



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

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

-AND-

**IN THE MATTER OF
PRO-FINANCIAL ASSET MANAGEMENT INC.,
STUART MCKINNON
and JOHN FARRELL**

**SETTLEMENT AGREEMENT BETWEEN
STAFF AND JOHN FARRELL**

PART I – INTRODUCTION

1. The Ontario Securities Commission (the “Commission”) will issue a Notice of Hearing to announce that the Commission will hold a hearing to consider whether, pursuant to section 127 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the “Act”), it is in the public interest for the Commission to make certain orders in respect of John Farrell (“Farrell” or the “Respondent”).

PART II – JOINT SETTLEMENT RECOMMENDATION

2. Staff of the Commission (“Staff”) agrees to recommend settlement of the proceeding commenced by Notice of Hearing dated December 9, 2014 (the “Proceeding”) against the Respondent according to the terms and conditions set out below in this agreement (the “Settlement Agreement”). The Respondent agrees to the making of an order in the form attached as Schedule “A”, based on the facts set out below.

PART III – AGREED FACTS

3. For the purposes of this Proceeding, and any other regulatory proceeding commenced by a securities regulatory authority, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement.

Overview

4. Pro-Financial Asset Management Inc. (“PFAM”) is an Ontario corporation that was registered as a dealer in the category of exempt market dealer (“EMD”). Prior to that registration being suspended by a consent temporary order of the Commission dated May 17, 2013, PFAM also acted as an investment fund manager (“IFM”) of nine prospectus-qualified mutual funds (the “Pro-Index Funds”) under the transition provisions in section 16.4 of NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“NI 31-103”). PFAM's application for registration as an IFM was ultimately not recommended for approval by Staff of the Compliance and Registrant Regulation (“CRR”) Branch.

5. PFAM was also registered as an adviser in the category of portfolio manager (“PM”) and acted as a PM for certain managed accounts and for the Pro-Index Funds and for certain hedge funds that PFAM created (the “Pro-Hedge Funds”).

6. Between May 2003 and August 2014 inclusive (the “Material Time”), pursuant to its EMD registration, PFAM acted as adviser, selling agent and note administrator for certain series of principal protected notes (“PPNs”) issued by Société Générale (Canada) (“SGC”) and BNP Paribas (Canada) (“BNP”) (collectively, the “Banks”).

7. Farrell joined PFAM on October 17, 2006 and resigned on April 15, 2013. He held the positions of Vice-President and Senior Vice-President. Farrell acted as PFAM’s chief compliance officer (“CCO”) from November 27, 2007 to September 28, 2009 and from October 28, 2009 to April 15, 2013. Farrell was also a permitted officer and director, registered dealing representative and advising representative with PFAM. In these roles, Farrell handled some of PFAM’s managed accounts and managed the investments for the Pro-Index Funds.

8. Farrell resigned from all roles at PFAM on April 15, 2013. He is retired.
9. In or about December 2012, Farrell became aware that the total cash obligation of the Banks to noteholders of the PPNs (the “PPN Noteholders”) as reflected in the records of the records of the trustee, Concentra Financial (“Concentra”), and the records of its record-keeper, The Investment Administration Solution Inc. (“IAS”), differed. On April 23, 2013, PFAM delivered a report to Staff (“PFAM’s Reconciliation Report”) that showed that the total cash obligations to PPN Noteholders as reflected in Concentra’s records and IAS’ records differed by \$1,222,549.45 according to the records held by IAS (the “PPN Discrepancy”).
10. PFAM failed to maintain adequate internal controls and compliance systems.
11. In 2012, PFAM operated with a capital deficiency in breach of section 12.1 of NI 31-103, failed to report its capital deficiency to Staff in a timely manner and failed to rectify the capital deficiency.
12. In 2013, PFAM disclosed inaccurate and incorrectly calculated management expense ratios (“MERS”) for the Pro-Index Funds.
13. To the extent set out below, Farrell failed to meet his obligations as PFAM’s CCO.

The PPN Discrepancy

14. During the Material Time, PFAM engaged in the following conduct in its roles as adviser, selling agent and/or notes administrator of nine series of PPNs, which conduct resulted in or contributed to the PPN Discrepancy.
15. At all relevant times, PFAM’s responsibilities in respect of the PPNs were managed by PFAM’s accounting department under the supervision of Stuart McKinnon.
16. Staff’s investigation into PFAM’s handling of the PPNs while Farrell was CCO, suggested that the PPN Discrepancy occurred in part because PFAM: (i) failed to account for

monies in the trust account; and (ii) failed to communicate and investigate PPN discrepancies when they arose.

i) Failure to Account for Monies in the Trust Account

17. PFAM acted as a conduit for noteholder redemptions, including redemptions prior to maturity. PFAM failed to properly account for the monies that PFAM received from the Banks via Concentra for certain early redemption requests. Staff's investigation into PFAM's handling of the PPNs suggests that PFAM was not in a position to identify the beneficial owners of the funds in the trust account, at least in part, due to the following:

- (a) PFAM commingled monies received for the different PPN series, as well as monies related to other PFAM products, in the trust account; and
- (b) PFAM failed to perform reconciliations of the trust account such that PFAM did not know, at any given time, how much of the balance of the trust account related to each PPN series.

18. PFAM failed to regularly analyze or reconcile the balance in the trust account and in doing so failed to comply with its own internal policies and procedures.

ii) Failure to Communicate and Investigate PPN Discrepancies

19. Farrell, as PFAM's CCO, ought to have known in December 2010, when the first PPN series ("Pro 101") matured, that IAS' records on the Pro 101 series differed from Concentra's records such that the maturity proceeds provided by SGC via Concentra was \$197,031 greater than what was necessary to repay all outstanding units based on IAS' records (the "Pro 101 Maturity Surplus").

20. Farrell, as PFAM's CCO, ought to have known in December 2011, when the second PPN series ("Pro 706") matured, that there was a further discrepancy between IAS' records for the Pro 706 series and Concentra's records as the maturity liability was \$114,803 ("Pro 706 Maturity Deficit") greater than the maturity proceeds which PFAM received.

21. Farrell acknowledges that had he been aware of the Pro 101 Maturity Surplus in December 2010, or the Pro 706 Maturity Deficit in December 2011, as he ought to have been, he would have taken additional steps to ensure that PFAM fully investigated the Pro 101 Maturity Surplus and the Pro 706 Maturity Deficit in a timely manner. His failure to take steps to ensure that he was aware of any PPN discrepancies was a breach of his obligations as PFAM's CCO to monitor and assess compliance by PFAM with securities legislation.

PFAM's Breach of its Standard of Care as an Investment Fund Manager

22. On March 28, 2013, PFAM filed its annual management reports of fund performance ("MRFPs") for the year ended December 31, 2012 ("December 2012 MRFPs") on SEDAR for each of the following prospectus-qualified mutual funds: (i) Pro FTSE RAFI Canadian Index Fund; (ii) Pro FTSE RAFI US Index fund; (iii) Pro FTSE RAFI Global Index Fund; (iv) Pro Money Market Fund; (v) Pro FTSE RAFI Hong Kong China Index Fund; (vi) Pro FTSE RAFI Emerging Markets Index Fund; (vii) Pro FTSE NA Dividend Index Fund; (viii) Pro-Fundamental Balanced Index Fund; and (ix) Pro-Fundamental Bond Index Fund (collectively, the "Pro-Index Funds").

23. Each of the 26 published MERs in the December 2012 MRFPs were incorrect. In two instances, the original published MERs were overstated by between 58% and 69%. In 24 instances, the original published MERs were understated by between 11% and 96%.

24. The MERs published in the December 2012 MRFP were not calculated in accordance with subsection 15.1(1) of National Instrument 81-106 – *Investment Fund Continuous Disclosure* ("NI 81-106"), which requires a specific calculation for MERs and only permits the publication of MERs calculated in accordance with subsection 15.1(1).

25. Although Farrell reviewed the MER calculations for the year ended December 31, 2012, that were reported in the December 2012 MRFP, Farrell did not scrutinize the backup documentation on which the MER calculations were based. He therefore was not aware that the published MERs were incorrect. This was a breach of his obligations as PFAM's CCO.

Failure to Maintain Required Working Capital

26. From May 31, 2012 to November 30, 2012, PFAM failed to comply with the working capital requirements as set out in subsections 12.1(1) to (3) of NI 31-103.

27. PFAM's working capital calculation for May 31, 2012 as set out in its Form 31-103F1 – *Calculation of Excess Working Capital* (the “Form 31-103F1”) failed to reflect the full balance of a note payable as a current liability when the full loan balance was due to mature on May 1, 2013. The effect of this error was that PFAM was below its minimum capital requirement as of May 31, 2012.

28. In the period from May 1 to October 31, 2012, PFAM failed to report its capital deficiency in breach of subsection 12.1(1) of NI 31-103. During this period, and after October 31, 2012, PFAM operated with an excess working capital less than zero, contrary to section 12.1 of NI 31-103.

29. On November 21, 2012, CRR Staff conducted a PFAM site visit. PFAM's chief financial officer (“CFO”) provided CRR Staff with documents showing PFAM's monthly working capital calculations for the period from May to October 2012 which purported to confirm that PFAM had adequate working capital as at October 31, 2012 and all other month-ends during the period.

30. On November 30, 2012, PFAM's CFO advised CRR Staff that recent adjustments affected PFAM's working capital calculations such that PFAM was now representing to CRR Staff that it was capital deficient by \$183,367 as at October 31, 2012 (the “Revised Calculation”).

31. The Revised Calculation reflected additional accrued liabilities that PFAM failed to initially account for which PFAM represented as being the primary reason for PFAM's working capital deficiency.

32. Farrell monitored and reviewed the working capital calculations that were performed by PFAM's accounting department and signed PFAM's Form 31-103F1, certifying that PFAM was in compliance with its capital requirements when it was not.

Failure to Fulfil Compliance Responsibilities

33. PFAM had an obligation as a registrant to establish, maintain and apply policies and procedures that establish a system of controls and supervision to: (i) provide reasonable assurance that PFAM and each individual acting on its behalf complied with securities legislation; and (ii) manage the risks associated with its business in accordance with prudent business practices.

34. The following conduct and/or failures by PFAM demonstrate its failure to establish, maintain and apply appropriate policies and procedures to establish an adequate system of controls and supervision:

- (a) failing to analyze and identify components of the balance in the trust account;
- (b) failing to investigate PPN discrepancies fully and in a timely manner and report the discrepancies to the Banks, Concentra, IAS and/or PPN Noteholders;
- (c) failing to ensure that adequate controls were in place for the for the calculation of MERs for the Pro-Index Funds; and
- (d) failing to ensure that adequate controls were in place for the calculation and maintenance of PFAM's excess working capital.

35. Farrell was the CCO of PFAM from November 27, 2007 to September 28, 2009 and from October 28, 2009 to April 15, 2013. As PFAM's CCO, pursuant to former subsection 1.3(1) of OSC Rule 31-505 before September 28, 2009 and on and after September 28, 2009, pursuant to section 5.2 of NI 31-103, Farrell had prescribed obligations in connection with PFAM's compliance with securities legislation. As CCO, Farrell had an obligation to, among other things: (i) establish and maintain appropriate policies and procedures for assessing compliance by PFAM with securities laws; and (ii) monitor and assess compliance by PFAM, and individuals acting on PFAM's behalf, with securities laws. His failure to do so, to the extent described herein, amounted to a breach of Farrell's obligations as PFAM's CCO. As a result of the conduct and/or failures set out above, Farrell breached his obligations as PFAM's CCO pursuant to former subsection 1.3(1) of OSC Rule 31-505 from November 27, 2007 to

September 27, 2009 and pursuant to section 5.2 of NI 31-103 from September 28, 2009 to April 15, 2013.

The Respondent's Position

36. The Respondent asserts the following are relevant mitigating factors:

- (a) He co-operated with Staff's investigation, including a voluntary telephone interview;
- (b) He has had a long career in the financial industry and, with the exception of the issues that arose with respect to PFAM, his record is unblemished; and
- (c) He is retired, and has no intention of resuming his career.

PART IV – BREACHES OF ONTARIO SECURITIES LAW AND CONDUCT CONTRARY TO THE PUBLIC INTEREST

37. By engaging in the conduct described above, the Respondent admits and acknowledges that he breached his obligations as PFAM's CCO, contrary to former subsection 1.3(1) of OSC Rule 31-505 and, on and after September 28, 2009, contrary to section 5.2 of NI 31-103.

38. The Respondent also admits that the conduct set out above was conduct contrary to the public interest.

PART V – TERMS OF SETTLEMENT

39. The Respondent agrees to the terms of settlement listed below.

40. The Commission will make an order pursuant to subsection 127(1) of the Act that:

- (a) this Settlement Agreement is approved;
- (b) pursuant to paragraph 6 of subsection 127(1) of the Act, Farrell is reprimanded;

- (c) pursuant to paragraphs 7, 8.1 and 8.3 of subsection 127(1) of the Act, that Farrell resign all positions that he holds as a director or officer of any issuer, registrant, or investment fund manager;
- (d) pursuant to paragraphs 8, 8.2 and 8.4 of subsection 127(1) of the Act, that Farrell be prohibited from becoming or acting as a director or officer of any issuer, registrant, or investment fund manager for 3 years;
- (e) pursuant to paragraph 8.5 of subsection 127(1) of the Act, that Farrell be prohibited from becoming or acting as a registrant, investment fund manager or a promoter, for 3 years; and
- (f) pursuant to paragraph 9 of subsection 127(1) of the Act, that Farrell be required to pay an administrative penalty of \$25,000, which amount will be designated for allocation or for use by the Commission pursuant to subsection 3.4(2)(b)(i) or (ii) of the Act.

41. The Respondent undertakes to consent to a regulatory order made by any provincial or territorial securities regulatory authority in Canada containing any or all of the sanctions set out in paragraph 40 above. These sanctions may be modified to reflect the provisions of the relevant provincial or territorial securities law.

42. The Respondent will co-operate with the Commission and Staff in this matter and will appear and testify at the hearing in this matter if requested by Staff.

PART VI – STAFF COMMITMENT

43. If the Commission approves this Settlement Agreement, Staff will not commence any proceeding under Ontario securities law against the Respondent in relation to the facts set out in Part III of this Settlement Agreement, subject to the provisions of paragraph 44 below.

44. If the Commission approves this Settlement Agreement and, at any subsequent time, the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Ontario securities law against the Respondent. These proceedings

may be based on, but not limited to, the facts set out in Part III of this Settlement Agreement as well as the breach of the Settlement Agreement.

PART VII – PROCEDURE FOR APPROVAL OF SETTLEMENT

45. The parties will seek approval of this Settlement Agreement at a public hearing before the Commission scheduled for June 26, 2015, or on another date agreed to by Staff and the Respondent, according to the procedures set out in this Settlement Agreement and the Commission’s Rules of Procedure.

46. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing on the Respondent’s conduct, unless the parties agree that additional facts should be submitted at the settlement hearing.

47. If the Commission approves this Settlement Agreement, the Respondent agrees to waive all rights to a full hearing, judicial review or appeal of this matter under the Act.

48. If the Commission approves this Settlement Agreement, no party will make any public statement that is inconsistent with this Settlement Agreement or with any additional agreed facts submitted at the settlement hearing.

49. Whether or not the Commission approves this Settlement Agreement, the Respondent will not use, in any proceeding, this Settlement Agreement or the negotiation or process of approval of this Settlement Agreement as the basis for any attack on the Commission’s jurisdiction, alleged bias, alleged unfairness, or any other remedies or challenges that may otherwise be available.

PART VIII – DISCLOSURE OF SETTLEMENT AGREEMENT

50. If the Commission does not approve this Settlement Agreement or does not make the order attached as Schedule “A” to this Settlement Agreement:

- (a) this Settlement Agreement and all discussions and negotiations between Staff and the Respondent before the settlement hearing takes place will be without prejudice to Staff and the Respondent; and

(b) Staff and the Respondent will each be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing of the allegations contained in the Statement of Allegations. Any proceedings, remedies and challenges will not be affected by this Settlement Agreement, or by any discussions or negotiations relating to this Settlement Agreement.

51. The parties shall keep the terms of this Settlement Agreement confidential until the Commission approves this Settlement Agreement. At that time, the parties will no longer have to maintain confidentiality. If the Commission does not approve this Settlement Agreement, both parties shall continue to keep the terms of this Settlement Agreement confidential, unless they agree in writing not to do so or unless otherwise required by law.

PART IX – EXECUTION OF SETTLEMENT AGREEMENT

52. The parties may sign separate copies of this agreement. Together, these signed copies will form a binding agreement.

53. A fax copy of any signature will be treated as an original signature.

Dated this 24th day of June, 2015_

“John Farrell”
John Farrell

“Tom Atkinson”
Tom Atkinson
Director, Enforcement Branch

Schedule "A"



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

- AND -

**IN THE MATTER OF
PRO-FINANCIAL ASSET MANAGEMENT INC.,
STUART MCKINNON and JOHN FARRELL**

ORDER

WHEREAS:

1. on December 9, 2014, the Ontario Securities Commission (the "Commission") issued a Notice of Hearing pursuant to section 127 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act") in relation to the Statement of Allegations filed by Staff of the Commission ("Staff") on December 8, 2014 with respect to John Farrell ("Farrell" or the "Respondent");
2. on June , 2015 the Respondent entered into a Settlement Agreement (the "Settlement Agreement") in relation to the matters set out in the Statement of Allegations; and
3. the Commission issued a Notice of Hearing dated June , 2015 setting out that it proposed to consider the Settlement Agreement;

AND UPON reviewing the Settlement Agreement, the Notice of Hearing, the Statement of Allegations and upon considering submissions from Respondent's counsel and from Staff of the Commission;

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

IT IS HEREBY ORDERED THAT:

- a. this Settlement Agreement is approved;
- b. pursuant to paragraph 6 of subsection 127(1) of the Act, Farrell is reprimanded;
- c. pursuant to paragraphs 7, 8.1 and 8.3 of subsection 127(1) of the Act, that Farrell resign all positions that he holds as a director or officer of any issuer, registrant, or investment fund manager;
- d. pursuant to paragraphs 8, 8.2 and 8.4 of subsection 127(1) of the Act, that Farrell be prohibited from becoming or acting as a director or officer of any issuer, registrant, or investment fund manager for 3 years; and
- e. pursuant to paragraph 8.5 of subsection 127(1) of the Act, that Farrell be prohibited from becoming or acting as a registrant, investment fund manager or a promoter, for 3 years; and
- f. pursuant to paragraph 9 of subsection 127(1) of the Act, that Farrell be required to pay an administrative penalty of \$25,000, which amount will be designated for allocation or for use by the Commission pursuant to subsection 3.4(2)(b)(i) or (ii) of the Act.

DATED at Toronto, Ontario this ___ day of June, 2015.
