NORTHERN MEMORANDUM TO OUR CLIENTS, FRIENDS AND EMPLOYEES ON COMPLIANCE MONITORING AND SUPERVISION MATTERS RAISED BY IIROC

July 29, 2011

INTRODUCTION

1. Staff ("Staff") of the Investment Industry Regulatory Organization of Canada ("IIROC" which includes RS and the IDA) have issued a Notice of Hearing dated July 29, 2011 (the "Notice of Hearing") challenging certain matters pertaining to the compliance monitoring and supervision system at Northern Securities Inc. ("NSI" or "Northern" or the "Firm").

2. IIROC's allegations are surprisingly harsh and appear to have been designed to compel Northern to agree to a new settlement in order to avoid the embarrassment and harm resulting from publication of the allegations, which Northern will not do. Northern previously agreed to a settlement with IIROC in April 2010 which IIROC has failed to honour. This 2010 settlement is explained in this memorandum. Northern believes that its compliance system is robust and its employees are honest, well-intentioned and trustworthy. While any dealer will be subject to compliance mistakes from time to time, Northern has achieved a high standard of compliance in the Firm.

3. Northern can do little to prevent IIROC from making and publishing the extremely damaging and substantially untrue allegations set out in the Notice of Hearing. We have a very good Firm hitting its stride and we are very confident about the future. As Northern is naturally concerned that some people will assume allegations made by a regulator to be true, Northern has chosen to set out a detailed response to IIROC's allegations in this memorandum.

The Compliance Values at Northern Are Set at the Top

4. The values and tone for compliance behaviour at Northern are set at the top by Mr. Vic Alboini as Ultimate Designated Person ("UDP"), Chairman and CEO. Mr. Alboini personally reviews all of the previous day's trades each morning. His key focus is to ensure that there is no potentially egregious activity such as front running of client orders, double printing of trades, trading by persons behind the ethical wall who are aware of confidential material information, discretionary trading, and artificial or manipulative trading such as high closing.

5. Mr. Alboini, Mr. Fred Vance, the Chief Compliance Officer ("CCO") and Mr. Doug Chornoboy, the Chief Financial Officer ("CFO"), and Northern's General Counsel reiterate the importance of compliance in regular meetings with employees, conference calls and emails. In addition to senior management at NSI, the independent directors of Northern Financial Corporation ("NFC"), the parent company of NSI, review compliance matters at NSI on a regular basis. Mr. Vance also provides an annual compliance report to the NFC Board.

6. Compliance is one of the three values at Northern shared by the Executive Committee of four persons which include Messrs. Alboini, Chornoboy and Vance; by the eight person

management team at NSI; by the 22 partners at Northern; and by the three independent directors of NFC.

7. The key focus on compliance is embedded in the culture at Northern and is fully shared by all employees. Personnel at Northern understand the value of compliance and the strict need to comply. Mr. Alboini's responsibility as UDP is to put in place a compliance system that will ensure to the fullest extent possible that employees are compliant. There are errors that will take place at any firm, however inadvertently. The key is to make sure that there are not any serious mistakes.

8. As directed by Mr. Alboini as UDP, Mr. Vance as CCO has established a system to supervise the activities of Northern's employees which is reasonably designed to achieve compliance with IIROC rules. Northern understands its business and its supervision issues better than anyone else. The NSI compliance system in no way can be perfect and in no way can be inadequate. It must be a reasonable system suited to NSI's business.

9. Northern has a relentless focus on compliance and strives to adopt the best practices suited to its business activities. Compliance does not sit still; NSI works at improving its compliance practices to take account of changes in the industry rules, changes in business activities, compliance initiatives, and regulatory developments.

IIROC's Failure to Meet Stated Goals

10. IIROC has publicly admitted the need to overhaul its compliance review programs. Northern fully understands this need given its very surprising, unfortunate experience with compliance examiners and compliance management at IIROC. As IIROC itself has publicly recognized, there is a need to discourage "dogmatic", "check the box" approaches to conducting its compliance reviews and instead to encourage a spirit of cooperation by promoting "independent thought, judgment and creativity" amongst its Staff members who assess the policies and procedures of IIROC's members. These are IIROC's own words.

11. IIROC has not carried out its publicly stated objective of recognizing that one compliance model does not fit all firms and that the compliance system of a firm should be tailored to its distinct businesses. IIROC compliance examiners have worked with a checklist rather than an understanding of the business carried on by the Firm and the people at the Firm. The allegations in the Notice of Hearing are therefore rooted in both differing interpretations of the rules and a failure by Staff to take into account Northern's unique business model, including the unique circumstances created by its relationship with its publicly traded parent company, NFC and Jaguar Financial Corporation ("Jaguar"), the publicly traded merchant bank in which NFC and Mr. Alboini together hold approximately 24% of Jaguar's issued and outstanding common shares.

Unjustifiably Harsh Allegations Made by Staff

12. Northern welcomes the opportunity to review in an open forum each allegation made by Staff. Although Staff received Northern's explanations and documentary evidence well before the Notice of Hearing was issued, Northern is at a loss to understand why Staff have chosen to frame certain allegations in the harshest possible way, alleging a culture of non-compliance and

insinuating, without outright alleging, intentions and motivations on the part of Northern and its senior officers that are contrary to the evidence and utterly untrue.

13. The Staff allegations are so over the top that it appears to Northern that Staff's motive is to compel Northern to agree to a new settlement rather than face the obvious embarrassment of having the allegations surface in the public eye. Northern has the highest respect for regulators, and in this instance is ready for an open forum to demonstrate its moral compass and outline the values and principles it follows in carrying on its business for the benefit of its clients and employees.

14. Unfortunately, these allegations and insinuations are highly prejudicial and their inclusion in the Notice of Hearing has caused and will continue to cause serious harm to Northern and its senior officers. Northern believes it is appropriate to question why certain allegations have been made which are unduly harsh and obviously untrue, in light of the documentary evidence provided to IIROC prior to the issuance of the Notice of Hearing.

IIROC Fails to Honour a Past Settlement

15. It is very troubling to Northern that a majority of the matters raised in the Notice of Hearing were resolved in April 2010 pursuant to a settlement between Mr. Alboini, NSI's CEO, and Maureen Jensen, who was then Senior Vice President of Surveillance and Compliance at IIROC.

16. Compliance management at IIROC referred various alleged "deficiencies" to IIROC's enforcement department because allegedly Northern had not, in a timely manner, implemented compliance staff's "views" or had not corrected various "deficiencies". When Northern was notified of the commencement of an investigation based on the referral to enforcement, Mr. Alboini reached out to Ms. Jensen and offered his personal commitment that the issues outstanding between NSI and IIROC would be resolved on an expedited basis. In response, Ms. Jensen agreed that the investigation "would go away" if Mr. Alboini fulfilled his commitment.

17. In good faith reliance on Ms. Jensen's commitment, Mr. Alboini directed NSI personnel to abandon NSI's position opposite IIROC on various issues that NSI was actively engaged in resolving, including five matters raised in the Notice of Hearing, namely (i) leasehold financial reporting in which Northern admitted an error; (ii) the use of escrow agreements in a financing which were properly used by Northern; (iii) the responsibility of Northern's carrying broker for margin in an institutional client accumulation account; (iv) the resolution of minor issues pertaining to external accounts, training programs for new investment advisors, grey lists and physical barriers; and (v) certain revisions made to Northern's Policies and Procedures Manual. The only issues not discussed or agreed upon between Ms. Jensen and Mr. Alboini referred to in the Notice of Hearing were the alleged failure to put up required margin on some trades, the alleged failure to provide Staff with all requested documents, and the best price obligation.

18. Although NSI compromised its position on several of the disputed issues and resolved all of them on an expedited basis to Staff's satisfaction, Staff now denies that a settlement was reached. At the hearing of this proceeding, Northern intends to assert and rely upon the settlement reached between Mr. Alboini and Ms. Jensen. Furthermore, as a matter of fairness, given the commitment carried out by Mr. Alboini to resolve the various matters, Staff ought to

be prevented from breaching Ms. Jensen's commitment to Mr. Alboini that the investigation would go away, which was made in her then capacity as a senior officer of IIROC.

JAGUAR TRADES

Overview of NFC, NSI and Jaguar

19. NFC and Mr. Alboini own approximately 24% of the issued shares of Jaguar. Jaguar is therefore a related company to NFC and NSI. Jaguar is a client of NSI and conducts its trades through NSI. NSI earns a commission on Jaguar trades. Mr. Alboini is the investment advisor at NSI for Jaguar. NSI introduces, reviews and conducts due diligence on the investment opportunities that are brought to Jaguar for its consideration. Investments by Jaguar above a specific threshold are approved by the independent directors of Jaguar. The independent directors of Jaguar are different from the independent directors of NFC.

20. Jaguar has in the past engaged NSI as its financial advisor for those investment opportunities approved by Jaguar and pursued to create shareholder value, such as a take-over bid, proxy campaign or other transaction. In this capacity as financial advisor, NSI would earn engagement fees and work fees and if approved by the independent directors NSI would also earn a success fee for successful investments. Jaguar, NFC and NSI entered into a Governance Agreement which provides for a maximum override payment to NSI or NFC of 25% of any portfolio gain. NSI was not and is not paid any annual management fee.

21. In 2009 Jaguar made a number of changes in the economics of the relationship between NSI and Jaguar. First, the trading commissions charged to Jaguar were reduced by 50%. Second, NSI will generally not receive any engagement or work fees in connection with investment opportunities pursued by Jaguar and in which NSI is involved. There may be limited exceptions where the work involved by NSI has been substantial and the independent directors of Jaguar are satisfied that a fee below market rates is appropriate to pay to NSI. Third, where a gain is realized by Jaguar, the options available to the independent directors of Jaguar are to pay a maximum override payment of 25% of the gain to NFC or NSI under the Governance Agreement or to declare a dividend payable to all shareholders, or some combination of both payments. It may be noted that the highest override payment made to date was 17% of a portfolio gain. Fourth, since 2009 no salaries are payable to the three senior officers of Jaguar, namely the Chief Executive Officer, the Chief Financial Officer and the General Counsel who hold the same officer positions in NFC. A Senior Vice President, Investments joined Jaguar in January 2011 and also is not paid a salary.

22. Accordingly, the way in which NSI can benefit economically through its relationship with Jaguar is to receive an override payment on an investment gain realized by Jaguar, or for Jaguar to pay as a dividend part of any investment gain to the shareholders of Jaguar and, if so, NFC would participate in receiving the dividend just like any other shareholder. These payment approaches are very success-oriented and are sensible given the commonality of the senior officers in NFC, NSI and Jaguar. Specifically, Mr. Alboini is Chairman and CEO of each of NFC, NSI and Jaguar. Mr. Chornoboy is Senior Vice-President and Chief Financial Officer of

each of NFC, NSI and Jaguar. Mr. Kyler Wells is Senior Vice President and General Counsel of NFC and of Jaguar.

23. Mr. Alboini owns 22% of the issued shares of NFC and may be considered to have effective control of NFC and in turn NSI. Mr. Alboini and NFC together own 24% of the issued shares of Jaguar. Accordingly NFC and NSI on the one hand and Jaguar on the other hand are related companies. This relationship is positive and brings substantial benefits to NSI and to Jaguar. At the same time, because of the obvious conflicts of interest, Mr. Alboini and the independent directors of each of NFC and Jaguar have implemented governance measures and policies to deal with these conflicts.

24. The benefits to Jaguar in its relationship with NSI are as follows:

(i) Jaguar has access to investment opportunities brought by the investment banking team at NSI, which team includes Mr. Alboini who is experienced in mergers and acquisitions;

(ii) Jaguar pays no annual management fee to NSI;

(iii) Jaguar will generally pay no engagement fees or work fees to NSI in its capacity as a financial advisor to Jaguar; if such fees are paid, they are fees below market rates;

(iv) Jaguar will generally pay override payments to NSI or NFC when investment gains are realized up to a maximum of 25% of any portfolio gain, or dividends to all shareholders; and

(v) the payment of less than market rate commissions on trading by Jaguar through NSI.

25. The benefits to NSI and NFC are as follows:

(i) Jaguar is a client which generates commission revenue for NSI in its trading in securities;

(ii) Jaguar is a tenant which pays NSI rent for the use of its space at the NSI head office;

(iii) if the investments made by Jaguar result in a realized gain NSI and NFC have the opportunity to earn an override payment, or the independent directors of Jaguar may declare dividends which would benefit all shareholders including NFC; and

(iv) in limited exceptions NSI may earn a work fee (albeit at a lower than market rate) on an investment opportunity being pursued by Jaguar.

26. The conflicts involving NFC and NSI on the one hand and Jaguar on the other hand are:

(i) the trading by Jaguar in securities which would generate commission revenue for NSI; this conflict is managed by the Jaguar requirement to obtain approval of the

independent directors for investments above a specific level and the fact that the commissions charged by NSI are below market rates;

(ii) the investments made by Jaguar would benefit NSI and NFC to the extent override payments are made to NSI or NFC; this conflict is managed in two ways: first, the independent directors of Jaguar must approve all investments above a specific threshold and also must approve any override payment, and second, the independent directors of Jaguar have the option of paying dividends to all shareholders as an alternative, in whole or in part, to approving an override payment to NSI or NFC; and

(iii) Jaguar can rely on the work carried out by the NSI investment banking team without any requirement to pay engagement fees or work fees for financial advisory services rendered to Jaguar, with limited exceptions as described above; however, NSI has an incentive to perform financial advisory services in order to earn success fees or override payments from Jaguar upon the realization of investment gains.

Jaguar Trades: The Global Financial Crisis Between August 2008 and November 2008

27. In September 2008, the full impact of the global financial crisis was realized with the failure to save Lehman Brothers. Share prices plummeted and there was a window of opportunity for Jaguar to invest in companies whose market capitalizations were less than their redundant cash resources or net asset values. Jaguar seized upon the opportunity to make ten investments in substantially undervalued companies during the period from August 2008 to December 2008 (the "Subject Period"). Seven of the ten investments were made solely by Jaguar and entirely for its own account. For the remaining three investments, Jaguar invested its own capital and in addition solicited funds from certain high net worth contacts of Mr. Alboini.

Jaguar Investment Opportunities

28. If Jaguar decided to pursue an investment opportunity, Jaguar would either pursue the opportunity in its Jaguar Main Account at NSI or it might open a separate investment account at NSI for each opportunity where Jaguar might decide to bring in outside investors. Each investment opportunity was referred to as a "Project". These investment opportunities were Jaguar Projects and not investment opportunities for NSI. Jaguar treated all of the Project Accounts as sub-accounts of the Jaguar Main Account.

29. At the time the decision was made to pursue an investment opportunity, Jaguar may not have made a decision to pursue the opportunity on its own or to invite investors to participate in the opportunity. If investors were invited to participate, the investors would vary from opportunity to opportunity. Accordingly for administrative and reporting purposes, Jaguar preferred to have separate accounts for the separate investment opportunities. All of the Jaguar investments could have been made in the Jaguar Main Account.

30. Each investment opportunity pursued by Jaguar during the Subject Period had a separate account at Northern. Of the ten accounts opened at Northern, three had outside investors,

namely Project Vulcan (a code name for Virtek Vision International), Project Titan (a code name for Tiomin Resources Inc., subsequently Vaaldiam Mining Inc.) and Project Hunter (a code name for HudBay Minerals Inc.).

Project Vulcan

31. In Project Vulcan, Jaguar invested by borrowing funds from two lenders. In addition, outside investors participated in the project by investing their own funds. These investors were entitled to a share of the gain if the shares were sold at a profit or a share of the net cash resources of Virtek Vision International ("Virtek") if Jaguar acquired all of the outstanding shares. As Virtek was already the subject of a take-over bid and therefore "in play", there was significantly less risk that this investment opportunity would be unprofitable. Ultimately, the investment in Project Vulcan was profitable and the outside investors realized a 46% annualized investment return in accordance with the terms of their investor agreements.

Project Titan

32. After the investment in Virtek, Mr. Alboini determined that in future investments in which outside investors participated, the overriding priority was that investors would have no downside risk in the investments. Therefore, in Project Titan, the investors made loans to Jaguar and were paid a nominal interest rate and were entitled to a specific percentage interest in any gain on the sale of the investment. There was no downside risk because the investors (lenders) would receive a return of their principal and a nominal interest rate if the investment did not result in a profit. Project Titan, ultimately did not result in a profit and the investors all received a return of their principal and interest.

Jaguar's Track Record

33. Jaguar has had a respectable track record on investment opportunities in which outside investors participated. The investor returns were as follows:

Project Vulcan	
Gross Project Gain	12.3%
Annualized Investor Return	46%
Project Titan	
Gross Project Gain	Loss
Annualized Lender Return	2%
Project Hunter	
Gross Project Gain	53.7%
Annualized Lender Return	117%
Project Block	
Gross Project Gain	31.2%
Annualized Investor Return	58%

Project White	
Gross Project Gain	43.5%
Annualized Lender Return	23%

Project Crest	
Gross Project Gain	Loss
Annualized Investor Return	2%

Jaguar Value Creation Options

34. For each investment opportunity pursued by Jaguar, there were several value creation options available to Jaguar, some of which are listed as follows:

(i) Jaguar could acquire up to 9.9% of the issued shares of the target company.

(ii) Jaguar could acquire more than 9.9% and up to 19.9% of the issued shares of the target company.

(iii) Jaguar could agree upon a value creation strategy with management or the Board of Directors of the target company.

(iv) Jaguar could obtain representation on the Board of Directors of the target company.

(v) Jaguar could initiate a proxy contest to elect its slate of directors on the Board of the target company.

(vi) Jaguar could simply sell the shares of the target company that had been acquired.

(vii) Jaguar could make a take-over bid for the target company.

Investor Agreements

35. On any specific investment opportunity, Jaguar would enter into an investor agreement with each outside investor. The Jaguar investor agreements provided a summary of the investment opportunity in a code format so that the identity of the target company was not disclosed. NSI, on behalf of Jaguar, would prepare an investment overview based on its review of all publicly disclosed information about the target company. NSI believes it has a very skilled group of investment bankers who carry out substantial due diligence in their review of investment opportunities.

36. The steps taken to maintain confidentiality of the name of the target company followed normal investment banking practice at Northern. In accordance with this standard practice, each of the investment opportunities was given a separate code name to maintain confidentiality behind the ethical wall and Jaguar opened a separate investment account for each investment opportunity (the "Jaguar Project Accounts"). The Jaguar Project Accounts were created for administrative and reporting purposes since it was generally not known at the beginning of each project whether outside investors would participate in the investment opportunity.

Risk Disclosure in Jaguar's Investor Agreements

37. The Jaguar investor agreements would always disclose the risks to investors in making an investment in any specific project. As noted above, after the Virtek investment, Jaguar was very careful to eliminate any downside risk to the investor by structuring the investment as a loan. In this manner, if the investment turned out to be unprofitable, the investors would receive a return of their capital together with a nominal rate of interest.

38. As an example of the risk disclosure, the Project Vulcan Investor Agreement disclosed the following risks to investors:

- Jaguar cautioned Investors that:

  (1) the opportunity was speculative and its success was dependent on a large number of factors, which in many cases were beyond the control of Jaguar;

  (2) as with all substantial reward opportunities there was also substantial risk – Investors could lose some or all of the amounts committed to this opportunity;

  (3) Investors should only invest that portion of their cash resources that they could afford to lose in its entirety;

  (4) Investors should not borrow to invest in the opportunity; and

  (5) there was no assurance that Jaguar would be able to realize a gain for the Investors.

The Project Titan Investor Agreement had substantially the same disclosure of risks to the investors. The investment opportunities were made available only to accredited investors.

Conflict of Interest Disclosure in Jaguar Investor Agreements

39. The investor agreements also disclosed conflicts of interest between Jaguar and NSI. In IIROC Notice 10-0028 IIROC requested comments on draft "Requirements and Best Practices for distribution of non-arm's length investment products." Northern reviewed the draft Notice and noted that it was already following many of the recommendations. Northern pointed out the following to IIROC:

> "We believe that in keeping with the concerns raised in the IIROC Notice that we should provide more complete disclosure of the conflicts of interest among, NSI, NFC and Jaguar despite the availability of such public disclosure on Sedar. Therefore while NSI believes that it has adequately managed any connected issuer conflicts, it is prepared to take additional steps to ensure that the relationships between NSI and Jaguar are also disclosed in any future Jaguar loan agreements for projects.

> We understand the lack of due diligence that was performed by many brokerage firms pertaining to the egregious scandals pertaining to asset-backed commercial paper and other incredibly complex products that were created very inappropriately for clients of many bank-owned firms and also larger boutique firms.
>
> It should be noted that NSI did not and will not participate in complex securities that neither the brokerage firm nor the client can understand."

Jaguar Raising Project Financing Independently of Northern

40. Each of these investment opportunities were projects of Jaguar and not NSI. NSI had no involvement in the financing of the ten projects and the investors in the three projects mentioned above were partnering with Jaguar, not NSI. During the Subject Period, NSI was not involved in soliciting funds from the Jaguar investors, was not engaged by Jaguar to raise the funds and was not paid a commission for the funds that were raised by Jaguar. The investor agreements were executed between Jaguar and the various investors involved in the projects. NSI was not a party to the investor agreements and, consequently, the investor agreements were the property of Jaguar, not its brokerage firm.

41. There was a reason for the practice of strictly limiting NSI's role. Each of the ten projects could have led to Jaguar making more than a passive investment by carrying out any of the value creation options such as initiating a proxy contest, making a take-over bid or pursuing some other value creation opportunity. Consequently, the manner in which the funds were raised, the names of the investors who funded the project, the identity of the target company, the nature of each project and the strategy behind it were not matters that could be shared with NSI personnel except as required by securities law. Although this information might be publicly disclosed in the normal course as the project's strategy was implemented, the only NSI personnel who would be aware of the information from the outset were those who occupied dual senior roles at both NSI and Jaguar, such as Mr. Alboini and Mr. Chornoboy.

Raising Funds from Accredited Investors

42. It was a normal business strategy for Jaguar to involve high net worth accredited investors in certain of its investment opportunities. The investor agreements Jaguar prepared for review by these accredited investors employed a code name for the target company to maintain confidentiality of the opportunity. The investor agreements also set out various potential options for creating value and set out the manner in which the investor would participate in any profit realized on the investment opportunity. The investor agreements for Project Vulcan and Project Titan stated that all actions undertaken by Jaguar for the projects would be taken by Jaguar as trustee.

43. It was not known at the outset which investment opportunity would include outside investors. Jaguar also could not identify all outside investors who would participate in an investment opportunity and collect all their committed funds before Jaguar began accumulating a position in the target company, so long as Jaguar had its own means to pay for the shares being accumulated, which it did. Similarly, it was perfectly appropriate for Jaguar to choose to include outside investors in certain projects but not others.

Transparency and Oversight of Jaguar Trading

44. As was made clear in documentary evidence provided to Staff prior to their issuing the Notice of Hearing, NSI was always completely transparent with Penson, its carrying broker, throughout the Jaguar trading on all ten projects.

45. The trading by Jaguar during the relevant time was conducted in a completely transparent manner and was closely monitored by Penson, by NSI's compliance and credit departments and by NSI's management, including Mr. Alboini, Doug Chornoboy, NSI's CFO, and, once the shares were transferred into the Jaguar Project Accounts, Mr. Vance, NSI's CCO. Throughout the course of Jaguar's trading, the value of the holdings in Jaguar's Main Account far exceeded the amount needed to cover any margin shortfall in the client accumulation account (the "TA Account") and the Jaguar Project Accounts in which the trading took place. The Jaguar Main Account guaranteed the Jaguar Project Accounts and vice versa.

46. As NSI's carrying broker, Penson had full knowledge of the holdings in all of the Jaguar accounts at all times. Penson was responsible for providing margin for the TA Account and was highly motivated to protect its own interests. Penson is entirely independent of and at arm's length from NSI. Both Penson and Mr. Vance were monitoring and querying the trading and both had the authority and ability to halt the Jaguar trading and compel a liquidation of any of the Jaguar accounts involved at any time.

47. On a consolidated basis, the Jaguar Main Account and the Jaguar Project Accounts (together, the "Jaguar Consolidated Accounts") fulfilled all margin requirements within 20 business days from the relevant settlement date with the exception of one instance. The period from November 5 to December 8, 2008, (24 business days) was the only instance where the Jaguar Consolidated Accounts were in a debit margin position for greater than 20 business days from the relevant settlement date. At no time did either Penson or Mr. Vance sell out any of the Jaguar Consolidated Accounts because (a) at all material times the Jaguar Main Account contained funds and securities in excess of $10,000,000, which was more than sufficient to cover margin, and (b) Mr. Alboini always kept his word that margin funds would be forthcoming whether from Jaguar or from outside investors participating in any specific investment opportunity. In other words, the Jaguar Consolidated Accounts always had positive equity notwithstanding there may temporarily have been negative margin in one or more of the underlying accounts.

48. Penson monitored the TA Account closely, queried the trading in the account and received explanations from Mr. Alboini and Mr. Chornoboy, who were both officers of Jaguar as well as NSI and therefore behind the ethical wall. At all times Penson had the ability to sell out the TA Account or require NSI to avoid such a sell-out by ticketing out the securities to cover margin. In short, contrary to IIROC's allegations, the Jaguar trading did not create any risk for NSI, its clients or its carrying broker because Jaguar had at least $10,000,000 in equity, NSI's Comfort Deposit with Penson exceeded $1,700,000, and Penson was monitoring margin in the TA account and the Jaguar Consolidated Accounts.

The Use of Multiple Jaguar Accounts was Proper and Appropriate

49. As explained above, multiple Jaguar accounts were created for administrative and reporting purposes as it was unknown at the outset whether outside investors would participate in

any particular investment opportunity. However, the Jaguar Main Account guaranteed the Jaguar Project Accounts and vice versa. These guarantees were put in place to ensure transparency on a consolidated basis respecting the availability of funds to cover any margin deficiency.

50. For the ten Jaguar projects, shares were acquired in the TA Account, which is an institutional client accumulation account that is used for non-contingent client accumulation trades. By accumulating the position in the TA Account, the identity of Jaguar as the buyer would not be known to any NSI personnel other than those who were aware by virtue of their dual positions at Jaguar and NSI. This was necessary to maintain the ethical wall involving on the one hand Jaguar and the investment bankers at NSI behind the ethical wall in the specific investment opportunity and on the other hand all other persons at NSI.

51. Maintaining an ethical wall is typical at Northern in any market accumulation by a client pursuing a potential M&A strategy. The difference here was that Jaguar as the client was related to NSI and there were common officers at both companies. Because of the close relationship between Jaguar and NSI and the presence of common officers, the need for very tight confidentiality was heightened and obvious. The use of the TA Account by Jaguar to accumulate ownership positions in target companies in question was entirely consistent with NSI's policies and procedures.

52. When the TA Account was used to accumulate a position in a particular security, NSI's normal practice was to ensure that the securities were contracted to client accounts by month end. In the meantime, NSI's carrying broker, Penson, put up the capital for the purchase of the shares by Jaguar in the TA Account. Penson was fully aware of the margin position in the TA Account.

53. In addition, pursuant to its agreement with its carrying broker, NSI had a comfort deposit with Penson that exceeded $1,700,000 during the relevant time (the "Comfort Deposit"). This Comfort Deposit in effect served as collateral for any capital put up by Penson for trading in the TA Account. This collateral was in addition to the positive equity position in the Jaguar Consolidated Accounts of at least $10 million.

Margin Requirements

54. After the shares were accumulated by Jaguar in the TA Account, they were transferred into the Jaguar Project Account that had been created for that particular investment. The Jaguar Project Accounts were considered by NSI to be sub-accounts of the Jaguar Main Account. Consequently, the Jaguar Main Account guaranteed each of the Jaguar Project Accounts while the Jaguar Project Accounts similarly guaranteed the Jaguar Main Account. These cross-guarantees provided NSI and Penson with a consolidated reporting position and were put in place to ensure total transparency with Penson respecting the availability of assets to cover any margin deficiency. These cross guarantees also provided total transparency for NSI's compliance department once the shares acquired were ticketed from the TA account to the Jaguar Project Accounts.

55. At all times the funds and securities held in the Jaguar Main Account totaled more than $10,000,000, which far exceeded the total margin debit in the Jaguar Consolidated Accounts and

were available to backstop any delay in the receipt of funds from Jaguar or from outside investors to finance the purchase of any shares. The highest total margin debit in the Jaguar Consolidated Accounts was $2,478,000 during the relevant time, which lasted one day (November 26, 2008). On November 27, 2008, the very next day, this debit margin was reduced to $850,000 and by November 28, 2008, was less than $70,000.

56. Once the securities were ticketed out of the TA Account into a Jaguar Project Account, Mr. Vance, the CCO of NSI, would become aware that Jaguar was the purchaser that had been accumulating the position in the TA Account. Credit inquiries regarding margin would be made by Penson, Mr. Chornoboy, as CFO, or Mr. Vance, as CCO and would be responded to immediately by Mr. Alboini. IIROC was aware of these inquiries based on documentary evidence provided to IIRIOC prior to the issuance of the Notice of Hearing.

Mr. Alboini's Disclosure of Jaguar Related Activities to Compliance was Proper and Appropriate

57. As explained above, Mr. Alboini followed standard investment banking practice in limiting those persons at NSI who needed to know the confidential material information respecting the specific investment opportunity that was being pursued by Jaguar. This was a proper part of normal ethical wall procedures required by securities law. The investor agreements were the property of Jaguar and it would not have been proper or appropriate to disclose them to NSI's compliance department.

58. Once the accumulated positions were transferred from the TA account to the appropriate Jaguar Project Account, Mr. Vance and NSI's compliance department became aware that Jaguar had been accumulating shares in a particular company. At all times, the margin position in the TA Account and the Jaguar accounts was transparent to the persons responsible for supervising margin in those accounts. NSI's compliance and credit departments, along with the credit department of Penson, NSI's carrying broker, were all in close contact with Mr. Alboini, who responded to margin related queries in a responsible, timely and forthright manner. At all material times the Jaguar Consolidated Accounts had in excess of $10,000,000 worth of cash and securities which was more than sufficient to cover any margin call.

59. Mr. Vance consistently made appropriate inquiries of Mr. Alboini with respect to the trading by Jaguar. Mr. Vance was aware that a number of new Jaguar accounts were opened and approved them, was aware of the trading in question once ticketed from the TA account to the Jaguar Project Accounts, and properly supervised Mr. Alboini's activity as a registered representative.

60. The fact that many investors in the Jaguar projects during the Subject Period were also NSI clients did not result in the imposition of any additional obligations on NSI if, as was the case during the Subject Period, NSI was not involved in soliciting investments from such clients. The solicitation of funds from accredited investors was directly undertaken by Jaguar. During this time NSI was not involved in the solicitation of any funds from outside investors who were high net worth contacts of Mr. Alboini. Therefore NSI was not paid any commission for the funds raised by Jaguar. Furthermore there was no requirement on Jaguar to use a registrant like NSI in the raising of funds from accredited investors which provided an exemption from the registration requirement, as is the case with many private placements in Canada to accredited investors.

61. NSI's compliance and credit departments, along with the credit department of NSI's carrying broker, were all in close contact with Mr. Alboini throughout the material time. Mr. Vance was part of that process and he fulfilled his obligations reasonably and in good faith.

The Cross-Guarantee of the Jaguar Accounts was Proper and Appropriate

62. The cross-guarantee of the Jaguar accounts described above was proper because the Jaguar Project Accounts were sub-accounts of the Jaguar Main Account. The cross guarantees presented an accurate, transparent position of the Jaguar Consolidated Account. Despite the cross guarantees, Jaguar continued to act as trustee of the ownership positions for the individual Jaguar project Accounts. The positive equity in the Jaguar Main Account of at least $10,000,000 together with the Comfort Deposit of at least $1,700,000 provided Jaguar with more than adequate security to meet Jaguar's trustee obligations for the individual Jaguar Project Accounts.

Adequate Records were Maintained

63. Mr. Alboini made reasonable and sincere efforts to maintain adequate records. To the extent that there were minor errors in the documentation, these were inadvertent. Some of the New Client Application Forms were incomplete in respect of third party beneficiaries as this information was not available at the time of account opening and thus could not have been included in the forms. In other words, at the time some of the Jaguar Project Accounts were opened, it had not been decided whether outside investors would participate in the investment opportunity.

No Harm, No Losses, Indeed Clients Made Money

64. No harm to NSI, its clients or its carrying broker resulted from the Jaguar trading during the Subject Period, nor was there any possibility of harm in light of the minimum equity of $10,000,000 in the Jaguar Main Account during the Subject Period, the funds received or to be received from outside investors and the Comfort Deposit. Penson never sold out any shares held in the TA Account or the Jaguar Consolidated Accounts because all purchases were ultimately funded or securities were sold or could be sold. Indeed, accredited investors in all the Jaguar Project Accounts made a return on their investments. Mr. Alboini had a relentless focus on making sure the outside investors would not lose money and therefore structured most of the investments as loans so that investors would at a minimum get a return of their capital plus interest earned if in the worst case scenario the investment did not work out as planned. This is discussed in more detail below. There was no inappropriate benefit gained by Jaguar as Jaguar always had sufficient resources available to pay for the shares purchased.

NORTHERN'S EXCELLENT CULTURE OF COMPLIANCE

IIROC's Recognized Need to Overhaul Its Compliance Review Program

65. In a remarkable accusation which Northern is at a loss to understand, Staff accuses Mr. Alboini and Mr. Vance of failing to create and maintain a culture of compliance. Staff's basis for this accusation is an apparent failure on the part of NSI to correct certain IIROC so-called

"deficiencies" over the course of three sales compliance reviews and one trade desk compliance review. With all dues respect to IIROC, the reality is that the so-called deficiencies were not in fact "deficiencies". NSI will deal with each of the "deficiencies" in turn.

66. As explained above, Northern has a very robust culture of compliance that is carried on by honest and well-intentioned personnel.

67. As explained in detail below, and with all due respect to IIROC:

(i) IIROC compliance examiners and management have made wrong judgment calls on Northern's compliance supervision and monitoring system.

(ii) The so-called "deficiencies" are not in fact deficiencies, and Staff has displayed the rigid thinking IIROC has publicly stated it needs to avoid. Unfortunately, this rigid thinking has been consistent over a period of many years.

(iii) The IIROC compliance examiners and managers for the most part do not have the depth of understanding and experience to deal with some of the issues and rely on form over substance, which again IIROC has publicly stated it wishes to avoid. The compliance examiners are generally not chartered accountants, MBAs or lawyers and lack practical experience in middle or top positions in the financial services industry, law or business.

(iv) Boutique firms like Northern should be able to tailor their compliance systems to dovetail with their business models. IIROC at times expressed a similar view but, at least in Northern's experience, Staff has failed to implement this approach.

(v) Northern just like any other boutique firm will make incremental improvements in its compliance and supervision monitoring programs, and all boutique firms wish to do their collective best in making improvements or adjustments to continually strive for a best practices theme in their businesses. Unfortunately, Northern's efforts in this regard appear to have been ignored by compliance examiners and managers at IIROC, or at least not given proper weight.

68. Set out below are detailed responses to each of the alleged deficiencies raised by Staff.

Overview on External Employee Accounts

69. In many brokerage firms, employees are permitted to keep or open accounts at outside brokerage firms. Where this is permitted, it is important for the employer firm to receive all monthly statements of their employees held at outside firms to monitor their trading in securities. This monitoring is done to ensure, among other things, that employees holding external accounts are not trading contrary to Grey Lists or Restricted Lists at their employer firm. Up until July 2010 Northern permitted its employees to have accounts at other firms, which has been a standard practice at most firms.

70. In July 2010, the Executive Committee made the decision to ban external accounts held by Northern employees at other firms. This decision was not widely accepted because Northern employees in some cases had long-standing relationships with investment advisors at other firms

and in other cases had accounts at discount or online firms where trading commissions are very low. Northern held several meetings with its employees to explain the rationale for this decision. Ultimately, the Executive Committee was able to convince the employee team about the importance of maintaining all employee accounts at Northern for compliance reasons. In the process, Northern decided to lower the commissions payable by employees (which were already at a discount to normal trading commissions at Northern) to a level that approximated the commissions charged at a discount or online firm.

71. The external account issue has plagued IIROC and Northern for 8 years. Although it is a minor issue, Mr. Alboini's decision to ban external accounts, after IIROC did not honour the April 2010 settlement, eliminated this point of friction once and for all.

The Difficult History of IIROC and Northern Dealing with a Simple Issue on Employee External Accounts

72. The history of the dealings between the compliance group at IIROC and the compliance group at Northern on this relatively simple issue is set forth below in somewhat painful detail. This detail is unfortunately necessary to show the inability of IIROC and Northern to arrive at a sensible solution long before the settlement reached between Ms. Jensen and Mr. Alboini and long before the decision to ban external accounts.

73. In the course of the sales compliance reviews from 2002 to 2007, Staff raised a concern about the maintenance of information concerning external employee accounts. In the 2002 sales compliance review, IIROC wanted to have a clear audit trail of the review Northern conducted on external employee accounts. Northern agreed.

74. In the 2004 sales compliance review, Staff asked for more adequate controls over the information reviewed in the external employee accounts. Northern made disclosure of the employee external accounts part of an annual disclosure form to be completed by its employees. Northern also developed a spreadsheet to track the external accounts. It is important to recognize the cooperative approach taken by Northern to respond positively to IIROC's requirements or recommendations.

75. As a follow-up in 2006 to the 2004 sales compliance review, IIROC noted in its May 23, 2007 report that "some improvements were noted from the 2004 SCR [i.e. Sales Compliance Review]: particularly, the dating of the reviews and evidence of reviews of activity against the firm's restricted lists." However, despite these improvements, quite surprisingly to Northern IIROC made a decision to refer the matter of employee external accounts to enforcement at IIROC. Here was an opportunity for IIROC to work with Northern; instead IIROC failed to establish that partnership spirit and referred the matter to enforcement.

76. During the material time, the essence of Northern's external employee account policy was straightforward. All NSI employees were required to disclose their outside securities accounts at the time they were hired and to update that information on an annual basis as part of the annual disclosure form to be completed by each employee. NSI used this information to maintain a spreadsheet of all external accounts held by all employees at the Firm. Letters were sent to the member firms where the external accounts were located to ensure that the accounts would be identified as "pro" accounts and copies of the account statements would be provided to

NSI's compliance department for review. This was confirmed by Mr. Vance in his response to IIROC on the 2006 follow-up sales compliance review.

77. In the April 30, 2009 report for the 2007 sales compliance review, IIROC mandated to Northern the time of year it should send out to employees the annual disclosure form to complete with respect to their external accounts. The timing of distribution of the annual disclosure form did not seem to NSI to be a relevant issue for inquiry by IIROC. Ultimately IIROC conceded that this was not a relevant issue. However, in its April 30, 2009 report, IIROC, quite amazingly, referred the matter of external accounts to enforcement.

78. NSI's procedures respecting external employee accounts complied with NSI's obligations and were implemented in a diligent fashion. In the 2009 report for the 2007 sales compliance review, Staff alleged that NSI was not "timely" in inputting the information received from employees into the external accounts spreadsheet.

79. Staff questioned why twenty external accounts for thirteen employees did not appear on NSI's spreadsheet. The answer was simple. Staff's 2007 business conduct compliance review commenced in November 2007. NSI had initially provided the spreadsheet to Staff on November 5, 2007. The annual disclosure forms from NSI's employees were due that year on November 12, 2007. The accounts Staff identified as missing from the spreadsheet were all accounts that NSI learned about *after* the spreadsheet had already been provided to Staff.

80. Staff was fully aware of the due date for receipt of annual disclosure forms, but nonetheless continued to report this matter as a "deficiency". This is another example of a judgment by IIROC compliance Staff that, with all due respect, is incorrect.

81. Although NSI has always held the view that its policies and procedures respecting external employee accounts complied with its regulatory obligations, in March and April 2010 Mr. Alboini reached out to Ms. Jensen to accelerate the resolution of all of the sales compliance matters that were outstanding including external employee accounts. Mr. Alboini committed personally to Ms. Jensen that these issues would be dealt with immediately. Mr. Alboini convened meetings with his management team and directed Mr. Vance to amend Northern's policies and procedures in accordance with Staff's directions pursuant to the agreement Mr. Alboini made with Ms. Jensen. Mr. Alboini determined that IIROC's position on external employee accounts should be accepted even if incorrect as long as NSI's business was not adversely impacted.

82. Mr. Vance sent a letter dated April 20, 2010 to IIROC dealing with all the Sales Compliance matters including external accounts which he dealt with as follows:

> "In the 2007 Business Conduct examination IIROC brought to our attention certain issues regarding NSI's recording and monitoring of employee external accounts. We take this opportunity to advise you of the following:
>
> All employees are required, on an annual basis, to complete our annual disclosure form. A member of Compliance staff is then assigned to review the forms and compile this information on a spreadsheet, which is typically completed within a few weeks of receipt of all forms. Where a deficiency is identified on a form, the compliance staff member

> follows up with the employee to address it in a timely manner and update the spreadsheet if necessary.
>
> When the Compliance Department becomes aware that an employee has opened, or intends to open, an unreported external account, the employee is contacted and requested to provide the required information for approval by Compliance and for updating the spreadsheet.
>
> We believe that these procedures help ensure that external employee accounts are properly catalogued so that they can be monitored appropriately."

All sales compliance matters were agreed upon with Staff.

83. After Staff determined not to honour the settlement reached with Mr. Alboini, in July 2010 the Executive Committee decided to ban all external accounts. The banning of external accounts was also viewed as a best compliance practice as recognized in OSC Policy 33-601. These external accounts were directed to be moved in-house which provides for real-time compliance monitoring of pro trading activities and which put an end to the issue.

84. In short, despite the initiative taken by Mr. Alboini to settle this issue with Ms. Jensen, Staff walked away from the settlement in April 2010. Furthermore, despite Northern having banned external employee accounts, Staff persisted in making an issue of external employee accounts in the Notice of Hearing.

90 Day Training Program

85. The requirement to provide a 90 day training program for new or inexperienced investment advisors ("trainees") is another example of a failure on the part of IIROC to work with Northern to develop a solution to what was a relatively minor issue.

86. NSI did have a 90 day training program in place that met NSI's regulatory obligations. This program was designed to complement the CSI Investment Advisor Training Program and required each department head to meet with new registrants and cover a detailed range of topics. The program was also shared with NSI's branch managers for customization for that branch, where required. Since October 2006, NSI hired only four registrants who required this program and no longer hires any trainees.

87. Ultimately the issue was resolved by Mr. Alboini in the settlement with Ms. Jensen. After IIROC walked away from the settlement, Mr. Alboini decided to put an end to the issue by not hiring any trainees, only experienced investment advisors.

88. In order to understand the relatively minor nature of the issue, it is necessary to review in some detail the history between IIROC and Northern in dealing with the 90-day training program.

89. Up to 2004 Northern had not hired any trainees. In 2004 Northern did hire a trainee. In the 2004 sales compliance review, IIROC recognized that this individual was the first trainee to be hired by the Firm in the head office. In its report IIROC directed that NSI subject any trainee to a trainee program approved by IIROC.

90. In reply, Northern referred to its Policies and Procedures Manual which requires trainees to complete the 90-day Training Program. In addition Northern pointed out to IIROC that an NSI Trainee package is provided to all trainees and newly hired investment advisors, including copies of NSI's Policies and Procedures Manual, Trading Supervision Policy, Credit Risk Policies Manual, Registered Account Guide and OSS User Manual. Acknowledgement of receipt and compliance with the above material is kept on file by the Compliance Department. Northern also restricted the activities of trainees to ensure that they were not carrying on any activity in which registration would be required under applicable securities legislation during the training period.

91. In the 2006 follow-up to the 2004 sales compliance review, IIROC directed Northern to maintain evidence of the training program for review. Northern agreed.

92. In the 2007 sales compliance review, IIROC directed Northern to develop a supplement to the Canadian Securities Institute training material that would cover all of the Northern's businesses. IIROC required that

> "the program should include, but not be limited to, the persons at head office and branches responsible for training new Registrants, the time spent with each department head/trainer, an outline of the topics each department head is expected to cover, the maintenance of written evidence of the material discussed with each individual and the persons responsible for maintaining this evidence Training at the head office and branch levels also needs to be consistent in order to ensure that all new registrants are trained to a common standard. However, the delivery and presentation of such training can differ depending on the region. All evidence of this training must be maintained for our review."

Despite outlining in detail its opinion on the applicable training program requirements for the first time, again quite amazingly, IIROC decided to refer this matter to enforcement at IIROC.

93. As Northern pointed out in its letter of response:

> "NSI provided our internal training program to IIROC as part of our July 7, 2008 letter; our program was designed to complement the CSI Investment Advisor Training Program (90-day). Our in-house program details each department head our new registrant is to meet with and includes suggested topics to cover including a section to identify 'points covered during training'. The program which was created at Head Office was shared with our respective Branch Managers in order for them to customize it where need be.
>
> It is for reasons such as this which is why we believe the comment made 'There was no evidence that the Member had created specific in-house training' on the final BCE report to be inaccurate.
>
> We will continue to update our training program in an effort to keep it current/relevant and we will ensure that the training covers the topics IIROC has informed us they wish to see covered.

We also bring to your attention that since October 2006 NSI has hired only four (4) registrants who required this type of training."

94. As part of his commitment made to Ms. Jensen to settle all sales compliance issues, Mr. Vance was directed by Mr. Alboini to satisfy the training program issue in the manner required by IIROC. Further to this directive, Mr. Vance sent a letter dated April 20, 2010 to Judy Long and to Sasha Latka dealing with sales compliance matters. On the 90 day training program, Mr. Vance stated the following:

"We have revised and updated our 90-day training materials, a copy of which is enclosed for your reference. You'll note that the training materials i) indicate the persons responsible for the various areas of training, ii) indicate the amount of time spent on each training section, iii) provide an outline of topics that are expected to be covered, and iv) provide a space for written evidence of the material discussed with each individual.

Copies of completed training materials will be maintained in the registration file of the trainee. We have updated these materials to address the concerns identified by IIROC in the 2007 Business Conduct Examination and note that we have not needed to administer this training program during the past two and a half years."

95. The following was the training program at Northern prior to the decision to end the program because Northern would not be hiring any trainees:

"Investment Advisor ("IA") or Investment Representative ("IR") Training (August 2010)

The CCO, BM or Designated Officer is responsible for the IA and IR training program. Every newly licensed IA or IR must complete the CSI 90-day training program or 30-day training program respectively. Trainees will be enrolled in the applicable Canadian Securities Institute ('CSI') training program. These programs are administered online and meet IIROC requirements for training IAs and IRs within the required time frame.

IAs and IRs are required to complete NSI's New Investment Advisor Internal Training Program. Trainees will meet with the departmental head/trainer to learn the functions of the respective department and the departmental trainer is required to summarize in writing what was discussed. Supervisors are able to monitor the progress of each trainee and use self –administered quizzes to assess their progress and comprehension. Copies of completed quizzes and a completed CSI Training Program Certificate (signed by the supervising BM or Designated Officer) will be kept in the registration file of each trainee for audit purposes. All new trainees will be provided with a 'NSI Trainee package' which includes a copy of the following:

• NSI's New Investment Advisor Internal Training Program Package
• NSI's P&P Manual,
• Registered Account Guide
• OSS or Trade Innovator User Manual

Activities of trainees are limited to those which do not require a registered status. OSS access and a quote service are not provided until after the trainee is duly registered and phone conversations and emails are monitored.

Following completion of the 90-day or 30-day training program, and upon licensing, the IA or IR must complete a six-month period of supervision defined in accordance with the 'Registered/Investment Representative Monthly Supervision Report'. During this 6-month period, all transactions must be approved by the Compliance Department or delegated manager. Pre-approval of all buy and sell orders is required before entry of any transaction, and newly approved individuals are restricted to view only access to ensure all trades are approved prior to execution. A monthly supervision report must be maintained in the IAs or IRs registration file in the Compliance Department."

96. After Staff failed to honour the settlement reached between Ms. Jensen and Mr. Alboini, in July 2010 Northern determined not to hire any new or inexperienced investment advisors who would require a 90 day training program, which put an end to the issue.

OSC Policy 33-601 Guidelines for Policies and Procedures Concerning Inside Information

97. In the Notice of Hearing, IIROC makes certain allegations concerning Northern's policies and procedures respecting grey lists and restricted lists. To put IIROC's allegations in context, we must first briefly examine the guidance provided by the Ontario Securities Commission.

98. OSC Policy 33-601 sets out guidelines for policies and procedures concerning confidential material information or inside information in a brokerage firm. The key is to make sure that knowledge of any confidential material information about a public company remains behind an ethical wall within a dealer which is established for employees who need to have knowledge of such information to carry out a financing or an M&A transaction for a client.

99. These employees behind the ethical wall are, of course, not permitted to trade in securities of that public company. All other employees of the brokerage firm are outside the ethical wall and therefore cannot and should not be privy to the confidential material information and can trade innocently in securities of the public company. In other words, knowledge of confidential material information by employees who need to know and cannot trade must be separated from innocent trading by other employees who cannot know and do not know and are permitted to trade.

100. A dealer can avoid liability for trading where it can prove that no individuals with knowledge of confidential material information made a decision to buy or sell the affected securities. In other words, the trading was innocent, or without knowledge of the confidential material information.

101. To carry out this burden of proof, the dealer must put ethical wall policies and procedures in place to prevent insider trading and tipping. OSC Policy 33-601 gives general guidelines on the adoption of ethical wall policies and procedures. As stated in the Policy:

> "the Commission recognizes that the circumstances of each registrant will differ and accordingly does not consider it appropriate or feasible to mandate particular policies or procedures."

Likewise, IIROC should not mandate particular policies or procedures. These policies and procedures are a decision for each dealer.

102. OSC Policy 33-601 sets out a "range of possible policies and procedures" which dealers may wish to adopt. The Policy makes it clear that failure to adopt the ethical wall policies and procedures will not, of itself, indicate that the dealer has failed to take reasonable precautions. Similarly, adopting all of the policies and procedures in Policy 33-601 will not provide assurance that reasonable precautions have been taken by the dealer.

103. As stated in OSC Policy 33-601:

> "Whether a registrant has implemented appropriate and sufficient policies and procedures to satisfy its obligations and to sustain the burden of proof will depend upon the circumstances of each case and each registrant."

This guideline underscores the importance of the dealer tailoring its policies and procedures to deal with the specific circumstances of the firm. The Policy also states that "these guidelines are not exhaustive" and "registrants should consider which practices and procedures would be appropriate for their business."

104. The focus of OSC Policy 33-601 is on the education of employees, containment of inside information, restriction of transactions, and compliance. On the subject of containment the Policy states that brokerage firms should consider restricting access to the investment banking department.

105. OSC Policy 33-601 states that a dealer should consider:

> "[i]f restricting access to departments is impractical or impossible, as in the case of a *smaller registrant*, treating all of its departments as being 'behind the wall' so that if the registrant is in receipt of inside information, all trading and advisory functions are subject to any restrictions imposed."(italics added)

This is an important guideline that gives flexibility to smaller dealers to shut down all trading in the firm where the firm does not have the ability to restrict access to its investment banking department.

106. As discussed in this memorandum, Northern adopted this approach in 2002 in its former head office location in Toronto and restricted trading in securities of public companies right across the Firm when Northern was in possession of confidential material information. Unfortunately IIROC rejected this approach and required Northern to use a grey list rather than to restrict trading Firm-wide. This was a critical error made by IIROC which has caused problems with the relationship between IIROC and Northern on this issue from the outset.

107. The OSC Policy states that a dealer should normally place an issuer on the Grey List when it has received confidential material information about the issuer, for example when the Firm has been invited to manage an offering or to act as an advisor concerning a possible M&A transaction. A Grey List is defined in OSC Policy 33-601 as a highly confidential list of companies about which the Firm has inside information (that is, confidential material facts or confidential material changes). A Grey List is a watch list that the Compliance Department uses to watch for any inappropriate trading by persons behind the ethical wall.

108. Generally, the brokerage firm does not impose any restrictions on trading, sales and research when a company is placed on a Grey List because personnel in these areas are not typically brought behind the ethical wall. It is important to make sure that the Grey List information stays in the infrastructure of the ethical wall, and that trading is done outside the ethical wall by someone who does not have knowledge of the confidential material information.

109. A Restricted List is a list of companies for which a dealer is acting as an agent or underwriter in a financing or as an M&A advisor in a proposed transaction, where generally the financing or transaction has been announced. In this case all trading is restricted right across the Firm with few exceptions such as trades resulting from unsolicited orders from clients.

Northern's Policies and Procedures on Grey Lists and Restricted Lists

110. NSI's procedures with respect to Grey and Restricted Lists have at all material times been set out in its Practice and Procedures Manual. NSI has updated its Practice & Procedures Manual to reflect its evolving practices with respect to Grey and Restricted Lists.

111. At all times, NSI's practices and procedures with respect to its Grey and Restricted Lists have complied with NSI's regulatory obligations. At all material times, NSI maintained adequate Grey and Restricted Lists and ensured that proper procedures were created and followed regarding the use of these lists.

112. The Compliance Department at Northern maintains a Grey List and a Restricted List in order to monitor on a daily and quarterly basis all trading activity in the securities on such lists in all accounts at NSI including, most importantly, employee accounts, NSI pro accounts and accounts of insiders of companies on these lists. Employees at Northern can no longer maintain accounts at other brokerage firms. This requirement to maintain all accounts at Northern facilitates the monitoring of trading activity by the Compliance Department.

113. The monitoring of trading in securities of companies on the Grey and Restricted Lists is done to ensure that restricted securities are not traded and that any trades in Grey Listed securities are done outside the ethical wall by persons without any knowledge of confidential material information.

114. The Compliance Department also reviews trading in Grey or Restricted listed securities for the 45 day period prior to the date of the listing of securities on the Lists. Look-back testing is not explicitly required by OSC Policy 33-601, but was implemented by NSI after it was recommended by IIROC in its 2007 sales compliance report dated April 30, 2009.

115. IIROC referred to enforcement the fact that NSI did not have a look back testing procedure of 45 days in the same April 2009 report, where it raised for the first time that NSI should have such a specific look-back testing period. IIROC's requirements are effectively moving targets.

116 In addition to the monitoring of trading by the Compliance Department, Mr. Alboini reviews all trades in Northern each morning with a specific focus on securities on the Grey and Restricted Lists.

117. Northern normally places on the Grey List all public companies when Northern has received confidential material information, including most importantly public companies that propose to do a financing where Northern is proposed to be involved as an agent or underwriter or that propose to carry out an M&A transaction where Northern is proposed to be involved as a financial advisor.

118. When Northern is close to signing an engagement to lead or participate in a financing or act as financial advisor in an M&A transaction, the Northern investment banker involved in the financing or M&A transaction will email the Institutional Compliance Officer ("ICO") at Northern to grey list the subject company and all the personnel at Northern who are also involved. The ICO will send an email to all NSI employees who have been grey listed so that they become specifically aware of the fact that they are on the Grey List for the subject company.

119. In addition to emails to the ICO on a real time basis when necessary to grey list companies and NSI personnel, a Vice-President, Investment Banking at Northern meets with the ICO weekly to review the status of the Grey and Restricted Lists. NSI normally removes a public company and the names of all NSI personnel when the financing or M&A transaction has been completed and publicly announced, or is abandoned and NSI no longer has any confidential material information regarding the public company.

120. The Grey List is used primarily for pending or proposed transactions or projects. NSI considers its Grey List to be a highly confidential document that is disseminated to and viewed only by those persons who are behind NSI's ethical wall and are privy to confidential material information. Only these individuals will be grey listed for that particular company. Therefore, a limited number of NSI employees will receive the Grey List and each individual will be grey listed on only those companies in which they are involved.

121. Members of the Investment Banking department are responsible for identifying and providing the names of public companies that should appear on NSI's Grey List on a timely basis to the Compliance Department. Hard copies of all communication between the Investment Banking department and the Compliance Department are kept on file in a binder located at NSI's head office labeled "Grey List Communications". The ICO is responsible for maintaining and disseminating the Grey List to the involved employees at NSI immediately following the addition or deletion of a named issuer as well as on a regular basis as a reminder to the applicable staff. The ICO emails all the Northern personnel who have been grey listed to let them know that they have been grey listed. The ICO then checks all trades against the Grey List on a daily basis to ensure that there is no trading in grey listed securities.

122. Once a company is placed on the Grey List, trading, advising and research activity by employees who lack access to confidential material information (i.e. are outside the ethical wall) may continue without restriction (subject to selective and confidential intervention by the Compliance Department on a case-by-case basis, as necessary).

123. When a company is placed on the Restricted List, NSI suspends all pro trading and principal trading except (i) market-making activities for permitted market stabilization trading for a financing or (ii) any trading necessary to carry out an engagement for a client which led to the public company being grey listed or restricted such as for example the purchase of shares in the market.

124. NSI also adds a company to the Restricted List when there has been a new recommendation made by the Research Department, or when there is a change to a previous recommendation. The Restricted List is distributed to all NSI employees immediately following the addition or deletion of a named public company when applicable as a reminder to all staff.

125. Northern typically moves a public company's name from the Grey List to the Restricted List when Northern has agreed to act as an underwriter or to represent the public company in an M&A transaction, and the transaction has been generally disclosed by press release.

126. Hard copies of all communications are kept on file in a binder located at NSI's Head Office labeled "Restricted List Communications" together with copies of the current list showing the applicable changes, proof of dissemination to all staff and copies of news releases detailing the reason for the change.

127. The investment banker at Northern or the Syndication Department will notify the Compliance Department to remove a security from the Restricted List when the financing has closed and a press release has been issued announcing the completion of the financing.

Northern's Struggle with IIROC on Proper Ethical Wall Procedures

128. The OSC has made it clear that the onus is on dealers to develop their own ethical wall procedures to suit their business activities. It is therefore clear that there are no hard and fast rules on ethical wall procedures. OSC Policy 33-601 sets out guidelines for review by dealers. It is therefore highly inappropriate for IIROC, with all due respect, to mandate specific rules and procedures for Northern or any other boutique firm. Unfortunately and in any event, the compliance examiners and management at IIROC do not have practical experience in the operation of ethical walls and therefore do not contribute positively to compliance themes and principles in this area.

129. It has therefore been an unwelcome struggle since 2002 to deal with IIROC on ethical wall procedures. Northern outlines the struggles below.

(i) Staff's Incorrect Decision in 2002 to Overrule Mr. Alboini's Decision to Restrict Securities Across the Firm in its Prior Head Office Location

130. NSI acquired the operating business and assets of St. James Securities, a financially troubled firm which was cleaned up by Northern. The office location of St. James Securities

was 150 York Street in Toronto. In this office location, there was no physical separation of the investment banking offices from the rest of the Firm. Northern put in place all of the necessary ethical wall procedures such as the use of code names, locked office doors in the investment banking offices, a clean desk policy for such offices, secured filing cabinets, separate and secure space for the investment banking group on Northern's computer server, and dedicated copiers and fax lines for the investment banking group.

131. However, despite the normal ethical wall procedures, Mr. Alboini decided to restrict securities of a public company across the Firm when Northern received confidential material information about a company. This decision was made because Mr. Alboini wanted to protect the Firm and its clients against any possible improper trading by reason of the fact that there was no complete physical separation of the investment banking offices from the rest of the Firm in this former head office location. Mr. Alboini believed then and believes now that this decision to use a Restricted List only was the right decision for the Firm at that time in that office location.

132. Therefore as soon as Northern received confidential material information, it would restrict the securities of the specific public company. Generally this confidential material information would be information that a public company proposed to do a financing or carry out an M&A transaction. OSC Policy 33-601 specifically recognized the ability of "smaller registrants" to restrict securities right across the Firm where there was no physical separation of the investment banking group from the rest of the Firm.

133. In its 2002 Sales Compliance Report dated June 2002, IIROC noted that Northern was restricting all employees at the time of engagement for all investment banking transactions. IIROC "*required* that [Northern] employ the use of both a grey list (watch list) and restricted list. (italics added)" This decision by IIROC was plainly wrong. This requirement did not have any basis in OSC Policy 33-601 or IIROC Rules and Policies. The responsibility for implementing proper ethical wall procedures is a matter for the individual registrant such as Northern.

134. Mr. Alboini's decision to restrict securities right across the Firm when in possession of confidential information was the most conservative decision that could be made given the physical circumstances of Northern's prior head office location, whereas IIROC's requirement that Northern use a Grey List was not appropriately conservative.

(ii) Staff's Failure to Understand the Purpose and Operation of Grey Lists

135. In a letter dated February 14, 2005, an IIROC examiner stated that a client of the Firm traded in shares which were on the Grey List, as if to suggest that there was something wrong about a client trading in grey listed securities. The examiner clearly did not understand how Grey Lists work.

136. The client's trade was done outside of the infrastructure of the ethical wall, and was therefore innocent trading without any knowledge of the confidential material information behind the ethical wall. The whole purpose of the ethical wall is to permit trading by clients outside the ethical wall who have no access and knowledge of the confidential material information.

(iii) Flaws in the 2004 Sales Compliance Report

137. The Sales Compliance Report dated October 2004 and sent to NSI on March 22, 2005 is a good example of the type of issues raised by IIROC that, with all due respect, do not have any basis in OSC rules or IIROC rules. Here is what IIROC stated in the 2004 Sales Compliance Report with regard to Restricted Lists:

> "The Association reviewed the Member's September 9 and September 16, 2004 restricted lists for accuracy and integrity. Numerous concerns regarding the firm's compilation, control and distribution of the restricted list were noted:
>
> - It was the Member's understanding and procedure to restrict an issuer as soon as an engagement letter had been signed. The firm had not taken into consideration the fact that the relationship may not come to fruition and the 'deal' not finalized [sic]."

138. This quoted statement does not make any sense and it is clear that the compliance examiner and the compliance manager who approved the Report did not understand Restricted Lists. Northern restricts trading in shares of a public company when Northern has been engaged in a financing or an M&A transaction and the financing or M&A transaction has been announced. It is unclear what the above-noted statement was intended to mean or how it is a breach of the letter or spirit of ethical wall procedures.

139. In the 2004 Sales Compliance Report, IIROC also stated that the Restricted List "was only formally updated and fully distributed on a weekly basis; therefore all employees were not being advised on a timely basis." This statement was simply not correct as Northern updates the restricted list regularly as companies are placed on the Restricted List, as well as on a weekly basis. The Restricted List is fully distributed to all employees each time that it is updated. This has always been the procedure followed at Northern, including during the period of time reviewed by the examiner.

140. IIROC also stated the following:

> "The Association detected instances where an issuer was not removed from the restricted list until well after the close of the deal. While this in itself is not in contravention of any regulations, it may be indicative of the member's lack of control and procedures concerning its restricted lists."

141. IIROC did not disclose which issuer it believed should have been removed from the Restricted List after the closing of the "deal", or which deal is being referred to. In several instances in compliance reports, names and events are not disclosed by IIROC making it impossible for Northern to respond. As a matter of basic fairness, IIROC should be open and transparent in disclosing alleged matters of concern. Just like any other boutique firm, Northern is anxious to advance its compliance platform, but it needs transparency, not anonymity.

142. IIROC is concerned that there were public companies (whoever they are) kept on the Restricted List "until well after the close of the deal". Was a press release issued after the closing of the financing or M&A transaction? Northern does not remove a public company

from the Restricted List until the completion of the financing or M&A transaction is announced. This is important because until the press release is issued Northern has confidential material information and cannot take the name off the Restricted List until there is public disclosure of the financing or M&A transaction.

143. If in fact there was a press release issued announcing the completion of a "deal" (we do not know because IIROC has not provided any disclosure), and a public company's shares stayed on a Restricted List too long, as IIROC itself has recognized, there was no breach of any rule. With all due respect, it is inappropriate for the compliance examiner and manager to jump to a conclusion that this minor matter may be a sign of lack of control and procedures concerning NSI's Restricted List, particularly without further investigation.

(iv) The Mistake-Riddled 2006 Sales Compliance Report

144. In a follow up in 2006 to the 2004 Sales Compliance Review IIROC stated the following:

> "During the 2004 SCR, the Association had a number of concerns regarding the compilation, control and distribution of the firm's restricted list. While some issues had been satisfactorily addressed, a random review of the Member's most recent restricted lists determined there were still gaps in the process, whereby issuers were not restricted on time, were restricted too early or remained restricted without explanation. For example; in reviewing the restricted list for August 15, 2006, the Association noted the following:
>
> - AVC was restricted March 20, 2006, however, the issuer did not publish a press release until April 25, 2006"

145. AVC is American Vanadium Corp. American Vanadium became a public company in July 2007 and could not have issued press releases in 2006. Northern has never done a financing or M&A transaction and has never been involved with this company in any other way. It is a mystery to Northern as to what IIROC meant in its reference to AVC.

146. IIROC also noted the following example in its report:

- "UNT was restricted June 13, 2006, however, a press release was not issued until June 21, 2006"

147. Northern did complete a financing for Uniterre Resources in September 2006. As explained below, there can be valid reasons to restrict shares prior to the issuance of a press release. It depends on the circumstances of each case. Restricting early will not cause harm. Depending on the circumstances, delaying a restriction could cause harm.

148. IIROC referred to the following example in its report:

- "PBC was restricted May 10, 2006, however, there was no press release or indication of the reason for the restriction"

149. PBC is Pebercan which was a company in which Northern was considering as a possible investment banking client in connection with a possible financing. Northern subsequently dropped its consideration of Pebercan as a potential client. Northern was not involved with Pebercan in any financing. Pebercan was restricted on May 10, 2006 at the request of a then Montreal-based investment banker at Northern. There were no financings or M&A transactions announced by Pebercan in 2006 and in any event as noted Pebercan never became an investment banking client at Northern. It appears that Pebercan was restricted rather than grey listed which may have been done for several reasons as noted below.

150. As a general comment, there could very well be important reasons for Northern to restrict trading in shares of companies before a financing or M&A transaction is announced. A client may request a restriction. Northern may believe that there is considerable speculation about a financing or M&A transaction in the public arena and restricting the stock may be a prudent course of action. There are no hard and fast rules in dealing with when companies should be placed on the Restricted List and when they should be removed. Northern should not be criticized, let alone penalized, for taking a conservative approach. It is Northern's responsibility to make such judgment calls. There is absolutely no harm caused in an early restriction. However, there could be harm involved in delaying a restriction. Careful judgments by investment banking personnel are required in assessing the circumstances of each case.

151. It should also be noted that Northern is dealing in real time when it makes decisions about companies being restricted. Those decisions are made taking into account the circumstances and facts available to Northern at that time. When IIROC reviews these decisions, they do so in hindsight, which is quite difficult because all the facts and circumstances cannot possibly be available to IIROC.

152. IIROC also stated the following in its September 2006 report:

> "Also, SHY, an equity offering announced December 1, 2006 in which the Member was clearly participating, was not restricted until December 13, 2006."

The press release announcing the financing was in fact issued on December 13, not December 1 as stated by IIROC, and Sharon Energy was restricted on the same date. IIROC was therefore mistaken.

(v) The 2009 Sales Compliance Report

153. In the 2009 Sales Compliance Report, IIROC stated that "we noted that the Member failed to grey list two out of four issuers selected for review." IIROC did not and has not identified the public companies it refers to in this statement. Therefore, Northern is unable to respond to this statement. This is another example of the compliance examiner providing anonymous rather than transparent information.

154. IIROC also alleged in the 2009 Sales Compliance Report that Northern did not review any trading of grey listed shares prior to the date that the shares were grey listed. In fact, Mr. Alboini reviews all trades on a daily basis and has been able to detect inappropriate trading within a significant period of time prior to the date of grey listing. IIROC recommended a 45

day look back in trading. In his reply Mr. Vance agreed and stated that the Compliance Department had adopted look back testing for a 45 day period.

155. IIROC also stated in the 2009 Sales Compliance Report that:

> "the Head of Private Client division was also acting in the capacity of an Investment Banker as he was also responsible for bringing in corporate finance revenue and signing off on deals. However, he was not part of the Corporate Finance department and his office was located in the retail area."

Mr. Shaule was the then Senior Vice President and Head of the Private Client Division. In that capacity, Mr. Shaule would have responsibility in helping investment advisors with their financings. There are many boutique firms that generate financings from their investment advisors. These financings are typically known to the Branch Manager or to the Head of the Private Client Group in such firms. In Northern's case, the investment banking group would handle the processing of the financings.

Northern's Ethical Wall Policies and Procedures to Contain Sensitive Information

156. Any investment dealer engaged in investment banking activities such as financings and M&A transactions is required to put in place policies and procedures to ensure that confidential material information is properly contained in the investment banking group and is not available to the rest of the Firm. The term "ethical wall" is used to describe the notional wall to house the confidential material information "behind" the ethical wall and to keep the rest of the Firm outside the wall and therefore without any access to such information.

157. OSC Policy 33-601 sets out various guidelines for consideration by investment dealers in developing ethical wall policies and procedures. The Policy makes it clear the responsibility for these policies and procedures rest with the investment dealer. There are no mandated policies and procedures in OSC Policy 33-601. Each investment dealer must consider all the circumstances unique to the firm in developing its ethical wall policies.

158. It is the dealer and only the dealer that must make its decisions on ethical wall policies. The OSC has not mandated ethical wall policies and procedures for dealers as they will vary from firm to firm. This is made clear in the Policy. It is therefore Northern's decision to put in place what it considers to be proper ethical wall policies, and not for IIROC or anyone else to dictate those policies.

159. Unfortunately, IIROC seems to be taking the view that it can mandate ethical wall policies on a firm by firm basis. With all due respect, Northern believes that this is wrong. If the OSC, properly in Northern's view, decides that mandated ethical wall policies are not appropriate, then it seems very reasonable to suggest that no one other than Northern itself should be determining the ethical wall policies and procedures that are appropriate for the business carried on by Northern.

160. An ethical wall infrastructure consists of many policies and procedures. The most important is to have personnel at Northern who understand the reason for an ethical wall and

who are committed to comply with its policies and procedures. A dealer can have the most stringent ethical wall policies but this alone will not ensure honesty and compliance by personnel at the firm. Therefore hiring the right people with the right moral fibre is clearly step one. Northern has the right people with the right moral fibre.

161. Northern also spends the time educating its employees as to how the ethical wall works. Northern has its Policies and Procedures Manual which outlines the rules to be followed at Northern in the ethical wall containment of information.

162. Northern has designated its investment banking area as a sensitive area. This sensitive area may only be accessed by investment bankers who have offices inside this area, the IT personnel who need access to the computer server room and the Vice President Administration. Access to the investment banking area is by passcard only.

163. Physical containment of sensitive information inside the investment banking area is carried out in several ways. Code names are employed for financings and advisory engagements on M&A transactions. Meetings are held in the investment banking area or in a Boardroom behind closed doors. Investment banking files are kept in locked filing cabinets. Each investment banker is in an office which is locked at the end of the day. The investment banking group has separate and secured space on the computer server. There is a dedicated fax line and dedicated photocopier which are housed inside the investment banking area.

164. There are physical walls that surround the investment banking area. One wall is 5 feet in height and does not go right to the top of the ceiling. Ms. Jensen and Mr. Alboini agreed that this physical wall was appropriate and sufficient.

165. In addition to the physical requirements to contain information, there are well known rules that are automatically observed by the investment bankers at Northern. No confidential material information is discussed outside Northern offices except if a meeting is held in secure offices, such as for example at the office of Northern's law firm or the law firm of the proposed issuer in a financing or party to an M&A transaction in which Northern is involved as an agent, underwriter or advisor. If a sensitive matter is discussed on a cell phone or a land line of an office other than Northern's office, code names are employed.

166. Investment bankers at Northern prepare working group lists for a financing or M&A transaction consisting of the group of advisors who are employed on any particular financing or M&A transaction. Apart from these permitted persons, investment bankers are not permitted to discuss any sensitive information with any other person.

167. All investment bankers are employed at the head office of Northern. The other offices of Northern in Vancouver, Calgary and Brandon, Manitoba do not have any investment bankers. In fact, all the personnel at Northern in the Capital Markets Group are located at the head office in Toronto. There is therefore an automatic separation of the investment banking group in Toronto from the Private Client advisors in the remaining offices.

168. In order to monitor trading by employees, all employees must maintain their accounts at Northern. Northern maintains a Grey List of public companies in which Northern is engaged or

about to be engaged on a financing or M&A transaction. Information about a proposed financing or proposed M&A transaction is treated as confidential material information. Accordingly once this information is known to Northern, Northern will place the name of the public company on a Grey List for the Compliance Department to watch for any inappropriate trading. The employees at Northern who have knowledge of the confidential material information about a public company are also placed on the Grey List. Obviously they cannot trade in securities of the public company.

169. Sometimes when Northern is engaged or about to be engaged on a financing or M&A transaction, Northern will bring persons other than investment bankers "behind the wall" in order to assist with the financing or M&A transaction. These persons will also be grey listed.

170. Northern also maintains a Restricted List of public companies in which Northern is engaged or about to be engaged in a financing or M&A transaction which has been publicly announced. This Restricted List of securities cannot be traded by anyone at Northern. There are exceptions such as Northern carrying out market stabilization trading in support of a financing, or in the case of an M&A transaction Northern purchasing shares in the market on behalf of a client which is a bidder for a target company. Private Client advisors cannot solicit shares of the restricted public company but clients can provide unsolicited orders (that is, orders not solicited by a Northern Private Client advisor) to trade in restricted securities.

171. Northern believes its ethical wall policies and procedures are very robust.

The History of Dealings Between IIROC and Northern On Physical Barriers

172. Northern is somewhat bewildered by the positions taken by IIROC with respect to physical barriers in the Notice of Hearing. Most importantly, the physical barriers are a decision to be made by Northern, not IIROC. In any event Ms. Jensen informed Mr. Alboini that she was comfortable with the physical barriers put in place by Northern. At all material times, NSI maintained adequate physical barriers in its office space to contain confidential material information. NSI has always designated the physical space occupied by the Investment Banking Group as a sensitive area and has taken proper steps to segregate its Investment Banking workspace from the rest of the Firm and to secure the confidential material information contained in that workspace.

173. There has been an unfortunate history between Northern and IIROC concerning IIROC's views of the physical barriers in Northern's ethical wall infrastructure. A summary of the history is noted below.

174. The Sales Compliance Review Report dated October 2004 and sent to Northern on March 22, 2005, set forth various concerns of IIROC with regard to physical barriers at the former head office location of Northern in Toronto, namely the lack of a dedicated fax machine for the investment banking group and the alleged lack of physical separation of the investment banking group. IIROC requested that Northern restrict access to the investment banking group.

175. The then CCO, Brian Driscoll responded to the 2004 Sales Compliance Report on June 24, 2005 by noting that Northern had installed a dedicated fax machine for the exclusive use of

its investment banking group, the investment banking area was designated as a separate sensitive area with separate offices for investment bankers and locked doors, separate secured filing cabinets were provided, separate and secure space on the firm's computer server was used, the use of code names for transactions was employed, and a mandatory clean desk policy was in place.

176. In a 2006 follow-up to the 2004 Sales Compliance Review IIROC prepared a report dated May 23, 2007 which required Northern to "establish a more obvious and effective separation of affected personnel and advise the Association of its intentions in that regard." It is to be recalled that Northern would restrict a stock as soon as Northern received confidential material information, which was overruled by IIROC in 2002 to require the use of a Grey List. Northern disagreed with IIROC's decision in 2002.

177. In his response to IIROC dated June 22, 2007 regarding the 2004 Sales Compliance Report, Mr. Vance pointed out that Northern was moving to a new head office location in Toronto at the end of 2007 and one of the main reasons for the move was to ensure that Northern would have physical separation of the Investment Banking group from the rest of the Firm.

178. In the 2004 Sales Compliance Report, the following was stated under the heading "Containment of Confidential Information-OSC Policy 33-601":

> "During the course of the Sales Compliance Review, a Corporate Finance employee was overheard advising a retail registrant of an impending deal or announcement by [sic] Medesys, a listed issuer. This information was not public at the time. The Member had no mechanism whereby an employee must report the knowledge of confidential information outside of normal corporate finance activities, or any means of monitoring the trading activity."

179. Medisys was a public company with which Northern had no relationship and no involvement in any manner. Furthermore, Northern was not aware of any confidential material information about Medisys.

180. Unfortunately, the compliance examiner did not disclose which investment banker allegedly spoke to the investment advisor and did not disclose the name of the investment advisor. The compliance examiner also did not identify the "impending deal or announcement." A Sedar search refers to two announced Medisys transactions in 2004. One was an acquisition of two medical imaging businesses and the second, the conversion of the business to an income trust. Northern had no involvement with these transactions and had no knowledge of any confidential information.

181. Despite the absence of any detail with respect to the identity of the investment banker, the investment advisor or the apparent transaction, when Mr. Alboini was informed of the allegation, he sent an email to all employees in the investment banking group and the special situations analyst and asked them to confirm whether they have ever had any confidential material information about Medisys, and if they had ever communicated any such information outside the investment banking group. All the investment bankers and the analyst confirmed by return emails to Mr. Alboini that they had not received any confidential information about Medisys.

182. As to the alleged Medisys incident, Mr. Driscoll, the then CCO informed IIROC that such incident:

> "was strictly against NSI's policies. NSI's management firmly believes that NSI has a culture whereby the behavior described above is almost non-existent. NSI's management believes that the alleged comment by the Corporate Finance department employee would have been sternly frowned upon and not utilized by the retail registrant. If NSI management was aware of this alleged incident occurring, NSI's CCO would have investigated, applied appropriate sanctions to the offending employee, initiated appropriate re-training and also would have added the reporting issuer's name to NSI's Restricted List until the undisclosed material information was generally disclosed. NSI's management suggests that if IDA staff are ever present at NSI's offices again and witness such a communication, that the IDA staff member immediately inform NSI's CEO and CCO."

183. In the 2007 Sales Compliance Review, IIROC stated the following in its April 30, 2009 Report with regard to physical barriers:

> "The 2004 and 2006 SCRs found inadequate controls over the safeguarding of confidential information in the Corporate Finance area. In its response, the Member advised that it would be changing locations to ensure physical separation of the Investment Banking group.
>
> However, at the time of the examination, the floor plans of the new office location provided by the Member did not demonstrate adequate controls to contain potential material and non-public information as follows:
>
> - A 5 foot wall was the only divider between the Corporate Finance area and the rest of the Member
> - The computer server room was located within the Corporate Finance area.
> - There were two entrances to the Corporate Finance area. One was pass card access only. The other was a divider separating Corporate Finance from other departments, which did not adequately prevent access by other employees.
> - The Head of Private Client division was also acting in the capacity of an Investment Banker, and his office was located within the retail area."

184. IIROC referred the matter of physical barriers to enforcement.

185. In his July 3, 2009 letter, Mr. Vance responded to IIROC as follows on physical barriers:

> "We are of the position we are meeting the requirements of …. OSC Policy 33-601; as we have restricted access to those typically in receipt of inside information and we have designated the department as a sensitive area and separated this area from others. We restrict access to inside information, use code names in place of names of issuers and

keep information secured when not immediately supervised by persons working on the project.

We have sent out memos to our Head Office Staff (prior to and after our change of location) notifying them of the importance of respecting our Chinese Walls and the memos have been adhered to by our Staff.

With respect to the computer server room being located within the corporate finance area, please be advised the room is kept locked and only the IT Staff and Office Manager have the key. We have added the aforementioned Staff to be included on our 'Grey' List. They like all NSI Staff are already included on the 'Restricted' List.

We are respectfully requesting clarification on what IIROC means by the term 'distinct separation of its Corporate Finance area from the rest of the firm' when the OSC guidelines do not reference this.

We are of the opinion we are meeting this requirement."

186. Mr. Vance is correct in his position that if the OSC guideline was to require all investment dealers to have fully separate enclosed investment banking departments behind closed doors, the OSC would have so specified. However, Northern has in fact secured its investment banking area with locked doors and blocked access. In a conversation with Ms. Jensen in April 2010, Ms. Jensen confirmed with Mr. Alboini that it was not necessary for Northern to construct a physical wall right to the top of the ceiling and that its 5 foot wall was fine. This is consistent with OSC Policy 33-601 which guidelines do not require that the Investment Banking group be located in an enclosed department which is completely walled off.

187. It is to be repeated that OSC Policy 33-601 sets out a range of possible policies and procedures which dealers may wish to adopt. A dealer's failure to adopt the ethical wall policies and procedures will not, of itself, indicate that the firm has failed to take reasonable precautions. Also, a dealer adopting all of the policies and procedures in the Policy will not provide assurance that reasonable precautions have been taken.

188. As stated in OSC Policy 33-601, whether a registrant has implemented appropriate and sufficient policies and procedures to satisfy its obligations and to sustain the burden of proof will depend on the circumstances of each case and each registrant. The guidelines in OSC Policy 33-601 are not exhaustive. OSC Policy 33-601 states that registrants should consider which policies and procedures would be appropriate for their business. IIROC Notice MR037 itself recognizes that policies and procedures will vary from firm to firm depending on factors such as the nature of the firm's business, its size, clientele and the markets in which it conducts business. Despite this recognition, IIROC does not respect its own policy.

189. OSC Policy 33-601 states that "To limit the unauthorized transmission of inside information, the registrant should consider restricting access…if restricting access to departments is impractical or impossible, as in the case of a *smaller registrant*, treating all of its departments as being 'behind the wall' so that if the registrant is in receipt of inside information, all trading and advisory functions are subject to any restriction imposed (italics added)." In an

email dated November 16, 2007 from Sasha Latka of IIROC to Mr. Vance, Mr. Latka stated, quite incredulously, that “Northern is not considered a small registrant”.

190. Northern clearly is a small registrant and if it chooses can make the decision to treat all of its departments as “being behind the wall” under Policy 33-601.

191. IIROC has consistently failed to recognize the circumstances of Northern in the treatment of ethical walls. In its prior head office location in Toronto, there was no ability to physically separate the investment bankers from other areas in the Firm. Therefore, Northern would restrict all employees once Northern was engaged on a financing or on an M&A assignment. IIROC disagreed with this practice in its Sales Compliance Review in June 2002 even though it was clearly the prudent and more conservative thing to do.

192. Northern moved to a new Toronto head office location in January 2008 and there is appropriate separation of the investment banking area from the rest of the Firm. In the future, if circumstances require, Northern may decide to eliminate the Grey List and use a Restricted List to restrict the whole Firm. OSC Policy provides Northern with the ability to do this, as it is clearly a small registrant.

Supervision of Trading Conduct

193. NSI made ongoing good faith efforts to improve its supervision of trading conduct. In this respect, NSI had a positive experience with Staff. After NSI received the letter from Staff referenced in paragraph 43(d) of the Notice of Hearing, Murray Lund, IIROC’s Director of Trading Conduct Compliance, offered to assist NSI with improving its policies respecting UMIR. NSI provided Mr. Lund with its revised policies and Mr. Lund commented that “good progress” had been made. Mr. Lund made additional recommendations that NSI implemented and, on April 20, 2010, NSI provided Mr. Lund with the final version of its UMIR policies, which Mr. Lund approved.

Conclusion on Sales Compliance and Trading Issues

194. The issues respecting external accounts, the 90-day training program, grey and restricted lists and physical barriers were all issues on which NSI had a good faith disagreement with Staff over whether the policies and procedures NSI had in place at the time were sufficient. NSI did not “repeatedly fail to correct deficiencies” as alleged by Staff, thereby fostering a culture of non-compliance. NSI disputed whether these issues had been properly identified by Staff’s auditors as deficiencies in the first place. The fact is that Staff’s auditors were incorrect in their assessment of these issues, which were never deficiencies that NSI ought to have been required to correct. The fact that NSI did ultimately address these issues to Staff’s satisfaction cannot be held against NSI, or treated as any kind of admission, as NSI only did so in reliance on the settlement reached between Mr. Alboini and Ms. Jensen, which is summarized in this memorandum.

195. Disputing certain findings made by compliance examiners on a sales compliance review does not constitute a failure to foster a culture of compliance, particularly where Northern is correct in its view. NSI’s position on each of the disputed issues was taken in good faith, communicated to Staff and addressed as part of an ongoing and healthy dialogue. Having relied

on Ms. Jensen's agreement that the investigation "would go away" if the remaining issues were dealt with on an expedited basis, NSI objects to Staff's decision to not only refuse to honour the settlement but to use these issues, and NSI's ultimate decision to acquiesce to Staff's position, as a basis for attacking NSI's culture as "non-compliant".

196. Many of IIROC's comments in compliance reviews are moving targets. There is no consistency of IIROC personnel due to the high turnover, and therefore a lack of consistency in compliance themes and principles. Northern very well understands IIROC's publicly announced need to "overhaul" its compliance review programs. Northern believes that its own experience is evidence of the wisdom of this initiative.

BEST PRICE OBLIGATION

197. Staff alleges that NSI has failed to comply with its best price obligation under UMIR 5.2 because it did not access three of the six protected marketplaces, specifically Alpha, Chi-X and Omega.

198. Throughout the material time, NSI has made reasonable efforts to comply with the best price obligation set out in UMIR 5.2 and Policy 5.2. NSI is a member of the Pure Trading alternative trading platform. It trades on the TSX, TSX.V and Pure. NSI executes trades via the IRESS smart router, which automatically finds the best price on these marketplaces.

199. Staff bases its allegation of a "lack of reasonable efforts" on the fact that NSI chose not to "have access to" Alpha, Chi-X and Omega. However, Part 1 of UMIR Policy 5.2 explicitly states that making "reasonable efforts" to obtain the best price does *not* require that a Participant become a "member, user or subscriber" of each protected marketplace. Dealers are not required to connect to all marketplaces in order to meet their trade-through and best execution obligations. Consequently, Staff cannot base its allegation of a lack of reasonable efforts on the fact that NSI is not a member of, did not subscribe to, and did not use the Alpha, Chi-X and Omega marketplaces.

200. UMIR 5.2 provides that "a participant make 'reasonable efforts' to ensure that a client receives the best price".

201. NSI did explore subscribing to the Alpha, Omega and Chi-X marketplaces. However, the costs to NSI of joining these marketplaces were prohibitively high. Based on quotes received from individual alternative trading system ("ATS") providers in February 2010, the estimated cost to subscribe to the ATSs would include initial fees of $7,500 and an additional $40,000 per year in subscriber fees. These estimates do not include ATS trading fees, which are charged based on the volume of transactions, or ticket fees, which were estimated to be $130,000 annually. Most of these additional costs would be passed along to NSI clients in the form of higher commissions and other charges, offsetting a good part, if not all, of the price improvement the client might enjoy.

206. NSI does have access to Alpha, Chi-X and Omega through its ability to "jitney" its trades through its carrying broker. However, Penson charges additional ticket fees each time individual

trade orders are filled on multiple trading platforms. As a result, NSI incurs substantial fees every time multiple trading platform order fills are employed, even where there is no trade price benefit to the client. Multiple trading platform order fills do not automatically guarantee better prices.

202. Consequently, although NSI does have access to Alpha, Chi-X and Omega through Penson, NSI considers it to be quite unlikely that jitney trading through Penson would result in NSI obtaining better net prices than it is obtaining under its current practices and procedures.

203. NSI has made reasonable efforts to comply however is effectively between a rock and a hard place. Subscribing to the various ATSs is prohibitively expensive for small firms and effecting the trades by jitney generates excessive ticket costs. The excessive ticket charges will offset in whole or in part any price improvement to clients. Unfortunately the multiple ticket charges by Penson appears to be unique to Penson and not other carrying brokers who have one fee per trade policy no matter how many marketplaces are accessed.

204. Since the above material time, in July 2011 Northern applied to join Alpha. At the time of writing, Northern is also engaged in negotiations with Penson and other carrying brokers on its carrying broker agreement. Northern believes it will be able to enter into a jitney arrangement with Penson or a new carrying broker where there will be a single ticket charge for a trade irrespective of the number of marketplaces accessed.

205. The TSX Market Surveillance department provides telephone notification to NSI of potential “trade through” violations at the time they occur. A notification does not necessarily mean that a violation has in fact occurred. Since May 2008, NSI has received fewer than 20 notifications of potential violations, resulting in a total price difference that was negligible.

206. Upon notification by TSX’s Market Surveillance department of a potential trade-through violation, NSI identified the trade, moved the trade into the error account, re-ticketed the trade from the error account into the client account at the better ticket price and informed TSX’s Market Surveillance department in each such case, thereby ensuring that the client received the best price.

207. NSI has policies and procedures which deal with UMIR 5.2. These policies and procedures were submitted to IIROC Staff for review in April 2010. Staff did not provide NSI with any responding comments or suggested revisions. On three different occasions, NSI requested meetings with Staff to discuss NSI’s efforts to comply with UMIR 5.2 and Policy 5.2. Each of these meeting requests was denied.

208. In all the circumstances, NSI has made reasonable efforts to fulfill its best price obligation. Although NSI is not required to be a member, user or subscriber of Alpha, Chi-X and Omega, NSI does have access to these marketplaces through its carrying broker. NSI expects that in the selection of its carrying broker, whether Penson or a new carrying broker, it will have the benefit of a jitney relationship granting access to all ATSs with a single ticket charge for a trade even where there are multiple fills. Up to this point of securing a jitney relationship on this basis, Northern has explored whether jitney trading through Penson would likely result in obtaining better prices and NSI has made a reasonable determination that it would not. NSI’s conduct in this regard was reasonable and does not violate its obligations under UMIR.

209. It is not practical or financially prudent for Northern to incur significant additional costs to join multiple marketplaces that boutique firms like Northern may use only infrequently. Because of the unique multiple ticket charges imposed by Northern's carrying broker, NSI suggests it would have been more prudent for IIROC to discuss a solution with Northern and its carrying broker, not just Northern. In this regard, Northern requested to meet with IIROC Staff on three different occasions to review the best price obligation issue and each request to meet was denied. It is difficult for Northern to advance this issue to a reasonable solution when IIROC refuses to meet to discuss it.

LEASEHOLD IMPROVEMENTS REPORTING

210. Staff alleged that from February 2008 to February 2009, NSI filed monthly financial reports that failed to take into account certain leasehold improvement costs and therefore misstated NSI's risk adjusted capital.

211. NSI was disputing the amount invoiced by the contractor and the amount could not be specifically be determined. However, Mr. Chornoboy has acknowledged that, in hindsight, he should have taken the leasehold improvement costs into account.

CANADA LITHIUM FINANCING

212. Staff alleged that NSI created a RAC deficiency in September 2009 by participating in an underwriting by Canada Lithium Corp. ("CL") without sufficient capital which is completely denied by NSI, Mr. Alboini and Mr. Chornoboy.

213. In September 2009, NSI was offered an opportunity to participate in 12.5% of a $15,000,000 bought deal financing ("CL Financing") by CL. In order to ensure that NSI had sufficient RAC to participate in the CL Financing, NSI arranged for two New Issue Letters from Jaguar and NFC to provide the necessary additional capital, in accordance with IIROC Dealer Member Rule 100.5(a)(v).

214. A New Issue Letter is an underwriting loan facility. The party providing the New Issue Letter must provide an irrevocable commitment to advance the funds to cover any unsold portion of the dealer's commitment on the financing. The substance of the arrangement is to provide a backstop to the dealer that is participating in the financing in case a portion of the commitment is not sold. In this case, in exchange for accepting the risk of having to fund NSI's share of any unsold portion of its bought deal commitment, Jaguar and NFC received an agreed upon interest rate and a fee.

215. NSI sought Staff's input on the form of the New Issue Letter as IIROC Dealer Member Rule 100.5(a)(v) explicitly states that the letter must be in a form that is satisfactory to IIROC. NSI inquired of Staff whether there was a standard form that IIROC had approved. Staff responded that no such standard form New Issue Letter existed and advised NSI that it would be "charting new waters" in the use of a New Issue Letter despite its permitted use in the IIROC rules.

216. However, Mr. Chornoboy of NSI subsequently was able to find, on IIROC's own website, a standard Master Loan Agreement prepared by IIROC which was the governing document for New Issue Letters. Mr. Chornoboy pointed out the IIROC standard form agreement to IIROC Staff who were previously unaware of their own standard form agreement. IIROC Staff confirmed to Mr. Chornoboy that the standard form was the correct agreement to use. NSI used the standard IIROC agreement to prepare Master Loan Agreements for each of NFC and Jaguar, and the New Issue Letters from NFC and Jaguar were completed in accordance with IIROC's standard form.

217. Pursuant to the terms of the New Issue Letters, Jaguar irrevocably agreed to advance $550,000 to cover any unsold portion of NSI's commitment on the bought deal while NFC irrevocably agreed to advance $200,000 for the same purpose. IIROC Dealer Member Rule 100.5(a)(v) required the funds committed by Jaguar and NFC to be either fully collateralized by high grade securities or held in escrow with an acceptable institution (such as one of the major banks). However, while IIROC Dealer Member Rule 100.5(a)(v) required the New Issue Letters to be "in a form satisfactory to [IIROC]", no such requirement existed for the escrow agreements or any other document that may be required to give effect to a new issue loan arrangement.

218. As a result, IIROC had not provided any guidance on the form of escrow agreement and NSI, through Kyler Wells, its General Counsel, a skilled lawyer who previously worked at the Ontario Securities Commission, prepared an escrow agreement for each of NFC and Jaguar to reflect their obligations under their Master Loan Agreements.

219. The escrow agreements prepared by NSI provided that the cash being committed by Jaguar and NFC would be held in escrow, in their respective bank accounts with the TD Bank, pending the release of the escrowed funds once the CL Financing closed without any commitment by NSI to advance funds. TD Bank is an acceptable institution within the meaning of IIROC Dealer Member Rule 100.5(a)(v). That rule does not require the acceptable institution to be a third party and the escrow agreements explicitly provided that no amount of the loan being advanced by Jaguar and NFC could be released from escrow except in accordance with the terms of the New Issue Letters, which incorporated the terms of the standard form Master Loan Agreement.

220. To carry out its escrow obligation, Jaguar had on deposit $1,400,000 in its TD bank account which was substantially in excess of the necessary cash resources of $550,000 required to meet its escrow obligation. To meet its escrow obligation, NFC deposited $200,000 in its bank account at the TD Bank on September 10, 2009. In accordance with normal revolving credit procedures, the TD Bank applied the $200,000 against the amount owing by NFC under its line of credit.

221. Staff alleged that the $200,000 amount deposited in escrow was not available to NSI if its commitment on the bought deal was undersold, which is completely incorrect. NFC's irrevocable obligation to advance the $200,000 continued to exist and would have been satisfied by an advance of funds under NFC's line of credit with the TD Bank, which had just been paid down by that very amount. These funds remained available throughout the period of the CL Financing. Northern notes that the CL Financing was publicly announced on September 9, 2009, and sold out overnight.

222. After the CL Financing closed, IIROC Staff surprisingly took the position that IIROC Dealer Member Rule 100.5 actually required NSI to ensure that the funds committed by Jaguar and NFC were held in escrow at a "third party" acceptable institution, not their own bank. According to IIROC Staff, to meet the requirement of the rule, the funds to be escrowed needed to have been transferred out of Jaguar's and NFC's accounts at the TD Bank to an entirely separate acceptable institution. There is no language in Rule 100.5 to support this view and IIROC Staff's view was not communicated to NSI when NSI called IIROC Staff for assistance in making sure NSI complied with the rule.

223. Here we have an example of compliance staff being of no assistance to Northern prior to the CL Financing and yet playing Monday morning quarterback to criticize Northern after the financing closed, on the basis of an additional requirement not found in the rule and which Staff did not raise at the time Northern was seeking Staff's assistance. IIROC Staff's position in this regard is a clear example of the kind of form over substance approach to regulation that IIROC has publicly acknowledged it must move away from.

224. First, IIROC Staff is attempting to read into IIROC Dealer Member Rule 100.5 a requirement that does not exist. That rule states only that the funds must be "held in escrow with an acceptable institution". It does not provide that the funds must be held in escrow with a *third party* acceptable institution.

225. Second, and more importantly, Staff's position completely ignores the legal effect of the New Issue Letters and escrow agreements executed by Jaguar and NFC. It is absolutely ludicrous for Staff to suggest that NSI did not have the necessary funds available to cover any unsold portion of its commitment on the CL Financing when: (a) NSI had received legally binding and *irrevocable* commitments from both NFC (which wholly owns NSI) and Jaguar (which is a related company); (b) the funds needed to fulfill those commitments were held in escrow at one of the major banks; (c) NFC, NSI and Jaguar had a history of working cooperatively together on deals of this nature; and (d) Mr. Alboini and Mr. Chornoboy were the CEO and CFO of all three companies and were therefore perfectly aware that NFC and Jaguar would clearly honour their commitments and had the financial means to do so.

226. In a letter from IIROC Staff to NSI following the closing of the CL Financing, Staff stated:

> "We acknowledge that NSI may have intended to comply with the requirements of the IIROC Rule and that NSI consulted IIROC staff on the use of SFNILs [standard form new issue letters] which, it is also acknowledged, has been relatively infrequent."

However, instead of working with NSI to put a revised protocol in place for the future use of New Issue Letters, IIROC Staff added insult to injury by sending a November 13, 2009 letter to eleven securities commissions and administrators stating its view that NSI had breached the rule, referred the matter to enforcement and included it as one of the allegations in the Notice of Hearing. NSI, Mr. Alboini and Mr. Chornoboy are at a loss to understand how this issue merits an enforcement proceeding when NSI complied with the rule, and as acknowledged by IIROC Staff, made good faith efforts to consult with Staff and comply with a rule that was rarely if at all used.

227. The manner in which IIROC dealt with the CL Financing is an approach by Staff that emphasizes form over substance, is antagonistic rather than cooperative and unilateral in hindsight rather than partnership oriented in advance. The CL Financing was sold out on an overnight basis after public announcement, there was no loss or harm to anyone, the escrowed funds were available at all times to NSI until the CL Financing closed and NFC, NSI and Jaguar were related parties with common management who would clearly ensure the escrow requirements would be met. Overall NSI certainly complied with the escrow requirement as matter of substance, and also complied with it as a matter of form.

CONCLUSION

228. Many of the matters raised in the Notice of Hearing by Staff result from a lack of understanding of the issues at hand, an unfortunate display of rigid thinking by IIROC compliance examiners and management that IIROC seeks to avoid, a lack of proper judgment and creativity in dealing with the specific business model at Northern, a continuing focus on form over substance, a serious turnover issue at IIROC that inhibits the development of consistent compliance themes and principles between IIROC and Northern, and a resulting absence of a spirit of partnership that IIROC promotes publicly but has failed to implement in practice. The lack of positive collaboration is the most consistent disappointment in Northern's experience with IIROC.