

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 102160 / January 13, 2025

ADMINISTRATIVE PROCEEDING
File No. 3-22398

In the Matter of

**BMO CAPITAL MARKETS
CORP.**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS, PURSUANT TO SECTION
15(b)(4) OF THE SECURITIES EXCHANGE
ACT OF 1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 (“Exchange Act”) against BMO Capital Markets Corp. (“CMC” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter involves CMC's failure reasonably to supervise certain CMC registered representatives with a view towards preventing and detecting their violations of the federal securities laws while offering and selling certain Agency Collateralized Mortgage Obligation Bonds ("Agency CMO Bonds").

2. Agency CMO Bonds are a type of multi-class mortgage-backed security that are created by pooling residential mortgages into trusts and issuing bonds that pay a rate of return to investors based on principal and/or interest payments made on the mortgages. A CMO is typically created from a pool of mortgage loans that share common characteristics (*i.e.*, interest rate or maturity), and then different tranches of securities (with different payment terms and risk profiles) are created and sold to customers as bonds. "Agency" CMO Bonds are issued by Fannie Mae, Freddie Mac, and Ginnie Mae. Agency CMO Bonds are considered relatively low-risk investments because of a full-faith guarantee of principal and interest to investors or other government support. From 2021 through 2022, Agency CMO Bond issuance exceeded \$450 billion.

3. The Agency CMO Bonds that are the subject of the Order are "Sliver Bonds" that were structured by certain CMC registered representatives who worked on the desk responsible for creating Agency CMOs ("Agency CMO Desk") and were offered and sold by Agency CMO Desk members and other CMC registered representatives (together the "CMC Registered Representatives") between December 2020 and May 2023 ("Relevant Period"). The Sliver Bonds are a subset of Agency CMO Bonds that were marketed and sold by CMC Registered Representatives in the Relevant Period. The Sliver Bonds, like other Agency CMO Bonds, were marketed using "Collateral Information" that certain members of the Agency CMO Desk ("Agency CMO Desk Members") generated using the platform of a particular third-party service provider ("Data Provider A"), which published information that certain customers used in making purchasing decisions.

4. A senior Agency CMO Desk Member who was primarily responsible for the structuring of new-issue Agency CMOs ("Agency CMO Desk Member 1") discovered that the Sliver Bond structure could favorably alter the Collateral Information that Data Provider A published about the Sliver Bonds. Specifically, Agency CMO Desk Member 1 discovered that when millions of dollars of mortgages from lower-interest mortgage pools were combined with a tiny sliver – usually just \$1,000 – of mortgages from higher-interest rate mortgage pools, the

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Collateral Information generated by Data Provider A would suggest the Sliver Bonds were backed by a large amount of the higher-interest rate mortgages.

5. This structure altered the Collateral Information of the Sliver Bonds displayed in the systems of third-party market data providers used by some industry participants to analyze the bonds and impacted, among other things, the reported weighted average coupon, weighted average life, weighted average term to maturity, and geographic location of the mortgaged properties. The certificate rate of the Sliver Bonds was not affected by the structure.

6. Agency CMO Desk Member 1 and a more junior member on the Agency CMO Desk who worked with Agency CMO Desk Member 1 (“Agency CMO Desk Member 2”) worked with a trader who supported the Agency CMO Desk (“Trader 1”) to sell certain of the Sliver Bonds. These Agency CMO Desk Members included the altered Collateral Information displayed in Data Provider A’s systems in written sales communications that were sent to CMC’s customers concerning the Sliver Bonds. And although these Agency CMO Desk Members provided additional information about the underlying collateral when requested, and they would explain why the Collateral Information used in their marketing communications was not consistent with the underlying collateral when asked, they did not affirmatively provide this information to all of CMC’s customers or with respect to each of the Sliver Bonds. In the Relevant Period, CMC Registered Representatives offered and sold more than \$3 billion worth of Sliver Bonds.

7. CMC failed to establish and implement supervisory procedures reasonably designed to prevent and detect the CMC Registered Representatives, subject to CMC’s supervision, from providing misleading information when offering and selling the Sliver Bonds to customers during the Relevant Period in violation of Section 17(a)(3) of the Securities Act of 1933 (“Securities Act”). As a result, CMC failed reasonably to supervise its associated persons within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Respondent

8. **BMO Capital Markets Corp.** is a Delaware corporation headquartered in New York, NY. CMC has been a registered broker-dealer since 1985 and registered investment adviser since 2012.

Background on the Agency CMO Market

9. Many Agency CMO Bond investors, or their brokers, have subscriptions to third-party data services that analyze mortgage-backed securities and provide bond-level Collateral Information used to model, price and otherwise evaluate Agency CMO Bonds. The Collateral Information includes the bond’s weighted average net coupon for the underlying collateral (“Net WAC”), the weighted average mortgage interest rate paid by the mortgage borrowers (“Gross WAC”), the number of months until bond maturity, the weighted average loan age, the issuing agency, mortgage geography, the mortgages’ servicers, and whether the mortgages were part of a

special government program (*e.g.*, VA or FHA loans). Agency CMO Bonds are backed by mortgage pools where each pool typically contains mortgages with similar features (such as loan age and interest rate). Data providers publish certain Collateral Information as a weighted average to provide information about the types of mortgages that are included in the pools.

10. Collateral Information published by data providers also includes historical prepayment speeds, which provide information about the rate at which borrowers paid off pooled mortgage loans ahead of schedule in the past, and projected principal repayment speeds, which provide estimated information about the rate at which borrowers might pay off the pooled mortgage loans ahead of schedule in the future. Prepayment speeds are a material consideration for many investors when purchasing Agency CMO Bonds. Certain Agency CMO Bond investors consider “consensus” median prepayment speed projections (which are generated by third-party data providers based on information submitted from market participants) when formulating their own prepayment assumptions about Agency CMO Bonds.

11. Agency CMO Bond purchasers may have specific preferences on what types of Agency CMO Bonds they would consider purchasing based on their market experience, existing mortgage-backed security portfolio and risk and return profile. Many Agency CMO Bond purchasers use Collateral Information to assist them in making purchasing decisions. Agency CMO Bond purchasers may use Collateral Information to screen Agency CMO Bonds as potential purchases, input certain published Collateral Information into models they use to evaluate projected Agency CMO Bond payment streams, or otherwise consider Collateral Information published by one or more third-party data providers when making their investment decisions. Certain of the Collateral Information used in making investment decisions is not available in the prospectus, while other information about the Agency CMO Bonds was available in the prospectus. Agency CMO Bond purchasers may also use modeling tools to analyze yield, valuations, and interest-rate risk, and evaluate a bond’s option-adjusted spread or option-adjusted duration.

12. Agency CMO Bonds are often marketed prior to the publication of the prospectus and are marketed to customers using “offering sheets” prepared by the Agency CMO Desk Members. The offering sheets may include links to third-party data provider Collateral Information about the Agency CMO Bonds and also include some Collateral Information to help customers sort through the securities available for purchase and determine which ones to evaluate further. Agency CMO Desk Member 1, Agency CMO Desk Member 2 and Trader 1 understood that certain customers tended to use the information in these written communications and information available on third-party data provider systems to assist them in making purchasing decisions, and that such customers would not be interested or would be less interested in purchasing Agency CMO Bonds that were marketed with Collateral Information that they perceived as unfavorable.

13. In the Relevant Period, interest rates rose significantly. Prepayments on Agency CMO Bond collateral declined at this time because of how prepayments are inversely correlated to interest rates. This impacted the market for Agency CMO Bonds in multiple ways. One impact was

that the price for certain bonds decreased. There were also certain investors in the Relevant Period that were not interested in purchasing Agency CMO Bonds backed by low weighted average coupon collateral.

Certain Agency CMO Desk Members Structured Sliver Bonds to Generate Favorable Collateral Information Used to Market the Sliver Bonds

14. In the Relevant Period, Agency CMO Desk Member 1 would discuss with certain Agency CMO Desk Members how structuring Sliver Bonds could increase the likelihood that they would be able to sell Agency CMO Bonds.

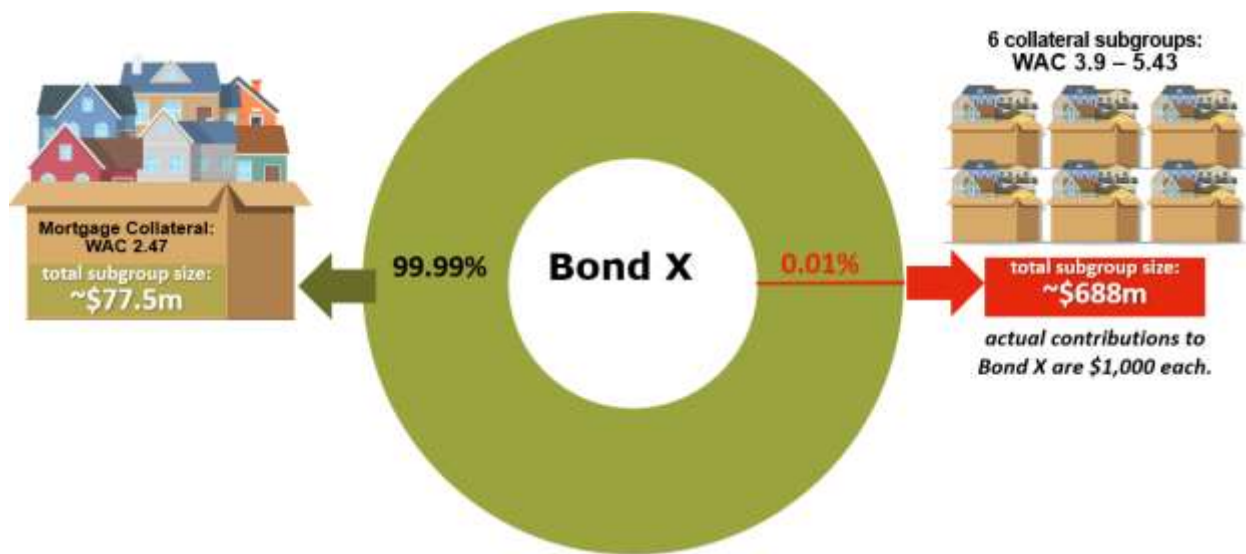
15. For example, in one recorded call, Agency CMO Desk Member 1 and Agency CMO Desk Member 2 discussed structuring Sliver Bonds. Agency CMO Desk Member 1 told Agency CMO Desk Member 2: "...we have the data point that with a clean label, we haven't been able to sell jack shit . . . whereas . . . when it's shortened to a 4-year . . . we have like a bunch of [] regionals [] coming in and [] starting to take a look, right?" On that same call, Agency CMO Desk Member 1 also stated "we gotta make shit look cosmetically short...I think that's paramount here...that's what sells."

16. And in an instant message Agency CMO Desk Member 2 wrote to Trader 1: "I can use 1k of some pools to [change] cosmetics and can move all these [bonds.]"

17. By combining multiple mortgage pools when creating the Sliver Bonds, the Agency CMO Desk Members were able to alter Collateral Information on Data Provider A's systems that were used to market the Sliver Bonds.

18. As one example, in November 2021, the Agency CMO Desk Members structured a Sliver Bond ("Bond X") that was backed by two sets of mortgages. The overwhelming majority of the contributed collateral consisted of mortgage loans with a relatively low Gross WAC (relatively low interest rate collateral), but a relatively smaller subset of mortgage collateral backing Bond X consisted of higher Gross WAC (higher interest rate) mortgage loans. The first set was from approximately \$77.5 million in mortgages that had a Gross WAC of 2.47%. This set made up approximately 99.99% of the collateral backing Bond X. The second subset was approximately \$6,000 in mortgages that had a Gross WAC ranging from 3.90% to 5.43%. This set contributed less than 0.01% of the collateral backing Bond X. Because the pools of loans that the second subset of mortgages came from were much larger than the pools underlying the first set, and due to how Data Provider A calculated Agency CMO Bond Collateral Information, the displayed Gross WAC for Bond X was 3.96% – higher than the Gross WAC of the overwhelming majority of the underlying collateral.

19. The figure below depicts the structure of Bond X:



20. Since Data Provider A’s methodology looks to the total size of each group of mortgages contributing to a bond – rather than to the actual contributions of each group – in weighting that group’s contribution to the bond, this structure had the effect of artificially increasing Bond X’s Gross WAC, making it appear that Bond X contained mortgages that were likely to pay more quickly than predicted by the consensus median prepayment speed projections displayed on Data Provider A’s systems.

21. This structure also altered other Collateral Information about Bond X generated on Data Provider A’s systems, including, but not limited to, Bond X’s Net WAC, the underlying mortgages’ weighted average loan age and weighted average term to maturity, the geographic location of the underlying mortgages, the type and amount of special mortgage programs in the underlying loans (*e.g.*, VA and FHA), the contribution amounts of the underlying mortgage pools, the bond’s historical prepayment speeds, and the underlying mortgages’ servicers. Other information on Data Provider A’s systems, such as option-adjust spread and option-adjusted duration, were not altered by the structure.

22. Some Sliver Bonds may have prepaid close to, or faster than, the projected median principal prepayment speeds published on Data Provider A’s systems at the time of sale. In addition, some of these Sliver Bonds were illiquid, small-sized “odd lot” CMOs that traded at a discount. Nonetheless, the structure also altered historical prepayment speeds and other Collateral Information displayed and available in third-party data provider systems that certain of CMC’s customers may have used to make their own prepayment speed projections at the time of purchase.

**CMC Registered Representatives Sent Materially Misleading Collateral Information
Concerning Certain Sliver Bonds to Customers**

23. CMC Registered Representatives structured, offered and sold more than 400 Sliver Bonds that were marketed using Collateral Information that was altered or inflated by Agency CMO Desk Members. The Agency CMO Desk Members included altered Collateral Information for certain Sliver Bonds in offering sheets they prepared that were distributed to other CMC Registered Representatives and customers in an effort to offer and sell those bonds.

24. For example, in September 2021, Agency CMO Desk Member 1 created and sent an offering sheet containing altered Collateral Information concerning “Bond Y,” another Sliver Bond, with the understanding that the information would be used to offer and sell Bond Y to customers. Certain of the Collateral Information was inflated because the offering sheet stated Bond Y had a Net WAC of 3.3% and a Gross WAC of 3.7%, when the overwhelming majority of the collateral underlying Bond Y had a Net WAC of 2.5% and a Gross WAC of 2.9%.

25. Subsequently, a CMC Registered Representative sent a customer information about Bond Y, including a link to a Data Provider A analytics screen for the bond. This screen contained the altered Collateral Information for Bond Y, and the customer ultimately purchased several million dollars of Bond Y.

26. And in June 2022, Agency CMO Desk Member 2 distributed to CMC sales team members an offering sheet including two different Sliver Bonds. The offering sheet included Collateral Information showing that both bonds had a Net WAC of 4.4% and a Gross WAC of 5.1%, when the Net WAC and Gross WAC for a majority of the collateral underlying the bonds was 3.1% and 3.9%, respectively. A CMC Registered Representative offered the bonds to a customer and the customer ultimately purchased millions of dollars of each bond.

27. Some of the Sliver Bonds may have ultimately prepaid close to or faster than certain of the Collateral Information displayed on Data Provider A’s systems predicted. Notwithstanding how the Sliver Bonds performed in hindsight, there were investors who may not have purchased the Sliver Bonds, or would have attempted to negotiate a lower price for the Sliver Bonds, had they received accurate information about the underlying collateral at the time of purchase.

**CMC Registered Representatives Received Complaints that the Collateral Information Used
to Market Sliver Bonds Were Misleading or Not Reflective of Underlying Collateral**

28. Certain Agency CMO Desk Members received internal and external feedback that should have put them on notice that the Collateral Information used to market the Sliver Bonds was misleading.

29. For example, in June 2022, one market participant sent a message to Agency CMO Desk Member 1 stating that certain information about the collateral underlying certain “‘mixed collateral’ deals...needs to be disclosed better...” and that “on bonds like these are you [sic] not selling what is advertised.”

30. Agency CMO Desk Member 1 sent a message in response stating Agency CMO Desk Member 1 “well understood” the market participant’s concerns regarding the Sliver Bonds, and stated that “all comments [were] taken to heart.” Agency CMO Desk Member 1 and other members of the Agency CMO Desk who learned of the feedback did not, however, escalate the market participant’s complaint to compliance or to more senior management. Certain Agency CMO Desk Members continued to structure and sell the Sliver Bonds using the altered Collateral Information.

31. In addition, certain Agency CMO Desk Members had communications with other CMC Registered Representatives in which the Agency CMO Desk Members were asked why the Collateral Information they had provided in offering sheets did not match certain of the Sliver Bonds’ underlying collateral. In some communications, Agency CMO Desk Member 1 acknowledged that this was because the Agency CMO Desk had used a blend for “cosmetics.” In at least one instance, Agency CMO Desk Member 1 told another CMC Registered Representative that they did have other “deals where [Collateral Information available on Data Provider A’s systems] matches actual blend” but stated that the pricing for those deals would be different.

32. Although the CMC Registered Representatives’ conduct and marketing of the Sliver Bonds was misleading to certain market participants, there were also certain market participants that were able to figure out that the Collateral Information CMC included in its offering sheets was not reflective of the mortgages underlying the Sliver Bonds prior to purchase. In addition, there were other customers that asked follow-up questions about the Collateral Information or for further information about the loan pools prior to purchase, and at times, CMC Registered Representatives would provide those customers with additional information about the Sliver Bonds in response to those requests.

CMC Failed Reasonably to Supervise CMC Registered Representatives

33. CMC was responsible for supervising the CMC Registered Representatives in their offering and selling of Sliver Bonds. In the Relevant Period, the activities of CMC Registered Representatives were supervised by “desk principals.” CMC desk principals are first line supervisors, responsible for day-to-day supervision in line with CMC’s supervisory policies and procedures and they receive support from a Capital Markets Supervisor and additional oversight from the Compliance Department. In the Relevant Period, CMC’s supervisory policies and procedures were not reasonably designed or implemented with a view towards preventing and detecting the violations described above.

34. While CMC had established policies and procedures requiring that the “Agency CMO Desk Principal” perform certain specified supervisory functions, those procedures did not include guidance concerning the structure and sale of new-issue Agency CMO Bonds structured by the Agency CMO Desk. For example, CMC’s supervisory policies and procedures did not include any approval process before the new-issue Sliver Bonds could be offered and sold by CMC Registered Representatives.

35. Moreover, although CMC’s policies and procedures prohibited registered representatives from sending external marketing communications that exaggerate or omit material facts that may cause marketing communications to be materially misleading in the Relevant Period and provided for a sample-based review of communications, CMC did not reasonably implement this requirement with respect to the marketing of the Sliver Bonds. For example, CMC lacked a process for reviewing the type of information shared with CMC’s customers about Agency CMO Bonds and lacked any process for reviewing the structures of Agency CMO Bonds offered to customers against the representations made about them in marketing communications.

36. Furthermore, CMC had established policies and procedures that required that external communications be reviewed for potential misconduct and customer complaints, and that registered representatives escalate customer complaints for further review. While CMC had processes in place for selecting voice recordings and electronic communications for further review, those processes were not reasonably implemented to identify customers complaints or potential misrepresentations concerning Agency CMO Bonds. None of the contemporaneous communications described in the order concerning the Sliver Bonds were identified or flagged as part of routine surveillance.

CMC’s Updates to its Supervisory Process

37. CMC has since established additional supervisory policies and procedures concerning the offering and sale of Agency CMO Bonds after retaining an outside consultant that performed a review of CMC’s compliance and supervisory processes and made recommendations for improvement. Specifically, CMC has implemented a supervisory review process for the offer and sale of new-issue Agency CMO Bonds, including a pre-approval process for certain collateral blends and Gross WAC features, as well as quarterly meetings to discuss new Agency CMO structures. CMC has also updated its policies and procedures to standardize new-issue marketing information provided to customers. Further, CMC has implemented a monthly review of trade blotters with an emphasis on customer types, desk concentration, and revenues.

38. CMC has also enhanced the lexicons it employs to monitor communications by registered representatives to detect potential misrepresentations concerning Agency CMO Bonds or potential customer complaints or dissatisfaction. In addition, CMC has implemented a new process for the Agency CMO Desk Members and Agency CMO Desk Principal to review the internally-calculated Gross WAC of new-issue CMOs against the Gross WAC displayed on the systems of various data services providers and flag significant discrepancies. CMC has also

updated its offering sheet templates to provide additional disclosures about the structure and collateral of blended Agency CMO Bonds marketed by CMC Registered Representatives.

39. Finally, CMC has implemented enhanced scenario-based training for its registered representatives focused on novel bond structures and escalation of complaints and potential issues.

Failure Reasonably to Supervise

40. As a result of the conduct described above, CMC failed reasonably to supervise the CMC Registered Representatives within the meaning of Section 15(b)(4)(E) of the Exchange Act, with a view to preventing and detecting their conduct in violation of Securities Act Section 17(a)(3) as described above.

Disgorgement

41. The disgorgement and prejudgment interest ordered in paragraph IV.B is consistent with equitable principles and does not exceed Respondent's net profits from its violations, and will be distributed to harmed investors to the extent feasible. The Commission will hold funds paid pursuant to paragraph IV.B in an account at the United States Treasury pending distribution. Upon approval of the distribution final accounting by the Commission, any amounts remaining that are infeasible to return to investors, and any amounts returned to the Commission in the future that are infeasible to return to investors, may be transferred to the general fund of the U.S. Treasury, subject to Section 21F(g)(3) of the Exchange Act.

Respondent's Cooperation and Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. Respondent is censured.

B. Respondent shall, within 21 days of the entry of this Order, pay disgorgement of \$19,417,908 and prejudgment interest of \$2,241,507 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

C. Respondent shall, within 21 days of the entry of this Order, pay a civil money penalty in the amount of \$19,000,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying BMO Capital Markets Corp. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Armita Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, prejudgment interest and penalties referenced in paragraphs IV.B and IV.C above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an

additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a “Related Investor Action” means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary