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
FACTORCORP INC., FACTORCORP FINANCIAL INC., AND
MARK TWERDUN

STATEMENT OF ALLEGATIONS OF STAFF OF THE ONTARIO SECURITIES COMMISSION

Staff of the Ontario Securities Commission (the "Commission") make the following allegations:

I. The Respondents

1. FactorCorp Financial Inc. ("FFI") was incorporated in Ontario on May 26, 2003. FFI was never registered under the *Securities Act*, R.S.O. 1990, c.S.5, (the "Act") and was never a reporting issuer in Ontario.

2. FactorCorp Inc. ("FCI") was incorporated in Ontario on August 13, 2002 and was registered with the Commission as a limited market dealer from 2004 to 2007. FCI was never a reporting issuer in Ontario.

3. Mark Twerdun is a resident of Ontario and was at all material times the sole officer, director and shareholder of FCI and sole officer, director and controlling shareholder of FFI. Twerdun's wife and children own or beneficially own the remaining shares of FFI. Twerdun was formerly registered with the Commission as the sole trading officer and compliance officer of FCI from 2004 to 2007 (the "Material Time"). During the Material Time, Twerdun was the sole directing mind of FFI and FCI (collectively, the "Companies").

II. Facts Relating to the Allegations

a) Overview

4. The Companies were held out as being in the business of providing short term financing to commercial clients ("Clients") through factoring, leasing and other secured, asset-backed financing services. The Companies purported to generate revenue by way of using capital to make short term loans on a secured basis.

5. The conduct at issue relates to misrepresentations made by the Respondents in relation to the nature and security of the purported loans made by the Companies. The offering memoranda and promotional material prepared and circulated by the Respondents stated that the financing extended by the Companies was for short term debt financing and was properly secured. In fact, many of the loans made by the Respondents to Clients were either not secured or inadequately secured and/or had unenforceable security.

6. Moreover, in many instances the Respondents failed to exercise any reasonable due diligence, care or control in ensuring, monitoring or reviewing the nature of the security or its adequacy and/or the investment risks. In two instances, the Companies directed funds for the purchase of shares; these purchases were not contemplated by the offering memoranda.

7. Twerdun was the directing mind of the Companies. Although the Companies were held out as separate entities, in practice the investments were pooled and operationally Twerdun did not distinguish between FFI and FCI.

8. During the Material Time, the Companies, by way of various offering memoranda, raised approximately $58 million through the sale of non-prospectus qualified debentures to

approximately 700 Ontario investors (the "Debentures") for the purported purpose of pooling funds for use in the Companies' secured short-term financing business.

9. The Debentures sold to Ontario investors, during the Material Time, were sold primarily through a registered dealer by way of offering memoranda without a prospectus, in reliance on the accredited investor exemption from the prospectus and registration requirements of the Act contained in OSC Rule 45-501 and, subsequently, NI 45-106 (the "AI Exemption"). The vast majority of investors to whom debentures were sold did not meet the criteria required for the AI Exemption.

b) Monitor, Receivership and Bankruptcy of the Companies

10. On August 1, 2007, further to a temporary order issued by the Commission on July 6, 2007 (the "Temporary Order"), the Commission ordered that the Companies appoint KPMG Inc. ("KPMG") as a monitor.

11. By Order of the Superior Court of Justice dated October 17, 2007, KPMG was appointed receiver and manager (the "Receiver") over the assets, undertakings and properties of the Companies. The Receiver was discharged by Order of the Superior Court of Justice dated March 18, 2009.

12. By Order of the Superior Court of Justice dated March 25, 2008 (the "Bankruptcy Proceedings"), the Companies were adjudged bankrupt on a consolidated basis and KPMG was appointed the trustee of the consolidated estate (the "Trustee").

13. In the First Report of the Trustee dated December 4, 2008, filed with the Court in the Bankruptcy Proceedings, the Trustee concluded that on the basis of available information, it expects that the ultimate realization on the loan and preferred shares held by the Companies may

be nominal and that investors in the Companies will suffer a significant loss on their investments in the Companies.

14. In the Trustee's Report of its Preliminary Administration dated April 24, 2008, the Trustee reported on its review and analysis of 11 loans contained in the Companies' loan portfolio and concluded: two were in receivership, three were making regular payments, six were in default, certain loans were not secured against all of the Client's assets, other loans were not secured at all and the value of the collateral securing certain loans was in question.

c) The Distribution and the Offering Memoranda

15. The terms of the Debentures ranged from one to five-year terms with interest of six to eight percent, depending upon the term. The majority of Debentures were sold through Farm Mutual Financial Services Inc. ("FMFS"), a mutual fund dealer and limited market dealer.

16. The Respondents distributed various offering memoranda (the "OMs"), which were used to sell the Debentures during the Material Time. Five of the OMs identify FFI as the issuer. FCI is identified as the issuer in at least two of the OMs. Despite the use of both FFI and FCI as the issuer, investors only received Debentures issued by FFI.

17. The OMs identify and describe two types of secured financing which the Companies would invest in: factoring and secured lending. The two types of secured financing are described as having similar "risk profiles". The OMs describe factoring as a process whereby the customer pledges its receivables or assets deemed by the 'factor' to be of acceptable credit quality in exchange for financing.

18. The OMs provided that the two types of financing would be secured and that the Companies would conduct risk assessments and due diligence in relation to the value of the

security. The OMs made statements in relation to the nature of the loans the Company would make and the nature of the security they would require. Those statements included, but were not limited to, the following:

- The OMs provide that the Companies would limit their secured lending to situations where there are independent valuations of the assets to be secured:

> *The Corporation will consider other temporary loans where there is alternative and strong tangible security such as collateral mortgages on principal residences, chattel mortgages on manufacturing equipment etc. In all such cases, the temporary advances are limited to circumstances in which there are available independent valuations by conservative industry sources (e.g. real estate and equipment appraisers, tax valuations, etc.) based either on liquidation values or a conservative advance rate (e.g., 70%) of market value. In such cases, the Manager will ensure that such temporary asset-backed "bridge" loans have similar or lesser risk characteristics as the factoring transactions described above.*

- The OMs describe the risk management practices the Companies would implement:

> *Overseen by the Manager [defined as FFI or FCI], the Corporation [FFI or FCI] will utilize an assortment of proprietary financial structures, security, credit decisioning and administrative procedures to ensure that the Corporation's funds are used to build a profitable portfolio at acceptable risk.*

- The OMs delineate types of security that would be provided on loans obtained:

> *Specific security requirements will be determined by the Manager and are specific to each transaction but will generally consist of elements of the following:*
>
> - *General Security Agreement registered in the first position over the receivables financed;*
> - *Acknowledgements / priority agreement from the current PPSA registrants;*
> - *Personal guarantees of the principal shareholders;*

- *Factoring Agreements, promissory notes and/or financing agreements incorporating repurchase agreements in the event that payment for the receivables is not received in the agreed timeframe;*
- *Other security specific to the transaction (i.e collateral mortgages on residences, chattel mortgages on specific equipment, irrevocable letters of direction over other cash receipts such as tax receivables, etc.)*
- *Government or Insurance Company covenants or guarantees.*

- In identifying risk factors the OMs make further representations as to the security and its valuation;
- A number of the OMs stated that FCI was the issuer.

19. The Respondents were obliged to file the OMs with the Commission and failed to do so, contrary to s. 4.3 of OSC Rule 45-501, subsequently amended to s. 6.4 of OSC Rule 45-501**.**

d) Other Promotional Material

20. During the course of the distribution, the Respondents circulated directly to FMFS and to debenture holders promotional material, including: the FactSheet, the Question and Answer Sheet, and the periodic reports to investors (the "Promotional Material"). In addition, through presentations to sales representatives, Twerdun communicated information about the nature of the investment. The presentations and/or Promotional Material contained statements relating to:

- the quality and nature of the security obtained to cover the loans to Clients;
- the risks involved with the investment; and
- the ongoing monitoring, analysis and assessment of the Companies' loan portfolio and related security.

IV. Misleading or Untrue Statements

a) Offering Memoranda

21. In the OMs distributed to investors during the material time and as more particularly described in paragraphs 17 to 19, above, the Respondents represented that:

(a) investor funds would be used only in factoring or secured lending transactions;
(b) loans would be backed by adequate collateral and secured;
(c) the Companies would implement risk management strategies to reduce risk and to monitor and value the security; and
(d) in some cases the issuer was FCI.

22. In fact, certain loans made by the Companies were insufficiently secured against all of the assets of the borrower, other loans were not secured at all, and the value of the collateral in the loans was in question. The Respondents failed to conduct reasonable due diligence or implement the "Risk Management Practices" as promised in the OMs in respect of certain loans, the value and/or enforceability of collateral to be secured thereby and the security actually granted.

23. Moreover, contrary to the OM, which stated that investor funds would be used for secured lending, the Respondents made the following two equity investments:

i) between July 10, 2003 and July 11, 2007, FFI used $19,568,300 of investor funds to purchase preferred shares in Express Commercial Services Inc. ("ECS"), an Ontario-based factoring business. This equity investment was not contemplated by the OMs.

ii) on or about May 15, 2006, FFI purchased treasury shares in Activecore Technologies Inc. ("Activecore") a Toronto based technology company that trades in the U.S. over-the-counter market. This equity investment was not contemplated by the OMs.

24. The Companies knew or ought to have known the above statements in the OMs were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue and/or did not state facts required to be stated or that were necessary to make the statements not misleading. Such statements would reasonably have had a significant effect on the market price or value of the security.

25. Twerdun knew or ought to have known of the above statements and conduct and authorized, permitted or acquiesced in the making of the statements and in the conduct.

b) Promotional Material

26. The statements, more particularly described in paragraph 21 above, contained in the Promotional Material and made at presentations to sales representatives, were misleading or untrue or omitted facts that would make them not misleading. Such statements would reasonably have had a significant effect on the market price or value of the security.

27. The Respondents knew or ought to have known that the statements made in the Promotional Material and presentations, more particularly described in paragraph 21 above, were in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue and/or did not state facts required to be stated or that were necessary to make the statements not misleading.

V. Illegal Distribution

28. Of the 680 Debentures sold through FMFS only a small fraction of investors met the income, net financial assets and/or net worth threshold necessary to qualify for the AI Exemption. The vast majority of the clients either did not meet the requirements or there was insufficient information to make that determination.

29. FFI relied on the AI Exemption to the registration and prospectus requirements of the Act. Investors in the Debentures were required to fill out and sign subscription agreements, including accredited investor certificates attesting to their purported status as accredited investors as Appendix A to the subscription agreements (the "Subscription Agreements"). Twerdun, on behalf of FFI, signed each of the Subscription Agreements, stating that "the foregoing subscription agreement is hereby accepted". In many instances, Twerdun knew or ought to have known that the investors were not accredited and ought to have made further inquiries.

30. FFI and Twerdun failed to ensure that the requirements of the AI Exemption were met and, therefore, cannot rely on the AI Exemption.

VI. Twerdun Materially Misled Commission

31. In proceedings before the Commission relating to the extension of the Cease Trade Order and appointment of a monitor, as described in paragraph 11 above, Twerdun swore an affidavit on July 16, 2007 (the "Affidavit") and filed it with the Commission with respect to a hearing held on July 20, 2007 wherein the Respondents sought to vary or revoke the Temporary Order and Staff sought to extend it (the "Temporary Order Hearing"). In the Affidavit, Twerdun stated that FFI's investments were all "performing" and none were in default.

32. At the Temporary Order Hearing, a Commissioner asked Twerdun a series of questions, relating to the status of the Companies' lending portfolio and whether there were any non-performing loans. In response Twerdun confirmed with the Panel that the loans were all

performing, that regular audits were conducted and there were no non-performing loans or other concerns relating to the portfolio.

33. In addition, in the Affidavit, Twerdun made untrue statements to the Commission in his evidence when he stated that the Companies had security over the loans and that no repayment of Debentures had taken place since April 2007.

34. Twerdun also misled the Commission about specific discussions he had with a certain U.S. hedge fund, a potential financier for the Companies, with respect to the impact of a monitor on financing negotiations. In response to questions posed by the Commission at the Temporary Order Hearing, Twerdun stated that he had specific discussions with the hedge fund about a monitor appointment and that the hedge fund had advised it would end financing negotiations were a monitor appointed.

35. The above representations made by Twerdun in the Affidavit and to the Commission at the Temporary Order Hearing were, in a material respect and at the time and in light of the circumstances under which they were made, misleading or untrue or failed to state a fact that was required to be stated or necessary to make the statements not misleading.

VII. Breach of Temporary Order

36. The Temporary Order, issued July 6, 2007, ordered, among other things, that:

> Twerdun, FactorCorp and any company controlled, directly or indirectly, by Twerdun, and FactorCorp including but not limited to FactorCorp Financial, are prohibited from making redemptions and participating in or acquiescing to any act, directly or indirectly, in furtherance of a redemption of securities of FactorCorp and FactorCorp Financial;

37. On July 12, 2007, in breach of the Temporary Order, FFI gave instructions to FFI's financial institution directing the electronic transfer of funds totalling $724,287.53, to be paid to

ten identified holders of Debentures. On July 13, 2007 the transfer was settled and the payment made.

38. It is the allegation of Staff that Twerdun was aware of authorized, permitted or acquiesced in the making of the above transfer in breach of the Temporary Order.

VIII. Breaches of Ontario Securities Law and Conduct Contrary to the Public Interest

39. Staff allege that the foregoing conduct engaged in by the Respondents constituted breaches of Ontario securities law and/or was contrary to the public interest:

(a) the OMs distributed by the Respondents contained misleading or untrue statements and/or failed to state facts which were required to be stated (as particularized above), in contravention of s. 122(1)(b) and/or s. 126.2 of the Act;

(b) the Promotional Material distributed by the Respondents to investors contained misleading or untrue statements and/or failed to state facts which were required to be stated (as particularized above), in contravention of s. 126.2 of the Act;

(c) FFI and Twerdun breached the Temporary Order by redeeming certain Debentures on July 13, 2007, in contravention of s. 122(1)(c) of the Act;

(d) Twerdun, as the sole officer and director of FFI and FCI, authorized, permitted or acquiesced in non-compliance with Ontario securities law described in subparagraph (a) to (c) above. Staff rely on sections 129.2 and 122(3) of the Act;

(e) Twerdun knowingly made statements and filed evidence and information with the Commission that was materially misleading or untrue and/or failed to state facts which were required to be stated, in contravention of clause (a) of subsection 122(1) of the Act;

(f) the course of conduct engaged in by the respondents as described herein compromised the integrity of Ontario's capital markets, was abusive to Ontario's capital markets and was contrary to the public interest;

40. Staff reserve the right to make such other allegations as Staff may advise and the Commission may permit.

Dated at Toronto, this 12th day of May, 2009