

# IIROC OVERSIGHT REVIEW

2009

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## **I. EXECUTIVE SUMMARY**

### **1. Background**

The Investment Industry Regulatory Organization of Canada (IIROC) is the national self-regulatory organization (SRO) that oversees all investment dealers, as well as trading activity on debt and equity marketplaces in Canada. IIROC was created through the merger of two predecessor SROs: the Investment Dealers Association of Canada (IDA) and Market Regulation Services Inc. (RS) (the merger). The effective date of the merger was June 1, 2008.

IIROC is recognized as an SRO by the Alberta Securities Commission (ASC), the Autorité des marchés financiers (AMF), British Columbia Securities Commission (BCSC), the Financial Services Regulation Division, Department of Government Services, Consumer & Commercial Affairs Branch (Newfoundland and Labrador), Manitoba Securities Commission (MSC), New Brunswick Securities Commission (NBSC), Nova Scotia Securities Commission (NSSC), Ontario Securities Commission (OSC), the Securities Office, Consumer, Corporate and Insurance Division, Office of Attorney General (Prince Edward Island), and the Saskatchewan Financial Securities Commission (SFSC) (collectively, the Recognizing Regulators (RRs)).

The RRs rely on IIROC to carry out certain regulatory functions, detailed in Recognition Orders (ROs). IIROC is subject to the terms and conditions (T&Cs) within the ROs as it carries out these functions. Most RRs have also officially delegated to IIROC the authority to conduct certain registration functions, and the AMF has delegated to IIROC inspection powers and functions.

The RRs have formal oversight programs for IIROC, which consist of reviewing regular reports of IIROC's regulatory activities, reviewing proposed new rules and rule amendments, and periodic oversight reviews.

### **2. Purpose and scope of the oversight review**

In October and November 2009, staff of the AMF, ASC, BCSC, MSC, NBSC, NSSC, OSC and SFSC (the Participating RR) conducted the first oversight review of IIROC. The objectives of this were as follows:

- to assess whether IIROC was in compliance with the relevant T&Cs of its ROs<sup>1</sup>;
- to assess whether IIROC's regulatory processes were adequate, consistent and fair; and
- to evaluate progress on the integration of IIROC's predecessor SROs, IDA and RS.

The Participating RR coordinated the timing of the review and evaluated the different IIROC offices using the same review program. As IIROC's Principal Regulator<sup>2</sup>, OSC staff coordinated the review and reviewed certain functions performed by IIROC's Toronto Head Office. The other Participating RR relied on OSC staff's review of these Head Office functions. Further detail on the areas examined by the

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<sup>1</sup> Although some parts of this report refer to the T&Cs of specific ROs, IIROC's ROs have identical requirements, with the exception of the AMF RO, which includes additional T&Cs.

<sup>2</sup> The Principal Regulator is the RR designated by the other RR to be responsible for coordinating the RR's review of an SRO's submissions, such as rule proposals; coordinating the oversight reviews; and arranging and chairing CSA/IIROC oversight committee meetings.

Participating RRs is set out below.

<b>IIROC office</b>	<b>Areas examined</b>	<b>Participating RR staff</b>
Toronto Head Office	Corporate governance Fees and Resources Policy Enforcement – Case Assessment Enforcement – Investigations Enforcement Counsel Business Conduct Compliance Financial and Operations Compliance Trading Conduct Compliance Market Surveillance Trading Review and Analysis Membership Business Continuity Plan	OSC OSC OSC OSC, NBSC, NSSC OSC, NBSC, NSSC OSC OSC, NSSC OSC, NSSC OSC, AMF OSC, AMF OSC, AMF OSC OSC
Montreal Office	Enforcement – Case Assessment Enforcement – Investigations Enforcement Counsel Business Conduct Compliance Financial and Operations Compliance	AMF AMF AMF AMF AMF
Pacific Regional Office	Enforcement – Investigations Enforcement Counsel Business Conduct Compliance Financial and Operations Compliance Trading Conduct Compliance Market Surveillance Trading Review and Analysis	BCSC BCSC BCSC BCSC BCSC BCSC BCSC
Prairie Regional Office	Registration Enforcement – Case Assessment Enforcement – Investigations Enforcement Counsel Business Conduct Compliance Financial and Operations Compliance	ASC, SFSC ASC, MSC, SFSC ASC, MSC, SFSC ASC, MSC ASC, MSC, SFSC ASC, MSC

For most areas covered by the oversight review, the period under review (Review Period) covered the time period since these areas were last reviewed as part of oversight reviews of the IDA and RS, with the exception of the review of Corporate Governance and Fees and Resources, for which the review period covered the period since the merger, and IIROC’s business continuity plan. Specifically, the Review Period by area under review was as follows:

<b>Area reviewed</b>	<b>Review Period</b>
Corporate governance Fees and Resources Policy – Dealer Member rules	June 1, 2008 to September 30, 2009 June 1, 2008 to September 30, 2009 August 1, 2002 to September 30, 2009

Policy – market rules	September 1, 2004 to September 30, 2009
Enforcement – Case Assessment	September 1, 2006 to September 30 2009
Enforcement – Investigations – Dealer Member cases	September 1, 2006 to September 30, 2009
Enforcement – Investigations – market cases	September 1, 2004 to September 30, 2009
Enforcement Counsel – Dealer Member cases	September 1, 2006 to September 30, 2009
Enforcement Counsel – market cases	September 1, 2004 to September 30, 2009
Registration	September 1, 2006 to September 30, 2009
Business Conduct Compliance	September 1, 2006 to September 30, 2009
Financial and Operations Compliance	September 1, 2006 to September 30, 2009
Trading Conduct Compliance	September 1, 2004 to September 30, 2009
Market Surveillance	September 1, 2004 to September 30, 2009
Trading Review and Analysis	September 1, 2004 to September 30, 2009
Membership	September 1, 2006 to September 30, 2009
Business Continuity Plan	As at September 30, 2009

### 3. Consolidated report

This report consolidates the reports of the Participating RRs. AMF’s report includes findings related to the IIROC Montreal office; AMF, NBSC, NSSC and OSC staff’s report includes findings from their joint review of functions performed by staff of IIROC’s Toronto Head Office; ASC, MSC and SFSC staff’s report includes findings from their joint review of the Prairie Regional Office; and BCSC’s report includes findings regarding the Pacific Regional Office.

This report has separate sections for each IIROC regional office, in order to allow IIROC and the Participating RRs to track the findings and recommendations by IIROC office.

### 4. Prioritization of report recommendations

The recommendations in this report have been prioritized as high, medium and low based on their significance and expected timeline for implementation:

**High** – The issue is of significant importance or relates to a repeat finding of some significance. IIROC should take corrective action immediately and regularly report on its progress on implementing the recommendation.

**Medium** –IIROC should resolve the issue within a reasonable timeframe. IIROC may be required to report on its progress on implementing the recommendation.

**Low** – The issue was brought to management’s attention for review and consideration.

### 5. Overall assessment

The Participating RRs acknowledge that, at the time we conducted the oversight review, IIROC was a relatively new organization. Progress had been made towards establishing a reasonable corporate governance framework and organizational structure, and towards integration of the regulatory functions previously performed by the IDA and RS. In addition, IIROC had taken steps to improve on the regulatory processes, policies and procedures of its predecessor organizations.

In light of these factors, and based on the oversight review findings, the Participating RRs are of the view that IIROC was in substantial compliance with the terms and conditions of its ROs at the time of our review.

Nevertheless, the Participating RRs identified a number of areas for improvement that require IIROC to take remedial action. The areas for improvement that are particular to each Participating RR are discussed in their respective sections.

## **II. TORONTO HEAD OFFICE**

### **1. Background**

Staff of the AMF, NBSC, NSSC and OSC conducted a review of certain functions performed by IIROC's Toronto Head Office during October and November 2009. Please refer to section I.2 for the areas reviewed by staff of each RR involved in the review and the Review Period for each section of the review.

### **2. Assessment of findings related to the Toronto head office**

This section of the report outlines the findings of NBSC, NSSC and OSC staff and, where applicable, our recommendations to IIROC. While the report acknowledges, in some parts, events that occurred subsequent to the time we performed the field work, our findings and recommendations relate strictly to the Review Period and were not modified to account for subsequent events.

OSC staff reviewed IIROC's corporate governance and found that, although IIROC was a relatively new organization at the time of our review, it had taken steps towards establishing a reasonable corporate governance framework and organizational structure. OSC staff, however, identified a number of areas where IIROC corporate governance could be further refined, and noted them in Section A *Governance*. In some cases, recommendations were made for IIROC to consider establishing more formal criteria and processes associated with the carrying out of Board and Board Committee responsibilities. OSC staff also noted the important role played by IIROC's District Councils and made recommendations to ensure that decisions of the District Councils and their Sub-committees are properly authorized.

OSC staff's review of IIROC's processes for monitoring resources, budgeting and fee setting found that these were generally sound. At the time of the oversight review, IIROC had also made a number of positive steps towards the development of an integrated fee model. We also reviewed IIROC's processes and internal controls regarding the use of certain restricted funds and found that they were generally adequate.

In the policy area, OSC staff found that IIROC established comprehensive policies and procedures and made efforts to integrate the former policy groups of the IDA and RS (the Member and Market Regulation Policy groups, respectively). However, we found that progress still had to be made towards more consistency of the processes followed by Member and Market Regulation Policy. We also had concerns that the staff level in the Market Regulation Policy group was not adequate, and that there was excessive reliance on the Vice President (VP) of Market Regulation Policy for the majority of the work in this group.

NBSC, NSSC and OSC staff reviewed IIROC's Enforcement area. We found that, subsequent to the merger, IIROC had taken a number of steps to increase communication, consistency of processes and coordination between IIROC Enforcement and other IIROC departments, between the enforcement functions performed by IIROC's Toronto Head Office and Regional Offices, and to harmonize the processes and procedures of the (formerly) IDA and RS Enforcement departments. We identified, however, a number of areas for improvement. For example, OSC staff were concerned that, even though the IDA-RS merger provided IIROC with an opportunity to broaden the scope of its enforcement activities, the focus of the Enforcement department remained on Dealer Members' retail activities. We

recommend that IIROC broaden the scope of its Enforcement activities and suggest a number of ways in which this could be done. On a related matter, we also found that IIROC had a much larger number of staff with experience in investigating member conduct cases than staff with specific marketplace experience, and strongly recommend that IIROC take steps to address this imbalance.

Our discussions with Enforcement management and our review of files related to Enforcement cases showed that the department's processes and work done by its staff were, for the most part, adequate. We identified, however, a number of areas where we believed changes in existing processes were needed. For example, OSC staff noted that IIROC's District Council jurisprudence required meeting a recklessness or gross negligence standard of liability and had concerns with the impact of this on Enforcement case selection. We strongly encourage that IIROC staff increase its efforts and take additional steps to pursue cases that only meet a negligence standard. NBSC and OSC staff also found a few cases where cases were closed without further action either because the subject of the investigation took steps to correct the issue after the investigation commenced, or because no formal complaint was made. We are of the view that this was not a sufficient rationale to close a case and recommend that IIROC change its approach in this regard.

OSC staff also obtained an understanding of the various technology systems used in the Enforcement department. These systems appeared to be used effectively by the department. However, we had a significant concern that the system used by Enforcement to track and document cases could not adequately prevent inadvertent modification of documents.

In the Business Conduct Compliance area, NSSC and OSC staff noted that many changes occurred since the IDA-RS merger. For example, the group started to use a more efficient technology platform for documenting field reviews. It also started a significant overhaul of its field examination modules that is expected to shift, in the future, their focus from one that was based on heavy substantive testing to a top-down, risk-based approach in order to better focus the examination work. The group also started to conduct sweeps in order to review high-risk and current regulatory issues. Despite these positive efforts, the group continued to struggle with high staff turnover, which impacted negatively on the timeliness of its work. Furthermore, Business Conduct Compliance was not able to conduct a sufficient number of branch reviews. We will continue to monitor the performance of this group closely.

OSC staff did not have significant concerns regarding the Financial and Operations Compliance group, but did identify an opportunity for additional communication between this group and other IIROC departments, especially other compliance groups such as Business Conduct Compliance or Trading Conduct Compliance. In addition, our file review showed that, while the work done by the examiners was generally thorough, the examination reports issued to Members offered few comments related to operational or internal control deficiencies that may be systemic in nature and therefore should have been reported to the Members.

OSC staff also reviewed IIROC's Trading Conduct Compliance group and found that, overall, the work done by this group was adequate, with one exception: at the time of the field review, IIROC's work to test compliance of dealers with their best execution obligations was not sufficient. OSC staff recommended that this be addressed and will monitor implementation of this recommendation.

Finally, while OSC staff had a few recommendations for improvement in the remaining areas of the IIROC's Toronto Head Office (Market Surveillance, Trading Review and Analysis, and the membership and business continuity planning processes), we had no significant concerns with these functions.

## **A. Corporate Governance**

### **1. Introduction**

IIROC's ROs set out various requirements pertaining to IIROC's corporate governance structure and arrangements. Generally, they must ensure: effective oversight of IIROC; fair, meaningful and diverse representation on the Board of Directors (Board) and its committees (Board Committees); a proper balance among the interests of those regulated by IIROC; and that directors and officers are fit and proper persons. The ROs also establish specific requirements pertaining to the composition of the Board, and around the identification and management of conflicts of interest.

### **2. Purpose and scope**

The purpose of this section was to assess the adequacy of IIROC's corporate governance structure and arrangements relative to the requirements under the ROs and the requirements in IIROC's By-law No. 1 (the By-law).

In connection with this objective, OSC staff considered IIROC's general organizational structure, the composition of the Board and Board Committees (including the nomination and selection processes), the processes for ensuring the fitness of directors and officers, the adequacy of the Board and Board Committee charters and progress towards fulfilling them, the reporting structure and processes governing the activities of the Board and Board Committees, and the means for identifying and managing conflicts of interest. OSC staff also considered the roles and responsibilities of the National Advisory Committee and District Councils, and reviewed IIROC's strategic planning processes.

In conducting its review, OSC staff gave consideration to the fact that IIROC is a relatively new organization and that its ROs contemplate a review by IIROC of its corporate governance structure (including Board composition) within two years from the date of the ROs (the Governance Review).

The Review Period for this section was limited to the period from IIROC's recognition as an SRO on June 1, 2008 to September 30, 2009, given that the corporate governance structure had been developed to suit the merged entity.

To meet these objectives, OSC staff held interviews and discussions with the respective Chairs of the Board, the Corporate Governance Committee and Finance and Audit Committee, the President and CEO (CEO), the Senior Vice President (SVP) General Counsel and Corporate Secretary, the Vice President and Associate General Counsel, the Vice President (VP) Professional Standards, the Director of Human Resources, and the Director of Registration. OSC staff also reviewed various documents pertaining to the corporate governance structure and arrangements of IIROC, and the operation of the Board and Board Committees, including:

- IIROC's By-law and rules;
- Board and Board Committee charters;
- Minutes of the Board and Board Committee meetings held during the Review Period;
- Materials related to selected agenda items from Board and Board Committee meetings;
- Codes of conduct and conflicts of interest policies and procedures;
- Mandates of the National Advisory Council and District Councils; and



- IIROC's Strategic Plan dated December 2008.

### **3. General organizational structure**

#### ***Background information***

IIROC's By-law establishes the Board constitution, general responsibilities and powers, as well as the powers of the Board Committees and of the CEO. It also establishes authority for the delegation of various powers down to the officers and staff of IIROC, and the ability to create Advisory Bodies (whether by the Board or others, as delegated).

During the Review Period, the Board had three Board Committees as required under the By-law: the Corporate Governance Committee (CGC), the Finance and Audit Committee and the Human Resources and Pension Committee.

IIROC's organizational chart sets out the reporting lines across the organization from staff up to the CEO.

#### ***Staff findings***

OSC staff found that IIROC established an organizational structure that appears to be in conformance with its By-law, and which establishes clear reporting lines to and from the Board, Board Committees, and senior management.

OSC staff also found that IIROC had established Board Committees and Advisory Bodies.

#### ***Staff recommendations***

None.

### **4. Composition of the Board and Board Committees**

#### **4.1 Nomination and selection process**

##### ***Background information***

Under the By-law and the CGC charter, the CGC is responsible for the identification and assessment of qualified director candidates to be recommended to the Board as nominees for election by IIROC members. The CGC is also responsible for making recommendations to the Board regarding the appointment of Board directors to the Board Committees.

The CGC charter sets out various considerations for recommending director candidates to ensure that the Board composition complies with the By-law, has appropriate diversity of representation, and addresses potential conflicts of interest. Other than what is set out in IIROC's ROs, By-law and CGC Charter, there are no other formal criteria used for the purposes of identifying and assessing director candidates.

The By-law provides for different processes for electing directors to the Board at the time of the merger date and at the time of IIROC's first annual general meeting held in September 2009 (the 2009 AGM).



OSC staff's review was focused on the processes applied for the election at the 2009 AGM, as these are more reflective of the processes to be used in the future.

For the election at the 2009 AGM, potential candidates were identified primarily through suggestions from the existing directors and the CEO. While there is no process in place to directly solicit names of potential director candidates from those directly regulated by IIROC, suggestions put forward for consideration often arise from interactions with the members. For each candidate, OSC staff were advised that consideration was given to their skills, reputation, integrity and experience, and to ensuring diversity of representation (including consideration of regional and stakeholder interests). Background checks were performed and independence was considered for potential Independent Director candidates.

### ***Staff findings***

Acknowledging that at the end of the Review Period IIROC was still relatively new as an organization, and taking into consideration the differences under the By-law in the processes for electing the Board at the time of the merger and at the September 2009 AGM, OSC staff did not identify issues with the processes employed in identifying and nominating director candidates for the Board and with the appointment of Board directors to the Board Committees, other than as noted below:

- there were no formalized criteria for achieving the broad diversity requirements set out in paragraph 5.5(1)(a) of the By-law (after taking into consideration specific board composition requirements set out in the By-law) and for ensuring adequate coverage of the varying skill sets necessary for the Board to effectively carry out its mandate;
- there were no formal processes in place for assessing the performance and continued eligibility of incumbent directors, but that this was intended to be considered once the CGC had finalized its Board and Board Committee self-assessment process, and once it had developed a skills matrix to help identify gaps in required skills and experience for the Board as a whole;
- no formal process had been developed, at the time of our review, for the CGC to review the level of turnover on the Board to ensure that it was adequate, given that the Board was still relatively new; OSC staff acknowledge that the By-law includes a mechanism by which the terms of directors can be staggered and provides for mandatory term limits, and we were also advised of the expectation that over the next couple of years, there may be Directors on the IIROC Board that may no longer wish to continue to serve given past service on the predecessor IDA and RS Boards; however, the mechanisms in place in the By-law do not ensure that adequate turnover will occur;
- consideration had been given by the CGC to establishing a formal cooling-off period for determining independence, but it was decided instead to consider the need for applying such a period on a case-by-case basis for each potential candidate;
- the process for soliciting and assessing potential director candidates did not appear to be transparent to members and other stakeholders.

### ***Staff recommendations***

1. OSC staff recommend that IIROC should consider and report to CSA staff, as part of its

Governance Review or otherwise, on the need for the following:

- formalizing the criteria for achieving adequate diversity of representation on the Board and adequate coverage of the varying skill sets necessary for the Board to effectively carry out its mandate;
- processes for assessing the performance and continued eligibility of directors;
- processes to review the turnover of directors on the Board to ensure its adequacy, so as to maintain a balance between the need for continuity and the need for fresh perspectives and ideas;
- the application of a formal cooling-off period when considering each candidate's independence; and
- greater transparency to members and other stakeholders in relation to the processes for soliciting and assessing potential director candidates.

**Priority: Medium**

***IIROC's response:***

The matters referred to above were duly considered by the CGC in connection with the Governance Review, resulting in a number of changes to the governance process that have been implemented, or are being recommended for implementation, as set out in the Governance Review Report dated May 28, 2010. The Governance Review Report was endorsed by the IIROC Board and filed with the CSA on May 28, 2010 in accordance with the terms of the Recognition Order.

***Staff comments and follow-up:***

OSC staff acknowledged that the Governance Review Report covered many of the matters identified in the above recommendation. OSC staff will follow-up with IIROC management where it is unclear from the Governance Review Report as to whether or how IIROC intends to implement any formal criteria or processes – specifically, in relation to any processes for reviewing turnover of directors on the Board to ensure its adequacy.

## **4.2 Processes for filling interim vacancies on the Board**

### ***Background information***

The By-law provides mechanisms for filling vacancies on the Board. The CGC is responsible for assessing potential appointees and making recommendations to the Board.

During the Review Period, four vacancies arose (two of these were as at the merger date). Three of the vacancies were filled within one or two months, while the other took approximately six months. The delay in filling the latter position related to the unexpected nature of the vacancy and process for filling it.

### ***Staff findings***

Staff did not have any issues with the processes followed in relation to the Board vacancies during the Review Period and did not note any evidence that the vacancies impeded the Board and Board Committees' ability to oversee the organization and carry out their functions. OSC staff were also advised that the CGC is contemplating a process of creating and maintaining an evergreen list of potential director candidates that can be referred to in the event of a vacancy, and that certain senior IIROC

management responsible for governance did maintain such a list, for the purposes of advising the CGC on an ongoing basis. We are of the view that the additional step to be taken by the CGC should help to ensure there are eligible and qualified candidates known to the CGC in the event of a vacancy to allow for such vacancies to be filled in a short period of time.

***Staff recommendations***

None.

**4.3 Board and Board Committee composition during the Review Period**

***Background information***

IIROC's ROs, By-law, Board and Board Committee Charters establish requirements pertaining to the composition of the Board and Board Committees, including the level of industry and independent representation on the Board.

OSC staff reviewed the minutes of the Board and Board Committee meetings in order to determine the composition of the Board and each Board Committee as at the merger date and after the 2009 AGM, and to identify any changes to the composition of each during the Review Period. OSC staff also reviewed the bios and other publicly available information regarding the individuals that were Board directors during the Review Period to assess their background.

***Staff findings***

OSC staff found that the composition of Board and Board Committees generally met the requirements of IIROC's ROs, By-law, Board and Board Committee charters. We also found that there was a measure of diversity on the Board (once fully composed post-merger) in relation to representation, experience and qualifications of the directors.

As noted earlier, there were some points during the Review Period where vacancies caused the Board to not be fully composed. Similarly, there were points where a Board Committee was not fully composed. Despite this, OSC staff did not note any evidence that the vacancies impeded the Board and Board Committees' ability to oversee the organization and carry out their functions.

***Staff recommendations***

None.

**5. Fitness of directors and officers**

***Background information***

IIROC's ROs require that IIROC's governance structure and arrangements ensure that each director or officer is a fit and proper person. The fitness of director candidates is assessed through the processes undertaken by the CGC in recommending such candidates to the Board for nomination. The CGC is also responsible for reviewing the performance and continued eligibility of incumbent directors to determine whether to nominate them for re-election. As set out above in section 4.1, during the Review Period there was no formal process for this review or for any assessment of the continued eligibility / fitness of

directors.

Fitness of candidates for officers (VP level or higher) is assessed through the IIROC's hiring processes. There are also processes in place to establish and assess performance levels of officers on an ongoing basis.

With respect to training, various opportunities are provided to directors and officers for training both at the initiation of and during their relationship with IIROC.

### ***Staff findings***

Except for the lack of formal processes for reviewing the continued eligibility/fitness of directors already discussed above in section 4.1, OSC staff had no concerns with the processes in place for assessing the fitness of candidates for directors and officers. For existing officers, OSC staff found that there were processes in place to assess their ongoing fitness. We are also of the view that there are adequate opportunities available to existing directors and officers to ensure that they continue to remain fit and proper persons.

### ***Staff recommendations***

See recommendation in section 4.1.

## **6. Mandates of the Board and Board Committees**

### ***Background information***

The charters of the Board and Board Committees generally set out the roles and responsibilities of each body, as well as Board / Board Committee operational matters including those relating to composition, frequency of meetings, quorum, voting, and the holding of *in camera* sessions. The charters provide each respective Board Committee with the authority to make recommendations to the Board, but do not provide for decision-making authority unless specifically provided for by resolution of the Board. OSC staff understand that, during the Review Period, no such resolutions were made. Certain operational requirements are also established through the By-law.

OSC staff reviewed the Board Committee charters and discussed the roles and responsibilities of each of these bodies and of the CEO and IIROC management vis-à-vis the Board and Board Committees during interviews with the Board Committee Chairs, the CEO, and the General Counsel and Corporate Secretary.

### ***Staff findings***

Generally, OSC staff found that the charters for the Board and Board Committees were clear and adequate for the purposes of establishing role and authority. The Board charter had sufficient focus on the mandate of IIROC as a self-regulatory organization, including its objective of protecting investors. The Board Committee charters were adequate for the purposes of supporting the Board in carrying out its mandate.

From discussions held with Board and Board Committee Chairs, OSC staff also did not note any inconsistencies between the views of the Board and Board Committees with respect to their roles and responsibilities and those as set out in the charters.

OSC staff did note, however, that the Board Committee charters were not particularly clear as to the role of the CEO and IIROC management vis-à-vis the Board Committees – this was partly a result of the potential for interpreting the differing *in camera* provisions within the charters as implying that IIROC management’s attendance at Board and Board Committee meetings was automatic. Despite this, OSC staff were satisfied that it was clear in practice that the role of the CEO and IIROC management was to provide advice to the Board Committees, and that attendance by these parties at Board Committee meetings was not a right as might have been implied through the lack of clarity in the charters.

OSC staff also noted that T&C #9 of IIROC’s ROs requires the CGC to approve the use of the Restricted Fund (i.e., approval of funding proposals), but the Board has not formally provided this committee with that authority during the Review Period. OSC staff noted from the minutes of the CGC and Board meetings during the Review Period that, while the CGC reviewed and approved funding proposals involving the Restricted Fund, the Board still made the final review and decision. OSC staff are of the view that, regardless of whether the CGC had authority for final approval of these funding proposals, the objective of T&C #9 would still be achieved through the screening function performed by the CGC.<sup>3</sup> OSC staff, however, believe that IIROC should consider reviewing the Board and CGC Charters to ensure that they reflect the processes employed for the review and approval of funding proposals involving the Restricted Fund and the requirements of T&C #9.

Finally, OSC staff noted a potential conflict of interest associated with the responsibility of the Finance and Audit Committee, which is comprised of a majority of Independent Directors, to advise the Board with respect to Independent Director compensation. OSC staff noted that minutes of the Board and Finance and Audit Committee meetings indicated that this conflict had been identified and considered immediately prior to the merger, but it was decided that the responsibility would rest with that Board Committee for the time being. OSC staff were advised that this matter was not revisited during the Review Period, but acknowledge that the Finance and Audit Committee did not consider any matters pertaining to Independent Director compensation, so any potential conflict could not have arisen.

### ***Staff recommendations***

2. IIROC should consider and report to CSA staff, as part of its Governance Review or otherwise, on the following:
  - whether the roles of the CEO and IIROC management vis-à-vis the Board Committees, and rights to attend Board Committee meetings, should be clarified in the Board Committee charters;
  - whether the Board and CGC charters reflect the process for approving funding proposals involving the Restricted Fund, and whether the current provisions in the charters are consistent with the requirements of T&C #9; and
  - whether and/or how to address the potential conflict of interest that arises when Independent Directors are involved in making recommendations on and approving their remuneration (whether through representation on the Finance and Audit Committee or Board review and/or approval).

**Priority: Medium**

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<sup>3</sup> This is because the CGC, a Board Committee comprised primarily or solely of Independent Directors, reviews funding proposals to ensure that only those proposals that meet the qualifications set out in T&C #9 and are consistent with the spirit of T&C #9, receive funding from the Restricted Fund.

***IIROC's response:***

The revised charters of the Board Committees were approved by the IIROC Board on January 26, 2010.

The charters of the Board Committees were clarified to reflect the practice that the attendance of the CEO and IIROC management at Board Committees is by invitation of the Board Committees.

The CGC approves the use of restricted funds in accordance with the terms of the Recognition Order. The charter of the CGC was revised to reflect the practice of the CGC to approve the use of restricted funds.

The responsibility to review and recommend Independent Director compensation to the Board of Directors was moved from the Finance & Audit Committee to the Human Resources and Pension Committee ("HRP"). The Independent Director(s) on the HRP abstain from voting on the recommendation to the IIROC Board on Independent Director compensation. IIROC believes that so long as the review and recommendation is made by Industry Directors on the HRP, the conflict of interest has been adequately addressed.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**7. Operation of Board and Board Committees**

***Background information***

OSC staff discussed the operation of the Board and Board Committees, including the processes for the setting of agendas, the format of meetings, and the follow-up of items requiring action with the Board and Board Committee Chairs and with certain IIROC management. We also reviewed certain policies and procedures of the Corporate Secretary's office and By-law sections pertaining to the operation of Board and Board Committee meetings.

In addition, OSC staff reviewed the agendas and minutes of the Board and Board Committee meetings held during the Review Period, and materials for a sample of agenda items from those meetings, to assess the Board and Board Committee processes and activities.

As part of the review, we also considered the processes in place through which the Board and Board Committees assesses their own performance relative to their respective roles and responsibilities. The CGC charter indicates that it is the CGC's responsibility to establish and oversee this process.

***Staff findings***

OSC staff were generally satisfied with the adequacy of the processes for the setting of agendas for Board and Board Committee meetings, that issues brought to the Board and Board Committees during the Review Period were relevant and timely, that the materials provided by IIROC staff were adequate for the purposes of assisting with the decision making functions of the Board and Board Committees, and that there were adequate processes in place for following up on action or request items arising from the meetings. OSC staff also noted that the frequency and length of meetings appeared to be sufficient,

attendance was high, and quorum requirements were always met.

From the review of the minutes of the Board and Board Committee meetings during the Review Period, OSC staff also saw no indications that these governing bodies were not giving consideration to IIROC's mandate to protect investors and strengthen market integrity in the carrying out of their duties (where such consideration would be warranted).

In relation to the activities of the Board and Board Committees during the Review Period, OSC staff were of the view that, for the most part, the Board and Board Committees appeared to be fulfilling their general and specific responsibilities, or had at least commenced processes before the end of the Review Period to fulfill those specific responsibilities that had not yet been addressed.

OSC staff also found that the CGC had established a process by which the Board and its Board Committees would self-assess their performance relative to their respective roles and responsibilities. At the end of the Review Period, the first self-assessment using this process had just commenced. It includes the completion of self-assessment forms by each director for the Board and for any Board Committees on which they sit. The points of assessment in these forms generally reflected the key responsibilities outlined in the Board and Board Committee charters, and also included an assessment of administrative matters. However, OSC staff noted that the self-assessment form applicable to the CGC only included an assessment of three aspects of its specific responsibilities, and did not encompass other important CGC responsibilities – for example, its responsibilities pertaining to the appointment of individuals to the Hearing Committees, and pertaining to conflicts of interest. OSC staff acknowledge that given this is the first time that these self-assessments are being performed, there will likely be an opportunity when reviewing the results to determine if there is any need for improvement in the process.

### ***Staff recommendations***

3. Subsequent to finalization and discussion of the results of the current self-assessment process by the Board and Board Committees, IIROC should consider reviewing the self-assessment process to determine whether there is any need for improvement in the process, and in particular as it relates to the robustness of the self-assessment performed for the CGC.

**Priority: Medium**

#### ***IIROC's response:***

IIROC has reviewed the self-assessment process and has made enhancements to the self-assessment form to be completed by members of the CGC in the 2010/11 self-assessment process.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. As part of OSC staff's follow-up on the implementation of the recommendations in this report, we may ask to review copies of the revised self-assessment.

## **8. Management of Conflicts of Interest**

### ***Background information***

IIROC is required by its ROs to effectively identify and manage conflicts of interest. In addition, IIROC



was required to file a Code of Business Ethics and Conduct and a written policy about managing potential conflicts of interests of members of IIROC's Board within one year after the date of recognition.

IIROC has established the Code of Conduct for Directors which includes guidance relating to conflicts of interest. Directors are also subject to IIROC's general Code of Conduct applicable to all employees. The CGC and/or the Corporate Secretary's Office have processes to confirm the independence of directors and identify potential conflicts, and for managing potential conflicts of interest that might arise in connection with Board and Board Committee meeting agenda items.

In addition to the general Code of Conduct, IIROC employees are also subject to a separate Conflicts of Interest Policy, as well as various policies pertaining to employee trading. IIROC employs the use of restricted lists as part of its employee trading policy, and pre-clearance of trades is required for staff involved in market surveillance and trade review and analysis.

### ***Staff findings***

OSC staff found that there are adequate policies and procedures in place to identify and manage conflicts of interest, both for directors and employees. We were also satisfied that the trading policies applicable to IIROC staff were appropriate.

### ***Staff recommendations***

None.

## **9. Role of the National Advisory Committee and the District Councils**

### **9.1 Roles and responsibilities of the National Advisory Committee**

#### ***Background information***

The By-law provides that the Board has the power to authorize committees of the Board and advisory bodies. The Board authorized the establishment of the National Advisory Committee (NAC), whose role includes advising IIROC staff about industry trends, and helping to ensure consistency in the decisions made by the District Councils.

The committee is composed of the chairs of the ten District Councils. Their roles and responsibilities are described further in section 9.2.

#### ***Staff findings***

The NAC is an advisory body only and has no decision-making authority. OSC staff have no issues or concerns with the role of the NAC.

#### ***Staff recommendations***

None.



## 9.2 Roles and responsibilities of the District Councils

### *Background information*

There are ten districts authorized under the By-law, covering all provinces and territories in Canada, and each district is represented by a District Council (DC).

Through the By-law and rules, the DCs have certain consent or approval authorities in relation to decisions affecting registration and membership. Depending on the authorizations under specific By-law provisions or rules, the activities of the DC pertaining to registration and membership matters might be performed by a DC as a whole, by a DC Sub-committee (typically the Registration Sub-committee or Membership Sub-committee), or can be delegated down to IIROC staff, for example, in the case of routine registration applications of individuals.

In relation to registration matters, the DCs or their delegates generally have the authority to make decisions pertaining to the registration of individuals, the imposition of terms and conditions on registration, the suspension or revocation of an individual's registration, and exemptions from proficiency requirements.

For membership matters, the DCs or its delegates generally have the authority to make recommendations to the Board on membership applications, and to make decisions regarding the imposition of terms and conditions on membership, on transactions involving member securities and ownership changes, on the business activities of Dealer Members and their subsidiaries, and on exemptions from requirements regarding introducing / carrying broker arrangements.

The Hearing Committees and Panels Rule from Schedule C.1 of IIROC Transition Rule No. 1 also gives the DCs the right to nominate individuals to the CGC for potential appointment to the Hearing Committee.

The DCs also perform other functions such as providing advice and input on policy matters, as well as educating members.

OSC staff were provided with the mandate of the DC and a manual that is provided to DC members to educate them about their roles and responsibilities. OSC staff also discussed the roles and responsibilities of the DCs and DC Sub-committees with IIROC staff and were advised that there are no mandates for DC Sub-committees.

### *Staff findings*

OSC staff found that the DC mandate does not clearly set out the roles and responsibilities of the DC in relation to its decision-making powers authorized under IIROC's By-law and rules. We also found that there was a lack of mandates for the DC Sub-committees, despite certain of these committees having decision-making powers under the IIROC rules, where so authorized or delegated.

### *Staff recommendations*

4. IIROC should revise the mandates of the DCs and their Sub-committees to ensure that they clearly articulate the roles and responsibilities of the DCs and their Sub-committees as they relate to the decision-making powers authorized under the IIROC By-law and rules.

**Priority: Medium**

***IIROC's response:***

IIROC is updating, on a national basis, the mandates and procedures of the DCs and DC Sub-committees to accurately reflect their regulatory decision-making powers, as set out in IIROC's By-law and Rules.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff ask to receive copies of the revised mandates and procedures upon their completion.

### **9.3 Composition of the District Councils**

#### ***Background information***

The By-law indicates that the DCs should be comprised of anywhere from four to twenty members, including a Chair and Vice-Chair. The IIROC Board can also appoint *ex officio* members.

OSC staff were advised that the typical process for selecting members of the DC involves soliciting potential nominees from Dealer Members. IIROC staff and the DC's Members Nominating Sub-committee will conduct a review of the potential nominees for the purpose of developing a slate to be elected at the annual meeting of Members. OSC staff understand that there are no formal criteria applied for the purposes of the review, but that there is generally consideration given to ensuring diversity of representation of the membership and adequacy of turnover.

The DC mandate indicates that the terms of DC members are two years, and are renewable with no mandatory term limit. OSC staff were advised that turnover results naturally from the member-driven nomination and selection process.

#### ***Staff findings***

OSC staff found that there was a general lack of formal criteria for and transparency around the DC nominee review and selection process. However, OSC staff did not note any evidence that the processes in place produced inappropriate results.

OSC staff acknowledge that the DCs are not governing bodies of IIROC similar to the IIROC Board and its Board Committees, and are comprised of and generally governed by the membership. However, as was noted earlier, the DCs do have decision-making powers authorized under the rules that are regulatory in nature and / or may impact a Dealer Member or Approved Person. We therefore question whether the DCs should be held to the same general principles of governance as the IIROC Board holds itself to.

In addition, while OSC staff understand that adequate turnover is one of the criteria considered by a DC's Members Nominating Sub-committee, we also question whether or not there should be a mandatory term limit to ensure a sufficient and continuing refreshing of experience and views.

#### ***Staff recommendations***

5. IIROC should review the governance structure applicable to the DCs and their Sub-committees for the purpose of assessing whether or not the DCs should be subject to the same, or similar,

principles of governance that the Board holds itself to, at least as they relate to the functions of the DCs and their Sub-committees that are regulatory in nature and / or affect Members or Approved Persons. This review should include consideration of:

- the processes by which DC members and Sub-committee members are selected (including whether the processes and criteria should be documented and made more transparent to Members); and
- consideration of the need for a mandatory maximum term limit for DC members.

OSC staff request that IIROC complete this review and submit a report to CSA staff by an agreed-upon deadline.

**Priority: Medium**

***IIROC's response:***

IIROC is conducting a review and assessment of the governance practices of the DCs, addressing the matters set out in the staff recommendation. This review will include consultation with the DCs and the National Advisory Committee, and will be completed by the end of June 2011.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff agree with the proposed deadline and request a copy of any reports produced upon completion of this review.

## **9.4 Decision making authority of the DCs and Sub-committees**

### ***Background information***

OSC Staff reviewed the IIROC rules pertaining to decision-making by the DCs and their delegates (i.e., DC Sub-committees or IIROC staff, where permissible). We also discussed these decision-making authorities, and the practices of the DCs and their delegates in exercising those authorities, with IIROC management. The authorities delegated and practices employed by the DCs and their Sub-committees vary by District.

### ***Staff findings***

OSC Staff found that, during the Review Period, there was a general lack of evidence to support delegations of authority made by the DCs in relation to registration matters. Specifically, we were advised that where decision-making authority had been delegated to a Registration Sub-committee in accordance with Rule 20 *Corporation Hearing Procedures* (Rule 20), the delegation would have been made many years ago and OSC staff found no record of it during the oversight review. OSC staff understand, however, that IIROC staff had commenced a process during the Review Period to ensure that motions would be proposed at DC meetings for the DCs to reconfirm these delegations, although this process was not completed at the end of the Review Period. We were also advised that the DCs had formally delegated certain decision-making authority to staff of the IDA, one of IIROC's predecessors, but such delegation has not been reconfirmed by IIROC post-merger.

In addition, OSC staff found that it is possible that decisions pertaining to certain membership matters are being made under the IIROC rules by DC Membership Sub-committees, without being properly authorized to do so. Specifically, Rule 5 *Ownership of Dealer Member Securities* (Rule 5) and Rule 6

*Dealer Member Holding Companies, Related Companies and Diversification* (Rule 6) do not expressly contemplate DC decisions under those rules being made by a Sub-committee, although OSC staff were advised that this does sometimes occur. (In contrast, Rule 20 specifically allows DC decisions on membership matters that are made under that Rule to be made by either the DC or a DC Sub-committee).

OSC staff also found that there is no formal documentation establishing quorum requirements for DC or Sub-committee decisions pertaining to registration or membership matters, including requirements around decision-making by that quorum. We were informed, however that, in practice, the DCs employ certain quorum criteria.

The above-noted findings raise concerns that the lack of processes might undermine a DC or Sub-committee decision.

***Staff recommendations***

6. IIROC should periodically review what types of decisions are being made by each DC, their Sub-committees, and by IIROC staff in each district, and compare that to the evidence of delegated authorities, to ensure that formal delegations exist to evidence those authorities.

**Priority: High**

***IIROC's response:***

As a matter of practice, in respect of registration matters delegated by the commissions, registration decision-making follows the same internal processes set out for other DC and/or DC Sub-committee regulatory decision-making under IIROC's Rules. Senior IIROC regional staff are assigned to work with and support each DC and DC Sub-committee, including participating in the preparation of agendas and minutes, with clear responsibility and accountability to escalate issues to senior IIROC management. To supplement this senior staff oversight, IIROC's General Counsel's Office will review the agendas and regulatory decisions of the DCs and DC Sub-committees to ensure compliance with formal delegations and national DC and DC Sub-committee procedures.

IIROC staff have reviewed and re-confirmed all formal delegations by the DCs to DC Sub-committees and/or IIROC staff with respect to the DC's regulatory decision-making authority under IIROC's Rules.

IIROC staff is reviewing the delegation of registration matters to DCs and/or DC Sub-committees under IIROC's Delegation Orders, and these matters will be formally documented by the end of March 2011.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff will follow up with IIROC on the implementation of this recommendation.

7. IIROC should review the extent to which DC decisions under Rules 5 and 6 are being made in each District by a DC Sub-committee, and whether those Sub-committees are properly authorized to make such decisions under the IIROC By-law, rules and mandates, and take any steps that are appropriate as a result of the review.

**Priority: Medium**

***IIROC's response:***

Only the Ontario DC included a membership sub-committee exercising regulatory decision-making authority under IIROC Dealer Member Rules 5 and 6. Subsequent to the Review Period, the Ontario DC disbanded this sub-committee. All regulatory decision-making pursuant to IIROC Dealer Member Rules 5 and 6 is now performed by the full Ontario DC.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

8. IIROC should undertake to ensure that requirements regarding quorum, and decision-making by that quorum, are formally documented, whether by inclusion in the mandates of the DC and Sub-committees or otherwise.

**Priority: High**

***IIROC's response:***

The quorum requirements for annual meetings of DCs are set out in IIROC's By-law. Quorum requirements are currently in place and applied nationally for meetings of DCs and DC Sub-committees. IIROC staff will document these quorum requirements in the updated national procedures for DCs and DC Sub-committees.

***Staff comments and follow up:***

OSC staff note that the concerns about the lack of formal documentation establishing quorum requirements did not pertain to quorum requirements for annual meetings of DCs, which are governed by IIROC's By-law.

OSC staff have requested copies of the revised DC mandates and procedures in connection with IIROC's response to recommendation #4. OSC staff ask that IIROC give consideration to formally documenting the quorum requirements in the revised mandates, as this would be consistent with how quorum requirements for IIROC's Board Committees are documented. OSC staff will review the revised mandates, when received, to see if they have been updated accordingly.

## **9.5 Coordination and monitoring of DC and Sub-committee decision-making function**

### ***Background information***

OSC staff were advised that IIROC staff coordinate the registration and membership decision-making function of the DCs, and monitor for the decisions made in order to communicate those decisions to the affected parties. The processes for this coordination and monitoring may differ nationally as the DC decision-making functions are not coordinated from IIROC's Toronto office. For example, IIROC's Montreal office coordinates and monitors for the Quebec District, while IIROC's Vancouver office coordinates and monitors for the Pacific District. OSC staff understand that there are no established policies and procedures for the coordination and monitoring function. We also understand that the decision-making responsibilities delegated by a DC to its Sub-committees might also differ by District,

and this may impact the way that coordination and monitoring might be carried out by each IIROC regional office.

***Staff findings***

OSC staff acknowledge that processes employed by IIROC staff for the coordination and monitoring of DC and Sub-committee decision-making may differ for the reasons outlined above. We noted, however, that there does not appear to be any central monitoring or oversight of the processes employed by IIROC staff in the regional offices in a manner similar to that used by IIROC for monitoring and overseeing operational functions (such as enforcement or compliance) conducted in the regional offices. This presents potential risk to IIROC insofar as the processes employed in the regional offices for coordinating and monitoring DC and Sub-committee decision-making are not adequate.

***Staff recommendations***

9. IIROC should review and document the processes employed in the IIROC regional offices in relation to the coordinating and monitoring of decisions of the DCs and their Sub-committees under the rules, to assess whether the processes being followed are adequate and consistent (where consistency is necessary).

**Priority: Medium**

***IIROC's response:***

Regional senior IIROC staff are assigned to work with and support each DC and DC Sub-committee, including participating in the preparation of agendas and minutes, with clear responsibility and accountability to escalate issues to senior IIROC management. This oversight of the DCs and DC Sub-committees has worked well. Upon the implementation of the updated mandates and national procedures described in response to item #4 above, senior IIROC staff will continue to be responsible for monitoring compliance, as appropriate. To supplement this regional senior staff oversight, the General Counsel's Office will review the agendas and regulatory decisions of the DCs and DC Sub-committees to ensure that regulatory decisions made by the DCs and DC Sub-committees are within the scope of the formal delegations and consistent with national procedures.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**9.6 Conflicts of interest in District Council decision-making functions**

***Background information***

For registration matters, OSC staff understand that where decisions have not been delegated to IIROC staff, these decisions are most commonly made by a Registration Sub-committee comprised of three DC members. For membership matters, decisions are often made by the DC as a whole, or by a Membership Sub-committee comprised of three members.

OSC staff were advised that there are no conflicts of interest policies applicable to the DC members in relation to their decision-making activities.

### ***Staff findings***

OSC staff are concerned that the lack of conflict of interest policies applicable to DC members presents a risk that an individual DC member in a conflict of interest position could be permitted to involve themselves in a decision of the DC or a Sub-committee, thereby potentially undermining the decision made. We acknowledge that, in practice, IIROC staff that coordinate the decision-making process are in a position to identify obvious conflicts (e.g., if a DC member is an employee of a Dealer Member firm that would be affected by the DC's decision); and that there have been instances where DC members have excused themselves by declaring a conflict.

### ***Staff recommendations***

10. In connection with recommendation #5 to review the governance structure applicable to the DCs and their Sub-committees, IIROC should undertake to formalize and document conflicts of interest policies applicable to all DC members to ensure the integrity of the decisions made by the DCs and their Sub-committees.

**Priority: Medium**

#### ***IIROC's response:***

Conflict of interest guidelines are followed by DCs and DC Sub-committees, but have not been documented in a formal code of conduct or conflict policy applicable to DCs or DC Sub-Committees. IIROC will implement a national code of conduct, including conflict procedures and confidentiality provisions, for the DCs and DC Sub-committees. IIROC will require each member of a DC to acknowledge the code of conduct upon appointment to the DC and annually thereafter.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request a copy of the proposed national code of conduct for the DCs and DC Sub-committees upon its completion.

## **10. Strategic, business and financial planning processes**

### ***Background information***

OSC staff were advised that the development of a strategic plan for IIROC was a priority for the newly merged entity. IIROC issued a strategic plan document in December 2008 (the 2008 Plan). OSC staff discussed with the CEO the processes employed by IIROC for the development of the 2008 Plan and the processes for future review and revisions.

### ***Staff findings***

Based on OSC staff's understanding of the processes employed for the development and review of the 2008 Plan, and how that process might change going forward, we found that there are processes in place for ensuring adequate and timely development, review and revision of IIROC's strategic direction. OSC staff are also satisfied that various processes and reporting mechanisms exist to ensure there is some form of monitoring of progress against the goals of the strategic plan.

OSC staff also found that, in developing the 2008 Plan, consideration appears to have been given to emerging trends, industry and investor needs, as well as the need to ensure that IIROC has adequate resources to carry out its mandate.

***Staff recommendations***

None.



## **B. Fees and Resources**

### **1. Introduction**

IIROC's ROs set out various requirements pertaining to the adequacy of resources for the carrying out of IIROC's regulatory responsibilities. These include requirements that IIROC operate on a not-for-profit / cost-recovery basis, that it maintain sufficient financial resources for the proper performance of its functions and to meet its responsibilities, and a requirement to maintain sufficient resources to efficiently, effectively and in a timely manner perform its regulatory functions and responsibilities.

In relation to fees, the ROs also establish requirements pertaining to the fairness, appropriateness and transparency of fees. It includes a requirement that all fees be equitably allocated, and not have the effect of creating unreasonable barriers to access, and also requires that the process for setting fees be fair and transparent.

The ROs also require IIROC to develop an integrated fee model and submit it for approval with the various Commissions within two years of the date of the ROs.

### **2. Purpose and Scope**

The purpose of this section was to assess whether adequate budgeting, staffing and fee setting processes are in place, to ensure that IIROC maintains sufficient resources to carry out its regulatory responsibilities, and to assess whether transparency exists around the fee-setting process.

In connection with this objective, OSC staff also considered the general adequacy of resources (primarily financial and staffing), and the processes for monitoring the continued adequacy of resources outside of the annual budgeting process.

The scope of the review of resources and fees did not include an assessment of IIROC's compliance with the ROs' requirements relating to the fairness and appropriateness of fees given that IIROC is required to develop and submit an integrated fee model for approval by each recognizing regulator, and there will be an assessment of the proposed fee model against the specific requirements of the recognition order that relate to fairness and appropriateness, at that time. OSC staff did, however, consider whether IIROC was making adequate progress towards meeting the deadline for its integrated fee model proposal.

The Review Period for this part of the review covered the period from IIROC recognition as at June 1, 2008 to September 30, 2009.

### **3. Budgeting and Fee-setting process**

#### ***Background information***

OSC staff interviewed the Chair of the Board<sup>4</sup>, the Chair of the Finance and Audit Committee, the SVP Finance and Administration, and the VP of Finance. OSC staff also reviewed various documents

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<sup>4</sup> This individual was the Chair of the Board during the Review Period.

pertaining to budgeting and fee-setting. Key documents reviewed included the budgets for fiscal 2009 and 2010, various materials provided to the Finance and Audit Committee in relation to IIROC's cost allocation methodology, IIROC's fee model document as at the end of the Review Period, the New Member Applicant Fee Guidelines for fiscal 2010, and a sample of the letter sent to members pertaining to annual fees. OSC staff also reviewed the minutes of the Board and Finance and Audit Committee meetings held during the Review Period, and materials for certain relevant agenda items.

IIROC generally employs a bottom-up approach to the budgeting process, requiring departmental heads to create their own budget for those expenses that are within their control. As part of the budgeting process, consideration is given to the adequacy of and need for resources, whether financial, staffing or technological. IIROC's Finance department is responsible for coordinating and preparing the budget, and there are various levels of review and approval that involve senior management, the Finance and Audit Committee, and the Board. IIROC's Human Resources department is responsible for coordinating the assessment of staffing needs, and approval processes are built into the budgeting processes in relation to these needs.

As IIROC operates on a not-for-profit / cost-recovery basis, its annual fee requirements are ultimately determined by the level of operating expenses budgeted for the year. IIROC employs a cost allocation methodology by which it allocates its operating costs between the dealer and marketplace regulation functions for the purpose of determining the level of fees to be recovered through the dealer and marketplace regulation components of the fee model that was in effect during the Review Period.

Transparency around fees is provided by IIROC through the availability on its website of an explanation of the fee model, and through letters sent to dealer and marketplace members explaining the annual fees and the basis for any increase / decrease in fees.

### ***Staff findings***

Based on the review performed, OSC staff found that the budgeting, staffing and fee-setting processes in place are adequate, but note that changes to the fee model in relation to the charging of fees for dealer and marketplace regulation may necessitate a reassessment of the current processes (in particular, a reassessment of the current cost allocation methodology) to ensure that costs will be recovered from Members in a fair and equitable manner. OSC staff expect that this aspect will be considered by the recognizing regulators in the context of their review of IIROC's proposal for an integrated fee model, and so at this time, no further consideration of this is required.

### ***Staff recommendations***

None.

## **4. Process for monitoring resources**

### ***Background information***

In considering the general adequacy of resources, OSC staff interviewed the Chair of the Board, the Chair of the Finance and Audit Committee, the SVP Finance and Administration, the VP of Finance and the Director of Human Resources. OSC staff also reviewed various documents including the By-law, the budget for fiscal year 2010, the fiscal 2010 Q2 unaudited financial statements, the audited financial statements for fiscal year 2009, the IIROC Employee Handbook and certain employee turnover statistics.

We also reviewed the minutes of the Board, Finance and Audit Committee and Human Resources and Pension Committee meetings held during the Review Period, and materials for certain relevant agenda items.

### ***Staff findings***

Those interviewed believed that IIROC had adequate resources to carry out its regulatory mandate. They also expressed the need for IIROC and its Board to maintain sufficient focus on the continued adequacy of technological resources to ensure the continued success of IIROC. The minutes did not reflect any expressed concerns as to the adequacy of resources that would call into question IIROC's ability to carry out its regulatory responsibilities.

OSC staff also found that management, the Board and relevant Board Committees monitor the overall adequacy of resources through regular financial, operational, and technology reporting. Processes are also in place to allow for additional resources to be obtained on an ongoing basis if necessary (if not provided for in the approved budget). Senior management can approve unbudgeted expenditures up to a certain threshold, while Finance and Audit Committee and Board approval would be required for amounts above that threshold. The IIROC By-law also provides for (or at least does not preclude) the ability for IIROC to obtain a loan or impose a special levy on members if additional financial resources are necessary.

OSC staff are satisfied that there are ongoing processes to monitor the adequacy of resources to carry out IIROC's overall mandate and that there are mechanisms to allow for additional resources to be obtained if necessary. OSC staff, however, have noted that staffing concerns in a few departments could impact the functions of those departments and have made some recommendations (see Sections D *Policy*, E *Enforcement*, and F *Business Conduct Compliance*).

### ***Staff recommendations***

Please refer to recommendations in Sections D, E and F of this report.

## **5. Progress towards the development of an integrated fee model**

### ***Background information***

OSC staff interviewed the Senior VP, Finance and Administration and the VP of Finance. OSC staff also reviewed various documents including materials provided to the Finance and Audit Committee in relation to the status of the progress towards an integrated fee model, and certain materials provided to an industry committee in connection with the development of the dealer regulation fee portion of the model. OSC staff also reviewed the minutes of the Finance and Audit Committee meetings held during the Review Period.

By the end of the Review Period, IIROC had undertaken a number of steps towards the development of a component of the fee model to recover costs associated with Dealer Member regulation. These included the formation of an industry committee to assist with the selection of an appropriate approach, research into fee models employed by other similar organizations, and the development and analysis of alternatives to the status quo. OSC staff were advised that subsequent to the Review Period, the industry committee had reached a conclusion as to the appropriate approach to be applied, subject to some further analysis.

OSC staff were also advised that, as at the end of the Review Period, a similar process had not commenced in relation to the development of a component of the fee model to recover costs associated with marketplace regulation, but that this would commence once the Dealer Member regulation component was near finalization.

***Staff findings***

At the time of our field review, IIROC was working towards the completion of an integrated fee proposal. OSC and other CSA staff will continue to monitor progress toward development of an integrated fee model on an ongoing basis.

***Staff recommendations***

None.

## **C. Restricted and Merger Funds**

### **1. Introduction**

T&C #9 of IIROC's ROs requires IIROC to ensure that all fines collected by IIROC, and all payments made under settlement agreements, may be used only as follows:

- (a) specified expenses as approved by the CGC, or
- (b) for reasonable costs associated with the administration of IIROC's hearing panels.

IIROC accounts for the collection and use of its fines and settlement payments separately in its Restricted Fund. The amounts included in the IDA's discretionary fund and RS's restricted fund were combined to become the IIROC's Restricted Fund on the merger effective date.

IIROC also maintains a Merger Fund for expenses relating to the creation of IIROC. Prior to the merger, the boards of directors of the IDA and RS had each approved funding of merger expenses (merger budget) from their discretionary fund and restricted fund respectively. Part of the approved merger budget was transferred to the Merger Fund, and the remainder of the approved merger budget will be transferred from the IIROC Restricted Fund as required.

### **2. Purpose and scope**

The purposes of this section are to:

- (a) understand and evaluate IIROC's process and internal controls over disbursements from its Restricted Fund and Merger Fund;
- (b) assess whether disbursements from the Restricted Fund since the merger effective date were in compliance with T&C #9 of IIROC's ROs; and
- (c) assess whether merger expenses funded from the Merger Fund appeared reasonable.

### **3. Controls over the use of the Restricted Fund**

#### ***Background information***

IIROC has put in place a Restricted Fund Policy, which outlines the principles for allocation of the Restricted Fund, the priorities for disbursement of the fund, the permitted uses of the fund, the process for reviewing third party proposals, and the approval process for disbursements.

According to the Chair of the CGC, each request for funding, whether initiated by IIROC management or an external party, must be in the form of a business proposal. It must identify how the project fits within the permitted uses, how the public interest will be advanced, the alternatives that were considered and the deliverables. The proposal must also include a budget. Each proposal will be presented to the CGC and the Board for approval.

Once a project has been approved, a copy of the CGC's resolution approving the project will be forwarded to the Finance and Administration Department, which is responsible for monitoring the actual disbursements of the Restricted Fund against the approved budget.

The General Counsel's Office (GCO) is responsible for monitoring the progress of third party projects. For each of these projects, there is a contract between IIROC and the external party outlining the purpose of the funding and the timing of deliverables. In some cases, the contracts also impose periodic reporting from the external party. For internal projects, management who initiated the projects is responsible for monitoring the progress of the project.

The Restricted Fund Policy also requires IIROC management to prepare annual status reports to the CGC and the Board to review ongoing and completed projects.

***Staff findings***

IIROC has formal processes for the approval and disbursements of fund from its Restricted Fund. Controls over disbursements also appear to be adequate. IIROC's Restricted Fund Policy is comprehensive and provides useful information with respect to the permitted uses, criteria to evaluate funding requests and the review and approval process.

IIROC management provide regular status reports to the CGC and Board on significant projects funded by the Restricted Fund.

***Staff recommendations***

11. IIROC management should provide status reports to the CGC and the Board on all projects funded by the Restricted Fund, at least annually in accordance with its policy. Such status reports are important tools to evaluate the success of each project funded and provide useful information for further funding decisions.

**Priority: Medium**

***IIROC's response:***

IIROC has implemented a process to provide an annual status report to the CGC and the Board on all projects funded by the Restricted Fund. The first such status report was provided in September 2010.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**4. Disbursements from the Restricted Fund**

***Background information***

OSC staff selected a sample of five projects that are being funded by the Restricted Fund. The sample included internally generated projects and third party projects. For each of the projects, IIROC provided the funding request that went to the CGC (or to the board of directors of the predecessor organizations), the resolution approving the funding, and the contract between IIROC and the external party if applicable.

### ***Staff findings***

Based on the review of the sample of projects, OSC staff noted that the funding was within the permitted uses of the Restricted Fund, adequate analyses were provided to support the funding requests, and proper approval was obtained from either the CGC or the board of directors of the predecessor organizations. We also noted that for third party projects, there are mechanisms (such as periodic reporting) to allow IIROC to monitor the use of funding and the progress of the project.

### ***Staff recommendations***

None.

## **5. Controls over the use of the Merger Fund**

### ***Background information***

Prior to the merger effective date, the board of directors of each of the IDA and RS had approved the maximum merger expenses that should be paid out of their discretionary fund and restricted fund respectively. Should additional amounts over and above the approved maximum be required to complete the merger, IIROC management is required to seek approval from the CGC. No such approval has been sought from management since the merger effective date.

Financial reports and budgets prepared by management identify separately the expenses that were or will be paid out of the Merger Fund. The process for budgeting and monitoring of the Merger Fund is consistent with that for the operating fund of IIROC.

### ***Staff findings***

OSC staff reviewed the minutes of the meetings of the board of directors of the IDA and RS prior to the merger effective date to determine the maximum merger budget that was approved by the respective boards. We noted that the RS Board had approved funding of 40% of \$8 million, i.e. \$3.2 million, and the IDA Board had approved funding of 60% of \$8.9 million, i.e. \$5.4 million, making the total approved merger budget of \$8.6 million. OSC staff, however, noted that IIROC is operating under the premise that the total approved merger budget is \$8.9 million, as indicated on the budget for the 10 months period ending March 31, 2009.

IIROC's GCO indicated that, when the IDA Board approved the funding for their portion of the \$8.9 million total merger expenses, they were aware that the RS Board only approved funding of total merger expenses of up to \$8 million; the IDA Board's resolution was, therefore, interpreted to mean that the IDA Board intended to fund the portion of the \$8.9 million that would not be funded by RS. There was no documentation that supports the IDA's agreement to provide an additional \$300,000 of funding.

### ***Staff recommendations***

12. IIROC should ensure that all approval for funding from the Restricted Fund are documented through minutes and resolutions of the CGC.

**Priority: Medium**

***IIROC's response:***

The background information and findings that precede this recommendation relate specifically to the merger fund. Prior to the merger, restricted / discretionary fund approvals were granted by the RS and IDA Boards, respectively. All funding of merger expenses was duly approved under the terms of RS and the IDA's respective recognition orders and documented at the time approval was given, prior to the merger.

Following the merger, IIROC has been very careful to ensure that all approvals of funding from the Restricted Fund are documented, including approval by the CGC and review by the IIROC Board.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**6. Disbursements from the Merger Fund**

***Background information***

OSC staff selected a sample of expenses that were paid from the Merger Fund during the period from the merger effective date to the end of the Review Period. For the selected expenses, we obtained source documents, such as invoices, to understand the nature of the expenses.

***Staff findings***

Based on the sample reviewed, the expenses appeared to be related to the merger and it is not unreasonable that they were paid out of the Merger Fund.

***Staff recommendations***

None.



## **D. Policy**

### **1. Introduction**

IIROC's policy department is currently split between Member Regulation Policy (formerly IDA policy) and Market Regulation Policy (formerly RS policy). The two policy groups are to be fully integrated in the future.

IIROC is required under T&C# 8(a) to set rules governing its members and others subject to its jurisdiction. IIROC is also required to establish and maintain rules that, among other things, are necessary or appropriate to govern and regulate all aspects of its functions and responsibilities as a self-regulatory entity, are designed to promote the protection of investors, and are not contrary to the public interest.

In addition, IIROC must comply with the process for filing and obtaining Commission approval for its By-laws, rules and any amendments to its By-law or rules as outlined in the Joint Rule Protocol. We note that prior to the merger, the IDA and RS each had their own rule protocols to follow.

IIROC's policy department monitors the effectiveness of IIROC's rules and recommends changes where appropriate, and drafts new or amended rules, along with notices and bulletins to IIROC members to assist them with the interpretation and application of IIROC rules.

### **2. Purpose and scope**

OSC staff's primary objectives were to determine whether IIROC has adequate processes and resources to ensure that policy issues are identified and addressed on a timely basis and to assess the effectiveness of the rule development process and the compliance of IIROC, IDA and RS with their respective Joint Rule Protocols and to assess IIROC's progress on the integration of the two policy groups.

To accomplish these objectives, OSC staff reviewed IIROC's internal policies and procedures documents and met with Member Regulation Policy and Market Regulation Policy management to discuss IIROC's rule making processes and procedures and the steps taken to integrate the policy groups.

### **3. Department organization and reporting structure**

#### ***Background information***

OSC staff reviewed the organizational chart of the policy groups provided by IIROC and interviewed management in both policy groups to discuss their reporting structure.

Each policy group has a Director that reports to a Vice President (VP) who in turn reports to the Senior Vice President of Enforcement, Policy and Registration (SVP ERP). Staff of the Member Policy group report to the Director of Member Policy, while the legal counsel in Market Regulation Policy is overseen by the VP of Market Regulation Policy.

### ***Staff findings***

At the time of the Review Period, the Market Regulation Policy group consisted of one senior legal counsel and one Director that both report to the VP of Market Regulation Policy. The Member Regulation Policy group consisted of two information analysts that report to a specialist; the specialist, two policy counsel and a committee coordinator report to the Director who in turn reports to the VP of Member Regulation Policy.

OSC staff noted that both policy groups have a reporting structure that establishes appropriate accountability.

### ***Staff recommendations***

None.

## **4. Integration of Policy Groups**

### ***Background information***

OSC staff reviewed the Integration Project Outline dated July 24, 2009 to get a better understanding of the progress towards the integration of the previous RS and IDA policy departments. The Integration Project Outline sets out the tasks to be completed to accomplish integration, as well as the expected timelines for their completion.

### ***Staff findings***

OSC staff note that as of the beginning of the oversight review, most of the integration steps as outlined in the Integration Project Outline dated July 24, 2009 had not been completed and that a majority of these steps are behind the stated deadline with one step still yet to be determined. For example, integrated budgets and a consolidated list of policy priorities were to be completed in the fourth quarter of 2008 but had not been done. The plan to bring staff together in a single premises is still to be decided.

### ***Staff recommendations***

13. OSC staff encourage IIROC to accomplish the tasks in the Integration Project Outline on a timely basis to ensure consistent practices between the Market and Member Regulation Policy groups.

**Priority: High**

### ***IIROC's response:***

As at April 2010, the Policy Department has completed all tasks. This status update was provided at the April 20, 2010 CSA/IIROC quarterly in-person meeting.

Specific to the issue of integrated budgets, the update indicated that the Market and Member Regulation Policy groups continue to maintain separate budgets in order to ensure that the costs of Dealer Member and Marketplace regulation are not commingled, but that the Policy Department's combined budget is overseen by the Senior Vice President, Enforcement, Policy and Registration. As such, the Senior Vice President is able to ensure that each policy group's budget is adequate to discharge their respective

responsibilities.

At the time of the merger, IIROC management determined that it would have been unnecessary and, in fact, not feasible to bring Policy staff together in one premises. As noted in the staff finding, IIROC is reviewing this decision in light of present circumstances.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**5. Interaction with other IIROC departments and regulators**

***Background information***

OSC staff discussed with management of both policy groups their processes regarding the communication and collaboration between the two policy groups themselves, and the communication of each policy group with other IIROC departments.

***Staff findings***

*Communication between the Policy Groups*

There has been some communication and collaboration between the two policy groups since the merger. The two groups have been working together on overlapping rules to create a consolidated IIROC rule book and have used this as an opportunity for cross-training.

*Communication with other IIROC Departments*

When drafting rules, Member Regulation Policy staff consult with other IIROC departments if the subject matter of the policy initiative falls in their area. This consultation will usually consist of asking the other department staff for their comment on specific initiatives.

Material prepared by Market Regulation Policy staff respecting an amendment or guidance is circulated to IIROC management and staff including, the SVP Surveillance and Compliance, the VP Surveillance, the Director of Trading Review and Analysis, the Director of Market Supervision, the Manager of Trading Conduct Compliance and the members of any working group established by the Executive Management Team.

A Market Policy Implementation Committee (MPIC) is to be struck shortly that will consist of members from a variety of IIROC departments, including Member Regulation Policy, to discuss market policy issues. MPIC is expected to serve as a forum for further input from the other departments within IIROC.

***Staff recommendations***

14. We support the implementation of the MPIC and ask that IIROC report to OSC staff in its final response when this committee is struck.

**Priority: Medium**

***IIROC's response:***

IIROC management is committed to operational department input into the policy development process. In line with this commitment, the Market Policy Implementation Committee (MPIC) was struck in Q1 of FY10. To ensure MPIC satisfies its objectives in an efficient manner, IIROC management continues to monitor and amend, as appropriate, the terms of reference for MPIC.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**6. Policy committees**

***Background information***

OSC staff reviewed the mandates and the composition of each of the Compliance and Legal Section (CLS), the Education and Proficiency Committee, the Financial Administrators Section, the Fixed Income Committee, the Market Rules Advisory Committee (MRAC), the Committee on Retail Investor Issues and the NAC to get an understanding of the policy areas each committee covers in order to determine how these committees are filled, the policy issues they discuss and how they operate.

OSC staff reviewed the list of policy committees and sub-committees that were disbanded as a result of the merger and the reasons for doing so. OSC staff also reviewed the list of committees that were discontinued after the merger and the reasons for discontinuation.

OSC staff also reviewed the agendas for the CLS and MRAC meetings to get a sense of the items discussed at these meetings and to determine if there are any items that the committee itself puts forward for discussion. A sample of minutes of various policy committees were reviewed in connection with OSC staff's file review (see section 11 for further details).

In addition, we interviewed the VPs of both policy groups and reviewed the processes for consulting with the various standing policy committees as set out in the Member and Market Manuals to understand the role these committees play in the policy development process.

***Staff findings***

The policy committees appear to cover all important policy areas and provide feedback on policy issues brought before them.

***Staff recommendations***

None.

## 7. Staffing resources and training

### *Background information*

#### *Staffing resources*

OSC staff interviewed management to get their sense of the adequacy of staffing levels in their respective groups and understand the processes of how staffing levels are monitored. Staff also looked at the turnover rates of each policy group and the list of open positions in each group provided by IIROC to gain a better understanding of the staffing levels of each group over the Review Period.

Both VPs indicated that they believe they have adequate resources to complete the core functions of their respective policy groups. As well, both groups consider staffing levels on a regular basis.

#### *Training*

OSC staff also interviewed management of both policy groups to better understand the training processes that are used for new hires and on-going training that is provided to current employees.

### *Staff findings*

#### *Staffing Resources*

We had no concerns with the staff level in Member Regulation Policy, but found that the Market Regulation Policy group did not have sufficient staff during the Review Period. For example, we found that there was a total of 45 projects assigned to three staff members. OSC staff also note that at present, there is an extensive reliance on the VP of Market Regulation Policy to shoulder the majority of the group's workload. While we acknowledge that some of these projects may be related, OSC staff question the sufficiency of resources in the Market Regulation Policy group. We acknowledge that IIROC was planning to hire additional staff to address this issue and that, since the Review Period, the group has in fact increased its staffing complement.

#### *Training*

Both Member and Market Policy Manuals aid in the training of new hires in both policy groups. New hires are also typically provided a mentor when assigned a particular project.

On-going training usually consists of courses and conferences organized by external parties. Staff may indicate an interest in a particular course or conference and receive approval from the VP of their group in order to attend.

### *Staff recommendations*

15. We note that, at the time of our review, there was a plan to hire additional staff in the Market Regulation Policy group to help assist with the current workload and we believe that this should address the current staffing resource issue. However, given the relatively new staff that comprise the rest of the Market Regulation Policy department, OSC staff recommend that steps should be taken to ensure appropriate succession planning of the VP of Market Regulation Policy.

**Priority: High**

#### *IIROC's response:*

Since the completion of the initial CSA oversight review field work, IIROC has hired two additional senior staff to work in the Market Policy group. Non-administrative staff in the Market Policy group now

total four persons, consisting of the Vice President, the Director, the Senior Policy Counsel and the Senior Policy Analyst. These individuals collectively provide IIROC with good mix of talent to draw upon in the development of market policy.

Succession planning is an overall corporate objective and a priority of IIROC's Executive Management Team (EMT). The EMT regularly reviews its succession plans for the groups / departments within IIROC.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **8. Policies and procedures**

### ***Background information***

OSC staff interviewed the VPs of each policy group to determine the processes followed when developing and approving a rule. The most recent version of the written Policy Manuals for each group was also reviewed. The Director of Member Regulation Policy indicated that the latest versions of the manuals for each policy group were prepared in tandem where each group compared what content would be included in each Policy Manual.

### ***Staff findings***

On the whole, the written policies and procedures are extensive and provide a good background on the role of IIROC as an organization, the role of the policy groups and detailed procedures with respect to the development of policy within the groups.

OSC staff noted, however, that there are differences between the steps in the rule development process as outlined in the Member and Market Policy Manuals. Specifically, the steps outlined in the Policy Manuals with respect to going to the board for approval are not the same, the steps after material changes are made to a proposal are different and the indicated minimum time for comment are not consistent.

In addition, we found that:

- neither Policy Manual included a description of what steps need to be taken before agreeing to terms and conditions as suggested by the CSA and how to keep track of them;
- the Policy Manuals did not contain information regarding the timing of when a summary of public comments and responses from IIROC staff should be provided to the principal regulator;
- neither Policy Manual set out the process to be followed for the immediate implementation of a rule or rule change;
- the Market Policy Manual did not include a description of the process for translating required documents in French or for providing UMIR interpretations; and
- the Member Policy Manual did not indicate the possibility that an advisory committee may also be consulted in the event a material change is made.

***Staff recommendations***

16. For consistency, OSC staff recommend that if possible, one policy manual be developed and at the very least there should only be one policy development process that is followed by both policy groups.

**Priority: High**

***IIROC's response:***

Immediately following the creation of IIROC in 2008, Member Regulation Policy and Market Regulation Policy staff began work to harmonize the policy development process for Dealer Member and Marketplace policy. The results of this harmonization work were in turn documented in each of the policy manuals for Market Regulation Policy and Member Regulation Policy. However, in a few instances, some of the updates were missed.

Both policy manuals have now been updated to ensure that the policy development processes are consistent. The differences that remain between the two processes are specific to the different internal staff and external advisory committee consultation processes that are used in the development of Dealer Member and Marketplace rules.

As a next step, a combined policy manual will be developed to document common policy development processes. This combined manual will also separately discuss the distinct processes that are used to consult with internal staff and external advisory committee consultation in the development of rules.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff ask to be notified upon IIROC's completion of the combined policy manuals.

17. OSC staff recommend that the Member and Market Policy manuals be revised to address the findings identified above.

**Priority: Medium**

***IIROC's response:***

Regarding the finding that the steps involved in bringing policy proposals to the IIROC Board for approval are not the same for both the Market Regulation and Member Policy teams, the only difference is that one of the policy manuals contained a chart that referred to an internal IIROC staff consultative committee that no longer exists. This chart has been updated by removing the reference to this committee. The steps involved in bringing policy proposals to the IIROC Board for approval are now the same in each manual.

Regarding the finding that some of the policy development steps differ after material changes are made to a proposal, the only difference identified between the two manuals is that the Market Regulation Policy manual indicated that policy committees are always consulted when a material change to a rule proposal is made while the Member Regulation Policy manual did not indicate whether an advisory committee would be consulted when a material change to a rule proposal is made. Both manuals have been revised to indicate that when material changes are made to a rule proposal, internal staff consultations and advisory committee consultations are optional, but senior management and IIROC Board review and

approval are mandatory.

Regarding the finding that the indicated minimum time for comment is not consistent, one of the policy manuals indicated that the public comment period was “at least 60 days” whereas the other indicated that the comment period could be “30, 60 or 90 days”. The IIROC policy is that the default comment period for a rule amendment proposal is 60 days, but this period can be either lengthened or shortened depending upon the relative importance and/or complexity of the proposal. Both manuals have been updated to reflect this IIROC policy.

Regarding the finding that neither policy manual included a description of the steps to be taken before agreeing to CSA terms and conditions and how to track these terms and conditions, the imposition of CSA terms and conditions on rule approvals is an infrequent occurrence that has been dealt with, to date, in the same manner as CSA rule approvals that are subject to rule wording revisions. In other words, if the CSA’s terms and conditions are not considered to be material, IIROC staff may agree the terms and conditions without further consultation with the IIROC Board; if the terms and conditions are material, they must be agreed to by the IIROC Board before the related rule amendments can be implemented. As to the tracking of compliance with CSA approval terms and conditions, this is currently done by adding any CSA terms and conditions to the Policy department’s project database as a new project to be completed within the CSA imposed deadline. These current processes have been documented in a new section in both of the policy manuals.

Regarding the finding that the policy manuals did not contain information relating to the timing of when a summary of public comments and responses from IIROC staff should be provided to the principal regulator, these procedures have now been documented in each of the policy manuals. To respond to the CSA staff preference to receive our consolidated response to public comments prior to CSA staff providing their comments, the procedures indicate that: (1) CSA staff will be provided with our draft consolidated response; and (2) a final response will be issued once IIROC staff have received and responded to CSA staff comments.

Regarding the finding that neither policy manual sets out the process to be followed for the immediate implementation of a rule or rule change, this process has never been required by Member Regulation Policy staff, as an immediate implementation Dealer Member Rule has never been pursued. Market Policy staff have adopted an immediate implementation rule on one occasion. The procedures for adopting an immediate implementation rule have now been documented in each policy manual.

Regarding the finding that the Market Policy Manual did not include a description of the process for translating required documents into the French language, this process, currently documented elsewhere, has been added to the Market Policy Manual.

Regarding the finding that the Market Policy Manual did not include a description of the process for providing UMIR interpretations, this process, currently documented within the staff job descriptions appendix to the Market Policy Manual, has been added as a separate section within the Market Policy Manual.

***Staff comments and follow-up:***

IIROC’s response is adequate. No further action is necessary.



## **9. Issue identification and process for rule development**

### ***Background information***

OSC staff interviewed management of both Member and Market Regulation Policy to discuss how regulatory matters and emerging industry trends are identified, how policy projects are prioritised and addressed and whether and how alternatives are considered and evaluated.

### ***Issue Identification and Prioritization***

Issues in the Member Regulation Policy group are identified mostly by staff. Developments in other jurisdictions such as the U.S., U.K. and Australia are reviewed. Field examinations and questions from the dealer community may also identify issues to be reviewed.

The Market Regulation Policy group regularly reviews a variety of websites and scans for international market structure developments, particularly in the U.S. and U.K. Some issues are also identified through the MRAC, complaints regarding trading activity, trade desk reviews and investigations and enforcement actions. Issues may also be identified by marketplaces and other regulators.

The Emerging Regulatory Issues Group, made up of members from a variety of departments within IIROC, meets to discuss industry trends and may specify follow-up action to be taken to address issues discussed.

In order for a new rule or amendment to receive a “high” priority, it must be approved by the Executive Management Team. The priorities of the other files are reviewed on a regular basis.

### ***Rule Development***

IIROC’s philosophy is to apply a risk based approach to dealer and market regulation and to consider whether alternatives to rule changes are appropriate. The management of both policy groups indicated that alternatives are considered when determining how to best address a regulatory issue at hand.

### ***Staff findings***

OSC staff had no concerns with the rule development process. We found that file status is tracked separately by each group using a chart and, in general, the process and timeliness of rule development appears to be reasonable.

### ***Staff recommendations***

None.

## **10. Granting of exemptions and provision of interpretations**

### ***Background information***

OSC staff interviewed management to determine the processes for granting exemptions from, and providing interpretations to, IIROC rules. OSC staff also reviewed the related processes contained in the Policy Manuals of each group. OSC staff note that the Member Policy group does not provide exemptions to Dealer Member rules, however other groups within IIROC may provide such exemptions.

***Staff findings***

OSC staff found that the Market Policy Manual includes a description of the processes for granting exemptions, however it does not outline the process for providing interpretations of UMIR.

We also found that the process for providing interpretations to IIROC Dealer Member rules is adequately set out in the Member Policy Manual, but noted that there is no central database where precedents of interpretations are stored. We noted, however, that the Policy Interpretations Database for the Member Policy group is due to be implemented in the near future, so that Member Policy and other IIROC staff can refer to it when providing interpretations of IIROC rules.

***Staff recommendations***

18. OSC staff recommend that the Policy Manual should describe the process for providing interpretations of UMIR and explain when Market Policy staff should consult with the VP of Market Regulation Policy before providing an interpretation.

**Priority: Medium**

***IIROC's response:***

The job descriptions of the individuals providing UMIR interpretations set out the process for providing exemptions and interpretations. The job descriptions are currently included in the Market Policy Manual as an appendix. The Market Policy Manual has been updated to include specific discussion of the process.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

19. OSC staff also recommend that interpretations of UMIR should be stored in a central database for future reference. IIROC should consider leveraging the Member Policy Interpretations Database for such purpose.

**Priority: Medium**

***IIROC's response:***

The practice of Market Regulation Policy is to follow up material or significant interpretations of UMIR with the issuance of a Guidance Notice, which is subsequently included in the annotated version of UMIR. Additionally, Market Regulation Policy staff ensure that they bring significant interpretations to the attention of affected operational staff.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## 11. Review of files

### *Background information*

OSC staff reviewed eight Member Regulation Policy files and four Market Regulation Policy files for new or amended regulatory instruments. OSC staff also reviewed the statistics of proposed new or amended regulatory instruments that were submitted to the CSA for approval during the Review Period for completeness of submissions to the CSA.

### *Staff findings*

OSC staff noted that documentation found in the files reviewed was lacking in certain instances. For example:

- documentation of what was done to track any terms and conditions of approval imposed by the CSA was not always included; for example, one Member Policy file where a CSA condition was imposed contained no documentation of whether this condition was ever met, and a Market Policy file where a request to provide a report had been imposed by the CSA upon approval did not document if this request was being fulfilled; and
- there was also inconsistency among the files regarding the documentation of secondary reviews.

OSC staff's file review also showed that:

- certain rules were implemented after a lengthy period of time from the date of the approval by the recognizing regulators; and
- in one of the Member Policy files reviewed, the Board notice and materials submitted to the CSA did not contain an adequate amount of analysis for the purposes of eliciting meaningful comments; for example, the notice did not include any commentary regarding the risk impact of a proposed decrease in margin rates.

### *Staff recommendations*

20. IIROC should ensure policy files are properly documented; such documentation should include: the research conducted; any alternatives that were considered and a record of why they were rejected; the rationale for the proposed new rule or rule amendment; evidence of secondary review; and how any terms and conditions of approval are monitored.

**Priority: High**

#### *IIROC's response:*

Both the Member and Market Policy teams ensure that all CSA terms and conditions are noted, tracked and addressed on a timely basis.

To address the documentation finding, we have developed a file documentation checklist which must be completed before a policy file can be closed. The checklist addresses documentation of the following items: (1) summary of research conducted and/or identification of background research files, (2) summary of advisory committee consultations and/or identification of relevant advisory committee files, (3) rulemaking alternatives considered and why they were rejected, (4) rationale as to why proposed rule amendment is being recommended, (5) internal rule reviews and approvals received, (6) summary of and

response to public comments received, (7) summary of and response to CSA staff comments, (8) CSA approval received, including the process to be followed in complying with any approval terms and conditions, and (9) rule implementation timing, including the rule implementation period provided.

In instances where documentation is stored separately from the policy file, or the documentation is otherwise readily available from a public source, the separate storage location/public source will be noted on the checklist.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

21. OSC staff recommend that all memos to the Board include all salient information to support the rationale for a new rule proposal or amendment.  
**Priority: High**

***IIROC's response:***

IIROC agrees that all memos should include all salient information and believe that we do so.

This finding relates to proposed minor amendments to IIROC's new approach for margining equity securities. Rule amendments regarding this new margining approach had previously been approved by the CSA as an IDA proposal in 2006 and portions of these amendments were awaiting CSA approval as a separate IIROC proposal.

As a result, at the time the proposed minor revisions were developed, there was already one existing proposal awaiting CSA approval relating to the margining of equity securities. IIROC staff therefore summarized the analysis in the proposed minor revisions submission (the second submission) in order to avoid repeating the detailed analysis set out in the first submission. IIROC agrees that each rule amendment submission include all salient information to support the rationale of the proposed rules amendment, even when one proposal is seeking to modify the language of another proposal, and IIROC staff have modified their approach in these rare instances accordingly.

***Staff comments and follow-up:***

IIROC's response is adequate. We will monitor the implementation of this recommendation through our reviews of IIROC rule proposals.

22. IIROC should closely track rules once approved by the recognizing regulators in order to ensure timely implementation of all new rules or amendments. We acknowledge that IIROC has recently established such a process.  
**Priority: High**

***IIROC's response:***

IIROC agrees that it is important to track the status of rules, during their development and public comment and approval period, as well as once approved. Toward that end, an electronic database designed to track the status of policy projects was launched in the Policy area in June 2009. The database

tracks the priority and status of all policy projects and is used to assign and prioritize staff work assignments, track key project documents and track rule development, approval and implementation status.

Monthly rule status reports, derived from this database, are also produced by both Member Regulation Policy and Market Regulation Policy to assist senior management in assessing each policy team's performance and priorities.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **E. Enforcement**

### **1. Introduction**

T&C #8 of the OSC RO requires IIROC to monitor compliance with its rules and securities laws by its Members and others subject to its jurisdiction. It also requires IIROC to enforce compliance with its rules. T&C #8 requires IIROC to administer, monitor and/or enforce rules pursuant to a Regulation Service Agreement between IIROC and an exchange or a quotation and trade reporting system (QTRS) if retained by the exchange or QTRS.

The OSC RO also establishes certain reporting and notification requirements to the OSC related to the enforcement functions that IIROC performs. For example, T&C #8 requires IIROC to provide notice to the Commission of any violations of securities legislation of which it becomes aware. T&C #10 requires IIROC to notify the Commission, the public and media of specifics of disciplinary and settlement hearings and the terms of each settlement and the disposition of each disciplinary action once the terms or disposition is determined. Detailed reporting requirements from IIROC to the Commission are set out in Schedule 2 to the OSC RO.

IIROC's Enforcement department is responsible for enforcing compliance with IIROC's rules. The department is organized into three main groups, described below.

The Case Assessment group (Case Assessment) is principally responsible for handling public inquiries and complaints, for assessing referrals from various sources, including other regulatory organizations or provincial securities commissions, assessing whether IIROC has jurisdiction to deal with matters and, where necessary, for escalating cases to the Investigations group (Investigations).

Investigations conducts investigations of IIROC Dealer Members and their approved persons, as well as marketplaces and access persons. Files may be closed in Investigations with no action, closed with a caution letter, referred to other agencies (such as the police or a securities commission) or referred to IIROC's Litigations Group (Litigation). Investigations staff also provide support for matters proceeding to a hearing.

Enforcement Counsel conduct disciplinary proceedings against IIROC Dealer Members and their approved persons, as well as marketplaces and access persons. Enforcement counsel are assigned to each investigation file and provide advice during the course of investigations. They also act as counsel representing IIROC appearing before IIROC District Councils which preside over IIROC disciplinary proceedings.

The Enforcement Department also includes the Intelligence & Analysis group, which maintains intelligence analysis tools and intelligence information and provides support to other Enforcement staff.

### **2. Purpose and scope**

OSC staff's primary objectives during the oversight review were to assess the structure, staffing and resources of IIROC's Enforcement department, and to assess whether the manner in which it conducts its functions raised any concerns and whether it complies with the applicable T&Cs of recognition. As part of this assessment, OSC staff also reviewed and assessed the progress made in the integration of the

enforcement activities previously conducted by each of RS and IDA prior to their merger in 2008. OSC, NBSC and NSSC staff also reviewed samples of files opened and closed by Enforcement staff of IIROC's Toronto office to assess the adequacy of work performed by IIROC staff.

### **3. Department organization and reporting structure**

#### ***Background information***

The organizational structure for IIROC's Enforcement activities is both national and regional. The SVP ERP, who reports directly to IIROC's CEO, is ultimately responsible for IIROC's national Enforcement functions. The Enforcement-related reporting lines to the SVP ERP are as follows:

- in Toronto, the VP Enforcement in the Toronto office reports directly to the SVP ERP
- in Calgary and Vancouver, the VP Western Canada has ultimate decision-making for Enforcement-related matters for the Western Provinces and the Territories of Canada and reports to the SVP ERP for Enforcement related matters; the SVP ERP participates in a consultative capacity with a view to ensuring consistency among files
- in the Montreal office, the VP Quebec has ultimate decision-making for enforcement related matters in Quebec and reports to the SVP ERP for Enforcement related matters; the SVP ERP participates in a consultative capacity with a view to ensuring consistency among files.

A number of processes are in place to ensure consistency of the processes and decisions made by each IIROC office. For example, there are weekly Enforcement management meetings, monthly meetings to review sensitive Enforcement files, and direct meetings between the VPs and the SVP ERP.

In IIROC's Toronto office, which is principally responsible for Ontario and Atlantic Region Enforcement activities, three positions report to the VP Enforcement:

- the Director of Investigations;
- the Director, Enforcement Litigation; and
- the Manager of Intelligence and Analysis.

#### ***Staff findings***

As set out above, IIROC has three separate (but related) decision-making centres for Enforcement-related matters. There is, however, extensive cross-consultation to ensure consistency of decisions made and processes followed by each IIROC office.

Given this context, and mindful of the high level of cross-regional consultations, OSC staff are generally satisfied that IIROC's Enforcement department has an adequate reporting structure that establishes appropriate accountability to IIROC's regional offices.

#### ***Staff recommendations***

None.

#### **4. Technology**

##### ***Background information***

IIROC's Enforcement Department uses five main technology systems, as follows:

- the Case Tracking System (CTS), a networked electronic database used for tracking and documenting cases;
- the Complaints and Settlement Reporting System (COMSET), a web-based system used by IIROC Dealer Members to report matters required by IIROC Rule 3100 *Reporting and Recordkeeping Requirements*; these may be complaints, securities-related settlements, civil claims, judgments and arbitrations;
- the Universal Business System Solution (UBSS), used for time tracking; and
- the Intelligence Reference Indexing System (IRIS), a legacy database containing historical information about individuals and other persons which is used as a source of background information by IIROC Enforcement staff.

In addition, IIROC staff used, until March 31, 2008, Magellan, a database with information on individuals used by the Intelligence and Analysis group to assist in providing background information to the Enforcement and Registration departments. Former RS investigators have access to Citrix and Lotus, a system previously used by RS before the merger and which provides investigators access to files and also a suite of applications for analyzing marketplace files. Access to Lotus is currently limited to investigators responsible for marketplace files, but IIROC plans to provide all other investigators with access to analytic tools for marketplace analysis in the near future.

OSC staff discussed the systems used in Enforcement with IIROC staff and viewed demonstrations of some of these systems.

##### ***Staff findings***

Subject to the comments below, OSC staff found that the technology systems used by IIROC's Enforcement department supported the various functions performed in this department. The systems also allow for an appropriate level of monitoring by management; for example, CTS is used to monitor Enforcement cases and has reporting functionality. COMSET is an effective tool for monitoring complaints respecting Dealer Members and their Approved Persons and is used by many IIROC departments and has reporting functionality. Recent enhancements now enable Dealer Members to print reports from their COMSET data.

However, OSC staff were concerned that CTS cannot adequately prevent inadvertent modification of documents and data, including after files are closed. As IIROC staff were concerned that the integrity of data on CTS could have been compromised if changes were made inadvertently, OSC staff were not provided unobstructed access to CTS and the electronic records of investigation files that were selected for testing. We note that the last oversight review report also included a finding and recommendation that CTS be enhanced to prevent modification of data after files are closed; in response, the (then) IDA noted that, while CTS allows for ongoing modification of files, it did nonetheless maintain an electronic audit trail of all changes made to electronic records, so IDA staff made no further changes to the system.

OSC staff also found that the documents recorded on CTS for any specific Enforcement investigation file do not reflect and do not make reference to all of the documentation in the file; this may include paper documents, such as documentation produced by Dealer Members or Approved Persons in the course of an



investigation, third-party correspondence, and the investigator notebook. OSC staff noted that the lack of a central place to track all the information related to investigation files may make it difficult to efficiently oversee the workflow and documentary contents of specific files, and can also make it difficult to transition a file from one staff member to another.

***Staff recommendations***

23. Given most investigation files are in electronic form, IIROC should consider how CTS can be modified to ensure that files content and documents will not be modified after the files are closed.  
**Priority: High**

***IIROC's response:***

The Enforcement department has requested that the IT department add a “marker” to closed files so these documents cannot be modified after the files have been closed on CTS.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff ask to be notified when this task is complete.

24. IIROC should consider using CTS as the principal location to document and store all key documents and information relating to files. This would ensure completeness of enforcement files, would facilitate transition of files to other staff and would also facilitate the making of appropriate and timely disclosure on matters that eventually proceed to a hearing.  
**Priority: Low**

***IIROC's response:***

CTS is the Enforcement department's principal document storage location. All key documents are uploaded to CTS by Enforcement staff. IIROC will remind staff that it is critical that all key documents related to a file be placed in CTS. IIROC does not have the functionality to upload all disclosure documents onto CTS and for large files has, historically, used outside electronic database services to create and store file documents that will serve as disclosure in regulatory proceedings. The use of this service has enabled Enforcement to provide timely disclosure to respondents.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**5. Integration of the IDA and RS Enforcement departments**

***Background information***

Since June 1, 2008, the effective date of the merger of IDA and RS, through to present, IIROC took a number of steps to integrate the operational procedures of the member conduct investigation activities previously conducted by IDA investigators and the marketplace investigations previously conducted by RS investigators. For example, both groups now share the same benchmarks, have the same reporting structure, are physically located beside each other, and use the same file management system.

### ***Staff findings***

Staff believe that IIROC took some positive steps to integrate the processes and operational procedures of activities conducted by Enforcement staff of IIROC's predecessor organizations. Staff identified, however, areas where IIROC could take steps to further integrate the former IDA and RS Enforcement departments. Please refer to the findings and recommendations in section 8.2 for further detail.

### ***Staff recommendations***

See recommendation in section 8.2.

## **6. Interaction and communication with other IIROC departments**

### ***Background information***

The Enforcement department interacts on an ongoing basis with other IIROC departments, including FinOps; BCC; TR&A; Registration; and Policy. The interaction may be for the purposes of case referral, or just to maintain an ongoing dialogue with a view to sharing information about trends and emerging issues.

In addition, the Enforcement department also participates on inter-departmental committees: the Emerging Regulatory Issues Committee, consisting of representatives of the Surveillance, Compliance and Policy groups which meets to discuss emerging issues, risks and trends and how to best position IIROC to prepare for them; the Strategic Issues Committee, where IIROC senior management discusses matters that affect IIROC's ongoing work, including resource allocation and ongoing trends; and the Executive Management Team, which meets on a regular basis to discuss trends, risks, resources and other issues facing IIROC.

In addition to obtaining an understanding of Enforcement's processes to communicate and interact with other groups, OSC staff also reviewed statistics showing the number of files referred to Enforcement by other IIROC departments to get an understanding of the number and types of cases sourced in this fashion.

### ***Staff findings***

OSC staff found that there were processes in place to facilitate interaction between Enforcement and other departments.

However, OSC staff's review of statistics relating to the source of investigations files suggest that there is a limited degree of cross-referral to Investigations from other IIROC departments. For example, staff's review of statistics showing the sources of investigation files shows that, while approximately 30% of cases have their source in COMSET, less than 9% are generated by referrals from other IIROC departments, such as BCC or FinOps. As a result, the Enforcement department has a strong retail focus, but there is an opportunity for IIROC to broaden the scope of its Enforcement activities to other activities such as corporate finance, institutional trading and research.

OSC staff also noted that, once a file is referred to Enforcement by other departments, such as the Compliance groups, IIROC's policy is to limit the communication between the departments. That is, the

Enforcement department will contact staff from the Compliance departments as necessary to gather more information, but there are no periodic update meetings between Enforcement and the groups that originated the referral to discuss status of the file.

***Staff recommendations***

25. IIROC should consider whether there is opportunity to strengthen its compliance-enforcement continuum by using findings from regulation by other departments as sources of investigations. IIROC Enforcement management should consider integrating data from IIROC's Risk-Based Member Scorecard for the purpose of, for example, identifying potential areas of Member operations to be investigated and better informing areas of risk relating to investigation files that are opened through other means.

**Priority: High**

***IIROC's response:***

All IIROC departments have standard practices for referrals to Enforcement. When a referral is made to Enforcement, staff review the findings contained in the referral as a source of potential investigations. IIROC recognizes the importance of eliminating silos that may exist between departments in order to better manage data created within the organization as a potential source for enforcement action. Enforcement recognizes the need to share information with departments to enhance its ability to source out emerging issues. To this end, Enforcement has granted other departments access to CTS.

Enforcement is creating a Departmental Referral Liaison. Enforcement staff will be responsible for improving the referral process with other IIROC departments, including means to better utilize existing data for referrals to Enforcement.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request further particulars as to the processes underlying the Departmental Referral Liaison framework, when completed.

26. IIROC should undertake a review of the interaction between Enforcement and other IIROC departments to identify whether the flow of referrals and information-sharing regarding specific referrals could be enhanced.

**Priority: Medium**

***IIROC's response:***

IIROC undertakes to review the interaction between Enforcement staff and other IIROC departments to strengthen and enhance the referral process and information sharing. IIROC will complete a review of referral protocols by March 31, 2011. As stated in IIROC's response to Recommendation 25 above, Enforcement is creating a Departmental Referral Liaison. Senior staff will be charged with improving the referral process with other IIROC Departments, including means to better utilize existing data for referrals to Enforcement.

As noted in finding 25, the Enforcement department recently provided access to CTS to Registration, BCC and FinOps, and plans to provide TCC access to CTS by year end. This access will permit staff in these departments to view enforcement matters which will enhance information sharing with other

departments.

Additionally, Enforcement has undertaken a review of its case selection criteria. As part of this project, staff are reviewing the criteria for internal department referrals to Enforcement, and believe that the new case selection criteria should assist IIROC staff in other departments in better understanding when a referral should be made to Enforcement... To this end, all IIROC Departments will receive a copy of the new case selection criteria once they have been approved by senior IIROC management.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request to receive a summary of the findings arising from IIROC's review of referral protocols that is expected to be completed by March 31, 2011, as well as of the findings from IIROC's review of the revised case selection criteria and the criteria for internal department referrals to Enforcement.

**7. Case Assessment**

**7.1 Benchmarks**

***Background information***

The benchmark used by IIROC's Case Assessment is to complete 80% of the cases within 75 days from the date of receipt of the complaint. Completion occurs when the case is closed in Case Assessment or escalated to Investigations. Benchmark reports are generated on a monthly, quarterly and annual basis for senior and executive management's review. Enforcement managers and directors can also use the reporting functionality on CTS to generate their own benchmark reports as needed, on a daily, weekly or monthly basis, for monitoring performance. The Case Assessment Manager examines the group's performance on a regular basis by monitoring the progress of files against the 75 day target.

***Staff findings***

OSC staff reviewed the performance of the Toronto's Case Assessment group against the benchmark and found that the benchmark was met and exceeded for the calendar years 2006, 2007, and 2008. For the period January to August 2009, only 76% of the files were closed in less than 75 days. This was due to a temporary staffing shortage and to the increase in volume of cases received (the group experienced an increase of 30% in the cases received between December 2008 to the summer of 2009). OSC staff had no concerns with the performance of the group, as it was still close to meeting its benchmark, despite this shortfall.

***Staff recommendations***

None.

**7.2 Staffing and training**

***Background information***

Toronto's Case Assessment group consists of a Manager, five full time Case Assessment Officers

(CAOs), one of which is on contract, and an assistant. The group handles complaints for the Ontario and the Atlantic provinces. IIROC's Montreal Office handles complaints for Quebec, and the Prairie Region Office handles complaints for the provinces located West of Ontario. In management's view, the group was at full complement at the time of the field review.

During the review, three Case Assessment staff members left the department: two CAOs left in 2009 and an Enforcement Assistant in 2008. To help manage the workload, including the increased volume of cases, a temporary staff member was hired, and some cases were sent to other Case Assessment groups at other IIROC offices for review. Generally, the average number of files assigned to each CAO is approximately 20, but more recently each CAO was assigned between 30 and 35 files to deal with the increased volume of files. The Manager may also work on cases, especially the more complex ones. This happens less often now that the group is at full complement.

CAOs usually have industry experience, either in compliance or in customer service at dealer member firms, or from other regulators. All of the CAOs completed the Canadian Securities Course. They may also complete other courses offered by the Canadian Securities Institute such as the Conduct and Practices Handbook Course, the Derivatives Fundamentals Course, the Trader Training Course, the Financial Planning I course, and other relevant industry courses.

New staff receive one-on-one training from the Case Assessment Manager, are required to read the Case Assessment Unit Procedures Manual (CAU Procedures Manual), relevant IIROC rules and notices, and spend time training with other CAOs to see how cases are reviewed. They also receive training on the various computer systems used by the group, including CTS and ComSet. While in training, CAOs may consult with Investigators on their files, but they don't formally work with them on cases. Ongoing training depends on each CAO's experience and educational background. It consists of both courses offered by external parties, and also in-house training. The latter are made available to all IIROC offices, whose staff may log in and view a Power Point presentation.

### ***Staff findings***

We noted that Case Assessment is currently at full complement, and is operating close to its established benchmark of completing 80% of cases within 75 days from the date of receipt of a complaint. Given that Case Assessment has historically performed above its benchmark when it was at full complement, OSC staff are of the view that the current staffing level should be sufficient going forward to handle the increased volume of complaints and inquiries, especially when the three relatively new staff are trained and be able to deal with more cases on their own.

OSC staff did not have concerns with the initial and ongoing training processes offered to CAOs.

### ***Staff recommendations***

None.

## **7.3 Written procedures and guidance**

### ***Background information***

OSC staff reviewed the CAU Procedures Manual which was most recently updated in July 2009.

### ***Staff findings***

In general, OSC staff found the CAU Procedures Manual to be comprehensive and informative. It has been updated with Complaints and Procedures Update Bulletins, as recommended during the last CSA oversight review. In addition to detailed instructions on how to process files received by the CAU, examples of topics covered in the CAU Procedures Manual are:

- the most common types of complaints received, such as complaints on unsuitable investments; it also includes guidance on how to analyze the issues underlying these types of complaints,
- matters to be referred to other IIROC departments, such as FinOps or BCC, other regulatory bodies and police agencies, or FINTRAC; such guidance includes the types of issues/situations that may arise in the review of such files and samples of referral letters,
- document control and evidence of conversations, which requires a CAO to keep written records of any conversations relating to a complaint, such as conversations with complainants, their representatives and employees or representatives of dealer member firms noting the date, time and details of the conversation.

The CAU Procedures Manual also includes sample document request letters to Dealer Members for each type of complaint received. Samples of other correspondence that CAOs may need to issue during the course of a files are also included.

OSC staff noted that the CAU Procedures Manual did not specify that Dealer Members are given 10 days to respond to IIROC staff's request for information and documentation, even though this was done in practice, as evidenced by correspondence in the files reviewed by OSC staff. In addition, OSC staff found that the final file screening scores for low priority files cited in different sections of the manual were different.

### ***Staff recommendations***

27. The CAU Procedures Manual should be updated as follows:
- all the practices followed by CAU staff, such as the 10 day timeframe for response by Dealer Members to requests for information and documentation, should be documented; and
  - references to the score for low priority files should be consistent throughout the manual.

**Priority: Low**

### ***IIROC's response:***

Enforcement staff will revise the applicable sections of the CAU Procedures Manual to include reference to the 10 day timeframe for Dealer Members to respond to document requests.

Enforcement will review the CAU Procedures Manual to ensure that all references to the score for low priority are consistent in the Manual. This project will be completed by January 31, 2011. However, the Enforcement department anticipates additional amendments will be made to the CAU Procedures Manual once the new case selection criteria has been approved and implemented.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **7.4 Processes**

### ***Background information***

Public inquiries and complaints are received by telephone, email, mail, fax or through the filing of a complaint form available online and are routed to the Case Assessment group of the appropriate IIROC regional office. Sources of complaints may also be matters reported on ComSet, referrals from securities commissions, other SROs or other IIROC departments. Marketplace type inquiries, calls and emails are handled by an Inquiries and Complaints Officer in the GCO, with three Case Assessment individuals with the appropriate training acting as backup in the absence of this individual. Marketplace type complaints are initially received by a Complaints and Inquiries Officer and entered into a database maintained by the TR&A group. Complaints and inquiries requiring further review are then referred to TR&A. If TR&A recommends an investigation, the file is then entered into CTS as a Case Assessment file, and moved to Investigations once the file has been reviewed by the Director of Investigations.

Issues reported through IIROC's Whistleblower Service are dealt with by members of IIROC's Whistleblower team, who are: the SVP of Surveillance and Compliance; the SVP, General Counsel and Corporate Secretary; the VP Quebec; and the VP Western Canada. If matters reported through this service are client complaints against an IIROC Dealer Member or an individual registrant, the Whistleblower team will direct the complaint to Case Assessment group for review.

All written complaints are forwarded to the Case Assessment Manager or, in her absence, to a backup individual which is another CAO or the Director of Investigations for preliminary review and assessment immediately upon receipt. Once a CAO is assigned a file, he/she generally performs the following processes:

- applies the file screening criteria to prioritize the case in accordance with the guidance provided in the CAU Procedures Manual;
- sends an acknowledgement letter to the complainant within two business days of receipt of the complaint; and
- if necessary, sends a request for additional information to the complainant and/or the subject registrant within five days of receipt of the complaint.

Once the CAOs complete their analysis and assessment of the files, they prepare a closing memorandum that outlines their findings and recommendation. They then update the final file screening scoring to support the recommendation and reassess priority if required. The closing memoranda prepared by the CAOs are reviewed and signed off by, in most instances, the Case Assessment Manager. The Director of Investigation reviews files completed by the Case Assessment Manager.

Based on the analysis, findings and file screening process, files may be closed either with no action or with a cautionary letter, may be forwarded to another regulator or agency, or may be forwarded to another department or group at IIROC such as the Investigations group, or the BCC or FinOps. Matters forwarded to the Investigations group for further investigation are reviewed by the Director of Investigations, who makes the final decision on next steps.



### ***Staff findings***

OSC staff did not have concerns processes for reviewing complaints. We found that a number of positive changes were made to the processes since the last oversight review, for example: the file screening scorecards have been updated to assign points for past complaints, investigations and/or prosecutions against a subject; and an exhibit log that serves as a quick reference for Investigations staff when reviewing case assessment files was adopted for all files since February 2008.

OSC staff also found that the categories on the file screening scorecard are appropriate for assisting in prioritization of the file.

### ***Staff recommendations***

None.

## **7.5 Review of case assessment files**

### ***Background information***

OSC staff reviewed a sample of 30 files from approximately 1,690 complaints opened and closed during the Review Period by Case Assessment. The sample included complaints received from various sources, violation types, different disposition types and different CAOs. NSSC staff reviewed a sample of 10 out of 57 complaints opened and closed during the Review Period by IIROC's Toronto Case Assessment group.

OSC staff also reviewed a sample of complaints related to market activities and included the findings in Section J - Trade Review and Analysis.

### ***Staff findings***

OSC staff's review of the files showed that the complaints were generally reviewed in a timely manner. Where delays were found, they were justified and supported by reasonable explanations. The recommendations made for each file appeared appropriate based on the documentation and evidence included in the files. The files were generally completed in accordance with the policies and procedures in the CAU Procedures Manual, and they showed good communication with IIROC and OSC registration departments. NSSC staff's review of the files showed that eighty percent of the complaints were reviewed within the benchmark of 75 days.

OSC staff did find a case where the CAO who reviewed the matter recommended that it proceed to Investigations, however only a cautionary letter was eventually sent; we were informed that this decision was made by the Case Assessment Manager, in consultation with the Director of Investigations, but no notes of their conversation were included in the file. OSC staff were advised that such types of conversation are not usually recorded unless the discussions are held via email.

NSSC staff found that 50% of the case assessment files closed did not contain evidence as to how the Dealer Member dealt with the clients or the outcome of the clients' complaints. NSSC staff has concerns that closing the case assessment files without evidence of the outcome of the client's complaint may deny NSSC staff the ability to determine if the case assessment was dealt with appropriately.

NBSC staff found a sample of Case Assessment files, all ComSet generated, of which they were not



notified by IIROC. One file in particular involved serious misconduct and should have been brought to the attention of NBSC staff when opened by IIROC. NBSC staff note that IIROC is already providing NBSC with details of ComSet filings from New Brunswick based Dealer Member branches. IIROC's database infrastructure currently prevents them from providing more detailed disclosure identifying New Brunswick based client complaints. This is in the process of being addressed by IIROC Information Technology staff.

***OSC and NSSC staff's recommendation***

28. IIROC should ensure that Case Assessment files include adequate support and documentation regarding the disposition of files. Such support may include notes from conversations.  
**Priority: High**

***IIROC's response:***

IIROC agrees with the finding that staff did not put an email on CTS confirming a discussion between the Case Assessment Manager and the Director, Investigations about the conduct of the file. IIROC management will remind staff to confirm all decisions in writing and upload them to CTS.

The greater part of the CSA finding in this section concerns a suggestion that Enforcement staff did not document how the Dealer Member dealt with the clients or the outcome of the clients' complaints. Currently, clients' complaints received through COMSET are assessed by Case Assessment against IIROC rules and standards for the purpose of determining whether there are reasonable grounds to pursue a disciplinary prosecution. At the time of this review IIROC did not track COMSET complaints beyond its initial assessment unless the matter was forwarded to Investigations. In this regard, we complied with the terms of our Recognition Order.

It is important to note that we are creating a Complaints and Inquiries Team. Staff from this group will work with clients to assist them in dealing with their complaints. Furthermore, we believe that the new Client Complaint Rule, which is tracked by IIROC, addresses some of the issues raised by the Nova Scotia Securities Commission.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

***NBSC staff's recommendation***

29. IIROC should notify NBSC of files related to New Brunswick based client complaints.  
**Priority: Medium**

***IIROC's response:***

IIROC disagrees with this finding. IIROC's reporting obligations are set out in section 8 of Schedule 2 of the Recognition Order, which includes IIROC's monthly, quarterly and annual reporting requirements. Specific to this finding, the Recognition Order requires IIROC to provide CSA members with a quarterly report summarizing client complaints. This information was provided to the NBSC in accordance with IIROC's reporting obligations. IIROC has nevertheless agreed with NBSC, subsequent to the Review Period, to provide additional information beyond the requirement of the Recognition Order.

***Staff comments and follow-up:***

NBSC staff are satisfied with the current information sharing procedures implemented.

**8. Investigations**

**8.1 Benchmarks**

***Background information***

IIROC's benchmark for completion of investigation files is to close 60% of investigation files within one year. This applies regardless of the file priority or sensitivity. IIROC prioritizes files by ranking them as high, medium and low priority. Matters prioritized as high priority are generally expected to receive greater emphasis by investigators and, generally, the ranking is intended to guide investigators on how to allocate their time between cases. In addition, and independent from the priority level of files, certain cases are marked as 'sensitive'. These are all cases with matters related to marketplaces, and certain cases dealing with serious member conduct issues.

OSC staff reviewed IIROC's performance against the target timeline to close investigation files for the Review Period.

***Staff findings***

OSC staff noted that the existing benchmark for completion of investigations does not distinguish between high, medium and low priority files or sensitive files. Rather, all files are subject to the same target completion time. OSC staff also found that, while there is an additional 'sensitivity' ranking used for all market files and certain member conduct files, there was no clear documented guidance at IIROC as to the inter-relationship between the prioritization level and sensitivity of the files.

In addition, OSC staff's review of the process for assigning priority rankings to files showed that it is done by the managers in charge of investigation files, sometimes with direction from the Director of Investigation. Prioritization is mainly judgmental. While there is a '*file screening scorecard*' process in Investigations, whereby each file receives a score based on a number of factors, and internal policies and procedures state that file prioritization is based on this file screening process, we were advised that as a matter of practice prioritization of specific investigation files is not consistently based on this process.

OSC staff are concerned that all these factors could promote confusion regarding file priorities and inconsistency in how rankings are assigned. In addition, OSC staff question the meaningfulness of the priority ranking, because it does not seem to inform work allocation and file completion timelines.

OSC staff's review of the performance of Investigations showed that the group consistently exceeded its benchmark to close 60% investigation files within one year.

***Staff recommendations***

30. IIROC should consider revising its existing benchmark for completion of investigation files to take into account the priority levels, sensitivity or complexity of the files.

**Priority: High**

***IIROC's response:***

The benchmarks are a management tool applied on a national basis and designed to assist management with overall completion times for Enforcement files. They function as an alert, which allows management to take a closer look at the file in question. IIROC is satisfied with the benchmarks applied in Investigations in light of their purpose.

IIROC benchmarks are not designed to assist staff or management in prioritizing or ranking files. There is an ongoing process of prioritizing investigation and prosecutions files by management, and Enforcement is confident that all files are reviewed regularly by management with a view to ensure that priority files receive the adequate resources for timely completion.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

31. IIROC should review their process for assigning file priorities with a view to promoting consistency among managers and ensuring that the file screening scorecard results are meaningful for file prioritization.

**Priority: Medium**

***IIROC's response:***

Enforcement is reviewing the case selection criteria, including the file screening scorecard. IIROC agrees that any case selection process adopted should employ appropriate screening tools for effective and consistent approaches to file prioritization.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request the revised case selection criteria and file screening scorecard, when IIROC's review of this area is complete.

## **8.2 Staffing and training**

### ***Background information***

At the time of our review, Investigations was comprised of:

- three Investigations managers who oversee three teams of investigators and assistants; two of the managers were formerly with the IDA and one with RS;
- 14 investigators who were primarily responsible for member conduct investigations and who were with the IDA prior to the IDA-RS merger; and
- three investigators who were primarily responsible for marketplace files and who were with RS prior to the merger.

Since the merger, marketplace cases have generally been assigned to investigators formerly with RS, but

IIROC also made efforts to cross-train all staff and integrate their activities and expertise. For example, former RS investigators were assigned to each of the three Investigation teams and educate former IDA investigators on UMIR and marketplace investigation particulars through such means as ‘Lunch ‘n Learn’ sessions. The Investigations group also initiated a “shadowing” program whereby certain investigators with member conduct experience were selected to work on marketplace files while being shadowed by the manager with experience in market cases.

OSC staff also obtained information regarding the formal training provided for Enforcement staff during the Review Period. The training framework includes: in-house ‘Lunch ‘n Learn’ sessions, a formal annual all-day training event, and attendance by staff at conferences and seminars. For new staff, there is an ‘Investigations Orientation Training’ which includes particulars about the structure of the investigations groups, sources of investigations, stages of investigations and work that takes place after investigations are completed.

### ***Staff findings***

OSC staff did not have concerns with the adequacy of the total number of Investigations staff. Staff also noted that the staff turnover in the Investigations group (both before and after the IDA-RS merger) was low during the Review Period.

OSC staff found that the training materials and programs are comprehensive, but could be further enhanced to cover a number of topics such as interviewing skills; investigating marketplace cases; investigating supervision cases; and general principles of administrative law.

OSC staff had concerns, however, with the potential imbalance in the number of investigators with marketplace expertise versus those with expertise in member conduct files (as set out above, there were three market investigators versus 14 member conduct investigators). OSC staff noted that in the period following the merger the proportion of marketplace and member conduct cases has been relatively equal (i.e. 28 member conduct versus 27 market cases), but there has been no increase in the number of investigators with specific market expertise. OSC staff acknowledge that efforts are being made to cross-train staff, but found that IIROC continues to rely mainly on the three former RS investigators to be primarily responsible for market type cases. OSC staff also found that, even after the merger, managerial oversight for market cases remained with a manager of Investigations who was formerly with RS.<sup>5</sup> OSC staff are concerned with the high level of reliance on investigative staff that were formerly at RS, and are also concerned about the impact on IIROC’s ongoing ability to effectively investigate marketplace cases if these individuals leave IIROC.

### ***Staff recommendations***

32. IIROC should take steps to ensure that it has an adequate number of investigative staff, including staff at the management level, with competency to conduct marketplace cases.

**Priority: High**

#### ***IIROC’s response:***

IIROC established a dedicated market enforcement team within the Enforcement department. The enhanced team, comprising one Manager, four Investigators and two Counsel in Toronto, will ensure

<sup>5</sup> This individual has since left IIROC.

continued marketplace expertise. IIROC also has dedicated market Enforcement staff in Montreal and Vancouver.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

33. IIROC should continue to enhance its training programs and materials, including the topics listed above.

**Priority: Medium**

***IIROC's response:***

IIROC agrees that it is important to continue to ensure robust training for the skill sets necessary to perform the various roles within Enforcement. IIROC recently hired a new Director of Training and Development who is charged with identifying the necessary training requirements for each department. The Enforcement management group will be working with the Director of Training and Development to develop training programs for all Enforcement staff.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

### **8.3 Written procedures and guidance**

#### ***Background information***

IIROC has two principal policies and procedures manuals relating to its investigation activities: the *General Policy and Procedures Manual*; and the *Investigations Procedures Manual*. The former includes high-level particulars such as enforcement strategy, roles and responsibilities of the department, code of conduct and coordination with regulators. The latter sets out more specific particulars respecting the processes followed in the course of an investigation.

#### ***Staff findings***

The *General Policy and Procedures Manual* is generally adequate, but staff found that it has not been updated since the merger and it does not specifically address marketplace cases. For example: it does not have references to marketplaces or access persons in the Strategy section of the manual; and the names of the IIROC departments in the post-merger setting are not referenced in the section dealing with the flow of information between IIROC departments. OSC staff found that, while the manual reflects an appropriate strategy for the Investigations group, it does not include an element dealing with consistency and coordination of effort among IIROC's various regional offices and departments and with other regulators. OSC staff also found that this manual includes particulars respecting file screening and states that file prioritization is based on the file screening process; but as noted earlier in this report, as a matter of practice, the file screening scorecards do not appear to play a role in prioritizing files at IIROC.

The *Investigation Procedures Manual* is generally adequate, but requires updating. For example, it does not include procedures for initial assessments of marketplace cases; nor does it include particulars respecting the recently established Disciplinary Advisory Committee and matters respecting sensitive

files.

***Staff recommendations***

34. The *General Policy and Procedures Manual* and the *Investigation Procedures Manual* should be revised to address the findings identified above.

**Priority: Medium**

***IIROC's response:***

Enforcement will update its manuals to include procedures for marketplace cases and any other changes referred to in this finding. This project will be completed by March 31, 2011.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request a copy of the updated *General Policy and Procedures Manual*.

**8.4 Processes**

***Background information***

OSC staff reviewed the *Investigations Policy and Procedures Manual* to gain an understanding of the processes followed in Investigations and discussed these processes with IIROC Enforcement management. OSC staff also reviewed file statistics to understand the types of cases handled by Investigations, as well as their breakdown by nature of cases (marketplace versus member conduct) and by types of matters.

Files opened in Investigations are either referred from Case Assessment, if they deal with member conduct issues, or from Trading Review and Analysis if they relate to marketplace issues. The latter category of files still goes through Case Assessment, but only to be entered into CTS and for the purposes of completing the *'file screening scorecard'*. The decision to pursue a case in Investigation is made by the Director of Investigations, who may consult with the Director of Enforcement Litigation and/or the VP of Enforcement in the process.

Once the decision is made that a case will be pursued in Investigations, the Managers of Investigations will select the specific investigator(s) to handle the file and then, along with the investigators selected, agree on the appropriate priority for the file. Files are assigned based on the subject matter of the file, expertise and time availability of the investigators, the urgency of the file and the importance of cross-training (particularly for marketplace files in the post-merger period). Each case is generally staffed with one or more investigators, depending on the complexity and time sensitivity of the case.

During the course of an investigation, staff prepare monthly or quarterly Case Summary Reports for review by senior management or by the Disciplinary Advisory Committee, if applicable (please see below for a description and composition of this committee). Investigators prepare monthly reports for 'sensitive' files and quarterly reports for non-sensitive files, which may include high-priority files.

At the completion of an investigation, staff prepare an Investigation Closing Recommendation Memorandum, a document that summarizes the file, including the allegations and summary of the

evidence. For non-sensitive files, this document is prepared for the review and approval of the Manager of Investigations and, following that, the Director of Investigations. For sensitive files, a review of the proposed disposition is referred to a different decision-maker: the Disciplinary Advisory Committee. This is a committee comprised of the SVP ERP, SVP Surveillance & Compliance, VP Western Canada, VP Quebec, VP of Enforcement, the Director of Enforcement Litigation and the Director of Investigations. Its objective is to ensure fair and reasonable communications between all levels of investigation, prosecution and senior management and, where appropriate, to ensure that there is a consistent approach to prosecutions across the different regions.

The range of disposition for investigation files include: (a) close with no action; (b) close with a caution letter; (c) refer to prosecution; (d) refer to another agency; and (e) refer to IIROC Registration group.

### ***Staff findings***

Generally, OSC staff did not have significant concerns regarding the majority of the processes followed in Investigations. OSC staff are also of the view that the Disciplinary Advisory Committee is a beneficial governance structure implemented by IIROC senior management that supports regional consistency and expertise from other subject-matter areas at IIROC (such as surveillance).

OSC staff also found that Investigations is generally proactive in identifying areas for further regulatory inquiry. For example, our review of file statistics and the various reports showing the sources of Enforcement files showed that a large number of cases (approximately 14%) are sourced from 'IIROC Enforcement'. OSC staff were informed that this type of sourcing derives from circumstances in which, for example, a supervision file was subsequently opened as an extension to another file following a review of supervision particulars on the initial files.

OSC staff found, however, a number of areas where the processes in Investigations could be improved. For example, our review of file statistics suggests that Enforcement activity places a strong emphasis on the retail market, as there are comparatively fewer cases dealing with non-retail aspects of Dealer Member operations (such as institutional trading, research and corporate finance activity). In addition, a majority (72%) of investigations were directed at the conduct of individuals. This could be due to the fact that a large proportion (approximately 30%) of investigation files are sourced through information reported by Dealer Members in COMSET, which reflects a potential bias towards investigations targeting individual approved persons' conduct. Comparatively fewer files (9.2%) are sourced from referrals from other IIROC departments (such as FinOps or BCC) or from other regulators (4.8%).

We also found an instance where the documented policies and procedures were not followed in practice. For example, OSC staff found that although the *Investigations Policy and Procedures Manual* sets out that every investigation file must include a memo recommending the rationale for opening the investigation, this process is not followed in practice. OSC staff are of the view that the discipline of setting out the rationale for opening an investigation file in a written memo is beneficial.

We also noted that Case Summary Reports can be quite lengthy, which raises concern about administrative time burden for investigations staff. However, towards the end of the Review Period, IIROC Enforcement management introduced a new streamlined template for these reports which has resulted in better consistency and shorter reports.



### ***Staff recommendations***

35. IIROC Enforcement management should consider undertaking an evaluation to broaden the range and scope of Enforcement activities, possibly in conjunction with other IIROC departments and other regulators, such as the CSA, with a view to continuing to identify industry trends and areas of risk in member activities beyond retail activities.

**Priority: High**

#### ***IIROC's response:***

IIROC believes that retail investor protection is a core component of the Enforcement mandate and will always remain a key Enforcement activity. However, IIROC also investigates and prosecutes a broad range of dealer and market conduct. A few recent examples are, in addition to the varieties of market files, we have prosecuted institutional money market issues in ABCP and analyst issues in TD Securities.

IIROC is open to enhancing the scope of enforcement activities and willing to meet with CSA staff to discuss possible new sources for enforcement files that are within IIROC's jurisdiction and core mandate

#### ***Staff comments and follow-up:***

IIROC's response is adequate. We will discuss possible new sources for enforcement files that are within IIROC's jurisdiction and core mandate as part of our ongoing discussions with IIROC.

36. IIROC should ensure that it follows the procedure set out in the *Investigations Policy and Procedures Manual* and document the rationale for opening an investigation in a written memo.

**Priority: Medium**

#### ***IIROC's response:***

IIROC disagrees with this finding as it is premised on an inaccurate understanding of our manual. Section 3.1 of the *Investigations Policy and Procedures Manual* outlines the investigation process. There is no reference in the manual mandating a memo to explain the rationale for opening an investigation. Rather, the manual stipulates that an investigation plan must be completed by the investigator and submitted to a Manager for approval. An investigation is opened once the plan is approved by the Investigation Manager. Staff follow this procedure.

#### ***Staff comments and follow-up:***

We acknowledge IIROC's response. We note that Section 2.2 of the *Investigations Policy and Procedures Manual* indicates that every investigation file must include a memo recommending the rationale for opening the investigation which must be approved by an Investigations Manager or higher authority. We understand that this may refer to the memo prepared by Case Assessment when referring a file to investigation. We will discuss this issue with IIROC to clarify.

## **8.5 Review of investigation files**

### ***Background information***

OSC staff selected a sample of 25 investigation files dealing with member conduct matters and six



investigation files dealing with marketplace matters that were completed and closed during the Review Period. The files covered a variety of file sources, types of defendants, member sizes, types of violations and investigators.

NSSC staff reviewed one investigation file, and NBSC also reviewed a sample of investigation files completed by Investigations in the Toronto office.

### ***Staff findings***

OSC staff found that generally the files sampled met the benchmark for completion of investigation files. Investigation files were assigned for review on a timely basis and were adequately staffed given the nature and size of the files.

Based on the documents reviewed, OSC staff also found that in most cases, the closing recommendation reports for these files included sufficient information to support the recommendation, and the recommendations appeared reasonable. In most circumstances where ‘*no action*’ was recommended, other administrative measures were actively considered – including documenting referrals to IIROC Registration so that they would have information on hand in the event that an individual might choose to return to the industry in the future.

NSSC staff found that the investigation file they reviewed was well documented. However OSC staff found a few cases where files related to member conduct matters did not include sufficient documentation of the work performed or where matters were not sufficiently pursued. For example:

#### *Files where there were indications of deficiencies in supervisory and compliance procedures at the Dealer Member*

- there was inconsistent treatment of files where IIROC’s investigation of approved persons indicated potential deficiencies in the supervisory and compliance structure at the Dealer Member: in one file, potential supervision deficiencies were further investigated and proceedings were taken against the firm respecting supervision, while other files with indications of weaknesses in the Dealer Members’ compliance processes did not proceed to prosecutions or were not referred to other IIROC departments, such as the Compliance groups for further scrutiny.
- in some cases, there was insufficient documentation as to why IIROC staff concluded that there were no supervisory issues; for example, the closing recommendation memoranda stated that there was no evidence of a supervision issue, but there was no documentation of what investigative steps were taken to support such a conclusion.
- a few files identified potential concerns with Dealer Members’ Research or Corporate Finance departments, but such issues and the Dealer Members’ overall adequacy of supervisory and compliance processes were not investigated, and we did not see evidence that they were referred to IIROC Compliance groups for further scrutiny.

#### *Other files*

- OSC staff reviewed a file where the subject Dealer had taken mitigating steps to correct the issues identified, and the file was closed in Investigations without being advanced to prosecutions; OSC

staff are concerned that this approach may impede general deterrence through transparent Enforcement hearing activities and the development of jurisprudence applicable to all persons in similar situations.

- OSC staff also found that two files were concluded without proceedings because IIROC staff interpret IIROC Rule 19.5 as a substantive provision respecting jurisdiction which requires IIROC to serve a notice of investigation before they can formally proceed with investigations.
- OSC staff also found that four cases included in the sample selected involved referrals to another agency. The referrals were made at the conclusion of the investigations, which in a couple of cases took a significant amount of time. OSC staff are concerned that the referrals may not have been made on a timely basis.

OSC staff discussed with IIROC Enforcement management an observation respecting IIROC District Council jurisprudence and the application by IIROC hearing panels of IIROC Rule 29.1 – which deals with, among other things, ‘conduct unbecoming’. A heightened standard of liability has resulted, reflecting a recklessness and gross negligence standard of liability for member conduct cases. This has had an impact on enforcement activity, including on the determination as to whether to commence proceedings in specific cases. IIROC Enforcement management acknowledged this trend and advised OSC staff that IIROC Enforcement Counsel continue to argue the negligence standard. However, proactive steps, such as IIROC appealing decisions in appropriate circumstances and focusing on the second branch of Rule 29.1 – which sets out a public interest mandate proscribing conduct ‘detrimental to the public interest’ – appear not to have been receiving appropriate regulatory emphasis at IIROC. This finding and a related recommendation are included in section 9 of the Enforcement section that deals with Litigation.

NBSC staff found that, in three cases, the depth of IIROC’s investigation was not, in NBSC staff’s opinion, sufficient in light of the apparent seriousness of the approved person’s alleged activities:

- in one file, there were multiple complaints of misconduct by an approved person (discretionary trading violations); a file was opened with respect to two complaints which were then jointly investigated; two additional complaints with respect to the same approved person were subsequently added to the file, but the latter two complaints do not appear to have been actively investigated beyond the request of some records; the file was closed with a warning letter;
- one file opened as a result of a ComSet complaint regarding unauthorized discretionary trading appears to not have been fully investigated (for example, there was no complainant or registrant interview and no trading records and authorizations were obtained) on the basis that, among other factors, there was no formal complaint, and the file was closed on that basis; NBSC staff note that there were a few other instances closed because there was no formal complaint, but agreed with IIROC’s conclusion to close the files based on the file content;
- another file opened as a result of a ComSet complaint and which related to alleged unauthorized trading, forging of Know Your Client information and execution of blank forms, was not fully investigated because there was no formal complaint; this file was closed without further action on the basis that, as IIROC was not privy to discussions between the registered representative and the client, it could not assess the complaint; NBSC staff note that this appears to be IIROC’s approach with respect to files involving a dispute regarding discussions between registrants and clients. NBSC staff acknowledge the necessity of prioritizing cases, but believe IIROC should at

the very least contact the parties and get formal statements from them, especially in cases involving similar allegations.

***OSC staff's recommendations***

37. IIROC should provide additional guidance to its staff regarding how to proceed in cases where supervision issues are identified to promote consistency of analysis and documentation for such cases. Such guidance should cover cases where supervision issues were identified in areas of a Dealer Member other than with respect to its retail business, such as research and corporate finance.

**Priority: High**

***IIROC's response:***

Enforcement staff considers proper supervision of registrable activity critical to creating a culture of compliance. IIROC reviews supervision in every investigation file opened by staff. Investigators work closely with investigation managers and counsel to ensure sufficient support and guidance is provided to investigative staff throughout the investigation process, including the review of supervisory issues.

We do not agree that the files cited as examples of matters requiring additional management guidance support that finding. As the OSC noted, in most cases sufficient information to support the recommendation was contained in the files. We believe there is satisfactory collaboration between investigators and managers on the conduct of a file. There is also review of files by the Director of Investigations, Director of Litigation and VP Enforcement to ensure consistency of prosecution files.

***Staff comments and follow-up:***

OSC staff acknowledge IIROC's response. We will continue our dialogue with IIROC Enforcement staff with a view to increasing consistency of approach regarding cases where supervision issues are identified.

38. IIROC should review its practice of closing investigations without further proceedings in circumstances where dealers take self-corrective steps, and instead conduct disciplinary proceedings in such circumstances and afford hearing panels discretion to evaluate self-corrective steps as mitigating factors on sanction, which would support IIROC's regulatory objective of achieving general deterrence through transparency of Enforcement proceedings.

**Priority: High**

***IIROC's response:***

IIROC will review its practice of closing investigations in circumstances where Dealer Members have taken self-corrective steps, and will complete this review by March 31, 2011.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request a summary of the results of IIROC's review of its practices in this area, which is anticipated to be completed by March 31, 2011.

39. IIROC should amend its Rule 19.5 that requires it to advise any person subject to an investigation to be advised in writing of the matters under investigation. We are of the view that this provision may hinder IIROC staff's ability to proceed with investigations and has led to inconsistent treatment of cases where former approved persons could not be located and could not be advised in writing of the start of an investigation. Staff further note that such notification does not inform investigative activities for marketplace cases, accordingly the recommended amendment would enhance harmonization of IIROC's rulebook.

**Priority: High**

***IIROC's response:***

IIROC agrees with this finding and has already drafted a rule proposal that dispenses with the requirement to send a letter to a subject of an investigation. Under this rule proposal, IIROC's jurisdiction to launch an investigation will not depend upon sending an opening investigation letter to the subject of an investigation.

***Staff comments and follow-up:***

IIROC's response is adequate. We will review the rule proposal in due course, when submitted by IIROC for CSA review and approval.

40. IIROC should consider identifying process enhancements to accelerate referrals of matters to outside agencies when such referrals are appropriate.

**Priority: High**

***IIROC's response:***

IIROC endeavours to refer matters not within its jurisdiction to outside agencies as soon as practicable. IIROC agrees that it is important to ensure that referrals to outside agencies are done promptly and undertakes to review its current referral procedures. This review will be completed by March 31, 2011.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request a summary of the results of IIROC's review of its referral procedures to other agencies that is anticipated to be completed by March 31, 2011.

***NBSC staff's recommendations***

41. IIROC should not consider the absence of receipt of a formal complaint a factor in determining to what extent a file should be investigated. Files should be assessed on the basis of the seriousness of the apparent or alleged misconduct, and not on whether a formal complaint was received or not.

**Priority: High**

***IIROC's response:***

IIROC disagrees with this finding. IIROC does not, as a matter of policy, consider the presence or absence of a formal complaint to be a factor driving whether a matter is investigated by us. IIROC

reviews all matters on the basis as to whether there exists evidence of regulatory misconduct.

***Staff comments and follow-up:***

A reading of the reports makes it clear that the absence of a complaint was a factor. It appears the policy does not match the execution.

42. In cases where the assessment of the files depends, to some extent, on the version of events as described by opposing parties, IIROC should not close the files simply because it was not privy to discussions between the registrant and the client and because it cannot assess the veracity of their respective positions. Rather, IIROC should seek more clarity by interviewing the complainant and the approved person, and by seeking corroboration of respective version of the events from available documents or other evidence. In particular, where there are material indications of misconduct, IIROC should at a minimum obtain statements from registrants and complainants. NBSC staff could assist in obtaining any such necessary statements or evidence.

**Priority: High**

***IIROC's response:***

IIROC disagrees with this finding. When IIROC open an investigation, it endeavours to gather evidence from all relevant parties and assesses the totality of that evidence against the standards and principles of our rules. IIROC does not close files on the basis of any representation made to us by the subject of an investigation. IIROC has pursued and initiated enforcement proceedings where the parties have provided conflicting versions of the relevant event(s).

***Staff comments and follow-up:***

NBSC maintains its comments as set out above.

**9. Enforcement Counsel**

**9.1 Benchmarks**

***Background information***

The benchmark used by Enforcement Counsel during the field review was as follows: 60% of cases are closed, settled or the subject of an issued Notice of Hearing within 10 months.

***Staff findings***

OSC staff have no concerns with the benchmark used by Enforcement Counsel.

***Staff recommendations***

None.

## 9.2 Staffing

### ***Background information***

Enforcement Counsel staff in the IIROC's Toronto office consists of eight Enforcement Counsel and an articling student who report to the Director of Enforcement Litigation. The Director of Enforcement Litigation reports to the VP Enforcement and is also responsible for the national oversight of four Enforcement Counsel in Vancouver, three in Montreal, two in Calgary and outside counsel, as required.

The current complement of Enforcement Counsel is drawn from various backgrounds including prosecution, civil practice and in-house practice. Enforcement Counsel are required to have the Canadian Securities Course or must undertake to complete the course within one year of commencing their employment at IIROC. They must be members in good standing of the provincial bar in which they will practice and must also complete the Conduct and Practices Handbook Course.

Training for new Enforcement Counsel is conducted in house, at IIROC's Toronto office, over the course of two to three days. In addition, there is a bi-annual conference for all Enforcement Counsel, which consists of various sessions and involves a variety of participants including the IIROC CEO, IIROC management, staff from other departments of IIROC, existing Enforcement Counsel, private practitioners, and hearing panel members.

### ***Staff findings***

OSC staff had no concerns with the staffing of Enforcement Counsel.

### ***Staff recommendations***

None.

## 9.3 Written procedures and guidance

### ***Background information***

OSC staff reviewed the *Litigation Manual* to see if it includes adequate written procedures and guidance for IIROC staff.

### ***Staff findings***

Overall, OSC staff did not have concerns with the adequacy of the policies and procedures related to Litigation. OSC staff noted, however, that the portion related to the "standard of proof" in the Litigation Manual, while it referred to *Bernstein and College of Physicians and Surgeons of Ontario*, did not refer to *F.H. v. McDougall*, [2008] S.C.J. No. 54, a more recent Supreme Court of Canada case which clarified what the standard of balance of probabilities means.

### ***Staff recommendations***

43. IIROC should ensure its written procedures included in the *Litigation Manual* contain references to precedent cases that are up to date.

**Priority: Medium**

***IIROC's response:***

The Litigation Manual is not a legal reference guide for Enforcement Counsel. The primary purpose of the Litigation Manual is to provide guidance to Enforcement Counsel on the policies and procedures relating to their core job function. Enforcement Counsel are expected to review case law as part of the execution of their prosecutorial duties. However, it is noteworthy that there is a current project underway to create a hearing reference book which would contain key administrative and regulatory case law. This guide will contain updated topical case law for issues that arise in IIROC discipline matters.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff ask to be notified when the project to create a hearing reference book is complete.

## **9.4 Processes**

### ***Background information***

OSC staff discussed the processes followed by Enforcement Counsel with Enforcement management and reviewed the *Enforcement Policy and Procedures Manual* to get an understanding of the responsibilities of Enforcement Counsel.

Enforcement Counsel are assigned to files when the investigation starts. At the investigation stage, they participate in the process by providing advice and by attending investigation interviews. When investigations are complete and the matters are transferred formally from investigation to litigation, Enforcement Counsel assumes carriage of the matters. Generally, the VP Enforcement decides whether files should be prosecuted, with the exception of 'sensitive' files where the decision is made by the SVP Enforcement.

If matters proceed to a hearing, a Notice of Hearing is posted on IIROC's website and stays there in perpetuity. Hearing Panels are constituted pursuant to IIROC's Transitional Rule 1.3 *Hearing Committees and Hearing Panels Rule*, and hearings are conducted in accordance with relevant IIROC Dealer Member rules if they relate to Dealer Member conduct matters or with the UMIR if they relate to market matters.

### ***Staff findings***

OSC staff had no concerns with the processes followed by Enforcement Counsel. OSC staff did note that IIROC follows different rules depending on whether cases are related to member conduct matters or to potential UMIR violations, but are aware that there is a process underway to consolidate the existing rules dealing with Enforcement processes.

OSC staff had a concern, however, with the standard of liability that must be met to successfully prosecute files. Specifically, OSC staff were informed that IIROC hearing panels have developed jurisprudence dealing with certain categories of enforcement cases, including those dealing with supervision and conduct unbecoming a Dealer Member, that requires meeting a recklessness or gross negligence standard. As a result, we have been informed that IIROC staff may not pursue cases that only meet the negligence standard, although IIROC staff believe that negligence is the appropriate standard.



### ***Staff recommendations***

44. OSC staff encourage IIROC staff to continue to pursue cases that meet only the negligence standard and to focus on submitting facts and arguments supporting the second branch of IIROC Rule 29.1, which sets out a public interest mandate proscribing conduct ‘detrimental to the public interest’. As part of the process, IIROC could consider appealing decisions of the hearing panels to the Commission, in instances where IIROC staff believes such decisions were made by applying the higher standard of recklessness or gross negligence, and to bring forward “conduct detrimental to the public interest” cases where the recklessness or gross negligence standard would have no application.

**Priority: High**

#### ***IIROC’s response:***

IIROC acknowledges that Rule 29.1 has been interpreted by IIROC Hearing Panels to require an elevated standard of proof such that a registrant is found liable only when Staff proves gross negligence on the part of the individual rather than the usual standard of simple negligence. The concern here is that a registrant may engage in conduct that is blameworthy and harmful to the public, but falls shy of the gross negligence standard and so is not held accountable.

The impact of this elevated standard of proof to a threshold of gross negligence is limited to cases brought solely under Rule 29.1. The elevated standard has not been extended to charges brought against individuals under any other rule, for example, Rules 1300, 18, and 38. Violations under these rules are subject to a standard of simple negligence.

IIROC has argued, in appropriate cases, that there is a second branch of Rule 29.1, which proscribes conduct “detrimental to the public interest”. This issue (i.e. whether there is a second branch to Rule 29.1 – “conduct detrimental to the public interest”) has not been decided by an IIROC panel to date, because IIROC met the higher threshold of gross negligence in those cases where it has been argued.

IIROC is in the process of considering an amendment to Rule 29.1 to address this issue. The objective of this amendment is to afford IIROC the ability to pursue charges of conduct detrimental to the public interest on a simple negligence standard.

#### ***Staff comments and follow-up:***

OSC staff maintain their comments as set out above. We encourage IIROC to continue to bring forward cases that raise the issue of conduct detrimental to the public interest and the appropriate standard of liability as an interim measure, and also to seek an amendment to Rule 29.1.

## **9.5 Review of litigation files**

### ***Background information***

OSC staff reviewed a sample of nine litigation files concluded during the Review Period. The sample included six files related to member conduct matters and three files related to marketplace matters.



***Staff findings***

OSC staff found that most files were closed on a timely basis. Where hearings were involved, they were conducted in accordance with IIROC’s *Rules of Practice and Procedures*, and IIROC properly notified the Commission, public and media of disposition of hearings, as required by the OSC RO. The files showed that there was consultation with other IIROC Enforcement groups, where appropriate, and there was secondary review.

OSC staff found that in one case where there were parallel OSC proceedings against an individual, IIROC delayed commencement of its own proceedings in order to wait for the conclusion of the OSC matter; the delay experienced was significant (over one year), and IIROC eventually decided to close the file with no action because in the time lapsed there were challenges against IIROC’s jurisdiction over former members. To avoid such delays in the future, OSC staff would like to work with IIROC staff towards enhancing “parallel” proceedings cooperation and will contact IIROC Enforcement staff to discuss this.

OSC staff also found that in two cases there were indications of supervision deficiencies at the Dealer Member, but the supervision aspects of the files were not pursued or were closed with no action.

***Staff recommendation***

- 45. IIROC should be more proactive in pursuing and advancing cases to prosecution in instances where there is evidence that supervision of a Dealer Member is an issue.

**Priority: High**

***IIROC’s response:***

IIROC disagrees with this finding. The files reviewed by the CSA which form the basis for this recommendation do not support the finding.

In the files cited by the CSA as examples that IIROC was not proactive in advancing supervision cases where there was evidence of misconduct, it was determined by IIROC staff that there was insufficient evidence to initiate proceedings. In both cases there were memos on file outlining the basis for the determination of insufficient evidence.

IIROC staff reviews the supervision of the underlying alleged misconduct in every investigation file.

***Staff comments and follow-up:***

OSC staff acknowledge IIROC’s response. We will continue our dialogue with IIROC Enforcement staff to achieve consistency in the approach regarding cases related to supervision.

## **F. Business Conduct Compliance**

### **1. Introduction**

IIROC is required by T&C#8 of the OSC RO to ensure it has adequate arrangements and resources for the effective monitoring of its Members' compliance with IIROC rules, as well as with securities legislation.

The Business Conduct Compliance (BCC) department's key responsibility is to monitor IIROC's Members' adherence to non-financial regulatory requirements, including those of IIROC, provincial securities acts and federal legislation such as Proceeds of Crime (Money Laundering) and Terrorist Financing Act 2001. To meet this responsibility, BCC staff conduct regular reviews and on-site examinations of Members including Dealer and, more recently, Marketplace Members, focusing on issues of suitability, anti-money laundering due diligence, supervision, corporate finance and research, employee activities and internal controls. BCC also provides best practice guidance and rule interpretations. In addition, it provides feedback on policy development to IIROC's policy group. BCC staff are also involved in the review and approval of membership applications.

### **2. Purpose and scope**

The main objectives of this part of the oversight review were to:

- Review and evaluate the structure, resources, including staffing, of the BCC group to ensure it performs its regulatory functions effectively and efficiently;
- Evaluate the adequacy of the performance measurement benchmarks for compliance examinations and determine whether they were met;
- Assess whether BCC is focusing on current risks and regulatory concerns when conducting its field reviews;
- Assess whether results of sweeps are used appropriately and to properly focus regulatory risks and concerns;
- Assess the adequacy, timeliness, and quality of compliance examinations performed by BCC staff; and
- Assess whether deficiencies reported in the last oversight review report were followed up and addressed by IIROC.

### **3. Department organization and reporting structure**

#### ***Background information***

OSC staff reviewed the BCC department's organizational chart for the Toronto region and noted that as at September 30, 2009, the BCC department consisted of 10 examiners, one senior examiner and four technicians who reported directly to one of seven managers. The seven BCC managers (one of which is on leave from July 2009 to June 2010) report directly to the Director of BCC. The Director of BCC reports to the VP of BCC, who in turn reports to the SVP of Surveillance & Compliance.

### ***Staff findings***

The review of the reporting structure of IIROC's BCC department raised no concerns regarding its adequacy.

### ***Staff recommendations***

None.

## **4. Interaction and communication with other IIROC departments**

### ***Background information***

OSC and NSSC staff met with the Director of BCC and the VP of BCC to discuss the BCC department's communication with the Policy and Enforcement departments.

OSC and NSSC staff were informed that on a monthly basis, Enforcement provides BCC with monthly reports regarding the status of the files referred to them by BCC. In addition, the BCC and Enforcement managers meet on an "as needed" basis to discuss 'grey areas/issues' that arise to determine whether the issue would be an Enforcement matter.

In addition, we were provided with internal reference manuals and policies and procedures regarding referrals to Enforcement entitled *Enforcement Referrals – Guidelines for handling enforcement referrals*. The referral policies specify the circumstances under which the BCC department is to refer files to Enforcement, which include instances of significant repeat deficiencies and serious compliance weaknesses.

We were also advised that the BCC interacts, as the need arises, with the Policy department to discuss interpretation of rules and policies.

### ***Staff findings***

BCC's process for communicating with the Policy and Enforcement departments does not raise concerns.

### ***Staff recommendations***

None.

## **5. Staffing resources and training**

### ***Background information***

OSC and NSSC staff met with the Director of BCC and the VP of BCC to discuss staffing resources. During these discussions, we were advised that, at the end of the Review Period, BCC was at full complement. Per discussion with the Director and VP of BCC, the current staff complement in the BCC department meets the current budget, and new staff will be hired according to what the budget will permit.

Initial training provided to staff involves a combination of group training sessions, self-study, and on-the-job training. Ongoing training is also provided through monthly national staff meetings for all staff of the BCC department where discussions are held regarding various issues including new regulatory concerns, emerging trends and new investment products.

### ***Staff findings***

OSC staff reviewed IIROC's written training materials and noted that they were adequate and comprehensive. The training materials include, but are not limited to, guidance on file documentation, documentation of review findings and recommendations to address them and guidance on how to complete the risk assessments. The initial and ongoing training processes also appear thorough and adequate.

With respect to staffing resources, OSC and NSSC staff noted that during the Review Period, there was a high turnover rate in the BCC department. For example, the turnover rate for the years ending 2006 and 2007 were 17.4% and 7.4%, respectively. In addition, the turnover rate for the period of June 1, 2008 to September 30, 2009 was 23.1%. This high turnover rate, due to factors including employees accepting positions within other areas of IIROC, retirement and maternity leaves, is one of the factors that prevented the BCC department from achieving its benchmark for issuing examination reports (refer to Section 6). Further, we note that this same issue was identified in the last oversight review of the IDA. At that time we were informed that BCC were actively recruiting, rectifying compensation disparities, implementing various automation projects and introducing procedural changes. While these actions may be noteworthy, they have not created the expected improvement to staffing issues. The fact that IIROC has consistently not met its benchmark for issuing examination reports highlights this issue as a concern.

OSC staff recognize that IIROC is making efforts to address the turnover problem and continues to consider other measures to improve the efficiency of the BCC department, such as implementing a new audit program (i.e. modules) on a more efficient platform for documenting field reviews called TeamMate (refer to Section 8). In addition, BCC is now making efforts in retaining staff by placing more focus on staff and training.

### ***OSC and NSSC staff's recommendation***

46. IIROC should continue with its efforts to hire and retain qualified BCC staff. IIROC should also contemplate whether the current and past approaches to staffing are working and consider whether more aggressive measures are necessary to ensure appropriate staffing levels are met and maintained.

**Priority: High**

#### ***IIROC's response:***

IIROC notes that BCC staff are quite attractive to the industry once they are fully trained, so that IIROC has faced challenges in hiring and retaining qualified BCC staff.

IIROC will add examiner positions to enhance BCC's ability to achieve its examination benchmarks, and will provide improved training for entry level examiner positions.

IIROC is also considering a restructuring of the BCC department intended to ensure that adequate senior resources are available.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC and NSSC staff request details regarding the increased number of examiner positions and plans for improved training. We also request confirmation as to whether IIROC has restructured BCC as indicated in IIROC's response and if so, the details regarding the changes.

**6. Benchmarks**

***Background information***

OSC and NSSC staff met with the Director and the VP of BCC to discuss the benchmarks for the BCC department in the Toronto region. In addition, staff discussed the process in place to monitor adherence with the established benchmarks.

The benchmarks for issuing examination reports during the Review Period are as follows:

- 60% of the reports are to be issued within 15 weeks of completion of the field work;
- 100% of the reports are to be issued within 26 weeks of completion of the field work;
- the portion of reviews of new membership applications to be completed by BCC staff must be completed (i.e. a response sent to the applicant) within two weeks from the receipt of the applications.

The Director of BCC monitors whether these benchmarks are met on a monthly basis.

***Staff findings***

OSC staff noted that during the Review Period, BCC was not able to meet its benchmark for issuing examination reports. For example, IIROC's (and, before the merger, the IDA's) fourth quarter reporting to the OSC for the years 2006, 2007 and 2008 revealed the following:

	<b>2006</b>	<b>2007</b>	<b>2008</b>
% of reports issued within 15-weeks	24%	29%	13%
% of all reports issued within 26 weeks	81%	82%	56%

Benchmark results for the periods of June 1/08 to March 31/09 and April 1/09 to June 30/09 are as follows:

	<b>June 1/08 to March 31/09</b>	<b>April 1/09 to June 30/09</b>
% of reports issued within 15-weeks	55.4%	62.5%
% of all reports issued within 26 weeks	88.7%	81.5%

Similarly, NSSC staff noted that during the Review Period, BCC has only once been able to meet its

benchmark for issuing examination reports to Nova Scotia Members. Benchmark results for the years 2006, 2007 and 2008 are indicated below:

NSSC	2006	2007	2008
% of reports issued within 15-weeks	50%	0%	0%
% of all reports issued within 26 weeks	100%	50%	50%

IIROC explained that this was partly due to high staff turnover resulting from examiners accepting other positions within IIROC and compliance staff leaving to work for other regulatory authorities. Additional reasons given were staff being on maternity leave (as noted in Section 5), new hires not working out, and training initiatives. In efforts to improve BCC’s ability to meet its benchmark, BCC is developing a new audit program on a more efficient platform. In addition, BCC managers will be making site visits throughout the field work period to provide BCC Examiners with training, and/or helping with the completion of the field work.

***OSC and NSSC staff’s recommendation***

- 47. OSC and NSSC staff reinforce the recommendation in Section 5 that IIROC should consider an aggressive plan to stabilize staffing levels, which appears to be the overriding factor in its inability to meet established benchmarks. Once this is done, IIROC should review and reassess the appropriateness of its business conduct compliance benchmarks.

**Priority: High**

***IIROC’s response:***

Benchmarks like those discussed above are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. BCC is undertaking a review and analysis of the current BCC examination cycle and benchmarks in light of current examination staffing levels. More generally, IIROC is reviewing all compliance benchmarks to ensure they are appropriate.

***Staff comments and follow-up:***

IIROC’s response is adequate. OSC and NSSC staff request the results of the review of BCC’s examination cycle and benchmarks.

**7. Written procedures and guidance**

***Background information***

OSC and NSSC staff met with the Director of BCC to discuss BCC’s written policies and procedures. In addition, we obtained and reviewed BCC’s written policies and procedures dated August 2009 entitled *Business Conduct Compliance – Policy, Procedure and Technical Guide*. The manual is divided into 3 sections: Regulatory Functions, Administration and Technical Guide. The section relating to Regulatory Functions encompasses some of the following topics:

- Risk assessment model
- BCC examination process
- Enforcement referrals
- New dealer member applications
- Dealer member material changes
- UN Suppression of Terrorism System Reporting
- Joint compliance risk trend report

The section relating to Administration encompasses some of the following topics:

- Quality assurance program
- Annual report
- Benchmarks
- Role of manager

The section relating to Technical Guide encompasses some of the following topics:

- Quarterly management reports
- UBSS
- Updating risk profiles (MIRA)
- Suitability review for monthly statements
- Time reporting

OSC staff were also advised that the manual is continuously being reviewed and updated by the Director of BCC, at least annually.

The manual also includes the identified risk inherent in the existence of a branch network and the types of exams IROC undertakes, which include branch exams.

### ***Staff findings***

The BCC department's *Business Conduct Compliance – Policy, Procedure and Technical Guide* provides adequate guidance with respect to the process of conducting BCC field examinations. There is also an adequate process in place to update these policies and procedures periodically, given that the Director of BCC reviews the policies and procedures at least annually.

### ***Staff recommendations***

None.

## **8. Regular BCC examinations**

### ***Background information***

OSC and NSSC staff interviewed the Director and the VP of BCC to discuss how BCC selects Members for business conduct compliance reviews. In addition, we reviewed BCC's written policies and procedures manual.

*Selection of members:*

In selecting Members for compliance examinations, BCC uses a risk based approach. Per review of BCC's policies and procedures manual, BCC's Risk Assessment Model is a risk management tool to help identify, define, assess and weigh risks in respect to IIROC members to determine priority of focus in the examination cycle. The model also determines whether a branch review of the member will be conducted and gives an indication of the comparable risk assessed for each member relative to other firms. Those members that are considered high risk will be reviewed more frequently than those considered lower risk.

*Integrated examinations:*

Per discussions with the VP of BCC and per review of IIROC's quarterly report ending June 30, 2009, IIROC conducted a pilot test to integrate the financial operation, business conduct compliance and trade desk compliance examinations for 4 Dealer Members. This involved coordination in scheduling, planning, execution, exit meeting and final report by Financial Operations, BCC and Trading Conduct Compliance examination staff. The integrated examination will also include post examination feedback from the Dealer Members that participated in the pilot tests. The results of the pilot work and feedback will be taken into consideration in determining how many integrated compliance examinations will be conducted for the 2011 examination schedule year.

*Examination program:*

Staff obtained and reviewed the examination program for Head Office examinations. The most notable updates during the Review Period were the addition of procedures to examine Dealer Members' due diligence procedures regarding "know your product" and the addition of a section relating to branch office procedures.

In addition, BCC conducted branch sweeps during the Review Period and developed examination modules to address areas of concern with respect to branch offices.

Furthermore, examinations of ATSS, which are both Dealer and Marketplace Members, were also conducted during the Review Period and examination modules were tailored to address concerns impacting ATSS. For example, the ATS examination module included the following sections: Supervision of employees, National Instrument 23-101, Advertising, Promotions and Sales Literature, and Other Business Activities.

***Staff findings***

OSC staff noted that branch offices were not selected for regular examinations during the Review Period. OSC staff acknowledges that during the Review Period, BCC conducted a Branch sweep where BCC conducted examinations of 28 branch offices and 10 head offices (refer to Section 9 for further details). However, similar to the concern raised in the 2006 oversight review, OSC staff continues to raise the concern that BCC may not be conducting a sufficient number of examinations of branch offices to adequately assess the member's compliance at the branch level.

NSSC staff noted that IIROC does not perform branch examinations in Nova Scotia. The fact that branch examinations are not conducted by the Toronto head office of IIROC has been raised in the three previous oversight reviews and yet no action has been taken to rectify the situation. This issue would seem to be in direct conflict to both BCC's written policy and procedures and the NSSC RO. NSSC staff do not perceive how IIROC can be meeting its mandate within the province without conducting regular branch reviews.



OSC also noted that the examination modules do not always have adequate guidance for examiners in conducting their examinations. For example, the modules do not identify the purpose and/or objective of a procedure or the associated risks. However, OSC staff acknowledges BCC's on-going initiative to revise the modules, such that each new and revised module will have an objective, and a study guide/education tool to provide examiners with guidance and to help examiners understand the risks that are being addressed. The new modules will be incorporated into BCC's new audit program in the TeamMate platform which is easier to navigate and more user-friendly. The roll-out of TeamMate and the new modules is scheduled to occur in the new fiscal year.

***OSC and NSSC staff's recommendations***

48. OSC staff recommend that branch reviews become part of BCC's regular review process to ensure adequate coverage and an adequate number of branch reviews are conducted per year.  
**Priority: High**

***IIROC's response:***

BCC now includes branch reviews as part of its regular planning of head office reviews. Given the number of branches (over 5,000), IIROC staff will plan the review of branches in each region using a risk-based approach. Branch reviews will be conducted at the same time as head office reviews, using BCC resources in the regions.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff will review the adequacy of the number of branch reviews performed as part of their ongoing oversight of IIROC's BCC function.

49. NSSC staff expects that branch examinations of members will be conducted in Nova Scotia by IIROC to sufficiently meet its obligations with regards to the NSSC RO. NSSC staff request that IIROC develop a plan to address this issue which will provide appropriate and proportional geographical coverage for IIROC's Members based in Nova Scotia.  
**Priority: High**

***IIROC's response:***

BCC staff have already completed a full examination of a Halifax-based Dealer Member at its head office. Additional reviews of Nova Scotia branches of Dealer Members with head offices outside Nova Scotia will be scheduled to ensure appropriate and proportionate geographical coverage, taking a risk-based approach.

***Staff comments and follow-up:***

Notwithstanding IIROC's risk-based approach to branch examinations, there must be a plan for regular examinations of Nova Scotia branches. High risk head offices of member firms, mostly located in the larger jurisdictions, could result in no allocation of compliance resources in Nova Scotia. IIROC staff should work with the NSSC to develop a satisfactory examination plan for Nova Scotia.

50. BCC should continue with its efforts to make improvements to the modules to enhance the guidance provided to examiners and inform OSC staff when this initiative has been completed.  
**Priority: High**

***IIROC's response:***

IIROC has already undertaken a detailed review of all elements of its examination modules and TeamMate is scheduled for implementation in April 2011. TeamMate is currently being rolled out for testing and training across the country. Following implementation, the modules will be continuously enhanced and updated with new and/or revised substantive compliance elements, and with improvements to examination processes, including guidance for examiners.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff request to be notified upon completion of the implementation of the revised examination modules in April 2011.

## **9. Targeted reviews and sweeps**

### ***Background information***

OSC and NSSC staff interviewed the Director of BCC and the VP of BCC to discuss targeted reviews and sweeps and the processes involved in planning and executing these initiatives.

OSC staff were informed that the determination of the type of sweep to be conducted is based on issues that come from senior management and emerging issues impacting the industry. For example, during the Review Period, BCC conducted a branch sweep and a principal protected notes (PPN) sweep. Although the PPN sweep is referred to as a sweep, it was more of an information gathering process since no on-site visits were conducted.

### ***Examination Programs***

As each sweep has its own focus, examination programs are tailored to reflect the nature of the sweep. In general, review procedures are developed to address the specific areas being reviewed during the sweep and the scope of the sweep will also vary based on the nature of the sweep being conducted.

### ***Selection process and Results of Sweeps***

The selection process for sweeps are also tailored to reflect the nature of the sweep. The results of the sweeps may consist of an internal report, an industry report and/or deficiency reports issued to Members.

### ***Staff findings***

With respect to the Branch Sweep that was conducted, OSC and NSSC staff noted that although deficiencies were identified and reported to the Members, Members were not required to respond to the findings outlined in the deficiency report.

### ***OSC and NSSC staff's recommendations***

51. OSC and NSSC staff recommend that any deficiencies noted in the process of a review or sweep

should be addressed and rectified by the Member.

**Priority: High**

***IIROC's response:***

IIROC will require that Dealer Members with findings detected during a regulatory review must respond to the findings in a timely manner and to IIROC's satisfaction as in normal Dealer Member examinations. IIROC has taken this approach to reviews and sweeps since the Branch Sweep.

While the PPN sweep was an information-gathering process with no on-site testing, IIROC staff has worked with all survey participants to ensure that all significant findings are addressed in a timely fashion.

Participants in the subsequent Product Due Diligence sweep each received written deficiency letters with timely follow-up by BCC Managers.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**10. Review of BCC examination files**

***Background information***

BCC provided OSC and NSSC staff with a listing of all BCC examinations conducted during the Review Period.

OSC staff reviewed the files for five of the 117 business compliance examinations conducted during the Review Period by the Toronto office. In addition, OSC staff reviewed one branch sweep examination file. The sample was selected to obtain coverage over size, BCC managers, type of Member (i.e. local vs. national firms, ATs), type of review (i.e. regular review vs. sweep), and both open and closed files. NSSC staff reviewed all of the five files related to BCC examinations conducted in Nova Scotia during the Review Period.

***Staff findings***

***OSC staff findings***

OSC staff's review of the sampled files showed that the level of analysis was thorough and the examination program included procedures which addressed regulatory changes and new rules.

OSC staff noted that, for all files reviewed, the member firms' risk assessment documents and planning forms were completed and reviewed by the manager prior to the start of the field work. Findings from previous reviews that required follow-up were properly identified, as were high-risk areas that required additional testing.

OSC staff noted that several files reviewed did not contain adequate documentation relating to the methodology behind how samples were selected for testing purposes. In addition, OSC staff noted that several of the files reviewed did not meet BCC's benchmark relating to the issuance of final reports (i.e.

final reports were not issued within either the 15-week or 26-week benchmark).

Furthermore, OSC staff noted that Members were not always required to respond to deficiency reports in the same manner. For example, some members were required to respond only to the significant deficiencies identified, while others were required to respond to both the significant and insignificant deficiencies identified. This practice promotes inconsistencies in the resolution of findings. However, we acknowledge that BCC has recently started to require a response to all deficiencies identified in the report, and BCC will require the member to give a general undertaking that they correct insignificant deficiencies identified.

*NSSC staff findings*

NSSC staff noted that in two files there was no indication that a risk assessment had been completed. In one file, risk scores were not applied as the scope of the review was expected to be limited. Commentary was provided which was intended to support the decision to include or exclude certain areas from the examination; however without a risk analysis it is difficult to determine if the scope was appropriate. One file indicated a change in the existing strategy to perform BCC reviews due to time constraints, which appears to be in conflict with the protocol for BCC. Members were only required to respond to significant deficiencies and in one case no response was required at all.

In one file, repeat deficiencies were noted in three consecutive reviews with no explanation as to why they were not addressed or followed up. Additionally, there was a lack of obtaining timely responses from the Member. This was apparent in a second file as well. Although a response is required within one month, it was noted that IIROC was not requesting a 'date to respond by' in their reports.

NSSC staff note that most files did not meet BCC's benchmark of 15 and 26 weeks for issuing final reports.

*OSC and NSSC staff's recommendations*

- 52. In order to ensure the adequacy of file documentation and the amount of testing performed, IIROC should ensure that examination files contain the examiners' methodology behind how samples are selected for testing.

**Priority: Low**

***IIROC's response:***

IIROC currently has written general guidance on sample selection methodology. TeamMate will include specific sample selection and testing guidance within each module.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

- 53. BCC should continue with its efforts in meeting its benchmark for to the issuance of final reports.

**Priority: Medium**

***IIROC's response:***

Benchmarks are a management tool designed to assist management in tracking performance and program

deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. IIROC will continue in its efforts to meet BCC benchmarks for the issuance of final reports, and will include a review of this benchmark in the overall review of benchmarks.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

54. NSSC staff note that IIROC has started to implement improvements to BCC which were discussed during the review including file management, file standards, benchmarks for replies from Members (which includes both the level and timing of response) and guidance to IIROC staff for follow-up on no response from the Member. NSSC staff recommend that any improvements not yet implemented or not fully implemented be given high priority. As set out before, IIROC must give due energy and time to the issue of staffing which seems to be having a direct effect on the quality and timeliness of reports.

**Priority: High**

***IIROC's response:***

IIROC will continue its efforts to analyse and improve the BCC work flow process, and will consider specific measures to address timeliness issues.

***Staff comments and follow-up:***

IIROC's response is adequate. Please provide the specific measures implemented to address timeliness issues.

## **G. Financial and Operations Compliance**

### **1. Introduction**

IIROC's Financial and Operations Compliance group (FinOps) is part of the IIROC's Surveillance and Compliance Department. It has four offices operating from Toronto, Calgary, Montreal and Vancouver. The group's primary responsibility is to review and analyze Members' financial filings to ensure each Member maintains and accurately reports adequate capital in accordance with IIROC rules. FinOps staff also conduct on-site financial examinations of members and review working papers prepared by the auditors of IIROC Members (AWP). FinOps is also required by its ROs to notify the RRs of circumstances with respect to a Member in financial difficulty including, but not limited to, capital deficiency, serious deficiencies in internal controls, and any conditions that could give rise to payments being made out of the Canadian Investor Protection Fund (CIPF), as well as a summary of the actions taken by IIROC to resolve the situation.

### **2. Purpose and scope**

The main objectives of this part of the oversight review were to review and evaluate the structure and resources of FinOps; to evaluate the adequacy of the performance benchmarks used by the group; and to assess the adequacy, timeliness, and quality of financial compliance examinations and reviews of financial filings.

In order to accomplish these objectives, OSC staff reviewed various internal policies and procedures, interviewed FinOps management, and reviewed samples of files and other reviews done by FinOps staff.

### **3. Department organization and reporting structure**

#### ***Background information***

OSC staff discussed the structure of IIROC's Toronto FinOps group with management. We also reviewed its organizational chart to gain an understanding of the staffing and reporting structure of this group.

In Toronto, FinOps consists of 18 Senior Examiners who report to six FinOps Managers, who in turn report to two Directors (one of them being an Acting Director on a one year term basis). The FinOps Directors report to the VP of FinOps, who in turn reports to the SVP Compliance and Surveillance.

Each Manager looks after a portfolio of over 20 firms. The intention is for the Managers to be intimately familiar with developments at Members under their watch. Examiners are "generalists" who are not assigned to any particular Manager or Member portfolio. They will assist in field examinations as assigned. Most Examiners have been with FinOps for a long time, and have all been promoted to senior status.

#### ***Staff findings***

OSC staff found the overall reporting structure and organization of FinOps adequate.

***Staff recommendations***

None.

**4. Communication with other departments**

***Background information***

OSC staff interviewed relevant IIROC management to understand how FinOps interacts and liaises with other IIROC departments.

***Staff findings***

We were informed that current interaction with other areas within IIROC is informal and communication done mostly through e-mail. While it is FinOps standard procedure in the examination planning process to request and review the last examination report issued by BCC and TCC, during the Review Period there were no regular, formal meetings with other divisions such as BCC and TCC to share experience and information. FinOps, BCC and TCC did not hold pre-examination planning sessions together to obtain information from each other that can be helpful in assessing the risk or issues related to a Member.

***Staff recommendations***

55. FinOps should establish a more frequent and formal communication process with other IIROC departments to share information and ideas relevant to the ongoing monitoring process of Members. We acknowledge that efforts have already been made in this area, for example, through the pilot program where FinOps, BCC and TCC staff coordinate their field review of Members, and encourage such efforts.

**Priority: Medium**

***IIROC's response:***

IIROC agrees that such communication is critical. Communication amongst IIROC departments has always been frequent and effective, and IIROC has formalized certain channels of communication. Since 2008, the Surveillance and Compliance Management Committee (comprising the VP and Directors for all compliance departments, including the regions) has met twice a month in order to discuss industry developments and firm issues. This information is then shared with staff at weekly FinOps manager meetings and quarterly with all FinOps examination staff.

Since January 2010, the Dealer Member portfolios of BCC and FinOps managers in Toronto have been aligned to promote consolidated knowledge of the business activities and regulatory issues of each firm, and to enhance the profiling of each firm for risk assessment purposes.

New procedures ensure that the Managers for each Dealer Member from each compliance area participate in the field planning meeting to enhance the consolidated understanding of the firm.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **5. Staff resources**

### ***Background information***

OSC staff reviewed FinOps' organizational chart and met with IIROC management to discuss staffing resources. Currently, FinOps has 50 employees in four offices across Canada. These offices are located in Ontario, Montreal, Calgary, and Vancouver. The four offices have a total of 10 Managers (six in Ontario, one in Calgary, two in Montreal and one in Vancouver), 33 Senior Examiners (18 in Ontario, two in Calgary, 8 in Montreal and 4 in Vancouver), three Directors (two in Ontario and one in Montreal), a VP and three Assistants.

### ***Staff findings***

Based on discussions with IIROC management, staffing levels supporting the FinOps Toronto functions appeared to be adequate. This finding is also supported by the fact that staff of the FinOps group in Toronto met the benchmark for issuance of field review examination reports. IIROC management also believed that the staffing levels were sufficient to meet the current workload and indicated that the Toronto FinOps group has been able to attract qualified candidates with the right industry experience, and enjoyed a low turnover of staff.

In addition, OSC staff's review of IIROC's Self Assessment Report, which includes statistics on staff turnover rate in the regional offices since 2004, showed that the turnover rate in the Toronto Office was less than 5% in 2007 and 0% for the 10 months from June 1, 2008 to March 2009.

### ***Staff recommendations***

None.

## **6. Training**

### ***Background information***

OSC Staff reviewed the FinOps Policies, Procedures & Guidelines and discussed with management the types of training provided to FinOps staff.

The continuing professional development and industry training for FinOps staff include structured and unstructured activities. Structured continuing professional development activities that Examiners are required to complete include:

- Industry and CICA courses;
- Industry seminars such as the IIROC Member Seminar; and
- The Panel Auditors' Seminar.

Unstructured continuing professional development activities include:

- In-house training sessions on technical issues;
- Weekly Member Issues Meetings where FinOps managers across Canada discuss member or industry issues;
- Quarterly Examiners' meetings, where Examiners discuss issues encountered and share



- information and ideas; and
- Informal lunch-and-learn sessions.

Examiners do not attend the weekly Member Issues Meetings. However, all items discussed in these meetings are recorded in SharePoint, an electronic information storage system, by meeting date, and Examiners have full access to the issues discussed at these meetings.

Training of new Examiners is achieved by assigning them to a Manager who is responsible for instructing them and for monitoring their training. As part of the training, this Manager will give on-the-job instructions to the new Examiner which include:

- Explanation of all examination procedures;
- Description of what is considered sufficient file documentation;
- Determination of extent and type of sample selection; and
- Completion of finding forms, risk assessment analysis and deficiency letters.

New Examiners are expected to complete the Canadian Securities Course within the first year of employment. Other courses such as the CSI Derivatives Fundamentals Course and the Chief Financial Officers Qualifying Exam must be completed before the Examiner is promoted to a Senior Examiner status.

Recently, FinOps has established a “Manager in training” program. Two Senior Examiners were identified to participate in the program. As part of the program, these Senior Examiners were given an opportunity to take on a portfolio of Members to manage under the direction of a Manager. This allows the Senior Examiners to gain valuable management experience and, at the same time, allows Managers with more seniority to devote more time to leading strategic compliance initiatives.

### ***Staff findings***

The structured professional development and industry trainings for Examiners and Managers are comprehensive and appear to be adequate.

### ***Staff recommendations***

None.

## **7. Benchmarks**

### ***Background information***

The benchmarks for key FinOps functions are as follows:

- Attain an average examiner utilization rate of 70%, meaning that 70% of available staff time is to be spent directly on Member reviews;
- Examine every Member annually (except for Members approved for biennial reviews, which generally include Members that are deemed to be low risk based on the risk assessment model);
- Complete and issue 60% of field examination reports within eight weeks, and all within

- six months from the end of the field work;
- Review AWP's within three months of their filing date for high-risk Members; and
- Complete and issue preliminary deficiency reports within two weeks of receipt of applications for new membership.

### ***Staff findings***

The existing benchmarks for FinOps appear reasonable and attainable. During the Review Period, FinOps met its key benchmark of examining every Member annually (except for Members approved for biennial review) and of issuing the examination reports within the targeted timeframe.

### ***Staff recommendations***

None.

## **8. Financial filing review**

### **8.1 Processes for review of Members' filings**

#### ***Background information***

Members are required to file a monthly regulatory report referred to as the "Monthly Financial Report" (MFR) within 20 business days after the end of each month, and the Form 1 *Joint Regulatory Financial Questionnaire and Report* (JRFQ&R) on an annual basis. Members file the MFRs and JRFQ&Rs on a web-based reporting system – The Securities Industry Regulatory Financial Filing System (SIRFF) - that collects financial information in a central database and is accessed by IIROC, CIPF and Members.

OSC staff discussed the review process of MFRs and JRFQ&Rs filed in SIRFF with FinOps management. We also reviewed the key analytical reports available on the SIRFF system and used by FinOps staff to analyze data included in MFRs and JRFQ&Rs.

FinOps Managers review the Members' filings and, as part of their review, check financial statements and related schedules for trends and significant unusual fluctuations. Examiners are not involved in the review.

#### ***Staff findings***

OSC staff noted that, while the FinOps Policies and Procedures Manual documents the MFR review process, there are no written comprehensive review checklists, or programs, for the desk reviews of MFRs submitted by Members. Rather, Managers, based on their cumulative knowledge of their assigned Members, check for early warning triggers, capital deficiencies, free credit segregation deficiencies, insurance deficiencies, and unusual changes or fluctuations in financial statement items. Managers evidence their review and approval of the MFR by changing the status of the filing in SIRFF to "passed SRO Review" within 25 business days of the month-end of the MFR.

JRFQ&R reviews are done annually and, in the past, the review was done in conjunction with IIROC staff's review of the AWP's (see section 9.a of this part of the report for further information on the AWP reviews). FinOps Managers follow a number of simple procedures to review the JRFQ&Rs, the purpose

of which is to ensure that statements and schedules are properly completed with no early warning triggers, free credit or insurance deficiencies. The procedures do not provide guidance on the review or any in-depth analysis. Review comments are documented in the “SRO comment” section on SIRFF and the FinOps Managers will pass the JRFQ&R to CIPF when the review is complete.

OSC staff noted that the analytical reports produced by SIRRF are comprehensive and provide a useful analytical tool for Managers to focus on critical financial statement information for the purposes of MFR or JRFQ&R review. These reports provide variance calculations of certain line totals or key items of the financial statements, but do not provide variance analysis of each line item in the MFR or JRFQ&R. We noticed that in the review of year-end JRFQ&R, some FinOps staff manually performed their own line-by-line variance calculation, which can be time-consuming and prone to clerical mistakes.

***Staff recommendations***

56. OSC staff acknowledge that experienced Managers perform the MFR desk reviews, but are of the view that checklists that formalize the procedures used are useful reminders of steps to be performed in the review and promote consistency of the review procedures performed by different FinOps Managers. Therefore, we recommend that FinOps consider developing an in-office review program to assist in the monthly reviews of MFRs. Such procedures could include guidance and criteria and conditions for follow up, and documentation on how issues are resolved or actions taken.

**Priority: Medium**

***IIROC’s response:***

The workflow for all regulatory financial reports is managed on-line using the SIRFF application that fully integrates the financial filing for regulatory review. IIROC has initiated enhancements to the SIRFF system to better evidence Manager sign-off following in-office review of MFRs. This enhancement will be implemented by April 1, 2011, subject to program change priority given to IFRS initiatives.

***Staff comments and follow-up:***

IIROC’s response is adequate. OSC staff would like to obtain more information on the enhancement that will be implemented in April 2011 as evidence of sign off following in-office review of MFRs.

57. If FinOps staff find it useful to manually produce a line-by-line analysis of the financial statements in the JRFQ&R or MFR, IIROC should consider automating the process. A complete line-by-line variance report can assist managers in a more thorough and efficient review, and may prevent clerical errors associated with manual calculations.

**Priority: Low**

***IIROC’s response:***

The SIRFF system enhancements noted above will include a report to flag unusual and material variances (including financial performance ratios and key item line-by-line percentage changes) for the Manager to follow up and document the resolution or explanation.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **8.2 MFR and JRFQ&R File review**

### ***Background information***

OSC staff reviewed a sample of 15 MFR filings and four filings of the JRFQ&R submitted by Members to assess the adequacy of the desk reviews performed by FinOps staff. The sample covered a period of 24 months between October 2007 to September 2009. Firms selected for review includes independent brokers, introducing brokers, bank owned firms, and firms with financial difficulties and had triggered early warnings. As part of the review, OSC staff identified significant changes or fluctuations on the MFRs that warranted, in our view, further investigation, and assessed the adequacy of the FinOps Managers' review and follow-up of such items.

### ***Staff findings***

OSC staff found that the reviews of MFRs and JRFQ&Rs were completed on a timely basis. OSC staff identified a few noticeable variances in the financial statements that, in our opinion, required clarification. For example:

- in a couple of instances, Members reported noticeable increases in the margin provided on unresolved differences on Statement B *Statement of Net Allowable Assets and Risk Adjusted Capital* of the MFR (Statement B); although the increase in margin did not affect the Member's capital position, the existence of unresolved differences deserved an explanation from the firm as it could have been an indication of potential concerns with the Member's operations or internal controls
- OSC staff identified significant increases or decreases in operating expenses reported on Statement E *Summary Statement of Income* and significant increases in margin provisions on Statement B, but found that there were few or no explanations provided by either the Member with their filing, or by the FinOps Manager in the comment section on SIRFF

### ***Staff recommendations***

58. For reviews of financial filings, IIROC should develop clear guidance on issues that require follow-up with Members. Such issues may include significant variances in financial statements line items or items that are indications of potential operational or internal control deficiencies.

**Priority: High**

***IIROC's response:***

IIROC has adopted and incorporated, into the MFR/JRFQ reviews, internal policies and procedures to address significant variances that may lead to potential operational changes or internal control deficiencies as they primarily relate to "unresolved differences." This will be included in the SIRFF system enhancements noted above.

***Staff comments and follow up:***

IIROC's response is adequate. No further action is necessary.

**9. Review of the AWP's**

**9.1 Process for review of AWP's and written procedures**

***Background information***

OSC staff reviewed FinOps's Procedures, Policy and Guidelines to understand the selection process for AWP review. We also reviewed the "In-Office JRFQ Review and Audit Working Paper Review Program" located in TeamMate, the electronic working paper system used by FinOps for file documentation.

IIROC staff conduct reviews of the AWP's prepared by the panel auditors. Until June 2009, such reviews were done annually, in conjunction with IIROC's reviews of the JRFQ&R filed by Member. Subsequently, IIROC discontinued its practice of performing annual AWP reviews and it now only conducts AWP reviews of Members with heightened regulatory or capital concerns. It also conducts examination sweeps of a representative sample of national, regional and small audit firms on a three-year cycle to ensure they comply with the requirements of IIROC Rule 300 *Audit Requirements*. The reason for the change in approach is that, over the years, IIROC found that panel auditors demonstrated increasing knowledge of IIROC requirements, and therefore reduced the need for IIROC to review their work.

FinOps staff issue a panel auditor report within six months of the due date of the filing, unless the Member is high risk in which case the time period will be three months. The Manager will sign off on the review. The Vice President/Director will only review the file if a condition is placed on the panel auditor.

***Staff findings***

In general, the review program and steps for the review of AWP's are thorough and comprehensive and provides detailed guidance to Examiners.

OSC staff also reviewed IIROC's new approach for selection of AWP's at the time of the change and did not have concerns with the change in approach.

***Staff recommendations***

None.

**9.2 File review**

***Background information***

OSC Staff selected four AWP files related to Members based in Ontario for review. The sample included a file related to a high-risk Member with early warning status.

As part of our review, OSC staff reviewed the file documentation in TeamMate pertaining to the AWP review, the prior and current year letters issued by IIROC to the panel auditors, the current year review findings, and IIROC staff's follow-up procedures.

***Staff findings***

Overall, the AWP review process was comprehensive and the files well structured. IIROC Examiners use a standard template to compile a list of observations to follow up with the panel auditors.

OSC staff found that documentation was generally adequate, with the following exception: while issues were properly identified in the in-office review, documentation on discussions or follow-up with panel auditors was sometimes inadequate. For example, in one instance, the Examiner identified a variance on the JRFQ&R during the in-office review and noted to follow up with the panel auditor, but OSC staff could not find documentation on results of discussion with the panel auditor and/or subsequent comments relating to the issue.

***Staff recommendations***

59. IIROC should ensure that AWP files include documentation of matters to be followed up with the panel auditors, including the results of discussion with panel auditor and the resolution of issues.  
**Priority: Low**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

**10. Field examinations**

**10.1 Written procedures and guidance**

***Background information***

OSC staff obtained and reviewed relevant materials describing FinOps's processes for field examinations. These are the FinOps Procedures, Policies & Guidance, Reference and Self-Study Guide for the Financial Regulation of Securities Firms, and the written examination procedures contained in TeamMate.

***Staff findings***

OSC Staff found FinOps's written procedures and guidance to be comprehensive and structured. They provide FinOps staff with detailed guidance and information relating to the process followed in financial compliance field examinations.

***Staff recommendations***

None.

## **10.2 Member selection process for financial compliance examinations**

### ***Background information***

OSC Staff reviewed FinOps's Member selection process for financial compliance examinations. At the beginning of each calendar year, the VP of FinOps completes an examination plan summarizing the financial examination schedule for the coming year. This schedule lists Members recommended, based on prescribed criteria, for rotational examinations. A rotational examination is the practice of performing a complete examination on a two-year rotational basis for any Member that meets a specified low risk assessment score by applying FinOps's risk assessment model used.

In the event of a change that will materially increase the risk score of the Member at any time during the year, the Member is included in the current examination calendar schedule at the discretion of the VP of FinOps. Similarly, for Members where a material change has been identified within the last quarter of the examination schedule year, an examination must be performed within the first quarter of the following examination schedule year.

In addition to regular reviews, IIROC also conducts sweeps. These are done when IIROC identifies regulatory or emerging issues that warrant further scrutiny. First, a survey is conducted as an initial assessment, to determine if a sweep should be performed. If IIROC management determines that a sweep needs to be performed, IIROC will select representative firms that should be targeted. A specified procedures program is developed and approved, staff resources are assigned, and timelines for the sweep determined. The findings of the sweep are used to provide industry guidance on regulatory expectations, and describes best practices observed. During the Review Period, FinOps staff were involved, along with BCC staff, in two sweeps: (a) the role of IIROC Members engaged in the manufacturing and distribution of third-party asset backed commercial paper; (b) Dealer Members' use of Principal Protected Notes, including examining marketing material, testing suitability assessments, etc.

### ***Staff findings***

In OSC staff's opinion, the selection and review of Members for examinations is adequate. The process for planning sweeps is also adequate.

### ***Staff recommendations***

None.

## **10.3 Financial compliance examination program**

### ***Background information***

OSC staff reviewed the examination program located in TeamMate to assess the adequacy of the procedures and guidance provided to Examiners. The examination program is standardized, but FinOps Managers and Examiners can tailor the program according to a Dealer Member's risk profile and operations.

In order to determine that changes made by FinOps to the standard examination program are reasonable, OSC staff selected a sample of three Type 2 introducing brokers with similar operations and subject to

similar regulatory requirements and compared IIROC's review procedures in the Regulatory, Inventory, and Client sections of the program. All these examinations were completed by FinOps staff prior to March 2009.

### ***Staff findings***

In general, OSC staff found the examination program comprehensive and well structured. It provides Examiners with detailed instructions and guidance.

OSC staff's review of the review procedures in the Client section of the examination programs for the three Type 2 introducing brokers showed that the audit and guidance steps on review of trading activities in significant client accounts that were under-margined or had large debit balances, or overdue client transactions in average price accounts, were inconsistent and generally inadequate. We were informed that, at the end of April 2009, IIROC implemented a new examination program customized to Type 2 introducing brokers. We reviewed the new examination program and were satisfied that the new examination steps were adequate.

### ***Staff recommendations***

None.

## **10.4 File review**

### ***Background information***

OSC staff selected a sample of ten Ontario based Members to review the adequacy of the work performed and documentation in the related working paper files; to determine if matters that warranted Enforcement referral were properly referred to Enforcement; and matters that should have been reported to the Commission under the OSC RO were properly reported. The sample selected included independent and bank-owned dealers and Members in financial difficulty that had triggered early warning.

In conjunction with the oversight review, OSC staff also performed independent field reviews of two Members, a Type 2 and a Type 3 introducing broker, also included in the above sample. The objectives of these two field reviews, conducted in the summer of 2009 were to assess, by re-performing the audit steps of IIROC staff, the quality of their financial compliance examinations, and specifically whether the work performed was timely, appropriate, and file documentation proper and complete.

### ***Staff findings***

OSC staff's review of financial compliance examination files indicated that the work conducted by FinOps Examiners were generally thorough. Files were well structured and organized. OSC staff noted, however, a number of areas where IIROC's processes and approach could be improved. Further detail is included below.

#### ***Members with indications of operational and/or internal control issues***

In general, while each examination module included a section devoted to the review and assessment of the internal controls of the firm, and there were comprehensive checklists listing the minimum applicable internal controls, there were very few comments in the examination reports to Members relating to systemic operational and/or internal control issues. Examination findings included in the deficiency letters to Members appeared to be governed mainly by whether there was a significant impact on the Member's



capital and materiality level, and findings that did not result in financial risk to the firm were excluded from the examination report to Members. OSC staff found that there was no assessment whether, despite their lack of materiality, such findings indicate potential operational or internal control deficiencies. For example:

- one of the Members had consistently reported unresolved differences in the reconciliation of brokers and clearing accounts over a period of 24 months; while the Member had put up capital on these unresolved positions and the amounts were deemed to be insignificant in comparison to the Member's Risk Adjusted Capital, documentation in the FinOps file offered few comments on circumstances that gave rise to these unresolved differences and on whether the fact that they were persistent was an indication of possible weaknesses in the internal controls or operations of the firm; and
- one Member's reconciliation on one of the error clearing accounts showed that some unresolved items were old and were carried forward from 2006, but there was no evidence of FinOps discussions with the Member on appropriate actions to take and time frames to resolve these unresolved items, or whether these unresolved items were an indication of potential inadequacies in the Member's recordkeeping.

#### *File documentation*

In some cases, file documentation was brief and contained insufficient information on the audit work performed; as a result, OSC staff were not able to assess the sufficiency of the work performed by FinOps Examiners. For example, in two of the files reviewed by OSC staff, file documentation related to testing of Foreign Exchange (FX) margin simply indicated "no FX margin reported"; however, OSC staff found that these Members had US dollar inventory positions and FX margin should have been calculated by the firm. It was unclear, based on the file documentation, whether the FinOps Examiners had conducted the required audit procedures and concluded that no margin was required, or that the firm did not report any margin and the Examiners therefore concluded that no further work need to be done.

#### *Members with repeated "significant" findings*

OSC staff found IIROC's procedures for dealing with Members with repeated "significant" findings unclear, and based on the discussions with FinOps management, IIROC did not have an established guideline or policy to deal with repeated deficiencies that indicated potential weaknesses in the compliance culture of the firm. For example:

- in one Dealer Member file, FinOps reviewed trading activities in the account of the senior officer of a Member firm and found trading violations in his Registered Retirement Savings Plan and Tax Free Savings Account in the prior year examination report, there was a similar finding relating to potential trading violations on another account of the same officer; and
- in another Dealer Member file, expenses were not properly reflected on the Member's books and instead, they were allocated to an affiliated company in order to avoid early warning profitability triggers; this was repeatedly raised, but not addressed by the Member.

#### *Reviews of Members' error and suspense accounts*

OSC staff found an instance where work performed by Examiners regarding Members' error and suspense accounts may not have followed the audit procedures specified in the examination program. For example, FinOps audit steps on error and suspense accounts require examiners to note the purpose and "perform detailed review as to how the accounts are cleared and/or margin provided". However, for one

Dealer Member that had a number of operations error/suspense accounts, the FinOps Examiner randomly sampled only one error account to review whether the Dealer Member had performed the necessary reconciliations, on the basis that a supervisor of the Dealer Member had reviewed and approved the reconciliations and margin was provided for unreconciled items. Given that multiple error or suspense accounts with unresolved/unreconciled items generally imply concerns with a firm's adequacy of internal controls and operations, OSC staff are of the view that a more detailed review of a sufficient sample or all error accounts should have been performed.

*Documentation of sample selection methodology*

Documentation on the methodology for sample selection was generally inadequate and OSC staff also noticed that the sample sizes were not always reflective of the population and/or complexity of the environment. OSC staff were informed that FinOps is revising its sample selection process and, subsequent to the field review, IIROC provided a draft "Guidance Document on Examination Approach and Testing" which will be employed by both BCC and FinOps to guide Examiners in sample selection.

*Staff recommendations*

60. IIROC should expand the examination reports comments to include issues identified during the examination process that could be an indication of systemic risks, procedural errors, operational and internal control concerns, or incomplete/improper books and records, regardless of whether they have a significant capital impact at the time of the examination. If a Member has prolonged operational issues, FinOps should require the firm to have a plan of action and time frame to resolve these issues.

**Priority: High**

***IIROC's response:***

FinOps is currently enhancing its examination program modules and structure. As part of this exercise, additional instruction and guidance will be incorporated into examination procedure guidance and exam finding forms to require reporting on all operational internal control deficiencies identified, regardless of whether or not they have a significant capital impact at the time of the examination.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff ask to be notified upon completion of this process.

61. FinOps Examiners should follow specified audit procedures especially in high-risk areas or, if Examiners believe that audit procedures are not applicable, the files should include sufficient explanations as to why steps were not performed. Examiners' documentation of work performed and the documents included in the working paper files should contain sufficient detail to enable reviewers to understand actual audit procedures performed and to allow them to assess if issues existed and were properly followed up.

**Priority: Medium**

***IIROC's response:***

The OSC staff findings relate to specific and isolated circumstances found in the sample exam files selected for review and, in IIROC's opinion, are not systemic to our examination approach. IIROC will

continue to emphasize in training the importance of file documentation in all circumstances to ensure that the extent of work performed is documented in sufficient detail to enable a file reviewer to understand the audit procedure performed and how issues identified were resolved.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

62. For significant repeat findings where Members have not responded to IIROC's repeated request for compliance, IIROC should consider enhancing its efforts to deal with such findings, in order to ensure that they are addressed by the Member. This may include a warning or, if warranted, referral to Enforcement.

**Priority: Medium**

***IIROC's response:***

The OSC staff findings relate to specific and isolated circumstances found in the sample exam files selected for review and, in IIROC's opinion, are not systemic to our examination approach. IIROC rules allow FinOps staff to exercise discretion and to designate a firm in early warning for any reason, including operational issues that may, if not corrected, lead to concerns over the solvency of the firm. The FinOps policies and procedure manual already has established criteria for referrals to Enforcement.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

63. FinOps should complete its process to develop and revise procedures for sample selection, and inform OSC staff when it has done so.

**Priority: Low**

***IIROC's response:***

IIROC staff have developed criteria for sample selection using a decision tree approach, have incorporated this material into the FinOps policies and procedures manual, and have reviewed this material with all examination staff. A copy of the material was provided to OSC staff.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **H. Trading Conduct Compliance**

### **1. Introduction**

IIROC's Surveillance and Compliance Department includes Trading Conduct compliance (TCC), Market Surveillance and Trading Review and Analysis (TR&A).

The main responsibility of IIROC's TCC group is to conduct field reviews of trade desk activities of IIROC Dealer Members that are Participants as defined in UMIR<sup>6</sup>. The purpose of these reviews is to assess whether the Participants' procedures comply with the UMIR and appropriate securities requirements. If Participants offer direct access to marketplaces to their clients the TCC group may, at the request of a marketplace, review the direct market access activities on that particular marketplace. In addition, TCC staff also assist in the development, introduction and education of users on new rules and policies.

### **2. Purpose and scope**

The main objectives of this part of the review were to:

- determine whether the TCC group had sufficient staff resources and training to allow it to perform an adequate number of field reviews during the Review Period;
- review the adequacy of the group's performance benchmarks and whether they are met; and
- assess the adequacy, timeliness and quality of reviews conducted by TCC staff.

To meet these objectives, staff reviewed the group's staffing statistics, benchmarks, policies and procedures, as well as a sample of files related to TCC field reviews. In addition, staff interviewed IIROC management.

### **3. Department organization and reporting structure**

#### ***Background information***

IIROC has two TCC teams: one in Toronto, and another in Vancouver. The Toronto group has a staff complement of six TCC examiners and a manager (TCC Manager). The TCC Manager's main responsibilities are to: review the completed TCC examination files to ensure the work performed is sufficient; review the deficiency letters prepared by TCC examiners; and participate in the development of policies and procedures and examination modules. The TCC Manager reports to the Vice President, Market Surveillance (VP Market Surveillance), who also reviews and signs all deficiency letters prior to their issuance to the Participants. The VP Market Surveillance reports to the SVP Surveillance and Compliance, whose responsibilities include providing overall direction for IIROC's TCC programs.

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<sup>6</sup> UMIR defines a Participant to mean a dealer registered in accordance with securities legislation of any jurisdiction and who is: (i) a member of an Exchange; (ii) a user of a QTRS; or (iii) a subscriber of an ATS; or a person who has been granted trading access to a marketplace and who performs the functions of a derivatives market maker.

### ***Staff findings***

The reporting structure of the TCC group appears adequate and the functions of staff and management are clearly delineated.

### ***Staff recommendations***

None.

## **4. Interaction and communication with other IIROC departments**

### ***Background information***

AMF and OSC staff interviewed management and reviewed the Trading Conduct Compliance Procedures Manual to understand how the TCC group liaises and communicates with other IIROC groups and departments.

The TCC group interacts on an ongoing basis with IIROC's BCC and FinOps departments, mainly at the planning stage of TCC reviews, when staff gather information from other IIROC groups about the Participants about to be reviewed. The TCC group also interacts with the TR&A group in instances where TCC staff find information during a field review that may warrant further investigation. Referral to TR&A is generally warranted when TCC staff find instances of: manipulative or deceptive trading; front running or lack of client priority; artificial pricing; possible insider trading; and other serious UMIR violations. In these cases, the TCC Manager will make a referral to the TR&A group, who will review the matter further in order to determine whether a referral to IIROC's Enforcement group is needed.

### ***Staff findings***

AMF and OSC staff found that the level of communication between the TCC and other IIROC groups was generally adequate at the time of the review. In addition, OSC staff noted that there were efforts underway to increase the level of communication and interaction with other IIROC groups, especially with BCC and FinOps. For example, the TCC group has started to use TeamMate, the software used by FinOps to conduct field reviews, which would enable better information sharing between the groups; BCC, FinOps and TCC consolidated their respective information databases into a common intranet web-based platform; and they conducted, on a pilot basis, coordinated field reviews. The latter allowed staff of different compliance groups to be on the field at the same time and promoted communication among the groups. OSC staff encourage such efforts.

### ***Staff recommendations***

None.

## **5. Staffing resources and training**

### ***Background information***

AMF and OSC staff discussed staffing and training with management and reviewed staffing and turnover information provided by IIROC. AMF and OSC staff also reviewed the TCC Procedures Manual, which is

used for training purposes.

Some turnover exists in the TCC group, and is mostly due to the fact that many TCC examiners use their training and experience acquired in this group to move on to other opportunities. At the beginning of our field review, the group was at full complement, but a position became open towards the end of our review, and efforts were made to fill it.

Most TCC examiners have industry experience, and some acquired experience from other IIROC compliance groups. Successful completion of various courses offered by the Canadian Securities Institute is required or strongly encouraged. Initial training involves self-study and on-the-job training, when new examiners conduct on-site reviews under the guidance and direction of experienced examiners. On average, new examiners obtain approximately six months of training before conducting field reviews on their own. In addition, TCC staff attend education sessions such as lunch-and-learn sessions or education events offered by IIROC's Compliance and Legal Section.

### ***Staff findings***

AMF and OSC staff found that, while a certain degree of staff turnover occurred in the TCC group during the Review Period, such turnover is expected and taken into account by management. In management's view, the turnover did not negatively impact the timeliness and the quality of the work completed by the group. OSC staff did not find evidence of issues caused by the turnover.

AMF and OSC staff's review of the TCC Procedures Manual showed that, subject to the improvements detailed in section 7 of this part of the report, it is an excellent training tool for staff. In addition, AMF and OSC staff had no concerns regarding the training processes followed by the TCC group.

### ***Staff recommendations***

None.

## **6. Benchmarks**

### ***Background information***

The benchmarks for issuing deficiency letters from TCC reviews are as follows:

- 60% of the deficiency letters must be issued within 15 weeks of the completion of the field work; and
- all deficiency letters must be issued within 26 weeks from the end of field work.

These benchmarks were established subsequent to the merger. Management believes that these benchmarks are appropriate for the time being, as TCC staff need additional time to learn TeamMate and to gather information to update the Dealer Members' risk profile with information gathered through TCC reviews.

OSC staff reviewed TCC statistics for files for which field work was completed during the Review Period. Such statistics listed the field reviews performed, the dates on which the field work for these reviews started and was completed and the deficiency letters were issued.

### ***Staff findings***

OSC staff's review of TCC review reports shows that the TCC group met the 26 week benchmark throughout the Review Period. The 15 week benchmark was met in 2004, 2005 and 2006, and was met, on average, 56% of the time in 2007 and 2008.<sup>7</sup> According to discussions with management, one of the reasons is that deficiency letters for reviews conducted in more recent years took longer to issue as the reviews became more complex and required more procedures to be performed. OSC staff also found that many of the delays were due to the complexity of the issues found and the need for follow-up meetings with staff of the Dealer Member or staff of other IIROC departments. There were also some temporary staffing issues that contributed to the delays, but they have since been resolved.

OSC staff acknowledges that, as TCC staff are learning new processes and a new software system is adopted, more time is needed to complete field reviews and issue deficiency letters. In OSC staff's view the existing benchmarks are adequate for the time being, but we question whether they are appropriate going forward. OSC staff is of the view that performance benchmarks should establish goals that motivate staff to be more efficient and promote timely written feedback to Dealer Member. We believe that IIROC should consider whether the current benchmarks continue to remain appropriate.

### ***Staff recommendations***

64. Once the TCC group has implemented and learned the new processes and software system, it should review the adequacy of its benchmarks. Once this review is complete, IIROC should provide to OSC staff a summary of the results of this review.

**Priority: Medium**

#### ***IIROC's response:***

Benchmarks are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. IIROC will review TCC's benchmarks as part of the overall review of compliance benchmarks, and will report the results of this review to the OSC.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff would like to review a summary of the results of IIROC's review of compliance benchmarks, when completed.

## **7. Written procedures and guidance**

### ***Background information***

AMF and OSC staff reviewed the TCC Procedures Manual that sets out the process to conduct field reviews and provides guidance on various parts of the TCC examination program.

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<sup>7</sup> As a number of field reviews for which the field work started in 2009 were still in progress at the time of our field review, OSC staff did not calculate benchmark statistics for 2009.

### ***Staff findings***

AMF and OSC staff found that the TCC Procedures Manual was comprehensive, easy to understand and included adequate guidance on various sections of the TCC examination program. It also included references to relevant UMIR rules. AMF and OSC staff understand that there is a process in place to ensure it is maintained up to date.

OSC staff found that the manual could be further improved if it includes the following:

- the benchmarks for issuing deficiency letters; and
- additional guidance on working paper documentation (please see examples where such guidance may be needed in section #10).

### ***Staff recommendations***

65. IIROC should revise its TCC Procedures Manual to address the items listed above.

**Priority: Low**

#### ***IIROC's response:***

IIROC has updated the TCC Procedures Manual to include these items.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **8. Process for selecting Participants for examinations**

### ***Background information***

AMF and OSC staff discussed with management the process for selection of Participants for TCC reviews, and also reviewed the description of process included in the TCC Procedures Manual.

Currently, the process for selection of Participants for TCC reviews is relatively informal. The goal is to review every Participant, including small Participants, at least every three years. Factors considered when selecting Participants for review are: existence of past issues and deficiencies and the length of time since the last review.

Recently, IIROC developed, with assistance from an external consultant, a new risk assessment model for the TCC group. This model will allow the group to rate the risk of every Participant. The TCC group expects that the risk ratings will be a factor in scheduling TCC reviews in the future.

### ***Staff findings***

OSC staff had no concerns with the number of TCC reviews performed in Ontario, and found that all Participants were reviewed on a three year cycle. However, OSC staff believe that the TCC group should adopt a more formalized, risk-based approach to schedule its reviews, in order to make optimal use of its resources. OSC staff therefore encourage IIROC's efforts to implement a risk assessment model in TCC and



use the results of this model in scheduling reviews.

AMF staff, however, found that from the five TCC review files related to Participants based in Quebec selected for their review, three of the small participants were reviewed in a period exceeding the three year cycle referred to above.

***OSC staff recommendation***

66. IIROC should use the results of the risk assessment model to prioritize and schedule TCC reviews.  
**Priority: Medium**

***IIROC's response:***

TCC established the risk assessment module in 2009 and will, going forward, use the risk scores to assist in prioritizing and scheduling reviews.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

***AMF staff recommendation***

67. IIROC should ensure that all Participants are reviewed within a three year cycle.  
**Priority: High**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**9. Examination program**

***Background information***

AMF and OSC staff reviewed the examination program that sets out the procedures to be performed by TCC staff during field reviews.

***Staff findings***

AMF and OSC staff found that the program is, with the exception of the items described below, thorough and comprehensive. It includes reference to relevant UMIR or Market Notices.

OSC staff also found that, in recent years, the program has been enhanced to address issues related to the evolving multiple marketplace environment. For example, the program now includes a section with

procedures to test Participants' compliance with UMIR 5.2 *Best Price Obligation* and trade through protection.

OSC staff found that, at the time of our field review, the program did not include sufficient steps to test Participants' compliance with UMIR 5.1 *Best Execution of Client Orders*. Rather, the procedures were limited to inquiring of Participants whether they communicate their order routing practices to their clients. IIROC staff informed us that they had started drafting procedures to assess the Participants' compliance with their best execution obligations.

***Staff recommendations***

68. IIROC should complete its procedures to assess Participants' compliance with UMIR 5.1 *Best Execution of Client Orders* and include them in their program as soon as practicable. Once the process is complete, IIROC should provide OSC staff a copy of their revised program.  
**Priority: High**

***IIROC's response:***

IIROC will implement a best execution module by Q3 FY11 and will provide the revised program to the OSC.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff would like to review this examination module when completed by IIROC.

**10. Review of TCC examination files**

***Background information***

OSC staff reviewed a sample of six files and AMF staff a sample of five files related to TCC reviews from a total of 225 reviews conducted by IIROC's Toronto TCC group during the Review Period. The sample covered small and large Participants with a variety of lines of business.

***Staff findings***

OSC staff found that, for the files reviewed, the deficiency letters were issued on a timely basis. Some files took longer to close (a file is closed when TCC staff are satisfied with the action taken by the PO to address the deficiencies), but in OSC staff's view, the delays were justified. Often, they were due to the fact that the POs were requested to provide internal monthly reviews of their trading activities for a period of time subsequent to the issuance of the deficiency letters and TCC staff only closed the file when satisfied with the results of such reviews.

In most of the files reviewed by OSC staff, the work appeared thorough and complete and was properly documented. OSC staff found that two of the files did not contain sufficient documentation to enable OSC staff to assess the adequacy of the work done or the appropriateness of the issue resolution. Examples of such documentation deficiencies are:

- findings were identified on the working papers but not included in the deficiency letters, and the reason for their exclusion was not documented in the file;
- answers to the questions in the examination module did not appear to address the questions;
- some of the procedures were not completed and the reason was not clear from the file documentation.

AMF staff noted that, in three of the five files reviewed, there was no record of IIROC staff's assessment of the Participants' responses to the deficiency letters. Also, three of the five files reviewed did not include explanations of why certain findings identified in the files were not included in the deficiency letters sent to the Participants. AMF staff also found that in three files, there was no evidence of secondary review. In one of the files, a repeat finding was not identified as such in the deficiency letter sent to the Participant.

OSC staff found that there was inconsistent treatment of instances where they found that Participant did not comply with best price or trade through obligations. For example, in one case, TCC staff correctly identified and reported that the Participant did not make reasonable efforts to fulfill its best price obligations when trading on multiple marketplaces, but it did not follow up with the Participant to ensure that they have taken adequate steps to do so. In others, they properly followed up. OSC staff were told that recently, and subsequent to this finding, the TCC group has been taking a firm stance with Participants that are not in compliance with best price and trade through obligations, and is actively following up on such deficiencies.

***AMF and OSC staff recommendations***

69. IIROC should provide additional guidance and training to TCC staff on documentation standards, including documentation regarding their assessment to the Participants' responses to the deficiencies noted in the deficiency letters, in order to ensure that the quality of documentation is adequate and consistent in TCC files. IIROC should include such guidance in the TCC Procedures Manual.  
**Priority: High**

***IIROC's response:***

IIROC will use the new TeamMate platform and UBSS to maintain an appropriate audit trail for the review process. IIROC will also provide guidance and training for TCC examiners on the documentation of their assessment of Dealer Members' responses.

***Staff comments and follow-up:***

AMF and OSC staff are satisfied with IIROC's response. No further action is necessary.

***AMF staff recommendations***

70. IIROC should ensure that all findings identified in TCC reviews are included in the deficiency letters sent to the Participants, and where they are dismissed, the files should include explanations as to the reasons for doing so.  
**Priority: High**

***IIROC's response:***

The new program on TeamMate is being changed to ensure all findings are included in the first draft of the report. A process is already in place to capture the entire audit trail of all subsequent draft report changes.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

71. IIROC should ensure that TCC files include evidence of secondary review.  
**Priority: Medium**

***IIROC's response:***

The newly-automated process incorporates a clear trail of review and approval.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

72. IIROC should ensure that all repeat findings are identified as such in the deficiency letters sent to Participants.  
**Priority: Medium**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

***OSC staff recommendation***

73. OSC staff encourage TCC's recent efforts to take a firm stance on Participants that are not, or do not take positive steps to be, in compliance with best price and trade through obligations and ask that IIROC report findings and follow up to OSC staff.  
**Priority: High**

***IIROC's response:***

IIROC does not believe this is a deficiency. Since 2009, TCC staff have reported all deficiencies, including best price, along with follow-up to the CSA in quarterly reports.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **I. Market Surveillance**

### **1. Introduction**

IIROC's surveillance functions include real-time monitoring of trading activity on the Canadian equity marketplaces, including TSX, TSXV, CNSX, Pure Trading, Omega ATS, Chi-X Canada, Bloomberg Tradebook, Alpha Trading Systems, Liquidnet Canada Inc. and MATCH Now.

IIROC's Market Surveillance group tracks trading behaviour in real-time and collects evidence required to pursue cases relating to violations of UMIR requirements, such as insider trading, manipulative activities, front-running, trade-through violations, etc. It can also detect the results of possible leaked information in advance of major announcements including mergers, acquisitions and earnings statements.

### **2. Purpose and scope**

AMF and OSC staff reviewed IIROC's Market Surveillance group to assess whether IIROC has adequate processes, systems, policies and procedures in place to meet its role. We also reviewed the department's organization, reporting structure and staffing to see if they are adequate and sufficient.

### **3. Department organization, staffing and reporting structure**

#### ***Background information***

AMF and OSC staff had discussions with IIROC's management and also reviewed IIROC's organizational chart, job descriptions, staffing statistics and written procedures to get an understanding of the organization, staffing and reporting structure of the Market Surveillance group.

Market Surveillance has two offices, one in Toronto and one in Vancouver. The Toronto Office has seven Surveillance Officers and one administrative staff and is managed by a Director that reports to the VP of Market Surveillance.

Staff also inquired about the training provided to surveillance staff and were informed that, as part of training, each new staff member receives the *Market Supervision Policies and Procedures Manual* and the UMIR, and is paired with an experienced surveillance officer and taught on the job how to conduct market surveillance. On an ongoing basis, there is a general education budget used for seminars, conferences and training sessions. Also, there are lunch-and-learn sessions that staff can attend.

#### ***Staff findings***

AMF and OSC staff did not have any concerns with the organization of the department and its reporting structure.

With respect to staffing, we noted that, at the end of the Review Period, there were two Surveillance Officer positions open. When asked, management noted that these positions had been provided for in the budget when IIROC expected new marketplaces to emerge and additional surveillance work would be required. These expectations did not materialize, and the positions are on hold until further decisions are made.

Our review of the training in place showed that documentation and guidance provided to new staff is adequate and covers a wide range of market surveillance protocols.

***Staff recommendations***

None.

**4. Interaction and communication with other IIROC departments**

***Background information***

AMF and OSC staff had discussions with management and also reviewed IIROC's Surveillance and Compliance policies and procedures to understand what is the interaction between Market Surveillance, TCC and TR&A and the responsibilities of each group with respect to market supervision.

Market Surveillance is the starting point of market supervision. Market Surveillance divides violations into the obvious (i.e. those that were self-reported or uncovered by Market Surveillance officers) and alleged. Obvious violations are recorded in the CASE database. Alleged violations are submitted electronically to both TR&A and TCC. TR&A is then responsible for conducting the preliminary investigations and, depending on the findings, either close a case or refer it to Enforcement.

If Market Surveillance uncovers a significant pattern of violations at a certain Participant it will advise TCC staff who will then conduct a trade desk review.

***Staff findings***

AMF and OSC staff did not have any concerns related to the flow of information between Market Surveillance, TCC and TR&A. Market supervision activity is well coordinated and the electronic links between the three groups ensure that the information flow is unobstructed by communication bottlenecks. We also found that there is a genuine effort by all involved to address issues of high priority in a timely fashion.

***Staff recommendations***

None.

**5. Technology**

***Background information***

AMF and OSC staff met with management and also attended a demonstration of the key systems IIROC uses in conducting market supervision. OSC staff reviewed service agreements between IIROC and the regulated marketplaces to identify any real-time connectivity issues between IIROC and its regulated marketplaces.

One key system used to monitor real-time trading is SMARS. It generates alerts screens that are used to conduct market supervision. SMARS reached its capacity two years ago due to increased market activity expressed in messages received from marketplaces each day. Because of these capacity issues, IIROC only

uses SMARS to monitor quotes and trades, but not orders. SMARS does not have the flexibility to handle multiple market feeds and, as a consequence, some marketplaces are monitored manually.

To address the multiple market monitoring issues, IIROC created a different SMARS monitor for each integrated marketplace and monitors one market at a time. Also, the capacity issue was handled by adding extra capacity through another system, ITS.

IIROC is in the process of implementing the Surveillance Technology Enhancement Program (STEP) to address the current system shortcomings. STEP will be able to handle multiple protocols (STAMP and FIX) and receive direct feeds from all marketplaces in Canada. The STEP system will also have enough capacity to handle all market messaging traffic (quotes, orders and trades) and can accommodate new alerts. Besides the surveillance function, the new system will integrate electronic communications between the groups within the Surveillance and Compliance and the Enforcement departments to facilitate resolution of issues.

Another key system IIROC uses in data collection and analysis is MaDCAT. This tool allows for integrated analysis of news stories, trade summaries, system alerts, price/volume graphs, records of surveillance, contact with issuers etc. and presents the data in a single format to a surveillance officer.

### ***Staff findings***

OSC staff noted the limitations of the SMARS system, particularly its limited capacity to generate alerts for multiple market surveillance. We acknowledge that IIROC management has already identified the exponential increase in message traffic due to a number of reasons, including the activity on multiple marketplaces and the adoption of high frequency trading in Canada. To deal with the issue, IIROC management identified that an alternative approach was required to conduct comprehensive market supervision across multiple marketplaces. For example, to address these issues in the short term, IIROC management hired ITS to provide extra capacity and allow for new multiple-marketplace alerts to be implemented. IIROC will replace SMARS with a system that would provide sufficient capacity and flexibility to adapt to any market structure changes that would impact the ways market supervision is conducted. IIROC expects to launch the new system in the second quarter of 2010. We commend these efforts.

### ***Staff recommendations***

None.

## **6. Written procedures and guidance**

### ***Background information***

AMF and OSC staff met with management and reviewed the Market Supervision Policies and Procedures Manual, OSC staff reviewed the surveillance procedures for monitoring different marketplaces and IIROC Notice 09-0107 *Provisions Respecting the "Best Price" Obligation* (IIROC Notice 09-0107).

The Market Supervision Policies and Procedures Manual describes the duties of Market Surveillance staff, outlines their confidentiality requirements and describes the market monitoring and case management software. It also documents standards in trading supervision, types of trades to investigate and guidance on how this is done.

Attached to the Market Supervision Policies and Procedures Manual are the surveillance procedures used to monitor all marketplaces together with specific instructions on how to access the marketplaces that are not directly connected to SMARS.

IIROC Notice 09-0107 requires a Participant to make “reasonable efforts” to fill better-priced orders displayed on a protected marketplace at the time the Participant executes at an inferior price on another marketplace or foreign organized regulated market. This document also describes IIROC’s role if a protected marketplace experiences a material malfunction or interruption of services.

### ***Staff findings***

AMF and OSC staff found that, in general, Market Surveillance has adequate policies and procedures in place to conduct market supervision in a multiple marketplace environment. However, at the time of our review, OSC staff did not find any procedures that would describe Market Surveillance actions in case of a material malfunction or interruption of services in a protected marketplace.

### ***Staff recommendations***

74. Market Surveillance should document their procedures with respect to its actions when a protected marketplace experiences a material malfunction or an interruption of services.

**Priority: Medium**

#### ***IIROC’s response:***

Market Surveillance staff do have established procedures for such events. IIROC will update the Market Supervision Policies and Procedures Manual to include these procedures.

#### ***Staff comments and follow-up:***

IIROC’s response is adequate. No further action is necessary.

## **7. Processes and timelines for investigating alerts**

### ***Background information***

IIROC’s Market Supervision Policies and Procedures Manual describes the systems used to generate alerts, the type of alerts generated, the procedures used to test whether the alerts generated are violations that should be further investigated or those that should be closed because they are insignificant. The manual also explains the difference between alerts investigated in real-time and alerts investigated post-trade.

SMARS is the general application used by Market Surveillance to conduct market supervision in real time. One of the SMARS functions is the intelligent market monitor system (IMM) that generates various alerts based on certain parameters and UMIR type alerts for UMIR violations. Other alerts are monitored using the ITS system.

In particular, the IMM system uses a combination of real time intra-day price, volume and activity to generate different types of alerts for all listed issuers. Price, volume and activity alerts are then prioritized to reflect the severity of the alert; the priority is displayed as a number from zero to 9999. Currently, the system



parameters are set to suppress alerts with a severity/priority number less than 100 (this is considered the default). These parameters can be changed when significant market movements occur due to market and/or economic developments. The change in parameters is not performed frequently.

The audit tracking capability allows for market surveillance in a post-trade environment. This review is manual and looks for a range of infractions such as double printing and price ramping or front running and/or best execution.

Once an alert is indicating possible unusual trading activity, surveillance officers have to follow certain procedures – as described in IIROC’s Market Supervision Policies and Procedures Manual - to determine whether further action is warranted.

If the cause of the unusual trading activity is not readily found, the surveillance officer may continue to monitor the trading activity, or choose to place a call to an Officer or Director of the issuer. Details of these calls are recorded in the SMARS Record of Contact database.

If the unusual activity relates to UMIR violations, once the alert is investigated and the violation is confirmed by market surveillance officer, the details of the violation are recorded in the violation portion of the CASE database. The CASE database is used as a placeholder for all violations confirmed by IIROC’s Surveillance and Compliance Branch. The CASE database is also used as a placeholder for potential violation alert notices (PVANs).

Usually, alerts have to be closed within the day. IMM alerts have to be addressed within minutes of being generated, whereas UMIR alerts, such as customer-principal trade and market stabilization, within an hour of being generated.

### ***Staff findings***

AMF and OSC staff found that, in general, Market Surveillance has adequate procedures in place to review alerts. The timelines set for investigating alerts are also appropriate.

We understand that alerts are generated by the IMM system based on a combination of parameters (volume, price and activity). When market conditions change significantly from what is considered “normal” market circumstances, the IMM system may generate an increased number of alerts that are not necessarily valid alerts. AMF and OSC staff found that any Market Surveillance officer could change the system parameters to adapt them to the change in market conditions, and to allow the number of alerts to drop to a more manageable level. We found out that there is no record of when the system parameters had been changed, nor when they had been returned to default.

### ***AMF and OSC staff recommendations***

75. When market conditions change and Market Surveillance staff have to alter the system parameters to align them with the prevailing market conditions, there should be a record of the change detailing the date the change was made, who made the change, what parameters had been changed, what caused the need to alter the default parameters, and the length of time the change should be in effect.

**Priority: High**

***IIROC's response:***

IIROC has implemented procedures to address the issues noted, including a process for following up and resetting parameters when activity returns to normal.

***Staff comments and follow-up:***

AMF and OSC staff are satisfied with IIROC's response. No further action is necessary.

76. Changes in the systems default should be approved by the Market Surveillance Director.

**Priority: High**

***IIROC's response:***

Changes may only be approved by the Director, Surveillance, the Vice President, Surveillance or the Regional Vice President. This is now documented in the procedures manual.

***Staff comments and follow-up:***

AMF and OSC staff are satisfied with IIROC's response. No further action is necessary.

**8. Review of alerts**

***Background information***

OSC staff selected a sample of alerts to determine the adequacy and timeliness of the analysis and review done by Market Surveillance staff. The sample included, but was not limited to, customer-principal trades alerts, front-running alerts, trade-through alerts and price manipulation alerts.

***Staff findings***

OSC staff's review of the selected sample of trades that generated alerts showed that, overall, these trades were investigated on a timely basis, decisions were documented and the process was in accordance with Market Supervision Policies and Procedures Manual.

***Staff recommendations***

None.

## **J. Trading Review and Analysis**

### **1. Introduction**

IIROC's Trading Review and Analysis group (TR&A) is responsible for conducting preliminary investigations when there is reason to believe that improper market activity, including violations of the UMIR or securities laws, may have occurred. Potential violations may be found through real-time monitoring of trading activity by Market Surveillance, or from reviews of historical trading activity.

### **2. Purpose and scope**

The objectives of this section of the review were to:

- ensure that TR&A has appropriate processes, systems, staffing, policies and procedures in place to assess potential trading infractions adequately and on a timely basis; and
- determine whether TR&A adequately investigates and appropriately deals with potential violations of the UMIR and other Canadian securities laws.

### **3. Department organization and reporting structure**

#### ***Background information***

IIROC has two TR&A teams: one in Toronto and one in Vancouver. The Toronto TR&A is part of the Surveillance and Compliance Group, which is overseen by the SVP of Surveillance and Compliance. It consists of the Director of TR&A, three Senior Investigative Trading Analysts (ITAs), seven ITAs and an ITA coordinator. There is also a Business Intelligence Analyst. The Director of TR&A reports to the SVP of Surveillance and Compliance, and all of the ITAs and the Business Intelligence Analyst report to the Director of TR&A.

#### ***Staff findings***

AMF and OSC staff are satisfied that the organization of the TR&A department is logical, efficient and promotes appropriate accountability.

#### ***Staff recommendations***

None.

### **4. Interaction and communication with other IIROC departments**

#### ***Background information***

TR&A works closely with several other IIROC groups such as Market Surveillance, TCC, Market Policy, BCC, FinOps and Enforcement, including Case Assessment. As most of the cases referred to TR&A are from Market Surveillance, TR&A staff often consult with Surveillance Officers on referred cases. They

also consult with Market Policy staff regarding interpretation of rules. If a matter is referred by TCC staff, they are also consulted in the process.

***Staff findings***

AMF and OSC staff found that TR&A interacts and communicates with other IIROC departments in a cooperative and thorough manner.

***Staff recommendations***

None.

**5. Interaction and communication with other regulators**

***Background information***

TR&A communicates on a daily basis with the provincial securities commissions, marketplaces, and other entities performing regulatory functions inside or outside of Canada. As IIROC is a member of the Intermarket Surveillance Group (ISG), an organization which includes securities regulators world-wide, it is able to share information with other ISG members that perform regulatory functions.

***Staff findings***

AMF and OSC staff found that there is adequate and timely interaction and communication between TR&A and other regulators.

***Staff recommendations***

None.

**6. Staffing resources and training**

***Background information***

*Staffing*

As set out above, the TR&A group has a Director, three Senior ITAs, seven ITAs, an ITA coordinator and a Business Intelligence Analyst. At the time of our field review, TR&A had one vacant ITA position.

*Training*

AMF and OSC staff were advised that the TR&A staff generally have securities industry experience and are required to have completed the Canadian Securities Course or complete it soon after being hired. They are also required to take the Trader Training Course and to familiarize themselves thoroughly with the UMIR. New ITA hires go through a six-day training and orientation program. During this time, they have one-on-one sessions with more experienced ITAs, the Director of TR&A and Surveillance staff.

ITAs also receive ongoing training, either by attending conferences and seminars, or industry courses. They also attend bi-weekly staff meetings, which have an educational component.

### ***Staff findings***

AMF and OSC staff did not note concerns with the staffing in the TR&A group and training of staff. There is currently no backlog of cases in TR&A, which is also an indicator that the group is adequately staffed.

### ***Staff recommendations***

None.

## **7. Written procedures and guidance**

### ***Background information***

AMF and OSC staff were provided with the TR&A Policies and Procedures Manual, the Orientation and Training Guide and a guide with tips for using TR&A tools.

### ***Staff findings***

OSC staff found that manual and guides mentioned above are comprehensive and well written, and they provide sufficient guidance to staff. They are organized in a logical manner with a table of contents and appendices enabling the user to access information with ease.

AMF staff identified, however, that the TR&A Policies and Procedures Manual included some references to rules that were dated between 2001 and 2003 and were outdated. Given that this Manual was implemented in August 2004 and revised in September 2009, it should include references to current rules.

### ***AMF staff recommendations***

77. References to rules in the TR&A Policies and Procedures Manual should be up to date.  
**Priority: Low**

#### ***IIROC's response:***

IIROC has updated the TR&A Policies and Procedures Manual.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

## **8. Processes**

### ***Background information***

As set out in the introduction to this section, the Toronto TR&A group is responsible for preliminary investigations of market activity on marketplaces and post-trade analysis of trading data.

Cases received by TR&A come from a variety of sources, including: referrals from Market Surveillance (which account for 75 to 80% of the cases); referrals from the TCC group; public complaints; issuer complaints; complaints by access persons of participant organizations (such as traders); matters reported to IIROC's Whistleblower Service; reviews of other reports produced by IIROC; reviews of historical trading data; referrals from other regulators and agencies; referrals from the Inquiries and Complaints Officer from the GCO; and gatekeeper reports. ITAs are also encouraged to develop cases, generally through conducting independent research for a potential case, and discuss such potential cases with the Director.

The Director of TR&A assigns cases to ITAs based on their availability and strengths. The Director tries to assign to ITAs different types of cases to ensure they get exposed to a variety of matters involving different UMIR rules. At any given time, each ITA has eight to nine files under review. Senior ITAs will handle the more complicated cases. They are also responsible for assisting the ITAs and for providing the first level of approval on case closings, with the Director having the ultimate approval.

Insider trading cases are fast tracked to the OSC. Cases related to PVANs are dealt with as follows: for the first infraction, a letter is sent to the Compliance department of the Participant, and there is no further follow-up by IIROC. For the second infraction that occurs within a year, a letter is sent asking for an explanation. For the third infraction, the case will go to Enforcement on the basis that the participant organization did not take action on the issue when it was first identified by IIROC. Cases may also be forwarded to the provincial securities commissions, generally in cases where IIROC does not have the jurisdiction to investigate them.

Generally, cases are prioritized as follows:

- insider trading cases are fast tracked to securities commissions that have fast-tracking protocols with IIROC, specifically the AMF, ASC, BCSC and the OSC (other commissions are contacted as needed, when a case related to their jurisdiction comes up, and they discuss whether or not they want IIROC to conduct the preliminary investigation or whether they will take the case right away); and
- for all other cases, a score based on a Regulatory Impact Rating is used to determine their priority; generally front-running and manipulation cases have a higher priority, but cases may receive higher priority if they relate to other issues that needs to be addressed, such as the short sale restrictions established by IIROC in the Fall of 2008.

The Director of TR&A reviews non-insider trading cases and, after a preliminary assessment which includes the review of trading data, news releases and other available data, assigns the case to the ITAs for investigation. Senior ITAs conduct a preliminary review of the insider trading cases to check data and facts before they are fast tracked to the securities commissions. Senior ITAs may also conduct the preliminary assessment of non-insider trading cases.

The potential outcomes of cases are: closure with no action, closure at assessment, issuance of a warning letter (mostly for UMIR violations), or issuance of a cautionary letter (for suspected but not proven UMIR violations). A copy of the letter is attached to the trader's file in the National Registration Database. For cases closed at the assessment stage, the reasons for closure are documented in the CASE database.

If a case is pursued, the ITAs generally follow a number of steps in their review, including: reviewing the materials received to determine the nature of the case and researching any alleged rule violation;

reviewing the Case Management System to see if there is other relevant information, such as past actions; determining the period for which trading activity is to be reviewed; requesting additional documentation, if needed; conferring with other IIROC staff, including a Senior ITA or the Director; completing the preliminary investigation report; and, if referral is warranted, preparing a referral memorandum.

### ***Staff findings***

AMF and OSC staff did not have concerns with the processes followed by ITAs when reviewing the files. OSC staff also found that in the past few months additional processes, such as a risk assessment for files fast tracked to the OSC, have been implemented.

### ***Staff recommendations***

None.

## **9. Review of files**

### ***Background information***

OSC staff reviewed a sample of 16 files and AMF staff a sample of 10 files opened and closed by the Toronto's TR&A group. The sample covered a variety of allegations such as best price and best execution violations, manipulations, naked short selling, wash trading, insider trading, supervision, client priority, market stabilization and technical violations.

### ***Staff findings***

For the most part, OSC staff found the reviews to be thorough, the conclusions supported by the evidence in the files, and that the majority of the files were completed on a timely basis and within the established benchmarks.

AMF staff, however, found that not all files reviewed were finalized within the established benchmark of 150 days. Specifically, in a sample of ten files of which one related to possible insider trading and nine with market manipulation, the former was processed within the benchmark, but five of the nine market manipulation files exceeded the set benchmark at the time the file was closed.

### ***AMF staff recommendations***

78. IIROC should evaluate whether the benchmark to complete files within 150 days, which applies to all files, including those related to market manipulation, continues to remain adequate. IIROC should establish processes to ensure it complies with the established benchmarks.

**Priority: High**

### ***IIROC's response:***

Benchmarks are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review.

IIROC notes that TR&A file benchmarks were historically different than other compliance benchmarks: benchmarks for this team were based on an average rate of turnaround rather than a specific maximum turnaround time. During the Review Period, IIROC adjusted TR&A benchmarks from 100% of cases completed in an average of 150 days, to 95% of cases completed in 150 days. IIROC will review these new benchmarks to ensure they are measurable and achievable.

IIROC acknowledges that file turnaround time has historically suffered during times when the TR&A team was focused on special reviews. IIROC plans to review the structure of the TR&A group and will consider how to mitigate such impacts.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.



## **K. Membership**

### **1. Introduction**

National Instrument 31-103 *Registration and Related Matters* requires an investment dealer to be a Dealer Member. In addition, National Instrument 21-101 *Marketplace Operation* requires ATs to be members of an SRO, currently IIROC. ATs are both Marketplace Members and Dealer Members. IIROC is required by the OSC RO to have reasonable written criteria that permit all persons or companies that satisfy the criteria to access IIROC's regulatory references. IIROC is also required to have fair and transparent access criteria the process for obtaining access.

Applications for membership to IIROC are reviewed by IIROC's FinOps, BCC, TCC and Registration staff. This includes a review and analysis of the information and documents submitted, discussions with the applicant's management and technical personnel and an on-site visit to examine premises and systems.

When IIROC staff are satisfied that the application meets membership requirements, the application is submitted to the DC in the province where the applicant's head office is situated. The DC considers the application and makes a recommendation to the Board whether to approve the application, including whether it should be approved subject to terms and conditions. The Board gives the ultimate approval. The applicant will be admitted to membership when administrative matters, such as the payment of any remaining fees, have been finalized.

### **2. Purpose and scope**

OSC staff's objective was to determine whether IIROC has fair, consistent, and effective processes for reviewing and approving membership applications and applications for Member resignations. The focus of this part of the review was on process put in place after the IDA-RS merger and whether they were reasonable. We also reviewed the processes for coordinating the review of membership application submitted by ATs by the IIROC groups involved in the review.

### **3. Policies and Procedures**

#### ***Background information***

IIROC's Procedures, Policies, & Guidelines include standard procedures to be used by FinOps, BCC, and Registration staff for reviewing applications for membership and resignations. They contain information on:

- Minimum criteria for new membership;
- Required documents, fees and processes for approving applications;
- IIROC's screening process;
- Due diligence checklist used by each department for review;
- The recommendation and approval process by the DC and the Board, respectively; and
- Communication with CIPF.

OSC staff reviewed IIROC's Procedures, Policies, & Guidelines and discussed the processes related to

applications for new membership and resignation with staff of IIROC's GCO. We also reviewed written procedures, checklists, and review programs used by IIROC staff to review membership and resignation applications.

***Staff findings***

The policies and procedures for processing new Member applications and resignations are clear and comprehensive. In addition, the detailed checklists used by IIROC staff in reviewing new membership applications give them adequate guidance when reviewing new membership applications.

***Staff recommendations***

None.

**4. Benchmarks**

***Background information***

The benchmarks for new member application reviews are as follows:

- FinOps and BCC must complete the preliminary review and issue deficiency letters to applicants within two weeks from receipt of the application; and
- The Registration department must complete a review of the qualifications and suitability of each Partner, Director and Officer and issue a preliminary deficiency letter within two weeks of receiving the application.

Generally, if a new membership application process (excluding ATs applications) is not completed within six months from the date the application was submitted and accepted for review by the Membership Coordinator, the applicant may be required to start the application process over by resubmitting the application for Membership. The application process is considered complete when staff are in a position to recommend to the applicable DC approval or refusal of the application.

Membership resignation applications are reviewed and approved by FinOps in conjunction with the GCO. The effective date of resignation is 5 p.m. on the date that IIROC received confirmation from the Member's Auditor that the Member has sufficient liquid assets to meet all its liabilities and no client assets are left at the Member, and when the Association Secretary has confirmed that the Member has no complaints or pending investigations and no outstanding fees unpaid to IIROC.

***Staff findings***

In OSC staff's opinion, the current benchmarks and timelines for processing new member applications reviews and resignations are reasonable.

***Staff recommendations***

None.

## 5. Review of files related to applications for membership

### *Background information*

OSC staff selected a sample of two new Member application files for review. They were both submitted by ATSS. The purpose of the review was to understand and assess the adequacy of the IIROC membership review processes, and particularly how it deals with and coordinates processes involved in the review of applications for entities wishing to be both Marketplace and Dealer Members.

As part of this review, OSC staff reviewed files maintained by the GCO, working paper files of BCC and FinOps and, at a high level, the procedures performed by TCC staff. We also discussed with staff of IIROC's GCO the processes for coordinating various reviews of firms that apply to be Marketplace and Dealer Members. We were informed that, since the merger, the GCO has performed the role of the Membership Coordinator and participates in the process from the onset, or at least has real-time access to information concerning the status of a membership application. While the other operational departments (such as FinOps, BCC or Registration) conduct the substantive review of new Member applications, GCO as the Membership Coordinator obtains written sign-off from the departments involved when their work is complete.

### *Staff findings*

OSC staff noted that the work involved in reviews of new Member application is done by the multiple IIROC departments involved in new Member application reviews. While the Membership Coordinator provides coordination of the review process, the process to respond to substantive issues that arise in the review process is somewhat informal. IIROC is looking to formalize this process and plans to establish a central point-of-contact for new Member applications. The intent is that this individual, which will be part of the GCO, will possess up-to-date information and be able to address enquiries regarding the application at all times.

OSC staff's review of the sampled files showed that, overall, the work performed by staff of each IIROC department was adequate. We did note, however, that the organization and documentation of files was different between FinOps and BCC departments. FinOps used TeamMate to store documentation, which was well organized and structured, while BCC used a manual paper filing system. The documentation and filing of information within the BCC files were less organized and did not follow any particular structure, although necessary checklists and notes were included in the folder. OSC staff were informed that IIROC is working on standardizing the file documentation systems for BCC and will be using TeamMate for future file documentation. Regardless of the condition of the BCC files, OSC staff was of the opinion that IIROC staff's conclusions in the working paper files were appropriate and properly supported by the documentation in the files.

### *Staff recommendation*

79. OSC Staff recommend that IIROC continues with its efforts to increase coordination of the different IIROC departments involved in the review of new membership applications, as well as to increase consistency of file documentation across the departments involved in the review. IIROC should inform us when they finalize these changes.

**Priority: Medium**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

IIROC's response is adequate. OSC staff ask to be notified once IIROC implements the changes that would increase coordination of the different IIROC departments involved in new membership application reviews, as well as of the nature of these changes.

**6. Review of resignation files**

***Background information***

OSC Staff reviewed a sample of two files related to applications for resignation completed during the Review Period, including working paper files and documentation from FinOps, and materials from GCO.

***Staff findings***

The files selected for review were adequately documented. The related working paper files showed that FinOps followed the relevant review requirements, and approvals for resignations were properly supported.

***Staff recommendations***

None.

## **L. Business Continuity Plan**

### **1. Introduction**

Business continuity planning is a critical component of any regulated entity. T&C #11 of the IIROC's ROs requires IIROC to annually review its business continuity plans.

### **2. Purpose and scope**

The purpose of OSC staff's review of business continuity planning (BCP) at IIROC was twofold: to review IIROC's role as a regulator in ensuring that its members have adequate plans that are tested regularly; and to review IIROC's own internal planning to ensure that it can continue to carry out its significant functions in the event of a disruption.

As these two activities are quite separate and report to different individuals within IIROC, they are described separately.

### **3. Industry BCP**

#### **3.1 Current Assessment of Member plans**

##### ***Background information***

Industry coordination of BCP within IIROC is handled by the VP Professional Standards.

Industry interest in BCP increased significantly after 9/11 but formal IIROC involvement began in 2005 with the publication of the International Organization of Securities Commissions (IOSCO) guidelines on BCP. IIROC developed a principle based Rule<sup>8</sup> in that year and gave Members twelve months to July 31, 2006 to comply. The focus of the Rule was investor protection and specifically, set a requirement that the BCP must enable clients to access their funds within 48 hours of a disaster.

The Rule required that the plan be reviewed by an independent third party except for introducing brokers who could have their plans reviewed internally. IIROC approval was required for each firm or individual to undertake a review.

To support the Rule, a road show was developed for Members along with a BCP development document, guidelines and a checklist. An industry committee was also formed that developed minimum requirements for reviewers and a template for the review report.

Originally, an independent review of Members' BCPs was to be performed every three years. This was changed to require an independent review only for new Members or for existing Members that have undergone a fundamental change in operations (e.g. a change from an introducing to a full service dealer). Beginning in 2009, other Members are required to submit an annual CEO certification and perform an annual test. The first certification was due by December 31, 2009.

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<sup>8</sup> Included in Rule 17 *Dealer Member Minimum Capital, Conduct of Business and Insurance*.

### ***Staff findings***

Limiting the ongoing requirement for an independent review of a Member's BCP to new Members and Members with significant operational changes and relying on a CEO certification from other Members would appear to be a cost effective means for IIROC to gain assurance that Members are meeting their BCP obligations.

### ***Staff recommendations***

None.

## **3.2 Industry-wide testing**

### ***Background information***

A limited industry test was conducted in September, 2007. An industry test was to be conducted in alternate years but the 2009 test was cancelled due to the market disruption.

At the time of our field review, OSC staff were informed that an industry test would be held in 2010 and was currently scheduled for June 26.<sup>9</sup> A Member Working Group has been established to plan the test. The test scenario will be based on accessibility to the downtown core being unavailable. The goal of the test is to validate Member and Utility organizations ability to process transactions without access to work areas/offices or data centres located in downtown core of Toronto.

### ***Staff findings***

While Member participation in the industry test is voluntary, IIROC will ensure that the major firms agree to participate. As well, the major service providers and utilities have confirmed that they will participate.

### ***Staff recommendations***

None.

## **3.3 Crisis Communications Centre (CCC)**

### ***Background information***

The CCC is an IIROC operated website that acts as both an information exchange mechanism and a tool to be used in the event of emergencies or significant operation disruptions. Access is restricted to approved individuals and contains notices of specific interest and a procedures manual.

### ***Staff findings***

OSC staff were informed at an industry infrastructure BCP meeting held in September, 2008 that a restructured CCC should be considered the industry communications hub for information prior to and during a disruption or disaster. This was confirmed during the oversight review. We believe that a BCP communications hub is a needed function and we fully support IIROC's position that its CCC can act as this hub. However, we note that the CCC, as currently implemented, does not yet fully meet that need.

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<sup>9</sup> This test was subsequently rescheduled to take place in September 2011.

The following recommendations are premised on the understanding that CCC will become the industry BCP hub.

***Staff recommendations***

80. The CCC Procedures Manual contains several references that suggest that the purpose of the hub is only to serve the IIROC Dealer Members. This is inconsistent with the stated objective of being the industry BCP hub. IIROC should review these references with a view to revising the manual to clearly indicate a broader industry based mandate.

**Priority: Medium**

***IIROC's response:***

IIROC disagrees with the statement that the CCC has the objective of being an industry BCP hub. IIROC's position is that the purpose of the CCC is solely to support IIROC Dealer Members.

***Staff comments and follow-up:***

We accept IIROC's position that the purpose of the CCC is solely to support IIROC Dealer Members. However, a meeting attended by major infrastructure entities was held in August, 2008 to discuss broad industry BCP issues. One discussion item was the need for a broadly based BCP communications hub. In light of this clarification, we will proceed on the basis that this need is still outstanding.

81. The CCC web site provides a contact name, title, email address and phone number for twenty-three participating entities. However, a quick scan of the list indicated an example of a non-current employee, an incorrect title, and an entity name change. IIROC should put in place a process to maintain the currency of the contact list.

**Priority: High**

***IIROC's response:***

IIROC will verify the list annually.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

82. The Procedures Manual states that "all identified core participants must have designated alternatives". This is a significant step in any well designed BCP. However, the contact list, apart from the IIROC contacts, does not identify an alternative contact for any of the other participating entities. IIROC should ensure that each of the participating entities has identified an alternative.

**Priority: High**

***IIROC's response:***

IIROC solicited alternates at the time of setting up the CCC but did not receive designations from all participating entities. IIROC will contact those entities that have not provided an alternate to obtain this information.

***Staff comments and follow up:***

IIROC's response is adequate. No further action is necessary.

83. In order for the CCC to become a living mechanism, it needs to be dynamic in nature. IIROC should undertake a review to determine the best means of fulfilling its industry hub mandate. For example, should there be a process for Member and participating entities to post relevant material to the site and should participating entities have an on-line facility to update their contact and alternate contact information along with say, an annual confirmation that it is correct.

**Priority: Medium**

***IIROC's response:***

The technology platform for the CCC does not permit Dealer Members and participating entities to post material directly to the CCC website, as this is not within the scope for the CCC that IIROC has established.

***Staff comments and follow-up:***

IIROC's response is adequate in light of the clarification in Recommendation 79.

#### **4. IIROC business continuity planning**

***Background information***

The Chief Information Officer's (CIO) responsibilities include overall direction and coordination of IIROC's disaster recovery plan and business continuity plan.

The market surveillance application, SMARS, is maintained by TMX Technologies and run at its data centre. In the event of a disaster, processing of SMARS would be transferred to the TMX back-up site. The latest test to ensure BCP capability was performed in the Spring of 2009. Other applications including email are run at a service bureau in Toronto. The service bureau has a fully redundant data centre in Vancouver and, in the event of a disaster, the applications would be run out of Vancouver.

Most employees have a CITRIX license which enables them to access their files (except for SMARS) from home in the event of a disaster. An off-site work area, outside of the downtown Toronto core, has been contracted from a major vendor. The site includes ten work stations, phones, desk top computers and related communications. These work stations are for the primary use of the Crisis Management Team (CMT), comprised of senior management, set up to provide overall direction in the event of a disaster.

If access to the IIROC Toronto premises was not available, surveillance could be carried out from either TMX data centre as well as from IIROC's Vancouver office.

A number of BCP tests have been established and are planned to be conducted annually. A disaster recovery plan (DRP) test is to ensure that technology services such as email and applications can be run from the contracted work site via the internet and Citrix. A test is also planned to test the capability of operating from service bureau's Vancouver site. A set of annual Table Top Exercises have been created



for the support groups (IT, GCO, HR, Finance, Office Services), the CMT, the regions, Market Surveillance, and general IIROC services and applications.

***Staff findings***

IIROC has made significant progress in addressing BCP issues. However, and as could be expected, certain integration issues remain as a result of the different approaches to BCP taken by the IDA and RS in the past. These are being identified and resolved.

The Table Top Exercises are a cost-effective way to test the individual business continuity plans. The objectives of the tests are: to demonstrate the viability of the plan; to use the results to update and improve the plan; and, to educate the responsible individuals on the workings of the plan.

After each test, various issues and related action items are identified. Some of these are specific to the individual department or region while other issues are of a corporate nature. The CIO maintains a BCP Action List of corporate level actions required, however, the list does not contain all of the corporate level actions identified from the individual tests. As well, the Action List does not contain target deadlines for the various actions.

***Staff recommendations***

- 84. The BCP Action list could be enhanced by including all the corporate actions identified from the individual BCP and DRP tests and by setting a target deadline for the resolution of each required action.

**Priority: Medium**

***IIROC's response:***

IIROC will consolidate into one list the actions from the prior individual BCP Table Top Exercises and DRP tests. IIROC will prioritize the items on the list and assign actionable completion dates and accountabilities to each item. The list will be refreshed on an ongoing basis with new Table Top Exercise and DRP test action items.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is necessary.

### **III. PRAIRIE REGION OFFICE**

#### **1. Background**

IIROC's Prairie Region Office (PrRO) is located in Calgary and is the office of IIROC for the jurisdictions of Alberta, Saskatchewan, and Manitoba (Prairie Region). The PrRO is comprised of four departments: Registration, Enforcement, BCC and FinOps. The Director of the PrRO oversees the Registration and Compliance functions of the PrRO and the VP of Western Canada, who works out of the Pacific Regional Office in British Columbia, oversees the Enforcement functions of the PrRO.

In addition to a continuous oversight process, the ASC, MSC and SFSC, (in this section of the report, "we") conduct triennial oversight reviews to determine whether IIROC is effectively overseeing its Members in the Prairie Region and that it is operating in accordance with the Recognition Orders. This is our joint report on the review of the PrRO for the Review Period.

The ASC reviewed all departments of the Calgary Office as outlined above. The MSC reviewed all areas except Registration, as the MSC carries out registration functions in Manitoba directly. The SFSC reviewed all areas except FinOps, as Saskatchewan does not have any IIROC Member head office locations.

#### **2. Findings related to the Prairie Region office**

Improvements required for areas in which deficiencies have been identified in the various departments have been reported in the appropriate sections below. Recommendations have been put forward to assist the PrRO in rectifying deficiencies. However, we emphasize that it is the responsibility of IIROC's Management to determine how best to rectify the deficiencies we have outlined.

## **A. Registration**

### **1. Introduction**

By virtue of an ASC Order effective June 1, 2008 (Registration Authorization Order), the ASC authorized IIROC to carry out certain registration functions on behalf of the ASC. On September 4, 2008 the SFSC issued the General Ruling/Order 11-912 *Assignment of Registration to Investment Industry Regulatory Organization of Canada* (GRO); which delegates Saskatchewan registration authority to IIROC.

Under each the Registration Authorization Order and the GRO (collectively, the Registration Orders), IIROC is expected to act on behalf of the respective Commission and to act in the public interest in the consideration of registration and related submissions. Specifically, IIROC is expected to review applications and determine the suitability of each registration candidate and whether registration of such candidates would not be objectionable.

### **2. Purpose and scope**

The purpose of the Registration review was to:

- Determine whether IIROC is carrying out its registration mandate in accordance with the applicable Recognition Orders.
- Assess the controls built into the registration review process to ensure that sound, professional judgment is being exercised by IIROC in all cases.
- Evaluate how the registration function has evolved since the last triennial examination.
- Assess procedures in place and actual practices for the elevation of applications to the Registration Subcommittee of the IIROC District Council (DC).

In order to accomplish these objectives, ASC and SFSC Staff conducted interviews with Registration staff and management, reviewed a sample of registration submissions<sup>10</sup> and reviewed the Registrations Policies and Procedures Manual.

### **3. Department organization and reporting structure**

At the time of fieldwork, the Registration department at the PrRO consisted of four Registration Officers (ROs), a Registration Supervisor and a Registration Manager. The ROs report to the Registration Supervisor and Registration Manager, the Registration Supervisor reports to the Registration Manager, and the Registration Manager reports to the Director of the Prairie Region.

The Director of the Prairie Region is responsible for overseeing registration activities of investment dealers in Alberta and Saskatchewan. The Director's duties include the responsibility of advocating on behalf of staff, making registration decisions on controversial submissions such as high risk submissions including refusals of registration, imposing terms and conditions on a registrant, and overseeing member resignations, that go to the District Council (DC).

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<sup>10</sup> The ASC reviewed 114 registration submissions and the SFSC reviewed 84 registration submissions.

#### 4. Approval of Outside Business Activities (OBAs)

##### *Background information*

Dealings of registrants outside of the normal course of the business activities they conduct can impose an increased risk upon their clients. IIROC Registration requirements require a registrant to identify outside business activities (OBAs) the registrant is engaged in and report them to IIROC. IIROC will review these OBAs upon the registrant's OBA submission to IIROC and subsequently approve or deny the OBA submission.

##### *Staff findings*

IIROC's Registration Policies and Procedures do not require reasoned documentation to be recorded in the file to support the rationale for the approval of OBA submissions. The ROs review and analyze OBA submissions and make recommendations to approve or deny the current employment submission to the Registration Supervisor. No verbal discussion takes place between the RO and the Registration Supervisor and the rationale is not documented.

The nature of OBAs undertaken by registrants can have a significant impact on their ability to effectively carry out their duties as registrants and may give rise to conflicts of interest which pose risks to the public. Discussion and documentation between the RO and the Registration Supervisor of the rationale for approval of OBA submissions are important steps that are necessary to demonstrate that sound judgment and consideration has been exercised in approving OBAs.

##### *Staff recommendations*

85. IIROC should establish guidelines to ensure appropriate discussion takes place and that the rationale for any approved OBAs is properly documented. The analysis should involve consideration of factors such as the nature and the percentage of time spent on OBAs and the documented rationale should address issues such as the ability of the registrant to service clients and mitigation of potential conflicts.

**Priority: High**

##### *IIROC's response:*

IIROC has developed procedures and completed staff training to ensure that conflict issues regarding OBAs are identified and considered. The Registration Supervisor must sign off on all OBAs.

##### *Staff comments and follow-up:*

ASC and SFSC staff are satisfied with IIROC's response.

## **B. Enforcement**

### **1. Introduction**

Under each of the ASC's, MSC's and SFSC's Recognition Orders, IIROC is responsible for enforcing compliance with its Rules by Dealer Members and others subject to its jurisdiction as well as performing investigation and enforcement functions so long as IIROC continues to be recognized by the Commissions as a self-regulatory organization.

The Enforcement Department of the PrRO is divided into three groups: Case Assessment, Investigations and Enforcement Counsel.

The Prairie Region Office handles the complaints for Alberta, Manitoba, Saskatchewan, and British Columbia.<sup>11</sup> The Investigations group is responsible for performing a more in-depth analysis of enforcement files which are referred to it by Case Assessment. The Enforcement Counsel group is responsible for conducting disciplinary proceedings and issuing warning letters from cases that are referred from other Enforcement groups. They are also responsible for providing guidance to the Case Assessment and Investigations groups on legal issues.

### **2. Department organization and reporting structure**

At the time of fieldwork, there were four Case Assessment Officers who report to the Case Assessment Manager, three Investigators who report to the Investigations Manager and two Enforcement Counsel Staff who report directly to the Vice-President of Western Canada. Both Enforcement Managers report to the Vice-President of Western Canada, who, as mentioned, operates out of the Pacific Regional Office.

### **3. Purpose and Scope**

The purpose of the Enforcement part of the Oversight Review was to ensure that:

- There is adequate information sharing and communication between the Enforcement Department and other IIROC departments.
- There is adequate communication with the relevant recognizing regulators.
- IIROC is taking appropriate Enforcement action when necessary.
- The Enforcement Department's structure, staffing, processes and resources are adequate in order to ensure it performs its regulatory functions effectively and efficiently and without undue delays.

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<sup>11</sup> Files are handled for British Columbia in the PrRO because there is no Case Assessment department in the Pacific Region Office.

#### 4. Training of Enforcement staff

##### *Background information*

Ongoing training for all Enforcement Staff in the PrRO occurs in a variety of formats including biennial conferences, webinars, lunch-and-learns and seminars presented by IIROC Enforcement Staff or subject matter experts. Some of this training is presented on a National level (i.e. biennial conferences and webinars) and some of it occurs on a regional level (i.e. lunch-and-learns and seminars).

The topics that are presented during Enforcement training sessions vary by region.

##### *Staff findings*

The training provided to the Prairie Region Enforcement Staff is deficient, and does not sufficiently cover the skill sets Staff requires in order to carry out their duties effectively. This is particularly apparent in the PrRO Investigations group, in areas such as interviewing techniques, knowledge and interpretation of securities legislation and technical knowledge of market risks. The current level of training provided does not give Enforcement Staff the ongoing knowledge required to keep pace with market trends in the Prairie Region. We also found that there are different levels of training provided to Enforcement staff in other jurisdictions, for example more extensive training is provided to staff in the Toronto Office. The training deficiencies in the PrRO are problematic because Enforcement staff requires a full training system to ensure completeness of their knowledge base so they are prepared to identify all potential risks when assessing files, conducting investigations, or conducting disciplinary proceedings.

##### *Staff recommendations*

86. IIROC should ensure that an adequate and appropriate training program, which is comparable to that of other jurisdictions, is implemented in PrRO to provide consistent and relevant training to all Enforcement Staff in order to ensure they are able to effectively discharge their duties. It is critical that this training be no less stringent than the requirements for Head Office training.

**Priority: Medium**

##### *IIROC's response:*

IIROC agrees that training is important. Comparable training will be made available in Calgary whenever possible and appropriate. Subsequent to the Review Period, IIROC hired a Director of Training and Development to develop and coordinate training programs across the country. Although IIROC agrees that training can be improved, IIROC disagrees that training was “deficient” in the sense that it materially impacted IIROC’s ability to fulfill its mandate.

##### *Staff comments and follow-up:*

ASC, MSC and SFSC staff are satisfied with IIROC’s response. We will continue to monitor the appropriateness of IIROC’s training program in the PrRO.

## 5. Case Assessment

### 5.1 Review of Case Assessment files

#### *Background information*

ASC, MSC and SFSC staff reviewed a sample of Case Assessment files.<sup>12</sup> Files that were reviewed included a cross-section of each Case Assessment Officer's work, complaint types, complaint sources and assessment outcomes.

Staff assessed the files for quality, timeliness, completeness, and appropriateness of outcomes.

#### *Staff findings*

##### *Referral procedures*

Case Assessment files that included documentation of the suggestion or consideration of making a referral to BCC were not followed-through by Case Assessment Officers or Case Assessment Management. Thus, it was unclear as to whether it was decided by Case Assessment Staff that a referral was, in fact, unjustified, or whether a referral should have been made to BCC but the referral documentation was not completed.

#### *Staff recommendations*

87. IIROC Case Assessment Officers and Staff should document their rationale and conclusions if they have considered a referral to BCC. This should be done in the Case Assessment Summary or another prominent place in the file so it is evident as to what decision was made with respect to the referral. If the decision is made to refer the file, then a referral memo should be drafted to the appropriate department, such as BCC, as it is outlined in the IIROC Case Assessment Policies and Procedures Manual.

**Priority: High**

#### *IIROC's response:*

IIROC staff will document when they consider a referral and, if the matter is not referred, document the reasons for that decision. If a matter is referred to another department, staff will do so by email and attach the closing memo, when appropriate.

#### *Staff comments and follow-up:*

ASC, MSC and SFSC staff are satisfied with IIROC's response.

#### *Managerial review of closing letters required*

Case Assessment Officers currently sign all of the closing letters for public and ComSet complaints. The closing letter explains the decision made from Case Assessment to the public complainant or firm who generated the complaint. Case Assessment does not have a procedure requiring the Case Assessment Manager to sign off on those letters as evidence of review. Such a procedure is important from a quality

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<sup>12</sup> The ASC reviewed 38 Case Assessment files, the MSC reviewed 24 Case Assessment files and the SFSC reviewed 5 Case Assessment files.

control perspective to ensure that Case Assessment is conveying the appropriate message to the public complainant or the firm who made the complaint.

***Staff recommendations***

88. IIROC should implement and enforce a policy that requires Case Assessment Managers to provide evidence of their review and sign-off on closing letters to ensure quality control of closing letters.  
**Priority: Medium**

***IIROC's response:***

IIROC has amended the checklist to indicate the Manager's sign off on the file.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

***File screening process***

The Case Assessment Policies and Procedures manual outlines the scoring system to be used in assessing severity and prioritization of files when they are opened at the Case Assessment stage. Based on the numerical score, a low, medium or high priority is assigned to the file.

It was noted that a number of files received inappropriate prioritization ratings based on the Case Assessment Policies and Procedures Manual (Case Assessment Manual). For example, some cases were classified as low priority even though the file score under the Manual was in the medium or high range. Some files that were referred by other groups (i.e. within IIROC or from Regulatory bodies) that should have been classified as high according to the Case Assessment Manual due to the nature of the referral were actually classified as low.

The Case Assessment Manual also outlines that an additional 10 points should be awarded when determining initial scores for files originating in Manitoba and Saskatchewan. This process reflects the additional risks involved in IIROC not having a physical presence in those jurisdictions. It was discovered by the MSC and SFSC during the file review process that Manitoba and Saskatchewan files were not always allocated an additional 10 points added to their score. Staff understand that IIROC has taken steps to ensure that the ComSet system now gathers sufficient and appropriate information when a compliant is filed to ensure that this assessment can be made.

An inappropriate scoring process is problematic in determining the order in which files will be addressed. There is the potential that high priority files may not be classified properly, which may result in a delay to the processing of critical cases.

***Staff recommendations:***

89. Case Assessment Management and staff should review the prioritization guidelines in the Policies and Procedures manual and ensure they comply with those guidelines in all instances. If there are deviations from these guidelines, then adequate rationale should be documented in the file.

The mandatory managerial review of Case Assessment files should be focused on ensuring that



the correct prioritization levels are assigned on the Case Tracking System (CTS), per the initial file score results.

**Priority: Medium**

***IIROC's response:***

Enforcement is reviewing the case selection criteria, including the file screening scorecard. IIROC agrees that any case selection process adopted should employ appropriate screening tools for effective and consistent approaches to file prioritization.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

***Handling of Case Assessment Files-SFSC***

SFSC staff is concerned that the Case Assessment group in the PrRO is not reviewing and assessing files in sufficient depth and that IIROC does not place due weight on warning letters that have been issued to registrants in the past.

A case pertaining to Saskatchewan was closed at the Case Assessment stage, a result which SFSC Staff, on review of the complaint file, did not believe was reasonable. As a result of this complaint file coming to light as part of the SFSC's ongoing oversight review process, SFSC pursued this matter further. It was determined by the SFSC that there were inconsistencies between the details provided by the approved person and the complainant. There were concerns relating to suitability of the investment for the investor, due to the nature of the timing of the investment involved. The approved person involved had been issued a warning letter in 2006 for similar activity and it did not appear to be considered when IIROC Case Assessment reviewed this complaint.

As a result of the SFSC Investigation, a settlement was reached, with the end result of funds being returned to the complainant. This instance highlighted inappropriate actions being taken by Case Assessment Officers in review of complaints.

***Staff recommendations***

90. IIROC Case Assessment should use warning letters as a trigger to exercise increased due diligence when conducting future assessments of registrants. Additionally, IIROC must have adequate procedures in place to ensure that matters are being assessed properly and are being referred to Investigations or Enforcement Counsel as necessary. IIROC should not close files prematurely if there are reasons to pursue such matters further.

**Priority: High**

***IIROC's response:***

IIROC does not claim to fully investigate every potential regulatory infraction as IIROC prioritizes its files. Some prioritization decisions are made at the case assessment stage. IIROC has reviewed the SFSC case and does not believe that this matter was closed prematurely.

IIROC recently reorganized its Case Assessment group and has created a complaints group within the Case Assessment group that will provide greater support and assistance to investors.

***Staff comments and follow-up:***

SFSC acknowledges the response of IIROC and we will continue to review files closed at the Case Assessment stage as part of our ongoing oversight process.

***Handling of Case Assessment Files-MSc***

MSc staff identified a file where the decision to close the file with a cautionary letter at the Case Assessment stage was inappropriate and the work completed on the file was inadequate. IIROC's Case Assessment staff did not consider or analyze all issues the complainant raised, nor did the closing letter address each of those issues. Due to the nature of the allegations and potential conflict of interest concerns, the file should have been escalated to Investigations for further attention. This raises concern of MSc staff as there can be significant impact on the parties involved if a file is not adequately addressed or referred at the Case Assessment stage.

***Staff recommendations***

91. IIROC must have sufficient processes in place to ensure that all files are adequately analyzed and reviewed by Case Assessment staff. IIROC should ensure that staff receives the proper training in order to have the ability to identify issues that require further investigation past the Case Assessment stage.

**Priority: High**

***IIROC's response:***

IIROC disagrees with this finding. IIROC believes that it has implemented sound processes to ensure appropriate review of all files by Case Assessment staff. Case Assessment utilizes an approved scoring methodology, which is overseen and reviewed by Enforcement management. However, as noted in Recommendation 88, IIROC is currently reviewing its case selection criteria, including the screening scorecard with a view to enhancing the assessment process.

***Staff comments and follow-up:***

We acknowledge IIROC's response, and request that IIROC provide Staff with a copy of the updated case selection criteria and file screening scorecard once it is completed.

## **6. Investigations Group**

### **6.1 Review of Investigation Files**

***Background information***

ASC, MSc and SFSC staff reviewed a number of investigation files to verify the quality, timeliness and compliance with IIROC Investigative Policies and Procedures.<sup>13</sup> Files were examined from a variety of investigators, time periods and outcomes.

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<sup>13</sup> The ASC reviewed 12 Investigations files, the MSc reviewed four Investigations files and the SFSC reviewed one Investigation file.

### ***Staff findings***

#### ***Referral of file to BCC not completed***

During the review of investigations files, it was discovered that there were some files indicating that a referral to BCC should have been made; however, there was no further documentation in the file or a memo completed in respect of referral of the matter. In these files, a referral was not completed in contravention of IIROC's process which dictates that the Investigator would complete a referral memo if they determine that a referral to BCC, or another department, should be made.

This is problematic because a file may be prematurely closed rather than referred as may have been considered appropriate by Investigations staff.

### ***Staff recommendations***

92. There must be adequate documentation and follow through in files where a referral to another department has been contemplated in the file. In those cases where it has been determined that a referral to another department is required, a referral memo should be completed and forwarded to the appropriate party, and a copy of the memo maintained on file. If it is determined that a referral to another department is not the appropriate course of action, a memo to file should be completed to indicate why the original intention to refer the issue to another department was not completed.

**Priority: High**

#### ***IIROC's response:***

IIROC agrees that documentation in this area needs to be improved. IIROC has also changed its processes so that all Prairie referrals are coordinated by the Director, Prairies and the VP Western Canada.

#### ***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

## **7. Enforcement Counsel**

### ***Background information***

ASC and MSC staff reviewed litigation files for quality of documentation, compliance with Enforcement Counsel Policies and Procedures, and evidence of Managerial review and discussion.<sup>14</sup>

### ***Staff findings***

Enforcement Counsel staff are required to record their time along with a description of the associated details for the purpose of cost recovery. From the file review, it was determined by ASC Staff that the

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<sup>14</sup> The ASC reviewed seven litigation files and the MSC reviewed four litigation files. There were no litigation files pertaining to the Saskatchewan jurisdiction during the period under review.

descriptions of details concerning the time recorded by Enforcement Counsel were very brief. Further, in some instances, time was charged without any supporting descriptions. There is no procedure in place that requires time reports to be reviewed to determine the appropriateness and completeness of the time being charged by Enforcement Counsel Staff.

This is problematic from an operational standpoint as costs cannot be recovered if sufficient details are not provided in order to justify the expenses recorded.

***Staff recommendation***

93. IIROC staff should record specific details of the time charged and ensure precision in the amount of the time charged. The time tracking reports in Enforcement Counsel should be reviewed on a regular basis, in order to ensure compliance and consistency.

**Priority: Medium**

***IIROC's response:***

IIROC Enforcement Counsel track their time and cost it out in a manner consistent with the legal profession across Canada. Some panels have requested additional information that goes beyond the issue of time tracking. IIROC is reviewing these issues that relate to how Counsel are costed out and why Enforcement staff do not always seek full costs. With respect to the finding about time tracking, it should be noted that time tracking is reported to the CSA on a regular basis through the Enforcement utilization report.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

## **C. Business Conduct Compliance**

### **1. Introduction**

Under each of the ASC's, MSC's and SFSC's Recognition Orders, IIROC is required to regulate investment dealers including the establishment, administration and monitoring of IIROC's rules, policies and other similar instruments. The BCC department of the PrRO is tasked with ensuring Prairie Region Member firms are complying with non-financial regulatory requirements. This is done through the field examinations of Members' head offices and branches, in areas such as corporate finance, supervision of employees, account activity and research requirements.

### **2. Purpose and scope**

The purpose of the PrRO BCC review was to:

- Ensure that the BCC function is operating in accordance with the Recognition Orders.
- Ensure that IIROC is monitoring their Members' compliance with non-financial regulatory requirements.
- Assess the response of the BCC department to external market issues and trends.
- Ensure that information is being effectively communicated between BCC and other IIROC departments.

ASC, MSC and SFSC staff completed a comprehensive review of the PrRO BCC department including a cross-sectional review of PrRO BCC files for the Review Period.<sup>15</sup>

### **3. Department organization and reporting structure**

At the time of fieldwork, the PrRO consisted of four BCC Examiners and one BCC Manager. The Director of the PrRO oversees the Prairie Region BCC function. The BCC Manager reports directly to the Director of the PrRO.

### **4. Product due diligence procedures**

#### ***Background information***

The need for a renewed focus on product due diligence procedures at member firms was highlighted by the Non-Bank Sponsored Asset-Backed Commercial Paper (ABCP) crisis, which was brought to the forefront during the non-bank sponsored ABCP market freeze in August of 2007. Since that time, IIROC has undertaken initiatives to bring awareness to their dealer members on the importance of product due diligence. These initiatives include:

- Publishing a regulatory study concerning the manufacture and distribution by IIROC

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<sup>15</sup> The ASC reviewed 12 BCC files, the MSC reviewed eight BCC files and the SFSC reviewed two BCC files.

- member firms of third-party ABCP (October 2008).
- Publishing an IIROC Member Notice on best practices for due diligence (March 2009).
- Holding educational seminars and presentations for members related to the observations and results of the regulatory study published in October of 2008.
- Adding additional due diligence questions to BCC Programs in the interview and pre-physical testing sections (March 2009)

### ***Staff findings***

In spite of the above efforts, the PrRO's implementation and use of examination program enhancements designed to examine member firms' due diligence practices and procedures have been untimely and insufficient.

Examination modules that incorporated due diligence questions released by the IIROC head office in March of 2009 were not uploaded in the Prairie Region Examiner's modules until May of 2009. Furthermore, these sections were not utilized by Prairie Region BCC Staff from May of 2009 through September of 2009.

ASC staff note that there has also been differential training provided to IIROC BCC staff in the area of product due diligence. Some jurisdictions received specific training after the ABCP market freeze-up. However, Prairie Region Examiners were not provided with similar training. There was also no guidance provided to the Examiners on how to complete the sections on due diligence in the new examination modules.

Additionally, the PrRO has not been connected to what the IIROC head office has done in terms of product due diligence initiatives. There is a lack of awareness at both the management and staff as to the specific initiatives that head office has undertaken.

### ***Staff recommendations***

94. A significant part of this finding relates to the timeliness of the Prairie Region's response to monitoring member firms' due diligence, so this cannot now be rectified. However, for the future, IIROC must take action to ensure that due diligence procedures are, in fact, being implemented and monitored at member firms.

IIROC National and Regional Senior Management must also ensure that there is a current understanding of any National initiatives that have been undertaken and they must ensure they understand their role in them.

Prairie Region BCC staff should ensure that due diligence examination procedures are being incorporated and utilized in ongoing compliance examinations and that BCC Staff are trained on how to complete these modules. Any National initiatives such as module revisions for due diligence procedures should be incorporated into regional examination programs on a timely basis. Additionally, IIROC BCC Management must emphasize with BCC Examiners the importance of member firms having effective due diligence procedures in place so that they can ensure there is sufficient focus given to this area during field examinations.

**Priority: High**

***IIROC's response:***

IIROC acknowledges that the roll out of the Product Due Diligence materials was not emphasised to BCC staff within the Prairies Region to the degree it should have been. IIROC is updating its programs to ensure that staff are aware of how new initiatives may impact a review and to provide the necessary training. IIROC will document training that has been provided.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

## **5. Written procedures and guidance**

### ***Background information***

The BCC Policies and Procedures Manual (BCC Manual) is provided by the National BCC group to Regional BCC departments. This guide summarizes technical, procedural and administrative matters related to Examinations, and is to be used as a reference tool for Examiners when conducting member firm BCC Examinations.

### ***Staff findings***

There is a lack of guidance in the BCC Manual regarding sample selection during a BCC review. The BCC Manual states that Examiners should document 1) the size of the sample, 2) the number of deficiencies found, 3) the time period on which the review was based, 4) the names of the documents or reports tested, and 5) the conclusions. However, there is no guidance as to how to pick a sample and what type of sample to select. There is also no guidance provided in the BCC Manual on how to document the sample rationale. Furthermore, there is no guidance on how the Examiner should expand the sample in the case of exceptions found or for higher risks caused by significant or repeated findings.

Based on the BCC files reviewed by Staff, it was largely undeterminable as to whether the sample size was adequate for the testing procedure since the population of the sample being tested was not documented and there was no rationale given for how and why the sample was chosen. While there is some informal guidance provided to Examiners for the number of accounts to sample based on the size of the firm being reviewed, these guidelines are not clear and were not consistently followed by the Examiners.

### ***Staff recommendations***

95. The BCC group should establish and set out in the BCC Manual, formal policies and procedures outlining an appropriate methodology for sample selection. Guidelines should also be developed for the documentation of sample selection rationale. Examiners should also be provided with guidance describing when an increase in sample size is warranted due to risk areas identified during the planning stage or identified during fieldwork.

**Priority: Medium**

***IIROC's response:***

IIROC currently has written general guidance on sample selection methodology. The implementation of TeamMate will ensure that examiners have specific sample selection and testing guidance within each relevant module. Documentation of specific sample selections will be retained in TeamMate.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

**6. BCC branch examinations (repeat finding)**

***Background information***

IIROC currently does not follow a standardized or prescribed approach when selecting Member Firm branches for review during its regular review cycle. When selecting branches for review, IIROC looks for branches that have not been recently reviewed, branches that Senior IIROC Management or BCC Management identify as high risk, and branches based on past experience that require review. IIROC does not prescribe the number of branches to be reviewed in any given year as generally, IIROC expects head office firms to review their branches either annually or based on a risk based approach to selecting branches for review.

***Staff findings***

The Prairie Region BCC department does not conduct a sufficient number of Member Firm branch exams. This is especially apparent in Manitoba and Saskatchewan as only four branch reviews were conducted in Manitoba and two branch reviews were conducted in Saskatchewan during the Review Period. Of these branches selected in Manitoba, some were reviewed on more than one occasion during the review period. While it is recognized that certain branches may present more risk and thus require more frequent review, the result of multiple reviews of certain branches is less coverage of the rest of the branch population in the Prairie Region. As the branch review file did not explain why the branch was selected for review, Staff were unable to determine why a certain branch was visited on more than one occasion.

Also, the list of branch reviews selected is not supported by any documentation on the Sales Compliance Review (SCR) schedule or elsewhere in the branch review file, so the rationale is not apparent as to why particular branches were visited and why others were not. Though IIROC uses a risk model to assess risk for head office firms, they do not track the risk profiles for each member firm branch.

Generally, IIROC relies on head office firms to review their branches. However, there are additional inherent risks associated with different jurisdictions and individual branches that the IIROC Prairie Region needs to assess. These inherent risks largely arise from operational risks due to the distance between the IIROC head office member firm and their branches.

***Staff recommendations***

96. The BCC department of the PrRO should conduct additional branch examinations in the Prairie Region to ensure adequate risk coverage in all jurisdictions under the scope of PrRO.



Additionally, IIROC should assess the risks that are unique to each province in the Prairie Region as well as the risks unique to the branch level and incorporate the assessment of these risks into the decisions made for the schedule of branch examinations. This assessment should also be formally documented in a prominent location such as the SCR schedule or in the BCC file to support the decisions made.

**Priority: High**

**IIROC's response:**

IIROC is developing a formal branch selection process which will allow for branches to be reviewed in coordination with a head office review in another province. Other branches will be selected based on a risk profile. Given the number of branches (over 5,000), IIROC staff will take a risk-based approach to the selection process.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

**7. Pre-physical interviews**

***Background information***

In the IIROC BCC Manual, under the "Completion of Modules" Section, it is stated that:

"Pre physical interviews are questions asked prior to the commencement of the physical review to ensure the examiner has preliminary information available so that one can commence the physical review."

The intention is that these interviews will provide the BCC Examiner with the background information necessary in order to start the examination. Additionally, pre-physical interviews will assist in completing the examination in an efficient and effective manner.

***Staff findings***

ASC staff noted that pre-physical interviews are not completed on a consistent basis. PrRO Management confirmed that these interviews are not completed for recurring Member examinations as they feel the information has already been obtained from the Member.

It is important that interviews are completed as they provide valuable insight into the changes that occur from the previous examination of a Member. The interviews may assist in ensuring that examiners obtain accurate and complete information during the examination. Furthermore, it is a procedure that is mandated by IIROC and is not being completed in the PrRO.

***Staff recommendations***

97. BCC staff should complete the pre-physical interviews, regardless if the Member examination is a recurring examination. IIROC should consider tailoring questions in these interviews appropriately if they are of the opinion that it is a duplication of information they may already

know. For example, they can structure the questions to ask what people, procedures and systems has changed, rather than following a standard template of interview questions, which may not be appropriate for a recurring examination.

**Priority: Medium**

***IIROC's response:***

BCC staff use knowledge of the firm, some of which is routinely captured and updated in TeamMate and MIRA databases, to be strategic in their reviews, concentrating on the highest risk areas within the firm and de-emphasizing or eliminating the less risky and irrelevant areas of a review. Interviews are an integral part of this process, including entrance interviews and, when appropriate, prior to each module being commenced. These processes are documented in the BCC Manual.

Going forward, the information-gathering process in preparation for on-site examinations will be driven by the TeamMate modules in the scope of activity and planning sections, resulting in the pre-physical interview template becoming redundant.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff agree that interviews are an integral part of the compliance process. We will continue to monitor changes in the IIROC examination process with respect to interviews as IIROC transitions to TeamMate and amends its procedures.

## **8. Method of referring BCC issues to Enforcement**

### ***Background information***

According to the IIROC BCC Manual, referrals to Enforcement must be accompanied by a referral memo. The manual outlines that the memo provided to Enforcement must contain certain components included in it such as: a summary of the facts and basis for referring the matter to Enforcement, a summary of any statements made by staff of the Member which is relevant to the matter, copies of any relevant documents and an assessment of the matter priority.

### ***Staff findings***

MSC Staff noted that during the oversight review period, a referral was made from the BCC to the Enforcement group. While MSC staff noted that a memo summarizing compliance issues related to the member was prepared, the memo did not contain any of the above requirements for a referral, including supporting documentation or an assessment of priority. Given that the referral process was not followed, MSC staff was unable to determine the date of the referral, the full scope of matters being referred and to whom the matter was referred.

### ***Staff recommendations***

98. IIROC should ensure that the established procedures related to referring BCC files to Enforcement are followed, and that all relevant information related to the referral is documented in the BCC file.

**Priority: Medium**

***IIROC's response:***

IIROC agrees that, in this case, the referral memo did not match the format required by BCC procedures. The memo did list the history of supervision failures and the VP Western Canada (responsible for both BCC and Enforcement) was very familiar with the firm and the reasons for this referral.

***Staff comments and follow-up:***

We are satisfied with IIROC's response. While we recognize that the history of the issues related to the referral was well known to IIROC staff, this may not be the case in the majority of referrals. As such, IIROC must ensure that the established procedures are followed.

## **D. Financial and Operations Compliance**

### **1. Introduction**

Under the ASC's, MSC's, and SFSC's Recognition Orders, IIROC is expected to:

- regulate investment dealers, including ATSS.
- establish, administer and monitor FinOps's rules, policies and other similar instruments.
- provide notice to the appropriate Commission of any violations of securities legislation of which it becomes aware.

The Prairie Region FinOps department carries out these functions by ensuring that Prairie Region Member are accurately reporting capital requirements in accordance with IIROC Rules at the PrRO through onsite-site financial examinations and desk reviews of filings of Members.

### **2. Purpose and scope**

The purpose of the FinOps part of the oversight review was to:

- Ensure that the PrRO is effectively reviewing and analyzing Members' financial filings to ensure capital adequacy.
- Determine the adequacy of the 'Examiners' documentation of Member field examinations.

The ASC and MSC completed a comprehensive review of the PrRO FinOps department including a cross-sectional review of PrRO FinOps files for the period under review.<sup>16</sup>

### **3. Department organization and reporting structure**

At the time of fieldwork, the Prairie Region FinOps department consisted of a Manager and two Examiners. The Manager reports to the Director of the PrRO. The Director is responsible for signing all field examination reports.

### **4. Field examinations**

#### **4.1 Written procedures and guidance**

##### ***Background information***

Prairie Region FinOps Examiners utilize the guidance in the IIROC National FinOps Manual as a reference point for member firm examinations and for other functions related to their role in FinOps. This guidance contains sections on regulatory functions, administrative items, and IIROC software programs

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<sup>16</sup> ASC reviewed 12 FinOps files and the MSC reviewed seven FinOps files.

used by FinOps staff.

### ***Staff findings***

There is no formal guidance given to Examiners on how to select samples and document the rationale for the samples that are selected. ASC and MSC staff noted that FinOps Examiners do not document details of the samples they select, including the rationale or methodology they used in selecting the sample. The samples are generally selected on a judgmental basis, but there is no support for the judgement used in selecting the sample.

ASC and MSC staff cannot verify that sufficient risk coverage is obtained without evidence of appropriate sample selections and supporting documentation.

### ***Staff recommendations***

99. Guidelines should be established in the FinOps Manual, or other training materials available to FinOps Examiners to specifically set out guidelines for selecting samples as well as required documentation standards to support the samples that have been selected.

**Priority: Medium**

#### ***IIROC's response:***

IIROC has developed guidance on criteria for sample selection, and has incorporated this guidance into the FinOps Manual. FinOps Managers have reviewed the guidance with examination staff, and will reinforce the approach in future field examinations.

#### ***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

## **4.2 Managerial file review - action plan**

### ***Background information***

FinOps Managers are involved in reviewing all stages of a FinOps examination file, including the planning, testing, and reporting stages. This is done through continuous communication with FinOps examination staff, attending onsite during field examinations, written coaching notes, and informal verbal communication with Examiners.

The conclusion of a file involves sending a final examination report to the Member and requires a timely written response of action items to address deficiencies. When the response is received, it is reviewed by the FinOps Manager to assess the adequacy of the firm's action plan.

### ***Staff findings***

It cannot be determined whether the Manager specifically agreed with all of the action points the firm is addressing as no evidence of review was provided to ASC and MSC Staff at the time of fieldwork. Such evidence of review is important to ascertain that all action points have been considered and that the Manager has no further concerns regarding the adequacy of the action items or whether deficiencies may

remain.

A second weakness in control procedures is that there are no closing letters sent in response to a Member Firm's action plan to address deficiencies. Thus, it leaves ambiguity in the sufficiency of the action items taken. This is especially concerning in situations in which significant findings were noted such as material Risk Adjusted Capital errors.

***Staff recommendations***

100. Control procedures should be established so that action items are reviewed by Managers and concluded appropriately. This would involve evidence of managerial review of action plans being maintained in the file. The file should also contain a concluding letter or a documented phone call to the firm regarding their action plan to conclude whether additional work is required or if the action items are sufficient to address the deficiencies noted.

**Priority: Medium**

***IIROC's response:***

IIROC currently has control procedures in place in either UBSS or TeamMate. Managers record their concurrence with Dealer Members' responses by creating a disposition "reply satisfactory" in the case tracking application that monitors a file's progress. When Managers are dissatisfied with a response, they create a disposition "reply unsatisfactory", which triggers an additional follow-up step prior to closing the file. Managers will document the nature of any follow-up, and obtain relevant evidence of compliance for significant findings, prior to closing the file. Where significant findings have material capital or other reporting implications, Managers will comment on follow-up in the course of reviewing the Dealer Member's subsequent MFR. IIROC will ensure that this record is clear in TeamMate.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

## **E. General Findings**

The following is a summary of additional findings that do not relate to specific departments, but were discovered as part of the Oversight Review:

### **1. Role of Director, Prairie Region**

#### ***Background information***

The Prairie Region Director Position at the PrRO was created in 2007 as part of IIROC's response to the ASC's finding from the 2006 Oversight Review of the IDA to address issues with interdepartmental communication. The job description for the Director of the Prairie Region sets out responsibilities and accountabilities in the areas of Registration, BCC, and FinOps. However, there is no responsibility or accountability for the Director in Enforcement areas at the PrRO. The VP Western Canada is responsible for the Enforcement departments at the PrRO.

#### ***Staff findings***

The ASC is concerned that because of the way the job description for the Director of the Prairie Region is set up, it creates a significant gap in the managerial oversight in the departments of the PrRO. There is no on-site managerial presence for the Case Assessment, Investigations and Enforcement Counsel Departments. These departments are not afforded the same level of leadership and oversight as other departments in the PrRO.

As set out in other sections of this Oversight Review Report, significant gaps in communication continue to occur between the Enforcement and Compliance groups. During the review, it was discovered that referral memos completed by the Case Assessment department, which were sent to the BCC group were not followed up on by the BCC group. A copy of the referral memos was retained, but there was no additional follow-up done on these referral memos. Also, managerial meetings, which were created by IIROC to enhance communication between departments, do not contain discussions of specific files that affect both Compliance and Enforcement departments. Thus, many of the interdepartmental communication issues found during the ASC 2006 Oversight Review of the IDA have still not been addressed.

#### ***Staff recommendations***

101. The ASC is concerned that the construction of role of the Director of the PrRO may have contributed to the current interdepartmental communication issues. IIROC should re-evaluate the Director's role and determine any causal factors that may have occurred in the Oversight of the PrRO which lead to the breakdown in the lines of communication between the Compliance and Enforcement departments. The ASC expects that an action plan should be established and enacted to ensure that the leadership and reporting structures of the PrRO does not create any opportunities for miscommunications between departments.

**Priority: High**

***IIROC's response:***

IIROC agrees that communication between departments is essential and has taken, and will continue to take, steps to improve such communication.

The specific finding regarding referrals from Case Assessment to BCC that were not properly documented or possibly followed up has been addressed. The Director of the Prairie Region is now the conduit for any referrals and will ensure that the outcome of a referral is properly documented.

IIROC does not agree that the reporting structure explains this finding. One Vice President located in Vancouver is responsible for all of the activities in the Prairie Office. He is assisted by a Director who leads the compliance and Registration departments under the supervision of the Vice President. While in Calgary, group meetings are held with the five Managers and the Director Prairies, the Director of Case Assessment and the VP Western Canada, and many informal discussions are held regarding current trends, compliance reviews, and enforcement matters. IIROC will ensure that relevant cases are discussed during these meetings and make appropriate notes.

Enforcement staff are encouraged to talk to the Director particularly to take advantage of his industry knowledge and his knowledge of compliance and registration matters. The Director, the compliance Managers and Registration staff also know that they are free to discuss matters with Enforcement staff and vice versa.

***Staff comments and follow-up:***

ASC staff acknowledge IIROC's response. We will continue to work with IIROC to ensure that interdepartmental communication and consistent regional leadership for all local departments is given adequate consideration both regionally and nationally.

**2. Governance**

***Background information***

Regional District Councils (DCs) are local committees that address areas such as regional registration, membership and discipline matters, issues of regional interest and regional perspectives on National initiatives. There are three DCs for the Prairie Region as each province has their own DC in order for them to provide an opportunity to raise regional perspectives on IIROC National matters.

Many of the key functions of the DC in the Prairie Region relate to registration and membership. They also identify candidates to be considered for the Nominating Committees and Hearing Panels. The regional DCs have a role in policy development. However, it is mostly carried out from the perspective of incorporating regional interests for rule proposals as most of the policy development is carried out by IIROC's Compliance and Legal Section and the Financial Administrators Section.

***Staff findings***

The Prairie Region DCs do not have formal conflicts of interest guidelines. If DC members believe that there may be a potential conflict of interest for a particular issue or concern that DC is discussing, then they are supposed to identify this conflict and remove themselves from the discussion and resolution of



the issue.

However, it is concerning to us that there are no formal guidelines in place. The nature of the structure of SROs gives rise to the potential for conflicts of interest and IIROC must take all necessary measures to manage these conflicts of interest.

***Staff recommendations***

102. IIROC should establish formal conflicts of interest guidelines that establish a firm protocol to manage conflicts of interest for DC members, should they arise.

**Priority: High**

***IIROC's response:***

Conflict of interest guidelines are followed by DCs and DC Sub-committees, but have not been documented in a formal code of conduct or conflict policy applicable to DCs or DC Sub-Committees. IIROC will implement a national code of conduct, including conflict procedures and confidentiality provisions, for the DCs and DC Sub-committees. IIROC will require each member of a DC to acknowledge the code of conduct upon appointment to the DC and annually thereafter.

***Staff comments and follow-up:***

ASC, MSC and SFSC staff are satisfied with IIROC's response.

## IV MONTRÉAL OFFICE

### 1. Background

IIROC was recognized by the *Autorité des marchés financiers* (AMF) as a self-regulatory organization (SRO) pursuant to *An Act respecting the Autorité des marchés financiers*, R.S.Q., c. A-33.2, under Order No. 2008-PDG-0126 on May 2, 2008 (“IIROC Recognition Order”).

The IIROC Recognition Order stipulates that IIROC will, among other things:

- regulate investment dealers, including alternative trading systems (Dealer Members);
- establish, administer and monitor its rules, policies and other similar instruments (Rules);
- enforce compliance with its Rules by Dealer Members and others subject to its jurisdiction;
- provide services to exchanges and quotation and trade reporting systems (QTRSs) that choose to retain it as a regulation services provider, as that term is defined under *Regulation 21-101 respecting Marketplace Operation*;
- if retained by an exchange or a QTRS, administer, monitor and/or enforce rules pursuant to a regulation services agreement between IIROC and that exchange or QTRS;
- conduct certain functions delegated to it by the securities regulators that have recognized it as an SRO (“Recognizing Regulators”), including registration functions.

The IIROC Recognition Order was issued by the AMF conditional upon, among other things, IIROC continuing to meet recognition criteria, which include issues related to governance, performance of regulatory functions, disciplinary matters, systems capacity and integrity, and a number of requirements specific to Québec. For example, in each jurisdiction where it has an office, IIROC must have sufficient resources, appropriate organizational structures and adequate technology systems. It must also maintain a Québec District that has clearly defined responsibilities in matters of regulation, membership, sales compliance, financial compliance, market surveillance, inspection of trade desks and application of rules regarding its Dealer Members and marketplace members.

The IIROC Recognition Order should be read concurrently with the Memorandum of Understanding regarding oversight of IIROC among the Recognizing Regulators (MOU). The MOU describes the terms and conditions of the oversight program, which includes periodic reviews of IIROC’s self-regulatory activities and regulation services. The Recognizing Regulators use their best efforts to carry out reviews of IIROC’s offices at least once every three years. The most recent review of the IDA by its Recognizing Regulators was performed in September and October 2006. The present oversight review of IIROC by the Recognizing Regulators therefore constitutes the first review of the new merged entity.

This initial review report of IIROC Québec District sets out the AMF’s review activities, findings and recommendations pertaining to the business conduct compliance, financial and operations compliance, and complaints, investigations and enforcement areas, the Québec District Council and information protection. The other three areas, covering trading conduct compliance, market surveillance and trading review and analysis, were reviewed by the AMF jointly with the Ontario Securities Commission at IIROC’s Toronto office and are integrated into the consolidated report of IIROC regional offices, entitled *IIROC Oversight Review 2009*.

## **A. Business Conduct Compliance**

### **1. Introduction**

IIROC's Business Conduct Compliance (BCC) department ensures that Dealer Members implement policies and procedures in order to ensure their compliance with all non-financial regulatory requirements, including those of IIROC, provincial securities acts and the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.

To do so, BCC conducts regular field reviews of Dealer Member firms. These on-site examinations focus on issues of supervision of accounts, employee supervision, internal controls, documentation, advertising and marketing, and anti-money laundering due diligence. For example, a sampling of client account opening files are reviewed to ensure that they are complete and that transaction suitability has been verified based on the client's profile; fee accounts and discretionary management are scrutinized; dealer manuals, procedures and forms are analyzed to ascertain whether they are up-to-date and correspond to their daily application; and client complaint reporting and handling procedures are reviewed. This list is not exhaustive, since the scope of the non-financial compliance requirements is very broad, as the different review modules and numerous related module sections show.

BCC reviews all Dealer Members at least every five years, i.e., annually for members serving retail clients, every two years for members with institutional clients and every five years for members trading for their own account. Dealer Members are selected for review using a risk-based approach. Dealer Members considered high risk are reviewed more frequently than Dealer Members considered lower risk.

### **2. Purpose and scope**

The objectives of this section of the review were to:

- review and evaluate the structure and resources, including staff, of the BCC department to ensure it performs its regulatory functions effectively and efficiently;
- evaluate the adequacy of the performance measurement benchmarks for compliance examinations and determine whether they were met;
- assess whether BCC is focusing on current risks and regulatory concerns when conducting its field reviews;
- assess the adequacy, timeliness, and quality of compliance examinations performed by BCC staff;
- assess whether deficiencies reported in the last oversight review report were followed up and addressed by IIROC;
- assess whether results of sweeps are used appropriately in order to properly focus on risks and regulatory concerns.

To gather the information needed to understand the operations of the BCC department, AMF staff interviewed the BCC manager and the Director, Member Regulation – IIROC Québec District. AMF staff also reviewed BCC's *Policy, Procedure and Technical Guide*, the examination program modules used by examiners (currently, approximately 15 modules) and a sample of Dealer Member review files. Given that information is now computerized, AMF staff consulted databases such as SharePoint, UBSS and MIRA, which are described later in this report.

### **3. BCC activities**

The type of exam conducted by BCC depends on the purpose of the field exam. Five types of field exams are typically conducted:

- a general risk-based field exam scheduled for a Dealer Member;
- a general risk-based field examination of a branch office of a Dealer Member;
- limited reviews of Dealer Members who are able to demonstrate a high degree of compliance and therefore represent a lower risk;
- a follow-up review to verify that a Dealer Member has carried out procedures and addressed a previously identified critical supervisory shortcoming;
- sweeps: a new form of review conducted by selecting a specific type of Dealer Member, based on criteria established at the beginning of the sweep, to review a specific issue.

The business conduct examination process is broken down into five parts: Planning, Field Work, Report and File Preparation, and Response-Management and Monitoring.

#### **3.1 Planning**

Good planning is the key to a successful business conduct examination. A planning checklist is prepared in consultation with other IROC departments, in particular, Financial & Operations Compliance, Trade Conduct Compliance and Market Surveillance. The checklist draws on the preceding business conduct compliance review report and the Dealer Member's response to the report, which may include points for follow-up during a future review.

In addition, the following data sources are used to obtain an up-to-date picture of the Dealer Member: ComSet (Complaints and Settlement Reporting System) and CTS (Case Tracking System, a national complaints and investigation database system), which enable IROC staff to identify potential compliance problems at a Dealer Member and the modules to be used when an enhanced compliance review is required; monthly financial reports and other regulatory filings; the BCC Risk Assessment Model, which gives an indication of the comparable risk assessed for each Dealer Member relative to all other firms and relative to other firms in a peer group (the Member Information Risk Assessment (MIRA) database reports the score obtained for a Dealer Member based on different risk types); the National Registration Database (NRD) and the list of individuals under strict supervision.

BCC staff then complete the planning checklist, an electronic form stored on Business Conduct Compliance's SharePoint site that maps out the major review objectives in advance. This checklist gives an historical and prospective overview of the Dealer Member, based on the information sources previously listed and all other useful information, and is used to assess the Dealer Member's risk. A planning table showing the modules and module sections to be used, the names of the assigned BCC staff and the allocated budget is also completed. The four core review modules are account opening, supervision of accounts, employee supervision, and branch audit compliance.

The planning file is generally prepared by a BCC technician. The lead examiner is responsible for analyzing the material collected. The BCC manager, who participates in different planning stages, reviews the plan. The final plan is approved by the Director, Member Regulation.

### 3.2 Field work

The field work stage begins with an entrance meeting between the Dealer Member and BCC to, among other things, outline the examination process and the expectations of each party. Field work includes examining, testing and validating the Dealer Member's internal controls and procedures using the modules identified in the planning checklist. The examiner therefore conducts a physical review, which consists in performing substantive tests of systems, procedures, files, reports or other documents using a sample of approximately 20 accounts over a given period. Findings must be based on documented facts and reported on the finding form, which highlights a deficiency or concern with respect to a module section. When the field work is completed, findings are discussed and the Dealer Member provides feedback. BCC then formally presents its findings to the Dealer Member during an exit meeting.

### 3.3 Report and file preparation

In preparing the examination file and report, the examiner must ensure that findings reported in the finding forms are clearly cross-referenced to the appropriate sections of the modules, as these modules are used to identify any weaknesses and detail discussions held between the examiner and the BCC manager. The lead examiner then updates the Dealer Member's risk profile on MIRA. The examination report, which draws the Dealer Member's attention to regulatory weaknesses or violations and alerts it to potential control weaknesses, is submitted to several levels of review within IROC Québec District. The final report is sent to the Dealer Member's designated compliance officers and senior management.

### 3.4 Response-Management and follow-up

The Dealer Member has one calendar month to respond to BCC's findings and recommendations. If the response is satisfactory, the file is closed. If the response is not satisfactory, a follow-up letter is issued to the Dealer Member and the process moves to the monitoring phase, which only ends when all issues have been resolved.

#### *Staff findings*

Whereas the module content is reviewed regularly as regards the module sections and underlying questions, it is not possible to see when changes are made, i.e., whether the change was an addition, a deletion or a change in module section. Since modules are now stored on SharePoint, each change in the content of a module permanently erases previously stored information.

IROC does not have a tool for easily tracking updates to its examination programs and understanding the reasons for the updates.

#### *Staff recommendations*

103. IROC should have tools that enable it to easily track updates to its examination programs and understand the reasons for the changes.

**Priority: Medium**

#### *IROC's response:*

IROC will ensure that all changes are documented and explained.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**4. Benchmarks**

BCC benchmarks are as follows:

- 70% of available staff time is to be spent directly on Dealer Member reviews;
- all mandated reviews must be completed during the year as established at the beginning of the year in the planning schedule;
- 60% of final examination reports must be issued to Dealer Members within 15 weeks of completion of field work;
- all final examination reports must be issued to Dealer Members within 26 weeks of completion of field work.

BCC – IIROC Québec District conducted an average of 20 reviews per year over the review period at the approximately 30 Dealer Members operating in Québec, including 17 head offices. Specifically, 20 reviews were conducted in 2006, 22 in 2007, 20 in 2008, and 19 in 2009, as well as 11 branch sweeps, which are discussed later in this report.

***Staff findings***

In 2007, one report was issued after the 26-week deadline, which violates the fourth benchmark above.

***Staff recommendations***

104. BCC - IIROC Québec District must ensure that its benchmarks are consistently met.  
**Priority: Low**

***IIROC's response:***

Benchmarks are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. IIROC notes that only one examination exceeded the benchmark during the Review Period.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained. No follow-up is required.

***Staff findings***

Also in 2007, five out of a total of 22 files did not meet the 15-week post-examination report issuance deadline. However, 77% of examination reports were issued to Dealer Members on time, exceeding the 60% threshold. For the other years under review, most reports were issued within the 15-week target deadline. AMF staff are concerned that this 60% threshold is easy to attain.

***Staff recommendations***

105. IIROC should re-evaluate the agreed-upon 60% threshold requiring that examination reports be issued to Dealer Members within 15 weeks of field work completion.

**Priority: Medium**

***IIROC's response:***

Benchmarks are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. IIROC intends to review all benchmarks across the compliance programs.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

These relatively lower outcomes in 2007 compared with the other years covered by AMF reviews correspond to the transition period between two BCC managers at IIROC Québec District. The situation has since stabilized.

**5. Examination file quality**

AMF staff reviewed a sampling of six examination files of BCC – IIROC Québec District, including one branch sweep file. These files were representative of the diversity of Dealer Members operating in Québec, i.e., two integrated firms, two retail firms and one discount brokerage firm.

***Staff findings***

Generally, the examination files tested were well documented. At each phase of the Dealer Member examination process (planning, field work, report and file preparation, follow-up), and despite the substantial amount of information, it was easy to trace and compare data and information, as references to each examination file were precise and supported by relevant documents. Tables of contents were sufficiently detailed to identify each topic.

The quality of examiners' work as regards selection of modules was highly satisfactory (linking points raised in the previous examination for follow-up), type of tests or size of samplings. Findings were explicitly detailed and recommendations referred to IIROC rules that were breached.

***Staff recommendations***

None.

**6. Changes since previous oversight review**

BCC's role has not changed substantially from the time of the review of the IDA by the AMF, and its report issuance benchmarks are the same.

However, IIROC has introduced new procedures since the previous oversight review. These changes relate to tools used, the examination process, types of examinations and determination of Dealer Member risks.

## **6.1 Tools**

BCC's *Policy, Procedure and Technical Guide* was fully reviewed and updated to August 2009. Because of the extent of the changes, there is no black-lined version of the guide.

BCC has refined its tools and now makes extensive use of computerized platforms. As a result, examination programs and reports and the contents of files are stored in UBSS, a management software system for tracking files and measuring utilization of examiners' time. This information is stored on BCC's SharePoint site, which is comparable to a national library.

One specific change is that all documents are now electronic; hard copies are automatically digitized and stored on SharePoint.

Since April 2008, BCC – IIROC Québec District has been using IDEA, a new software that allows users to select a sample of client accounts based on refined criteria in order to test trading activity such as order priority or multiple trading in an account. IIROC's Montréal office has developed expertise in using this software and its BCC examiners train staff in other IIROC regional offices. IDEA was designed to be integrated into TeamMate, a user-friendly platform containing IIROC's examination programs.

## **6.2 Examination process**

The examination process based on the four to five phases described above has not changed substantially. Nonetheless, for greater efficiency, some operational procedures were moved within the process.

Consequently, the entrance meeting is now conducted prior to, rather than after, finalizing the planning phase. Also, since early 2009, draft reports have not been issued to Dealer Members, a decision by IIROC senior management that applies to all regional Districts. Lastly, BCC – IIROC Québec District examiners no longer schedule the exit meeting on the date of the final field work, as was customary until 2007. The meeting is now held after the finding forms have been documented and reviewed by the BCC manager; in other words, after examiners return to IIROC's Montréal office.

## **6.3 Types of examinations**

BCC has developed a new type of examination called a "sweep." This examination consists in selecting a specific type of Dealer Member based on criteria established at the beginning of the sweep and reviewing a specific issue. A module was created for examinations of a branch office of a Dealer Member (branch sweep), which sets out procedures that focus on the effectiveness of a head office's supervisory controls of its branches. Branches are selected via a risk rating assessment questionnaire in order to obtain a representative sampling. The selection is guided by several criteria such as head office location, number of products offered, size of Dealer Member, retail clientele, and distance between branches and the head office.

In the first quarter of 2009, BCC – IIROC Québec District performed 11 branch sweeps of eight Dealer Members, representing just over one-third of all BCC examinations conducted in 2009.

## ***Staff findings***



Only two lines in the August 2009 *Business Conduct Compliance Policy, Procedure and Technical Guide* are devoted to sweeps. No details on sweep procedures are provided.

### ***Staff recommendations***

106. IIROC should develop and draft a complete and detailed section on sweeps, including procedures, in its *Business Conduct Compliance Policy, Procedure and Technical Guide*.  
**Priority: High**

#### ***IIROC's response:***

IIROC will develop a general procedure with some generic language and will develop, on an *ad hoc* basis, a detailed procedure targeted for each sweep. Given the particularities of each sweep, IIROC believes that adapted policies which include a set of criteria and project plan will be useful.

#### ***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

Another new development in 2009 was the introduction by IIROC of integrated examinations at the pan-Canadian level. As part of this pilot project, the Business Conduct Compliance, Financial & Operations Compliance and Trading Conduct Compliance departments in IIROC's regional Districts performed joint examinations, i.e., concurrently at the same firm rather than separately at different times of the year, as was customarily done. In each District, these three departments worked together on planning, the entrance meeting, field work, the exit meeting and examination report production.

IIROC Québec District conducted its first integrated examination in the third quarter of 2009, which corresponds to the end of the review period.

## **6.4 Determination of risks**

During the review period, BCC performed an in-depth review of its risk model, including key risk assessment factors, definitions and guidelines. This initiative was carried out jointly with Financial & Operations Compliance so as to benefit from its experience with its own risk assessment model. A Risk Trend Report is created for every Dealer Member to encourage them to strengthen their governance and risk management practices and facilitate IIROC regulatory activities. Each Dealer Member is rated low, moderate-low, moderate-high or high based on an assessment of the business risks inherent in its operations and the manner in which those risks are managed. The report also provides comparisons of the member's peer group (nine peer groups; for example, integrated, retail, institutional, etc.) and the industry as a whole.

Since June 2008, this information has been stored in MIRA rather than on paper support. MIRA, which assesses a Dealer Member's overall risk profile, is one of the key components of the planning checklist that examiners draw on to determine which modules they will use for the examination. Therefore, in order to guide examiners in the planning process, the planning checklist need only show one of three risk categories (low, moderate or high) for each area selected for review.

Prior to April 2009, a Dealer Member's risk rating was determined at the planning phase in order to select the sections to be completed for the scheduled inspection and then re-assessed when the field examination was completed. IIROC no longer determines a rating prior to the examination, preferring instead to now assign a general risk level (low, moderate, high) so as to determine the risk attributable to different aspects which, based on this determination, should be covered during the inspection. The risk rating is updated in MIRA only after the on-site examination is completed.

### ***Staff findings***

It is difficult to draw a link between the information collected used to determine which module sections should be completed and the risk rating information on the planning checklist in a Dealer Member's file. In fact, the checklist provides no explanation of the information source used to determine the score obtained.

### ***Staff recommendations***

107. AMF staff recommend that IIROC Québec District provide the information source needed to detail each Dealer Member's risk score identified in the planning checklist.

**Priority: Medium**

### ***IIROC's response:***

The risk score used in the planning checklist is calculated through a database called MIRA. MIRA can generate a report called "Internal Risk Assessment Report". We will make sure to include this report along with the planning checklist as back-up to the risk rating used in the planning checklist.

### ***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained. No follow-up is required.

## **7. Staffing and training**

BCC staff – IIROC Québec District increased from eight in 2006 to 10 in 2007. Staff remained at 10 in 2008 and 2009, with a turnover rate of 10% during the past year. In September 2009, BCC staff consisted of six examiners, plus one examiner position that became vacant during the same month, two technicians and one manager. IIROC's Montréal office also plans to hire a second BCC manager (new position) in 2010 to assist the current manager in rolling out the integrated examination approach. The vacant examiner position and the new manager position were filled in March 2010.

Technicians help prepare examination files, in particular during the planning phase; they also input data and carry out various tests on the samplings mentioned above.

### ***Staff findings***

BCC examiners in Montréal have in-depth knowledge and are experienced in many fields, such as derivatives. They come from the brokerage or exchange industry and hold various professional designations.

IIROC Québec District has a significant annual training budget earmarked for improving examiners' knowledge through courses, mainly given by CSI Global Education Inc.

AMF staff are of the opinion that the quantity and quality of IIROC Québec District BCC staff are sufficient.

***Staff recommendations***

None.

## **B. Financial and Operations Compliance (FinOps)**

### **1. Introduction**

In 2008, the Canadian Investor Protection Fund (CIPF) discontinued its oversight of IIROC's financial compliance audits. This oversight is now the responsibility of the Recognizing Regulators. The review of FinOps – IIROC Québec District is therefore a first-time mandate for AMF staff, in keeping with the mandates assigned to staff of the other Recognizing Regulators, who conducted reviews in their respective regions.

The role of FinOps Compliance is to monitor the financial status of its Dealer Member firms and enforce compliance with IIROC rules. The main elements of the department's work are:

- Review of financial regulatory filings: FinOps staff review monthly financial reports and the audited Joint Regulatory Financial Questionnaires and Reports (JRFQR) to identify changes in trends, financial status, and profitability. Any Dealer Member firm that does not meet minimum capital requirements is referred to as capital-deficient and must immediately remedy its capital position or face possible suspension or termination of membership. All capital deficiencies are referred to IIROC's Enforcement department for possible disciplinary action. All clients of IIROC Dealer Member firms are covered by the CIPF, which protects clients in the event that a Dealer Member firm becomes insolvent.
- Annual and biennial "surprise" field examinations: FinOps staff conduct "surprise" examinations of Dealer Members' books and records to ensure the reliability of their unaudited regulatory filings.
- Review of audit working papers: Each Dealer Member firm is subject to a year-end audit by an approved panel auditor to validate the information filed by the firm with IIROC. To ensure the quality of the audit, FinOps staff review the panel auditor's working paper files within three months of the filing date of the JRFQR by a high-risk firm or within six months for other firms.

At the time of the examination, FinOps – IIROC Québec District had 13 employees, compared with 11 in 2006 and 2007.

### **2. Purpose and scope**

The objectives of this section of the review were to:

- review and evaluate if FinOps has the appropriate structure and resources, including staffing, to ensure that it performs its regulatory functions effectively and efficiently;
- evaluate the adequacy of the performance measurement benchmarks for the financial compliance functions and determine whether they were met;
- assess the adequacy, timeliness, and quality of financial compliance examinations performed by FinOps;
- determine whether FinOps has appropriate review processes and procedures to perform its member regulation functions adequately;

- assess whether IIROC effectively enforces its rules and monitors its Dealer Member firms' compliance with securities legislation.

AMF staff examined the *Policies, Procedures & Guidelines* manual dated August 2009 and held discussions with the FinOps manager and the Director, Member Regulation – IIROC Québec District. Staff also consulted a sampling of Dealer Member examination files stored on TeamMate.

### 3. Benchmarks

The benchmarks for FinOps are as follows:

- attain an average examiner project utilization rate of 70%, meaning 70% of available staff time is to be spent directly on Dealer Member firm examinations;
- examine every Dealer Member annually (except Dealer Members approved for biennial review) within a calendar year;
- complete and issue 60% of field examination reports within eight weeks to a maximum of six months for all examination reports;
- perform an audit working paper review within three months of the filing date for high risk firms;
- complete all other audit working paper reviews within six months of the filing date.

FinOps – IIROC Québec District met the benchmarks during the review period.

Following their review, AMF staff report the following four significant findings.

#### *Staff findings*

When combined, non-significant file errors can become significant in respect of the pre-established materiality threshold. We have no indication that FinOps – IIROC Québec District measures this impact.

#### *Staff recommendations*

108. FinOps – IIROC Québec District should demonstrate that the total number of non-significant file errors is taken into account when evaluating whether aggregate errors have an impact on the materiality threshold.

**Priority: Medium**

#### *IIROC's response:*

IIROC staff establishes a materiality threshold at the beginning of each examination. Any file error that could lead to a material impact is documented in a finding form. All findings and their capital impact are entered into a "Consolidated Summary of Errors" spreadsheet.

If the Manager responsible for reviewing the file encounters many non-material errors, he or she considers whether an adjustment to the Risk Adjusted Capital is required.

IIROC does not believe it is necessary to report all non-material errors that are non-systemic below the established materiality threshold, and believes that the current practice is sufficient to determine the need for adjustments to Risk Adjusted Capital. All findings that relate to internal control or procedural test, regardless of materiality, are reported.

***Staff comments and follow-up:***

The role of FinOps is to monitor the financial status of its Dealer Member firms and enforce compliance with IIROC rules. However, AMF staff observed that the main objective of FinOps' current procedure is to identify weaknesses having a material impact and determine the need for adjustments to Risk Adjusted Capital.

Material impact is of such importance to IIROC's current review procedure that only those weaknesses resulting in a material impact above the materiality threshold established in the file are documented in the Consolidated Summary of Errors spreadsheet.

We observed that internal control weaknesses, material weaknesses in procedures (i.e., not in compliance with IIROC rules) and weaknesses that could represent a significant systemic risk were, for the most part, less perceptible in the inspection reports because they did not result in a material impact and therefore do not require an adjustment to Risk Adjusted Capital, even though certain weaknesses were recurring.

Although AMF staff are of the opinion that it is not necessary to report all non-material weaknesses, they nonetheless are of the view that the identification of weaknesses should not be guided solely by material impact, but also by the need to ensure compliance with IIROC rules and identify weaknesses that could present systemic risk.

AMF staff will follow up this recommendation with IIROC.

***Staff findings***

AMF staff observed in one file that there was no justification by the Director, Member Regulation – IIROC Québec District for a change in the classification of a finding.

***Staff recommendations***

109. All classification changes should be justified in the finding forms.

**Priority: Low**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained. No follow-up is required.

***Staff findings***

Changes to the *Policies, Procedures & Guidelines* manual are made via e-mail; the manual is not updated immediately.

***Staff recommendations***

110. Changes to the *Policies, Procedures & Guidelines* manual should be reflected immediately in the document.

**Priority: Low**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

***Staff findings***

The checklist used for biennial reviews does not show that the examiner is required to consult BCC's most recent examination file or the most recent auditors' report, whereas, FinOps – IIROC Québec District examiners do in fact consult these documents.

***Staff recommendations***

111. The checklist used for biennial reviews should indicate that the information to be obtained includes the most recent BCC examination report and the most recent auditors' report.

**Priority: Low**

***IIROC's response:***

Examiners do, as a matter of practice, consult these materials. IIROC will add this to the checklist.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## **C. Complaints, Investigations and Enforcement**

### **1. Introduction**

In August 2008, the Complaints and Investigations division – IIROC Québec District was divided into two separate departments: Complaints and Investigations. Enforcement, which already existed, is a separate department.

IIROC's Enforcement department may conduct an investigation of individuals and firms under IIROC's jurisdiction as a result of a complaint, referral from a securities commission, other agency, or other sources where it is necessary to enforce compliance with IIROC rules. IIROC investigates complaints about IIROC-regulated firms and their registered employees and has established services to help investors who are seeking compensation. Investigations are most often the first phase of the enforcement process.

Since August 2009, cases examined by the Case Assessment manager (considered "complaints") have been reviewed by the Director, Member Regulation, whereas cases examined by the Investigations manager have been reviewed by the Vice-President, IIROC Québec.

As well, since the fall of 2009, Enforcement has been actively involved in investigations. Enforcement legal staff are involved in cases at the outset, helping to develop the investigation plan and attending interviews. IIROC Québec District's intention in introducing these changes was to improve Investigations' benchmarks and the quality of investigation files escalated to Enforcement.

These three departments have a total of 13 employees.

### **2. Purpose and scope**

The objectives of this section of the review were to:

- ensure that staff in place are sufficiently and properly experienced and have received appropriate continuing training;
- evaluate that benchmarks used appear reasonable and attainable;
- ensure that cases are processed adequately;
- ensure that decisions are well documented.

The review of the Complaints, Investigations and Enforcement departments was conducted by gathering information from the following sources: discussions with the Case Assessment manager and the Investigations manager, in the presence of the Director, Member Regulation – IIROC Québec District to understand the operations of the Complaints and Investigations departments; discussions with the Vice-President, IIROC Québec to understand Enforcement operations; examining the guides and policies and procedures manuals of the Complaints, Investigations and Enforcement departments; and, finally, examining a sample of complaint files (26 files), investigation files (6 files) and enforcement files (6 files) handled during the review period.



### 3. Benchmarks

The benchmarks set out in the procedures manuals of each of the three departments covered in this section are:

- 80% of complaint files must be processed in less than 75 days;
- all standard investigation files must be completed within one year of being opened and investigations requiring more than one year must be identified to and approved by an IIROC officer;
- 60% of enforcement files must be completed in less than 10 months.

#### *Staff findings*

Benchmarks for complaint files were met for each review period: 87% of files were processed on time in 2006, 82% in 2007, 81% in 2008 and 83% for the period from January to August 2009.

However, Investigations benchmarks were not met for the review period. The number of files requiring more than one year to process was 37% in 2006; 42% in 2007, 50% in 2008 and 15% from January to August 2009.

In addition, Enforcement benchmarks were not met for much of the review period. In 2006, 83% of files were processed in less than 10 months, whereas in 2007, 2008 and for the first eight months of 2009, that number fell to 47%, 50% and 25%, respectively.

IIROC explains these results by the fact that until 2009, staffing was insufficient due to extended absences (illness, maternity leave, staff loans or resignations). As well, some major files were processed during this period.

In order to improve file processing times, IIROC's Montréal office made two changes to its structure and procedures. First, in August 2008, the Complaints and Investigations teams were split to specialize staff and meet benchmarks. Second, to improve Enforcement file processing timelines, Enforcement legal counsel have, since the fall of 2009, been involved in investigation files. This helps lawyers familiarize themselves with cases that they may be assigned and improves the quality of the evidence gathered during investigations.

Despite the changes made to improve productivity, AMF staff noticed that the Investigations and Enforcement departments – IIROC Québec District did not meet their respective benchmarks for the review period.

#### *Staff recommendations*

112. IIROC Québec District should take the necessary steps to ensure that Investigations and Enforcement comply with their respective benchmarks.

**Priority: High**

#### *IIROC's response:*

Although the benchmark indicated in the Investigations Manual mentions that all investigations must be completed within a year, the benchmark that has always been applied is that 60% of the investigations files must be completed within one year. The Manual will be amended to reflect that fact. The practice

also is that for files that will take more than one year, there is a specific scrutiny of the merits of a longer investigation and it has to be approved by the Vice-President, Quebec.

The benchmarks are a management tool applied on a national basis and designed to assist management with overall completion times for Enforcement files. They function as an alert, which allows management to take a closer look at the file in question. IIROC is satisfied with the benchmarks applied in Investigations in light of their purpose.

IIROC benchmarks are not designed to assist staff or management in prioritizing or ranking files. There is an ongoing process of prioritizing investigation and prosecutions files by management, and Enforcement is confident that all files are reviewed regularly by management with a view to ensure that priority files receive the adequate resources for timely completion.

IIROC agrees that it is important to complete investigations and prosecutions within the benchmarks established by IIROC and are working to that end. We have recently established an Integrated Enforcement Team model. Lawyers and Investigators will work closely together on a file as soon as it is opened in Investigations. IIROC believes that this will improve the time it takes to complete files, and expect better compliance with our benchmarks.

It is also important to note that we now have a full complement of three full-time Enforcement Counsels in the Montreal office. The priority is to clear the backlog of old files and also make sure that new files are prosecuted within the benchmarks, if possible.

***Staff comments and follow-up:***

AMF are satisfied with the response obtained and will follow up this recommendation with IIROC, in particular, the new integrated Investigations and Enforcement teams model, to confirm whether this approach will have an impact on file processing times and benchmarks.

**4. File closings**

***Staff findings***

The reasons given for closing complaint files were not always in compliance with those set out in the complaints procedures manual, and certain justifications were, in our opinion, not valid. Therefore, several policy violation files (containing evidence) were closed instead of being escalated to Investigations. This is not in compliance with the *Case Assessment Procedures Manual* of July 2009.

We consider these closings to be premature. In fact, if proper procedures had been followed, some files would have been referred to Investigations. The premature closing of complaint files falls into two categories: closings based on criteria in the *Investigations Procedures Manual*, dated August 2009 (severity of violation, public interest, availability of evidence), and those based on criteria not set out in manuals but which IIROC has unofficially established (the main criteria considered when closing a complaint file are severity and repeat violations, availability of evidence, vulnerability of complainant and previous sanctions imposed on the representative by the dealer firm).

We observed that four complaint files were closed prematurely. These files stated that the dealer's representative had no disciplinary record or that the Dealer Member firm had sanctioned the representative in the past.

IIROC cites shortage of Enforcement staff at its Montréal's office as the reason for the premature closing of files. Enforcement staff are only able to process 10 to 15 files per year; therefore, procedures are relaxed based on staff availability.

### ***Staff recommendations***

113. AMF staff recommend that IIROC Québec District meet the file closure criteria set out in the *Case Assessment Procedures Manual* and the *Investigations Procedures Manual*.

AMF staff also recommend that personnel be hired as needed.

**Priority: High**

#### ***IIROC's response:***

IIROC acknowledges the importance of closing files using the criteria established in the Case Assessment and Investigations manuals. Files must be reviewed in light of the established criteria and closed in conjunction with the procedures set out in the manuals.

It is important to note that IIROC employs a risk based strategy, which means that we do not open an investigation for every complaint. We apply our limited resources to those matters that pose the greatest risk to investors and the capital markets.

We conducted staff training sessions with Case Assessment employees from February 28 to March 4, 2011 in which new case selection criteria were discussed. The file closing procedures are detailed in the case selection criteria document. We will remind Case Assessment employees to close files only when they meet the criteria for closure in the manuals.

We believe we have appropriate staffing for Case Assessment and Investigations. If this situation changes we will assess the situation and hire as appropriate.

#### ***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained with respect to the recommendation on compliance with file closure criteria set out in the manuals.

As regards the staff hiring recommendation, IIROC Québec District should demonstrate that the new integrated team model will improve file processing times.

AMF staff will follow up these recommendations with IIROC.

## **5. Use of WatchBrief**

IIROC uses WatchBrief. This application will keep a file open in CTS, but does not record statistics on the length of time the file remains pending. A file can be opened directly in WatchBrief, or an open file can be transferred to WatchBrief. When a file is transferred, it is closed and re-opened under another file

number, which brings the time counter back to zero. This same file can be closed while it is still pending, or it can be closed and re-opened as an active file under another number. There are no rules governing when a pending file under WatchBrief is reactivated.

### ***Staff findings***

Procedures do not describe or define situations where use of the pending function is permitted under WatchBrief, yet we observed several instances where this function is used. For example, if a legal notice is requested for a file opened at a phase other than Enforcement, a file will be opened under WatchBrief so that when legal counsel completes its assessment, the accurate number of files processed is reflected, regardless of whether or not they are Enforcement files.

In addition, use of this function may skew statistics with respect to actual processing times and the number of processed files by impacting the benchmarks in two ways. On the one hand, processing times are not measurable because this function suspends processing, and on the other hand, a file is recorded twice: once when opened in WatchBrief and again when it is transferred from WatchBrief to active file status.

### ***Staff recommendations***

114. AMF staff recommend that IIROC Québec District evaluate the use of WatchBrief and describe this function in the procedures manual.

**Priority: Medium**

#### ***IIROC's response:***

IIROC recognizes the limited use of a WatchBrief for Enforcement matters and agree that there should be criteria established for how and when it will be used by staff. IIROC will develop criteria and amend the manual to address this issue.

We do take issue with the suggestion that we use the WatchBrief as a means to suspend benchmark tracking. We do not convert active files into watch briefs in order to stop benchmark times. Watch briefs are only opened for non-enforcement matters of particular interest to the Enforcement Department.

We will complete a review of the use of the WatchBrief and make any necessary amendments to the manuals by June 30, 2011.

#### ***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained regarding the changes to be made to the procedures manual.

During its review of the use of WatchBrief in CTS, IIROC should determine whether the time a file spends as a WatchBrief file should be included in total processing times for benchmark purposes, and should reflect this decision in the procedures manual. CTS should adequately manage the WatchBrief function and generate the appropriate data.

AMF staff will follow up this recommendation with IIROC.

## 6. File amalgamation

### *Staff findings*

Files can be amalgamated for strategic reasons. However, when a file is combined, it is not clearly shown in the file or in CTS that it has been closed (in fact, the file is continued as part of another file). As a result, it is difficult to adequately monitor amalgamated files, since there is no tool for tracing them.

As well, closing files before they are completed reduces processing times and, consequently, benchmarks are met more quickly.

### *Staff recommendations*

115. AMF staff recommend that the IIROC Québec District implement tools for tracing amalgamated files.

**Priority: Low**

#### ***IIROC's response:***

IIROC tracks the progress of all files on CTS. When two files are amalgamated, staff will track on CTS that one of the files has been closed and joined with another file. On each file summary page on CTS there is a section called "View Related" which tracks all related matters, including those that have been joined with others. CTS improvements are a priority project for IIROC in the coming year.

#### ***Staff comments and follow-up:***

AMF staff have noted the project to improve CTS.

IIROC should also ensure that physical files are complete and include closing details (date of amalgamation, number of files amalgamated and the reasons for the amalgamation) and that this information is also available in CTS.

AMF staff will follow up this recommendation with IIROC.

## 7. Model letters in French

### *Staff findings*

The French version of the most recent model letters used for complaints is not included in the procedures manual.

### *Staff recommendations*

116. AMF staff recommend that IIROC Québec District include the French version of model letters used to respond to complaints in the procedures manual.

**Priority: Medium**

***IIROC's response:***

IIROC had modified model letters in French and will integrate them in the manual.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**8. Complaints procedures manual**

***Staff findings***

The complaints procedures manual does not reflect the fact that the Director, Member Regulation – IIROC Québec District has, since August 2009, reviewed all complaint files prepared by the Case Assessment manager, including closed files. Similarly, the manual does not reflect the fact that the Case Assessment manager has reviewed all investigators' files related to complaints since 2008. Since this situation is specific to Québec, the procedure should be drafted into the complaints procedures manual.

***Staff recommendations***

117. AMF staff recommend that IIROC Québec District modify the complaints procedures manual so that it reflects managers' duties.

**Priority: Low**

***IIROC's response:***

The basis of the staff finding is that the IIROC Case Assessment Manual does not outline the actual process in place in Quebec in terms of the management review when a file is closed by Case Assessment. Section 5.1 of the Case Assessment Manual provides that a file which is to be closed with no action must be reviewed by the Case Assessment Manager or higher Manager. If the file has been handled by that Manager, the file must be reviewed by the next more senior manager. IIROC therefore believes that the manual provides for appropriate management review. However, we agree with the AMF that there is an omission in Section 5 of the Case Assessment Manual in that it does not specify that the Director, Member Regulation in Quebec can approve the files done by the Manager, Case Assessment. It rather specifies only that the VP Quebec can perform such approval. We will change our Manual accordingly.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained regarding section 5 of the complaints procedures manual and will follow this up with IIROC.

Since the current process is specific to Québec and the Director, Member Regulation – IIROC Québec District is not among the managers authorized to approve file closings, AMF staff are of the opinion that IIROC should also modify section 5.1 of the manual to clearly stipulate that, in Québec, files prepared by the Case Assessment Manager are reviewed by the Director, Member Regulation – IIROC Québec District, as the immediate line manager.

AMF staff will follow up this recommendation with IIROC.

## 9. Delegation of powers

### *Staff findings*

At present, the Vice-President – IIROC Québec has no delegation of powers related to enforcement, such as the power to sign off on documents. We suggest that IIROC consider whether such delegation would be necessary in emergency situations.

### *Staff recommendations*

118. AMF staff recommend that IIROC Québec District evaluate the need to establish delegation of powers for the Vice-President – Québec.

**Priority: Low**

#### *IIROC's response:*

IIROC's Vice-President – Québec is working with the General Counsel's Office to implement a formal delegation.

#### *Staff comments and follow-up:*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## 10. Conflicts of interest

### *Staff findings*

AMF staff observed a deficiency with respect to the identification and disclosure of a conflict of interest. In one complaint file dating back to 2008, there was a significant delay in identifying and reporting a conflict of interest involving a staff member of Complaints – IIROC Québec District, and the individual against whom the complaint was filed was working for a Dealer Member. In fact, 40 days elapsed between the time the file was received at IIROC and when it was transferred to the AMF.

The obligation to report conflicts of interest is set out in the *Case Assessment Procedures Manual*. The *Conflicts of Interest Policy*, which is part of IIROC's *Code of Conduct* (updated in September 2009), contains a procedure stipulating that conflicts of interest must be disclosed when employees are hired, when they make any changes to their conflict of interest statements and on an annual basis. A copy of this statement is given to the employee's manager and IIROC General Counsel Office.

### *Staff recommendations*

119. IIROC Québec District must adhere to conflict of interest written policies in place in IIROC's *Code of Conduct* and the procedures manual.

**Priority: High**

#### *IIROC's response:*

Employees are required to acknowledge and comply with the *Code of Conduct*, including the Conflicts of Interest Policy, at the commencement of employment and annually thereafter. In addition, employees are

required to identify potential conflicts of interest with member firms and complete a disclosure form, and to update this disclosure annually. Conflicts of Interest Forms were signed by all employees upon the merger in June 2008. The electronic annual acknowledgment was undertaken in October 2009 during which the employees were reminded to confirm or update the Conflicts of Interest Form. The annual renewals on a going forward basis are being conducted in January/February of each year.

A potential conflict of interest was identified by the Montreal Office with respect to an employee in connection with one file. IIROC management made a decision that the conflict was such that the file should not be reviewed by the Montreal Office and the file was transferred to the AMF. IIROC is of the view that the *Code of Conduct* and procedures were complied with and worked properly in this case.

To assist in the earlier identification of potential conflicts of interest, IIROC has implemented a process where employee disclosure forms and updates are retained by the VP of the employee's region and/or department, as well as at IIROC's head office.

***Staff comments and follow-up:***

AMF staff are satisfied with the new process for disclosing and updating staff conflicts of interest under which the forms will be retained by the Vice-President – Québec. We will follow up this recommendation with IIROC.



## D. Requirements for Québec

### 1. Introduction

The IIROC Recognition Order (in French only) contains a number of conditions, set out in Schedule A, including the condition regarding requirements for Québec. Paragraph 13 a) of Schedule A states as follows:

[Translation]

“IIROC shall maintain a Québec District that has clearly defined responsibilities in matters of regulation, membership, sales compliance, financial compliance, market surveillance, inspection of trade desks and application of rules regarding its Dealer Members, marketplace members and authorized persons. Any decision concerning oversight of its self-regulatory activities and Dealer Members, marketplace members and authorized persons in Québec is principally made by persons residing in Québec.”

### 2. Trade desk supervision

#### *Staff findings*

In connection with paragraph 13 a) above, paragraph 13 f) of Schedule A of the IIROC Recognition Order stipulates that IIROC Québec District must, within six months of the recognition order, report in writing on its plan and timetable for development of its expertise in the examination of trade desks.

The IIROC Recognition Order was signed on May 2, 2008. At the time of the oversight review of the activities of IIROC Québec District by AMF staff, namely, 17 to 18 months after the signing of the order, this expertise in trade desk inspection had still not been developed. IIROC Québec District reported on its plans and timelines on a regular basis to the AMF and took concrete steps in the desired direction. It initially contemplated hiring a Director, Surveillance & Trading Review and Analysis, a position which was later converted into a Senior Investigative Trading Analyst position. The job posting process was completed in February 2010 and the aim was to have the position filled by the first quarter of 2010. However, at the time of drafting of this report, the position had still not been filled.

#### *Staff recommendations*

120. AMF staff recommend that IIROC Québec District finalize the development of this expertise by hiring a trade desk inspector.

**Priority: High**

#### *IIROC's response:*

IIROC has added this expertise to the Montreal office. A senior investigative trading analyst began in September 2010 and is involved in Quebec market files. IIROC has also begun training sessions for Montreal staff, and two such sessions have taken place. BCC examiners will be trained to assist in TCC examinations and this function will be transitioned to the region once a full-time examiner has been trained.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**3. Mediation process**

***Staff findings***

AMF staff reviewed letters issued during the review period in connection with the closing of complaint files, investigations and enforcement matters and IIROC's website. Their findings show that IIROC was not promoting the AMF's mediation service.

The requirement to promote the AMF's mediation service is set out in paragraph 13 g) of Schedule A of the IIROC Recognition Order. Under this paragraph, IIROC undertakes to comply with and promote the complaint examination and dispute resolution process put in place by the AMF under the laws it administers. IIROC Québec District should be reminded of obligation to comply with this requirement.

File closing letters have since been modified. However, IIROC's website does not provide visible references to the AMF's mediation services, yet it clearly directs site visitors to the services offered by the Ombudsman for Banking Services and Investments. For example, the website contains a link to a section (including a guide) entitled *Getting Help With Your Complaint*, which does not present the AMF's services among the recourses offered to investors.

***Staff recommendations***

121. IIROC's website should provide clear information about the AMF's mediation services.

**Priority: High**

***IIROC's response:***

IIROC's Public Affairs Department has amended the information appearing on the IIROC website in order to identify clearly the AMF's mediation services.

The guide "Getting Help With your Complaint" was prepared jointly by the MFDA, the OSC and IIROC for Ontario residents, explaining the lack of mention of the AMF's mediation services. IIROC notes on its website that this guide is intended for Ontario residents.

***Staff comments and follow-up:***

AMF staff are satisfied with the changes made to IIROC's website further to its recommendation. No follow-up is required.

## E. Québec District Council

### 1. Introduction

In accordance with section 10.1 of IIROC General By-law No. 1, any geographic area in Canada may be designated as a District of IIROC. Ten geographic areas were designated as the initial Districts of the IDA (and subsequently continued), including the Québec District. Each District has its own District Council. A District Council is a local committee that addresses regional registration, membership and discipline matters, raises issues of regional interest and adds regional perspective to national initiatives during quarterly meetings of the National Advisory Committee, which is composed of the Chairs of the District Councils.

Each District Council is composed of four to 20 members, including a Chair and a Vice-Chair, but exclusive of *ex-officio* members, as may be determined at the annual meeting of Dealer Members of the District called to elect the District Council members. In 2009-2010, the Québec District Council had 18 sitting members. District Council members are appointed for a two-year renewable term. Standing Sub-Committees may be established on the initiative of the District Council; for example, the Québec District Council has established a Nomination Sub-Committee, a Continuing Education Sub-Committee, a Regulation Sub-Committee, an Approval Sub-Committee, and, recently, a Derivatives Sub-Committee.

AMF staff reviewed the minutes and related documents of all Québec District Council meetings for the review period. They also interviewed the Vice-President – Québec and the Director, Member Regulation – IIROC Québec District. Their findings are as follows.

### 2. Disclosure policy

#### *Staff findings*

There is no written information confidentiality and conflict of interest disclosure policy or formal process for Québec District Council members establishing, for example, the conditions whereby a member of the District Council is required to withdraw from a meeting during discussions involving the firm where he currently works or a firm where he has previously worked.

#### *Staff recommendations*

122. IIROC's Québec District Council should establish a disclosure policy and process for members in order to maintain information confidentiality and manage potential conflicts of interest. In the near term, it should obtain a formal commitment from the members of the Québec District Council to comply with the confidentiality of information obtained.

**Priority: Medium**

#### *IIROC's response:*

IIROC has developed a new Code of Conduct and Conflicts of Interest Policy which was approved by the IIROC Board on January 27, 2011. Council members will be required annually to acknowledge that they have read and understood the Policy.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**3. Quorum**

In accordance with IIROC's *Dealer Member Rules*, in particular, Rules 5, 6 and 8, prior approval of the District Council is required in the following situations: changes in Dealer Member ownership, Dealer Member holding companies, related companies and diversification, and Dealer Member amalgamations or acquisitions. In addition, under section 18 of Rule 20, the District Council has the power, which it may delegate to a sub-committee of the District Council, in matters pertaining to the registration of individuals.

***Staff findings***

Since the District Council has the above-described powers with respect to Dealer Members, the determination of a quorum for meetings and the reporting of the attainment of quorum in the minutes are intended to validate committee decisions.

Under section 10.4 of IIROC General By-law No. 1, two members of the District entitled to vote, present personally or by a partner, director or officer shall be a quorum for any meeting of the Dealer Members of the District. Compared with the quorum for the District Council, the Approval Sub-Committee is comprised of three industry members, pursuant to section 18 of Rule 20 of IIROC's *Dealer Member Rules*. The definitions of these two quorums are not consistent.

***Staff recommendations***

123. AMF staff recommend that IIROC revise the definition of quorum for any District Council meeting so that it is consistent with the definition of quorum for a District Council sub-committee meeting.

In order to validate decisions made with respect to Dealer Members, the minutes of the Québec District Council meetings should indicate that a quorum has been reached.

**Priority: Medium**

***IIROC's response:***

IIROC is reviewing, on a national basis, the rules for quorum requirements and District Council Sub-committees, having regard to the composition, size and mandate of each. The minutes of Quebec District Council meetings have, since May 2010, recorded the presence of a quorum. Please note that the new requirements will specify that the quorum is achieved for District Council meetings when 50% + 1 of members represented on the Council is obtained.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

#### 4. Mandate

##### *Staff findings*

Prior to the merger of the IDA and RS, IDA's *Dealer Member Rules* articulated the functions and responsibilities of the District Council and set out the sub-committees that could or should be created. Since the formation of IIROC, Rule 11 – *District Councils and Meetings* and Rule 13 entitled *Election of District Council Members*, have been repealed. Article 10 of IIROC General By-law No. 1 only briefly covers District Councils, and there is no information on committees or sub-committees.

##### *Staff recommendations*

124. AMF staff recommend that IIROC more fully document the roles, functions and responsibilities of the District Council, its committees and sub-committees.

**Priority: Medium**

##### *IIROC's response:*

IIROC is updating, on a national basis, the mandates and procedures of the District Councils and District Council Sub-committees to accurately reflect their regulatory decision-making powers, as set out in IIROC's By-law and Rules.

IIROC will also ensure that the mandates of the District Council Sub-committees established in Quebec are properly documented.

The new draft District Council procedures will be presented to the IIROC Board in March 2011.

##### *Staff comments and follow-up:*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

#### 5. Nominee selection criteria

According to the minutes of a meeting of the Québec District Council Nomination Sub-Committee held in 2009, the applications of individuals seeking nomination to the Québec District Council are evaluated using criteria developed in 2007. These criteria cover skills sets, availability, and jurisdiction and industry representation. In addition, the renewal of a sitting member is conditional on attendance at meetings, substantive contribution and representation by Dealer Member head office.

##### *Staff findings*

Despite the existence of these criteria, it is difficult to determine whether they are actually considered when evaluating a nominee. In fact, during the review period, AMF staff found that some members seeking renewal did not meet all the criteria.

##### *Staff recommendations*

125. AMF staff recommend that IIROC Québec District Council’s Nomination Committee improve documentation of member nomination and renewal criteria to clearly show that these criteria have been applied.  
**Priority: Medium**

***IIROC’s response:***

IIROC has drafted a new set of District Council Procedures that dealt with District Council governance. On the nomination process, the new procedures will require the Nominations Sub-Committee to ensure a proper balance of Council members who will collectively provide effective representation of the membership having regard to each nominee’s disciplinary history, if any, skills, experience and expertise necessary to discharge his or her obligations as a Council member including regulatory responsibilities pursuant to IIROC rules and delegation orders. The new draft procedures will be submitted to the IIROC Board for approval in March 2011.

In the future, we will better document the application of the nominations process.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**6. Minutes**

***Staff findings***

When documents are filed following approval by IIROC Québec District Council members, the minutes are brief. They do not contain the main points discussed prior to approval of the documents and the nature and the level of members’ involvement in the discussions.

***Staff recommendations***

126. AMF staff would like to see more detailed minutes that reflect discussions, particularly when members are required to approve measures to be taken regarding a Dealer Member.  
**Priority: Low**

***IIROC’s response:***

IIROC will comply.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained. No follow-up is required.

**7. Hearing Committees and Hearing Panels Rule**

One of the mandates of the District Council is to identify competent nominees for hearing panels. Hearing panels play an essential role in the enforcement of rules. Each year, the District Council

establishes a Nomination Committee that prepares a list of nominees recommended to sit on the Hearing Committee and the Hearing Panel. This list is then approved by the District Council and submitted to the governance of IIROC's Board of Directors for nomination purposes.

In accordance with IIROC's *Hearing Committees and Hearing Panels Rule* in Schedule C.1 to Transition Rule No. 1, one-third of the individuals nominated to the Hearing Committee must be public members and two-thirds must be industry members. The resulting Hearing Panel is composed of two industry members and one public member, who are appointed to the Hearing Committee. The definition of "industry member" includes a current or former director, officer, partner, or employee of a current or former member or access person. A public member means, for purposes of the Québec District Council, a person who is a current or retired member in good standing of the Law Society of Québec (Québec Bar). Furthermore, the District Hearing Committee chair must be a public member and the Hearing Panel chair must be a public member of the Hearing Committee.

### ***Staff findings***

The rules governing the composition of the Hearing Committee and the Hearing Panel must be clear. The definitions of industry member and public member are such that the same person may act in both capacities at the same time. Regardless of an individual's functions, the fact that he is a member of the Law Society of Québec (Québec Bar) is sufficient to qualify him as a public member. This cancels the distinction between the two types of members, and as a result, the Panel Hearing may be composed exclusively of industry members.

### ***Staff recommendations***

127. AMF staff recommend that IIROC amend the definition of public member to exclude any individual already eligible as an industry member, so as to clarify the composition of the Hearing Committee and the Hearing Panel.

**Priority: High**

#### ***IIROC's response:***

IIROC has independently identified the desirability of reviewing the definition of public member. Proposed rule amendments resulting from the review will be published for public comment and filed with the CSA in accordance with the rule approval protocol.

#### ***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## F. Information Protection

### 1. Purpose and scope

It is essential that an organization such as IIROC take the necessary measures to protect the information it receives. This applies to its premises, computer equipment and the training of key staff. These measures will ensure that operations are effective under all circumstances.

The objectives of this section of the review were to:

- ensure that IIROC Québec District has followed up on the AMF's recommendations made during the previous review of the IDA Québec District with respect to information protection;
- ensure that procedures for managing access, conservation, use and destruction of documents are adequate.

During its review, AMF staff visited IIROC's premises in Montréal, interviewed the individuals tasked with protecting information and examined current procedures.

### 2. Computer systems

In 2004, the IDA outsourced the management of its data centre to an independent specialized service provider and IIROC has continued this outsourcing. The service provider is responsible for the physical protection of and access control to servers, applications and data. Servers are installed in all of IIROC's regional offices so that systems, files and data are safeguarded using the same procedure in each office. These regional servers are managed remotely by the service provider and physical access is controlled by a designated IIROC staff member.

Therefore, at IIROC's Montréal office, the server and peripheral equipment is protected through limited access by a designated person (who is assisted by other individuals who assume this responsibility in her absence) and an uninterruptible power supply. Data is saved daily and kept on a cartridge (containing a high capacity tape) that the designated person must replace in accordance with a defined rotation order. This cartridge is kept in a closed room. In addition, the cartridge recorded on the last Friday of each month is designated as the monthly back-up and sent to the service provider in Toronto. These procedures were tested in August 2009 during a server breakdown in Montréal, and all files were recovered.

#### *Staff findings*

AMF staff noticed that back-up tapes are placed on a shelf in the server room at IIROC's Montréal office. They are exposed to risks (water, fire, etc.) in this location. This is a recurrent finding from the previous review of the IDA.

#### *Staff recommendations*

128. IIROC Québec District must ensure that cartridges and tapes are stored in a secure location.  
**Priority: High**



***IIROC's response:***

IIROC will review the current process for backups in Montreal (frequency, accountability, overwrites, etc.). A secure storage cabinet has been put in place for backup materials and IIROC has instituted a process for storing cartridges and tapes in that secure cabinet. IIROC will develop, document and follow a process for transferring cartridges and tapes to secure off-site storage.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up on this recommendation with IIROC.

### **3. Documentation**

***Staff findings***

IIROC still does not have a written policy covering paper and electronic document archiving and destruction. This is a recurring finding from the previous review of the IDA. However, for some years, the organization has stated that it would like to develop a national archiving and destruction policy.

Since moving to its new premises in June 2008, IIROC Québec District has been archiving its documents at an outside location.

IIROC Québec District has no written document management policy; each department has its own filing system.

***Staff recommendations***

129. IIROC must implement a written policy covering paper and electronic document management, archiving and destruction to ensure access to and the protection, retention and proper use of documents.

**Priority: High**

***IIROC's response:***

IIROC implemented a national data retention policy in August 2010. This policy covers all hard copy documents, records and data.

Certain IIROC departments have procedures in respect of retention and destruction of electronic data (particularly for market surveillance data) and these continue to be in effect. IIROC is reviewing practices in other departments, and will assess electronic data storage capabilities and will consider extending electronic data retention and destruction guidelines to all other IIROC departments in FY11.

***Staff comments and follow-up:***

AMF staff are satisfied with the response obtained and will follow up this recommendation with IROC.

## **V. VANCOUVER OFFICE**

### **1. Background**

BCSC staff conducted the oversight review of IIROC's Vancouver Office (Vancouver office) from October to December 2009.

Previously, the BCSC conducted an oversight review of the IDA's Vancouver office which covered the period from January 1, 2004 to August 31, 2006. This was part of a nationally coordinated review of a number of departments in various IDA offices.

Due to the recent introduction of National Instrument 31-103, BCSC staff, like AMF and OSC staff, deferred reviewing IIROC Registration Department's approval of firms and individuals until Spring 2010.

### **2. Findings for the Vancouver office**

BCSC staff are generally satisfied that the Vancouver office has operated with an investor protection focus and is compliant with the relevant T&Cs of IIROC's BCSC RO.

In general, the Vancouver office maintained adequate processes, policies and procedures for all departments reviewed. Files were generally complete and well organized, and checklists and review programs were comprehensive.

The Vancouver office's Compliance and Enforcement departments continue to regulate regional membership towards a culture of compliance and are generally responsive to emerging industry trends. From the enforcement files reviewed, the Enforcement Department has acted firmly against misconduct and case outcomes appear reasonable. The FinOps group is able to mitigate existing and potential financial risks to protect the investing public. Generally, the Vancouver office's operations appear efficient, effective, and fair.

Nonetheless, BCSC staff have some high and medium priority recommendations for the Vancouver office's TCC and BCC groups and low priority recommendations for the Market Surveillance and Investigations departments. The high and medium priority recommendations identify areas for improvement which require IIROC's timely remedial actions.

## **A. Enforcement**

### **1. Introduction**

IIROC's Enforcement department in the Vancouver office is organized into two main groups: Investigations and Litigation.

IIROC's PrRO conducts case assessment reviews for Western Canada – there are no case assessment staff in the Vancouver office. The Investigations group investigates possible violations of IIROC rules by Members and Approved Persons. The Litigation group conducts disciplinary proceedings against member firms and their registered representatives and provides advice to Investigators.

The Case Assessment Group was reviewed by the staff of the ASC. Consequently, BCSC staff elected to forego the review of IIROC's Calgary Case Assessment group.

### **2. Purpose and scope**

The purpose of this part of the oversight review was to assess the:

- adequacy of regional staffing, resources and training;
- efficiency and effectiveness of regional investigation and litigation processes; and
- adequacy of performance measurement benchmarks and whether they were met.

BCSC staff interviewed the Vancouver office Manager of Investigations, Investigators and Enforcement Counsel. BCSC staff also reviewed a sample of investigation and litigation files as well as the relevant policies and procedures manuals.

### **3. Enforcement department organization and reporting structure**

#### ***Background information***

The VP Western Canada is responsible for all member regulation functions in Western Canada, including Enforcement. The VP Western Canada has regional autonomy to make Enforcement decisions while IIROC head office's role is to provide advice and oversee the overall activities of the Vancouver office.

The Vancouver office Investigators report to the Manager of Investigations, who reports to the Director, Pacific Region. Vancouver office Enforcement Counsel also reports to the Director, Pacific Region, who, in turn, reports to the VP Western Canada.

Consequently, although file decisions and dispositions rest with the VP Western Canada, the VP Western Canada is accountable for such decisions to the SVP ERP and, ultimately, to the CEO.

#### ***Staff findings***

The reporting structure establishes appropriate accountability and appears adequate.

### ***Staff recommendations***

None.

## **4. Staffing and training**

### ***Background information***

BCSC staff discussed staffing and training with the Manager of Investigations. During the period under review, staff turnover was limited to the departure of one Senior Investigator and one Enforcement Assistant.

BCSC staff reviewed the job descriptions for the VP Western Canada, the Director, Pacific Region, the Manager of Investigations, and Enforcement Counsel.

### ***Staff findings***

Investigations staff are experienced, qualified, and satisfactorily performed their investigative duties. In addition, investigations staff keep abreast of regulatory trends and periodically attend in-house and external training seminars.

### ***Staff recommendations***

None.

## **5. Review of investigation files**

### ***Background information***

Of 222 closed investigation files, BCSC staff selected 29 files, or 13%, for detailed analysis. BCSC staff extracted this sample of files using a judgmental selection process.

The mix of selected files allowed for analysis of diverse file types including:

- unauthorized trading;
- manipulation;
- supervision;
- client priority;
- pricing of listed security;
- outside business activities; and
- conflict of interests.

The selected sample comprised ten files, representing 34.4% of total files completed by staff of the RS Enforcement department and 19 files or 65% of total files in the former IDA. These files were, of necessity, paper files since BCSC staff did not have unrestricted access to IIROC's electronic Case Tracking System (CTS).

## ***Staff findings***

### *Documentation*

Of the 29 files reviewed, 25 files clearly indicated that the investigative work was completed and the files contained documentation evidencing such closure.

However, BCSC staff found that in four cases (14% of sample) it was not possible to clearly determine that IIROC had completed its investigation, due to a lack of documentation on the files. BCSC staff were advised that full closing details may have been entered on CTS, but no paper copy was placed on the file.

### ***Staff recommendations***

130. BCSC staff recommends that IIROC review its administrative process to ensure its paper and electronic filings are harmonized.

**Priority: Low**

#### ***IIROC's response:***

CTS is Enforcement's our principal document storage location. All key documents are uploaded to CTS by Enforcement staff. IIROC management will remind staff that it is critical that all key documents related to a file be placed in CTS.

It should be noted that BCSC staff was granted access to CTS in IIROC's offices but chose not to avail themselves of it.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

## ***Staff findings***

### *Disposition / Managerial Review of investigation files*

BCSC staff found that 12 files (41% of selected sample) lacked sufficient documentation of file disposition or managerial review. Those files with insufficient documentation comprise six files (or 60% of the sample drawn) from the former RS, and six files (or 31% of the sample drawn) from the former IDA. It is possible that, as in the case of files closing comments noted above, appropriate notations were entered electronically on the CTS.

Since BCSC staff were not granted unrestricted access to the IIROC electronic CTS system during our on-site review, we were unable to verify if notes on managerial review, and/or disposition of files, were present in the electronic files.

### ***Staff recommendations***

131. BCSC staff is of the view that the paper files should contain either a paper copy or a notation of the electronic CTS entry evidencing managerial review and disposition of investigation files. Consequently, staff recommend that IIROC review its administrative procedures and ensure that

its documentation of managerial review and disposition is adequate.

**Priority: Medium**

***IIROC's response:***

IIROC will ensure that evidence of managerial review is uploaded to CTS. Management staff will be reminded of the importance of evidencing management review of files and placing it on CTS.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

## **6. Enforcement Counsel**

### **6.1 Benchmarks**

***Background information***

The key litigation benchmark is that 60% of enforcement counsel files must be completed within ten months from referral to litigation.

***Staff findings***

Enforcement Counsel staff seem to consistently meet this benchmark. BCSC staff recommends that IIROC consider whether the benchmark for file completion of 60% is somewhat low.

***Staff recommendations***

132. Staff recommend that IIROC review the benchmark and confirm whether it is reasonable given IIROC's experience with this benchmark.

**Priority: Low**

***IIROC's response:***

The benchmarks are a management tool applied on a national basis and designed to assist management with overall completion times for Enforcement files. IIROC is satisfied with the benchmarks applied to Enforcement Counsel in light of their purpose.

***Staff comments and follow-up:***

Having brought this issue to IIROC's attention, and in light of their response, no further action is required.

### **6.2 Staffing and training**

***Background information***

BCSC staff reviewed the job descriptions for the VP Enforcement, the Director of Enforcement Litigation as well as Enforcement Counsel.

***Staff findings***

Enforcement Counsel staff are well trained and in all cases are qualified to carryout the litigation function. In addition, litigation staff attends regular in-house training as well as periodic external training opportunities, as necessary.

***Staff recommendations***

None.

**6.3 Written procedures and guidance**

***Background information***

BCSC staff reviewed the *Prosecutions Procedures Manual* and interviewed the Director, Pacific Region and litigation counsel concerning litigation processes.

***Staff findings***

BCSC staff found that the written procedures are adequate and that the file review and decision process appear effective.

***Staff recommendations***

None.

**6.4 Processes**

***Background information***

BCSC staff interviewed the Director, Pacific Region as well as enforcement counsel. The Director described the process of referral from the Investigation Department as well as the process of case tracking once litigation files are opened. BCSC staff also reviewed the mandate of the Discipline Advisory Committee (DAC), the role of the Director, Litigation at IIROC's head office, and discussed the workings of DAC. The DAC includes the SVP ERP.

***Staff findings***

BCSC staff noted the frequent involvement of senior officials of the regional office including the VP Western Canada and the involvement of head office through the DAC. While involvement from multiple levels can potentially lead to a reduction in efficiency, there is no apparent negative effect on the DAC's decision-making process. We found the decision-making and file review processes reasonable and effective.

Consideration by various senior officials, and in particular the Director, Litigation, is apparent in the case files reviewed.



***Staff recommendations***

None.

**6.5 Review of litigation files**

***Background information***

BCSC staff reviewed six files selected to represent a cross section of cases.

***Staff findings***

In general, BCSC staff found the files to be in good order and the file documentation adequate. In all cases, there was ample evidence of review and sign off in accordance with the procedures outlined in the *Prosecutions Procedures Manual*. The outcomes of the files were reasonable and in all cases, the relevant benchmarks were met.

***Staff recommendations***

None.

## **B. Business Conduct Compliance**

### **1. Introduction**

The Vancouver BCC department is responsible for examining sales compliance systems of IIROC Members' offices located in British Columbia (BC). Currently, the Vancouver office has jurisdiction over 19 members with head offices in BC.

While conducting compliance examinations remains the primary focus of the group, the BCC group also focused staff resources to deal with issues arising from the merger. IIROC is integrating the BCC, TCC and FinOps groups into one technology platform and eliminating gaps and overlaps between audit programs. At the time of the field review, the integration process was nearing completion for the BCC department.

In 2008, the BCC department began using sweep examinations to review single issues or groups of issues across Dealer Members. The Vancouver BCC department participated in the national branch sweeps.

### **2. Purpose and scope**

The purpose of this part of the oversight review was to review and evaluate the adequacy of the Vancouver BCC department's:

- organization and reporting structure;
- interaction and communication with other IIROC departments;
- staffing resources and training;
- performance measurement benchmarks used in BCC and whether the Vancouver BCC department met them; and
- on-site examinations for timeliness and quality.

BCSC staff interviewed local management and staff to gain an understanding of the staff levels, sales compliance and training programs, and the review process. The individuals interviewed at the IIROC Vancouver Office were the Director, Pacific Region, Manager, Business and Trading Conduct Compliance, and the BCC Examiners. Further, BCSC staff reviewed the local sales compliance training program, BCC written procedures, the examination program and checklists, and a sample of examination files.

The Director, Pacific Region, informed BCSC staff that trends and problems facing BCC are identified through:

- quarterly meetings with CSA and separate meetings with the BCSC;
- common deficiencies noted at examinations;
- the way Dealer Members respond to rule changes; and
- IIROC deficiency notices.

### **3. Department organization and reporting structure**

#### ***Background information***

IIROC's Vancouver BCC Examiners report to the Vancouver BCC Managers. These Managers report directly to the Director, Pacific Region and indirectly to the BCC Director at IIROC's Toronto head office. The IIROC hired the Director, Pacific Region, in October 2008 and he reports to the VP Western Canada. Prior to October 2008, the BCC managers reported directly to the VP Western Canada.

#### ***Staff findings***

BCSC staff found the department organization and reporting structure to be adequate.

#### ***Staff recommendations***

None.

### **4. Interaction and communication with other IIROC departments**

#### ***Background information***

The Vancouver BCC department interacts with IIROC's Enforcement, TCC, FinOps, and Registration departments.

BCC staff mainly contact other departments when planning examinations. For instance, the BCC Examiners usually obtain information from COMSET and CTS regarding the Member and its registrants. They may contact the Manager of Investigations and/or the Investigator responsible to obtain further details.

During the examination, BCC staff may need to contact Enforcement in order to discuss whether they should refer an issue to Enforcement. If there are any referrals to be made to enforcement, BCC staff would draft an Enforcement referral memo to Enforcement staff. Enforcement staff interact with BCC staff if further clarification is required.

#### ***Staff findings***

The Vancouver BCC department has good communications with the other departments. The communication between BCC and TCC examiners in the Vancouver office is especially good as the TCC examiners report to the same manager as some of the BCC examiners.

#### ***Staff recommendations***

None.

## **5. Staffing resources and training**

### **5.1 Staffing resources**

#### ***Background information***

The Vancouver BCC department currently has two BCC managers, seven examiners, and one technician.

The Director, Pacific Region, informed BCSC staff that the department had eight Examiners during a three-year period, which exceeded its budgeted seven examiner positions. They permanently retained an Examiner hired on contract in 2005 to cover a leave of absence. In November 2008, the IIROC promoted one of the senior examiners to Manager, Business and Trading Conduct and Compliance and, consequently, the BCC staff complement reverted to the budgeted seven examiners.

During the period under review, the Vancouver BCC department had relatively low staff turnover and few resource issues. In total, the Vancouver BCC department had one leave of absence, one termination, and one resignation. In addition, the Manager, Business and Trading Conduct Compliance, assumed BCC management duties for PrRO office when the Calgary BCC manager went on leave.

#### ***Staff findings***

There were two staff turnover for the review period, both in 2009. The department was able to replace those staff with qualified candidates in a timely manner. BCSC staff are satisfied that the Vancouver BCC department took steps to ensure it continued to operate at a stable level during the period under review.

However, BCSC staff noted the Vancouver BCC department only met the 70% project utilization benchmark in one of the quarters during the review period. This finding is addressed under section 6 (“Benchmarks”) below.

#### ***Staff recommendations***

Please see section 6 (“Benchmarks”) below for a discussion of BCSC staff recommendations.

### **5.2 Training program**

#### ***Background information***

The *Sales Compliance Training Manual* and the *Business Conduct Compliance Policy, Procedure, and Technical Guide* manual (BCC PPM) (version August 2009) are good precursors to the BCC Examiner training in the field. They provide new examiners with background information, general guidance on the completion of various parts of an examination, a collection of materials or evidence for the file, standards of documentation, a sample organization of a file, post visit procedures, and file closure procedures. The new examiners also receive presentation materials on various topics including recent rule changes and new initiatives.

The one-on-one training in the field is an appropriate and effective approach to provide the knowledge and experience required for the job. All significant rule changes and important new initiatives are covered in their examination modules and the new examiners are expected to learn about these on the job. Useful lessons learned in the field that the manager reinforces using file review feedback are also critical to the success of the training program.

### ***Staff's findings***

IIROC has not updated its training manual for new BCC examiners since the last examination. Further, the manual still shows the Word document version of the examination program, but the examiners are no longer using the Word version of the program. They have been using the UBSS software since the last review by BCSC staff in 2006. The BCC manager explained that new Examiners learn their job mostly from on the job training and they review the *BCC PPM* to gain an understanding of how to complete the examination process.

### ***Staff recommendations***

133. While the new examiner training procedure is adequate, the IIROC should update the BCC training manual, to reflect the current system, as this is a tool for training new examiners.

***Priority: Low***

#### ***IIROC's response:***

IIROC will comply.

#### ***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

## **6. Benchmarks**

### ***Background information***

As part of the preparation of the quarterly reporting to the IIROC board of directors, each department of each office receives its quarterly performance reports for review. The manager must provide comment on any unfavourable performance variances greater than 10%.

The BCC department has the following benchmarks:

- Issue the final examination report within 15 weeks from the end of fieldwork in 60% of the cases and within 26 weeks in all cases;
- Complete all mandated reviews, including branches, as established at the beginning of the year; and
- Achieve a project utilization rate of 70%.

Each IIROC office is required to meet each of these benchmarks individually. IIROC as a whole must also meet these benchmarks. BCSC staff reviewed examination statistics for files that had fieldwork completed between September 1, 2006 and September 30, 2009 for the Vancouver BCC department. Further, BCSC staff reviewed *Member Regulation Quarterly Reports* for quarters ending December 31, 2006 to September 30, 2009.

The IIROC Vancouver office provided BCSC staff with its examination statistics, examination time reports, and annual examination schedules for the review period.

### *Staff findings*

IIROC has processes in place to monitor the appropriateness of the benchmarks and ongoing compliance with these benchmarks.

BCSC staff compiled project hours and the available hours for the Vancouver BCC department from the *Member Regulation Quarterly Reports* for quarters ending March 31, 2007 to September 30, 2009. BCSC staff calculated the annual and the overall project utilization rates for the department. The department only met the 70% project utilization benchmark in one of the quarters during the review period and did not meet the benchmarks for any of the following figures:

- 2007 – 59%
- 2008 – 62%
- 2009 – 65% (Year-to-date figure: January 1 to September 30, 2009)

Part of the explanation for not meeting this benchmark was due to:

- one examiner being on leave for a few months.
- one of the senior examiners being promoted to Manager, Business and Trading Conduct Compliance.

BCSC staff also noted the examination schedules submitted to BCSC during the review period had the following discrepancies:

- For 2006, there were no calculations to support the projected number of examinations;
- For 2007, 46 work weeks per examiner was used to project the number of examination hours. The 2007 schedule also included the BCC Technician hours in its calculations, when it was not included in the other years;
- For 2008, 52 work weeks per examiner was used to project the number of examination hours.
- For 2009, 48 work weeks per examiner was used to project the number of examination hours

### *Staff recommendations*

134. The Vancouver BCC department should:

- apply their benchmarking processes consistently from year to year and the calculations should be based on those agreed upon with the CSA; and
- review its processes and take steps to address the identified root causes for the diminished productivity.

**Priority: Medium.**

#### ***IIROC's response:***

IIROC disagrees with this finding on the basis that it conflates tracking for two different purposes: scheduling and adherence to benchmarks. Prior to 2006, the IDA had difficulty adhering to examinations schedules. In 2006, the IDA adopted a new scheduling process based on available staff time. This calculation has nothing to do with benchmark tracking. A year-to-year comparison of available hours is

of little value. The benchmark calculation methodology is consistent from year to year, and benchmark performance is calculated electronically.

***Staff comments and follow-up:***

BCSC staff will continue to follow up with IIROC on this issue.

**7. Written procedures and guidance**

***Background information***

BCSC staff reviewed the *BCC PPM*. BCC staff use this guide nationally. Prior to August 2009, they were using the *IDA Sales Compliance Policies and Procedures Handbook (version date May 2001)*.

***Staff findings***

BCSC staff found the *BCC PPM* to be adequate.

***Staff recommendations***

None.

**8. Regular business conduct compliance examinations**

**8.1 BCC review process for Dealer Members' head office**

**(a) Member selection process**

***Background information***

Every December, the BCC Managers prepare a three-year examination schedule based on each Dealer Member's risk profile. The Vancouver BCC department groups Dealer Members into 12, 18, 24, and 36 month review cycles.

The IIROC's risk profile system assesses a Dealer Member's level of business risk from its operations and from its ability to mitigate risks. The system evaluates the adequacy of a Dealer Member's supervisory, risk management, and internal control processes using information from the IIROC's BCC and FinOps departments, and from ComSet.

***Staff findings***

BCSC staff found the current scheduling approach to be adequate.

***Staff recommendations***

None.

**(b) BCC review program and written procedures checklists**

***Background information***

IIROC provided BCSC staff with a copy of the current examination program and written procedures checklists.

The program uses a risk-focused approach. The risk assessment checklist includes a question that identifies new rule changes since the last examination. All significant new rule changes and important new initiatives are included in the examination modules.

The BCC examiners begin with a brief interview to help locate relevant records and identify responsible persons, followed by more comprehensive testing of existing and new functions. They end with an interview focused on problems identified during the examination testing. They use the UBSS and Microsoft InfoPath systems to capture, analyze, and report certain test results.

***Staff findings***

BCSC staff reviewed the current examination program and written procedures checklists, and they are adequate.

***Staff recommendations***

None.

**8.2 BCC review process for branches**

**(a) Branch selection process**

***Background information***

The BCC Managers include about three branch examinations into the annual examination schedule at the beginning of the year. The Vancouver BCC department closed seven of the 10 branch reviews it started during the three-year review period. In addition, they completed three branch reviews as part of the branch sweep.

The Director, Pacific Region, informed BCSC staff that their priority is to review Dealer Member head offices and Dealer Member supervision of branches. The Dealer Member supervises branches by reviewing branches onsite periodically and by reviewing trades on a daily basis.

IIROC Examiners review the Dealer Member's internal branch audits including a review of the dealer's branch audit program, the branch audit schedule, a sample of branch audit reports and the associated working papers. During the course of these reviews, if the IIROC examiners find there is cause to conduct an onsite review, they would request approval of such reviews from their manager.

The director is comfortable with the current number of branches reviewed annually as the reviews to date, including the branch sweeps, have not uncovered any issues that warrant increasing the current level of



branch reviews.

***Staff findings***

BCSC staff had no concerns with the current branch selection and review process in BC and with the number of branch reviews conducted by IIROC's BCC Vancouver office during the Review Period.

***Staff recommendations***

None.

**(b) Examination of branch operations**

***Background***

The BCC department's oversight of its Dealer Members' branches is a two-part process. It includes BCC reviewing the Dealer Member's:

- head office for effective self-governance of branch operations.
- branch offices onsite.

BCSC staff reviewed the BCC examination program and statistics for files with fieldwork completed between September 1, 2006 and September 30, 2009.

The 19 Dealer Member head offices registered with IIROC in BC operate 141 branches nationally. The number of Dealer Members and their corresponding number of branches are:

Number of Branches	Number of Dealer Members
0	5
1 to 5	10
5 to 25	3
Over 25	1

***Staff findings***

Nationally, IIROC examined seven out-of-province branches of four BC Dealer Members over the review period. The Vancouver BCC department examined nine provincial branches of seven non-BC Dealer Members and 1 provincial branch of a BC Dealer Member.

BCSC staff noted that the examination program includes comprehensive review procedures related to the Dealer Member's self-governance of its branch operations. It examines the adequacy of the member's internal branch review program and process and, on a sample basis, tests account supervision at the branch.

In combination with the IIROC's review of the Dealer Member's self-governance of branches and considering the number of branches operated by BC Dealer Members, BCSC staff found the number of IIROC onsite branch reviews to be adequate.

### ***Staff recommendations***

None.

## **9. Targeted reviews and sweeps**

### ***Background information***

In 2008, IIROC started using sweeps to target reviews, across their Dealer Members, for single issues or groups of issues. IIROC's head office in Toronto determines the issues and scope covered by the sweeps based on identified high risk areas. IIROC head office also selects the dealers for review and develops the appropriate examination programs.

BCSC staff reviewed the BCC branch sweep program and all three branch sweeps conducted by the Vancouver BCC department.

### ***Staff findings***

BCSC staff found the branch sweep program to be adequate.

The documentation was complete in the three files reviewed. BCSC staff noted one of the files required extensive manager review notes to the examiner. The examiner's responses to these review notes were required for file documentation to be considered complete.

### ***Staff recommendations***

None.

## **10. Review of BCC examination files**

### ***Background information***

BCSC staff selected for review three BCC examination files from a population of 23 closed files and assessed adequacy of:

- risk assessment and planning documentation;
- file documentation;
- quality of work;
- referral to enforcement process; and,
- timely completion of examinations.

The sample included firms representing dealers of:

- small, medium, and large sizes;
- local and national coverage; and,
- low, medium, and high risk rankings.

### ***Staff findings***

Overall, the examination files were adequate. The negative findings for the examination files relate to documentation.

The IIROC head office had a quality assurance (QA) program in place prior to the IDA and RS merger. Toronto BCC staff sampled examinations from different regions and provided feedback to those regions. The Manager, Business and Trading Conduct Compliance, informed BCSC staff that this program was put on hold since the merger for the following reasons:

- IIROC staff were busy with various integration projects since the merger.
- IIROC has identified a number of issues that its BCC departments needed to deal with before restarting the QA program.

### ***Staff recommendations***

135. In order for the examination file documentation to improve, IIROC must restart its quality assurance program.

**Priority: Medium.**

#### ***IIROC's response:***

The new modules and TeamMate system will help with documentation. IIROC intends to reinstitute some form of a QA program when all the BCC changes have been implemented.

#### ***Staff comments and follow-up:***

BCSC staff will regularly follow up with IIROC to monitor this issue.

## **10.1 Risk assessment and review plan**

### ***Background information***

During the planning process, the Examiner:

- gathers and analyzes the information from internal and external regulatory sources;
- completes the risk assessment checklist, which includes a review plan;
- identifies, systematically and objectively, areas of concern and set the scope of the upcoming examination; and,
- maps out a review plan from the results of the risk assessment.

### ***Staff findings***

Overall, the risk assessments and review plans were of good quality.

All three examination files reviewed had a completed risk assessment checklist, review plan, and supporting materials. The Examiner promptly completed the risk assessment checklist and review plan within the first week of fieldwork.

Generally, the examiners documented follow-up procedures arising from their evaluation of each risk assessment section. However, in one of the three files reviewed, the examiners did not document the required follow-up adequately.

BCSC staff typically found the pre- and post-examination risk scores and the planned examination procedures reasonable according to the analyses and supporting materials. The examiners did a good job of explaining qualitatively the risks involved but they did not explain how the qualitative description correlates to the risk scores they assigned for the individual questions.

The review plan usually reflected the key risks and issues from the risk assessment. Generally, examiners will omit certain interview questions and/or a few specific tests, when they feel results of the current or past examination justify it. However, BCSC staff noted one file where the explanations for de-emphasizing four program modules were not properly documented.

All three risk-assessment checklists evidenced the examiner signature and managerial review on the cover page. However, BCSC staff noted the risk assessment checklist and review plan did not have adequate file assurance of reliability as the individual pages were not numbered or signed off by the examiner or manager, or otherwise showed adequate audit controls to preserve the integrity of the process.

### ***Staff's recommendations***

136. The Vancouver BCC department should ensure its examiners adequately and consistently document their work in order to limit future occurrence of the above deficiencies. Further, the file documentation should improve once the QA program resumes.

***Priority: Medium.***

#### ***IIROC's response:***

TeamMate has a strong audit trail feature that includes tracking document revisions which will assist with compliance.

#### ***Staff comments and follow-up:***

BCSC staff note IIROC's reference to this process enhancement and will follow up in future oversight reviews.

## **10.2 File documentation**

### ***Background information***

The IIROC provided BCSC staff with the *BCC PPM*. This contained the IIROC's file documentation standards for the BCC department. BCSC staff reviewed a sample of three examination files for adequacy of the file documentation.

### ***Staff findings***

BCSC staff noted the extent of file documentation varied among BCC Examiners. Most of the examination work reviewed was fairly well documented. Areas showing good documentation included work that BCC Examiners had:

- identified interviewees;
- listed file contents;
- documented work completion dates;
- specified the file preparer;
- evidenced lead examiner for the review;
- included supporting documents;
- referenced working papers in the modules;
- noted and detailed the deficiencies; and
- cross-referenced deficiencies to the modules and report.

Generally, BCSC staff found the BCC Examiners documented working papers to:

- evidence review or test procedures;
- evidence the work and analyses performed;
- state the results and conclusion reached; and
- update the file with issues identified from the manager's review.

Managerial review was generally evident in all three files.

However, some BCC Examiners were inconsistent in documenting their work within a file. For these Examiners, the extent of documentation ranged from poor to adequate. Poor documentation included:

- no rationale for omitting some of the examination steps;
- no documented follow-up for issues raised in the previous examination;
- lack of conclusions being drawn;
- contradictions in the module question where one box in the question states "not yet reviewed" while there is clearly some review that took place; and
- lack of rationale for selecting account sample size.

Three out of 30 know-your-client (KYC) information sampled by BCSC staff were input incorrectly into the IIROC system. The KYC sample included those selected from the three head office and three branch sweep examinations.

For examination findings that were classified as not significant, there were no Dealer Member responses to reports. The Director, Pacific Region, informed BCSC staff that this is no longer an issue as they are currently requiring Dealer Members to respond to all report findings.

A properly documented file:

- facilitates the supervision and review of the work performed;
- enables the identification of training needs;
- assists in the planning of the next examination;
- guides examiners in subsequent examinations;
- helps identify improving and worsening trends; and
- provides insight into the member's compliance system for enforcement purposes.

***Staff's recommendation***

137. IIROC's Vancouver BCC department should ensure its examiners adequately and consistently document their work in order to limit future occurrence of the above deficiencies. As with the risk assessment and review plan, the rest of the file documentation should improve once the QA program resumes.  
**Priority: Medium.**

***IIROC's response:***

IIROC will comply. TeamMate will assist in this process.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

### **10.3 Quality of BCC reviews**

***Background information***

The Vancouver office provided the working paper and permanent files for the three examinations selected by the BCSC staff for review.

***Staff's findings***

BCSC staff reviewed the three files to ensure the Vancouver BCC department properly identified and reported regulatory issues. Generally, BCSC staff found the quality of the work was good.

***Staff's recommendation***

None.

### **10.4 Referrals from BCC to Enforcement**

***Background information***

The IIROC provided BCSC staff with its *BCC PPM* including enforcement referral procedures. In addition, the Vancouver office provided a list of sales compliance referrals to enforcement for the period under review.

***Staff's findings***

BCSC staff reviewed the sample of three examination files for compliance with *BCC PPM*. None of the files resulted in a referral to the Enforcement department.

BCSC staff noted one case that appeared to require referral to Enforcement. The examiner provided a satisfactory response to BCSC staff about the reason for not referring this issue. BCSC staff noted the examiner should have documented the reason in the examination file.

***Staff's recommendation***

138. The Vancouver BCC department should ensure its examiners adequately and consistently document their work in order to limit future occurrence of the above deficiencies. Further, the file documentation should improve once the QA project resumes.  
**Priority: Medium.**

***IIROC's response:***

BCC examiners have been reminded of the need for complete documentation. TeamMate BCC modules will assist in this process.

***Staff comments and follow-up:***

IIROC's response is adequate. Staff will follow up in future oversight reviews.

## **10.5 Timeliness of BCC reviews**

### ***Background information***

The IIROC provided BCSC staff with examination statistics for files with fieldwork completed between September 1, 2006 and September 30, 2009 for the Vancouver BCC department. Further, the Vancouver department provided its examination statistics and time reports and access to its electronic examination files, and where available, the physical files.

### ***Staff findings***

During the period under review, the Vancouver BCC department closed 23 head office and seven branch examination files. BCSC staff reviewed the timelines and statistics for these files and the sample of three files.

BCSC staff noted that one of the three sampled files materially exceeded the budgeted time by 40%. In this case, IIROC examiners noted an issue that required extensive review of some client files. The department completed the file preparation and issued the draft report by the reporting benchmarks.

### ***Staff recommendations***

None.

## **10.6 Examination program**

### ***Background information***

IIROC staff use standard BCC and TCC modules when conducting Dealer Member reviews. The modules provide direction on the methodology of the review for a number of specific reviews and provide a format for reporting results of the review.

### **Detection and Oversight of Insider-Trading Activities**

### ***Staff findings:***

The TCC module provides an excellent and comprehensive framework for carrying out reviews. However, there are some potential improvements that can be made.

Neither the TCC nor the BCC module provides for a review of trading patterns to identify potential improper insider trading activity nor does it provide for a review of the Dealer Member's internal compliance activities to detect, investigate and address improper insider-trading activity. Policies focus on issuers which are placed on the firm's grey list but do not provide for any testing of securities that are not placed on a firm's grey list. Testing for potential insider trading activity should include securities not placed on a firm's grey list and transaction where the trade has not been marked as "insider".

***Staff recommendations:***

139. IIROC should include, as an element of either the TCC or BCC examination program, reviews of: (i) Dealer Member monitoring of non-client and client-trading activities to detect improper insider trading activities; and (ii) a sample of trading activities prior to the public disclosure of material, non-public information to detect patterns of potential insider-trading activities. Currently IIROC's surveillance systems only facilitate review of trading activity where the order contains an appropriate marker. Additional testing should be carried out to determine if improper trading is being conducted and not marked as an insider trade.

***Priority: Medium***

***IIROC's response:*** Detection of potential illegal insider trading activity is important, but IIROC does not consider it to be the role of TCC. Following the recommendation would lead to an unnecessary duplication of effort, as IIROC already undertakes reviews for insider trading through Market Surveillance and TR&A. TR&A reviews all potential instances of insider trading and sends these to the relevant commissions for further investigation and enforcement. Order marking is tested by TCC during its reviews.

***Staff comments and follow-up:***

BCSC staff's concerns relate to Dealer Member compliance with their gatekeeper obligations, to determine whether clients are insiders or trading using non-public material information. BCSC staff believe that TCC should be reviewing Dealer Member procedures relating to how they fulfil their gatekeeper obligations. BCSC staff will continue its dialogue with IIROC on this issue.



## **C. Financial and Operations Compliance**

### **1. Introduction**

IIROC's FinOps group has four offices operating from Toronto, Calgary, Montreal and Vancouver. The group's primary responsibility is to review and analyze Members' financial filings to ensure each Member maintains adequate capital and accurately reports this in accordance with IIROC Rules. FinOps staff also conduct on-site financial examinations of Dealer Members, and working paper file reviews of the Members' auditors.

### **2. Purpose and scope**

The purpose of BCSC staff review of the FinOps department was:

- to evaluate if FinOps has the appropriate structure and resources, including staffing;
- to evaluate the adequacy of the performance measurement benchmarks for the financial compliance functions and determine whether they were met;
- to assess the adequacy, timeliness, and quality of financial compliance examinations performed by FinOps;
- to determine whether the IIROC has appropriate review processes and procedures to perform its member regulation functions adequately; and
- to assess whether the IIROC effectively enforces its rules and monitors its member firms' compliance with securities legislation.

### **3. Department organization and reporting structure**

The VP Western Canada is responsible for all member regulation functions in Western Canada. The Manager, Financial Compliance & Operations (FinOps Manager) reports to the Director, Pacific Region who, in turn, reports to the VP Western Canada. The FinOps Manager also indirectly reports to the Director of FinOps at IIROC's head office.

### **4. Staffing resources and training**

#### ***Background information***

The Vancouver office FinOps group consists of a Manager, four Examiners and an Administrative Assistant. The department's staffing level is assessed annually.

BCSC staff discussed the current staffing resources as well as the process to review the adequacy of staff resources with Vancouver office's FinOps manager. In addition, BCSC staff also reviewed departmental staffing statistics for the period under review, in order to assess staffing levels and turnover rates.

BCSC staff discussed FinOps staff qualifications and training and reviewed the internal procedures for training new FinOps staff. BCSC staff also reviewed the FinOps *Policies, Procedures and Guidelines Manual*. New hires must complete a mandatory in-house training program. FinOps staff training takes

place initially on hiring and is also ongoing as new regulatory trends evolve.

### ***Staff findings***

BCSC staff's review of turnover rates, and qualification records, indicated that FinOps staff turnover has been relatively stable for the period under review. BCSC staff found that the FinOps staff are suitably qualified and experienced to effectively monitor dealer member firms in the Pacific region.

There were no apparent resource issues and BCSC staff have no concerns with the department's structure or staffing composition. In addition, the IIROC's training materials appear adequate and the FinOps department reporting structure provides clear accountability.

### ***Staff recommendations***

None.

## **5. Benchmarks**

### ***Background information***

BCSC staff reviewed the internal benchmarks used by the FinOps group and discussed them, as well as the process for monitoring their continuing adequacy, with IIROC Vancouver office management.

FinOps' benchmarks are assessed at least annually.

The benchmarks used by the FinOps group for issuing examination reports during the Review Period were as follows:

- staff must spend 70% of available time directly on Dealer Member firm reviews;
- examine every Dealer Member annually within the examination year ( except for Dealer Members approved for biennial review);
- complete and issue 60% of field examination reports within 8 weeks to a maximum of 6 months for all examination reports;
- perform audit working paper (AWP) reviews within 3 months of the filing date (effective June 2009, **for high risk Dealer Members** meeting the AWP review criteria - prior to this, **all** Dealer Members meeting AWP criteria was examined);
- complete and issue preliminary reports for new Dealer Member applicants within 2 weeks; and
- allocate and spend at least 68% of core examination time on business activities rated as high risk or moderate risk.

BCSC staff reviewed the IIROC's quarterly Member Regulation Benchmarks and Performance Measures reports, with specific reference to Fin Ops results. BCSC staff also conducted discussions with the Vancouver office's FinOps Manager and reviewed Vancouver office FinOps statistics for the period under review.

### ***Staff findings***

BCSC staff found that IIROC has satisfactory processes in place to monitor performance benchmarks. Moreover, the Vancouver office is able to monitor whether its regional benchmarks are met.

Notwithstanding minor variations, performance benchmarks appear reasonable and were adequately met during the period under review.

### ***Staff recommendations***

None.

## **6. Financial filing review**

### **6.1 Written procedures and guidance**

#### ***Background information***

BCSC staff discussed written filing review procedures with the Vancouver office FinOps Manager and, specifically the process for review of Members' MFRs and Audited JRFQ&Rs. BCSC staff also reviewed the FinOps *Policies, Procedures & Guidelines Manual*.

#### ***Staff findings***

Vancouver office FinOps processes appeared to be functioning well and the policies and procedures manual reflected how the Vancouver office FinOps department pursues its mandate.

BCSC staff has no concerns with written FinOps policies and procedures.

#### ***Staff recommendations***

None.

### **6.2 Review program**

#### ***Background information***

BCSC staff reviewed the procedures relevant to in-office review of MFRs and JRFQ&Rs, and discussed these procedures and processes with IIROC's senior management in the Vancouver office.

The FinOps Manager is directly responsible for the supervisory review of the regulatory filings from Members under his portfolio. IIROC management will check for early warning triggers and take action as required by IIROC policies and procedures. The manager will obtain explanations from Members and document these in their file notes.

#### ***Staff findings***

BCSC staff found that Manager's cumulative knowledge of assigned Members facilitates identification of

unusual trends or activities and provides assurance for reliable reviews.

Generally, IIROC's documented procedures provide adequate guidance for reviewing the MFRs and JRFQ&Rs.

***Staff recommendations***

None.

**6.3 File review**

***Background information***

BCSC staff reviewed three MFR and JRFQ&R filings completed by the FinOps Manager during the review period to assess if the Manager reviewed the Members' monthly and annual financial filings adequately and on a timely basis. BCSC staff also assessed whether IIROC's FinOps staff adequately identified and resolved issues

The sample selected included a small Type 2 introducer, a medium-sized full service, self-clearing dealer, and a large introducing and carrying dealer.

***Staff findings***

BCSC staff were generally satisfied with the quality of the MFR and JRFQ&R reviews. Issues were properly identified and resolved.

***Staff recommendations***

None.

**7. Review of auditors' working papers**

**7.1 Written procedures and guidance**

***Background information***

BCSC staff obtained and reviewed the procedures relevant to the review of Panel Auditor Working Papers and discussed these procedures and processes with management.

***Staff findings***

BCSC staff found that IIROC has documented procedures that provide adequate guidance for the processes to conduct reviews. The documented procedures give in-depth guidance on the steps to be followed to achieve comprehensive review of the audit working papers.

***Staff recommendations***

None.

## **7.2 Process for review of auditors' working papers**

### ***Background information***

Effective June 1, 2009 IIROC changed the existing examination requirement for low risk Dealer Members from an at least annual or biennial review to reviewing a representative sample of national, regional and small audit firms on a 3-year cycle.

In addition, FinOps' procedures, policies and guidelines establish specific criteria, which mandate the review of Panel Auditor Working Papers in the course of any year.

IIROC will continue to conduct a review of audit working papers of any panel auditor of a Dealer Member where there are heightened regulatory concerns.

BCSC staff discussed these processes with management and reviewed the *Procedures Policies and Guidelines Manual*.

### ***Staff findings***

The manual and internal procedures are comprehensive and contain specific instructions to provide proper guidance to FinOps staff.

### ***Staff recommendations***

None.

## **7.3 Selection of auditors' working papers**

### ***Background information***

FinOps' *Procedures, Policies and Guidelines Manual* establishes specific criteria, which mandate the review of Panel Auditor Working Papers in the course of any year.

The FinOps Manager applies these criteria to each panel auditor for his assigned Dealer Member. Based on the applicability of these criteria to each auditor, the FinOps Manager decides whether a review of audit working papers is mandatory or discretionary for that year.

### ***Staff findings***

The selection process for review of audit working papers is satisfactory. The process ensures that the minimum audit requirements of IIROC's rules, specifically Rule 300, are met.

### ***Staff recommendations***

None.

## **7.4 Review program**

### ***Background information***

BCSC staff reviewed desk review procedures and audit working paper review program.

### ***Staff findings***

Overall, the audit working paper review program is comprehensive and appears to be successful in achieving its objectives.

### ***Staff recommendations***

None.

## **7.5 File review**

### ***Background information***

BCSC staff reviewed three audit working paper files completed during the review period to assess if the reviews were adequate and were completed on a timely basis. BCSC staff assessed if IIROC staff produced properly documented files. In addition, BCSC staff ascertained whether IIROC staff adequately identified and resolved issues.

The sample selected included a small Type 2 introducer, a medium-sized full service, self-clearing dealer, and a large introducing and carrying dealer.

### ***Staff findings***

BCSC staff's review of audit working paper files indicated that the work performed by IIROC staff was generally thorough and of high quality. Issues were brought to the attention of the audit partner and these were followed up and resolved.

### ***Staff recommendations***

None.

## **8. Field examinations**

### **8.1 Written procedures and guidance**

#### ***Background information***

BCSC staff obtained and reviewed the procedures relevant to field examinations and discussed examination procedures and processes with IIROC's management.

#### ***Staff findings***

BCSC staff found that IIROC has documented procedures that provide adequate guidance to Financial Compliance Examiners about the processes to conduct field examinations. These procedures give guidance on the frequency of examinations, scheduling and staffing, and planning and conducting field reviews. BCSC staff discussed the process, at a high level, with management and found no cause for concern.

***Staff recommendations***

None.

**8.2 Member selection process for financial compliance examinations**

***Background information***

IIROC uses a risk-based approach for scheduling field examinations of its Members. The FinOps group uses a risk assessment model to help identify, define and assess risks for each Dealer Member. The resultant risk score helps to determine priority focus in the examination cycle of Dealer Members.

The FinOps group performs annual financial and operations compliance examinations of all Dealer Members unless the Dealer Member's risk score falls in the low risk category.

Subject to the discretion of the VP of FinOps, low-risk Members are scheduled for examinations on a biennial, rotational cycle.

BCSC staff reviewed the examination schedule, as well as statistics provided by the IIROC showing Members that are designated in early warning.

***Staff findings***

In BCSC staff's view, the selection and review of Members for field examinations is satisfactory.

***Staff recommendations***

None.

**8.3 Financial compliance examination program**

***Background information***

BCSC staff reviewed the examination program used by the FinOps group to perform their field examinations to assess the adequacy of procedures and guidance provided to IIROC staff. BCSC staff also reviewed a sample of financial compliance examination files to determine whether the procedures were followed.

***Staff findings***

BCSC staff found that the examination programs are comprehensive and include specific and detailed instructions and guidance to Financial Compliance Examiners.

***Staff recommendations***

None.

## **8.4 File review**

### ***Background information***

BCSC staff selected a sample of three financial compliance files for review. The sample included files for small, medium and large dealers with varied risk profiles. The sample also covered member dealer types; including a small Type 2 introducer, a medium-sized full service, self-clearing dealer, and a large introducing and carrying dealer.

### ***Staff findings***

Overall, files were well structured and organized. BCSC staff noted that the introduction of electronic working papers, since 2006, facilitates quicker comprehensive reviews. BCSC staff's review of financial compliance examination files indicated that the work performed was generally thorough. Management informed BCSC staff that, going forward, IIROC would be focusing on the qualitative components of its risk assessment procedures.

### ***Staff recommendations***

None.

## **9. Interaction with CIPF**

### ***Background information***

BCSC staff discussed the communication processes between IIROC and CIPF. In addition, BCSC staff reviewed the *FinOps Procedures, Policies and Guidelines Manual* regarding the role of CIPF. These policies specify the circumstances under which FinOps communicates with CIPF. Such circumstances include instances of examination exemption requests, significant changes in the IIROC risk assessment model and reporting the discovery of any capital deficiency in a Member.

### ***Staff findings***

IIROC's process for communicating with CIPF appears adequate.

### ***Staff recommendations***

None.



## **D. Trading Conduct Compliance**

### **1. Purpose and scope**

The purpose of this part of the review was to determine whether TCC reviews are properly conducted, and in a timely manner. BCSC staff also assessed whether the procedures followed are comprehensive, and address regulatory risks and concerns.

### **2. Department organization and reporting structure**

#### ***Background information***

IIROC's TCC group, based out of Vancouver, reports to the Manager, Business and Trading Conduct Compliance who reports to the Director Pacific Region.

BCSC staff conducted a complete review of the TCC group's policies and procedures, TCC's examination program (referred to as the "module") utilized by staff to conduct TCC reviews, and three TCC review files representing large, medium and small sized firms located in B.C. and Alberta. The review also involved interviews with the Manager, Business and Trading Conduct Compliance in Vancouver and TCC staff.

#### ***Staff findings***

BCSC staff was advised that the TCC Manager in Toronto reviews draft versions of all Vancouver reports and provides comments. However, BCSC staff subsequently confirmed that IIROC applies adequate quality assurance procedures to ensure consistency of TCC reviews.

#### ***Staff recommendations***

None.

### **3. Interaction and communication with other IIROC departments**

#### ***Background information***

Prior to each review, the TCC solicits comments from staff in BCC, Market Surveillance, TR&A, FinOps, and Enforcement, so as to identify potential issues that may affect the focus of the TCC's review of the applicable Dealer Member.

Significant deficiencies discovered during reviews may be forwarded to IIROC's investigations group for further review. TCC staff are made available to the enforcement group, as needed during these processes.

#### ***Staff findings***

Vancouver office staff are generally very good in obtaining information from other IIROC departments before conducting TCC reviews. While this information is noted in the module and staff indicated that it allows them to concentrate their review in certain areas, it is not clear, however, how this information impacts the conduct of TCC reviews and TCC records do not provide any indication of this.

### ***Staff recommendations***

140. IIROC procedures should document the expectations placed on TCC staff and the conduct of TCC reviews in instances where a potentially significant issue has been brought to staff attention. In addition, if a significant issue was raised by other staff prior to a review, the resulting activity undertaken in relation to that issue should be documented in the review report.

**Priority: Low**

***IIROC's response:*** The manager of TCC asks for and receives feedback from the various departments when a new review is being planned. During this planning stage TCC staff make recommendations regarding the scope and focus of the review, which are reviewed and approved by the Manager. Any significant issues identified in the planning stage are documented and are carried forward to the relevant examination section. IIROC feels this procedure ensures adequate and consistent consideration of all such information.

### ***Staff comments and follow-up:***

While the procedure outlined above ensures consideration of the information, BCSC staff could not identify whether such issues were sufficiently addressed at the reporting stage. BCSC staff have noted this issue for follow up in future oversight reviews.

## **4. Interaction and communication with other regulators**

### ***Staff findings***

IIROC's TCC procedures do not specifically provide for interactions with other regulators.

### ***Staff recommendations***

141. Prior to commencing a review, TCC staff may derive useful information from other regulators which may allow them to focus on potential issues. Copies of reports provided by other regulators should be provided to TCC staff prior to the review.

**Priority: Medium**

***IIROC's response:*** IIROC shares TCC reports with the Montreal Exchange on an ongoing basis, and collaborates with FINRA on regulatory issues and examinations. Copies of reports provided by other regulators are sent to the TCC manager. These documents are filed as planning points for future examinations. During the planning stage, the examiner will review these reports and, where applicable, will include matters raised in the reports for review during the examination.

### ***Staff comments and follow-up:***

The *TCCPM* does not specifically mandate this process. Staff saw no evidence of this practice in the files reviewed. BCSC staff will note this for follow up in future oversight reviews.

## 5. Staffing resources and training

### *Background information*

The Vancouver office TCC group has two dedicated examiners reporting to the Manager, Business and Trading Conduct Compliance.

### *Staff findings*

The Vancouver office TCC group appears to be adequately staffed to carry out annual reviews of members located in Western Canada. The TCC staff are experienced and have the necessary training to carry out their functions.

### *Staff recommendations*

None.

## 6. Benchmarks

### *Background information*

While historically IIROC's TCC group did not have specific benchmarks, the Vancouver office has generally attempted to review all Dealer Members annually. IIROC has adopted new benchmarks for the completion and issuance of final examination reports

### *Staff findings*

IIROC's benchmarks for completion of final reports is satisfactory for the time being.

### *Staff recommendations*

142. IIROC staff should monitor the new benchmarks to ensure their suitability and consider whether additional benchmarks relating to reviews should be developed.

**Priority: Low**

<i>IIROC's response:</i> IIROC will comply.
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<i>Staff comments and follow-up:</i>
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IIROC's response is adequate. BCSC staff will follow up with IIROC about monitoring of these new benchmarks.
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## 7. Written procedures and guidance

### *Background information*

TCC's activities are primarily guided by two documents, the *TCC Procedure Manual (TCC PM)* and the *Trade Desk Review Module*. BCSC staff reviewed the document as well as the results of TCC reviews.

## 7.1 TCC PM and the Trade Desk Review Module

### *Staff findings*

The *TCCPM* and *TDRM* provide TCC staff with guidance in conducting TCC reviews. These documents address the majority of regulatory requirements for which IIROC is responsible. However, current procedures reference TSX/TSXV members only but do not provide for situations where participants may only be members/subscribers of other marketplaces.

### *Staff recommendations*

143. Procedures should be updated to ensure that they reflect the current multiple marketplace environment and (in conjunction with the activities of other departments within IIROC) address all applicable regulatory issues. Specifically, they should include:
- Provision of reviews for all participants, not just TSX/TSXV members/POs; and
  - Provisions relating to direct access clients to all marketplaces.

**Priority: Medium**

#### *IIROC's response:*

Currently, there are no Dealer Members that subscribe solely to ATSS, although this is possible. TCC staff will insert a placeholder in the procedures document and will develop appropriate procedures when necessary.

With respect to direct access, TCC testing includes testing of trading by direct access clients. TCC has a specific section in its procedures relating to direct access and IIROC reports to the exchanges on direct access issues detected by TCC.

#### *Staff comments and follow-up:*

BCSC staff will continue follow up of this issue with IIROC to ensure appropriate procedures are implemented as the multiple marketplace environment evolves.

## 7.2 Impact of Risk Factors on TCC Reviews

### *Staff findings*

The procedures indicate that the scope of the IIROC TCC review is to be determined by risk factors and the nature of the Dealer Member's business. However, the *TCCPM* does not provide guidelines on how such factors should affect the review. At present the reviews are scheduled by the TCC manager, with the director's approval, and do not seem to take into account risk factors. Risk factors do not seem to impact the scope, scale or focus of the review.

### *Staff recommendation:*

144. IIROC should establish criteria or guidelines to establish standards for frequency and appropriate scale of each TCC review. If IIROC considers risk factors when scheduling reviews, procedures should outline how risk factors will affect frequency of reviews as well as the scope of review to be completed and the scale of testing to be undertaken.

**Priority: Medium.**

***IIROC's response:*** The risk assessment program was initiated in April 2009. Once a sufficient sample of reviews is available to properly identify “high”, “medium”, and “low” risk firms, the ratings will be a key factor in schedule development and determination of the scope of examinations. Firms classified as “high” will be visited on at least a yearly basis. Standards and procedures will be developed as soon as possible and prior to the review of the first participant with a risk score. It should be noted that firms of a particular concern have historically been visited on a more regular basis. Further, the western office has been able to conduct examinations of all the Participants located in BC, Alberta and the Prairies within a 16-month cycle.

***Staff comments and follow-up:***

BCSC staff will continue its dialogue with IIROC on this issue. We look forward to receipt of IIROC's action plan for developing standards and procedures noted above.

### **7.3 Deficiency Reporting**

***Staff findings***

TCC procedures indicate examination findings will be considered to be deficiencies where agreed upon by Dealer Member firm. BCSC staff confirmed that Dealer Member agreement is not a prerequisite to finding a deficiency.

***Staff recommendations***

145. TCC procedures should make it clear that IIROC will, at its sole discretion, determine whether or not to make a deficiency finding (though the procedures may reference discussing the proposed findings with the Dealer Member firm).

**Priority: Low.**

***IIROC's response:*** While IIROC does ensure that Dealer Members understand the deficiencies found, the Dealer Member's agreement is not required and the determination is IIROC's alone. IIROC will clarify the TCC procedures in this respect.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

### **7.4 Standardized Categorization of Deficiencies**

***Staff findings***

TCC procedures do not provide guidance on determining whether a Dealer Member's non-compliance with relevant requirements will be categorized as a deficiency. Deficiency findings are made at the discretion of staff and management without guidelines.

***Staff recommendations:***

146. We understand that IIROC has recently adopted specific guidelines relating deficiency findings. The new guidelines should be monitored to ensure ongoing applicability.

**Priority: High**

***IIROC's response:*** IIROC will comply.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

***Staff findings:***

TCC procedures differentiate between "significant" and "non-significant" deficiencies but not provide clear direction on how to categorize a deficiency as a "significant" deficiency (there is a reference to an error rate in excess of 25% but this would seem to apply only to identifiers or markers and not other deficiencies).

***Staff recommendations:***

147. The new guidelines should be monitored to ensure ongoing suitability and applicability.

**Priority: High**

***IIROC's response:*** Clear direction is included in Appendix I of TCC's written procedures: *Deficiencies and Ratings Classification*.

***Staff comments and follow-up:***

BCSC staff will request a follow-up review of Appendix 1 to re-assess the adequacy of guidance.

***Staff findings:***

TCC procedures do not provide clear guidelines as to when a deficiency is deemed to be a "repeat deficiency". While staff seem to have an understanding of what constitutes such a deficiency there are no documented guidelines. In discussions with staff it is clear that there are many situations where the decision to categorize a deficiency as a repeat deficiency is not "clear-cut".

***Staff recommendations:***

148. IIROC should adopt procedures that provide staff with clear guidelines as to when deficiencies are to be considered to be "repeat deficiencies".

**Priority: High**

***IIROC's response:***

The TCC audit program requires the examiner to review the previous finding for each test and there is clear guidance in the procedures that a repeat deficiency is "significant". In addition, a review of the deficiency letters issued indicates that repeat deficiencies are found and declared.

TCC will revise its manual to include commentary that deficiencies which are materially similar to those in the previous review should be considered "repeat deficiencies".

***Staff comments and follow-up:***

BCSC staff have noted IIROC's response for follow up in future oversight reviews.

**7.5 Dealer Member selection process for examinations**

***Background information***

The *TCCPM* indicates that the frequency of the IIROC TCC review will be determined by risk factors and the nature of the business but do not provide guidelines on how such factors should affect scheduling.

***Staff findings***

At present the TCC reviews are scheduled by the Manager, Trading and Business Conduct Compliance, with the Director, Pacific Region's approval and these reviews do not seem to take into account risk factors.

There are no procedures providing direction on when targeted reviews or "sweeps" are to be conducted.

***Staff recommendations***

149. If IIROC considers risk factors when scheduling reviews, procedures must be established to outline how risk factors will affect scheduling. These procedures should provide managers with guidance on how risk factors will effect scheduling of TCC reviews.
150. Additionally, procedures should be adopted outlining when targeted reviews or "sweeps" are to be conducted and how such reviews should be carried out (i.e. if they should address a single area of concern or address a broad range of potential issues, etc.)

**Priority: Medium.**

***IIROC's response:***

Please note our response to report item 7.5 regarding risk factors.

With respect to sweeps, sweeps by their very nature are *ad hoc* and do not lend themselves to developing procedures that extend beyond the circumstances of the sweep itself.

***Staff comments and follow-up:***

BCSC staff will continue its dialogue with IIROC on this issue. We look forward to receipt of IIROC's action plan for developing standards and procedures, as noted above.

**7.6 UMIR Best Execution Rule**

***Staff findings***

The TCC module does not include any provisions relating compliance testing with UMIR's Best Execution Rule.

***Staff recommendations***

151. IIROC adopt specific processes within the module to test Dealer Members' compliance with applicable best execution requirements. Such tests may involve reviewing and evaluating each Dealer Member's policies and procedures and technology systems pertaining to best execution, the Dealer Member's methods of ascertaining clients' execution goals, methods of carrying out reviews of samples trade to monitor achievement with the Dealer Member's policies and regulatory requirements.

**Priority: High**

***IIROC's response:*** IIROC has drafted a best execution portion for the TCC module which will be added to the procedures when finalized. This new material will complement the work TCC already does regarding the closely-related best price obligation.

***Staff comments and follow-up:***

IIROC's response is adequate. BCSC staff have noted IIROC's response and will follow up in future reviews.

## **7.7 Oversight of Best Price Violations**

### ***Staff findings***

The IIROC TCC module does include a review of the Dealer Member firm's policies and procedures relating to accessing multiple marketplaces as well as order routing technology available to the dealer. The module does not review the Dealer Member's internal testing of best price violations or any investigation into potential patterns of best price violations detected by IIROC's Market Surveillance group.

### ***Staff recommendations***

152. IIROC should adopt processes, within the TCC module, to facilitate TCC staff's review of: (i) Dealer Member reviews of best price violations; and (ii) patterns of violations of the best price rule (or the CSA's order protection rule) as detected by IIROC's surveillance group.

**Priority: Low**

***IIROC's response:*** While IIROC agrees that best price violations are important to detect, IIROC disagrees that this role is best performed by TCC. TCC is tasked with reviewing the best price policies and procedures at each firm on a supervisory level, and reviews the firm's internal compliance testing. Best price is monitored on a real-time basis by Market Surveillance and subsequent investigations are conducted by TR&A. In addition, TR&A conducts analysis of trade-through alerts to identify patterns and trends that may indicate non-compliance.

***Staff comments and follow-up:***

The TCC module used by TCC staff should explicitly provide for a review of members' policies to ensure compliance with best price obligations and should provide for a review where a pattern of violations has been established. These policies will have to be adapted for the new order protection requirements.

## **7.8 Review of Marketplace Traded Equities**

### ***Staff findings:***



IIROC's TCC Module does not include any references relating to reviewing Dealer Member compliance reviews of trades involving derivatives relating to marketplace traded equities (either exchange traded or OTC derivatives).

***Staff recommendations:***

153. BCSC staff encourages IIROC to develop processes, within the TCC module, to review Dealer Member's internal reviews of equity and equity-related derivative trading activities for possible violations of UMIR prohibitions relating to improper trading activities or manipulative and deceptive practices.

**Priority: Low.**

***IIROC's response:***

While IIROC agrees that consideration of derivatives is relevant to uncovering market manipulations, IIROC does not agree that this is an area where TCC can materially assist. A review by TCC would only detect a manipulation if, by some chance, the sample included the right security and the right time frame. This type of approach is unlikely to succeed and is not productive.

Instead, TCC's approach is to first identify anomalous price movements, then review the account activity and holdings to ascertain motivations. The existence of listed or OTC derivative positions is always considered when determining if the price movement or quote change is *bona fide* or manipulative. Any concerns that TCC identifies are referred to TR&A for in-depth review.

Dealer Members also have an obligation to monitor for artificial pricing and IIROC staff routinely review firms' internal testing in this area, as well as high and low closing, and ensures that Dealer Members are considering all relevant factors, including account holdings, when determining whether manipulation is occurring.

***Staff comments and follow-up:***

BCSC staff will continue dialogue with IIROC on this issue. BCSC staff remain concerned that IIROC's current approach may not be effective in some instances.

**7.9 TCC Oversight of Dealer Member Compliance with UMIR 7.2, and 10.12**

***Staff findings***

The TCC module does not include any processes to ensure that the Dealer Member is complying with the requirements set out in UMIR 7.2 - Proficiency Obligations or UMIR 10.12 – Retention and Inspection of Records and Instruments.

***Staff recommendations***

154. IIROC should adopt procedures to review Dealer Member's policies relating to compliance with UMIR's 7.2 and 10.12 and procedures to monitor the effectiveness of such policies.

**Priority: Medium.**

***IIROC's response:***

IIROC believes that these procedures are in place, and were in place during the Review Period as follows.

UMIR 7.2: IIROC ensures that all persons accessing any marketplace have received approval of an Exchange or QTRS for the entry of orders on that Exchange or QTRS. Since ATS requirements to date are such that in order to obtain access to the ATS, a trader must have obtained access to the TSX or TSXV, IIROC takes the position that the proficiency requirement has been reviewed and approved by the exchange's acceptance of the trader.

UMIR 10.12: IIROC reviews Dealer Members' policies regarding retention of records (Section AT5) and internal reviews (Supervision of Trading).

***Staff comments and follow-up:***

BCSC staff will continue its dialogue with IIROC on this matter.

## **8. Review of TCC examination files**

### ***Background information***

BCSC staff reviewed three TCC examination files provided by IIROC representing a large, a medium sized and a small Dealer Member. The Dealer Members reviewed were located in Calgary and Vancouver and carried out trading activities on behalf of institutions, retail clients and proprietary accounts. One Dealer Member whose file was reviewed provides services as an executing/clearing Dealer Member on behalf of other Dealer Member firms.

The BCSC review consisted of a review of:

- all correspondence relating to the TCC review, including correspondence with the Dealer Member firm to be reviewed and internal correspondence;
- the TCC questionnaire completed by the Dealer Member firm;
- the completed TCC Module;
- the TCC's final report; and
- data and records relating to the review.

### ***Staff findings***

In each case reviewed, IIROC staff conducted thorough reviews, which reflected staff expertise in their areas of responsibility. Generally, testing was acceptable. However, some sample sizes, used in testing the smaller firms, were insufficient to provide meaningful conclusions.

In each case reviewed, IIROC produced a final report within 65 days of commencing the TCC review. This represents excellent timeliness, which are well within IIROC's guidelines.

Documentation retained, and final reports, were clear and complete. However, in one case the Dealer Member firm contested IIROC's TCC findings. IIROC's response to the Dealer Member addressed a

number of the issues raised, but did not address all issues. This omission raises uncertainty as to whether the original deficiency findings remain valid.

***Staff recommendations***

155. IIROC should ensure that staff conducting reviews conduct tests on a substantially large sample size to ensure that it is representative and to minimize the margin for error. While the size of the firm and the amount of trading activity conducted by a firm is a relevant factor in determining an appropriate sample size, a reasonable sample size should be utilized even if that means utilizing records outside of the date range of the review. Where an appropriate sample size can not be obtained all records can be reviewed.
156. Where a Dealer Member contests any TCC deficiency findings, IIROC's response should clearly indicate whether the original findings remain on the record as deficiencies or whether IIROC accepts the dealer's submissions and the deficiency will be deemed to have been deleted.  
**Priority: High**

***IIROC's response:*** IIROC disagrees that current sample sizes need to be substantially larger. IIROC's approach is for our sample sizes to be large enough to reveal a potential problem or deficiency. Sample sizes do not have to be large enough to prove a deficiency exists or does not exist. If staff are unsure, staff increases the sample size when necessary.

IIROC will ensure that responses to Dealer Members clearly indicate whether each deficiency has been addressed or remains outstanding.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

## **E. Market Surveillance**

### **1. Introduction**

IIROC's Western Market Surveillance (MS) office is responsible for monitoring the trading activity and real time disclosure by issuers that trade on the TSX Venture Exchange (TSXV) and the Canadian Unlisted Board. It is also responsible for TSXV issuers trading on alternative markets, which include Canadian National Stock Exchange (CNSX), Pure Trading, Omega Chi-X Canada, Bloomberg Tradebook, Alpha Trading Systems, Liquidnet Canada Inc. and Match Now.

Surveillance staff use sophisticated software programs to search for instances of:

- violations of the Universal Market Integrity Rules (UMIR) - front running, market stabilization alerts, customer principal trade alerts;
- securities Act Violations – illegal insider trading and market manipulation.
- TSXV disclosure violations – disclosure and exchange policies

#### *Primary Differences – Western and Eastern Surveillance*

The two offices use the same software programs, external vendors, governing rules and procedures; however, the issuers on the TSXV require greater oversight due to their junior nature.

#### *Characteristics of TSXV Issuers*

- Illiquid
- Highly speculative
- Poor governance
- Promotional

#### *The previous review*

ASC and BCSC staff conducted a joint audit of one of IIROC's predecessors, RS, in 2005. That review covered the period March 1, 2002 to August 31, 2004. The review noted that RS and the TSXV had collaborated to address concerns over non-compliant technical disclosure by mining and exploration companies.

The review found that:

- trading halts were administered in a timely manner; and
- surveillance staff maintained good communication with TSXV staff.

There were no areas of concern identified.

## **2. Purpose and scope**

The objectives of this review are:

- to assess the adequacy of the policies and procedures, training and other guidance used by staff performing real-time surveillance; and
- to assess, by reviewing a sample of alerts, whether they are properly followed-up.

## **3. Department organization and reporting structure**

### ***Background information***

BCSC staff obtained and reviewed the organizational chart for the Vancouver office.

### ***Department Reporting Structure***

The Vancouver MS office consists of six surveillance officers including one senior surveillance officer and one geologist. MS staff report directly to the Director, Trading Surveillance and Compliance. The director's office is adjacent to the area that houses surveillance staff. Any issues that the Senior Surveillance Officer is unable, or not permitted, to resolve are brought to the attention of the Director.

The Director, Trading Surveillance and Compliance reports to IIROC's VP Western Canada.

### ***Department Organization***

The Department has one senior surveillance officer, four surveillance officers, and one geologist. The surveillance officers have access to the same information and generally share responsibilities. The department is well organized with staff members in close proximity to each other allowing matters to be well coordinated and quickly resolved.

### ***Staff findings***

Surveillance is appropriately organized. Its reporting structure is also adequate. IIROC is considering whether it would be beneficial to have two senior surveillance officers in MS.

### ***Staff recommendations***

None

## **4. Interaction and communication with other regulators**

### ***Background information***

BCSC staff interviewed the Director, Trading Surveillance and Compliance and MS staff members.

TSXV issuers are under the jurisdiction of the provinces in which they reside. As a result, MS staff may contact staff members at provincial securities commission to consult on disclosure issues. MS staff maintain close contact with relevant compliance and disclosure staff at certain commissions, including ASC, BCSC and OSC.

***Staff findings***

MS staff maintain a good working relationship with personnel at provincial securities commissions and the staff at the TSXV. MS also communicates with its international counterparts for TSXV issuers that cross list on foreign stock exchanges.

MS staff make themselves available for consultations as needed.

***Staff recommendations***

None.

**5. Interaction and communication with other IIROC departments**

***Background information***

BCSC staff interviewed the Director, Trading Surveillance and Compliance and MS staff members.

***Staff findings***

Surveillance staff maintain regular communication with staff members in TR&A and TCC. Surveillance also communicates with IIROC's Eastern Region MS department. MS has been increasing interaction between itself and other IIROC departments that have infrequent or no involvement in real-time trading matters.

***Staff recommendations***

157. BCSC staff encourages IIROC to continue cross training to improve inter-departmental relations.  
**Priority: Low**

***IIROC's response:***

IIROC will comply.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

**6. Staffing resources and training**

***Background information***

*Staffing Resources*

There are six staff members in the IIROC's Western MS office. All six are knowledgeable and experienced. There has been no recent turnover.

### *Staff Training*

New hires in MS must have industry experience and direct knowledge of trading matters prior to being hired. The training program is primarily on-the-job training supported by the procedures manual. The Senior Surveillance Officer conducts the majority of the training.

### *Staff findings*

At current trading volumes, MS has sufficient personnel to regulate and monitor the trading on the TSXV. The training regime available to new staff members is adequate given the qualifications that are required for new hires.

### *Staff recommendations*

None.

## **7. Technology**

### *Background information*

IIROC's Eastern and Western MS rely on the same technology.

### *Staff findings*

BCSC staff noted that the trading volumes appear to be increasing on ATs and had concerns that these trades were not sufficiently monitored. However, staff understand that surveillance of ATs' trading has been integrated in the next generation of surveillance monitoring software (SMARTS), and all cross-market activity and trading on the ATs (including TSXV issuers) are now being monitored on a test basis.

### *Staff recommendations*

None

## **8. Written procedures and guidance**

### *Background information*

The Eastern and Western offices of MS use the same procedural manual. BCSC staff obtained and reviewed IIROC's MS procedural manual. The last revision to the manual occurred on August 20, 2009.

### *Staff findings*

*MS' Policies and Procedure Manual* is a key training tool and likely the second best method for new employees to develop the necessary skills and knowledge to be a productive member of MS. The manual is thorough and covers the key areas involved in the day-to-day functions of the MS department.

BCSC staff reviewed each section of the procedures manual. The following table lists the results of that the review:

<b>Heading</b>	<b>Comments</b>
Market Supervision Overview	Adequate
Software Applications	Adequate
Smars Functions	Adequate
General Market Supervision	Good
Order Markets & Violation Recording	Adequate
Trade Cancellations & Adjustments	Good
Halts and Resumptions	Good
Disclosure	Adequate
Other Market Supervision Procedures	Adequate

***Staff recommendations***

158. The *MS' Policies and Procedure Manual* should include a section outlining the duties of the surveillance's geologist.  
**Priority: Low.**

***IIROC's response:***

The January 2010 version of the Manual includes the noted material concerning the IIROC geologist.

***Staff comments and follow-up:***

IIROC's response is adequate. No further action is required.

**9. Processes and timelines**

***Background information***

Surveillance staff deal with hundreds of trading alerts each day. MS staff use their knowledge and experience to determine which alerts deserve immediate attention or no attention at all. The *MS Policies and Procedures Manual* details the procedures for each type of alert.

***Staff findings***

The specialist nature of Surveillance requires that most, if not all, alerts be concluded within a very short period.

BCSC staff does not have concerns with any of the processes and timelines listed in the *MS Policies and Procedures Manual*.

***Staff recommendations***

None.



## **10. Review of alerts**

### ***Background information***

The alerts are captured by a software program called the Intelligent Market Monitor. All five surveillance officers have this application on their desktops and share the workload. BCSC staff also reviewed a comprehensive list of alerts from January 2008 to November 2009. The statistics show the integral role that MS plays in the monitoring of the trading and disclosure on the TSXV.

### ***Staff findings***

BCSC staff reviewed the alerts of April 15, 2009. MS staff dealt with alerts in a timely manner as required in the *MS Policies and Procedures Manual*.

### ***Staff recommendations***

None.

## **F. Trading Review and Analysis**

### **1. Introduction**

The Western TR&A department is responsible for trading activity occurring on the TSXV and the trading activity of TSXV issuers on alternative marketplaces. TR&A is dependant on M S for the majority of it cases. TR&A also reviews matters brought to its attention through gatekeeper reports and public complaints.

### **2. The Previous Review**

The ASC and the BCSC conducted a joint oversight review of RS in 2005. That oversight review resulted in the following findings:

- Caseloads were well managed.
- TR&A files were thorough and completed in a timely manner.
- Some files were not prioritized according to procedures.
- Staffing levels were adequate.

The oversight review recommended that TR&A follow its procedural manual and develop benchmarks to measure staff performance.

### **3. Purpose and scope**

The purpose of this review is to ensure that preliminary investigations carried out by TR&A are adequate and conducted in a timely manner. The review will also assess whether regulatory issues and concerns are addressed.

Key areas covered are:

- review of policies and procedures manual;
- review case opening for timeliness;
- review the number of open cases; and
- review a sample of TR&A files.

### **4. Department organization and reporting structure**

#### ***Background information***

BCSC staff obtained and reviewed the IIROC's organizational chart.

TR&A consists of four Investigative Trade Analysts (the ITAs) and one Investigative Trading Coordinator (the ITC). All of the ITAs and the ITC report to the Manager, TR&A. The Manager, TR&A reports to the Director, Trading Surveillance & Compliance, Western Region. The Director reports to the VP Western Canada.

### ***Staff findings***

#### ***Department Reporting Structure***

The reporting chain is organized in a logical manner.

#### ***Department Organization***

TR&A is well structured and efficiently organized. The addition, or promotion of one ITA, to a senior role is under consideration.

### ***Staff recommendations***

None.

## **5. Interaction and communication with other IIROC departments**

### ***Background information***

Most of the cases opened in TR&A are referred from Market Supervision. TR&A and the Investigations department meet regularly on an informal basis to discuss files that may be referred and workflow in general. Those meetings are held at the management level. Referrals from TR&A to Investigations are discussed at management meetings. Informal meetings between TR&A and Surveillance are held to discuss workflow issues. Meetings are also held, bi-weekly, with TCC. TR&A's interaction with TCC, Investigations and MS is apparent. There is less contact with other departments.

### ***Staff findings***

TR&A has extensive contact with staff in Market Supervision .

### ***Staff recommendations***

None.

## **6. Interaction and communication with other regulators**

### ***Background information***

TR&A staff communicate frequently with staff at the provincial securities commissions, FINRA, ISG and other international regulators. The majority of contact relates to cases of joint interest, case referrals or information requests. Monthly and quarterly meetings, or teleconference meetings, are held between IIROC management and oversight staff at the ASC and BCSC.

### ***Staff findings***

TR&A staff have good levels of interaction with other regulators. BCSC staff are aware TR&A staff are available for consultations.

### ***Staff recommendations***

None.

## **7. Staffing resources and training**

### ***Background information***

BCSC interviewed then Director, Trading Surveillance & Compliance, Western Region. BCSC staff also reviewed the following documents:

- TR&A – Policies and Procedures Manual
- TR&A – Orientation & Training Guide

TR&A currently has a compliment of four ITAs, one ITC and a manager. There are no vacancies or recent staff turnover and this has resulted in a stable and experienced workforce.

### ***Caseloads***

The previous oversight review of TR&A noted an average caseload of 35 cases per ITA. That number has declined to 8-10 cases in 2009 (see table below). The reduction is likely in response to insider trading protocols established in 2007. As of December 9, 2009, TR&A maintained an unassigned pool of 15 low priority cases.

<b>Period</b>	<b>Caseloads</b>
2005	35 cases
2007	13 – 15 cases
2008	15 – 20 cases
2009	8 – 10 cases

TR&A has met its regional benchmarks in 2007 and 2008. In 2009, TR&A has completed 81% of its files within 150 days, which is below TR&A's newly established target benchmark of 100% completion.

#### **Regional Benchmarks**

1. Each ITA is required to complete 24 cases per year
2. Complete 75% of files within 100 days
3. Complete 100% of files within 150 days

TR&A has adequate staff to deal with current caseload levels. BCSC staff conclude that TR&A has sufficient staff to process caseloads beyond its current caseload. That conclusion is based on TR&A ability to meet its benchmarks in 2007 and 2008 when caseloads were higher.

### ***Staff Training***

New hires are required to have a certain amount of industry or regulatory experience and certain prerequisite courses such as the Canadian Securities Course. TR&A staff obtain the majority of their training on the job. TR&A augments on the job training with a training and orientation program conducted by the manager of TR&A.

### ***Staff findings***

TR&A has adequate staff to process its current caseload volumes. It also has sufficient resources to process higher caseload volumes. The lack of turnover reflects a stable, experienced workforce. TR&A's staff training program is adequate.

### ***Staff recommendations***

None.

## **8. Written procedures and guidance**

### ***Background information***

The Eastern and Western offices of TR&A use the same procedures manual, training guide and tips/tools manual. These are:

- TR&A – Policies and Procedures Manual
- TR&A – Tips for TR&A Tools
- TR&A – Orientation & Training Guide

BCSC staff reviewed all available procedures and guidance documents used by staff in TR&A.

### ***Staff findings***

BCSC staff found all documents to be well written, comprehensive and informative.

### ***Staff recommendations***

None.

## **9. Processes**

### ***Background information***

TR&A opens cases arising from the following sources:

- Trading Conduct Compliance;
- Market Supervision;
- Member Firms via gatekeeper reports;
- TSXV Issuers;
- Other Regulatory Agencies – domestic/international;
- Public complaints; and
- IROC Case Assessment.

### *File Priority – Regulatory Impact Rating*

The Manager or Director ranks incoming cases to separate higher priority issues from lower priority matters. The criteria is set out in Appendix D of the TR&A Policies and Procedures Manual. The manager of TR&A then assigns the file to an ITA. Lower priority files may end up in an unassigned pool.

TR&A concludes its cases with the following potential outcomes:

- Close no action;
- Warning letter;
- Refer to a securities commission;
- Refer to Enforcement;
- Refer to a Marketplace;
- Refer to a ISG member; and
- Refer to TCC.

All files are reviewed by the Manager or Director prior to assigning an outcome.

### *Work Performed*

The ITA is required to complete a preliminary investigation report for each file under their conduct. The format of the report is detailed in the procedures manual. Most reports follow a basic format requiring the ITA to obtain and analyze trading documents and/or reports.

### *Insider Trading Matters*

TR&A assesses an issuers trading activity prior to the disclosure of material information. If warranted, TR&A refers the trading activity to the provincial securities commission that has primary jurisdiction over the issuer. The process is detailed in the TR&A – Policies and Procedures Manual. Referrals to BCSC involve a series of steps be performed to assess the merits of a referral.

### ***Staff findings***

BCSC staff reviewed TR&A processes relating to case opening, case ranking/prioritization, case assignment and case closing. TR&A's insider trading protocols were also reviewed. BCSC staff found no weaknesses and have no recommendations that would enhance the processes that are in place.

### ***Staff recommendations***

None.

## **10. Review of files**

### ***Background information***

BCSC staff reviewed 21 randomly selected files from 2004 to 2009. The exact breakdown by year is listed in the table below. Most of the files originated in Market Surveillance. The files reviewed involved either technical violations, market manipulation or matters relating to possible insider trading.

### *Market Manipulation*

BCSC staff reviewed six files that involved suspected market manipulation. Five of the files required an investigation report. One file was closed at the assessment stage by the Director. All five-investigation reports exhibited sound judgment and appropriate levels of analysis. The length of time that the files remained open ranged from one to thirteen months. TR&A has implemented a new benchmark for 2009 to close 100% of files with 150 days.

### *Insider Trading (Fast Track)*

TR&A is responsible for referring suspected instances of illegal insider trading to the provincial securities commissions. The provincial securities commissions and IIROC have established procedures governing how these matters are referred. BCSC staff reviewed ten fast track files and found that the established procedures were followed in all cases. There were two files for which referral was delayed BCSC staff found that the delay was insignificant and not an indication of a systemic failure.

### *Technical Violation*

BCSC staff reviewed four files that involved technical violations. Three of the files were completed within a very short time period. One file (opened in 2004) was open for over a year. All files were completed using sound judgment and appropriate levels of documentation.

### ***Staff findings***

BCSC staff found that the files were completed using sound judgment and sufficient documentation. In all cases, management reviewed the files. The majority of files were opened and closed within reasonable time periods.

BCSC staff expect that the length of time that cases remain open in TR&A will decline because of reduced overall caseloads and the introduction of new benchmarks that require 100% of cases to be completed within 150 days.

### ***Staff recommendations***

None.