

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20110279990**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: National Bank of Canada Financial, Inc., Respondent
CRD No. 22698

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. National Bank of Canada Financial, Inc. ("NBCFI" or "the Firm") hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

NBCFI has been a member of FINRA since November 1988 and its registration remains in effect. The Firm is an indirectly-owned subsidiary of National Bank Financial & Co. Inc., both of which are ultimately owned by National Bank of Canada ("NBC"). NBCFI is an introducing broker as its transactions are cleared through a separate U.S. clearing firm. The Firm's primary business areas are fixed income, equities, equity derivatives, and merchant banking.

RELEVANT DISCIPLINARY HISTORY

The Firm has no relevant disciplinary history.

OVERVIEW

As of January 2009, the Firm improperly designated \$10,258,027 in inventory positions as allowable assets for purposes of its net capital computation in violation of Section 15(c)(3) of the Securities Exchange Act of 1934 (the

"Exchange Act") and Rule 15c3-1 promulgated thereunder and FINRA Rule 2010. As a result, the Firm maintained inaccurate net capital records and filed ten erroneous FOCUS reports between January 2009 and October 2009 in violation of NASD Rule 3110(a) and FINRA Rule 2010 and Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-5 promulgated thereunder.

In addition, between April 5, 2006 and December 7, 2009, the Firm outsourced certain of its proprietary trading functions to a third-party investment advisor, AB, which resulted in unregistered individuals managing the Firm's proprietary trading functions in violation of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 promulgated thereunder, NASD Rules 1031, 2110 and FINRA Rule 2010.

During this same period, the Firm failed to implement adequate written supervisory procedures that were reasonably designed to oversee the proprietary trading functions it had outsourced to AB in violation of NASD Conduct Rules 3010(b), 2110 and FINRA Rule 2010.

Moreover, between January 1, 2009 and May 2012, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010 by failing to implement an adequate supervisory system that was reasonably designed to achieve compliance with Exchange Act Rule 15c3-1(c)(2) and 15c3-1 as interpreted in Interpretation 15c3-1(c)(2)(iv)(C)/073.

Lastly, in July 2010, the Firm improperly netted a bank loan payable from one affiliate with another bank loan receivable from a different affiliate in violation of Exchange Act Rule 15c3-1(c)(2) and 15c3-1 as interpreted in Interpretation 15c3-1(c)(2)(iv)(C)/073(c) and FINRA Rule 2010. As a result, the Firm maintained inaccurate net capital records and filed three erroneous FOCUS reports between July 2010 and September 2010 in violation of NASD Rule 3110(a) and FINRA Rule 2010 and Section 17(a) and Rules 17a-3 and 17a-5 promulgated thereunder.

FACTS AND VIOLATIVE CONDUCT

A. Net Capital Computation.

Section 15(c)(3) of the Exchange Act and Rule 15c3-1 promulgated thereunder requires brokers and dealers to maintain sufficient capital to protect their customers from the firm's potential insolvency. See 17 C.F.R. § 240.15c3-1. Generally, it requires a broker-dealer to have sufficient assets that are readily convertible to cash to cover its indebtedness to customers and other broker-dealers. Moreover, the net capital rule requires a broker-dealer to make certain deductions from its net worth to determine its net capital. Accordingly, Exchange Act Rule 15c3-1(c)(2)(iv) requires a broker-dealer to deduct from the net capital formula, assets that are not readily convertible to cash.

Section 17(a) of the Exchange Act and Rule 17a-5(a) promulgated thereunder requires the filing of accurate FOCUS Reports by broker-dealers. The filing of an inaccurate FOCUS Report is also a violation of FINRA Rule 2010. Section 17(a) of the Exchange Act and Rule 17a-3(11) promulgated thereunder requires that each broker-dealer keep "a record of the computation of aggregate indebtedness and net capital."

NASD Conduct Rule 3110(a) requires that each member "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17a-3."

FINRA Rule 2010, as well as its predecessor rule, NASD Rule 2110, provides that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."¹

A firm's failure to maintain accurate net capital records constitutes a violation of Rule 17a-3 and a violation of NASD Conduct Rule 3110 and FINRA Rule 2010.

As of January 30, 2009, the Firm reported holding inventory positions, with a market value of \$10,258,027, at CDS Clearing and Depository Services, Inc. ("CDS") in the name of its Canadian affiliate. The Firm, on its January 2009 FOCUS Report characterized these proprietary positions as allowable assets (i.e. assets that are readily convertible to cash) in its net capital computation.

The Firm did not have sufficient possession and/or control of the proprietary positions held at CDS because they were not under the Firm's name. In the event that the Firm had needed to convert these inventory positions to cash, the proceeds would not have been readily available in the Firm's name. Thus, the inventory positions should have been characterized as non-allowable assets (i.e. assets that are not readily convertible to cash).

In November 2009, the Firm re-characterized the \$10,258,027 inventory holdings as non-allowable assets. As a result, the Firm filed ten inaccurate FOCUS reports with FINRA between January 2009 and October 2009.

This mischaracterization of assets did not result in a net capital deficiency as there were sufficient net capital reserves to buttress the loss of the inventory holdings from the net capital computation.

Therefore, because the Firm failed to properly characterize its inventory positions with its Canadian affiliate as non-allowable assets in its net capital computation, it

¹ On December 14, 2008 NASD Rule 2110 was superseded, without substantive changes, by FINRA Rule 2010. Accordingly, all violative conduct occurring on or after December 14, 2008 is a violation of FINRA Rule 2010.

violated Section 15(a) of the Exchange Act and Rule 15c3-1 promulgated thereunder and FINRA Rule 2010.

As a result, the Firm maintained inaccurate net capital records and filed ten inaccurate FOCUS reports with FINRA between January 2009 and October 2009 in violation of NASD Rule 3110(a) and FINRA Rule 2010 and Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-5 promulgated thereunder.

B. Outsourcing Proprietary Trading Functions.

Rule 15b7-1, which was promulgated pursuant to Section 15(b)(7) of the Exchange Act, provides that:

“No registered broker-or-dealer shall effect any transaction in, or induce the purchase or sale of, any security unless any natural person associated with such broker or dealer who effects or is involved in effecting such transaction is registered or approved in accordance with the standards of training, experience, competence, and other qualification standards... established by the rules of any national securities exchange or national securities association of which such broker or dealer is a member or under the rules of the Municipal Securities Rulemaking Board...”

In addition, NASD Membership and Registration Rule 1031 states the following with regard to the registration of persons engaged in the securities business:

“All persons engaged or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered as such with NASD...”

NASD Rule 1031(b) defines a representative as:

“Persons associated with a member... who are engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities... are designated as representatives.”

On April 5, 2006, the Firm outsourced certain proprietary trading functions relating to the majority of its inventory to AB, an unaffiliated third-party investment advisor. As of January 30, 2009, the inventory positions under AB’s control had a market value of \$219,293,716.

The investment advisory agreement (the “Agreement”) between the Firm and AB reflects the broad discretionary trading powers that the Firm granted to AB. The

Agreement states the following: “[p]rovided that [AB] compl[ies] with the foregoing objectives, strategies and restrictions, [AB] shall manage the Notional Equity Baskets...in such manner as in [AB’s] sole discretion[AB]...may deem advisable.”

The individuals at AB who performed the contracted trading functions on behalf of the Firm were not registered with the Firm. No more than two individuals at AB performed the contracted trading functions that were delineated in the Agreement.

On December 4, 2009, the Firm terminated its investment advisory relationship with AB. All trading authority over the Firm’s inventory positions by AB ceased on December 7, 2009.

Therefore, because the Firm outsourced part of its proprietary trading functions to AB and provided AB with broad discretionary trading authority, it was required to register, with the Firm, the AB employees who performed the proprietary trading functions on behalf of the Firm. Thus, the Firm’s conduct violated Section 15(b)(7) of the Exchange Act and Rule 15b7-1 promulgated thereunder and NASD Rules 1031, 2110 and FINRA Rule 2010.

C. Written Supervisory Procedures.

NASD Rule 3010(a) requires firms to “establish and maintain a system to supervise activities of each registered representative...that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules.” Under NASD Rule 3010(b), these systems must be documented in the firm’s written supervisory procedures (“WSPs”). Moreover, the WSPs must be tailored to the specific nature of the business engaged in by the firm.

The Firm’s WSPs did not include any provisions regarding its supervisory controls over the proprietary trading functions that were outsourced to AB. Specifically, the Firm’s WSPs failed to detail the Firm’s risk management practices for the trading of its inventory positions by AB (e.g., investment criteria, trading parameters, and product suitability guidelines).

Because the Firm’s WSPs failed to detail its risk management practices with regard to the supervision of the proprietary trading functions that were outsourced to AB, it violated NASD Rules 3010(b) and 2110 and FINRA Rule 2010.

D. Financial and Accounting Controls.

Exchange Act Interpretation 15c3-1(c)(2)(iv)(C)/073 states, among other things, that an account with an affiliate which could be classified as a customer securities

account may not be netted with accounts of other affiliates for purposes of calculating Net Capital.

Between January 2009 and May 2012 (the “Relevant Period”), the Firm’s general ledger commingled securities and non-securities related balances and transactions between the accounts of the Firm, its parent, NBC, and other intercompany affiliates. Specifically, NBCFI’s financial systems permitted securities and non-securities related transactions to be recorded within the same general ledger accounts. As a result, the Firm improperly netted transactions and balances between intercompany securities and non-securities-related accounts.

On May 12, 2012, the Firm eliminated all customer-related securities balances from its books and records, including intercompany securities transactions and balances, by the assignment of all-customer accounts to a U.S.-clearing firm.

During the Relevant Period, the Firm’s systems improperly netted transactions and balances between intercompany securities and non-securities-related accounts for purposes of computing Net Capital. Accordingly, the Firm violated NASD Rule 3010(a) by failing to implement an adequate supervisory system that was reasonably designed to achieve compliance with Exchange Act Rule 15c3-1(c)(2) and 15c3-1 as interpreted in Interpretation 15c3-1(c)(2)(iv)(C)/073.

E. Netting of Two Separate Bank Loans

Exchange Act Interpretation Rule 15c3-1(c)(2)(iv)(C)/073(c) states that “[n]etting can be accomplished by recording all non-securities transactions with affiliates in a single account carried for a parent organization” provided that certain terms are made clear. In order to ensure compliance with the rule’s mandate of clarity, the affiliates must enter into a netting agreement.

A review of the Firm’s receivables from affiliates for July 30, 2010 disclosed that the Firm netted two separate bank loans. Specifically, the relevant loan agreements show that the Firm, on July 30, 2010, lent \$146,100,000 to the parent’s New York affiliate and in a separate agreement the Firm, on July 14, 2010, borrowed \$60,317,046 from its parent, NBC.

These two separate loans are substantiated by two different loan agreements containing, inter alia, different nominal amounts, maturity dates, and interest rates. There is no netting agreement in place to reconcile these loans.

Therefore, the Firm improperly netted a bank loan payable from one affiliate with another bank loan receivable from a different affiliate in violation of Exchange Act Rule 15c3-1(c)(2) and 15c3-1 as interpreted in Interpretation 15c3-1(c)(2)(iv)(C)/073(c) and FINRA Rule 2010.

This resulted in the Firm understating its non-allowable assets and liabilities on its

balance sheet by \$60,317,046. As a result, the Firm's Excess Net Capital was reduced from \$197,284,823 to \$136,967,777 as of July 30, 2010.

As a result, the Firm maintained inaccurate net capital records and filed three erroneous FOCUS reports with FINRA between July 2010 and September 2010 in violation of NASD Rule 3110(a) and FINRA Rule 2010 and Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-5 promulgated thereunder.

B. The Firm also consents to the imposition of the following sanctions:

A censure and a fine in the amount of \$75,000.

The Firm agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. The Firm has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

The Firm specifically and voluntarily waives any right to claim that the Firm is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

The Firm specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The Firm understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. The Firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct.

The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

Date

April 16/2013

Respondent

[Signature]
National Bank of Canada Financial, Inc.

Reviewed by:

[Signature]
D. Grant Vingoe, Esq.
Counsel for Respondent
Arnold & Porter LLP
399 Park Avenue
New York, NY 10022-4690

Accepted by FINRA:

Date

5/9/13

Signed on behalf of the
Director of ODA, by delegated authority

[Signature]
Richard R. Best
Chief Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street, 11th Floor
New York, New York 10281
Phone: (646) 315-7386
Fax: (646) 315-7425