspension of Registration	Canadian Pacific Investment Management Limited 123 Front Street West Citibank Place Suite 1200 Toronto ON M5J 2M8	Limited Market Dealer Investment Counsel & Portfolio Manager	Jul 02/03

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Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 IDA By-law 29.6A Referral Arrangements – Withdrawal of By-law

INVESTMENT DEALERS ASSOCIATION OF CANADA – BY-LAW 29.6A REFERRAL ARRANGEMENTS – WITHDRAWAL OF BY-LAW

I. OVERVIEW

On February 2, 2001 the Ontario Securities Commission published for comment a proposed Association By-law that would permit Member firms that receive commissions on the sale of securities to pay referral fees to or split commissions with other Members or financial services entities. The By-law was subsequently withdrawn and then republished for comment on July 5, 2002. The revised By-law would have removed the restrictions as to the parties that could enter into referral arrangements.

II. WITHDRAWAL

The Association has informed the Canadian Securities Administrators that the Association has withdrawn the proposed By-law at this time in order to properly consider the comments received from the CSA on the revised By-law.

Questions may be referred to:

Michelle Alexander
Senior Legal and Policy Counsel
Investment Dealers Association of Canada
(416) 943 – 5885

July 11, 2003.

13.1.2 IDA – Confirmations for Managed Account Transactions

INVESTMENT DEALERS ASSOCIATION OF CANADA – CONFIRMATIONS FOR MANAGED ACCOUNT TRANSACTIONS

I OVERVIEW

A -- Current Rules

Regulation 200.1(h) requires that Members issue a confirmation of each trade in securities or commodity futures in a customer account and lists the information that must be included on the confirmation. It provides an exemption from doing so for accounts managed by external portfolio managers provided that the customer consents and a confirmation is sent to the external portfolio manager.

B -- The Issue

Holders of accounts managed by internal portfolio managers at Members have also raised objections to receiving confirmations for every transaction as they have passed the making of investment decisions to the Member. Such customers are interested in overall performance rather than in reviewing each individual investment decision.

C -- Objective

The objective of the amendment is to relieve members from sending and customers from having to deal with confirmations that the customers do not want.

D -- Effect of Proposed Rules

The proposed rule change will reduce the cost of administration of managed accounts at Members who offer managed accounts.

II -- DETAILED ANALYSIS

A -- Present Rules, Relevant History and Proposed Policy

The current provision regarding confirmations for managed accounts was passed by the Board of Directors and implemented in 1997. It responded to complaints from managed account customers that, having signed the management of their portfolios over to others, they had no use for and did not want to receive a separate confirmation of each trade, and would be satisfied with monthly statements showing all transactions.

The provision, as originally passed by the Board of Directors, did not restrict the exemption to externally managed accounts. That restriction was included at the insistence of those Canadian Securities Administrators whose approval of IDA By-laws and Regulations is required.

Members that offer managed accounts have continued to report that some clients complaint about receiving separate confirmations of every trade for their accounts.

In May, 2003 all members of the Canadian Securities Administrators except the Prince Edward Island Securities Office, to which application was not made, granted to an applicant Member an exemption from providing confirmations to managed account customers in an internally managed program, subject to certain conditions. The Member has sought an exemption from By-law 200.1(h) for the accounts in the program.

This by-law amendment will extend that exemption to all Members offering managed accounts, subject to the same conditions and the conditions already included in the exemption for externally managed accounts.

These conditions are:

1. The client must consent to not receiving confirmations and must be able to terminate that consent by notice in writing. The firm must resume sending confirmations on receipt of the notice for trades the following day. These provisions are unchanged from the current provision.

2. The member must send to the client a monthly statement in compliance with Regulation 200.1(c). The monthly statement must contain all of the information for each trade that is required on the confirmation except:

   a. The day and exchange on which the trade took place;

   b. The fee or other charge, if any, levied by any securities regulatory authority in connection with the trade.

      This is largely an outdated provision as no securities regulatory authorities now charge per trade fees.

   c. The name of the salesman, if any, in the transactions.

      This information is also irrelevant as the trading decisions are made by the portfolio manager(s) or associate portfolio manager(s) responsible for the account or the account program so there is no salesman in the transaction.

   d. The name of the dealer, if any, used by the Member as its agent to effect the trade.

   e. For a stock exchange trade, the name of the counterparty.

3. There are two items of information that are found on confirmation but not normally on monthly statements and that will have to be included on the monthly statements. These are:

   a. The commission.

      This requirement will be irrelevant to many managed account programs, which charge management fees rather than commissions.

   b. Whether the Member acted as principal or agent in the transaction.

The proposed revision also removes the requirement to send a confirmation to the manager of an externally managed account, to make the requirements consistent as between internally and externally managed accounts. The external manager acts under contract to the Member, which bears the responsibility for the suitability of trading in such accounts.

B -- Issues and Alternatives Considered

No alternatives were considered.

C -- Comparison with Similar Provisions

Provincial securities legislation such as Section 36 of the *Securities Act (Ontario)* requires that registered dealers send a confirmation of each trade to the customer. No similar provision applies to registered portfolio managers, who also manage customer accounts. Under Section 123 of Ontario Regulation 1015, registered portfolio managers are required to send quarterly statements of the portfolio.

D -- Systems Impact of Rule

The rule will have systems implications for some Members in that it will require that additional disclosures or information be added to the monthly statements for those clients that do not receive confirmations.

Members will also have to obtain and document consent from clients that do not want to receive confirmations.

Members' choosing to make use of the exemption will be required to file with the Association consent forms and any other relevant revised forms and confirm their ability to provide the additional information required on monthly statements for clients to whom they do not send confirmations.

E -- Best Interests of the Capital Markets

The Board has determined that the public interest Rule is not detrimental to the best interests of the capital markets.

F -- Public Interest Objective

The proposal is designed to eliminate unnecessary paperwork which is unwanted by customers.

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

III -- COMMENTARY

A -- Filing in Other Jurisdictions

These proposed amendments will be filed for approval in Alberta, British Columbia and Ontario and will be filed for information in Nova Scotia and Saskatchewan.

B – Effectiveness

The revision will eliminate the Association requirement with regard to confirmations but does not address similar requirements under Provincial and Territorial securities legislation. Members seeking to use the exemption under the revised rule will have to apply for exemptions under securities legislation to the provinces and territories in which they are registered.

C -- Process

The issue was raised by Members offering managed accounts in response to client demand. It was reviewed and supported by the Joint Industry Compliance Group (now the Compliance and Legal Section of the Association) when the provision in its current form was first passed and was passed by the Board of Directors but subsequently changed because of opposition from certain of the Canadian Securities Administrators.

This issue has since been raised on several occasions by the Compliance and Legal Section, which has continued to support the extension of the exemption to internally managed accounts.

IV -- SOURCES

- IDA Rules
- Securities Acts
- Foreign Regulations
- etc.

V -- OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying (amendment/policy/regulation/by-law).

The Association has determined that the entry into force of the proposed (amendment/ policy/regulation/by-law) would be in the public interest. Comments are sought on the proposed (amendment/policy/regulation/by-law). Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Lawrence Boyce, Vice-President, Sales Compliance and Registration, Investment Dealers Association of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Lawrence Boyce
Vice-President
Sales Compliance and Registration
Investment Dealers Association of Canada
(416) 943-6903
lboyce@ida.ca

INVESTMENT DEALERS ASSOCIATION OF CANADA

CONFIRMATIONS FOR MANAGED ACCOUNT TRANSACTIONS

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada ("Association") makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association

1. Regulation 200.1(h) is amended as follows:

(h) copies of confirmations of all purchases and sales of securities and of all trades in commodity futures contracts and commodity futures contract options and copies of notices of all other debits and credits of money, securities, property, proceeds of loans and other items for the account of customers. Such written confirmations are required to be sent promptly to customers and shall set forth at least the day and the stock exchange or commodity futures exchange upon which the trade took place; the commission, if any, charged in respect of the trade; the fee or other charge, if any, levied by any securities regulatory authority in connection with the trade; the name of the salesman, if any, in the transaction; the name of the dealer, if any, used by the Member as its agent to effect the trade; and,

in the case of a trade in securities:

(1) the quantity and description of the security,

(2) the consideration,

(3) whether or not the person or company registered for trading acted as principal or agent,

(4) if acting as agent in a trade upon a stock exchange the name of the person or company from or to or through whom the security was bought or sold,

in the case of trades in commodity futures contracts:

(5) the commodity and quantity bought or sold,

(6) the price at which the contract was entered into,

(7) the delivery month and year,

in the case of trades in commodity futures contract options:

(8) the type and number of commodity futures contract options,

(9) the premium,

(10) the delivery month and year of the commodity futures contract that is the subject of the commodity futures contract option,

(11) the declaration date,

(12) the striking price;

and in the case of trades in mortgage-backed securities and subject to the proviso below:

(13) the original principal amount of the trade,

(14) the description of the security (including interest rate and maturity date),

(15) the remaining principal amount (RPA) factor,

(16) the purchase/sale price per $100 of original principal amount,

(17) the accrued interest,

(18) the total settlement amount,

(19) the settlement date,

provided that in the case of trades entered into from the third clearing day before month end to the fourth clearing day of the following month, inclusive, a preliminary confirmation shall be issued showing the trade date and the information in clauses (13), (14), (16) and (19) and indicating that the information in clauses (15), (17) and (18) cannot yet be determined and that a final confirmation will be issued as soon as such information is available. After the remaining principal amount factor for the security is available from the central payor and transfer agent, a final confirmation shall be issued including all of the information required above;

and in the case of stripped coupons and residual debt instruments:

(20) the yield thereon calculated on a semi-annual basis in a manner consistent with the yield calculation for the debt instrument which has been stripped,

(21) the yield thereon calculated on an annual basis in a manner consistent with the yield calculation for other debt securities which are commonly regarded as being competitive in the market with such coupons or residuals such as guaranteed investment certificates, bank deposit receipts and other indebtedness for which the term and interest rate is fixed.

Each such confirmation shall, in respect of transactions involving securities of the Member or a

related issuer of the Member, or in the course of a distribution to the public, securities of a connected issuer of the Member, state that the securities are securities of the Member, a related issuer of the Member or a connected issuer of the Member, as the case may be. For the purposes of this paragraph, the terms "related issuer" and "connected issuer" shall have the same meaning as ascribed to them in the Regulation made under the *Securities Act* (Ontario).

In the case of a Member controlled by or affiliated with a financial institution, the relationship between the Member and the financial institution shall be disclosed on each confirmation slip in connection with a trade in securities of a mutual fund sponsored by the financial institution or a corporation controlled by or affiliated with the financial institution.

The Association's policies with respect to electronic delivery of documents are set out in the applicable guideline.

Notwithstanding the provisions of this Regulation 200.1(h), a Member shall not be required to provide a confirmation to a client in respect of a trade in a managed account, provided that:

~~(i) the account is managed by a person other than the Member;~~

(i) ~~(ii)~~ prior to the trade, the client has consented in writing to waive the trade confirmation requirement;

(ii) The client may terminate the waiver in paragraph (i) by notice in writing. The termination notice shall be effective upon receipt of the written notice by the Member, for trades following the date of receipt.

~~(iii) a trade confirmation has been sent to the manager of the account; and~~

(iii~~v~~) the Member ~~has complied with the requirements of Regulation 200.1(c).~~ sends to the client a monthly statement that is in compliance with Regulation 200.1(c) and contains all of the information required to be contained in a confirmation under this Regulation 200.1(h) except:

(a) the day and the stock exchange or commodity futures exchange upon which the trade took place;

(b) the fee or other charge, if any, levied by any securities regulatory authority in connection with the trade;

(c) the name of the salesman, if any, in the transaction;

(d) the name of the dealer, if any, used by the Member as its agent to effect the trade; and,

(e) if acting as agent in a trade upon a stock exchange the name of the person or company from or to or through whom the security was bought or sold,

(iv) the Member maintains the information not required to be in the monthly statement pursuant to paragraph (iii) and discloses to the client on the monthly statement that that information will be provided to the client on request.

~~The client may terminate a waiver by notice in writing. The termination notice shall be effective upon receipt of the written notice by the Member, for trades following the date of receipt.~~

PASSED AND ENACTED by the Board of Directors this 22nd day of June, 2003, to be effective on a date to be determined by Association staff.

13.1.3 IDA – Know Your Client Requirements for Non-Individual Accounts

INVESTMENT DEALERS ASSOCIATION OF CANADA – KNOW YOUR CLIENT REQUIREMENTS FOR NON-INDIVIDUAL ACCOUNTS

I OVERVIEW

Current rules and industry practice require those authorized to trade on behalf of corporations, trusts and similar entities to be identified and documented. This proposal addresses the issue of the need to know the beneficial owners behind a corporate account. The highlights are:

- beneficial ownership information requirements refer to individuals, whether their ownership is direct or indirect as in ownership through other corporations or trusts;
- knowledge of beneficial ownership is not required for certain types of corporations and trusts;
- for new accounts of private corporations and similar entities, the identity of the beneficial owners must be obtained and verified;
- for new accounts of trusts the identities of the settlors and beneficiaries, where known, must be obtained and verified;
- where the identities of beneficial owners, settlors or beneficiaries, as appropriate, are not known for accounts open at the time the changes are implemented, Members will have one year after implementation to obtain the information.

An exemption for the accounts of financial institutions regulated in their home jurisdictions and their affiliates is provided. However, the Association is empowered to remove the exemption for financial institutions in jurisdictions found by the Government of Canada or international organizations of which Canada is a member to have deficient regulatory regimes.

An exemption is also provided for publicly traded corporations, trusts and similar entities and their affiliates.

It should be noted that this proposal represents a significant change from the current practice and requirements in the industry today.

A -- Current Rules

As stated previously, current rules and industry practice require that those authorized to trade on behalf of corporations be identified and documented. Current rules include:

- the "Know Your Client" rule as detailed in IDA Regulation 1300.1;
- the requirements under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act 2000* ("the Proceeds of Crime Act" and the regulations thereto; and
- in the case of accounts of United States citizens and accounts with holdings in United States issued securities, Sections 1441 and 1442 of the United States Internal Revenue Code.

B -- The Issue

In the British Columbia Securities Commission (the "BCSC") hearing regarding Jean-Claude Hauchecorne on December 17, 1999, the BCSC concluded that the Know Your Client rule requires a broker to look behind any corporate veil to determine who has a financial interest in the account. As a result of that hearing, the BCSC requested clarification from the Association on its Know Your Client requirements, in particular, when Members should attempt to determine the beneficial owners of corporate accounts and what compliance controls are necessary for these accounts.

Changes have recently been made to the 40 Recommendations of the Financial Action Task Force on Money Laundering ("FATF") regarding international efforts to combat the laundering of criminally-derived assets and funds used to finance terrorist activity. Recommendation #5 relating to customer due diligence is Attachment #1. Rule changes are required to assist the Association and its Members in contributing to these efforts.

C -- Objective

The objectives of the proposed amendments to IDA Regulation 1300.1 are to:

- ensure that Members obtain sufficient information with regard to the accounts of corporations, trusts and similar entities to enable them to properly monitor and supervise the activity in those accounts;
- ensure that information necessary to the proper regulation of securities markets is available to Canadian regulatory and self-regulatory agencies;
- make IDA Regulation 1300.1 consistent with international customer due diligence standards designed to combat money laundering and terrorist financing.

D -- Effect of Proposed Rules

The making of the proposed amendments may have a material effect of the costs of compliance in that the obtaining and recording of beneficial ownership information will take time and the verification of the identity of beneficial owners is likely to take time and, in some cases, involve extra costs. For example, where beneficial owners are not Canadian residents, Members may be required to obtain

professional assistance in their home jurisdiction(s) in order to verify their identities.

II -- DETAILED ANALYSIS

A -- Present Rules, Relevant History and Proposed Policy

Regulation 1300.1, often called the "Know Your Client rule" was primarily developed to ensure that registrants had sufficient knowledge of clients' affairs to determine if investments were suitable to their particular circumstances as well as assess their creditworthiness.

The purpose of this proposal is not to address all aspects of the Know Your Client rule obligations. It is inherent in many areas of law, the Association's By-laws and Regulations, the procedures of Member firms and in the training given to industry participants that an individual and a firm must know the client. The focus of this proposal is to clarify the requirements to identify the beneficial ownership of certain non-individual accounts.

In October, 2001 the Association passed changes to Regulations 1300.1 and 1300.2 which would have required Members to obtain beneficial owner information where possible, but would have permitted them to open accounts for which the information could not be obtained subject to special approval and account monitoring provisions. At that time, there were no similar provisions in the securities laws and regulations in other countries with well-developed capital markets, in Canadian anti-money laundering laws and regulations or in the international standard for anti-money laundering regimes, the FATF 40 Recommendations.

Shortly thereafter, a number of initiatives were undertaken that appeared likely to match and perhaps exceed the proposed amendments to Regulation 1300.1 and 1300.2. These included the publication in October 2001 of the Basel Committee for Banking Supervision report on "Customer Due Diligence for Banks" and the initiation of a review of the FATF 40 Recommendations, beginning with the publication in May 2002 of a "Consultation Paper" and request for comments.

In light of these international developments, the Association withdrew the previously proposed changes to Regulations 1300.1 and 1300.2 in order to ensure that the final changes were consistent with developing international standards. That development process was completed on June 20, 2003 with the publication by the FATF of its final revised 40 Recommendations.

The FATF Recommendations must be enacted into national laws and regulations and countries take different approaches to enacting the specifics. While it is not possible to determine when or how the changes to the Recommendations will be enacted in Canadian law, the proposed amendments to Regulation 1300.1 were drafted to be consistent with current approaches to anti-money laundering laws and regulations.

Subsections (b) to (d) contain requirements for the opening of accounts of corporations and similar entities, as follows:

- These sections relate to the accounts of corporations and similar entities. While there is no definition of similar entities, the sections apply to other non-individual customers such as partnerships.

- The requirements apply to the opening of the initial account of a corporation or similar entity. There is no requirement to re-obtain and re-verify the information if the customer opens another account or sub-account. However, Members remain under a general obligation under Regulation 1300.1 to make reasonable efforts to remain informed of the essential facts relative to every customer account, including material changes to beneficial ownership.

- Subsection (b)(i) requires that Members obtain specified information about individual beneficial owners of more than 10% of the customer. The 10% threshold is consistent with the percentage of voting rights ownership making an individual an insider under the *Canada Business Corporations Act* and related Regulations. The threshold is designed to eliminate any requirement to obtain and verify the identities of beneficial owners of non-material positions.

  The subsection also specifies that it applies to natural persons who are direct or indirect beneficial owners. Where such ownership is indirectly held through other corporations, members will be required to ascertain the identity of the ultimate individual (individuals) that is (are) the beneficial owner(s).

- Section (b)(ii) requires that Members verify the identity of beneficial owners. It adopts the language of rule adopted jointly by the United States Department of the Treasury and the Securities and Exchange Commission to meet the requirements of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, which requires that dealers undertake verification procedures enabling them to form a reasonable belief that they know the true identity of each customer. The section also requires that Member's verification procedures comply with applicable Canadian law.

  At present, Members are required under the Proceeds of Crime Act and Regulations to verify the identity of individual customers and those authorized to give instructions for non-individual accounts, using methods prescribed in the Regulations. The expansion of verification requirements to include beneficial owners will greatly increase the number of persons whose identity must be verified. There are other methods

than those prescribed under the current Proceeds of Crime Act and Regulations that may serve to give a Member a reasonable belief that the Member knows the identity of a beneficial owner, such as credit bureau checks, reliance on third party financial institutions or reference to publicly available databases and registries.

In the absence of certainty as to when the Regulations under the Proceeds of Crime Act may be amended to include verification requirements for beneficial owners and what methods may be available, the Association has adopted the more flexible standard in the draft Regulations under the USA Patriot Act, but included a requirement that the methods comply with Canadian law in the event that changes to the Regulations under the Proceeds of Crime Act do not expand the possible methods of verification. Members will have to consider whether to use the methods currently acceptable for individual accounts or risk using alternative methods that may not be acceptable when and if the Regulations under the Proceeds of Crime Act are amended to cover beneficial owners.

The Regulations under the Proceeds of Crime Act require that securities dealers verify client identity within six months of account opening. The FATF 40 Recommendations suggest that the verification be done as soon as possible. Verification requiring, for example, review of government-issued identity documents in the presence of the person may be difficult to arrange where there is any distance between the Member's offices and the beneficial owner's location. The proposed amendments to Regulation 1300 therefore adopt the more rigorous standard of requiring verification "as soon as practicable," while setting an upper limit of 6 months from account opening consistent with the current Proceeds of Crime Regulations.

- Subsections (c) and (d) exempt financial institutions and publicly traded corporations or similar entities from the beneficial ownership identification requirements. Those requirements are clearly inappropriate for public corporations, which are in any event subject to public disclosure requirements under securities laws. The exemption for financial institutions is based on those types of institutions being regulated, and specifies that the institutions must be subject to satisfactory regulatory regimes in their home countries. Subsection (d) gives the Association authority to state that that exemption is inapplicable to financial institutions located in certain countries. Examples of such countries could include, for example, countries on the list of non-cooperating countries and territories published by the FATF.

- Subsection (e) requires the identification and verification of the identity of settlors and beneficiaries of trusts. Similar provisions to the provisions for corporate accounts regarding the requirement being applicable to the opening of the customer's initial account, the 10% materiality threshold and the timelines for identity verification are included.

  The requirements extend to "known" beneficial owners "as far as is reasonable." Some types of trusts can have unknown beneficiaries such as unborn children. In some cases the exact level of interest of beneficiaries may be uncertain or subject to alteration.

- Subsection (f) exempts testamentary trusts, which are common and present little risk of abuse, and trusts whose units are publicly traded such as income trusts and real estate investment trusts.

- Subsection (g) prohibits a Member from opening an account for a corporation, trust or similar entity if the Member cannot obtain the required beneficial ownership information.

- Subsection (h) requires a Member to restrict an account to liquidating trades if it cannot verify the identity of beneficial owners within six months of the account opening.

- Subsections (i) through (k) prohibit dealings with shell banks. Shell banks are banks that have no physical presence in any country. They are chartered in some countries in which they are unregulated and are often forbidden to do domestic business, and have frequently been used as vehicles for fraud, money laundering and terrorist financing. However, some regulated international banks and similar institutions use shell banks in some jurisdictions as a vehicle to conduct legitimate business; therefore affiliates of banks subject to a suitable regulatory regime in their home jurisdiction are exempted.

- Sections (l) and (m) require that Members ascertain the identity of beneficial owners of existing corporate accounts and the settlors and beneficiaries of existing trust accounts where such accounts would be subject to the account opening provisions if opened after the proposed provisions come into effect.

  The revised FATF Recommendations consider requirements to ascertain and verify client identity for accounts opened prior to the implementation of these requirements and suggest that it be done using a risk-based approach.

  The Association believes that non-personal accounts do present a higher risk of misuse when the beneficial owners are not known and therefore that beneficial owners of existing corporate, trust and similar non-personal accounts should be identified. However, verification of the identity of

beneficial owners of existing accounts would be a very expensive and time-consuming undertaking of limited benefit. It would also go well beyond the Proceeds of Crime Regulations, which do not apply to accounts opened prior to their coming into effect. The provisions do not, therefore, require verification of the identity of beneficial owners of existing accounts.

A survey of Members conducted in 2002 found that in most cases Members already know the beneficial owners of most corporate accounts, albeit that in not all cases is this knowledge documented. Given the work that will be required to identify and correct gaps in their knowledge of beneficial owners, the provisions give Members a year to comply with sections (l) and (m). Like the requirements when Members are unable to verify the identity of the beneficial owners of corporate accounts, any accounts whose beneficial owners cannot be identified within the year must be restricted to liquidating trades until the required information is obtained.

- Subsection (n) contains recordkeeping provisions regarding identification and verification requirements under the proposed amendments. These are consistent with other recordkeeping provisions under IDA By-laws and Regulations in that they do not specify specific forms of recordkeeping, only that such records be accessible. This permits the maintenance of such records in paper or electronic form.

  The requirement to maintain the records for a minimum of five years after the closing of the account is consistent with the recordkeeping requirements under the Proceeds of Crime Regulations.

B -- Issues and Alternatives Considered

The purpose of determining the beneficial owners of a corporate account is to assist in the prevention of activities such as deceptive trading, manipulative trading, money laundering, terrorist financing, insider trading, tax evasion and the avoidance of requirements in securities legislation.

The standards of customer due diligence are evolving rapidly through the efforts of the FATF and the adoption of the FATF 40 Recommendations in different ways in different countries. The timing and exact terms of any adoption into Canadian laws and regulations of recent changes to the FATF 40 Recommendations has not yet been determined. Chief among these is the adoption of identity verification requirements with regard to beneficial owners.

The Association therefore considered whether to adopt any requirements now, or whether to restricted the proposed amendments to obtaining beneficial ownership information from those opening new corporate or trust accounts without requiring the verification of that information until such time as the latter is incorporated in the Proceeds of Crime Regulations.

The Association believes that the issue is important enough that immediate changes should be made, and that those changes should make its Regulations comply with the most advanced standards. The proposed amendments therefore include verification requirements while leaving greater flexibility as to method than is adopted in the current Proceeds of Crime Regulations for individual accounts and those holding authority to give instructions for corporate and other non-individual accounts.

The Association also considered making the beneficial ownership requirements applicable only to new customers. However, in keeping with its decision to make the proposals consistent with the most up-to-date international standards, and considering that corporate accounts of unknown ownership are at greater risk of use for improper purposes than accounts of individuals, the Association has adopted a requirement to obtain beneficial ownership information for existing accounts.

The Association also considered including identity verification requirements for existing accounts, but believes that that extra step would involve costs that would outweigh the benefits gained. Members are subject to requirements under the Proceeds of Crime Act and Regulations to identify and report activity suspicious of money laundering or terrorist financing. Where unusual activity is identified, Members may well be required to take additional customer due diligence steps in order to determine whether the activity is suspicious of money laundering or terrorist financing, which could include verification of beneficial ownership identity information. The Association believes that Members should be given the flexibility to identify those few accounts for which such additional steps need be taken.

C -- Comparison with Similar Provisions

There are no similar provisions in current Provincial or Federal legislation.

Provisions of the United States Securities and Exchange Commission and Department of the Treasury joint regulations under the USA Patriot Act, as described above, require that dealers develop a Customer Identification Program which includes the identification and verification of the identity of beneficial owners, but sets the general standard of being sufficient for the dealer to form a reasonable belief that it knows the customer's identity, while leaving specific methods to the discretion of the dealer using a risk-based approach.

D -- Systems Impact of Rule

There are no necessary impacts on systems. However, firms that maintain Know Your Client information electronically may have to alter those systems to include beneficial ownership information if they wish to maintain that information in the same form as they currently maintain client information. The costs of such alterations will vary

from Member to Member depending on their individual systems and development capacities.

E -- Best Interests of the Capital Markets

The Board has determined that the public interest Rule is not detrimental to the best interests of the capital markets.

F -- Public Interest Objective

The proposal is designed to ensure compliance with Canadian securities laws, prevent fraudulent and manipulative acts and practices; promote the protection of investors, just and equitable principles of trade and high standards of operations, business conduct and ethics; and generally promote public confidence by preventing those who would hide behind anonymous corporate vehicles in order to misuse the markets from doing so.

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

III -- COMMENTARY

A -- Filing in Other Jurisdictions

These proposed amendments will be filed for approval in Alberta, British Columbia and Ontario and will be filed for information in Nova Scotia and Saskatchewan.

B – Effectiveness

The proposed rules will be effective in that they will prohibit Members from opening non-individual accounts without obtaining and verifying the identity of the owners of such accounts.

C -- Process

The previous proposal, passed in October, 2001 and later withdrawn, was drafted by a special committee in response to the Hauchecorne decision of the British Columbia Securities Commission.

The proposal was subsequently revised to prohibit any opening of an account for a corporation or similar entity without obtaining beneficial ownership information and to include settlors and beneficiaries of trusts. This revision was reviewed by the original special committee, the Retail Sales Committee and the Compliance and Legal Section of the IDA.

Verification of identity requirements were subsequently added as a result of the changes to the FATF Recommendations and have been reviewed only by the Board of Directors in considering the proposed amendments.

IV -- SOURCES

References:

- IDA Regulation 1300
- Financial Action Task Force on Money Laundering, "The Forty Recommendations," June 20, 2003
- Unites States Securities and Exchange Commission, Release 34-47752, "Joint Final Rule: Customer Identification Programs for Broker-Dealers," April 29, 2003
- Basel Committee on Banking Supervision, "Customer Due Diligence for Banks," October, 2001
- *Proceeds of Crime (Money Laundering) and Terrorist Financing Act 2000; Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations 2002.*

V -- OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying regulation amendment.

The Association has determined that the entry into force of the proposed regulation would be in the public interest. Comments are sought on the proposed regulation. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Lawrence Boyce, Investment Dealers Association of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:
Lawrence Boyce
Vice President, Sales Compliance & Registration
Investment Dealers Association of Canada
(416) 943-6903
lboyce@ida.ca

IDA REGULATION 1300.1

IDENTITY AND CREDITWORTHINESS

(a) Each Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.

(b) When opening an initial account for a corporation or similar entity, the Member shall:

(i) ascertain the identity of any natural person who is the beneficial owner, directly or indirectly, of more than 10% of the corporation or similar entity, including the name, address, citizenship, occupation and employer of each such beneficial owner, and whether any such beneficial owner is an insider or controlling shareholder of a publicly traded corporation or similar entity; and

(ii) as soon as is practicable after opening the account, and in any case no later than six months after the opening of the account, verify the identity of each individual beneficial owner identified in (a) using such methods as enable the Member to form a reasonable belief that it knows the true identity of each individual and that are in compliance with any applicable legislation and regulations of the Government of Canada or any province.

(c) Subsection (b) does not apply to:

(i) a corporation or similar entity that is or is an affiliate of a bank, trust or loan company, credit union, caisse populaire, insurance company, mutual fund, mutual fund management company, pension fund, securities dealer or broker, investment manager or similar financial institution subject to a satisfactory regulatory regime in the country in which it is located

(ii) a corporation or similar entity whose securities are publicly traded or an affiliate thereof.

(d) The Association may, at its discretion, direct Members that the exemption in subsection (c) does not apply to some or all types of financial institutions located in a particular country.

(e) When opening an initial account for a trust, a Member shall:

(i) ascertain the identity of the settlor of the trust and, as far as is reasonable, of any known beneficiaries of more than 10% of the trust, including the name, address, citizenship, occupation and employer of each such settlor and beneficiary and whether is an insider or controlling shareholder of a publicly traded corporation or similar entity.

(ii) as soon as is practicable after opening the account, and in any case no later than six months after the opening of the account, verify the identity of each individual identified in (a) using such methods as enable the Member to form a reasonable belief that it knows the true identity of the customer and that are in compliance with any applicable legislation and regulations of the Government of Canada or any province.

(f) Subsection (e) does not apply to a testamentary trust or a trust whose units are publicly traded.

(g) If a Member, on inquiry, is unable to obtain the information required under subsections (b)(i) and (e)(i), the Member shall not open the account.

(h) If a Member in unable to verify the identities of individuals as required under subsections (b)(ii) and (e)(ii) within six months of opening the account, the Member shall restrict the account to liquidating trades and transfers, payments or deliveries out of funds or securities only until such time as the verification is completed.

(i) No Member shall open or maintain an account for a shell bank.

(j) For the purposes of section (i) a shell bank is a bank that does not have a physical presence in any country.

(k) Subsection (i) does not apply to a bank which is an affiliate of a bank, loan or trust company, credit union, other depository institution that maintains a physical presence in Canada or a foreign country in which the affiliated bank, loan or trust company, credit union, other depository institution is subject to supervision by a banking or similar regulatory authority.

(l) Any Member having an account for a corporation, similar entity or trust subject to the provisions of subsections (b) through (k) and which does not have the information required in those sections at the date of implementation of those subsections shall obtain the information required by those subsections within one year from date of implementation of subsections (b) through (k).

(m) If the Member does not or cannot obtain the information required under subsection (l) the Member shall restrict the account to liquidating

trades and transfers, payments or deliveries out of funds or securities until such time as the required information has been obtained.

(n) Members must maintain records of all information obtained and verification procedures conducted under this Regulation 1300.1 in a form accessible to the Association for a period of five years after the closing of the account to which they relate.

FATF RECOMMENDATION #5

CUSTOMER DUE DILIGENCE AND RECORD-KEEPING

5. Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names.

Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers, when:

- establishing business relations;
- carrying out occasional transactions: (i) above the applicable designated threshold; or (ii) that are wire transfers in the circumstances covered by the Interpretative Note to Special Recommendation VII;
- there is a suspicion of money laundering or terrorist financing; or
- the financial institution has doubts about the veracity or adequacy of previously obtained customer identification information.

The customer due diligence(CDD) measures to be taken are as follows:

a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information[3].

b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer.

c) Obtaining information on the purpose and intended nature of the business relationship.

d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

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[4] Reliable, independent source documents, data or information will hereafter be referred to as "identification data".

Financial institutions should apply each of the CDD measures under (a) to (d) above, but may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction. The measures that are taken should be consistent with any guidelines issued by competent authorities. For higher risk categories, financial institutions should perform enhanced due diligence. In certain circumstances, where there are low risks, countries may decide that financial institutions can apply reduced or simplified measures.

Financial institutions should verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers. Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering risks are effectively managed and where this is essential not to interrupt the normal conduct of business.

Where the financial institution is unable to comply with paragraphs (a) to (c) above, it should not open the account, commence business relations or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transactions report in relation to the customer.

These requirements should apply to all new customers, though financial institutions should also apply this Recommendation to existing customers on the basis of materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

13.1.4 MFDA Rule 1.1.6(b) – Introducing and Carrying Arrangement

MFDA – INTRODUCING AND CARRYING ARRANGEMENT [Rule 1.1.6(b)]

I. OVERVIEW

A. Current Rules

Rule 1.1.6(b)(viii) currently requires all introducing dealers to obtain an acknowledgement in writing from the client on account opening that the introducing dealer has advised the client of the introducing dealer's relationship to the carrying dealer and of the relationship between the client and the carrying dealer.

Rule 1.1.6(b)(ix) currently requires that the name and role of the carrying dealer appear, in at least equal size to that of the introducing dealer, on all contracts, account statements, confirmations and, in the case of a Level 1 introducing dealer, all client communications (as defined in Rule 2.8.1) and advertisements and sales communications (as defined in Rule 2.7.1) sent by either the introducing dealer or the carrying dealer in respect of accounts carried by the carrying dealer.

B. The Issue

The current disclosure requirements for introducing dealers set out under the Rule were drafted in contemplation of one type of introducing/carrying dealer arrangement involving Level 1 introducing dealers, where compliance responsibility is joint and several between the introducing and the carrying dealer. Carrying dealers for Level 2, 3 and 4 introducing dealers are responsible for compliance only for those specific functions they agree to perform for their introducing dealers. The current disclosure requirements do not accord with the degree of compliance responsibility assumed by carrying dealers in Level 2, 3 and 4 introducing/carrying dealer arrangements.

C. Objective

The objective of the proposed Rule amendments is to ensure that clients are informed about the role and identity of the carrying dealer while also ensuring that the disclosure requirements appropriately reflect the degree of responsibility for compliance that carrying dealers of Level 2, 3 and 4 introducing dealers assume.

D. Effect of Proposed Amendments

The proposed amendments will provide a more balanced approach to achieving the regulatory objective of ensuring that clients are informed of the parties that are involved in processing their trades.

II. DETAILED ANALYSIS

A. Current Rules and Relevant History

The draft MFDA Rules published for comment on June 16, 2000 provided for one type of introducing/carrying dealer arrangement whereby only Level 1 introducing dealers could be carried by another dealer. Under this model, the Level 1 introducing dealer and Level 4 carrying dealer were jointly and severally responsible for compliance with MFDA Rules. During the public comment period, the MFDA received many comments indicating that the introducing/carrying dealer model set out in the draft Rules did not adequately accommodate all of the existing arrangements and that carrying arrangements should be permitted for all dealer levels. In response to the public comments, the MFDA amended its introducing/carrying dealer rules to also allow Level 2, 3 and 4 dealers (as defined in Rule 3.1.1) to use the services of a carrying dealer.

Carrying dealers for Level 2, 3 and 4 dealers are not required to have the same degree of responsibility for compliance as carrying dealers for Level 1 introducing dealers. Carrying dealers for Level 2, 3 and 4 introducing dealers are responsible for compliance only for those specific functions they agree to perform for their introducing dealers. Carrying dealers for Level 1 introducing dealers remain jointly and severally responsible for compliance under MFDA Rule 1.1.6.

The current disclosure requirements are incongruous with the degree of compliance responsibility assumed by carrying dealers in Level 2, 3 and 4 introducing/carrying dealer arrangements. The disclosure requirements will be amended to reflect the fact that Level 2, 3 and 4 dealers may also now be carried by a carrying dealer, which does not have joint and several compliance responsibility.

B. Proposed Amendments

Level 3 and 4 Introducing Dealers

The proposed amendment to Rule 1.1.6(b)(viii) will delete the requirement for Level 3 and 4 introducing dealers to obtain a client acknowledgement on account opening. Level 3 and 4 introducing dealers will instead be required to advise the client of the introducing dealer's relationship to the carrying dealer and of the relationship between the client and the carrying dealer. Level 3 and 4 introducing dealers will also have the option of providing written disclosure at least annually to clients of the relationship between the introducing dealer and the carrying dealer and the relationship between the client and the carrying dealer or disclosing the carrying dealer's name and role on an ongoing basis on all contracts, account statements and trade confirmations.

Level 2 Introducing Dealers

Under MFDA Rules, Level 2 introducing dealers do not hold client cash or securities. In the MFDA Level 2 introducing/carrying dealer arrangement, the carrying dealer handles all client cash and client cheques are payable to the carrying dealer. The MFDA is of the view that clients of Level 2 introducing dealers should be made aware of the important role that the carrying dealer plays with respect to client cash. Accordingly, the proposed amendments to Rule 1.1.6(b)(viii) will require Level 2 introducing dealers to advise clients on account opening that the carrying dealer shall be responsible and shall maintain in its name any trust accounts established in respect of cash received from clients and all client cheques shall be payable to the carrying dealer.

Disclosure of the carrier's name and role will continue to be required on all contracts, account statements and trade confirmations. However, in recognition of the responsibility of the Level 2 introducing dealer with respect to compliance, disclosure of the carrier's name and role in equal or greater size to that of the Level 2 introducing dealer will no longer be a requirement under MFDA Rule 1.1.6(b)(ix).

C. Issues and Alternatives Considered

No other issues or alternatives were considered.

D. Comparison with Similar Provisions

The proposed amendments are consistent with the IDA's disclosure requirements for Type 3 and 4 introducing/carrying broker arrangements set out in By-law No. 35.

The IDA Type 2 introducing/carrying broker arrangement differs from the MFDA Level 2 introducing/carrying dealer arrangement in that the IDA Type 2 introducing broker has the ability to handle cash and facilitate cash transactions on behalf of clients through the use of an account in the name of the introducing broker. Accordingly, Type 2 introducing brokers, like Type 3 and 4 introducing brokers, have the option under IDA By-law No. 35 of providing written disclosure to clients of the relationship between the introducing broker and the carrying broker either on an annual basis or on an ongoing basis on all contracts, account statements and trade confirmations. As discussed above, given the important role that the carrying dealer assumes with respect to client cash in the context of the MFDA Level 2 introducing/carrying dealer arrangement, the MFDA is of the view that disclosure of the carrier's name and role should be required on all contracts, account statements and trade confirmations.

E. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendments are in the best interests of the capital markets.

F. Public Interest Objective

The MFDA believes that the proposed amendments are in the public interest in that they will ensure that clients understand the role of the carrying dealer in processing their trades.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 1.1.6(b)(viii)(ix)
IDA By-law No. 35

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

INTRODUCING AND CARRYING ARRANGEMENT (Rule 1.1.6(b))

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 1.1.6(b):

1.1.6 Introducing and Carrying Arrangement

(b) Terms of Arrangement. A Member may enter into an agreement with another Member in accordance with Rule 1.1.6(a) if it satisfies the following requirements:

(i) Minimum Capital. The carrying dealer shall maintain at all times minimum capital of a Level 4 Dealer, and the introducing dealer shall maintain at all times minimum capital of a Level 1, 2, 3 or 4 Dealer, as the case may be;

(ii) Reporting of Client Balances. In calculating the risk adjusted capital required pursuant to Rule 3.1.1 and Form 1, the carrying dealer shall report all accounts of the clients (introduced by the introducing dealer to the carrying dealer and for whom assets are held in nominee name) on the carrying dealer's Form 1 and Monthly Financial Report;

(iii) Comfort Deposit. Any deposit (other than deposits on behalf of clients) provided to the carrying dealer by the introducing dealer pursuant to the terms of the agreement between them shall be segregated in accordance with Rule 3.3 by the carrying dealer and shall be held by the carrying dealer in a separate designated trust account for the introducing dealer;

The deposit provided by the introducing dealer to the carrying dealer shall be reported by the introducing dealer as an allowable asset on its Form 1 and Monthly Financial Report;

(iv) Segregation of Client Cash and Securities. The carrying dealer shall be responsible for holding and segregating in accordance with the requirements of Rule 3.3 all cash and securities held for clients introduced to it by an introducing dealer, provided that a Level 3 introducing dealer may hold cash, and a Level 4 introducing dealer may hold cash and securities, for the accounts of clients to the extent to which such functions are not part of the services to be provided by the carrying dealer;

(v) Trust Accounts. The carrying dealer shall be responsible for and shall maintain in its name any trust accounts established in respect of cash received for the account of clients introduced to it by the introducing dealer, provided that a Level 3 or 4 introducing dealer may hold cash in such trust accounts to the extent to which such functions are not part of the services to be provided by the carrying dealer;

(vi) Insurance. The introducing dealer and carrying dealer shall each maintain minimum insurance in the amounts required and in accordance with Rule 4;

(vii) Amount of Insurance. The carrying dealer shall include all accounts introduced to it by the introducing dealer that are held in nominee name in its calculation of the "base amount" asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E) under Rule 4;

(viii) Disclosure and Acknowledgement on Account Opening. At the time of opening each client account, the introducing dealer shall ~~obtain from the client an acknowledgement in writing that the introducing dealer has advised~~ advise the client of the introducing dealer's relationship to the carrying dealer and of the relationship between the client and the carrying dealer and, in the case of a Level 1 or 2 introducing dealer, obtain from the client an acknowledgement in writing to the effect that such advice has been given. In the case of a Level 2 introducing dealer, the acknowledgement shall reflect that the introducing dealer has advised the client that the carrying dealer shall be responsible for and shall maintain in its name any trust account established in respect of cash received from clients and that all client cheques shall be payable to the carrying dealer;

(ix) Contracts, Account Statements, Confirmations and Client Communications. The name and role of each of the carrying dealer ~~shall,~~ and the ~~name and role of the~~ introducing dealer ~~may in equal or lesser size,~~ shall be shown on all contracts, account statements, confirmations and, in the case of a Level 1 introducing ~~D~~dealer, all client communications (as defined in Rule 2.8.1) and advertisements and sales communications (as defined in Rule 2.7.1) sent by either the introducing dealer or the carrying dealer in respect of accounts carried by the carrying dealer. In the case of a Level 1 introducing dealer, the name and role of the carrying dealer shall appear in at least equal size to that of the introducing dealer. The use of business or trade or style names shall be in accordance with Rule 1.1.7 as applicable. The carrying dealer shall be responsible for sending account statements and confirmations to clients introduced to it by the introducing dealer as required by the By-laws and Rules to the extent such statements and confirmations relate to trading or account positions in respect of which the carrying dealer has provided services;

(x) Annual Disclosure. A Level 3 or Level 4 introducing dealer may comply with the disclosure requirements under paragraph (ix) by providing written disclosure at least annually to each of its clients whose accounts are being carried by the carrying dealer, outlining the relationship between the introducing dealer and the carrying dealer and the relationship between the client and the carrying dealer;

~~(x)~~(xi) Clients Introduced to the Carrying Dealer. Each client introduced to the carrying dealer by the introduced dealer shall be considered a client of the carrying dealer for the purposes of complying with the By-laws and Rules to the extent of the services provided by the carrying dealer; and

~~(xi)~~(xii) Responsibility for Compliance. Unless otherwise specified in Rule 2 or in this Rule 1.1.6, the introducing dealer which is a Level 1 Dealer and its carrying dealer shall be jointly and severally responsible for compliance with the By-laws and Rules for each account introduced to the carrying dealer by the introducing dealer, and in all other cases the introducing dealer shall be responsible for such compliance, subject to the carrying dealer being also responsible for compliance with respect to those functions it agrees to perform under the arrangement entered into under this Rule 1.1.6.

13.1.5 MFDA Rule 1.1.7 – Business Names, Styles, Etc.

MFDA – BUSINESS NAMES, STYLES, ETC. [Rule 1.1.7]

I. OVERVIEW

A. Current Rules

Rule 1.1.7(b)(ii) currently requires that the trade name of the Member or the legal name of the Member accompany the trade name of the Approved Person on materials communicated to the public and clients other than contracts, account statements and trade confirmations.

Pursuant to Rule 1.1.7(c), only the legal name of the Member can appear on contracts, account statements and trade confirmations.

B. The Issue

There is currently confusion among Members and Approved Persons with respect to what is required where the trade name of an Approved Person is used. Concerns have also been raised that the use of an Approved Person's trade name in the absence of the Member's legal name can lead to client confusion as to which legal entity is responsible and liable to the client.

C. Objective

The proposed Rule amendments will clarify the requirements and standardize industry practice with respect to the use of trade names by Approved Persons.

D. Effect of Proposed Amendments

The proposed Rule amendments will ensure that where an Approved Person's trade name is used, clients are not confused as to which legal entity is responsible and liable to the client.

II. DETAILED ANALYSIS

The proposed amendments to Rule 1.1.7 will require that where an Approved Person's trade name is used on communications to the public and clients, the legal name of the Member always appear. The proposed amendments will also require that either the Member's legal name or a business, style or trade name of the Member appear in at least equal size to the trade name of the Approved Person on all communications. Allowing either the trade name of the Member or the legal name of the Member to appear in equal size will provide Members and their Approved Persons with flexibility while still ensuring that clients are not confused about the legal entity with which they are conducting business.

Rule 1.1.7 will also be amended to permit the trade name of an Approved Person to be included along with the Member's legal name on contracts, account statements and trade confirmations. The objective of ensuring that clients are not confused about which legal entity they are dealing with can still be achieved by permitting the Approved Person's trade name to appear on these client communications provided there is also disclosure of the Member's legal name. As discussed above, the legal name of the Member or the trade name of the Member would be required to appear in at least equal size to the trade name of the Approved Person.

Minor housekeeping amendments (renumbering of paragraphs and the addition of sub-headings) were also made to Rule 1.1.7 for clarity.

A. Issues and Alternatives Considered

No other issues or alternatives were considered.

B. Comparison with Similar Provisions

The proposed amendments are consistent with the IDA's requirements with respect to the use of trade names by Approved Persons. IDA By-law 29.7A requires that the full legal name of the Member accompany the trade name of an Approved Person on materials that are used to communicate to the public. However, IDA By-law 29.7A requires that the legal name of the dealer appear in at least equal size to the trade name of the Approved Person on materials that are used to communicate to the public. The proposed amendment to MFDA Rule 1.1.7 (b) will require that either the Member's legal name or a business, style or trade name of the Member appear in at least equal size to the trade name of the Approved Person on all communications.

IDA By-law 29.7A also permits the trade name of an Approved Person to be included on contracts, account statements and trade confirmations along with the Member's legal name.

C. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendments are in the best interests of the capital markets.

D. Public Interest Objective

The proposed amendments would standardize industry practice with respect to the use of trade names. Furthermore, the proposed amendments will assist in the protection of the investing public by ensuring that clients are not confused about the entity they are dealing with and which entity is responsible and liable to the client.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 1.1.7
IDA By-law 29.7A

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

BUSINESS NAMES, STYLES, ETC. (Rule 1.1.7)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 1.1.7:

1.1.7 Business Names, Styles, Etc.

(a) **Use of Member Name.** Except as permitted pursuant to Rule 1.1.6 with respect to introducing dealers and carrying dealers and subject to Rule 1.1.7~~(b)~~ (c), all business carried on by a Member or by any person on its behalf shall be in the name of the Member or a business or trade or style name owned by the Member~~, an Approved Person in respect of the Member~~ or an affiliated corporation of the Member ~~either of them, and the Member shall notify the Corporation prior to the use of any business or trade or style name other than the Member's legal name~~.

(b) **Contracts, Account Statements and Confirmations.** Notwithstanding the provisions of paragraph (a), only the legal name of the Member shall appear on any contracts, account statements or confirmations of the Member.

(c)~~(b)~~ **Use of Approved Person Trade Name.** Notwithstanding the provisions of paragraph (a), ~~No~~ an Approved Person ~~shall~~ may conduct any business of the Member ~~in accordance with (a)~~ in a business or trade name or style name that is not that of, or owned by, the Member or its affiliated corporation ~~unless~~ if:

(i) the Member has given its prior written consent; and

(ii) in all materials communicated to clients or the public:

(A) the name is used together with the Member's legal name ~~or a business or trade name or style of the Member in at least equal size in all materials communicated to clients or the public (other than contracts, account statements or confirmations in~~

~~accordance with (c)).~~; and

(B) the Member's legal name or a business or trade or style name of the Member is at least equal in size to the business or trade or style name used by the Approved Person.

(d) **Notification of Trade Names.** Prior to the use of any business or style or trade names other than the Member's legal name, the Member shall notify the Corporation.

~~(c) Notwithstanding the provisions of paragraph (b), only the legal name of the Member shall appear on any contracts, account statements or confirmations of the Member.~~

(e)~~(d)~~ **Single Use of Trade Name.** No Member or Approved Person shall use any business or trade or style name that is used by any other Member, unless the relationship with such other Member is that of an introducing dealer and carrying dealer, in compliance with Rule 1.1.6;

(f)~~(e)~~ **Misleading Trade Name.** No Member or Approved Person shall use any business or trade or style name that is deceptive, misleading or likely to deceive or mislead the public.

(g)~~(f)~~ **Prohibition on Use of Trade Name.** The Corporation may prohibit a Member or an Approved Person from using any business or trade or style name in a manner that is contrary to any provision of this Rule 1.1.7 or that is objectionable or contrary to the public interest.

13.1.6 MFDA Rule 2.3.1 – Power of Attorney

MFDA – POWER OF ATTORNEY [Rule 2.3.1]

I. OVERVIEW

A. Current Rule

Members and their Approved Persons are prohibited under Rule 2.3.1 from accepting or acting upon a general power of attorney or similar authorization in favour of the Member or Approved Person. A Member or Approved Person may accept a limited trading authorization from a client for the express purpose of facilitating trade execution. A limited trading authorization may not confer general discretionary trading authority upon a Member, an Approved Person or any person acting on behalf of the Member.

B. The Issue

The MFDA has received several requests from Members and their Approved Persons for exemptions from the prohibition in MFDA Rule 2.3.1 to permit Approved Persons to accept or act upon powers of attorney from family members. Members have commented that Approved Persons are often required to manage their family's personal finances as well as their own. In these types of situations, an Approved Person may want to accept a power of attorney over the account of a family member and to give instructions for the account. This is currently prohibited by Rule 2.3.1.

C. Objective

The proposed amendment will permit Approved Persons to accept a general power of attorney or similar authorization from immediate family members (spouse, parent of child) subject to certain compliance controls as prescribed by the Corporation.

D. Effect of Proposed Amendments

By permitting an Approved Person to accept a general power of attorney or similar authorization from an immediate family member, the proposed amendment will avoid the necessity of having to move the family member's account to another dealer with which the client is unfamiliar. The proposed amendment will ensure that the client is protected by requiring that a Member implement certain compliance controls when an Approved Person is acting on a power of attorney for a family member.

II. DETAILED ANALYSIS

When the draft MFDA Rules were published for comment on June 16, 2000, the MFDA received comments from the industry that exceptions from the prohibition on general powers of attorney in Rule 2.3.1 should be permitted for family members of Approved Persons. The MFDA was of the view that the prohibition on powers of attorney should be maintained for the time being, but that limited exceptions to the general prohibition on powers of attorney may be considered post-recognition if a need arises.

After reviewing further submissions received by Members post-recognition, and in the course of reassessing Rule 2.3.1 further, the MFDA is of the view that a limited exception for immediate family members (spouse, parent or child) of Approved Persons is appropriate. Concerns for client protection, which underlie Rule 2.3.1, can be addressed in such circumstances through the implementation of compliance controls by the Member.

Accordingly, the proposed amendment will provide that Members may permit their Approved Persons to accept or act upon a general power of attorney or similar trading authorization from a spouse, child or parent of the Approved Person. This limited exception will be subject to certain compliance controls, which will be set out in a Member Regulation Notice. These compliance controls will include the following:

- Each trade made pursuant to the general power of attorney or similar authorization must be reviewed by the branch manager; and
- All trades placed pursuant to the general power of attorney or similar authorization must be executed by an Approved Person other than the Approved Person holding the general power of attorney or similar authorization over the account.

A. Issues and Alternatives Considered

No other issues or alternatives were considered.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

The proposed amendment is in the public interest in that it will accommodate client service objectives. Permitting an Approved Person to accept a power of attorney or similar authorization from a close family member will avoid the necessity of having to move the account to another dealer with which the client is unfamiliar. The proposed amendment will ensure that the client is protected by requiring the implementation of certain compliance controls designed to minimize the potential for conflicts of interest that may arise where an Approved Person exercises discretionary trading authority over a client account.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 2.3.1

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

POWER OF ATTORNEY/LIMITED TRADING AUTHORIZATION (Rule 2.3.1)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 2.3.1:

2.3 **Power of Attorney/Limited Trading Authorization**

2.3.1 (a) **Prohibition.** No Member or Approved Person shall accept or act upon a general power of attorney or other similar authorization from a client in favour of the Member or Approved Person.

(b) **Exception.** Notwithstanding the provisions of paragraph (a), an Approved Person may accept or act upon a general power of attorney or similar authorization from a client in favour of the Approved Person where such client is a spouse, parent or child of the Approved Person and provided the conditions prescribed by the Corporation are met.

13.1.7 MFDA Rule 5.3.1 – Delivery of Account Statement

MFDA – DELIVERY OF ACCOUNT STATEMENT (Rule 5.3.1)

1. Rule 5.3.1 (c) – Self-Directed Registered Plans Administered by a Trustee

I. OVERVIEW

A. Current Rule

A Member may not rely on any other person (including an Approved Person) to send the account statements required by Rule 5.3.1.

B. The Issue

Under MFDA Rule 5.3.1(a), a Member operating in client name that executes a trade for a self directed registered plan administered by a trustee is required to send an account statement at least annually showing only transactions executed by Member. Currently however, mutual fund dealers rely on the trustee administering the self-directed registered plan to send client account statements. The account statement sent by the trustee shows all the assets held within the client's registered account, including securities not sold through the mutual fund dealer. Clients are used to receiving only the statement of the trustee, which fully discloses all of their portfolio information. To require MFDA Members to send another account statement showing only the mutual fund transactions in their clients' registered plans may result in client confusion.

C. Objective

The objective of the proposed amendment is to permit Members operating in client name to rely on the trustee administering self-directed registered plans to send account statements as required by Rule 5.3.1 provided the conditions prescribed by the Corporation are met.

D. Effect of Proposed Amendments

The proposed amendment will avoid the potential for client confusion associated with receiving multiple statements from different sources. The proposed amendment will also take into account the business structures and arrangements of mutual fund dealers.

II. DETAILED ANALYSIS

A. Current Rules and Relevant History

Currently, MFDA Rule 5.3.1(a) requires mutual fund dealers operating in client name to send a statement of account to clients at least once every twelve months. When the draft MFDA Rules were published for comment on June 16, 2000, the MFDA received comments from the industry that there were some dealers that relied on the fund companies to send client statements. It was the view

of the MFDA that clients should be provided with an account statement from their dealer that reflects all transactions of the dealer where the dealer operates in client name. Clients should be given one statement reflecting all the transactions executed by the dealer rather than simply receiving multiple statements from the fund companies. However, since a large number of dealers did not have the ability to send client statements, the MFDA provided a two-year transition period to comply with Rule 5.3.1(a), which expired March 1, 2003. This matter is currently under review by the relevant provincial securities commissions and any proposed MFDA amendments will have to be coordinated with requirements under provincial securities legislation.

In further reviewing current industry practices relating to statements of account, the MFDA understands that mutual fund dealers not only rely on fund companies to send client statements, but also rely on financial institutions to deliver account statements where the financial institution acts as trustee for self-directed registered plans of its clients. In these cases, the dealer executes the transaction but the security is registered in the name of the trustee in trust for the client and the dealer does not act as agent for the trustee. The dealer performs no administrative function other than trade execution and the trustee is responsible for the administration of the plan including maintaining books and records and client reporting of the assets it holds for the client. The account statement sent by the trustee will include information relating to non-mutual fund securities held within the registered account and provides a full picture of the client's portfolio, including information relating to the foreign content of the account. Accordingly, the receipt of an account statement from the mutual fund dealer showing only the mutual fund transactions in their registered plans does not provide any added benefit to clients and may potentially create client confusion.

B. Proposed Amendment

The proposed amendment will permit Members operating in client name to rely on the trustee administering self-directed registered plans to send account statements as required by Rule 5.3.1 provided the conditions prescribed by the Corporation are met. These conditions, which will be set out in Member Regulation Notice will include the following:

- The Member does not act as agent for the trustee for the registered plans;
- The trustee meets the definition of "Acceptable Institution" as defined in Form 1;
- There is a services agreement in place between the Member and the trustee which complies with the requirements of MFDA Rule 1.1.3 and provides that the trustee is responsible for sending account statements to clients of the Member that comply with the requirements of MFDA Rule 5;
- There is clear disclosure about which trades are placed by the Member;
- Clear disclosure must be provided on the account statement regarding which securities positions referred to on the statement are eligible for coverage by the MFDA Investor Protection Corporation and which are not (once the Corporation is offering coverage);
- The Member's full legal name must appear on the account statement together with the name of the trustee; and
- The Member must receive copies of the statements to ensure that the information contained therein match its own information regarding the transactions it executes.

C. Issues and Alternatives Considered

No other issues or alternatives were considered.

D. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

E. Public Interest Objective

The MFDA believes that the proposed amendment is in the public interest in that it will reduce client confusion associated with receiving multiple statements from different sources. In addition, the conditions that will be prescribed by the MFDA will ensure that the client receives a statement that is accurate and complete.

2. Member Exclusively Distributing the Funds of Affiliated Mutual Fund Manager (Rule 5.3.1(d))

I. OVERVIEW

A. Current Rule

A Member may not rely on any other person (including an Approved Person) to send the account statements required by Rule 5.3.1.

B. The Issue

Where a Member is affiliated with a mutual fund manager and the Member is only selling the mutual fund securities of an issuer managed by the affiliated fund manager, the information contained in the account statement provided by the fund manager (as custodian) would be identical to the information provided on the account statement sent by the Member. The client would not receive any added value or benefit from the receipt of two identical statements.

C. Objective

The proposed amendment will permit a Member that is affiliated with a fund manager and selling only the mutual fund securities of an issuer managed by the affiliated fund manager to rely on the affiliated fund manager to send the account statements required by Rule 5.3.1.

D. Effect of Proposed Amendments

The proposed Rule amendment will reduce unnecessary mailing and production costs and for Members.

II. DETAILED ANALYSIS

The proposed amendment will provide that where a Member is affiliated with a mutual fund manager and the Member is only selling the mutual fund securities of an issuer managed by the affiliated fund manager, the Member should be entitled to rely on the fund manager to send the account statement.

This exemption from the requirements of Rule 5.3.1 would not apply where a Member is selling multiple funds managed by different fund managers. In this situation, the account statement sent by the Member would contain all the mutual fund transactions executed by the Member on the client's behalf, whereas the account statements sent by the various fund managers would each show only a portion of the client's mutual fund holdings. The account statement sent by the Member would thus serve as an important means to verify that the account statements sent by the various mutual fund managers are accurate and complete.

A. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

B. Public Interest Objective

The proposed amendment is in the public interest in that it will avoid client confusion associated with receiving duplicate statements from two sources and will reduce unnecessary production and mailing costs for the industry.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 5.3.1

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

DELIVERY OF ACCOUNT STATEMENT (Rule 5.3.1)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 5.3.1:

5.3.1 Delivery of Account Statement.

(a) Each Member shall send an account statement to each client in accordance with the following minimum standards:

~~(a)~~ (i) once every 12 months for a client name account;

~~(b)~~(ii) once a month for nominee name accounts of clients where there is an entry during the month and a cash balance or security position; and

~~(c)~~(iii) quarterly for nominee name accounts where no entry has occurred in the account and there is a cash balance or security position at the end of the quarter.

(b) A Member may not rely on any other person (including an Approved Person) to send account statements as required by this Rule.

(c) Notwithstanding the provisions of 5.3.1(b), a Member may rely on the trustee administering a self-directed registered plan to send the account statement required by paragraph (a)(i) where the conditions prescribed by the Corporation are met.

(d) Notwithstanding the provisions of 5.3.1(b), where a Member is affiliated with a fund manager and is selling only the mutual fund securities of an issuer managed by such affiliated fund manager, the Member may rely on the affiliated fund manager to send the account statement required by paragraph (a)(i) subject to compliance with any conditions which may be imposed by the Corporation.

13.1.8 MFDA Rule 1.1.1(a) – Business Structures

MFDA – BUSINESS STRUCTURES [Rule 1.1.1(a)]

I. OVERVIEW

A. Current Rule

MFDA Rule 1.1.1(a) currently requires all securities related business engaged in by a Member or Approved Person in respect of a Member to be carried on for the account of the Member, through the facilities of the Member, other than the sale of deposit instruments.

B. The Issue

Provincial securities legislation together with regulations made under the *Bank Act* permit bank employees to transact certain securities-related activities through the bank. Bank-owned MFDA Members commonly have Approved Persons that are dually employed with the bank. These dually-employed Approved Persons sell certain securities as permitted by the *Bank Act* for the account of the bank and mutual funds for the account of the MFDA Member. However, pursuant to Rule 1.1.1(a) all securities related business, other than the sale of deposit instruments, must be conducted through and appear on the books of the mutual fund dealer.

C. Objective

The proposed amendment to Rule 1.1.1 will expressly allow Approved Persons to continue to engage in securities related business as an employee of the bank as permitted by the *Bank Act* and applicable securities legislation for the account of, and through the facilities of the bank, rather than the Member.

II. DETAILED ANALYSIS

Regulations made under the *Bank Act* and provincial securities legislation permit bank employees to conduct certain securities-related activities, including government bonds, treasury bills and guaranteed investment certificates through a bank.

Accordingly, the proposed amendment will expressly permit securities related business engaged in by an Approved Person as an employee of the bank and in accordance with the *Bank Act* and the regulations thereunder and applicable securities legislation, to be carried on for the account of the bank, through the facilities of the bank, rather than the Member.

A. Issues and Alternatives Considered

No other issues or alternatives were considered.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

The proposed amendment is in the public interest. As noted above, the activities of banks are subject to a comprehensive regulatory scheme pursuant to the *Bank Act* and the regulations thereunder. The securities-related dealings of investors with banks are thus adequately protected by this regulatory regime.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 1.1.1
"Securities Dealing Restrictions (Bank) Regulations" (SOR/92-279)
Hockin-Kwinter Accord Securities Act (Ontario) Accord

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

BUSINESS STRUCTURES (Rule 1.1.1(a))

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 1.1.1(a):

Business Structures

1.1.2 Members. No Member or Approved Person (as defined in By-law 1.1) in respect of a Member shall, directly or indirectly, engage in any securities related business (as defined in By-law 1.1) except in accordance with the following:

(a) all such securities related business is carried on for the account of the Member, through the facilities of the Member (except as expressly provided in the Rules) and in accordance with the By-laws and Rules, other than:

(i) such business as relates solely to trading in deposit instruments conducted by any Approved Person not on account of the Member; and

(ii) such business conducted by an Approved Person as an employee of a bank and in accordance with the *Bank Act (Canada)* and the regulations thereunder and applicable securities legislation.

13.1.9 MFDA Policy No. 3 – Handling Client Complaints

MFDA POLICY NO. 3 – HANDLING CLIENT COMPLAINTS

I. OVERVIEW

A. Current Rule

MFDA Policy No.3 "Handling Client Complaints" establishes minimum industry standards for handling client complaints. There are currently no reporting requirements for Members or their Approved Persons under Policy No. 3 or MFDA Rules regarding private settlements with clients or dispositions of securities-related claims. There are also no specific provisions requiring Approved Persons to report customer complaints to the Member and prohibiting direct settlements between Approved Persons and clients made without the Member's knowledge.

B. The Issue

The MFDA's Terms and Conditions of Recognition as a Self-Regulatory Organization require that the MFDA annually review all material settlements involving Members or their Approved Persons with a view to determining if action is warranted. The Terms and Condition of Recognition also require the MFDA to prohibit Members and their Approved Persons from imposing confidentiality restrictions on clients vis-à-vis the MFDA or the securities commissions, whether as part of a resolution of a dispute or otherwise.

The current reporting requirements under Policy No.3 are not sufficient to provide critical information to the MFDA and to Members. In particular, there are no reporting requirements for Members or their Approved Persons regarding private settlements with clients or dispositions of securities-related claims. There are also no express requirements under Policy No. 3 that Approved Persons report certain matters, such as client complaints and pending legal actions, to the Member.

C. Objective

The objective of the proposed amendments to Policy No. 3 is to provide for more comprehensive requirements with respect to what matters are to be reported by Approved Persons to their Members and by Members to the MFDA. This will ensure that the MFDA and Members receive critical information on a timely and consistent basis.

D. Effect of Proposed Amendments

The reporting requirements set out in the proposed amendments will provide the MFDA with additional information to identify areas of possible compliance weaknesses for review and assist in identifying areas where enforcement is required. This will facilitate the regulatory oversight function of the MFDA and enhance investor protection.

The additional reporting required by the proposed amendments will lead to an increase in compliance costs for Members. However, the specific requirements to report complaints to the Member will increase Members' ability to manage risk and potentially reduce losses.

II. DETAILED ANALYSIS

Policy No. 3 will be amended to:

- require Members and Approved Persons to ensure that all complaints and pending legal actions are made known to the compliance officer at head office (or another person at head office designated to receive such information) within two business days;
- require each Member to report to the MFDA whenever such Member or a partner, director, officer, salesperson, employee or agent of the Member has entered into a private settlement or has disposed of any claim in securities related litigation or arbitration by judgement, award or settlement where the amount exceeds the monetary threshold prescribed ($25,000 for a Member and $15,000 for an individual);
- prohibit Approved Persons from entering into a settlement with a client without the prior written consent of the Member; and
- prohibit Members and Approved Persons of Members from imposing confidentiality restrictions on clients with respect to the MFDA or any securities commission, regulatory authority, law enforcement agency, self-regulatory organization, stock exchange or other trading market as part of a resolution of a dispute or otherwise.

A. Comparison with Similar Provisions

IDA Policy No. 8 "Reporting and Recordkeeping Requirements" establishes minimum reporting requirements concerning information that registrants are required to report to Members and information that Members are required to report to the designated self-regulatory organization. The Policy requires registrants to report, among other matters, client complaints to the Member within two business days and prohibits registrants from entering into settlements with a customer without the prior written consent of the Member. IDA Policy No. 8 requires reporting of all settlements, judgments, awards, arbitrations or other resolutions of securities related claims regardless of monetary amounts.

The MFDA is of the view that the determination of whether a judgment, award or settlement is sufficiently material to trigger a reporting requirement should be made in accordance with a clear monetary threshold. This will allow Members to clearly understand what their reporting obligations are and ensure consistent reporting practices across the industry. In this respect, the proposed amendments to Policy No.3 are consistent with the

requirements of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD"). The NYSE Rule 351 "Reporting Requirements" and Section 50 of the NASD Rules of Fair Practice require reporting of securities-related claims that have been disposed of by judgment, award or settlement for an amount exceeding $15,000 (in the case of a person associated with the Member) and $25,000 (for a Member).

The IDA has a similar provision in its Terms and Conditions of Recognition as a Self-Regulatory Organization, which requires the IDA to preclude Members from imposing confidentiality restrictions on clients vis-à-vis the IDA. IDA Member Regulation Notice MR-076 entitled "Releases Entered into Member Firms and Clients and Confidentiality Restrictions" states the IDA's position with respect to language that should not be included in releases entered into between Members and clients. The Notice states that these releases should not contain language, which would prevent the client from disclosing to securities regulatory authorities, self-regulatory organizations or other enforcement authorities the facts and terms of the settlement. The Notice further states that the release shall not contain any language that prevents a client from initiating a complaint.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Policy amendments are in the best interests of the capital markets.

C. Public Interest Objective

The proposed amendments to Policy No. 3 are in the public interest in that they will protect the investing public by providing for consistent industry practices with respect to reporting requirements. The reporting requirements set out in the proposed amendments will provide the MFDA with a tool to ensure compliance with and enforcement of MFDA Rules and securities law.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Policy amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Policy No.3 "Handling Client Complaints"
IDA Policy No. 8
NYSE Rule 351 Reporting Requirements
NASD Rules of Fair Practice – Section 50

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

MFDA POLICY NO. 3 – "HANDLING CLIENT COMPLAINTS"

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Policy No.3 "Handling Client Complaints":

MFDA POLICY NO. 3

HANDLING CLIENT COMPLAINTS

Introduction

This Policy establishes minimum industry standards for handling client complaints. A "complaint" shall be deemed to mean any written statement of a client or any person acting on behalf of a client alleging a grievance involving the conduct, business or affairs of the Member or any registered salesperson, partner, director or officer of the Member.

Although the definition of "complaint" refers to only written complaints, there may be instances where a Member receives a verbal complaint from a client which will warrant the same treatment as a written complaint. Such situations depend upon the nature and severity of the client's allegations and require the professional judgement of the Member's supervisory staff handling the complaint.

Complaint Procedure

Each Member must establish procedures to deal effectively with client complaints, which should include the following:

1. Each Member must acknowledge all client complaints.

2. Each Member must convey the results of its investigation of a client complaint in writing to the client in due course.

3. Client complaints involving the sales practices of a Member, its partners, directors, officers, salespersons or employees or agents must be handled by qualified sales supervisors/compliance staff.

4. Each Member and Approved Person must ensure that all complaints and pending legal actions are made known to the compliance officer at head office (or another person at head office designated to receive such information) ~~head office.~~ within two business days.

5. Each Member must ensure that registered salespersons and their supervisors are made aware of all complaints filed by their clients.

6. Each Member must put procedures in place so that senior management is made aware of complaints of serious misconduct and of all legal actions.

7. Each Member must maintain in a central place an orderly, up-to-date record of complaints together with follow-up documentation regarding such complaints, for regular internal/external compliance reviews. For each complaint, the record should include the following information:

   - the date of the complaint;
   - the complainant's name;
   - the name of the person who is the subject of the complaint;
   - the security or services which are the subject of the complaint; and
   - the date and conclusions of the decision rendered in connection with the complaint.

   This record must be retained for a period of seven years from the date of receipt of the complaint.

8. Each Member must establish procedures to ensure that breaches of MFDA By-laws, Rules and Policies are subjected to appropriate internal disciplinary procedures.

9. When a Member finds complaints to be a significant factor, internal procedures and practices should be reviewed, with recommendations for changes to be submitted to the appropriate management level.

Complaint Reporting

Each Member shall promptly report to the MFDA whenever such Member or partner, director, officer, salesperson, employee or agent of the Member, is the subject of any client complaint involving allegations of theft or misappropriation of funds or securities or of forgery.

Settlement Agreements and Dispositions of Securities-Related Claims

Each Member shall report to the MFDA whenever:

(i) such Member has entered into a private settlement or has disposed of any claim in securities-related litigation or arbitration by judgement, award or settlement where the amount of the judgement, award or settlement exceeds $25,000; or

(ii) a partner, director, officer, salesperson, employee or agent of the Member has entered into a private settlement or has disposed of any claim in securities-

related litigation or arbitration by judgement, award or settlement where the amount of the judgement, award or settlement exceeds $15,000.

No Approved Person shall, without the prior written consent of the Member, enter into any settlement agreement with a client.

No Member or Approved Person of such Member may impose confidentiality restrictions on clients with respect to the MFDA or a securities commission, regulatory authority, law enforcement agency, self-regulatory organization, stock exchange or other trading market as part of a resolution of a dispute or otherwise.

13.1.10 MFDA Rule 1.2.6 – Notification of Termination of Approved Persons

MFDA – NOTIFICATION OF TERMINATION OF APPROVED PERSONS [Rule 1.2.6]

I. OVERVIEW

A. Current Rule

There is currently no requirement under MFDA Rule 1.2.5 for Members to notify the MFDA of the termination of an employment or agency relationship with an Approved Person.

B. The Issue

There is currently no requirement under MFDA Rules for Members to notify the MFDA of the termination of an employment or agency relationship with an Approved Person, even where an Approved Person is dismissed for reasons that may involve a breach of MFDA Rules. Accordingly, the MFDA must currently rely on the applicable provincial securities commissions for notification and information regarding misconduct or potential misconduct by Approved Persons of a Member. As a result, information that would be useful to the MFDA in performing its compliance and enforcement functions may not be gathered on a timely basis.

C. Objective

The objective of the proposed amendment is to provide for more comprehensive reporting by Members with respect to their Approved Persons, which will facilitate the regulatory oversight function of the MFDA and enhance investor protection.

D. Effect of Proposed Amendment

The proposed amendment will lead to an increase in compliance costs for Members by requiring that additional information be filed with the MFDA. The MFDA is of the view that these costs are generally not significant and are justified by the anticipated benefits.

II. DETAILED ANALYSIS

Where an Approved Person is dismissed for cause or is the subject of unresolved client complaints, internal discipline matters or restrictions for violation of regulatory requirements, there may also be a breach of MFDA Rules. Currently, securities commissions have sole responsibility for the registration and approval of Approved Persons of MFDA Members. Securities law requires dealers to notify securities commissions of the termination of an employment or agency relationship with a registered individual by filing a Notice of Termination in the prescribed form.

The proposed amendments will require Members to notify the MFDA within five business days of the termination of an employment of agency relationship with an Approved

Person where the Notice of Termination filed with the applicable securities commission discloses that the Approved Person was dismissed for cause or discloses information regarding unresolved client complaints, internal discipline matters or restrictions for violation of regulatory requirements. The Member must comply with this notification requirement by filing a copy of the Notice of Termination prescribed by the applicable securities commission with the MFDA.

A. Issues and Alternatives Considered

No other issues or alternatives were considered.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

By imposing a direct reporting requirement on the Member, the proposed amendment will enhance investor protection by ensuring that the MFDA is made immediately aware of misconduct by Approved Persons that may pose an actual or potential risk to the investing public. The proposed amendment will also enhance the efficacy of regulatory oversight by assisting in identifying situations at a Member that may indicate a lack of supervision or weakness in internal controls.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 1.2.5

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets.

Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

NOTIFICATION OF TERMINATION OF APPROVED PERSONS (RULE 1.2.6)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendment to Rule 1.2:

1. New Rule 1.2.6 is added as follows:

"**1.2.6 Notification of Termination of Approved Persons.** Every Member must notify the Corporation within five business days of the termination of an employment or agency relationship with an Approved Person where the Notice of Termination filed with the applicable securities commission discloses that the Approved Person was dismissed for cause or discloses information regarding unresolved client complaints, internal discipline matters or restrictions for violation of regulatory requirements. The Member must comply with this requirement by filing a copy of the Notice of Termination prescribed by the applicable securities commission with the MFDA."

13.1.11 MFDA Rule 2.2.1 – "Know-Your-Client"

MFDA – "KNOW-YOUR-CLIENT" [Rule 2.2.1]

I. OVERVIEW

A. Current Rule

Rule 2.2.1 (c) currently requires each Member to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and in keeping with the client's investment objectives. The current Rule does not address the obligations of a Member where a client insists on proceeding with an order that is determined by the Member to be unsuitable based on the client's investment objectives and risk factors.

B. The Issue

Members and Approved Persons have expressed confusion regarding their obligations under MFDA Rules where a client places an order that is determined to be unsuitable for the client.

C. Objective

The objective of the proposed amendment is to clarify the obligations of Members and Approved Persons in the event that they receive an unsolicited order that they determine is unsuitable for the client.

D. Effect of Proposed Amendments

The proposed amendments will assist in ensuring that Members and Approved Persons understand their obligations to clients with respect to unsolicited orders that are determined to be unsuitable and will ensure consistent industry practice.

II. DETAILED ANALYSIS

It is a registrant's duty under the "Know Your Client" rule to give appropriate cautionary advice if a client places an order that appears unsuitable based on the client's investment objectives and risk factors. Whether or not a dealer wishes to refuse such a trade is an internal policy decision of the dealer.

Rule 2.2.1 will be amended to clarify the requirements for Members and Approved Persons where an unsolicited order is determined to be unsuitable for the client. The reference to "each order accepted" will be deleted in paragraph (c) of Rule 2.2.1 and a new provision will be added to ensure that where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member has so advised the client before execution thereof. The proposed amendments will not relieve Members from the obligation to make a suitability determination for proposed trades, whether or not a recommendation is made.

A. Issues and Alternatives Considered

No other issues or alternatives were considered.

B. Comparison with Similar Provisions

The proposed amendments to MFDA Rule 2.2.1 are consistent with Section 48(2) of the *Securities Rules (British Columbia)*, which specifically requires that where a registrant considers that a proposed purchase or sale is not suitable for the investment needs and objectives of the client, the registrant make a reasonable effort to so advise the client before executing the proposed transaction.

The Canadian Securities Institute's Conduct and Practices Handbook Course Textbook expressly states that registrants must provide cautionary advice to clients with respect to unsolicited orders that appear unsuitable based on client information.

C. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

D. Public Interest Objective

The proposed amendments are in the public interest in that they will ensure that clients are appropriately advised where an order is determined by the Member to be unsuitable for the client.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 2.2.1(c)
Securities Rules (British Columbia), Section 48(2)
Conduct and Practices Handbook Course Textbook (Canadian Securities Institute)

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
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Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

"KNOW-YOUR-CLIENT" (RULE 2.2.1)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 2.2.1:

2.2.1 "Know-Your-Client". Each Member shall use due diligence:

(a) to learn the essential facts relative to each client and to each order or account accepted;

(b) to ensure that the acceptance of any order for any account is within the bounds of good business practice; and

(c) to ensure that each ~~order accepted or~~ recommendation made for any account of a client is suitable for the client and in keeping with the client's investment objectives~~,~~ and in any event where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member shall so advise the client before execution thereof.

13.1.12 MFDA Rule 4.1 – Mail Insurance

MFDA – MAIL INSURANCE [Rule 4.1]

I. OVERVIEW

A. Current Rule

Rule 4.1 requires every Member to effect and keep in force mail insurance against loss arising out of the use of mail in the transmittal of cash, securities or other property.

B. The Issue

The MFDA has received comments from Members that they either do not handle securities and/or never use mail to transmit cash, securities or other property. In light of this, the MFDA is of the view that the requirement for mail insurance is unnecessary for these Members.

C. Objective

The objective of the proposed amendment is to relieve a Member from the mail insurance requirement where the Member does not use the mail to transmit cash, securities or other property.

D. Effect of Proposed Rule

The MFDA has determined that the entry into force of the proposed amendment to Rule 4.1 will have no effect on market structure or other rules.

II. DETAILED ANALYSIS

The proposed amendment will provide that Members are not required to effect and keep in force mail insurance if the Member does not use the mail for outgoing shipments of cash, securities or other property, negotiable or non-negotiable.

A. Comparison with Similar Provisions

The proposed amendment is consistent with recent amendments made to IDA Regulation 400.1 regarding mail insurance requirements. IDA Regulation 400.1 does not require IDA Members to maintain mail insurance coverage if the Member delivers a written undertaking to the IDA stating that it will not use the mail to transmit money or securities.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

The MFDA believes that the proposed amendment is in the public interest. The proposed amendment is designed to facilitate fair and open competition in securities transactions generally. The proposed amendments do not permit unfair discrimination among customers, issuers,

brokers, dealers, Members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 4.1
IDA Regulation 400.1

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

FINANCIAL INSTITUTION BOND (MAIL INSURANCE) (Rule 4.1)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendment to Rule 4.1:

1. The following paragraph is added after Clause E:

   "A Member is not required to effect and keep in force mail insurance where the Member does not use mail for outgoing shipments of cash, securities or other property, negotiable or non-negotiable."

13.1.13 MFDA – Withdrawal of Proposed Rule 5.3.5 (Consolidated Statements)

MUTUAL FUND DEALERS ASSOCIATION – WITHDRAWAL OF PROPOSED RULE 5.3.5 (CONSOLIDATED STATEMENTS)

I. Overview

On May 25, 2001, the Ontario Securities Commission published for comment proposed Rule 5.3.5 that would permit the delivery of consolidated account statements. Rule 5.3.4 provided that a Member may satisfy its obligations under Rules 5.3.1(Delivery of Account Statements), 5.3.2 (Automatic Payment Plans) and 5.3.3(Content of Account Statement) by sending to its client a consolidated statement in accordance with Rule 5.3.5 at the times required.

Rules 5.3.4 and 5.3.5 were added to the final version of the MFDA Rules submitted to the Alberta, British Columbia, Ontario and Saskatchewan Securities Commissions (the "Recognizing Jurisdictions") as part of the MFDA's revised application for recognition as a self-regulatory organization on December 15, 2000. As a term and condition of recognition, the Recognizing Jurisdictions suspended the operation of Rule 5.3.5 until it was published for comment for a minimum of 30 days and approved by the Recognizing Jurisdictions.

II. Withdrawal

The MFDA has informed the Recognizing Jurisdictions that the MFDA has withdrawn the proposed Rule at this time. Following discussions with the Recognizing Jurisdictions together with the MFDA Investor Protection Corporation and after considering the comments received, the MFDA has reconsidered its original approach to the delivery of consolidated statements set out in proposed Rule 5.3.5. The MFDA is of the view that despite the disclosure requirements set out in proposed Rule 5.3.5, the practice of consolidated reporting may result in client confusion about the investor protection applicable to the financial products shown in a consolidated statement.

MFDA staff will issue a Member Regulation Notice clarifying that Members and their Approved Persons can send portfolio summaries in addition to, but not in place of, the account statements required by Rule 5.3.1.

Questions may be referred to:

Laurie Gillett
Corporate Secretary/Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

13.1.14 IDA Policy No. 1 Relationships Between Members and Financial Services Entities: Sharing of Office Premises

INVESTMENT DEALERS ASSOCIATION OF CANADA – POLICY NO. 1 RELATIONSHIPS BETWEEN MEMBERS AND FINANCIAL SERVICES ENTITIES: SHARING OF OFFICE PREMISES

I OVERVIEW

A -- Current Rules

The IDA currently has in place Policy No. 1 entitled Use of Branches of Affiliated and Related Financial Institutions. This Policy was based upon the Canadian Securities Administrators' Principles of Regulation Re: Distribution of Mutual Funds by Financial Institutions, Principles of Regulation Re: Full Service and Discount Brokerage Activities of Securities Dealers in Branches of Related Financial Institutions and Principles of Regulation Re: Activities of Registrants Related to Financial Institutions (collectively, "the Principles of Regulation").

B -- The Issue

The Principles of Regulation were repealed and replaced with National Instrument 33-102 Regulation of Certain Registrant Activities on August 1, 2001.

The National Instrument significantly revises and simplifies the provisions as they were set out in the Principles of Regulation. Consequently, IDA Policy No. 1, which was based upon the Principles of Regulation, should be revised in order to mirror the new requirements in National Instrument 33-102 and remove obsolete requirements.

In addition, it was determined that with the development of new business structures, in particular the sharing of office premises between Member firms and financial services entities (such as mutual fund dealers), a revised Policy No. 1 could address the issues and concerns surrounding these structures. Consequently, Policy No. 1 was renamed Relationships Between Members and Financial Services Entities: Sharing of Office Premises (the "revised Policy No. 1").

C -- Objective

The revised Policy No. 1 will ensure that where a Member carries on business in the same location as a financial services entity, clients are informed of the products they are purchasing, clients are not confused as to which entity they are dealing and that clients understand the relationship that a Member may have with that financial services entity.

D -- Effect of Proposed Rules

The revised Policy No. 1 will assist in increasing client knowledge and decreasing client confusion regarding understanding the legal entity with which they are dealing and assist in removing any conflicts that may arise as a

result of a Member firm sharing office premises with a financial services entity.

II DETAILED ANALYSIS

A -- Present Rules, Relevant History and Proposed Policy

Currently, Policy No. 1 is outdated as it was based upon the Principles of Regulation, which have been repealed and replaced with National Instrument 33-102 Regulation of Certain Registrant Activities.

One aspect of National Instrument 33-102 was recently included in the IDA Rulebook. By-law 29.26 now requires that when a Member or a partner, director, officer or registered or approved person of a Member initially makes a recommendation to a client to purchase securities and knows that the client will be using in whole or in part borrowed money or becomes aware that the client intends to use borrowed money for the purchase, a Leverage Risk Disclosure Statement must be given to the client.

However, as other aspects of National Instrument 33-102 contain important provisions that are relevant to our Members, they have either been reiterated or expanded upon within the revised Policy No. 1.

Comments received on Draft National Instrument 33-102 led the Canadian Securities Administrators (the "CSA") to decide that client confusion over the entity with which the client is dealing need not be dealt with by such requirements as identifiably separate premises, but through other means, such as disclosure. However, while Members supported the more relaxed requirements, they requested guidance from the IDA regarding what would constitute adequate disclosure.

In addition, comments received on Draft National Instrument 33-102 prompted the CSA to determine that the National Instrument should apply to all registrants and not just those that operate out of the branches of financial institutions. In part, as a result of the shift in the National Instrument, the Compliance and Legal Section struck a Sub-Committee on Policy No. 1, the purpose of which was to solicit comments from our Members on concerns and issues they had with respect to the sharing of office premises between Members and other financial services entities. The revised Policy No. 1 was intended to provide some guidance on these issues.

The IDA also felt that the provisions in National Instrument 33-102 regarding the confidentiality of client information was of sufficient importance that it deserved to be re-emphasized in the revised Policy No. 1.

B -- Issues and Alternatives Considered

No other issues or alternatives were considered.

C -- Comparison with Similar Provisions

The revised Policy No. 1 was originally based, in part, upon National Instrument 33-102.

D -- Systems Impact of Policy

It is not anticipated that the Policy will have an impact on Member's systems.

E -- Best Interest of the Capital Markets

The Board has determined that the public interest Policy is not detrimental to the best interests of the capital markets.

F -- Public Interest Objective

The Association believes that the revised Policy No. 1 is in the public interest in that it will assist clients in avoiding confusion as to which entity they are dealing and protect the investing public by providing clear requirements with respect to privacy and confidential information. The revised Policy No. 1 is designed to protect the clients and will promote public confidence in the industry.

The revised Policy No. 1 does not permit unfair discrimination among clients, issuers, brokers, dealers, Members or others.

III COMMENTARY

A -- Filing in Other Jurisdictions

The revised Policy No. 1 will be filed for approval in Alberta, British Columbia and Ontario and will be filed for information in Nova Scotia and Saskatchewan.

B -- Effectiveness

The revised Policy No. 1 provides clear guidance and consistent standards to Members who share premises with other financial services entities.

C -- Process

The revised Policy No. 1 has been reviewed by the Compliance and Legal Section Executive and the Compliance and Legal Section.

IV SOURCES

National Instrument 33-102 Regulation of Certain Registrant Activities
IDA By-law 29.26
IDA Policy No. 1 Use of Branches of Affiliated and Related Financial Institutions

V OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying Policy.

The Association has determined that the entry into force of the proposed Policy would be in the public interest. Comments are sought on the proposed Policy. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Michelle Alexander, Investment Dealers Association of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Michelle Alexander
Senior Legal and Policy Counsel
Regulatory Policy
Investment Dealers Association of Canada
(416) 943-5885
malexander@ida.ca

INVESTMENT DEALERS ASSOCIATION OF CANADA – POLICY NO. 1

RELATIONSHIPS BETWEEN MEMBERS AND FINANCIAL SERVICES ENTITIES: SHARING OF OFFICE PREMISES

INTRODUCTION

This Policy establishes guidelines for Members to ensure that clients are informed of the products they are purchasing and that clients understand the relationship that a Member may have with a financial services entity in circumstances where a Member carries on business in the same location as that entity. For the purposes of this Policy No. 1, a financial services entity would include an entity that is licensed or registered in another category pursuant to applicable securities legislation or subject to another regulatory regime. Financial services subject to another regulatory regime would include banking, mutual funds, insurance, deposit taking and mortgage brokerage activities.

Members should also refer to National Instrument 33-102 Regulation of Certain Registrant Activities, which came into force on August 1, 2001.

This Policy No. 1 is applicable to retail clients only.

GENERAL PRINCIPLES

1. A Member may share premises with another financial services entity, whether or not the Member is related or affiliated with that entity.

2. A Member shall ensure that the client clearly understands with which legal entity they are dealing. The client may be informed through various methods, including appropriate signage and disclosure, as set out below. Members are reminded of By-law 29.7A, which deals with the use of trade names and legal names in connection with the conduct of Member business. This By-law shall be complied with regardless of the location of the Member or its branches.

3. The provisions of this Policy apply to the Member and its branches or sub-branch offices. Such sub-branch offices shall have no more than three registered representatives. The head office or a branch office of the Member firm shall be designated as having supervisory responsibility for the sub-branch.

DISCLOSURE OF SECURITIES RELATED ACTIVITIES

1. Where a Member opens an account for a client, the Member shall deliver a written disclosure statement outlining the relationship between the Member and the financial services entity and stating that the Member is a separate entity from the financial services entity. This disclosure is only required when the client is a client of a branch where there are shared premises.

2. At the time the account is opened, the Member shall obtain an acknowledgement from the client that specifically refers to the written disclosure statement required above and confirms that the client has read the written disclosure statement.

3. The acknowledgement may be obtained in a number of ways, including requesting the client's signature or initials at a designated place or that the client place a check in a check box. It is the responsibility of the Member to draw the client's attention to the disclosure.

4. For existing clients, the Member shall provide clients with a notice that contains the disclosure required in section 1 above.

CONFIDENTIALITY OF CLIENT INFORMATION

General

Where a client consents to the disclosure of confidential information, the information may be shared as set out in the consent disclosure document, described in section 2 below.

Consent for New Clients

1. This section does not apply to a Member subject to securities legislation in Quebec with respect to its dealings with clients in Quebec. In such circumstances, Members are advised to comply with *An Act Respecting the Protection of Personal Information in the Private Sector*, regarding the protection of personal information of their clients.

2. A Member shall hold all information about a client confidential and shall not disclose the information to representatives, employees or agents of another financial services entity located in the same premises, except as expressly permitted or required by law or the by-laws, rules, regulations or policies of the Association, unless before disclosing the information

   (a) the Member provides at least the following information to the client to whom the information pertains:

      (i) the name of the financial services entity to which the information will be disclosed,

      (ii) the nature of the relationship between the Member and the financial services entity,

      (iii) the nature of the information that will be disclosed,

      (iv) the intended use of the information by the financial services entity, including whether that entity will disclose the information to others,

      (v) a statement that the client has the right to revoke the consent referred to in paragraph (b), and

      (vi) a statement that the client's consent under paragraph (b) is not required as a condition of the Member dealing with the client, except in circumstances described in section 3; and

   (b) the client provides specific and informed consent to the specific disclosure of the client information.

3. No Member shall require a client to consent to the Member disclosing confidential information regarding the client as a condition, or on terms that would appear to a reasonable person to be a condition, of supplying a product or service, unless the disclosure of the information is reasonably necessary to provide the specific product or service that the client has requested.

4. Client consent may be obtained in a number of ways, including requesting the client's signature or initials at a designated place or that the client place a check in a check box. No Member shall use a "negative option" to obtain consent. A "negative option" would, for example, occur where a client who did not check a check-off box or initial an initial box would nonetheless be deemed to have consented.

5. Despite section 2, a Member does not need to obtain client consent to disclose confidential retail client information

   (a) for audit, statistical or record-keeping purposes;

   (b) to a law enforcement agency, securities regulatory authority or self-regulatory organization;

   (c) for the collection of a debt owed by the client; or

   (d) to a lawyer for the purposes of obtaining legal advice.

6. Dually Employed Representatives – Where registrants are dually employed such individuals shall not disclose any confidential client information to any person other than the staff of the entity with which the client is dealing or for the purpose of performing the relevant services for that client, unless the client's consent has been obtained.

Consent for Existing Clients

1. An existing client of a Member is considered to have provided consent, as required above, if the client:

   (a) has provided consent, either positively or negatively, to the Member to disclose the confidential client information prior to the implementation of this Policy; and

   (b) is provided with a notice that contains

      (i) the disclosure required in section 2 above, and

      (ii) a statement of the right of the client to withdraw his or her consent.

MINIMUM STANDARDS FOR SHARED PREMISES

1. Introduction – The following minimum standards are intended as guidelines for Members. The Association acknowledges that such standards may not be practicable in certain business arrangements, such as where there are numerous dually employed representatives or the Member engages in discount brokerage operations. The guiding objective behind the standards is to ensure clients are not confused as to which entity they are dealing. Based on the organization of business arrangements, Members may need to develop policies and procedures that differ from this Policy yet still achieve the underlying objective.

2. Telephone Operations – Clients should have a clear understanding of with which entity they are dealing when they call the Member or financial services entity. A shared receptionist is permitted. Separate directory listings for each entity are recommended.

3. Client Records – Members are required to keep client records separate from the records of the financial services entity. The financial services entity shall not have access to the client records of a Member unless the provisions relating to confidentiality above are complied with. Hard copies of client files shall not be accessible to representatives, employees or agents of the financial services entity. Electronic records must have separate passwords or other similar controls to ensure they are not accessible by the financial services entity. Separate computer hardware and software is recommended.

4. Signage – The legal names under which the Member and financial services entity operate must be clearly displayed in a prominent location such as the office entrance door or reception area. A business, trade or style name under which all the entities operate may also be displayed. The names of each individual representative of the entities need not be displayed.

5. Physical Premises – The layout of the shared location must ensure confidentiality of client information. The following guidelines apply:

   (a) Separate entrances are not necessary;

   (b) Where necessary to minimize client confusion and ensure confidentiality of records and privacy, and if permitted by resources and infrastructure, it may be advisable for representatives, employees or agents of the Member and the financial services entity to be situated in separate areas; and

   (c) Client files, account process areas, etc. must be effectively controlled and physically secured.

6. CIPF Logo and Brochures – The CIPF logo and brochures must be displayed in a manner that makes it clear that they are applicable only to the Member and not to the other financial services entity.

7. Supervision

   (a) Branch Managers

      (i) Dual Employment - In some jurisdictions it is permissible that a trading officer be dually employed with an affiliated Member and non-Member, provided that the requirements of By-law 7.1(1)(b)(iv) are satisfied. Such dually employed trading officers may be designated as a branch manager for both the Member and financial services entity. In other jurisdictions, securities legislation requires that different branch managers conduct supervision. In either situation, the branch manager may be on-site or off-site, as required by the circumstances.

      (ii) Supervision – Branch managers are required to devote sufficient time to the supervision of the branch. In addition, Policy No. 2 details specific supervisory requirements that branch managers must undertake. Regulation 1300 details what is required for the supervision of accounts. By-law 29.27 in part

requires periodic onsite reviews of branch office supervision to ensure that supervision is adequate. In addition, due to the sharing of office premises, branch managers have additional responsibilities with respect to the confidentiality of client records, the separation of files and operations, the issue of dually employed registrants, registrants not acting outside the limitations of their registration, etc.

(b) Adequate resources and appropriate systems – The Member must have written procedures and systems in place for the supervision of shared office premises reasonably designed to ensure that representatives adhere to the provisions contained in this Policy in order that clients are not confused as to with which entity they are dealing. The Member must have sufficient supervisory resources allocated at head office and at the shared office premises to effectively implement supervisory procedures required under this Policy. The Member must have a program for communicating the provisions in this Policy to the representatives at the shared office premises and ensuring that the provisions are understood and implemented.

(c) Administration Officer – An administration officer responsible for general office oversight may be shared between the Member and financial services entity. The administration officer is not required to be a registered person. Branch managers, however, are still required in order to supervise business practices and monitor compliance with Association and securities regulatory requirements.

8. Business Cards

(a) Where registrants are dually licensed as an investment adviser and life insurance representative, insurance legislation differs in the provinces regarding the use of separate or double-sided business cards. It is the responsibility of the Member to ensure compliance with applicable securities and insurance legislation.

(b) Where registrants are dually employed by a Member and a financial services institution, it is recommended that the registrant have double-sided business cards.

9. Permissible Non-Registrant Activities

(a) Non-registered personnel employed by the Member or representatives of the financial services entity may not conduct certain activities. These individuals may not:

(i) open client accounts at the Member,

(ii) distribute or receive order forms for securities transactions to be conducted through the Member,

(iii) assist clients in completing order forms for securities transactions to be conducted through the Member,

(iv) provide recommendations or any advice on any activity in or for the account of the Member,

(v) complete know-your-client information on a New Client Application Form other than the biographical information, and

(vi) solicit securities transactions to be conducted through the Member.

(b) However, these individuals are permitted to:

(i) advertise the services and products of the Member,

(ii) deliver or receive securities to or from clients,

(iii) contact clients to arrange appointments or give notice regarding deficiencies in completed forms,

(iv) provide information on the status of a client's account and provide account balances,

(v) provide quotes and other market information,

(vi) contact the public, including inviting the public to firm seminars and forwarding non-securities specific information,

(vii) receive completed New Client Application Forms to forward to the Member for approval, and

(viii) distribute New Client Application Forms, provided that

(1) apart from specific allowances described elsewhere in this Policy No. 1, if assistance is given to a client in completing the Form, it is given by a registered person of the Member, or by the manager, assistant manager or credit officer in the branch where there is no registered person of the Member, provided that such person possesses a high degree of knowledge about the client's financial affairs, and

(2) before any trades are conducted on behalf of a client, the Form is approved by the designated person or branch manager in accordance with Regulation 1300.2.

(c) It is recommended that sales assistants and other employees be assigned to either the Member or financial services entity rather than shared between both. If warranted by the circumstances, certain individuals should sign confidentiality agreements.

Prohibited Registrant Activities – Registrants are permitted to offer services and products to clients but only with respect to the category of registration within which they are licensed. For example, a mutual fund salesperson is registered solely for the purpose of trading in mutual fund shares or units. The purpose of this restricted category is to allow individuals whose business focuses on a single product to access the securities market with reduced registration requirements. Consequently, mutual fund salespersons may not offer or advise their clients with respect to securities in which they are not registered to trade, nor may they communicate client orders directly or indirectly to an investment dealer salesperson. Furthermore, mutual fund salespersons are permitted to accept orders only for the accounts at the dealer with which they are registered.

TIED SELLING

1. No Member shall require a client to purchase or use any product or services, either as a condition or on terms that would appear to a reasonable person to be a condition of selling particular securities.

2. No Member shall require a client to invest in particular securities, either as a condition or on terms that would appear to a reasonable person to be a condition for supplying or continuing to supply products or services.

3. These above provisions are not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing (whereby financial incentives or advantages are offered to clients).

13.1.15 Miscellaneous Administrative Amendments to MFDA By-law No. 7

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

BY-LAW AMENDMENTS

MISCELLANEOUS ADMINISTRATIVE AMENDMENTS

MFDA BY-LAW NO. 7

June 2003

INDEX

PART 1

SUMMARY AND REQUEST FOR PUBLIC COMMENT

I. OVERVIEW

A. Current By-laws

The current MFDA by-laws contain particulars developed at a time when the MFDA was in its early stage of development.

B. The Issues

On June 13, 2003, the MFDA Board of Directors passed by-law amendments (the "**By-law Amendments**") that reflect administrative corrections or clarifications to the text of MFDA By-law No. 1 (as amended). The By-law Amendments enhance the clarity and flexibility of the MFDA By-laws.

C. Objectives

The objectives of the By-law Amendments are to clarify and improve administrative details.

D. Effect of Amendments

The By-law Amendments will enhance the efficiency and effectiveness of the MFDA.

II. DETAILED ANALYSIS

The By-law Amendments are contained in a new by-law passed by the MFDA Board of Directors on June 13, 2003.

- By-law No. 7: Miscellaneous Administrative Amendments.

Details respecting this by-law are set out below.

A. Issues and Alternatives Considered

The By-law Amendments are unique to the circumstances of the MFDA. No alternatives were considered.

B. Public Interest and Best Interests of the Capital Markets

The By-law Amendments are in the public interest and in the best interests of the capital markets.

III. COMMENTARY

A. Filing in Other Jurisdictions

The By-law Amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Ontario and Saskatchewan Securities Commissions.

B. Effectiveness

The By-law Amendments are simple and effective.

C. Process

The By-law Amendments were developed by MFDA staff in the course of reviewing the operation of the MFDA by-laws and were passed by the MFDA Board of Directors on June 13, 2003.

IV. SOURCES

The By-law Amendments are internal to the MFDA.

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the By-law Amendments so that the particulars referred to above and described below may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the By-law Amendments would be in the public interest and not detrimental to the capital markets. Comments are sought on the By-law Amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

PART 2

MFDA BY-LAW NO. 7: MISCELLANEOUS ADMINISTRATIVE AMENDMENTS

A. Introduction

By-law No. 7 sets out administrative corrections or clarifications to the text of MFDA By-law No.1 (as amended). The By-law Amendments were passed by the MFDA Board of Directors on June 13, 2003.

B. Summary of By-law Amendments in MFDA By-law No. 7

(i) Definition Amendments

- Definition of **"Board"**

  The short-form "*Board*" has been added to the definition of "*Board of Directors*".

  This amendment will provide flexibility in the by-laws.

- Definition of **"client name"**

  The phrase "*its agent or its custodian*" has been added to the end of definition.

  The purpose of this amendment is to clarify that client name property does not include property held for the Member by its agent or custodian.

- Definition of **"control"** or **"controlled"**

  The word "*Policies*" has been added to the last phrase of the definition which currently references MFDA "*By-laws, Rules and Forms*".

  The purpose of this amendment is to correct an unintended omission in the current by-law. There are four MFDA regulatory instruments that are mandatory for Members: By-laws, Rules, Policies and Forms.

- Definition of **"MFDA"**

  A new definition has been added for "*MFDA*" which will provide flexibility in the by-laws.

- Definition of **"nominee name"**

  The phrase *"other than client cash held in a trust account of the Member"* has been added to the first line of the definition immediately following the *phrase "in respect of an account or client property"*.

  The purpose of this amendment is to clarify that client cash held in a trust account of a Member is not, for the purposes of the definition, considered to be held in "nominee name".

- Definition of **"related Member"**

  The reference to *"sole proprietorship"* in the definition has been deleted.

  The MFDA does not accept membership applications from sole proprietorships. As a result, there can never be circumstances in which a Member is related to another Member, which is organized as a sole proprietorship.

- Section 2.6: Interpretation Provision

  The word *"Policies"* has been added in the last phrase of the definition, which currently references MFDA *"By-laws, Rules and Forms"*.

  The purpose of this amendment is to correct an unintended omission in the current by-law. There are four MFDA regulatory instruments that are mandatory for Members: By-laws, Rules, Policies and Forms.

(ii) Other Amendments

- Section 8.2: Indemnity Provision

  Section 8.2 of the by-law has been amended to conform to the content of current indemnification protections in place generally for the benefit of directors and officers of business corporations. The particulars of protections are important factors for individuals to evaluate when considering whether to agree to serve as a director or officer of the MFDA. The particular amendments are as follows:

  - In section 8.2.1, the text has been clarified to expressly reference possible *"fines or penalties"* which directors and officers might sustain or incur. The text has also been amended to expressly reference the possibility that exposure for directors and officers can arise in the context of *settled* matters as well as *threatened* matters.

  - In section 8.2.2, the text has been clarified to expressly reference the fact that indemnification includes the value of time spent by a director or officer in dealing with litigation (or threatened litigation), as well as associated tax consequences. The objective is to indemnify directors and officers and save them harmless.

- New Section 8.3: Corporation Actions Against Directors and Officers.

  Subsection 8.3 is a new provision dealing with the situation in which the Corporation threatens, brings, commences or prosecutes, on a derivative basis, an action, suit or proceeding against a director, officer or other person who has undertaken or is about to undertake any liability on behalf of the Corporation.

  The purpose of this technical amendment is to address the situation in which parties are joined in litigation as a consequence of a Member or other person being entitled to bring a derivative action in the name of the Corporation or possibly the application of rules of civil procedure. The objective is to provide a court-supervised mechanism for the Corporation to indemnify directors and officers in these settings. This amendment reflects the content of current indemnification protections in place generally for the benefit of directors and officers of business corporations.

- New Section 11.8: Review of Membership Application Decisions

  Section 11.8 is a new provision clarifying the review process that is available to an applicant for membership in the MFDA in circumstances where the applicant contests a refusal by the MFDA Board to admit the applicant to the MFDA or contests the imposition of terms and conditions on proposed membership in the MFDA by the MFDA Board.

  The amendment will afford the applicant, as well the MFDA, a right to request a review of the initial MFDA Board decision respecting the membership application. This review hearing must be requested within 21 days of the initial decision. The amendment requires that no members of the MFDA Board that participated in the initial decision may participate in the review hearing. The amendment allows the MFDA Board to create a committee to deal with such review hearings.

  There are three conforming changes relating to the addition of Section 11.8:

  - Section 11.8 has been re-numbered Section 11.9.

  - Paragraph 11.6.3 has been deleted in its entirety.

  - Paragraph 11.6.4 has been re-numbered Paragraph 11.6.3.

- Section 12.12: Proxies for Annual Meetings of Members

  Section 12.12 has been clarified to provide that a person appointed by proxy must be a *"director, officer or employee of a Member or of an affiliate of a Member"*.

Currently, the by-law requires that the person appointed by proxy must be a *"Member"* - which is not a natural person and therefore not a practical candidate to attend a meeting in person. The amendment will correct this error.

- Section 13.4: Time at Which a Resignation by a Member Becomes Effective

  The word *"the"* has been added to the third line of the text immediately preceding the phrase "Board of Directors".

  The purpose of this amendment is to correct a typographical error in the by-law.

- Section 13.9: Ownership

  The word *"proposes"* has been deleted in the second line of the first sentence in Section 13.9.

  The purpose of the amendment is to correct a typographical error in the by-law.

- Section 15.1.3: Protection Fund Assessments

  Section 15.1.3 has been made more flexible by substituting a generic description for the express reference to "Mutual Fund Dealers Investor Protection Plan."

  When the MFDA By-laws were originally drafted, it was anticipated that the Mutual Fund Dealers Investor Protection Plan would be the actual entity in respect of which levies or assessment might be made. That plan is not presently in active operation. The amendment will accommodate assessments or levies made by any such entity, fund or plan.

- Section 24: Co-operation with Other Authorities

  The scope of this information-sharing provision has been broadened to afford the MFDA flexibility to provide information to additional entities, including a customer or investor protection or compensation fund or plan. It has also been amended to provide that the MFDA may share information with organizations regulating or providing services in connection with securities trading not only in Canada but also in any other country.

  Flexibility to participate in information-sharing arrangements with other organizations will contribute to effective regulation of capital markets and will enhance the effectiveness of the MFDA.

- Section 30.1: Execution of Instruments

  The signing authority provision has been amended to permit contracts, documents or any instruments in writing requiring the signature of the MFDA to be signed by any two of Chair of the MFDA Board, the Vice-Chair of the MFDA Board, the President and Chief Executive Officer, the Chief Operating Officer, a Vice-President, the Secretary or the Controller.

  The current by-law provision requires that one of the two signatories must always be the Secretary or the Treasurer of the MFDA. The amendment will provide flexibility. The amendment also substitutes the reference to *"Treasurer"* with *"Controller"* as the MFDA does not have a *"Treasurer"*.

- Section 32.1: Notices

  The phrase *"Rules or Policies"* has been added in the second line of the definition, which currently references MFDA *"By-laws"*. Section 32.1 has also been amended to provide flexibility to send documents by e-mail or other electronic means.

- Section 33: By-laws

  Section 33 has been amended to reflect the Minister is not required to approve all by-law amendments.

- Designate the Ombudservice By-law Amendments as "By-law No. 4"

  The Ombudservice Amendments made by the MFDA Board on September 27, 2003 and confirmed and sanctioned by the Members on December 13, 2002 have been re-designated as *"By-law No. 4"*.

PART 3

BLACKLINED COPY OF MFDA BY-LAW NO. 7

BY-LAW NO. 7
(Miscellaneous Amendments)

being a by-law amending the General By-law No. 1 of

MUTUAL FUND DEALERS ASSOCIATION OF CANADA/ ASSOCIATION CANADIENNE DES COURTIERS DE FONDS MUTUELS
(hereinafter referred to as the "Corporation")

By-law No. 1 of the Corporation is hereby amended as follows:

DEFINITIONS

1. The definition of "Board of Directors" is amended as follows (changes are marked):

   "Board of Directors" or "Board" means the board of directors of the Corporation and any committee or panel of directors appointed by the Board under the By-laws with the authority to exercise any powers of the Board of Directors;

2. The definition of the terms "client name" is amended as follows (changes are marked):

   "client name" means in respect of an account or client property, an account established by a Member for a client in accordance with the By-laws and Rules, and the cash, securities or other property held for such account, where the cash, securities and property is held in the name of and by a person other than the Member, its agent or custodian;

3. The definition of "control" and "controlled" is amended as follows (changes are marked):

   "**control**" or "**controlled**", in respect of a corporation by another person or by two or more corporations, means the circumstances where:

   (i) voting securities of the first-mentioned corporation carrying more than 50% of the votes for the election of directors are held, other than by way of security only, by or for the benefit of the other person or by or for the benefit of the other corporations; and

   (ii) the votes carried by such securities are entitled, if exercised, to elect a majority of the Board of Directors of the first-mentioned corporation,

   and where the Board of Directors orders that a person shall, or shall not, be deemed to be controlled by another person, then such order shall be determinative of their relationships in the application of the By-laws, Rules, Policies and Forms with respect to that Member;

4. Add a new definition as follows:

   "**MFDA**" means the Corporation;

5. The definition of "nominee name" is amended as follows (changes are marked):

   "**nominee name**" means, in respect of an account or client property, other than client cash held in a trust account of a Member, an account established by a Member for a client in accordance with the By-laws and Rules in which the securities or other property is held by the Member, its agent or its custodian in the name of the Member or its agent or its custodian, for the benefit of the client;

6. The definition of "related Member" is amended as follows (changes are marked):

   "**related Member**" means a ~~sole proprietorship,~~ partnership or corporation which:

   (i) is a Member; and

   (ii) is related to a Member in that either of them, or their respective partners, directors, officers, shareholders and employees, individually or collectively, have at least a 20% ownership interest in the other of them, including an interest as a partner or shareholder, directly or indirectly, and whether or not through holding companies;

   provided that the Board of Directors may, from time to time, include in, or exclude from this definition any person, and change those included or excluded;

INTERPRETATION

7. Section 2.6 is amended as follows (changes are marked):

   2.6 **Interpretation of the Board of Directors**

   In the event of any dispute as to the intent or meaning of the Letters Patent, By-Laws, Rules, Policies or Forms, the interpretation of the Board of Directors, subject to the provisions of Section 27.1, shall be final and conclusive.

DIRECTORS' AND OFFICERS' PROTECTION

8. Section 8 is amended as follows (changes are marked):

8.1 **Limitation of Liability**

No director, officer, employee or agent shall be liable for the acts, receipts, neglects or defaults of any other director, officer, employee or agent, or for joining in any receipt or other act for conformity, or for any loss, damage or expense happening to the Corporation through the insufficiency or deficiency of title to any property acquired for or on behalf of the Corporation, or for the insufficiency or deficiency of any security in or upon which any of the moneys of the Corporation shall be invested, or for any loss or damage arising from the bankruptcy, insolvency or tortious acts of any person with whom any of the moneys, securities or effects of the Corporation shall be deposited, or for any loss occasioned by any error of judgment or oversight on his or her part, or for any other loss, damage or misfortune whatever which shall happen in the execution of the duties of his or her office or in relation thereto; provided that nothing herein shall relieve any director or officer from the duty to act in accordance with the Act and the regulations thereunder or from liability for any breach thereof.

8.2 **Indemnity**

Every director or officer of the Corporation, or other person who has undertaken or is about to undertake any liability on behalf of the Corporation or any company controlled by it, and their heirs, executors and administrators, and estate and effects, respectively, shall from time to time and at all times, be indemnified and saved harmless out of the funds of the Corporation, from and against:

8.2.1 all costs, charges, fines, penalties and expenses which such director, officer or other person sustains or incurs in or about or to settle any action, suit or proceeding which is threatened, brought, commenced or prosecuted against him or her, or in respect of any act, deed, matter or thing whatsoever, made, done or permitted by him or her, in or about the execution of the duties of his or her office or in respect of any such liability; and

8.2.2 all other costs, charges and expenses which he or she sustains or incurs in or about or in relation to the affairs thereof, including an amount representing the value of time any such director, officer or other person spent in relation thereto and any income or other taxes or assessments incurred in respect of indemnification provided for in this By-law, except such costs, charges or expenses as are occasioned by his or her own wilful neglect or default.

The Corporation shall also indemnify such persons in such other circumstances as the Act permits or requires. Nothing in this By-law shall limit the right of any person entitled to indemnity apart from the provisions of this By-law.

8.3 **Action, Suit or Proceeding Threatened, Brought, etc. by the Corporation**

Where the action, suit or proceeding referred to in Section 8.2.1 above is threatened, brought, commenced or prosecuted by the Corporation against a director, officer or other person who has undertaken or is about to undertake any liability on behalf of the Corporation or any company controlled by it, the Corporation shall make application at its expense for approval of the court to indemnify such persons, and their heirs, executors and administrators, and estates and effects respectively, on the same terms as outlined in Section 8.2.

8.4 **Insurance**

The Corporation may purchase and maintain insurance for the benefit of any person referred to in Section 8.2 against such liabilities and in such amounts as the Board may from time to time determine and are permitted by the Act.

REVIEW OF MEMBERSHIP APPLICATION DECISIONS

9. Add new Section 11.8 as follows:

11.8 **Review**

11.8.1 In the event of a decision of the Board of Directors

(a) to approve an application subject to terms and conditions pursuant to Section 11.4.2;

(b) to refuse an application pursuant to Section 11.4.3; or

(c) to vary terms and conditions in a manner that would be more burdensome to an applicant pursuant to Section 11.7.1,

the Board of Directors shall, upon application of either the Corporation or the applicant, made within 21 days of receiving notice of the decision of the Board, review the

decision and either (i) confirm the decision, or (ii) make such other decision as the Board of Directors considers proper.

11.8.2 If the Board of Directors is required to review a decision pursuant to Section 11.8.1, the provisions of Sections 11.5 and 11.6 shall apply in the same manner as if the Board of Directors was exercising its powers thereunder in regard to the applicant.

11.8.3 The authority of the Board under this Section 11.8 may be exercised by a committee of the Board appointed pursuant to Section 3.11. No Member of the Board of Directors who has participated in a decision in respect of an application pursuant to Section 11.4.2, 11.4.3 or 11.7.1 shall subsequently participate in a hearing pursuant to Section 11.8.1 regarding that decision.

10. Renumber Section 11.8 as Section 11.9

11. Delete Section 11.6.3 and renumber Sections 11.6.4 as 11.6.3.

PROXIES

12. Section 12.12 is amended as follows (changes are marked):

12.12 **Proxies**

Votes at meetings of the Members may be given either personally or by proxy or, in the case of a Member who is a body corporate or association, by an individual authorized by a resolution of the Board of Directors or governing body of the body corporate or association to represent it at meetings of Members of the Corporation. At every meeting at which a Member is entitled to vote, every Member and/or person appointed by proxy to represent one or more Members and/or individual so authorized to represent a Member who is present in person shall have one vote on a show of hands. Upon a poll and subject to the provisions, if any, of the Letters Patent, every Member who is entitled to vote at the meeting and who is present in person or represented by an individual so authorized shall have one vote and every person appointed by proxy shall have one vote for each Member who is entitled to vote at the meeting and who is represented by such proxy holder.

A proxy shall be executed by the Member or the Member's attorney authorized in writing or, if the Member is a body corporate or association, by an officer or attorney thereof duly authorized.

A person appointed by proxy must be a ~~Member~~ director, officer or employee of a Member or of an affiliate of a Member. A proxy may be in the following form:

> The undersigned Member of Mutual Fund Dealers Association of Canada / Association canadienne des courtiers de fonds mutuels appoints _____ of _____ or failing the person appointed above, _____ of_____ as the proxy of the undersigned to attend and act at the _____ meeting of the Members of the said Corporation to be held on the _____ day of _____ 20 , and at any adjournment or adjournments thereof in the same manner, to the same extent and with the same power as if the undersigned were present at the said meeting or such adjournment or adjournments thereof.

RESIGNATION

13. Section 13.4 is amended as follows (changes are marked):

13.4 **Time at Which Resignation Becomes Effective**

Unless the Board of Directors, in its discretion otherwise declares, a resignation shall take effect as of the close of business (5:00 p.m. head office local time) on the date the Board of Directors (by its Chair, a Vice-Chair or the President) receives confirmation from the Corporation that, in its opinion, the reports of the Member's auditor pursuant to Section 13.2 are in order and if, to the knowledge of the Corporation after due enquiry, the Member is not indebted to the Corporation and no complaint against the Member or any investigation of the affairs of the Member by the Corporation is pending.

OWNERSHIP

14. Section 13.9 is amended as follows (changes are marked):

13.9 **Ownership**

No Member shall permit an investor, alone or together with its associates and affiliates, ~~proposes~~ to own:

(a) a significant equity interest in the Member; or

(b) special warrants or any other securities that are convertible or exchangeable at any time in the future, into a significant equity interest in the Member;

without the prior approval of the Corporation.

For the purposes of this By-law 13.9, a significant equity interest means the holding of:

(c) voting securities carrying 20 per cent or more of the votes carried by all voting securities of the Member or of a holding company of a Member;

(d) 20 per cent or more of the outstanding participating securities of the Member or of a holding company of a Member; or

(e) an interest of 20 per cent or more of the total equity in the Member.

Notwithstanding the foregoing, the legal representatives of a deceased person who had been approved by the Corporation as the owner of a significant equity interest may continue as a registered holder or to hold such interest for such period as the Corporation may permit.

PROTECTION FUND ASSESSMENTS

15. Section 15.1 is amended as follows (changes are marked):

15.1 **Power to Make Assessment**

Notwithstanding Section 14, the Board of Directors shall have power to make an assessment in any fiscal year upon each Member on account of:

15.1.1 any extraordinary costs and expenses of the Corporation incurred in connection with the review and/or approval of any reorganization, takeover or other substantial change in the business, structure or affairs of a Member;

15.1.2 fees levied by the Corporation in connection with:

(a) exemption application filings or any other such filing fees which the Board of Directors in its discretion may determine from time to time;

(b) a Member changing its name from that which is shown on the most recent Membership List; or

(c) an application for Membership under Section 10; or

15.1.3 assessments or levies made by ~~the Mutual Fund Dealers Investor Protection Plan~~ any customer or investor protection or compensation fund or plan in respect of which Members of the Corporation are required to participate.

CO-OPERATION WITH OTHER AUTHORITIES

16. Section 24 is amended as follows (changes are marked):

24. **Co-operation with Other Authorities**

24.1 **Request for Information**

Any Member, Approved Person or any person under the jurisdiction of the Corporation, that is requested by any securities commission or regulatory authority, law enforcement agency, self-regulatory organization, stock exchange~~,~~ ~~or~~ other trading market, customer or investor protection or compensation fund or plan or other organization regulating or providing services in connection with securities trading located in Canada or any other country to provide information in connection with an investigation of trading in securities shall submit the requested information, books, records, reports, filings and papers to the commission, authority, organization, exchange or market making the request in such manner and form, including electronically, as may reasonably be prescribed by such commission, authority, organization, exchange or market.

24.2 **Agreements**

The Corporation may enter into in its own name agreements or arrangements with any securities commission or regulatory authority, law enforcement agency, self-regulatory organization, stock exchange~~,~~ ~~or~~ other trading market, customer or investor protection or compensation fund or plan or other organization regulating or providing services in connection with securities trading located in Canada or any other country for the exchange of

any information (including information obtained by the Corporation pursuant to the By-laws or Rules or otherwise in its possession) and for other forms of mutual assistance for market surveillance, investigation, enforcement and other regulatory purposes relating to trading in securities in Canada or elsewhere.

24.3 **Assistance**

The Corporation may provide to any securities commission or regulatory authority, law enforcement agency, self-regulatory organization, stock exchange~~,~~ ~~or~~ other trading market, customer or investor protection or compensation fund or plan or other organization regulating or providing services in connection with securities trading located in Canada or any other country any information obtained by the Corporation pursuant to the By-laws or Rules or otherwise in its possession and may provide other forms of assistance for surveillance, investigation, enforcement and other regulatory purposes relating to trading in securities in Canada or elsewhere.

EXECUTION OF INSTRUMENTS

17. Amend Section 30 as follows (changes are marked):

30. **Execution of Instruments**

Contracts, documents or any instruments in writing requiring the signature of the Corporation may be signed by

30.1 any ~~one~~ two of the Chair of the Board, the Vice-Chair of the Board, the President and Chief Executive Officer, the Chief Operating Officer~~, or~~ a Vice-President, ~~together with any one of~~ the Secretary or the ~~Treasurer~~ Controller;

30.2 any two directors; or

30.3 any one of the aforementioned officers together with any one director;

and all contracts, documents and instruments in writing so signed shall be binding upon the Corporation without any further authorization or formality. The Board of Directors shall have power from time to time by resolution to appoint any officer or officers or any person or persons on behalf of the Corporation either to sign contracts, documents and instruments in writing generally or to sign specific contracts, documents or instruments in writing.

The term "contracts, documents or instruments in writing" as used in this By-law shall include but not be limited to deeds, mortgages, hypothecs, charges, conveyances, transfers and assignments of property real or personal, immovable or movable, agreements, releases, receipts and discharges for the payment of money or other obligations, conveyances, transfers and assignments of shares, share warrants, stocks, bonds, debentures or other securities and all paper writings.

The seal of the Corporation when required may be affixed to any instruments in writing signed as aforesaid or by any officer or officers appointed by resolution of the Board of Directors.

SERVICE

18. Amend Section 32.1 as follows (changes are marked):

17.1 **Service**

Any notice or other document required by the Act, the Regulations, the Letters Patent, Rules or the By-laws to be sent to any Member, director or Approved Person or to the auditor shall be delivered personally or sent by prepaid mail or by facsimile to any such Member, director or Approved Person at their latest address as shown in the records of the Corporation and to the auditor at its business address, or if no address be given therein then to the last address of such Member, director or Approved Person known to the Secretary; provided always that notice may be waived or the time for the notice may be waived or abridged at any time with the consent in writing of the person entitled thereto.

NOTICES

19. Amend Section 32.1 as follows (changes are marked):

32.1 **Service**

Any notice or other document required by the Act, the Regulations, the Letters Patent, Rules or the By-laws to be sent to any Member, director or Approved Person or to the auditor shall be delivered personally or sent by prepaid mail, ~~or~~ by facsimile, e-mail or any other electronic means to any such Member, director or Approved Person at

their latest address as shown in the records of the Corporation and to the auditor at its business address, or if no address be given therein then to the last address of such Member, director or Approved Person known to the Secretary; provided always that notice may be waived or the time for the notice may be waived or abridged at any time with the consent in writing of the person entitled thereto.

BY-LAW AMENDMENTS

20. Amend Section 33 as follows (changes are marked):

33. **By-laws**

The Board of Directors may from time to time enact By-laws relating in any way to the Corporation or to the conduct of its affairs, including, but not limited to, By-laws providing for applications for supplementary letters patent, and may from time to time by by-law amend, repeal or re-enact the By-laws but no By-law shall be effective until sanctioned by at least 2/3 of the votes cast at a meeting of the Members duly called for the purpose of considering same, and the repeal or amendment of By-laws not embodied in the Letters Patent shall not be enforced or acted upon until ~~the~~ any approval of the Minister required under the Act in respect thereof has been obtained.

BY-LAW DESIGNATION

21. The By-law of the Corporation amending By-law No. 1 by adding Section 24.A relating to an ombudservice for Members, and as made by the Board of Directors on September 27, 2002 and confirmed and sanctioned by the Members on December 13, 2002, is designated as By-law No. 4.

13.1.16 MFDA Rule 1.1.3 – Service Arrangements

MFDA – SERVICE ARRANGEMENTS [Rule 1.1.3]

I. OVERVIEW

A. Current Rule

Rule 1.1.3 permits Members or Approved Persons to engage the services of a person who is not a Member or Approved Person to provide certain services to the Member or Approved Person. The Rule provides, among other things, that such services do not in themselves require registration under securities legislation, or are duties or responsibilities that the Member or Approved Person must perform directly pursuant to the By-laws, Rules or applicable securities legislation.

B. The Issue

Rule 1.1.3 was never intended to prohibit a Member or Approved Person from engaging the services of another Member or Approved Person in the circumstances prescribed by Rule 1.1.3.

C. Objective

The objective of the proposed amendment is to clarify that Members and Approved Persons may enter into service arrangements with another Member or Approved Person as contemplated by Rule 1.1.3.

II. DETAILED ANALYSIS

Rule 1.1.3 was not intended to restrict service agreements to non-Members but rather restrict the services to non-registerable activities. There are services not requiring registration that a Member may perform on behalf of another Member or Approved Person that would be considered a service arrangement under Rule 1.1.3. Accordingly, the MFDA wanted to reflect this arrangement through the proposed amendment, which will permit a Member or Approved Person to engage the services of any person, including another Member or Approved Person, under Rule 1.1.3. However, the services cannot comprise registerable activity. If a Member is engaging another Member to perform services that would require registration under securities legislation, then that arrangement would be considered an introducing/carrying arrangement pursuant to Rule 1.1.6.

A. Issues and Alternatives

No other issues and alternatives were considered.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

The MFDA believes that the proposed amendment is in the public interest in that it will clarify that Members and Approved Persons may enter into service arrangements with other Members and Approved Persons provided the conditions set out in Rule 1.1.3 are met.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 1.1.3

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

SERVICE ARRANGEMENTS (Rule 1.1.3)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 1.1.3:

1.1.3 Service Arrangements. A Member or Approved Person may engage the services of any person including another Member or Approved Person, ~~a person who is not a Member or an Approved Person~~ to provide services to the Member or Approved Person, as the case may be, provided that:

(a) the services do not in themselves constitute securities related business or duties or responsibilities that are required to be performed by the Member or Approved Person engaging the services ~~itself or him/herself~~ pursuant to the By-laws, Rules or applicable securities legislation;

(b) any remuneration or compensation in any form in respect of such services shall only be paid or credited by the Member or Approved Person engaging the services, as the case may be, directly to the person providing the services and the payment or credit of such remuneration or compensation shall be recorded in the books and records required to be maintained in accordance with the By-laws and Rules by the Member or Approved Person engaging such services;

(c) the Member or Approved Person engaging the services shall remain responsible for compliance with the By-laws and Rules and any applicable legislation;

(d) any person preparing and maintaining books and records as a service in respect of the business of the Member or Approved Person shall do so in accordance with the requirements of Rule 5, and such books and records shall be available for review by the Member or Approved Person during normal business hours and by the Corporation in accordance with the By-laws and Rules; and

(e) all material terms of the services to be engaged that relate to requirements of the Member or Approved Person under the By-laws, Rules, Policies or Forms shall be evidenced in writing and a copy of such terms, together with any

amendments thereto from time to time or termination, shall be provided by the Member or Approved Person promptly to the Corporation upon request, together with any other information relating thereto as may be requested by the Corporation.

13.1.17 MFDA Rule 2.12 – Transfers of Account

MFDA – TRANSFERS OF ACCOUNT [Rule 2.12]

I. OVERVIEW

A. Current Rule

Rule 2.12 sets out general requirements for account transfers. "Account transfer" is defined under the Rule as the transfer in whole or in part of an account of a client with a Member to another Member at the request or with the authority of the client.

B. The Issue

The current Rule does not expressly deal with account transfers that may involve a non-Member.

C. Objective

The objective of the amendment is to clarify that the requirements of Rule 2.12 apply generally to any account transfer of a client of a MFDA Member.

II. DETAILED ANALYSIS

The current rule does not expressly deal with the situation where an account of a client of an MFDA Member is transferred to a non-Member (receiving dealer). Under the current definition of "account transfer", the requirements of Rule 2.12.2 apply only where an account or part of an account with a Member is transferred to another Member. The proposed amendment will ensure that account transfers of clients of MFDA Members are performed on an orderly and timely basis in all cases whether or not the receiving dealer is an MFDA Member. The reference to "another Member" will be deleted from the definition of "account transfer" in 2.12.1.

A. Issues and Alternatives Considered

No other issues or alternatives were considered.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

The proposed amendment is in the public interest in that it will ensure that account transfers of clients of MFDA Members are subject to the same standard, regardless of whether the account is being transferred to another Member or a non-Member.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendment will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendment is simple and effective.

C. Process

The proposed amendment was developed by MFDA staff in response to comments received from Members and was approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 2.12

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendment so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendment would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

TRANSFERS OF ACCOUNT (RULE 2.12)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to Rule 2.12:

2.12 TRANSFERS OF ACCOUNT

2.12.1 Definitions. For the purposes of the By-laws and Rules:

(a) "account transfer" means the transfer in whole or in part of an account of a client ~~with~~ of a Member ~~to another Member~~ at the request of with the authority of the client;

(b) "delivering Member" means in respect of an account transfer the Member from which the account of the client is to be transferred; and

(c) "receiving Member" means in respect of an account transfer the Member to which the account of the client is to be transferred.

2.12.2 Transfers. No account transfer shall be effected by a Member without the written authorization of the client holding the account. If an account transfer is authorized by a client ~~the~~ a delivering Member and ~~the~~ a receiving Member shall act diligently and promptly in order to facilitate the transfer of the account in an orderly and timely manner.

13.1.18 Disciplinary and Enforcement Amendments to MFDA By-law No. 8

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

BY-LAW AMENDMENTS

DISCIPLINARY AND ENFORCEMENT AMENDMENTS

MFDA BY-LAW NO. 8

June 2003

INDEX

PART 1

SUMMARY AND REQUEST FOR PUBLIC COMMENT

I. VERVIEW

A. Current By-laws

The current MFDA by-laws contain particulars developed at a time when the MFDA was in its early stage of development.

B. The Issues

On June 13, 2003, the MFDA Board of Directors passed by-law amendments (the **"By-law Amendments"**) that reflect changes to certain disciplinary and enforcement provisions in MFDA By-law No. 1 (as amended). The By-law Amendments enhance the clarity and flexibility of the MFDA By-laws.

C. Objectives

The objectives of the By-law Amendments are to:

- Clarify the role of Hearing Panels in MFDA disciplinary proceedings.
- Standardize fines and Hearing Panel powers with those at the IDA and securities commissions.
- Strengthen the effect of Hearing Panel decisions.
- Streamline the process respecting the approval of settlement agreements.
- Harmonize investigation and examination provisions with those in place at securities commissions.

Certain of the By-law Amendments reflect conforming changes to the text of By-law No. 1 (as amended). For example, certain references to "Regional Council" have been replaced with "Hearing Panel" to clearly distinguish the disciplinary activities of Regional Councils from their policy functions. Also, internal cross-references have been updated to reflect changes in the sequencing of various provisions.

D. Effect of Amendments

The By-law Amendments will enhance the efficiency and effectiveness of the MFDA.

II. DETAILED ANALYSIS

The By-law Amendments are contained in a new by-law passed by the MFDA Board of Directors on June 13, 2003:

- By-law No. 8: Disciplinary and Enforcement Amendments.

Details respecting this by-law are set out below.

A. Issues and Alternatives Considered

The MFDA reviewed disciplinary and enforcement requirements and practices at the Investment Dealers Association of Canada, Member Regulation Services Inc. and securities commissions in jurisdictions that have recognized the MFDA as a self-regulatory organization in Canada.

B. Comparison with Similar Provisions

The By-law Amendments are generally consistent with disciplinary and enforcement requirements and practices at the Investment Dealers Association of Canada, Member Regulation Services Inc. and securities commissions in jurisdictions that have recognized the MFDA as a self-regulatory organization in Canada.

C. Public Interest and Best Interests of the Capital Markets

The By-law Amendments are in the public interest and in the best interests of the capital markets.

III. COMMENTARY

A. Filing in Other Jurisdictions

The By-law Amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Ontario and Saskatchewan Securities Commissions.

B. Effectiveness

The By-law Amendments are simple and effective.

C. Process

The By-law Amendments were developed by MFDA staff in the course of reviewing the operation of the MFDA by-laws and were passed by the MFDA Board of Directors on June 13, 2003.

IV. SOURCES

- Disciplinary and enforcement requirements and practices of the Investment Dealers Association of Canada and Member Regulation Services Inc.
- Securities regulatory requirements and practices in the jurisdictions that have recognized the MFDA as a self-regulatory organization.

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the By-law Amendments so that the particulars referred to above and described below may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the By-law Amendments would be in the public interest and not detrimental to the capital markets. Comments are sought on the By-law Amendments.

Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services
Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

PART 2

MFDA BY-LAW NO. 8: DISCIPLINARY AND ENFORCEMENT AMENDMENTS

A. Introduction

By-law No. 8 sets out By-law Amendments to MFDA enforcement and disciplinary provisions designed to enhance the efficiency and effectiveness of MFDA and Hearing Panel operations. The By-law Amendments were passed by the MFDA Board of Directors on June 13, 2003.

The By-law Amendments support the following objectives:

- Clarifying the role of Hearing Panels in MFDA disciplinary proceedings.
- Standardizing fines and Hearing Panel powers with those at the IDA and securities commissions.
- Strengthening the effect of Hearing Panel decisions.
- Streamlining the process respecting the approval of settlement agreements.
- Harmonizing investigation and examination provisions with those in place at securities commissions.

Certain of the By-law Amendments reflect conforming changes to the text in By-law No. 1 (as amended). For example, certain references to "*Regional Council*" have been replaced with "*Hearing Panel*" to clearly distinguish the disciplinary activities of Regional Councils from their policy functions. Also, internal cross-references have been updated to reflect changes in the sequencing of various provisions.

B. Summary of By-law Amendments in MFDA By-law No. 8

(i) Powers of Hearing Panels

- The maximum fines that may be imposed by a Hearing Panel will be increased as follows:
  - The dollar limit will be increased from $1million to $5 million.
  - The pecuniary benefit limit will be modified to reflect not only three-times the profit made, but also three-times the loss avoided.
- Hearing Panels will have authority to make two additional types of orders against a Member:
  - Imposition of a monitor to oversee and report on a Member's activities.
  - Directions for the orderly transfer of client accounts from the Member.
- Hearing Panels will have authority to discipline an Approved Person for breach of an agreement with the Corporation.

MFDA Commentary:

The current maximum fine set out in the MFDA by-laws is $1 million. At the time when the MFDA By-laws were originally approved, this figure was identical to the maximum fine that a court could impose under applicable securities law in Alberta, B.C., Nova Scotia, Ontario and Saskatchewan.

Recently, the Ontario Government, on recommendation of the Five Year Review Committee, amended Ontario securities law to increase the maximum fine from $1 million to $5 million. The amendments will harmonize the MFDA fine provisions with those under Ontario securities law.

The inclusion of powers to impose a monitor or make directions for the orderly transfer of client accounts provides Hearing Panels with flexibility to make remedial orders in appropriate circumstances.

The inclusion of authority to discipline Approved Persons for breach of an agreement with the MFDA reflects a conforming change with an existing counterpart provision in the MFDA by-law dealing with agreements between the MFDA and Members in section 25.1.2(g) of By-law No. 1 (as amended).

(ii) Effect and Review of Hearing Panel Decisions

- A decision of a Hearing Panel will have effect in all Regions where the MFDA has jurisdiction, unless otherwise ordered by the MFDA Board.
- Orders of the Hearing Panel will remain in effect pending review by the MFDA Board unless the Hearing Panel or the MFDA Board directs otherwise.
- Persons affected by Hearing Panel decision who wish to have the MFDA Board review the decision must file their request within 30 days.

MFDA Commentary:

The extension of the effect of Hearing Panel decisions to all Regions where the MFDA has jurisdiction will enhance the regulatory efficiency of the MFDA. If a Hearing Panel has determined that it is appropriate to make an order against a Member, then that order should apply to all jurisdictions in which the Member conducts business, not only the Region in which the disciplinary proceeding took place.

There is no current provision in the MFDA by-laws expressly dealing with stays of Hearing Panel orders pending review or appeal. The amendment will require that all Hearing Panel decisions take effect immediately and continue in force pending appeal or review, unless otherwise ordered by the Hearing Panel or the MFDA Board. This approach reflects a presumption of regularity on the part of Hearing Panels and their processes and conforms with the approach regarding stays of decisions pending appeals under securities legislation in Alberta, B.C., Nova Scotia, Ontario and Saskatchewan.

(iii) Settlement Agreements

- All settlement agreements between the MFDA and a proposed respondent will be approved by Hearing Panels.
- Hearing Panel decisions approving settlement agreements will be final with no right of review.

(iv) Examinations and Investigations

- There will be no specific requirement to notify a Member or Approved Person in writing of matters under investigation.
- MFDA examinations and investigations will be streamlined, so that MFDA may request information:
  - That the MFDA considers relevant.
  - That is in the possession of partners, directors, officers, employees, agents or other persons under the direction or control of a Member or Approved Person.
- The MFDA will be able to conduct such examinations and investigations as it considers necessary or desirable without the limitations set out in section 22 of the by-laws, which have been removed.

MFDA Commentary:

Securities commissions in Canada have authority to conduct examinations and investigations without regard to external referrals, such as client complaints or requests from self-regulatory organizations. In addition, securities commission staff which conduct investigations are not presently required to inform, in writing, persons subject to an investigation of matters under investigation. The absence of this requirement provides securities commission staff with flexibility to conduct inquiries without tipping a person and thereby possibly placing evidence at risk. The amendments respecting investigations and examinations are designed to provide the MFDA with flexibility.

C. Comparison between Current Provisions and By-law Amendments

The following table compares current provisions in MFDA By-law No. 1 (as amended) with counterpart By-law Amendments set out in MFDA By-law No. 8.

	Current By-law Provisions	By-law No. 8 Amendments
Maximum Fines a Hearing Panel May Impose	• Fine not exceeding the greater of: • $1 million per offence, and • An amount equal to three-times the pecuniary benefit which accrued to the person as a result of committing the violation. *By-law No. 1 - sec. 25.1.1 and 25.1.2*	• Fine not exceeding the greater of: • $5 million per offence, and • An amount equal to three-times the profit obtained or loss avoided by the person as a result of committing the violation. *By-law No. 8 - sec. 25.1.1 and 25.1.2*
New Orders Hearing Panels My Impose	• No current counterpart provision in by-laws.	• A Hearing Panel may make these orders against a Member: • Imposition of a monitor to oversee and/or report on a Member's activities. • Directions for the orderly transfer of client accounts from a Member. *By-law No. 8 - sec. 25.2.1(g) and (h)*
New Authority for Hearing Panels	• No current counterpart provision in by-laws	• A Hearing Panel will have authority to discipline an Approved Person for breach of an agreement between the Approved Person and the MFDA. *By-law No. 8 - sec. 25.1.1(g)*
Settlement Agreements	• Settlement Agreements must be approved by the MFDA and the MFDA Regional Director, and then referred to the Regional Council for approval. • No express provision that disposition of settlement agreement by Regional Council is final. *By-law No. 1 - sec. 25.15.3*	• Settlement Agreements must be approved by the MFDA and then referred to the Hearing Panel for approval. • The acceptance or rejection of a settlement agreement by a Hearing Panel is final and not subject to appeal or review. *By-law No. 8 - sec. 25.4.3 and 25.4.7*
Effect of Hearing Panel Decisions	• Any decision of Regional Council by which a Member's rights and privileges are suspended or terminated, or a Member expelled from the MFDA, has effect only in the Region where the Regional Council has jurisdiction, unless otherwise ordered by the MFDA Board. *By-law No. 1 - sec. 25.17.1*	• Any decision of a Hearing Panel by which a Member's rights and privileges are suspended or terminated, or a Member expelled from the MFDA, has effect in all Regions where the MFDA has jurisdiction, unless otherwise ordered by the MFDA Board. *By-law No. 8 - sec. 25.6.1*
Review of Hearing Panel Decisions	• If a Regional Council makes an order against a Member suspending or terminating rights and privileges or expelling the Member from the MFDA, or imposes a fine or conditions on a Member, then on application of the Member or MFDA within 21 days of receipt of notice of the decision, the MFDA Board shall review the decision and confirm or modify or change the territorial scope of the decision. *By-law No. 1 - sec. 25.17.2 and 25.17.3*	• If a Hearing Panel makes an order against a Member suspending or terminating rights and privileges or expelling the Member from the MFDA, or imposes a fine or conditions on a Member, then on application of the Member or MFDA within 30 days of receipt of the notice of the decision, the MFDA Board shall review the decision and confirm or modify the decision. *By-law No. 8 - sec. 25.6.2*
Stay of Hearing Panel Decisions	• No current counterpart provision in by-laws.	• An order of a Hearing Panel takes effect upon its issuance and remains in effect pending a review by the MFDA Board, unless the Hearing Panel or the MFDA Board directs otherwise. *By-law No. 8 - sec. 25.6.4*

	Current By-law Provisions	By-law No. 8 Amendments
Re-Numbered Sections in the By-laws	Sec. 25.3 - Notice of Hearing Sec. 25.4 - Right to be Heard Sec. 25.5 - Costs Sec. 25.6 - Reply Sec. 25.7 - Acceptance of Facts/Conclusions Sec. 25.8 - Failure to Reply or Attend Sec. 25.10 - Open to the Public Sec. 25.11 - Jurisdiction Sec. 25.12 - Parties to Proceedings/Witnesses Sec. 25.13 - Reasons Sec. 25.14 - Suspensions in Certain Instances Sec. 25.15 - Settlement Agreements Sec. 25.16 - Publication of Notice and Penalties Sec. 25.17 - Effect and Review of Regional Council Decisions	Sec. 20.1 - Notice of Hearing Sec. 20.1.5 - Right to be Heard Sec. 25.2 - Costs Sec. 20.2 - Reply Sec. 20.3 - Acceptance of Facts/Conclusions Sec. 20.4 - Failure to Reply or Attend Sec. 20.5 - Open to the Public Sec. 25.1.4 - Jurisdiction Sec. 20.6 - Parties to Proceedings/Witnesses Sec. 20.7 - Reasons Sec. 25.3 - Suspensions in Certain Instances Sec. 25.4 - Settlement Agreements Sec. 25.5 - Publication of Notice and Penalties Sec. 25.6 - Effect and Review of Hearing Panel Decisions
Deleted Sections of the By-laws	• Sec. 25.9 - Prior Involvement	• Deleted
Basis for Examination/ Investigation	• Any examination or investigation may be instituted upon the basis of: • a complaint received by the MFDA, • a direction from the MFDA Board, • a request from a securities commission or SRO, or • any information received or obtained by the MFDA relating to the business or affairs of the Member or person. *By-law No. 1 - sec. 22*	• Deleted
New Investigation Power	• No current counterpart provision in by-laws.	• MFDA may obtain information from third parties who are under the direction or control of a Member, Approved Person or other person under the jurisdiction of the MFDA. *By-law No. 8 - sec. 23.1(d)*
Notification of Investigations	• MFDA is required to advise, in writing, any Member or person subject to an investigation of the matters under investigation. *By-law No. 1 - sec. 23.1*	• Deleted.

PART 3

BLACKLINED COPY OF MFDA BY-LAW NO. 8

BY-LAW NO. 8
(Disciplinary and Enforcement Amendments)

being a by-law amending the General By-law No. 1 of

MUTUAL FUND DEALERS ASSOCIATION OF CANADA/
ASSOCIATION CANADIENNE DES COURTIERS DE FONDS MUTUELS

(hereinafter referred to as the "Corporation")

By-law No. 1 of the Corporation is hereby amended as follows:

DEFINITIONS

The definition of "Notice of Hearing" in Section 1 is amended as follows (changes are marked):

"Notice of Hearing" means a notice of hearing given pursuant to Section ~~25.3~~ 20.1.

DISCIPLINARY PROCEEDINGS

Section 20 is deleted in its entirety and replaced with the following:

20. DISCIPLINARY HEARINGS

20.1 **Notice of Hearing**

20.1.1 ***Contents of Notice.*** Before a Hearing Panel may impose any of the penalties provided for in Section 25.1 hereof (other than pursuant to the approval of a settlement agreement pursuant to Section 25.4.3), the Member, Approved Person or other person, as the case may be, shall have been summoned before a hearing of such Hearing Panel, of which at least 14 days' notice shall be given, by way of Notice of Hearing, to the Member or person concerned. Such Notice of Hearing shall be in writing, shall be signed by an officer of the Corporation and contain:

(a) the date, time and place of the hearing;

(b) the purpose of the hearing;

(c) the authority pursuant to which the hearing is held;

(d) a summary of the facts alleged and intended to be relied upon by the Corporation and the conclusions drawn by the Corporation based on the alleged facts; and

(e) the provisions of Sections 20.2 to 20.4 inclusive and a description of the penalties and costs which may be imposed pursuant to Sections 25.1 and 25.2, respectively.

20.1.2 ***Notice Addressed to Corporation.*** Any notice to a Hearing Panel must be in writing and addressed to the Corporation in care of the office of the Corporation having responsibility for the applicable Regional Council.

20.1.3 ***Notice to Members in the Case of an Individual.*** In the case of an individual summoned before a hearing of a Hearing Panel, the Member or Members concerned shall be served with a copy of the Notice of Hearing.

20.1.4 ***Publication Notices.*** A Notice of Hearing shall be published in the same manner as a notice of penalty pursuant to Section 25.5.

20.1.5 ***Right to be Heard.*** The Member or person summoned pursuant to Section 20.1 and the Corporation shall be entitled to appear and be heard at the hearing and shall be entitled to be represented by counsel or an agent and to call, examine and cross-examine witnesses and present evidence and submissions.

20.2 **Reply**

A Member or person summoned before a hearing of a Hearing Panel pursuant to a Notice of Hearing shall, within ten days from the date of service of the Notice of Hearing, serve on the Corporation a reply that either:

20.2.1 specifically denies (with a summary of facts alleged and intended to be relied upon by the Member or person, and the conclusions drawn by the Member or person based on the alleged facts) any or all of the facts alleged or the conclusions drawn by the Corporation in the Notice of Hearing; or

20.2.2 admits the facts alleged and conclusions drawn by the Corporation in the Notice of Hearing and pleads circumstances in mitigation of any penalty to be assessed.

20.3 **Acceptance of Facts and Conclusions**

The Hearing Panel may accept as having been proven any facts alleged or conclusions drawn by the Corporation in the Notice of Hearing that are not specifically denied in the reply.

20.4 **Failure to Reply or Attend**

If a Member or person summoned before a hearing of a Hearing Panel by way of Notice of Hearing fails to:

(a) serve a reply in accordance with Section 20.2; or

(b) attend at the hearing specified in the Notice of Hearing, notwithstanding that a reply may have been served;

the Hearing Panel may proceed with the hearing of the matter on the date and at the time and place set out in the Notice of Hearing (or on any subsequent date, at any time and place), without further notice to and in the absence of the Member or person, and the Hearing Panel may accept the facts alleged by the Corporation in the Notice of Hearing as having been proven by the Corporation and may impose any of the penalties described in Section 25.1.

20.5 **Open to the Public**

A hearing pursuant to Section 20.2 shall be open to the public except where the Hearing Panel is of the opinion that intimate financial or personal matters or other matters may be disclosed at the hearing which are of such a nature, having regard to the circumstances, that the desirability of avoiding disclosure thereof in the interests of any person affected or in the public interest outweighs the desirability of adhering to the principle that hearings be open to the public, in which case the Hearing Panel may hold the hearing *in camera*.

20.6 **Parties to Proceedings and Witnesses**

20.6.1 ***Parties to Proceedings.*** The parties to proceedings before a Hearing Panel are:

(a) the Corporation, which shall be represented by the Corporation, or any person designated by it; and

(b) in the case of:

(i) an individual, the individual and, in the discretion of the Hearing Panel, the Member concerned;

(ii) a Member, the Member.

20.6.2 ***Attendance or Production.*** Every Member, Approved Person and other person under the jurisdiction of the Corporation may be required by a Hearing Panel:

(a) to attend before it at any of its proceedings and give information respecting any matter involved in the proceeding; and

(b) to produce for inspection and provide copies of any books, records and accounts of such person, or within such person's possession and control, relevant to the matters being considered.

20.6.3 ***Required Attendance of Employee or Agent of Member.*** In the event that a Hearing Panel requires the attendance before it of any employee or agent of a Member who is not under the jurisdiction of the Corporation, the

Member shall direct such employee or agent to attend and to give information or make such production as could be required of a person referred to in Section 20.6.2.

20.7 **Reasons**

Any decision of a Hearing Panel at a hearing held pursuant to Section 20.1 shall be in writing and shall contain a concise statement of the reasons for the decision. Notice of a decision shall be delivered to the Secretary who shall then promptly give notice, in the case of an individual, to the individual and to the Member concerned, or in the case of a Member, to the Member. A copy of the decision shall accompany the notice.

DISCIPLINE

Section 25 is amended as follows (substantive changes are marked):

25. Discipline ~~Procedures~~. Powers

25.1 Power of Hearing Panels to Discipline

25.1.1 ***Approved Persons.*** A Hearing Panel of the applicable Regional Council shall have power to impose upon an Approved Person or any other person under the jurisdiction of the Corporation any one or more of the following penalties:

(a) a reprimand;

(b) a fine not exceeding the greater of:

(i) ~~$1,000,000.00~~ 5,000,000.00 per offence; and

(ii) an amount equal to three times the ~~pecuniary benefit which accrued to~~ profit obtained or loss avoided by such person as a result of committing the violation;

(c) suspension of the authority of the person to conduct securities related business for such specified period and upon such terms as the Hearing Panel may determine;

(d) revocation of the authority of such person to conduct securities related business;

(e) prohibition of the authority of the person to conduct securities related business in any capacity for any period of time;

(f) such conditions of authority to conduct securities related business as may be considered appropriate by the Hearing Panel;

if, in the opinion of the Hearing Panel, the person:

(g) has failed to carry out any agreement with the Corporation;

(h) has failed to comply with or carry out the provisions of any federal or provincial statute relating to the business of the Member or of any regulation or policy made pursuant thereto;

(i) has failed to comply with the provisions of any By-law, Rule or Policy of the Corporation;

(j) has engaged in any business conduct or practice which such Regional Council in its discretion considers unbecoming or not in the public interest; or

(k) is otherwise not qualified whether by integrity, solvency, training or experience.

25.1.2 ***Members.*** A Hearing Panel of the applicable Regional Council shall have power to impose upon a Member any one or more of the following penalties:

(a) a reprimand;

(b) a fine not exceeding the greater of:

a. ~~$1,000,000.00~~ 5,000,000.00 per offence; and

b. an amount equal to three times the ~~pecuniary benefit which accrued to~~ profit obtained or loss avoided by the Member as a result of committing the violation;

(c) suspension of the rights and privileges of the Member (and such suspension may include a direction to the Member to cease conducting securities related business) for such specific period and upon such terms as such Hearing Panel may determine, or, if the rights and privileges have already been suspended under Section 25.3, the continuation of such suspension (including a prohibition on the Member conducting securities related business) for such specified period and upon such terms as such Hearing Panel may determine;

(d) termination of the rights, privileges and Membership of the Member;

(e) expulsion of the Member from the Corporation;

(f) such terms and conditions on Membership of the Member as may be considered appropriate by the Hearing Panel;

(g) imposition of a monitor to oversee and/or report on the Member's activities; and

(h) directions for the orderly transfer of client accounts from the member.

if, in the opinion of the Hearing Panel, the Member:

(i) has failed to carry out any agreement with the Corporation;

(j) has failed to meet any liabilities to another Member or to the public;

(k) has engaged in any business conduct or practice which the Hearing Panel in its discretion considers unbecoming a Member or not in the public interest;

(l) has ceased to be qualified as a Member by reason of the ownership, integrity, solvency, training or experience of the Member or any of it's Approved Persons or other employees or agents, or any person having an ownership interest in the capital or indebtedness of the Member;

(m) has failed to comply with or carry out the provisions of any of the By-laws, Rules or Policies of the Corporation; or

(n) has failed to comply with or carry out the provisions of any applicable federal or provincial statute relating to its business or of any regulation or policy made pursuant thereto.

25.1.3 ***Continuation of Liability***. If the rights, privileges or Membership of a Member are suspended or terminated or a Member is expelled from the Corporation, the Member or former Member shall remain liable to the Corporation for all amounts due to the Corporation by it.

25.1.4 **Jurisdiction**

(a) ***Former Members***. For the purposes of Sections 20 to 25 inclusive, any Member, Approved Person or other person subject to the jurisdiction of the Corporation shall remain subject to the jurisdiction of the Corporation notwithstanding that such Member has ceased to be a Member, Approved Person or other person subject to the jurisdiction of the Corporation.

(b) ***Limitation.*** No proceedings shall be commenced pursuant to Section 20.1 against a former Member or person referred to in Section 25.1.4 (a) unless a Notice of Hearing has been served upon such Member or person no later than five years from the date upon which such Member or person ceased to be a Member or held the relevant position with the Member, respectively.

25.2 **Costs**

A Hearing Panel may in any case in its discretion require that the Member or Approved Person pay the whole or part of the costs of the proceedings before the Hearing Panel and any investigations relating thereto.

25.3 **Suspensions in Certain Circumstances**

25.3.1 ***Power to Suspend.*** Notwithstanding anything in this Section 25 or in Section 20, in the event that:

(a) the registration of a Member as a mutual fund dealer under any securities legislation of any province or territory in which the Member is carrying on business is suspended or cancelled, or a Member fails to renew any such registration which has lapsed; or

(b) a Member makes a general assignment for the benefit of its creditors or is declared bankrupt or makes an authorized assignment or a proposal to its creditors under the *Bankruptcy and Insolvency Act*, or a winding-up order is made in respect of a Member or a receiver or other officer with similar powers is appointed in respect of all or any part of the undertaking and property of a Member; or

(c) a stock exchange, securities commission, self-regulatory organization or other securities regulatory authority suspends the membership or privileges thereof of a Member who is a member of such exchange or self-regulatory organization;

then a Hearing Panel of the applicable Regional Council shall have the power and, with respect to an event referred to in Section 25.3.1(b) above, shall be obliged, forthwith upon receiving notice of such event, to suspend the rights and privileges of the Member for such period and on such terms and conditions as such Hearing Panel may in its discretion determine.

25.3.2 ***Further Suspension. Termination of Rights and Privileges, Expulsion.*** In any of the events referred to:

(a) in Sections 25.3.1(a) or (c), if the Member fails to take appropriate proceedings within the time provided for by the legislation or stock exchange, securities commission, self-regulatory organization or regulatory authority rules for a review of or by way of appeal from such suspension or cancellation of registration or membership, or fails within such period as the Hearing Panel may prescribe to renew any such registration which has lapsed, or if, notwithstanding such review and appeal, such suspension or cancellation of registration or membership, is confirmed and becomes final, the Hearing Panel may, either with or without notice to the Member, suspend the Member for a further period, terminate the rights, privileges and Membership of the Member or expel the Member from the Corporation, and such suspension, termination or expulsion shall take immediate effect and there shall be no review or appeal therefrom. If upon review or appeal the registration or membership of a Member under the legislation, stock exchange, self-regulatory organization or regulatory authority rules is reinstated, the Hearing Panel may reinstate the Member and cancel any suspension imposed by it upon the Member.

(b) in Section 25.3.1(b), if the Member fails within such period as the Hearing Panel may prescribe to satisfy the claims of its creditors and/or obtain a discharge under the *Bankruptcy and Insolvency Act* or cause the winding-up order or receivership to be discharged or terminated, the Hearing Panel may, either with or without notice to the Member, suspend the Member for a further period, terminate the rights, privileges and Membership of the Member or expel the Member from the Corporation, and such suspension, termination or expulsion shall take immediate effect. If the Member satisfies its creditors and/or obtains a discharge under the *Bankruptcy and Insolvency Act* or causes the winding-up order or receivership to be discharged or terminated within such period as the Hearing Panel may determine, the Hearing Panel may reinstate the Member upon such terms and conditions as the Hearing Panel may determine and cancel any suspension imposed by it upon the Member.

25.3.3 ***Cause of Financial Loss to the Public.*** Notwithstanding anything in Sections 21 to 25, inclusive, if, as a result of information received by the Chair or any Vice-Chair of the applicable Regional Council, such Chair and Vice-Chair after consultation with the President or one or more members of the Board of Directors is of the opinion that a Member has breached any By-law, Rule or Policy of the Corporation and that such breach or breaches is likely to result in financial loss to the public, the Chair or the Vice-Chair may immediately suspend the rights and privileges of such Member and direct such Member to immediately cease dealing with the public. If the Chair or Vice-Chair of the Regional Council acts under the provisions of this Section 25.3.3, he or she shall summon the Member to appear before a hearing of the Hearing Panel of the applicable Regional Council to be held within 15 days upon notice to the Member, with such notice and hearing to be in accordance with the provisions of this Sections 25, as applicable.

25.3.4 ***Failure to Pay Fine or Comply with Condition.*** In the event that a fine or condition imposed by a Hearing Panel pursuant to Section 25.1 is not paid or complied with, respectively, with the time prescribed by the Hearing Panel, the Hearing Panel may, upon application by the Corporation, and without further notice to the Member or person

concerned, suspend the authority of such person to conduct securities related business or the rights and privileges of such Member, respectively, until such fine is paid or condition fulfilled.

25.3.5 ***Other Proceedings.*** Nothing contained in Section 25.3 shall prevent any other proceedings being taken against a Member, Approved Person or other person pursuant to any other provisions of Section 25.

25.4 **Settlement Agreements**

25.4.1 ***Power to Enter into Settlement Agreement.*** The Corporation or any other person designated by it or the Board of Directors may negotiate a settlement agreement with a Member, Approved Person or other person under the jurisdiction of the Corporation, in respect of any matters for which the Member or person could be penalized on the exercise of the discretion of a Hearing Panel pursuant to Section 25.1.

25.4.2 ***Contents of Settlement Agreement.*** A settlement agreement shall be in writing and be signed by or on behalf of the Member or person and shall contain:

(a) a statement of facts sufficient to identify the matter to which the settlement agreement relates;

(b) a reference to any statutes or regulations thereto, By-law, Rules or Policies of the Corporation with which the Member or person has not complied and a statement as to future compliance therewith;

(c) the consent and agreement of the Member or person to the terms of the settlement agreement;

(d) the acceptance of the penalty to which the Member or person could be subject pursuant to Section 25.1;

(e) the waiver of the rights of the Member or person to a hearing pursuant to the By-laws and all rights or review thereunder; and

(f) such other matters not inconsistent with Section 25.4.2(a) to (e), inclusive, which may be agreed upon including, without limitation, the agreement by the Member or person to pay the whole or part of the costs of the investigation and any proceedings relating to the matters which are the subject of the settlement agreement.

25.4.3 ***Review and Determination by Hearing Panel.*** Such settlement agreement shall, on the recommendation of the Corporation, be referred to a Hearing Panel of the applicable Regional Council which shall:

(a) accept the settlement agreement; or

(b) reject it.

A Hearing Panel shall not consider a settlement agreement pursuant to this Section unless at least 14 days' notice of the hearing of the Hearing Panel has been given in accordance with Section 25.5 specifying:

(c) the date, time and place of the hearing; and

(d) the purpose of the hearing with sufficient information to identify the Member or Approved Person involved and the general terms of the settlement agreement.

25.4.4 ***Binding Upon Acceptance or Imposition.*** A settlement agreement shall only become binding in accordance with its terms upon such acceptance and, in such event, the Member or person shall be deemed to have been penalized by a Hearing Panel of the applicable Regional Council for the purpose of giving notice thereof.

25.4.5 ***Rejection of Settlement Agreement by Hearing Panel.*** If a Hearing Panel rejects a settlement agreement pursuant to Section 25.4.3, the provisions of Sections 20, 21 and 25.1 shall apply, provided that no member of the Hearing Panel who participated in the deliberations of the Hearing Panel rejecting the settlement agreement shall participate in any hearing conducted by the Hearing Panel with respect to the same matters which are the subject of the agreement.

25.4.6 ***Without Prejudice.*** All negotiations of a settlement agreement shall be without prejudice and the negotiations may not be used as evidence or referred to in any hearing.

25.4.7 ***No Appeal of Acceptance or Rejection of Settlement Agreement***. The acceptance or rejection of a settlement agreement by a Hearing Panel is final and is not subject to appeal or review pursuant to Section 25.6.3.

25.5 **Publication of Notice and Penalties**

25.5.1 ***Notice Requirements***. If and whenever:

(a) a Member (except as provided by Section 25.5.1(b) hereof), Approved Person or other person is penalized by a Hearing Panel, notice of the penalty shall be given by the Corporation forthwith; or

(b) the rights and privileges of a Member are suspended or terminated, or a Member is expelled from the Corporation, notice of the penalty and notice of the disposition of any review from the imposition thereof shall be given forthwith by the Corporation. If such penalty is subject to review the notice shall so indicate;

25.5.2 ***Content of Notice***. A notice of penalty given pursuant to Section 25.5.1 shall include a summary of the facts, shall specify the By-law, Rules or Policies violated and the penalty assessed, and shall include the name of the Member or person upon which the penalty is imposed and, in the case of a penalty imposed upon an Approved Person or other person, shall include the name of the Member employing or retaining such person at the relevant time.

25.5.3 ***Method of Giving Notice***. A Notice of penalty given pursuant to Section 25.5.1 shall be given:

(a) by publication in a Corporation bulletin;

(b) by delivery of the notice to a news service or newspaper having national distribution;

(c) by delivery of the notice to any securities commission, stock exchange, self regulatory organization or other securities regulatory authority having jurisdiction over the Member or individual concerned, and

(d) to such other persons, organizations or corporations, and in such other manner as the Hearing Panel imposing the penalty, and/or the Corporation from time to time, deems advisable.

25.6 **Effect and Review of Hearing Panel Decisions**.

25.6.1 ***Effect ~~Only in Applicable Region~~ in All Regions***. Any decision of a ~~Regional~~ Hearing ~~Council~~ Panel in respect of a Member, an Approved Person or other person subject to the jurisdiction of the Corporation shall have ~~the~~ effect ~~only~~ in ~~the~~ all ~~Region~~ Regions where ~~such Regional Council~~ the Corporation has jurisdiction, unless and until otherwise ordered by the Board of Directors.

25.6.2 ***Review***. In the event of a decision by a Hearing Panel:

(a) by which a Member's rights and privileges are suspended or terminated or a Member is expelled from the Corporation;

(b) by which it imposes a fine or conditions upon a Member;

the Board of Directors shall, upon the application of either the Corporation or the Member concerned made within 30 days of receiving notice of the decision of the Hearing Panel, review the said decision and confirm or modify the decision of the Hearing Panel.

25.6.3 ***Review Hearing***. With respect to a review pursuant to Section 25.6.2:

(a) the provisions of Sections 25.1 apply *mutatis mutandis* to any review by the Board of Directors;

(b) the Board of Directors:

(i) shall consider the record of the proceedings before the Regional Council;

(ii) shall permit the parties to appear before it on reasonable notice, with counsel or by agent, to make submissions and the provisions of Section 20.7 apply *mutatis mutandis*; and

(c) Members of the Board of Directors participating in a review hearing pursuant to this Section 25.6.3 shall not have taken part before the hearing in any proceedings with respect to the decision which is being reviewed. Subject to the provisions of Section 27, decisions of the Board of Directors pursuant to this Section 25.6.3 are final and there shall be no further review of such decisions within the Corporation.

25.6.4 ***Stay of Proceedings***. An order of a Hearing Panel takes effect upon its issuance and remains in effect pending a review under Section 25.6.2, unless the Hearing Panel or the Board of Directors directs otherwise.

25.6.5 ***Prohibition Against Review By Court or Tribunal***. Except as provided in Section 27, no proceedings shall be taken in any court or other tribunal to question or review any decision, order, direction, declaration or ruling of a Hearing Panel or the Board of Directors or to prohibit or restrain any Hearing Panel or the Board of Directors or their proceedings.

BASIS OF EXAMINATION OR INVESTIGATION

Section 22 is deleted.

INVESTIGATORY POWERS

Section 23.1 is amended as follows (changes are marked):

23.1 For the purpose of any examination or investigation pursuant to this By-law, a Member, Approved Person or other person under the jurisdiction of the Corporation pursuant to the By-laws or the Rules may be required by the Corporation.

(a) to submit a report in writing with regard to any matter involved in any such investigation;

(b) to produce for inspection and provide copies of the books, records and accounts of such person that the Corporation considers relevant to the matters being investigated.

(c) to attend and give information respecting any such matters; and

(d) to make any of the above information available through any directors, officers, employees, agents and other persons under the direction or control of the Member, Approved Person or other person under the jurisdiction of the Corporation;

and the Member or person shall be obliged to submit such report, to permit such inspection, provide such copies and to attend, accordingly. Any Member or person subject to an investigation conducted pursuant to this By-law ~~shall be advised in writing of the matters under investigation and~~ may be invited to make submission by statement in writing, by producing for inspection books, records and accounts and by attending before the persons conducting the investigation. The person conducting the investigation may, in his or her discretion, require that any statement given by any Member or person in the course of an investigation be recorded by means of an electronic recording device or otherwise and may require that any statement be given under oath.

13.1.19 MFDA Rule 2.8.3 – Rates of Return

MFDA – RATES OF RETURN [Rule 2.8.3]

I. OVERVIEW

A. Current Rule

Rule 2.8.3 requires that any client communication containing or referring to a rate of return regarding a specific account or group of accounts must be based on an annualized rate of return.

B. The Issue

The current Rule does not expressly deal with situations where a specific account or groups of accounts have been open for less than twelve months.

C. Objective

The objective of the amendment is to provide clarification to address situations where a specific account or groups of accounts have been open for less than twelve months.

D. Effect of Proposed Rule

The amendment will help to ensure that clients are not misled regarding the rate of return reported on their client communications. The amendment will also ensure that Members report rates of return in a consistent and accurate manner.

II. DETAILED ANALYSIS

The current rule does not address situations where accounts are open for less than 12 months. Where an account has been open for less than a year, an annualized rate of return may be misleading in that it would project the rate of return for the remaining part of the year. Accordingly, the proposed amendment will require that where an account has been open for less than twelve months, the rate of return shown must be the total rate of return since account opening.

A. Issues and Alternatives

No other issues or alternatives were considered.

B. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

C. Public Interest Objective

The MFDA believes that the proposed amendment is in the public interest in that it will ensure that Members report rates of return in a consistent and accurate manner.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and were approved by the MFDA Board of Directors.

IV. SOURCES

MFDA Rule 2.8.3

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

Laurie Gillett
Corporate Secretary and Membership Services Manager
Mutual Fund Dealers Association of Canada
(416) 943-5827

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

RATES OF RETURN (RULE 2.8.3)

On June 13, 2003, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendment to Rule 2.8.3:

(a) In addition to complying with the requirements in Rule 2.8.2, any client communication containing or referring to a rate of return regarding a specific account or group of accounts must be based on an annualized rate of return and explain the methodology used to calculate such rate of return in sufficient detail and clarity to reasonably permit the client to understand the basis of the return.

(b) Notwithstanding the provisions of paragraph (a), where an account has been open for less than 12 months, the rate of return shown must be the total rate of return since account opening.

13.1.20 RS Disciplinary Notice - Taylor Shambleau

DISCIPLINARY NOTICE

July 8, 2003 **2003-006**

Person Disciplined

On June 10, 2003, following a contested hearing, a Panel of the Hearing Committee of the Toronto Stock Exchange (the "Exchange") rendered a decision concerning Taylor Shambleau. Mr. Shambleau was at all material times an Approved Person employed with Sprott Securities Ltd., a Participating Organization of the Exchange.

Requirements Contravened

Mr. Shambleau was found to have contravened s. 11.26(1) of the General By-law of the Exchange in connection with a bid made for the account of a customer on March 31, 1999.

Mr. Shambleau was also alleged to have contravened s. 11.26(1) of the General By-law of the Exchange with respect to a trade executed on March 30, 1999. The Panel did not find a contravention.

Sanctions Assessed

On July 3, 2003, the Hearing Panel imposed the following sanctions upon Mr. Shambleau:

(a) a fine of $15,000;

(b) suspension for two weeks from acting in any capacity as an Approved Person with a Participating Organization of the Exchange commencing no later than August 1, 2003; and

(c) payment of $12,000 towards the cost of the investigation.

Summary of Facts

On the afternoon of March 31, 1999 at approximately 3:47 p.m., Mr. Shambleau received instructions from RT Capital Management Capital Inc. ("RT") in relation to the shares of Pacifica Paper Limited Partnership ("PPP"). Mr. Shambleau was instructed, "What I want to do is unless somebody sells the stock at 9.50, just in the last minute or so, would you put in a 9.90 bid for 2,000?" Mr. Shambleau confirmed the instructions: "Buy 2,000 at 9.90 fairly late in the day. OK." At 15:59:45, Mr. Shambleau entered an order to buy 2,000 shares of PPP at $9.90. The order expired unfilled at the end of the day but changed the market quote from $9.50 bid to $9.90 bid, with offer side remaining $9.95.

Further Information

Participants who require additional information should direct questions to Marie Oswald, Vice President, Investigations and Enforcement, Market Regulation Services Inc. at 416-646-7283.

About Market Regulation Services Inc.

Market Regulation Services Inc. is the regulation services provider for Canadian equity markets including the TSX and TSX Venture Exchanges. RS has been recognized by the securities commissions of Ontario, Quebec, British Columbia, Alberta and Manitoba to regulate the trading of securities on these markets by participant firms and their trading and sales staff. RS is mandated to conduct its regulatory activities in a neutral, cost-effective, service-oriented and responsive manner.

ALEXANDER DASCHKO
VICE PRESIDENT
OPERATIONS AND GENERAL COUNSEL

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