

ALBERTA SECURITIES COMMISSION

Docket: ENF-009610

Citation: Re The Cash Store Financial Services Inc., 2017 ABASC 173

Date: 20171115

NOTICE OF HEARING

To: 1511419 Ontario Inc., formerly known as The Cash Store Financial Services Inc., Gordon Reykdal and Nancy Bland (the **Respondents**)

Notice: The Alberta Securities Commission (the **Commission**) will convene at 2:30 p.m. on Wednesday, March 14, 2018 at Calgary, Alberta, to set a date for a hearing regarding the allegations in this Notice (**Set Date**). At the hearing, the Commission will consider whether it is in the public interest to make orders against you under sections 198, 199, and 202 of the *Securities Act*, RSA 2000, c S-4, as amended (**Act**).

Location: Alberta Securities Commission, 5th Floor, 250 – 5 Street SW, Calgary, Alberta.

Procedure:

1. You may obtain disclosure and particulars of the allegations in this Notice from Robert Stack, c/o Alberta Securities Commission, 600, 250 - 5 Street SW, Calgary, Alberta, T2P 0R4, telephone: 403.297.4370, email: robert.stack@asc.ca.
2. You may be represented by legal counsel and you or your counsel may make representations and introduce relevant evidence.
3. If you or your counsel fail to attend on Wednesday, March 14, 2018 at 2:30 p.m., or as directed, the hearing may proceed in your absence and an order may be made against you without further notice.

See attached sections 29, 198, 199, and 202 of the Act, and Commission Rule 15-501 – Rules of Practice and Procedure for Commission Proceedings.

Reciprocation: Take notice that orders or settlements made by the Alberta Securities Commission may form the basis for parallel orders in other jurisdictions in Canada. The securities laws of some other Canadian jurisdictions may allow orders made in this matter to take effect in those other jurisdictions automatically, without further notice to you. If an order is made or a settlement agreement is reached in relation to this Notice, you should contact the securities regulator of any other jurisdiction in which you may intend to engage in any securities-related activities.

Allegations

Parties

1. 1511419 Ontario Inc., formerly known as The Cash Store Financial Services Inc. (CSF), is an entity incorporated pursuant to the laws of Ontario. Its shares traded on the Toronto Stock Exchange and on the New York Stock Exchange. At all relevant times, its head office was located in Edmonton, Alberta.
2. CSF was in the business of providing retail consumers with alternative financial products and services in Canada and the United Kingdom.
3. Gordon Reykdal (**Reykdal**) is a resident of Alberta and was at all material times the Chief Executive Officer of CSF. He was also Chairman of the Board of CSF until the fall of 2012.
4. Nancy Bland (**Bland**) is a resident of Alberta. She was Chief Financial Officer of CSF until in or around June 2012.

Circumstances

Relevant Disclosure

5. As a reporting issuer, CSF provided continuous disclosure to the market. The disclosure documents most relevant to this matter are as follows:
 - 5.1 Annual 2011 Consolidated Financial Statements for the 12 and 15 months ended September 30, 2011 and September 30, 2010 (**YE 2011 Financial Statements**)
 - 5.2 Interim Consolidated Financial Statements for the 3 months ended December 31, 2011 (**Q1 2012 Financial Statements**)
 - 5.3 Interim Consolidated Financial Statements for the 3 and 6 months ended March 31, 2012 (**Q2 2012 Financial Statements**)
 - 5.4 Interim Consolidated Financial Statements for the 3 and 9 months ended June 30, 2012 (**Q3 2012 Financial Statements**)
 - 5.5 Annual 2012 Consolidated Financial Statements for the years ended September 30, 2012 and September 30, 2011 (**YE 2012 Financial Statements**)
6. Also relevant to this matter is exempt-market disclosure CSF provided in an offering circular dated January 24, 2012, relating to a private placement (**Offering Circular**).

CSF's Payday Loan "Broker" Business

7. CSF operated in the payday loans industry in Canada and the United Kingdom. CSF obtained funds from creditors and provided them to borrowers, who paid interest and fees

on short-term loans. Wholly-owned CSF subsidiaries managed the operation of retail lending outlets in different regions. In order to obtain lending funds, CSF signed a number of agreements (**Broker Agreements**) between 2002 and 2010 in which it promised to act as loan broker on behalf of creditors, which CSF described as "third party lenders" (**TPL(s)**). The Broker Agreements set out the following arrangements:

- 7.1 CSF would arrange loans between borrowers and TPLs, handle the paperwork, deal with collections and generally administer the loan process;
 - 7.2 CSF would only advance TPL funds on loans approved by the TPL;
 - 7.3 CSF would keep the TPLs' money segregated and in trust;
 - 7.4 CSF would not use TPL funds in its own operations;
 - 7.5 CSF could be responsible for loan losses if it failed to show that it had met its duties under the agreement (in terms of loan selection, documentation, collection, etc.); and
 - 7.6 Borrowers were to pay the TPLs an annual interest rate of 59%.
8. CSF earned money on the loans by charging borrowers a broker fee, calculated as a percentage of the loan funds.
 9. CSF collected interest and principal on the loans. Contrary to the Broker Agreements, it did not keep these monies segregated or in trust, but in accounts that included its fee and other revenue. In general, CSF did not return the principal and interest it collected to the TPLs but used collection funds for further lending. In lieu of forwarding actual repayments of principal and interest by debtors to the TPLs, CSF made payments to the TPLs at predetermined rates, as more fully described below.

Disclosure Regarding TPLs

10. In the YE 2011, Q1 2012, Q2 2012, and Q3 2012 Financial Statements, CSF made the following disclosure:
 - 10.1 that responsibility for losses suffered on account of uncollectible loans rests with the TPL, except in the case where CSF failed to perform specific duties set out in the Broker Agreements; and
 - 10.2 that CSF's Board regularly approves "a maximum amount of retention payments per quarter to [TPLs] as consideration to those lenders that continue to be willing to fund advances to the Company's customers." The disclosure affirmed that "...**the third party lenders have not been guaranteed a return...**" and that the payments were made "**voluntarily**". (emphasis added)
11. The YE 2011 and Q1 2012 Financial Statements included an expense for "retention payments". However, there was no accrual on CSF's balance sheet of a liability to make

retention or other payments to the TPLs and no recognition of a liability for the TPL loans (other than note disclosure of a contingency for possible loan loss claims if CSF failed to perform its obligations under the Broker Agreements).

Loan Acquisition and Offering Circular

12. In or around the spring of 2011, CSF began to consider moving away from the "broker model" of payday lending and towards a "direct lending" model, where CSF would provide its own funds to borrowers. It decided to adopt the direct lending model in Canadian provinces that had enacted regulations over the payday loan industry, called "regulated provinces" in the industry. CSF would continue to use the "broker model" in the unregulated provinces.
13. In or around January 2012, CSF purchased the outstanding TPL loans in the regulated provinces for \$116,334,000 (the **Loan Purchase Transaction**). CSF funded this purchase through a sale of senior secured notes bearing an interest rate of 11.5% (the **Bond Issuance**), a transaction that raised \$125,377,501. Some parties that purchased CSF's notes were Alberta residents.
14. CSF used the Offering Circular to provide disclosure to potential investors regarding the Bond Issuance. The Offering Circular indicated that the Broker Agreement terms, as described above, would apply in the unregulated provinces. The Offering Circular stated: "Losses suffered on account of uncollectible loans are not contractually our responsibility as long as we have performed and fulfilled our obligations under the terms of the third-party lender agreements" and the "third-party lenders are not guaranteed any specific returns."
15. The Offering Circular also stated that "proceeds from the offering will be used to purchase loans receivable" from the current TPLs in regulated provinces.

Untrue or Misleading Disclosure in the Financial Statements and Offering Circular

16. CSF's disclosure regarding the TPLs and the retention payments was untrue or misleading in a number of material respects and omitted to describe key facts of the actual arrangements between CSF and the TPLs. The following paragraphs describe those arrangements.
17. CSF paid the TPLs a guaranteed rate of return on their funds. The parties varied the rate from time to time; in the period 2011-2012, TPLs expected to receive and CSF paid a 17.5% per annum return on the amount the TPLs had provided to CSF for lending.
18. Reykdal negotiated the return rate with the TPLs, and in the period 2011-2012 he assured at least some TPLs that CSF would continue to make these regular payments of a pre-determined return, using phrases such as "the retention payments will continue at the current rate as always" or "returns paid to [a TPL] for all funds provided or advanced will remain at 17.5% per annum paid monthly."

19. The CSF Board of Directors regularly authorized another form of "retention payment" to compensate TPLs for loan losses. CSF made these payments either in cash or as "credits" on records CSF maintained showing what TPLs were owed. The payments reflected in whole or in part the losses that CSF estimated the TPLs had suffered in relation to uncollectable loans. The credits were meant to protect against erosion of the TPLs' principal.
20. Further, on several occasions both before and during the period 2011-2012, Reykdal communicated to one or more TPLs that CSF would ensure the TPL or TPLs suffered no loss of principal. He used phrases such as "uncollected amounts as at September 30, 2011 will be made up through future retention payments" or confirmed that the loan portfolio of a TPL was "valued at 100% of the capital that has been received" from the TPL.
21. Further, when CSF acquired the TPLs' receivables in the Loan Purchase Transaction, it agreed to a price that was above the fair market value of the loan portfolio. The excess amount compensated the TPLs for past loan losses and ensured they received back all the original principal they had forwarded to CSF for lending. This use of offering proceeds was not disclosed in the Offering Circular.
22. In light of these facts, CSF contravened section 92(4.1) of the *Act* by stating in its YE 2011, Q1 2012, Q2 2012 and Q3 2012 Financial Statements that:
 - 22.1 the TPLs "have not been guaranteed a return", when in fact Reykdal had negotiated a specific rate of return, which CSF paid; and
 - 22.2 the TPLs were responsible for loan losses (except where CSF failed to perform its duties), when in fact Reykdal had committed CSF to compensate TPLs for loan losses, regardless of whether CSF had or had not performed its duties, and CSF recorded credits to TPLs internally and made payments pursuant to this obligation.
23. Further, CSF contravened section 92(4.1) of the *Act* by stating in the Offering Circular that:
 - 23.1 the TPLs were not guaranteed any specific return, when in fact Reykdal had negotiated a specific rate of return, which CSF paid;
 - 23.2 loan losses were not contractually CSF's responsibility (as long as it performed under the Broker Agreements), when in fact Reykdal had committed CSF to compensate TPLs for loan losses, regardless of whether CSF had or had not performed its obligations, and CSF recorded credits to TPLs internally and made payments pursuant to this obligation; and
 - 23.3 the offering proceeds would be used to purchase the TPLs' loans receivable, when in fact CSF used a considerable portion of the Bond Issuance funds to fulfill a pre-existing obligation to indemnify the TPLs for past loan losses.

24. These untrue or misleading representations in the YE 2011, Q1 2012, Q2 2012, and Q3 2012 Financial Statements and in the Offering Circular would reasonably be expected to have a significant effect on the price or value of CSF's shares and the senior secured notes CSF distributed in the Bond Issuance.
25. Reykdal, who was fully aware of the negotiations with the TPLs and the representations he made to them, authorized, permitted or acquiesced in these contraventions of section 92(4.1) of the *Act*.

Omitted Disclosures

26. The YE 2011 Financial Statements and Q1 2012 Financial Statements, which related to periods when CSF still operated primarily under the "broker model", did not disclose and record CSF's liability to pay guaranteed returns and loan loss indemnification to the TPLs.
27. Failure to disclose and record CSF's guarantee of returns and principal to the TPLs was inconsistent with the requirements of Canadian GAAP (which applied to the YE 2011 Financial Statements) and US GAAP (which applied to the Q1 2012 Financial Statements). It, therefore, represented a contravention of sections 146 of the *Act* and Part 3 and Part 4 of National Instrument (NI) 52-107.
28. Reykdal was aware of these obligations he had negotiated with the TPLs and the representations he had made to them. He authorized, permitted or acquiesced in this contravention of sections 146 of the *Act* and Part 3 and Part 4 of NI 52-107.

Valuation of Loan Portfolio

29. CSF first reported on the Loan Purchase Transaction in its Q2 2012 Financial Statements. It allocated the purchase price as follows:

Consumer Loan Portfolio Purchase Price Allocation

	Q2 2012 F/S
Consumer loan portfolio	80,334
Non-compete agreement	18,998
Favorable supplier relationships	17,369
Proprietary knowledge	2,714
Total acquired assets	119,415
Deferred tax liability	3,081
Total purchase price	116,334

**Note: Amounts reported in thousands.

30. These numbers were revised in the Q3 2012 Financial Statements to read as follows:

Consumer Loan Portfolio Purchase Price Allocation

	Q3 2012 F/S
Consumer loan portfolio	70,334
Non-compete agreement	24,274
Favorable supplier relationships	22,193
Proprietary knowledge	3,469
Total acquired assets	120,270
Deferred tax liability	3,936
Total purchase price	116,334

**Note: Amounts reported in thousands.

31. In December 2012, CSF filed restated Q2 and Q3 Financial Statements that revised the Consumer Loan Portfolio Price Allocation as follows:

Consumer Loan Portfolio Purchase Price Allocation

	Restated Q2 & Q3 2012 F/S
Consumer loan portfolio	50,014
Non-compete agreement	15,524
Favorable supplier relationships	14,220
Proprietary knowledge	2,280
Total acquired assets	82,038
Premium paid to acquire loan portfolio	36,820
Deferred tax liability	2,524
Total purchase price	116,334

**Note: Amounts reported in thousands.

32. The restated Q2 and Q3 2012 Financial Statements disclosed that CSF had in the Loan Purchase Transaction paid a "premium" of \$36,820,000 to acquire the TPLs' loan portfolio. The disclosure indicated that the premium "settled pre-existing relationships" between CSF and the TPLs. This premium was then listed as a one-time expense.
33. The Q2 and Q3 2012 Financial Statements were reported in US GAAP. US GAAP requires issuers to report the fair market value of acquired debt assets. The fair market value attributed to the Consumer Loan Portfolio itself fell by over \$30M from the Q2 2012 Financial Statements to the restated Q2 and Q3 2012 Financial Statements. The original Q2 and Q3 2012 Financial Statements were not prepared in accordance with US GAAP and represent a contravention of section 146 of the *Act* and Part 3 NI 52-107.
34. The restated Q2 and Q3 2012 Financial Statements acknowledged that restatements were necessary because of accounting errors CSF had made. Bland and Reykdal supervised and were involved in the valuation process and knew, or ought to have known, of the errors that led to the restatements.

35. Reykdal authorized, permitted or acquiesced in the contraventions of section 146 of the *Act* and Part 3 of NI 52-107 in the Q2 and Q3 2012 Financial Statements. Bland authorized, permitted or acquiesced in the contraventions of section 146 of the *Act* and Part 3 of NI 52-107 in the Q2 2012 Financial Statements.

Loan Loss Provision

36. The Q2 2012 Financial Statements disclosed a provision for loan losses of \$7,487,000 and \$8,155,000 respectively for the three and six months ended March 31, 2012.
37. The Q3 2012 Financial Statements disclosed a provision for loan losses of \$6,413,000 and \$14,568,000 respectively for the three and nine months ended June 30, 2012.
38. In December 2012, CSF filed restated Q2 and Q3 2012 Financial Statements.
39. In the restated Q2 2012 Financial Statements, CSF restated its provision for loan losses to \$10,798,000 and \$11,466,000 respectively for the three and six months ended March 31, 2012. In Note 3, CSF explained that its provision for loan losses was understated as a result of an error, and that, as a result, it recorded an additional expense of \$3,311,000 for the three and six months ended March 31, 2012. In conjunction with the restatement of the provision for loan losses, the allowance for consumer loan losses increased by \$3,311,000 from \$10,604,000 to \$13,915,000.
40. In the restated Q3 2012 Financial Statements, CSF restated its provision for loan losses to \$10,104,000 and \$21,570,000 respectively for the three and nine months ended June 30, 2012. In Note 3, CSF explained that its provision for loan losses was understated as a result of an error, and that, as a result, it recorded an additional expense of \$3,691,000 and \$7,002,000 respectively for the three and nine months ended June 30, 2012. In conjunction with the restatement of the provision for loan losses (\$7,002,000) and the effect of foreign exchange translation (-\$1,000), the allowance for consumer loan losses increased by \$7,001,000 from \$16,726,000 to \$23,727,000.
41. The Q2 and Q3 2012 Financial Statements were required to have been prepared in accordance with US GAAP. US GAAP requires issuers to measure loan impairment using estimates based on reasonable and supportable conclusions. CSF's own review indicated it had not applied reasonable and supportable conclusions to calculate its loan loss provision and allowance. The Q2 and Q3 2012 Financial Statements were not prepared in accordance with US GAAP and represent a contravention of section 146 of the *Act* and Part 3 of NI 52-107 by CSF.
42. Bland supervised and was involved in the formulation of the loan loss provision and allowance. She authorized, permitted or acquiesced in the contraventions of section 146 of the *Act* and Part 3 of NI 52-107 in the Q2 2012 Financial Statements.

Related Parties

43. The Q1, Q2, and Q3 2012 Financial Statements did not disclose that a key TPL, Assistive Financial Corp. (**Assistive**), was controlled by an individual, Randy Schiffner, who is

within the immediate family of Cameron Schiffner, Senior Divisional Vice President of CSF. The statements failed to disclose related party transactions between CSF and Assistive, particularly the \$45,520,000 that Assistive received as part of the Loan Purchase Transaction.

44. This omission was corrected in the restated Q2 2012 and restated Q3 2012 Financial Statements.
45. US GAAP requires disclosure of material related party transactions. The failure to disclose related party transactions between CSF and Assistive in the Q1, Q2 and Q3 2012 Financial Statements was a violation of US GAAP and therefore represented a contravention of section 146 of the *Act* and Part 3 of NI 52-107.
46. Reykdal and Bland were aware of the relationship between Cameron Schiffner and Randy Schiffner. Reykdal authorized, permitted or acquiesced in this contravention of section 146 of the *Act* and Part 3 of NI 52-107 in the Q1, Q2 and Q3 2012 Financial Statements. Bland authorized, permitted or acquiesced in this contravention of section 146 of the *Act* and Part 3 of NI 52-107 in the Q1 and Q2 2012 Financial Statements.

Certifications

47. Pursuant to Part 4 and Part 5 of NI 52-109, Reykdal signed certifications regarding the YE 2011, Q1, Q2 and Q3 2012 Financial Statements. Bland signed certifications for the YE 2011, Q1 and Q2 2012 Financial Statements. In these documents, Reykdal and Bland certified that they:
 - exercised reasonable diligence to ensure the filings did not contain an untrue statement of a material fact or omit to state a material fact;
 - exercised reasonable diligence to ensure the filings fairly presented, in all material respects, the financial condition, results of operations and cash flows of the issuer;
 - are responsible for establishing and maintaining DC&P (disclosure controls and procedures) and ICFR (internal controls over financial reporting); and
 - have designed ICFR, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.
48. In fact, the YE 2011 and Q1 2012 Financial Statements failed to disclose guarantee obligations in relation to TPL loans. The YE 2011, Q1 2012, Q2 2012 and Q3 2012 Financial Statements contained the misrepresentations described above. Reykdal was aware of CSF's representations and obligations to the TPLs.
49. Further, the Q2 2012 and Q3 2012 Financial Statements did not fairly present the financial condition of CSF in so much as there was a large over-valuation of the consumer loan portfolio, a failure to disclose a significant premium paid to "settle a pre-

existing relationship" and a failure to record a reasonable and supportable loan loss provision and allowance.

50. Moreover, restated Q2 2012 MD&A for CSF disclosed weaknesses and breakdowns in CSF's processes and controls for determining a supportable loan loss provision and accounting for the valuation of assets acquired in the Loan Purchase Transaction. Further, additional restated Q2 2012 MD&A acknowledged that CSF had failed to design and implement ICFR related to the identification, assessment, and disclosure of related parties and related party transactions, resulting in the failure to disclose related party transactions. Reykdal and Bland knew, or should have known, about the deficiencies in CSF's systems and processes for tracking and reporting financial information in relation to the loan loss provision and allowance, the Loan Purchase Transaction and related parties.
51. Therefore, Reykdal contravened section 221.1 of the *Act* and Part 4 and Part 5 of NI 52-109 in falsely certifying the YE 2011, Q1 2012, Q2 2012 and Q3 2012 Financial Statements. Bland contravened section 221.1 of the *Act* and Part 4 and Part 5 of NI 52-109 in falsely certifying the Q1 2012 and Q2 2012 Financial Statements.

Breaches

52. As a result of the above, Staff allege that:
 - 52.1 CSF contravened section 92(4.1) of the *Act* by stating in its YE 2011, Q1 2012, Q2 2012 and Q3 2012 Financial Statements and in the Offering Circular that it had not guaranteed returns on the TPL loans and was not responsible for losses on the TPL loans;
 - 52.2 Reykdal authorized, permitted or acquiesced in the contravention set out in subparagraph 52.1;
 - 52.3 CSF contravened section 146 of the *Act* and Part 3 and 4 of NI 52-107 by failing to disclose in its YE 2011 and Q1 2012 Financial Statements that it had an obligation to pay guaranteed returns to the TPLs and had undertaken to "make whole" any losses the TPLs might suffer on their loans;
 - 52.4 Reykdal authorized, permitted or acquiesced in the contravention set out in subparagraph 52.3;
 - 52.5 CSF contravened section 146 of the *Act* and Part 3 of NI 52-107 by failing to disclose in its Q2 2012 and Q3 2012 Financial Statements an appropriate valuation for the TPL portfolio of consumer loans it purchased;
 - 52.6 Reykdal authorized, permitted or acquiesced in the contravention set out in subparagraph 52.5 in the Q2 2012 and Q3 2012 Financial Statements;

