Re Deutsche Bank Securities Ltd

IN THE MATTER OF:

The By-Laws of the Investment Dealers Association of Canada

and

The Dealer Member Rules of the
Investment Industry Regulatory Organization of Canada (IIROC)

and

Deutsche Bank Securities Ltd.

2013 IIROC 07

Investment Industry Regulatory Organization of Canada
Hearing Panel (Ontario District)

Heard: February 8, 2013
Decision: February 21, 2013

Hearing Panel:
The Hon. Patrick T. Galligan, Q.C. – Chair, F. Michael Walsh
Appearances:
Susan Kushneryk – Enforcement Counsel – IIROC
Nigel Campbell - Counsel for the Respondent

REASON FOR DECISION

PRELIMINARY MATTER

¶ 1 At the outset of the hearing counsel for the parties consented to the continuation of the hearing with two panel members in the absence of Mr. Donald Lawson.

OVERVIEW

¶ 2 The Staff of Investment Industry Regulatory Organization of Canada ("IIROC") and the Respondent entered into a Settlement Agreement, which they had negotiated pursuant to By-law 20.35. They submitted the Settlement Agreement to this Hearing Panel, pursuant to By-law 20.36 and Rule 15 of the Rules of Practice and Procedure, for approval or rejection. After considering the material filed and the submissions made by counsel, we issued an order accepting the Settlement Agreement. These are our reasons for making that order.

THE CONTRAVENTION

¶ 3 The Respondent has admitted to the following contravention of IIROC Dealer Member Rules, Guidelines, Regulations or Policies and those of its predecessor, the Investment Dealers Association of Canada ("IDA"):

> In late July and early August 2007, the Respondent failed to engage Compliance with emerging issues in the ABCP market, contrary to Policy 5.

TERMS OF SETTLEMENT

¶ 4 Staff and the Respondent have agreed to the following terms of settlement:

- The Respondent to pay a fine of $1,000,000.

THE CIRCUMSTANCES

¶ 5 The circumstances are set out, in detail, in paragraphs 8-60 of the Settlement Agreement. It is attached as Appendix "A" to these reasons for decision. The following is a brief summary of them.

¶ 6 The Respondent was a member of a group of dealers selling Canadian non-bank backed Asset-Backed Commercial Paper ("ABCP"). It sold ABCP to its institutional clients. Its role in selling ABCP in the Canadian market was smaller than other dealers. It did not hold or sell ABCP from its inventory.

¶ 7 In July and August 2007 issues arose in the ABCP market which led to the market freezing on August 13, 2007. When the market froze investors were left with securities which they could neither liquidate nor sell. The Respondent failed to engage its Compliance department as those issues emerged. The emerging issues related to worsening conditions in the market and that there was potential for significant market disruption.

SERIOUSNESS OF THE CONTRAVENTION

¶ 8 The responsibility of Members to engage Compliance when "business and market circumstances change" is a very important one. The freezing of the ABCP market had drastic consequences. The failure to engage Compliance as the issues leading to that freeze emerged must be viewed as a serious one.

DUTY OF A HEARING PANEL UPON A SETTLEMENT HEARING

¶ 9 It is clear from jurisprudence emanating from the courts and from Hearing Panels of IIROC, Investment Dealers Association and the Mutual Fund Dealers Association, that our task is not to decide whether, in this case, we would have arrived at the same decision as that reached by the parties. Rather, our duty is to determine whether the penalty is a reasonable one and that it meets the objectives of the disciplinary process which are to maintain the integrity of the investment industry. We cite from the recent decision of the Hearing Panel in *Re CIBC World Markets Inc.*, [2011] IIROC No. 38:

> 13 Finally, hearing panels will not lightly interfere with a negotiated settlement. As was said in *Re Milewski*, [1999] IDACD No. 17,
>
> > … a District Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness.
>
> 14 Or, as put by Winkler J. (albeit in another context) in *Gilbert v. CIBC*, [2004] O.J. 4260:
>
> > There is a presumption of fairness when a proposed class settlement negotiated at arms length … is presented to the court for approval. A court will only reject a proposed settlement when it finds that the settlement does not fall within a range of reasonableness.
> >
> > The test to be applied is whether the settlement is fair and reasonable … This allows for a range of possible results and there is no perfect settlement. Settlement is a product of compromise, which by definition, necessitates give and take.
>
> 15 In our view, the settlement, negotiated as it was by the parties assisted by capable counsel, does not clearly fall "outside a range of appropriateness" and it should therefore be, and was, accepted by the panel.

¶ 10 We share the opinion expressed by the hearing panel in *Re Vorstadt*, [2012] IIROC that the settlement process is an important one which should be "encouraged and supported".

OTHER DECISIONS

¶ 11 Decisions in other cases can often be of assistance by helping to indicate what might be a reasonable

range of monetary penalties. Counsel referred us to a number of cases in Ontario and Quebec, which involve the failure by a number of other financial institutions to adequately respond to the emerging issues which led to the ABCP market freeze. Those cases are *Re Scotia Capital Inc.*, 2009 IIROC 53; *Re Canadian Imperial Bank of Commerce and CIBC World Markets Inc.*, (21 December 2009, Ontario Securities Commission); *HSBC Bank Canada*, (21 December 2009, Ontario Securities Commission); *National Bank Financial Inc.*, (December 2009, Autorité des marchés financiers); *Valeurs Mobilières Banque Laurentienne Inc.*, (December 2009, Autorité des marchés financiers). We have decided that it is not necessary to review those decisions because each has its own peculiar set of facts, which are not the identical to the facts in this case. These cases are helpful, however, because they show that this case fits within a reasonable range of penalties.

IMPACT OF THE PENALTY

¶ 12 Monetary penalties are necessary to act as specific and general deterrence. The penalty, a fine of $1,000,000, is a significant penalty. The penalty is sufficient to act as a specific deterrent to this Respondent and should be sufficient to alert all Members that failure to engage Compliance when issues emerge which could lead to market disruption will attract significant consequences.

DECISION

¶ 13 After the hearing, we considered the circumstances of this case and reached the conclusion that the settlement was a reasonable one. Therefore, we accepted it.

DATED this 21st day of February 2013

The Hon. P. T. Galligan, Q.C. - Chair

F. Michael Walsh - Industry Representative

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. Enforcement Staff of the Investment Industry Regulatory Organization of Canada ("IIROC") and the Respondent, Deutsche Bank Securities Ltd. ("DBSL" or the "Respondent"), consent and agree to the settlement of this matter by way of this agreement (the "Settlement Agreement").

2. The Enforcement Department of IIROC has conducted an investigation (the "Investigation") into DBSL's conduct.

3. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (the "Hearing Panel")

II. JOINT SETTLEMENT RECOMMENDATION

4. IIROC Enforcement staff ("Staff") and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

5. The Respondent admits to the following contraventions of IIROC Dealer Member Rules, Guidelines, Regulations or Policies and those of its predecessor, the Investment Dealers Association of Canada ("IDA"):

   (a) In late July and early August 2007, the Respondent failed to engage Compliance with emerging issues in the ABCP market, contrary to Policy 5.

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

   (a) DBSL shall pay a fine of $1 million.

III. STATEMENT OF FACTS

(i) Acknowledgement

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

(ii) Factual Background Overview

8. On August 13, 2007, Canadian non-bank sponsored ABCP stopped selling, resulting in a market freeze.

9. The Respondent played a role in the operation of the Canadian non-bank sponsored ABCP market including the sale and distribution of non-bank sponsored ABCP.

10. At all material times, the Respondent was a Member firm of the IDA, with its head office located in Toronto, Ontario.

11. On June 1, 2008, the Respondent became a Member firm of IIROC.

12. In May 2008, Staff initiated an investigation into the conduct of the Respondent relating to the sale, distribution and other activities of third-party ABCP.

Asset-Backed Commercial Paper

13. ABCP is a short-term debt instrument backed by a pool of underlying assets, with typical maturities of 30 to 180 days. ABCP offers a yield slightly better than the yield offered on short-term Canadian government issued debt instruments.

14. ABCP is issued by a special purpose vehicle (also referred to as a conduit). In Canada, the conduits are trusts established by sponsors who also arrange for or carry out the administration of the assets, are responsible for asset selection and for the arrangement of the sale of the ABCP notes.

15. In 2007, the Canadian ABCP market was generally grouped into two categories: bank sponsored ABCP and non-bank sponsored ABCP. Non-bank sponsored ABCP was also referred to as third-party ABCP.

16. Due to the long term horizon of the underlying assets and the short-term nature of ABCP notes, there was an inherent timing mismatch between the cash flowing from the underlying assets and the cash needed to repay maturing ABCP notes. For many years, conduits successfully met their maturity obligations by selling newly issued ABCP, the proceeds of which were used to pay maturing ABCP obligations.

17. To safeguard against meeting maturity obligations, many conduits entered into liquidity agreements with liquidity providers which provided credit lines where certain conditions were met. In general, there were two main types of liquidity facilities: (1) General Market Disruption (“GDM”) and (2) Global style. GDM liquidity was also called “Canadian-style” liquidity since it was only available in the Canadian ABCP market. The Canadian-style liquidity facilities were more restrictive in nature than the Global style liquidity facilities. Canadian-style liquidity facilities required specified “general market disruption” events and a credit rating affirmation before liquidity was provided to the affected conduit. By contrast, Global style liquidity facilities had no similar conditions before payment was required.

18. While the general concept of Canadian style liquidity was generally known to large institutional investors, its details including the pre-conditions for liquidity support were not widely known. DBRS Limited (“DBRS”) issued a press release in January 2007 advising that they would not rate new conduits with Canadian-style liquidity.

19. As of September 2005, ABCP distributed in Canada was exempt from the requirement to file a prospectus under the short-term debt exemption set out in section 2.35 of National Instrument 45-106 — *Prospectus and Registration Exemptions.* Section 2.35 provided that no prospectus was required where the commercial paper being traded had an “approved credit rating" from an "approved credit rating organization".

20. DBRS, an approved credit rating organization, was the sole credit rating organization which rated third-party ABCP that contained Canadian-style liquidity facilities.

21. All Coventree Inc. ("Coventree") sponsored conduits but one received an R1-(high) rating (the highest credit rating available, equivalent to "AAA" for long term debt) by DBRS, as did other Canadian third-party ABCP. This rating remained in place at all material times up to and including August 13, 2007. Coventree ABCP was rated by DBRS above the minimum "approved credit rating" required by NI45-106 at all material times.

Third-party ABCP

22. Third-party ABCP was first issued in Canada in around 2000.

23. Historically, the underlying assets of conduits issuing ABCP consisted of traditional assets such as consumer loans, credit card receivables and residential mortgages. Non-traditional complex synthetic assets, such as collateralized debt obligations, began to come into these structures over time.

24. Third-party ABCP was typically issued by a series of notes, the most common being Series "A" Notes and Series "E" Notes. The "A" Notes were supported by the Canadian-style liquidity facilities. The "E" Notes were not supported by liquidity facilities, but could be extended up to 364 days after the original maturity date if certain conditions were met, including that market conditions did not allow for "E" Notes to be sold at a specified spread.

25. The sponsors published limited information regarding the underlying pool of assets in conduits issuing ABCP. Sponsors typically provide an information memorandum describing the basic elements of ABCP. In most cases, the general asset classes were the only information publically disclosed; there was no disclosure of the specified assets held in the conduits or the terms of the liquidity agreements supporting ABCP.

Coventree Inc.

26. At all material times, Coventree was the largest sponsor of third-party ABCP in Canada. Coventree also issued third-party ABCP through one of its subsidiaries, Nereus Financial Inc. ("Nereus").

27. At all material times, Coventree and Nereus (hereinafter collectively referred to as Coventree) sponsored the following third-party ABCP conduits:

Coventree:

Apollo Trust

Aurora Trust

Comet Trust

Gemini Trust

Planet Trust

Rocket Trust

Slate Trust

Venus Trust

Nereus:

Structured Investment Trust III

Structure Asset Trust

The Distribution of Third-Party ABCP

28. In general, third-party ABCP was distributed to investors through a dealer syndicate group (the "dealer

syndicate”). Typically, one member of the dealer syndicate would be appointed as lead dealer. In general, the lead dealer would be responsible for the direction and supervision of the distribution of the third-party ABCP by the dealer syndicate. Some of the lead dealer's daily duties included the allocation of ABCP notes to dealer syndicate members and setting the yield in consultation with the conduit sponsor.

29. The dealer syndicate members maintained trading lines, up to a certain credit limit, for third-party ABCP mainly to provide a market-making function. Dealer syndicate members would typically purchase third-party ABCP that was not sold at the end of a trading day. These positions were intended to be held on a short-term basis, typically overnight, until the notes could be sold to investors. Dealer syndicate members also purchased third-party ABCP from clients in the secondary market. While the dealer syndicate was under no obligation to purchase any third-party ABCP, they did so from time to time as a service to their clients. Dealer syndicate members other than the lead dealer also had the option to turn back ABCP to the lead dealer if they were unable to sell their daily allocation, but this was not their ordinary practice.

The Third-Party ABCP Market

30. Third-party ABCP traded in a dealer market, also known as an over-the-counter ("OTC") market. Unlike an auction market or exchange, the OTC market did not have a centralized quotation system.

31. Investors were provided with access by the conduit sponsors to information memoranda, conduit reports and other documentation prepared by the sponsors, and DBRS reports. The information that ABCP purchasers typically requested of dealers, and dealers provided, was the name, yield, terms and credit rating of third-party ABCP.

The Market Freeze

32. On August 13, 2007, a number of third-party ABCP conduits distributed in Canada including the Coventree and Nereus conduits were unable to sell new ABCP to fund the repayment of maturing ABCP. Many of the conduits' liquidity providers did not agree that the conditions for liquidity funding had occurred on August 13, 2007 and refused to provide liquidity to the affected conduits on that day.

33. As of August 13, 2007, the third-party ABCP market totaled approximately $35 billion, with Coventree and Nereus conduits representing approximately 46% of the value of the third-party ABCP market.

34. On August 16, 2007, a consortium representing banks, asset providers and major ABCP holders, agreed to take steps to establish normal operations in the ABCP market. This agreement was known as the Montreal Proposal.

35. A Pan-Canadian Investors Committee, including investors who were signatories to the Montreal Proposal plus other significant holders was established to oversee the orderly restructuring of third-party ABCP. It ultimately put forward the Plan of Compromise and Arrangement (“the Plan”), which was implemented on January 21, 2009.

36. Pursuant to the Plan, holders of the eligible third-party ABCP had their short-term notes exchanged for longer term notes to match more closely the maturity dates of the underlying assets.

37. These new notes were issued by Master Asset Vehicles ("MAVs").

The Respondent's Participation in Selling Third-Party ABCP

38. At all material times, the Respondent participated as a member of a selling group in third-party ABCP. The Respondent's responsibilities included soliciting sales and receiving offers to purchase third-party ABCP. The Respondent accepted the instructions of the lead dealer on any allocation and market making functions.

39. Initially, the Respondent's understanding of the third-party ABCP market was limited to allocation. With some exceptions, the Respondent only provided secondary market trading on a best-efforts basis and did

not take third-party ABCP into inventory. The Respondent only sold ABCP to institutional investors and not to retail customers.

Emerging Issues

(a) US Sub-prime Exposure

40. During the period from March to June, 2007, increasing defaults in US subprime mortgages started to place strains on credit markets in the US. The Respondent and some of its clients attended a Coventree investor presentation in late April 2007. At the presentation, Coventree disclosed that the overall US subprime exposure in its conduits was 7.4 percent.

41. On July 23 and 24, 2007, the Respondent bought back $51 million of Coventree E Notes from the Caisse de depot et placement du Quebec ("CDPQ"). This particular transaction was an exception to the Respondent's general practice against providing a secondary market for "E" Notes. The purchase only included extendible notes in Comet, Planet and Slate. The CDPQ had just purchased the same notes weeks earlier and the Respondent felt it was unusual for that client to sell back any ABCP.

42. In reaction to general market trends, a recent speech given by the U.S. Federal Reserve and the purchase from the CDPQ, the Respondent sent an email to Coventree on July 23 requesting information on the extent of U.S. subprime exposure in individual trusts.

43. On July 24, 2007, Coventree sent an email ("July 24th email") to all of Coventree's syndicate members, including the Respondent, setting out information regarding U.S. subprime exposure in Coventree conduits as of June 28, 2007. The U.S. subprime content in each of the conduits was noted as follows:

Conduits	Series A	**Series E**	**Total ABCP**
Aurora Trust	0%	8%	3%
Comet Trust	0%	42%	16%
Planet Trust	26%	3%	17%
Slate Trust	0%	16%	13%
Apollo Trust Gemini Trust Rocket Trust Venus Trust	0%	0%	0%
SAT	0%	0%	0%
SIT III	1%	0%	1%
TOTAL	3%	6%	5%

44. The email stated that Coventree was committed to furnishing investors and dealers with information they needed to support the market. The email also included summary notes that stated all deals remained at 'AAA' level, were performing as expected, there were minimal loss levels and the subprime exposure was to the more favourable pre-2006 vintages. The Respondent's position is that it viewed this email as a positive statement on the quality of all Coventree ABCP. The Respondent had not previously received such particulars on the subject of U.S. subprime from Coventree.

45. The information communicated in the July 24th email concerning subprime content was not verifiable through publically available sources.

46. At all times, the Respondent took the position that it was Coventree's responsibility to distribute the information to the investor community similar to the periodic disclosure in the monthly investor reports distributed on a password protected, investor-only website, made available to investors. The Respondent spoke with Coventree and confirmed that Coventree was in the middle of the rebalancing of the subprime assets. The Respondent chose not to distribute the July 24th email to its clients who had either invested in Coventree-sponsored ABCP or were prospective investors of Coventree-sponsored ABCP. The Respondent's position is that it did not disclose the information because the information was

outdated, not publicly verifiable and presented as “good news” as opposed to “bad news”.

47. The Respondent’s practice was not to provide any documentation to investors other than the information memorandum and to direct investors to Coventree for further information. The Respondent circulated the July 24th email or its contents to the credit and market risk division of its parent company, which did not voice any concern over the Coventree ABCP.

48. During the same period, some of the Respondent’s clients were asking questions about U.S. subprime content in third-party ABCP. The Respondent did not ensure all its clients who had invested or were interested in investing in Coventree sponsored ABCP knew of the detailed information contained in the July 24th email.

49. The Respondent's Compliance Department ("Compliance") was not made aware of the July 24th email until after August 13, 2007. The Respondent did not engage Compliance regarding the information contained in the July 24th email so as to consider potential issues arising from the information contained in the July 24th email.

50. In late July and early August 2007, the Respondent failed to engage Compliance with this emerging issue in the ABCP market.

(b) Liquidity Concerns

51. Beginning in late July 2007, the ability to place ABCP was a concern for the Respondent and all other market participants, including investors, although ABCP continued to roll up to August 13, 2007, with the spreads on the ABCP widening noticeably.

52. On August 7, 2007, the CDPQ arranged a teleconference with certain syndicate members including the Respondent. During the call the CDPQ advised the dealers that they would continue to support the market and stressed the importance of the syndicate doing the same. The CDPQ also wanted the syndicate to be transparent and reassure their clients that they were supporting the market. Some liquidity returned to the market after the call on August 7 and 8, 2007.

53. The liquidity problems continued to persist after August 9, 2007 until the market froze on August 13, 2007.

54. The Respondent continued to sell third-party ABCP to its clients after August 7, 2007. None of these sales were from the Respondent’s inventory, other than the sale to the CDPQ described below. In telephone conversations with clients, the Respondent disclosed that it had participated in a conference call with the CDPQ. The Respondent told clients that the CDPQ felt there would not be a market disruption.

55. On August 8, 2007, the CDPQ agreed to repurchase the $51 million worth of extendible notes from the Respondent's inventory.

56. Compliance was not made aware of the liquidity issues until after August 13, 2007, so as to consider potential issues arising from them.

The Respondent's Distribution of Third-Party ABCP

57. Between July 25 and August 2, 2007, when it was aware of emerging issues of liquidity in the ABCP market, the Respondent sold Planet A in the amount of $25,800,000 to a large institutional investor. These notes were not from the Respondent’s inventory. While the Respondent did not provide the details of the subprime content of the notes, it advised the client that there was subprime content in some Coventree ABCP but that Conventree was in the process of rebalancing this subprime.

58. Between August 3 and August 10, 2007, the Respondent sold $54,100,000 of Coventree third-party ABCP (exclusive of third-party ABCP which matured prior to the market freeze) to a large international bank and a large Canadian financial institution. The Respondent did not deliver the July 24th email to either of these investors; however, liquidity issues and Coventree subprime were discussed in a general

way at the request of one of the clients. None of this ABCP came from the Respondent's inventory. In that same period, the Respondent also sold $1,300,000 of other non-Coventree third-party ABCP to a large deposit-taking financial institution. None of the ABCP sold to these institutions came from the Respondent's inventory. Liquidity was discussed generally with these clients.

59. The Respondent continued to support the ABCP market and the Respondent continued to acquire unsold paper and place it into inventory overnight during the week of August 7, 2007.

60. Compliance was not aware of the receipt of the July 24th email or of the worsening market conditions in third-party ABCP and the potential for a market disruption. The Respondent did not engage the appropriate involvement of Compliance in matters related to the worsening conditions of the third-party ABCP market and the potential for a market disruption.

The Respondent's Misconduct

61. In late July and early August 2007, the Respondent failed to engage Compliance with emerging issues in the ABCP market.

IV. TERMS OF SETTLEMENT

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

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

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

65. The Settlement Agreement will be presented to the Hearing Panel at a hearing (the "Settlement Hearing") for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.

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

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

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

69. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.

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

71. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Toronto, in the Province of Ontario, this 18th day of January, 2013.

"Nigel Campbell"	*"Dan Sooley"*
Witness – Nigel Campbell	Deutsche Bank Securities Ltd.
	Per: Dan Sooley
	"*I am authorized to bind the corporation*"

AGREED TO by Staff at the City of Toronto, in the Province of Ontario this 18th day of January, 2013.

"Brian Connell-Tombs"	*"Elsa Renzella"*
Witness – Brian Connell-Tombs	Elsa Renzella
	Director, Litigation
"Vito Pedone"	*"Susan Kushneryk"*
Witness – Vito Pedone	Susan Kushneryk
	Senior Enforcement Counsel

ACCEPTED at the City of Toronto, in the Province of Ontario, this 8th day of February, 2013, by the following Hearing Panel:

"Patrick Galligan"

The Honourable Patrick Galligan

"Michael Walsh"

Mr. Michael Walsh