

Re: **BDO Dunwoody Limited (the "Receiver") in its capacity as Receiver and Manager of Buckingham Securities Corporation**

As requested, I include my commentary respecting the Seventh Report (the "7th Report") of BDO Dunwoody Limited ("BDO"), in its capacity as Receiver and Manager of Buckingham Securities Corporation ("Buckingham"). In this regard, please note the following:

COMMENTARY ON THE 7TH REPORT

1. With respect to paragraph 2 of the 7th Report, I concur with the commentary therein.

In addition, we must consider the Investment Dealers Association of Canada's ("IDA") By-laws, Regulations and Policies (collectively, the "IDA Rules") as W.D. Latimer ("Latimer") is a member. The requirement that member firms must determine, on a daily basis, the quantity of securities that must be held (segregated) on behalf of customers is particularly relevant to this case (By-law 17.3, 3A and 3B as well as Regulation 2000.6 and 2000.7).

2. With respect to paragraph 3 of the 7th Report, I concur. In practice, client securities may be pledged, used or loaned by a registrant only to the extent that the client is indebted to the registrant. Any excess value or fully-paid-for securities must be segregated or held free of any encumbrance. Failure to do so is a breach of the IDA Rules and securities legislation.

In the case of fully paid securities, Buckingham was acting as a custodian. Those securities could only be released on instruction from the clients and not solely because a client had become indebted to the firm.

In practice, protection of client assets is paramount. As such, the IDA has set forth requirements, (Regulations 2000.6-2000.8) stipulating the frequency of segregation obligations and the restrictions to be imposed should a segregation deficiency exist.

3. With respect to paragraph 4 of the 7th Report, I concur with the commentary therein for reasons noted earlier.

4. With respect to paragraphs 5-8 (inclusive) of the 7th Report, I concur with the comments therein contained and also note:

(a) Both Buckingham and Latimer had available to them information and reports produced by ISM (now IBM), an industry (IDA) approved service provider.

ISM provides to its clients on a daily basis various reports required by registrants in order to conduct their business in accordance with the requirements of section 113 of Regulation 1015 made under the Securities Act (Ontario) ("Securities Act"). This section deals with record keeping requirements for registrants under the Securities Act.

Included in these reports are various reports on segregation requirements, including, but not limited to, a Segregation Control Report, a Segregation Allocation Report, and a Stock Record Report. A proper review of these reports allows a registrant to comply with the requirements of section 117 of Regulation 1015 made under the Securities Act ("Regulation 1015") and the various segregation requirements of the IDA, including Bylaw 17.3 and Regulation 2000.

- (b) A cornerstone of regulation in the securities industry is the "Know Your Client Rule". Regulation 1300.1 of the IDA Rules requires that Member firms must use due diligence to learn the facts relative to every customer to ensure that, among other things, transactions are within the bounds of good business practice and appropriate in the circumstances. This would include knowing your client's financial circumstances. In the case of Buckingham, this would include knowing whether Buckingham had the right to pledge the securities in question to Latimer.
- (c) Latimer, as an IDA member, was and is subject to the Know Your Client Rule. Latimer was aware that Buckingham utilized the ISM system and, as such, could have obtained the necessary information to confirm Buckingham's right to pledge the securities in question. This would have revealed to Latimer Buckingham's breaches with regard to section 117 of Regulation 1015.
- (d) The reports noted in (a) above do not disclose full client name and address information and, as such, would not have presented a confidentiality conflict problem for Latimer vis a vis Buckingham.
- (e) The argument cannot be made that such due diligence would not necessarily be required by Latimer because Buckingham was an OSC registrant. Under the IDA regime, Buckingham would not meet the definition of a "Regulated Entity" (Form 1, Joint Regulatory Financial/Questionnaire and Report) and, as such, was not subject to IDA regulation. Consequently, additional care should have been taken by Latimer.

The OSC regime does not provide the same protection as the IDA regime when it comes to ensuring compliance with the obligation to segregate. Under the IDA regime, the auditor must conduct specific tests and obtain specific information to form the basis for a report on compliance for segregation of securities. Further, the IDA regime effectively builds into the Capital Formula a differing level of risk for differing OSC registrant categories.

An asset such as a receivable held by an IDA member from an entity that did not meet the definition of a regulated entity for capital calculation purposes would be treated as a non-allowable asset, resulting in a reduction in the firm's Risk Adjusted Capital.

In addition, IDA staff conduct annually a detailed field exam of the member to verify, among other things, the member's segregation procedures.

Under the OSC regime, however, a schedule is completed annually by the registrant and the auditor attests to it as part of the annual report. No specific tests are required. The auditor is not required to be a member of the approved IDA Panel Auditor List. Further, the OSC does not conduct annual field visits.

- (f) The segregation calculation, and thus the amount of securities required to be segregated, is impacted by a number of factors including, among other things, daily price movements. Such movements necessarily require adjustments to securities segregated regardless of other transactions, such as sales, purchases or payments. As such, Latimer should have been reacting on a regular basis to requests to return certain securities to Buckingham.

5. With respect to paragraph 9 of the 7th Report, Schedule I was prepared on an account-by-account basis, utilizing an individual segregation calculation, as BDO did not have access to the ISM-generated segregation reports prepared as of July 6, 2001.

I concur that the schedule does identify the securities Buckingham was required to segregate on an individual account basis, as well as the securities eligible, on the same basis, for pledging to Latimer.

6. With respect to paragraph 11 of the 7th Report, the calculation method chosen assumes compliance with section 116(2) of Regulation 1015. Under no circumstances was Buckingham entitled to pledge or Latimer entitled to accept a pledge of securities that Buckingham was obligated to segregate (section 117(2) of Regulation 1015).

ADDITIONAL POINTS FOR CONSIDERATION

1. Buckingham's letter to Latimer, dated July 25, 2000

With respect to Buckingham's letter to Latimer, dated July 25, 2000 concerning Buckingham's use of the ISM system, it should be noted that:

- (i) Point 2 states that securities are segregated as trades are executed.

Mr. DeLuca, as CEO of an IDA member (and formerly a CFO) would know that securities are segregated after a trade settles, not when it is executed.

- (ii) The fact that Buckingham said they were segregating on a trade date basis and not on a settlement date basis should have indicated to Latimer that Buckingham may not have been utilizing the information provided to them from the ISM system and, thus, not complying with sections 116 and 117 of Regulation 1015.

2. Latimer's Client Account Application Form

In April 1997, Buckingham completed the above noted form. Under the IDA Rules, a requirement exists to update a client account application form when there has been a material change in circumstances or where there has been a change in representative, or, generally, where information may not be current. This requirement enables the member to comply with the Know Your Client Rule, as noted earlier.

Latimer did not update the application from the time it was filled out in 1997 to the commencement of activity in July 2000. This indicates that Latimer's due diligence was inadequate.

3. Fee Schedule of Latimer

I note that Latimer's trade execution fees of \$35.00+ are far in excess of the industry standard for carrying dealers.

The ranges I have seen are between \$12.50 and \$30.00, with the bulk being less than \$25.00. In the case of the higher end of the range, the services provided by the carrying dealers far exceed the services provided by Latimer to Buckingham.

I would also note that the prime + 4% cost of money seems excessive.

CONCLUSION

The whole concept of segregation is one of safekeeping and custodianship, all for the protection of the customer.

It must be kept in mind that this concept:

- (i) has been created by statute, the regulations and the IDA Rules; and
- (ii) is put into practice using segregation systems provided by service bureaus such as ISM and ADP.

In the context of the fore-noted, Latimer had available to them information that should have told them that Buckingham did not segregate its clients' securities in accordance with sections 116 and 117 of Regulation 1015.

Buckingham had an obligation to segregate client securities, it failed to segregate, and consequently, Buckingham was not entitled to pledge these securities.

Latimer had access to information that would have indicated to it that Buckingham was pledging as security for its own borrowing from Latimer securities it ought to have segregated.

Latimer had an obligation to "know its client" under Regulation 1300 of the IDA Rules and, on the basis of the foregoing, did not do enough to discharge its obligation.