

**Oversight Review Report of  
the Investment Industry Regulatory Organization of  
Canada**

**Issued: December 4, 2014**

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## **I. Introduction**

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 is recognized as an SRO by the Alberta Securities Commission (ASC), the Autorité des marchés financiers (AMF), the British Columbia Securities Commission (BCSC), the Financial and Consumer Affairs Authority of Saskatchewan (FCAA), the Financial and Consumer Services Commission of New Brunswick (FCNB), the Manitoba Securities Commission (MSC), the Nova Scotia Securities Commission (NSSC), the Office of the Superintendent of Securities, Service Newfoundland and Labrador, the Ontario Securities Commission (OSC), and the Prince Edward Island Office of the Superintendent of Securities Office, collectively, the Recognizing Regulators (RRs). IIROC's head office is in Toronto with regional offices in Montreal, Calgary and Vancouver.

This oversight review was conducted jointly by RR staff (Staff) of the ASC, AMF, BCSC, FCAA, FCNB, MSC, NSSC, and OSC.

This report details the objectives, methodology, frame of reference, report format, scope, overall assessment, and findings of the review for the period from October 1, 2009 to December 31, 2013 (the review period).

### **1. Objectives**

The objectives of the review were to:

- assess whether IIROC was in compliance with the relevant terms and conditions (T&Cs) of its recognition orders (ROs)
- evaluate whether the identified regulatory processes were operating effectively
- determine if certain key regulatory processes were efficient, consistent, and fairly applied

### **2. Methodology**

The RRs adopted a risk-based methodology for this review. The RRs:

- assessed the inherent risks of each functional area or key process based on:
  - reviews of internal IIROC documentation (including annual management self-assessments and risk assessments)
  - information received from IIROC in the ordinary course of oversight activities (periodic filings, discussions with Staff)
  - breadth and prioritization of findings from the prior oversight review
  - the impact of significant events in or changes to markets and participants to a particular area
- evaluated known controls for each area

- considered relevant situational/external factors and the impact of enterprise wide risks on IIROC as a whole or on multiple departments
- calculated an overall risk score for each area
- used the risk score to determine the scope and depth of the review

### **3. Frame of Reference**

Since the last oversight review, IIROC has managed certain challenging events and market conditions while continuing to carry out its regulatory responsibilities. As part of the risk assessment process, Staff considered the impact of the following events and market conditions on IIROC as an organization, as well as on the relevant functional areas and processes:

- *Loss of personal information:* In February 2013, a portable device believed to contain personal client information was lost. The incident precipitated an internal review of IIROC's policies, procedures and controls in regard to information security. A class action lawsuit in the matter was filed against IIROC in Québec. Subsequently, the motion to certify was dismissed, though counsel for the lead plaintiff has filed an appeal.
- *Bankruptcies / wind-downs:* The bankruptcy of MF Global Canada Co. (the first Dealer Member specializing in derivatives) and the wind-down of Penson Financial Services Canada Inc. (a large carrying and servicing dealer) highlighted the risks posed by dealers affiliated with foreign parents and outsourcing to 3<sup>rd</sup> party service providers, as well as the increasing reliance by the Canadian investment industry on a small number of carrying and servicing dealers.
- *Unsettled economic conditions:* Many dealers continue to be challenged to return to profitability levels not seen since before the "2008 crisis". This led some dealers to rethink their business models and has precipitated a consolidation of Dealer Members. For investors, there has been an increasing demand for yield in this low-interest rate environment, which has triggered some dealers to introduce clients to non-traditional products and explore new business models (e.g. provision of advice in discount brokers) to supplement traditional revenue sources.
- *Innovations in technology:* – While changes in technology have enabled dealers to stay connected and better communicate with their clients (e.g. via websites and social media), client expectations as to the level of innovation a dealer should provide have also grown, adding pressure to fund the related systems projects to remain competitive. Innovations in technology have also allowed dealers to engage in or facilitate the increasing speed and frequency of trading, but this change has also contributed to other risks to a dealer's business (e.g. cyber-attack, algorithmic trading errors), as well as to IIROC's ability to maintain adequate surveillance systems.

#### **4. Report Format**

Previous Staff oversight reports detailed both effective and ineffective processes of IIROC. In keeping with a risk-based approach, this report focuses on those functional areas or key processes with findings that are significant and require corrective action. While Staff agree that each finding included within the report requires an IIROC response and description of the corrective action to be taken, not all findings were made in each regional office where a particular IIROC function or process was sampled for testing. In any case, as applicable, Staff require that IIROC take corrective action that will ensure nationwide consistency in IIROC's approach.

#### **5. Scope**

In consideration of the challenging events and market conditions, through the risk assessment process, Staff identified the following high and moderate risk areas as the focus for the review.

##### *High*

- Information Technology
- Financial Operations
- Risk Management
- Enforcement

##### *Moderate*

- Financial & Operations Compliance
- Business Conduct Compliance
- Trading Conduct Compliance
- Market Surveillance
- Trade Review & Analysis

Also, Staff identified the following low risk areas where the breadth of the review was reduced:

##### *Low*

- Corporate Governance
- Policy
- Membership & Registration

#### **6. Finding Prioritization**

Staff prioritized all findings into high, medium, and low, based on the following criteria:

**High** The issue is significant or is a significant repeat finding. IIROC should take immediate corrective action and regularly report on its progress.

**Medium** The issue is moderately significant. IIROC should resolve the issue within a reasonable timeframe and periodically report on its progress.

**Low** The issue is less significant. Staff raise the issue with IIROC management for resolution.

## **7. Overall Assessment**

Staff noted a number of significant regulatory process related findings, particularly in the Enforcement and Business Conduct Compliance departments. Staff will continue to monitor IIROC's progress in resolving the findings as part of its ongoing oversight activities. Staff also noted findings in other areas covered in this review.

Nevertheless, based on the risk assessment, the scope of the work performed, and the results of the review, Staff are satisfied that during the review period IIROC met the relevant terms and conditions of the ROs in the areas covered, subject to IIROC taking corrective action on the findings detailed within the report in accordance with the priority assigned.

The high and medium priority findings are set out in the *Fieldwork & Findings* section of the report, with low priority findings set out in Appendix A. Other than the findings noted, Staff did not identify further concerns with other aspects of IIROC's operations that were included in this review. For IIROC operations or activities not within the scope of the review, Staff make no comments or conclusions on such operations or activities.

## II. Fieldwork & Findings

### A. Information Technology

Under Term & Condition 11 of the Recognition Order, IIROC must ensure critical technology systems have appropriate (i) internal controls to ensure the integrity and security of information and (ii) capacity; as well as controls that manage the risks associated with its operations.

Earlier this year, one of IIROC's representatives lost a portable device believed to contain confidential information concerning corporate and individual clients of Dealer Members. Efforts to retrieve the device were unsuccessful.

IIROC took steps to mitigate harm to potentially affected clients, which included the following:

- notifying and coordinating with affected Dealer Members
- distributing letters to potentially affected clients
- arranging for a call centre to provide assistance to potentially affected clients
- paying for credit alert and monitoring services

As a result of the above, Staff focused their review on:

- evaluating the current and remedial processes and controls for the
  - gathering and retention of personal data
  - use of portable electronic devices
  - annual independent systems review (ISR)
  - outsourcing of information technology (IT) functions
  - business continuity plan
- staffing levels and reporting lines within the department
- surveillance system benchmarks

Staff reviewed the following documents:

- annual risk assessments and related IT risk register
- annual ISR and other third party reports
- organizational charts
- policy and procedural manuals

Staff noted that IIROC is taking steps to address issues identified by the data loss incident.

During the period under review, Staff also noted that IIROC's documentation of the IT component within the Department Risks Summary and Ranking was not sufficiently complete prior to the adoption of an enterprise risk management (ERM) framework. However, IIROC has taken steps to update its processes by designing a new Information Technology Risk Register. As part of the ongoing oversight of IIROC, Staff will continue

to monitor events surrounding the loss of the portable device, improvements associated with the noted IT processes, as well as IIROC's ability to ensure critical systems as identified in the RO have appropriate internal controls that effectively manage the risks associated with its operations and the integrity and security of information.

**Finding**

There were no high or medium priority findings noted for the area.



## **B. Financial Operations**

Under Criterion 6 of the Recognition Order, IIROC must have sufficient financial resources for the proper performance of its functions and to meet its responsibilities.

As part of its framework, IIROC:

- has been set up as a not-for-profit corporation and manages its operations on a cost-recovery basis
- has designated the Finance and Administration Department to monitor the financial operations and report to the Finance and Audit Committee, which in turn reports to the Board of Directors (the Board) on at least a quarterly basis
- derives fees from Dealer and Market Members as its key source of revenue
- maintains various types of corporate insurance policies

As a direct result of the data loss incident, IIROC incurred unexpected costs to investigate and manage the event and enhance internal controls during continuing unsettled economic times. IIROC also defended a class action lawsuit related to the data loss incident. Subsequent to the completion of Staff's fieldwork, the motion to certify the class action was dismissed; however, the denial of certification has been appealed by the lead plaintiff.

Staff focused their review on:

- the current financial position
- the budgetary process
- the funding of future regulatory initiatives
- instruments in place to mitigate exposures (e.g. insurance)

Staff reviewed the following:

- financial statements
- budgetary documents
- insurance policies
- Board and Committee meeting minutes

Staff noted that IIROC's financial planning process took into consideration known exposures and was adaptable to unexpected costs with respect to the need to fulfill its regulatory responsibilities.

### **Finding**

There were no findings noted for the area.

## C. Risk Management

Under Terms & Conditions 11(a)(ii) and 12(f) of the Recognition Order, IIROC is required to have controls in place to manage the risks associated with its operations, including an annual review of its contingency and business continuity plans; and to perform a self-assessment of its regulatory responsibilities.

In terms of IIROC's risk management framework:

- the Executive Management Team (CEO, SVPs, Regional VPs) is responsible for the identification of the principal risks of the organization's business and ensuring that these risks are managed
- the Senior VP, Finance & Administration is responsible for reporting on Risk Management to the Finance & Audit Committee (FAC)
- the mandate of the Finance & Audit Committee (as documented within the FAC Charter) includes assisting the Board in its oversight of IIROC's processes relating to risk management and control systems
- an annual Risk Management Report which summarizes a review of IIROC's risks and outlines strategies to address those risks is presented to the Board
- the approach used for the Risk Management Report includes internal and external risk categories, a likelihood assessment and an impact assessment

In light of the factors noted under the Frame of Reference within the Introduction, and as the risk management function in its entirety was not examined in prior oversight reviews, Staff focused on:

- gaining an understanding of the FAC Charter
- an appraisal of the 2012 FAC member survey and self-assessment
- an evaluation of the processes to complete the annual risk management report
- an assessment of the content (risks, mitigating strategies, impact, timelines) within the annual risk assessment reports
- a review of the FAC meeting minutes

As well, Staff performed limited procedures following up on the findings in the 2009 Oversight Report relating to business continuity.

Staff reviewed the following FAC related documents:

- annual risk management reports prepared for the Board
- Charter
- 2012 self-assessment
- 2012 member survey
- meeting minutes
- business continuity plans

During the review, Staff were informed that IIROC will be transitioning its enterprise risk

<p>management framework to The Committee of Sponsoring Organizations of the Treadway Commission (COSO) or other available framework. As well, Staff received documents that evidence IIROC's actions to implement an internal audit function in the near future, though it had not been established by the end of the review period. Furthermore, Staff identified one high priority finding detailed below.</p>	
<p><b>(1) Finding – Written Policies</b></p> <p>Staff were informed that IIROC does not have written policies in place that (i) summarize its risk management function and (ii) reference other policies and procedures included in the overall risk management framework.</p>	
<p><b>Risk Implication</b></p>	<p>Written policies and procedures are integral to effective risk management. Without written policies and procedures, it is difficult to ensure effective communication, coordination, a consistent implementation and updating of a risk management regime.</p>
<p><b>Priority</b></p>	<p><b>High</b></p>
<p><b>Requirement</b></p>	<p>Please describe the action IIROC will take to address this matter, including a timeline for resolution.</p>
<p><b>IIROC's Response</b></p>	<p><i>A comprehensive ERM policy and associated procedures for IIROC will be implemented by the end of the current fiscal year, March 2015.</i></p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff acknowledge IIROC's response to address the matter. Going forward, Staff expect IIROC to monitor and assess the effectiveness of the comprehensive policy and associated procedures when implemented, as described in the response.</p>

## D. Enforcement

Terms & Conditions 5 and 8 of the Recognition Order require IIROC to enforce compliance with its rules by Dealer Members and their registered staff, Alternative Trading Systems (ATSS) and others subject to its jurisdiction.

To meet its regulatory requirements, IIROC Enforcement staff are organized into the following groups:

- case assessment
- investigations
- litigation

During the review period, IIROC created a separate group to handle client complaints and inquiries. This new group is separate from the Enforcement Department, although the Director of the group is also the Director of Case Assessment.

Enforcement staff are primarily responsible for:

- performing a preliminary assessment of case files
- investigating complaints or referrals about possible regulatory misconduct
- taking disciplinary action when misconduct has taken place

Since 2008, continuing unsettled economic conditions and low interest rate environment, increased use of technology by Members and Approved Persons (e.g. websites and other forms of social media - blogs, specialty channels) as well as other key market events (2010 'flash crash') have increased risk to investors and impacted the integrity of the capital markets. Specifically, IIROC Members have had to consider new lines of business to support overall profitability. Furthermore, non-traditional products and complex trading strategies have become more pervasive. In this environment, Staff expect IIROC to conduct timely identification, investigation and prosecution of cases where investors were harmed. In addition, Staff noted significant findings in the 2009 review of the Enforcement department and that IIROC made changes to help address those findings. As a result, Staff focused this review on:

- understanding the new systems used (Enforcement Case Management - ECM)
- assessing the case selection process, including criteria used to evaluate cases
- analyzing statistical data and reviewing of case files in each group
- assessing IIROC's hearing panel and disciplinary process<sup>1</sup>
- assessing the referral process to other regulators
- analyzing IIROC's handling of cases subsequently reviewed by the Ombudsman for Banking Services and Investments (OBSI)
- evaluating the role and function of the new client inquiry group
- following up on all findings in the 2009 Oversight Report

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<sup>1</sup> Hearing Panels are the responsibility of the National Hearing Coordinator, which is part of the General Counsel's Office

As well, Staff performed other limited procedures, including:

- reviewing the adequacy of benchmarks
- staff turnover rates

Staff reviewed the following documents:

- statistical data for and a sample of case files within each group
- case criteria policies
- hearing panel procedures and a sampling of decisions
- OBSI related case files
- a sample of case files referred to other regulators
- organizational charts
- policies and procedures manuals
- quarterly and annual reports

During the course of the review Staff identified multiple areas of concern within the department. They are detailed in the high and medium priority findings below.

#### **(1) Finding – The Number of Market Conduct Cases**

Staff noted that during the review period:

- Market conduct case files referred to Investigations from Trade Review & Analysis (TR&A) had a higher rate of closure with no actions taken (40%) than Member related files escalated from Case Assessment (30%)
- in a number of the sampled Market related case files closed by Investigations with no action taken, there was no indication of material work in addition to that in the TR&A referral; and no clear written explanation from Investigation staff justifying the decision not to perform additional work
- 25% of case files opened in Investigations were Market and 75% Member related; of those case files that were taken to a disciplinary result, 12% were Market compared to 88% Member
- furthermore, of those Market case files taken to a disciplinary result, there was little variety in the nature of the Universal Market Integrity Rules (UMIR) violation, especially against individual respondents, with a majority of case files alleging the entering of artificial closing bids

In Staff's assessment, there was no obvious explanation for the different proportion of Market and Member cases; especially in light of the fact that TR&A personnel have specific market expertise and their referrals were typically more detailed and provided more thorough analyses than files escalated from Case Assessment. Though senior Enforcement management are aware of the different proportions, Staff have not been provided with an overall analysis with supporting documents that may provide a reasonable explanation.

<b>Risk Implication</b>	Market misconduct issues may persist and become more pervasive if there is less of a regulatory focus on alleged UMIR violations.
<b>Priority</b>	<b>High</b>
<b>Requirement</b>	Please describe the action plan that IIROC will implement to evaluate the reasons for the disproportionate results.
<b>IIROC's Response</b>	<p><i>IIROC Enforcement continues to focus on market cases which seriously impact upon market integrity and result in significant harm to the market. As such, one of our key market enforcement priorities is the investigation and prosecution of cases involving manipulative and deceptive trading.</i></p> <p><i>In order to effectively pursue that enforcement priority, we undertake a risk-based approach to the identification and pursuit of market cases involving misconduct that poses the greatest risk to market integrity, based upon clear and cogent evidence. Several process changes have recently taken place to ensure that the proper cases are pursued by Enforcement. In December 2013, Enforcement updated its case selection criteria to provide more clarity and guidance relating to the selection of market files. Concurrently, Trade Review and Analysis (TR&amp;A) developed a risk-based process to identify incoming matters which pose a high risk to market integrity. Further, Enforcement and TR&amp;A staff maintain an ongoing dialogue to ensure the alignment of the departments' respective policies and approaches to cases, including regular management team meetings. Collectively, these steps help to ensure that high risk matters are referred to and pursued by Enforcement.</i></p> <p><i>The decision to close a file will be governed by our case selection process and the quality of the evidence obtained. Accordingly, we do not work toward any expected or standardized closure rate. We therefore do not consider the 40% closure rate of referrals from TR&amp;A to be indicative of any problem inherent in our enforcement process. Rather, we believe that the closure rate simply reflects the proper operation of our case selection criteria and process.</i></p> <p><i>Similarly, we also do not view the 10% discrepancy between the closure rates for market and member conduct cases to be either material or problematic. The nature of market and member conduct cases are different. Accordingly, we would not expect to</i></p>

	<p><i>see a clear correlation between the closure rates of market and member conduct cases. The difference between market and member conduct cases may equally affect the number of files that are taken to a disciplinary result in each category.</i></p> <p><i>Our investigative procedures are both robust and comprehensive and we continue to make improvements. The majority of our market cases are referred by TR&amp;A. All TR&amp;A referrals are further assessed by the Manager, Investigations to determine whether to initiate a formal investigation.</i></p> <p><i>The market files sampled by the CSA reflect our current processes. In our review of the sample files, we identified evidence of additional work performed, either by the Manager, Investigations during the initial assessment or by the investigator during the formal investigative stage. Examples included expanding the review period or set of trades identified in the original referral, additional analysis, or seeking additional information from the firm during the investigation.</i></p> <p><i>In addition, the documents reviewed contain a specific rationale for the recommended course of action. While changes have been made over the last few years to streamline our recommendation memos and make our processes more efficient, there remain specific sections that clearly highlight the recommendation being made and the information/evidence obtained in support of the recommendation. In addition, the management team has recently renewed its focus on the quality of recommendation memos prepared by staff.</i></p> <p><i>With respect to the issue raised relating to the types of prosecutions, the majority of our market cases have dealt with not only “high closing” but also trading supervision. In fact, in 2013, 50% of our market cases involved trading supervision failures. The number and types of market cases have been impacted by changes in recent years in market structure. TR&amp;A, the primary source of market referrals, is detecting more potential violations at the underlying client level. As these matters fall outside of IIROC’s jurisdiction, these cases are referred to the relevant CSA jurisdiction. Accordingly, IIROC Enforcement has become increasingly focused on the Dealer Member’s oversight of these client activities, namely the adequacy of their supervision to prevent manipulative and deceptive trading practices.</i></p>
<b>Staff Comments and</b>	Staff acknowledge IIROC’s response to address the matter.

<b>Follow-up</b>	Going forward, Staff expect IIROC to monitor and assess if the different proportion of Market and Member cases are reasonable. Staff will also continue to monitor the level of Enforcement activities and assess trends as part of our ongoing oversight process.
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<p><b>(2) Finding – Effectiveness of Investigations</b></p> <p>Staff have concerns that in some cases, IIROC investigation staff decided not to proceed with allegations of unsuitable investments or unauthorized trading investigations because of:</p> <ul style="list-style-type: none"> <li>• the lack of detailed notes in the file concerning conversations between the registered representative (advisor) and clients</li> <li>• an incomplete assessment by investigation staff to determine if the firm effectively supervised its advisors (i.e. provided guidance on risk levels of products, reviewing if client risk tolerance was raised to match new holdings)</li> <li>• reliance on the receipt of a formal complaint to assess the severity of an alleged misconduct as potentially serious</li> </ul>	
<b>Risk Implication</b>	Investigations of unsuitable investments and unauthorized trading may not be appropriately pursued due to a perceived failure of the firm or advisor to follow IIROC guidance, or the lack of a formal complaint. This investigation approach may allow the issues to persist.
<b>Priority</b>	<b>High</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC’s Response</b>	<p><i>In early 2011, Enforcement adopted a case selection process in order to ensure that we focus our resources on the cases that involve regulatory misconduct that is harmful, and that send strong regulatory messages that contribute to IIROC’s investor protection mandate.</i></p> <p><i>This risk-based approach to case selection informs all stages of Enforcement activity, from Case Assessment, to Investigations and Prosecution. The selection criteria consist of a variety of factors, including the severity of the alleged misconduct, harm to investors and the presence of any patterns that may suggest recurring and/or systemic concerns. Equally important is the need to assess the quality of the evidence which is required to sustain any allegations in a formal disciplinary process. For this</i></p>



*reason, witness/complainant cooperation, while not determinative, is an important element of our case selection process. In addition, the lack of advisor notes simply demonstrates an absence of corroborating evidence. While it may inform our assessment of the evidence, it has never been the sole determinative factor in closing a file. Our current process does not support such an approach.*

*Our case selection process also provides for a more robust review of ComSet events reported to IIROC. Specifically, Case Assessment staff are required to conduct a review of every ComSet event, regardless of whether or not there is a direct complaint made to IIROC. Staff will also reach out to ComSet complainants, where appropriate, to ensure a thorough review of the complaint, again regardless of whether or not they have made a direct complaint to IIROC. Often, staff look beyond the individual ComSet entry to determine whether there are other indicia of systemic issues or patterns of activity that warrant further investigation.*

*Of the case assessment files sampled by the CSA, the decision to close these files was generally based on several factors including the existence of compelling contradictory evidence and the absence of any pattern of misconduct or significant harm. There were only a few files where the lack of a direct complaint was the primary factor in the file being closed. However, it is worth noting that these files pre-dated our current case selection process.*

*With respect to supervision, it has been our long-standing practice that all investigations include a review of supervision. Recognizing the importance of ensuring a consistent and effective approach in undertaking supervision reviews, a working group was developed consisting of investigators, counsel and management.*

*In January 2014, a detailed and comprehensive supervision policy was implemented along with a working guidance document for staff. The purpose of the policy is to clarify the process, highlight the key issues to be addressed, and ensure consistency in application across all supervision cases.*

*In the context of suitability cases, our review focuses on whether the firm took reasonable steps to oversee the advisor and, where warranted, questioned any unsuitable trades made on behalf of clients. Our review will also include an assessment of whether*

	<i>there were any systemic issues or patterns indicating a breakdown in a firm's procedures or internal controls which may have contributed to the underlying misconduct. We believe that the new comprehensive policy sets out appropriate guidance for staff to ensure all the necessary issues are identified and pursued in relation to supervision cases.</i>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC's response to address the matter. Going forward, Staff expect IIROC to monitor the effectiveness of (i) the new comprehensive policy designed to provide appropriate guidance for Enforcement staff to ensure all necessary issues are identified and pursued; and (ii) the updated risk-based approach to case selection to ensure that the lack of a direct complaint or advisor notes are not the primary factor in certain files being closed.

<b>(3) Finding – ECM Access</b>	
IIROC does not restrict access to the case management database to manage potential conflict issues involving the system users (e.g. allegations made against a relative).	
<b>Risk Implication</b>	Users with a perceived or actual conflict of interest have the opportunity to access information on ECM to their benefit.
<b>Priority</b>	<b>High</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC's Response</b>	<p><i>The ability to restrict staff access to ECM requires a material information technology systems change. Implementing restrictions manually is not feasible due to the integrated nature of our business application systems. IIROC Enforcement management and IIROC's IT unit have commenced the process of developing a business case for this change as part of the capital budgeting process for the 2016 fiscal year.</i></p> <p><i>In the interim, we note that there are other measures in place to identify and manage staff conflicts. Specifically, as per IIROC policy, a positive obligation is placed upon all employees to disclose all actual or potential conflicts to the organization on an ongoing basis. As such, Enforcement management are aware of any conflicts specific to ongoing Enforcement files and take the</i></p>

	<i>necessary steps to properly manage these conflicts.</i>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC’s response to address the matter. Staff expect IIROC to take the necessary steps to properly manage ECM user perceived or actual conflicts of interest until the changes to the system have been implemented.

<b>(4) Finding – Case File Standards</b>	
<p>Staff reviewed a sample of case files from each Enforcement group. In specific cases within the sampling, the following were noted, all relating to file organization and documentation:</p> <ul style="list-style-type: none"> <li>• insufficient documentation of why a file was categorized as discretionary or low impact and the criteria to determine if that file should be investigated</li> <li>• insufficient documentation of why a file was closed in the file closing memo</li> <li>• specific to Investigation and Litigation files – <ul style="list-style-type: none"> <li>○ the required level of management review and approval was not consistently documented</li> <li>○ lack of consistent file documentation standards for the retention of notes and supporting documents referenced within a file</li> </ul> </li> </ul>	
<b>Risk Implication</b>	The inconsistent application of file standards may not provide a proper level of assurance and may undermine the effectiveness of prosecutions.
<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC’s Response</b>	<i>The implementation of new case selection criteria in 2011 provided very specific guidelines to staff relating to file categorization, with minimal discretion available to staff. These criteria are well known to all Enforcement staff and are documented within the written guidelines. We are therefore confident that the categorization of Enforcement files, which is also subject to management oversight, is accurate. Case Assessment in particular has rigorously applied the case selection criteria since its inception. Case Assessment staff applies the selection criteria to the specific facts of each case at both the opening and closing of a file. At the conclusion of the file review, a recommendation memo is prepared by staff which contains specific reference to the criteria and the qualitative</i>

	<p><i>review that must be undertaken by staff, all of which informs the decision as to whether to pursue a formal investigation.</i></p> <p><i>Notwithstanding this fact, Enforcement recognizes the need to continually improve documentation standards. We believe the documentation issues identified by the CSA will be addressed by Enforcement’s new ECM system, which became operational in August 2013. ECM resulted in significant upgrades to Enforcement’s electronic storage systems, including the purchase of new case management and document storage software. Among other things, ECM:</i></p> <ol style="list-style-type: none"> <li><i>1. permits staff to clearly identify the file categorization and consider the key considerations required under our qualitative review of cases in order to determine which cases to pursue;</i></li> <li><i>2. improves our electronic storage capacity, thereby ensuring case file information is now electronically stored, including all notes and management reviews; and</i></li> <li><i>3. ensures more consistent documentation and tracking of key information and reporting requirements.</i></li> </ol> <p><i>The ECM system was implemented shortly before the end of the review period. As a result, it was difficult to assess at the time the full impact that ECM will have on these issues going forward. However, it is anticipated that the benefits of the ECM system, coupled with ongoing staff training on the use of this system and related updates to the department’s policies and procedures, will result in measurable improvements in this area.</i></p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff acknowledge IIROC’s response to address the matter. Going forward, Staff expect IIROC to monitor the effectiveness of the new system and processes and to make other continuous improvements as required.</p>

## **E. Financial & Operations Compliance**

Under Term & Condition 8(b) of the Recognition Order, IIROC must monitor compliance with its Rules and securities laws by Members and others subject to its jurisdiction, including ATSS.

In order to ensure Member compliance with prudential requirements, IIROC's Financial & Operations Compliance (FinOps) staff are responsible for:

- reviewing and analyzing Members' financial filings to ensure each member maintains and accurately reports adequate capital in accordance with IIROC Rules
- conducting on-site financial examinations of Members
- reviewing working paper files of the Members' auditors

Given volatile economic conditions which intensified the loss of two key interconnected dealers and the data loss incident that occurred during the review period, Staff focused their review on:

- assessing the implementation of changes to the examination cycle, which included reviewing a sample of Member examination files
- assessing amended and new examination modules and FinOps processes developed and implemented to address issues arising from MF Global and Penson
- evaluating the processes and controls for the gathering and retention of personal data, and the use of portable electronic devices

As well, Staff performed other limited procedures, including:

- following up on all findings in the 2009 Oversight Report, which included assessing program changes made to the electronic Securities Industry Regulatory Financial Filing (SIRFF) system
- reviewing the adequacy of benchmarks
- staff turnover rate

Staff reviewed the following documents:

- monthly financial report (MFR) and Form 1 filings
- field examination module changes
- field examination files
- organizational charts
- policies and procedures manual
- quarterly and annual reports

Staff noted that FinOps implemented changes to its regulatory processes to address issues arising from significant events (e.g. MF Global); and Staff noted no issues with changes made to the examination cycle. Nevertheless, Staff identified the following medium

priority findings.	
<b>(1) Finding - Materiality</b>	
There was no formalized process in place to review the materiality threshold calculation and to make subsequent adjustment of sample sizes if the residual risk assessment changed during a field examination.	
<b>Risk Implication</b>	Without a process to assess if sample sizes continue to be adequate after field work commences, relevant issues and/or deficiencies may not be properly identified.
<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC's Response</b>	<i>We have formalized our examination practices to review and ensure that the materiality threshold calculation reflects any changes in the residual risk score of the firm throughout the period of examination and, if appropriate, adjust sample sizes accordingly.</i>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC's response and have no further comment.

<b>(2) Finding - Report Standards</b>	
Staff found multiple instances within reports whereby no rule or securities legislation was cited to substantiate a finding. Staff acknowledge that subsequent to the review period, IIROC staff have taken actions to address the issue. The departmental head has communicated in writing to FinOps managers to remind them to reference each deficiency to a rule, by-law or applicable securities legislation. As well, the policies and procedures manual was updated accordingly.	
<b>Risk Implication</b>	Without a reference to IIROC rules, by-laws or securities legislation, Members have no regulatory standard to use as a reference in determining how best to resolve the issue.
<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe any further actions IIROC may take to resolve the

	issue.
<b>IIROC's Response</b>	<i>We have updated our examination practices to ensure that all examination deficiencies cited include a reference to a rule, by-law or applicable securities legislation. The quality control process includes a Director level review and sign off of the final examination report issued.</i>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC's response and have no further comment.

## **F. Business Conduct Compliance**

Under Term & Condition 8(b) of the Recognition Order, IIROC must monitor compliance with its Rules and securities laws by Members and others subject to its jurisdiction, including ATSS.

In order to monitor Member compliance with IIROC requirements, Business Conduct Compliance (BCC) staff are responsible for conducting on-site examinations of Member firms, focusing on issues of:

- suitability
- supervision
- anti-money laundering
- due diligence
- activities of corporate finance and research employees
- Member internal controls

Dealer and advisor business models continue to be challenged in the current economic conditions. This has led some dealers to venture into new areas of business, outsource their back-office functions, increase the size and complexity of their product shelf or adopt more lucrative trading and investment strategies. As well, the expansion of social media has resulted in investors expecting more timely communication from dealers and advisors through various outlets, which has added to the compliance burden on dealers, and in turn the regulatory burden on IIROC. Lastly, the loss of the portable electronic device raised concerns over data security. Staff, therefore, focused their review on:

- evaluating changes to the examination cycle, which included reviewing a sample of Member and business location examination files and related statistics
- assessing amended and new examination modules and specific procedures developed and implemented to address potential issues arising from increased leveraging, order-execution only business models, the distribution of non-arm's length investment products, the breadth of higher risk investment products in client accounts, social media and outsourcing
- evaluating the processes and controls for the gathering and retention of personal data, and the use of portable electronic devices

Staff also focused on specific aspects of BCC staff's review of IIROC Members' compliance with securities legislation in addition to IIROC Member rules. Staff determined that as part of its ongoing oversight, Staff will coordinate with IIROC staff to agree upon the allocation of responsibility to assess Members' compliance with specific aspects of securities legislation not fully contemplated by current IIROC rules or regulations.

Staff performed other limited procedures, including:



- following up on all findings in the 2009 Oversight Report
- documenting controls
- reviewing the adequacy of benchmarks
- staff turnover rate

Staff reviewed the following documents:

- program module changes
- examination files and related statistics
- organizational charts
- policies and procedures manual
- quarterly and annual reports

During the course of the review Staff identified multiple areas of concern within the department. They are detailed in the high and medium priority findings below.

**(1) Finding – Report Resolution**

Staff found multiple instances where the follow up of findings in reports was inadequate (e.g. accepting a response that was unclear or had little detail) and /or not timely.

<b>Risk Implication</b>	Without a consistent process to ensure that all findings are resolved in a timely manner, issues of non-compliance may continue which may be detrimental to the investing public.
<b>Priority</b>	<b>High</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC’s Response</b>	<p><i>BCC has a written process to ensure timely resolution of findings. This process is documented in BCC Policies and Procedures under the headings “BCC Examination Process – Response Management” and “BCC Examination Process – Monitoring”. These Policies and Procedures clearly document the methodology for achieving the substantive resolution of compliance deficiencies and closing of examinations.</i></p> <p><i>Since the CSA Review, BCC’s Policies and Procedures have been amended to include departmental benchmarks (which require staff to make reasonable efforts to “close” examinations within eight weeks of a firm’s response to the BCC examination report). BCC will also ensure adequate documentation of the follow-up process.</i></p> <p><i>“Closed” examinations include matters agreed to by the</i></p>

	<p><i>respective parties requiring the fulfillment of an undertaking or the scheduling of a follow-up examination within a specified timeframe. A finding and/or an examination may also be “closed” following a referral to Enforcement.</i></p> <p><i>The UBSS system is also currently used to provide a consistent method for tracking timelines of examinations. In addition, there is a planned migration of the Compliance Case Management system off of UBSS to a new system called CRM, which will provide additional tools for the monitoring of the progress of examinations.</i></p>
<b>Staff Comments and Follow-up</b>	<p>Staff acknowledge IIROC’s response to address the matter. Going forward, Staff expect IIROC to monitor and assess the effectiveness of the departmental written policies and procedures and the migration to the new Compliance Case Management system.</p>

<b>(2) Finding – Business Location Review Policy</b>	
<p>There is no formal written policy for the selection process of Dealer Member business location reviews. As a result, no documented rationale has been adopted to guide and support the number, frequency, and locality of business location examinations performed by BCC staff. In particular, during the review period, Staff identified a lack in coverage of business location reviews in the province of Nova Scotia.</p>	
<b>Risk Implication</b>	<p>Without a stated policy in place, IIROC staff do not have sufficient guidance on when, how often or how to choose dealers for business location reviews. This may result in timing issues, an insufficient number of business location reviews being conducted, or inappropriate business locations being chosen for review. This may in turn also increase risk to investors in areas not subject to an adequate regulatory regime.</p>
<b>Priority</b>	<b>High</b>
<b>Requirement</b>	<p>Please describe the action IIROC will take to address this matter. As this is a repeat finding from the prior oversight report, please provide an action plan including a timeline for resolution.</p>
<b>IIROC’s Response</b>	<p><i>A written business location selection criteria process was implemented in March 2012, codifying a process in which BCC Managers, in conjunction with senior management, annually determine the business location examination schedule for the</i></p>

	<p><i>coming year. The written selection criteria are applied and the proposed schedule of selected business locations is reviewed on a quarterly basis to ensure the schedule is being adhered to or should be amended as a result of intervening events. IIROC provides CSA staff with this schedule (which includes both numbers and addresses of head offices and business locations) on an annual basis and provides quarterly updates.</i></p> <p><i>BCC has since updated its business location selection process and has incorporated it into its formal written Policies and Procedures.</i></p> <p><i>Following the previous CSA oversight review in 2009, BCC undertook to provide proportionate, geographical coverage in Nova Scotia, while still applying a risk-based examination approach. IIROC has met that undertaking.</i></p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff acknowledge IIROC’s response to address the matter. While IIROC has increased the number of business location reviews in total and has commenced more business location reviews in the province of Nova Scotia during fiscal 2012, Staff expect IIROC to continue to monitor the effectiveness of the review schedule and openly dialogue with Staff, as necessary to ensure ongoing appropriate oversight of IIROC Member business locations in all jurisdictions.</p>

<p><b>(3) Finding – Suitability Procedures</b></p> <p>Staff noted that there were insufficient procedures in the examination program to direct BCC examiners to:</p> <ul style="list-style-type: none"> <li>• select client accounts with a high concentration in particular issuers or industries to review for suitability</li> <li>• identify advisors recommending high risk products across clients</li> <li>• confirm the accredited investor status for distributions of exempt products outside the corporate finance module</li> </ul>	
<p><b>Risk Implication</b></p>	<p>Without clear and specific examination procedures BCC staff may not consistently test for emerging issues which are in the public interest.</p>

<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC's Response</b>	<p><i>BCC has now expanded its examination procedures in its retail modules to better direct examiners to:</i></p> <ul style="list-style-type: none"> <li>• <i>select client accounts with a high concentration in particular issuers or industries to review for suitability, including guidance on how to select highly concentrated accounts for testing;</i></li> <li>• <i>identify advisors recommending high risk products across clients, including guidance on how to identify advisors recommending high risk products; and</i></li> <li>• <i>confirm the accredited investor status for distributions of exempt products in both retail and product due diligence examination modules.</i></li> </ul>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC's response and have no further comment.

## G. Trading Conduct Compliance

Under Term & Condition 8(b) of the Recognition Order, IIROC will administer and monitor compliance with its rules and securities laws by Members and others subject to its jurisdiction, including ATSs. Subsection 6.1(b) of NI 21-101 requires all ATSs to be a member of a self-regulatory entity, and therefore each ATS operating in Canada has contracted with IIROC to act as its self-regulatory provider and has become a Member of IIROC.

IIROC's Trading Conduct Compliance (TCC) department is primarily responsible for:

- conducting field reviews of ATS and trade desk activities of participants as defined in the Uniform Market Integrity Rules to assess whether Members and participants' procedures comply with all regulatory requirements
- assisting in the development, introduction and education of users on new market rules and policies

Given the continued innovations in the speed and frequency of trading, the differences in ATS business models, and the data loss incident that occurred during the review period, Staff focused their review on:

- assessing the trade desk review modules and a sample of participant examination files
- evaluating the ATS review process
- evaluating the processes and controls for the gathering and retention of personal data, and the use of portable electronic devices

As well, Staff performed other limited procedures, including:

- following up on the findings in the 2009 Oversight Report
- reviewing the adequacy of benchmarks
- staff turnover rate

Staff reviewed the following documents:

- trade desk review files
- ATS review files
- review modules
- gatekeeper reports and surveys
- organizational charts
- quarterly and annual reports
- policies and procedures manual

Staff noted that TCC had adequate procedures for trade desk and ATS examination reviews. However, Staff identified the following medium priority finding.

### **(1) Finding - Staffing**

<p>Staff confirmed that IIROC did not conduct a TCC review for all participants within the last three year cycle due to staffing vacancies and insufficient resources. Staff acknowledge that all high risk rated reviews were completed.</p>	
<p><b>Risk Implication</b></p>	<p>Ongoing staffing issues may result in participant issues not being identified on a timely basis and missed benchmarks.</p>
<p><b>Priority</b></p>	<p><b>Medium</b></p>
<p><b>Requirement</b></p>	<p>Please describe the action IIROC will take to address this matter, including a timeline for resolution.</p>
<p><b>IIROC's Response</b></p>	<p><i>Recent challenges in completing TCC examinations were due to insufficient resources for the group's growing workload, coupled with some turnover and resulting vacancies. An incremental position has been added and all vacancies have now been filled.</i></p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>

## H. Market Surveillance

Under Terms & Conditions 8(b) and 11 of the Recognition Order, IIROC must monitor compliance with its Rules and securities laws by Members and others subject to its jurisdiction, including ATSS; and ensure that its critical systems contain appropriate controls to ensure capacity, security and integrity of information.

IIROC's Market Surveillance department (MS):

- conducts real-time monitoring of trading on all Canadian equity marketplaces
- may halt trading in particular securities or all securities, and may cancel or reprice unreasonable trades as part of its regulatory responsibilities
- uses the Surveillance Technology Enhancement Platform (STEP). STEP provides MS with a single portal through which to monitor trading activity. STEP includes SMARTS, which is the system that generates trading alerts and has features allowing customized views of market activity
- provides significant news items to other departments so that IIROC will be promptly aware of information to better respond to a failure such as MF Global
- collects information from Dealer Members on over-the-counter debt trading and is building a surveillance database for reported debt transactions

Given the increasing reliance on and changes in technology to facilitate order flow, the growing complexity of trading patterns, and the need to collect and disseminate important public information (e.g. news on affiliated reporting issuers) within IIROC on a timely basis, Staff focused their review on:

- assessing the adequacy of regulatory intervention on markets
- evaluating the alert monitoring process, including the process to maintain or change the parameters used in generating alerts
- assessing the new process of disseminating significant news items within IIROC

As well, Staff performed other limited procedures, including:

- following up on all findings in the 2009 Oversight Report
- reviewing the adequacy of benchmarks
- staff turnover rate

Staff reviewed the following documents:

- a listing of alert types
- a listing of IIROC alert parameters
- supporting documentation for a sample of generated alerts
- listing of affiliated reporting issuers tracked for news
- organizational charts
- quarterly and annual reports

- policies and procedures manual

Staff noted that MS had adequate alert monitoring and regulatory intervention processes; and that MS was timely in disseminating relevant news to other departments.

**Finding**

There were no high or medium priority findings noted for the area.



## I. Trade Review & Analysis

Under Term & Condition 8(b) and (c) of the Recognition Order, IIROC must monitor compliance with its Rules and securities laws by Members and others subject to its jurisdiction, including ATSS; and if retained by an exchange or quotation and trade reporting system, IIROC must administer, monitor and/or enforce rules pursuant to a regulation services agreement.

IIROC's Trade Review & Analysis (TR&A) department is primarily responsible for conducting:

- preliminary investigations when there are reasons to believe that improper trading activity on marketplaces may have occurred
- post-trade analysis of trading data
- studies on emerging issues in conjunction with the market policy group

With the growing size and technological complexity of trading data, the impact of the new (i) Analytics group, (ii) Equity Data Warehouse (EDW) and (iii) High Frequency Trading studies on resources, Staff focused their review on:

- assessing the group's new risk-based approach to case procedures by reviewing the adequacy of a sample of case files.
- evaluating TR&A's ability to facilitate potential policy developments through trend analysis of post-trade data
- assessing actions taken by IIROC to address cyber-attacks
- evaluating applicable processes and controls for the gathering and retention of personal data

As well, Staff performed other limited procedures, including:

- following up on all findings in the 2009 Oversight Report
- reviewing the adequacy of benchmarks
- staff turnover rate

Staff reviewed the following documents:

- TR&A risk based assessment companion guide
- EDW queries and reports
- TR&A case files
- organizational charts
- quarterly and annual reports
- policies and procedures manual

Staff noted that TR&A had adequate risk-based procedures to analyze post trade data; and the design and roll out of the analytics factory and EDW were progressing. As well, IIROC has commenced raising awareness regarding cyber-risks.

### **Finding**

There were no high or medium priority findings noted for the area.

## J. Corporate Governance

Term & Condition 3 and Criterion 1 of the Recognition Order set out the specific requirements pertaining to the composition of the Board. The composition of the Board, as well as the Board's powers, and the powers and duties of directors and officers, is defined more specifically in IIROC's By-law No. 1.

As the area was considered lower risk, Staff's focus of review was limited to:

- findings in the CSA 2009 Oversight Report and the IIROC 2010 Corporate Governance Review Report
- the composition and mandates of the Board and its Committees, to assess the impact of any changes to the governance structure during the period under review
- the management of potential conflicts of interest in the director nomination and approval process, as changes in directors and their status occurred during the review period

Staff reviewed the following documents for the Board, its Committees and IIROC senior management, as applicable:

- organizational charts
- codes of conduct
- charters
- terms of reference
- meeting minutes

Staff had no concerns with IIROC's governance structure and mandates of the Board and its Committees. Nevertheless, during the review period, the Board Chair ended her industry affiliation. With the full support of the Board, she stepped down as an industry director and immediately became an independent director without an interim period being observed. As a result of Staff's review, the following medium priority finding was identified.

### **(1) Finding - Cooling Off Period**

Staff confirmed that there were no written criteria in place as to when a prospective independent candidate for Board membership was sufficiently removed from the industry to ensure objective and unbiased participation on the Board ("cooling off" period). There were also no written guidelines to consider for waiving the cooling off period and managing perceived conflicts if waived.

<b>Risk Implication</b>	Without the written criteria and guidelines, IIROC or its Board may not be able to effectively demonstrate why a decision regarding a cooling off period was made.
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<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC's Response</b>	<p><i>Following the 2010 Corporate Governance Review, the Corporate Governance Committee adopted a one-year cooling-off period in practice. The Committee has recently amended its Charter to document this cooling-off period as one of the matters that the Committee will consider in recommending candidates for Independent Director to the Board.</i></p> <p><i>The Committee does not believe that it would be feasible to establish written criteria or guidelines for waiving the cooling-off period and managing perceived conflicts that might arise following a waiver. The need to consider a waiver has arisen only once since IIROC was created (in connection with the Board Chair, as noted), and we expect that the considerations relating to any future proposed waiver will be highly fact-specific. Instead, the Committee believes that any future waivers can, like the waiver provided in relation to the Board Chair, be reviewed, and perceived conflicts of interest managed, by the Committee through a robust and comprehensive process that is tailored to the particular circumstances.</i></p>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC's response to address the matter. Going forward, in similar circumstances, Staff expect IIROC or its Board to document the reasons to effectively demonstrate why a decision regarding a cooling off period was made.

## K. Policy

Under Terms and Conditions 7 & 8(a) and Criteria 7 & 9 of the Recognition Order, IIROC is required to set rules governing its Members and others subject to its jurisdiction.

As the area was considered lower risk, Staff's focus of review was limited to:

- following up on all findings in the 2009 Oversight Report
- assessing and evaluating the effectiveness of Member and Market Regulation Policy staff interactions and information sharing (including the use of a central database)

Staff reviewed the following:

- policy development processes
- the functionality of the central database - Sharepoint
- organization chart
- departmental manuals

Staff noted that there were adequate processes and controls to ensure information was shared by Market and Member Regulation Policy staff. To resolve a finding from the prior oversight review, the Policy Department implemented a 'checklist' to ensure that files were properly documented. Although Staff found that the checklist was not in all files, Staff were generally satisfied that files were properly documented. And overall, Staff did not have concerns with the rule amendment process; however the following medium priority finding was identified.

### **(1) Finding - Rule Amendment Process**

In one instance, IIROC was not timely in developing and issuing a proposed rule amendment for review and public comment. IIROC had previously communicated that a proposed rule amendment changing the free credit usage limit requirements would be published for public comment in June 2014. The publication has been deferred for six months.

#### **Risk Implication**

The expected rule amendment was a direct result of IIROC's assessment of the failure of MF Global, which in part focused on the current segregation requirements given their importance to investor protection. As an interim measure, IIROC communicated with its Dealer Members by broadcast e-mail and obtained voluntary compliance from Dealer Members with the proposed changes to the free credit limit requirements. However, rule amendments that are not proposed on a timely basis may not be in the best interest of investors and other stakeholders as they do not all have access to the information from the interim

	measure, as a result of the public comment period process being delayed. Furthermore, there may be concerns about the enforceability of voluntary compliance.
<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe the action IIROC will take to address this matter, including a timeline for resolution.
<b>IIROC's Response</b>	<i>The interim measure that IIROC took to obtain voluntary Dealer Member compliance with a stricter client free credit cash usage limit was done for investor protection reasons - to quickly address and more appropriately constrain the use of client free credit cash balances in the Dealer Member's operations. It is IIROC's intention to propose the codification of this stricter limit as part of a set of proposed rule amendments that will be considered by the IIROC Board of Directors in November 2014.</i>
<b>Staff Comments and Follow-up</b>	Staff acknowledge IIROC's response to address the matter. Staff expect IIROC to file the proposed rule amendments with the RRs by the end of December 2014.

## L. Membership & Registration

Under Term & Condition 8(b) and (c) and Criterion 5 of the Recognition Order, IIROC must monitor compliance with its Rules and securities laws by Members and others subject to its jurisdiction, and must have reasonable written criteria that permits all persons or companies that satisfy the criteria to access IIROC's regulatory services, which should be fair and transparent.

As the area was considered lower risk, Staff's focus of review was limited to:

- following up on all findings in the 2009 Oversight Report for Membership, and the 2010 Oversight Report for the Membership and Registration functions
- assessing whether T&Cs of strict supervision on registration were complied with and if disciplinary information in the National Registration Database (NRD) was properly recorded, as these are critical processes to ensure higher risk Approved Persons are properly identified for supervisory purposes
- evaluating the processes and controls for the gathering and retention of personal data

Staff reviewed the following:

- systems used by IIROC (e.g. NRD, InfoCentre, ComSet)
- complaints and inquiries logs
- exception reports
- policies and procedures manual

### **Finding**

There were no high or medium priority findings noted for the area.

### III. Appendix A – Low-Priority Findings

The following are low priority findings. If findings were noted within multiple areas they are categorized as Cross-Departmental findings. If they are specific to a functional area, they are categorized within that area.

Functional Area	Staff Findings	IIROC's Response	Staff Comments
<b>Cross-Departmental</b>	<p><b>Data Security Policies</b></p> <p>Soon after the data loss incident, various IIROC departments made effective data security policies tailored for their operations. Subsequently, IIROC implemented an overall data security policy. Staff have confirmed that the departmental data security policies have not been amended to be as comprehensive as IIROC's overall policy.</p>	<p><i>Individual departments adopted departmental information security policies as soon as possible after the data loss incident. At the same time, IIROC began developing corporate information security policies, which are being implemented. These corporate policies apply to all departments and supersede departmental policies to the extent that the corporate policies impose higher standards. Individual departments are updating their departmental information security policies to address department-specific risks where measures in addition to those set out in the corporate policies are desirable.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>
<b>Cross-Departmental</b>	<p><b>Member Information and Risk Assessment (MIRA) Database</b></p> <p>IIROC confirmed that they do not have a set or formalized schedule to review the various components of its MIRA risk model to assess ongoing relevance. However, groups using the database have performed some ad-hoc back-testing to assess specific processes based on known occurrences and have</p>	<p><i>We have developed formal policies and procedures that set out the frequency, method of back-testing validation and documentation of the FinOps and BCC Residual Risk Models. This includes annual review of the relevance of business risks, risk controls and weightings in the model.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>



Functional Area	Staff Findings	IIROC's Response	Staff Comments
	performed other testing.		
<b>Cross-Departmental</b>	<p><b>Benchmarks</b></p> <p>In a review of benchmarks Staff noted the following:</p> <ul style="list-style-type: none"> <li>• established benchmarks are mostly time-based, with no consideration given for other factors (complexity of dealer, usefulness on an operational level, etc.)</li> <li>• no defined mandatory process or timeline whereby changes or revisions are considered</li> </ul> <p>Staff understand that IIROC is currently developing for approval departmental and corporate wide key performance indicators (KPIs).</p>	<p><i>As noted, IIROC is presently developing corporate KPIs. The next phase after the development of corporate KPIs will be to develop departmental KPIs which will consider non-time based measures where appropriate, and will incorporate a timeline for periodic review.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>
<b>Cross-Departmental</b>	<p><b>Self-Assessment Reporting</b></p> <p>In a review of the self-assessment reports Staff noted the following:</p> <ul style="list-style-type: none"> <li>• the turnover rate calculation is based solely on budgeted staff. Subsequent to the review, Staff received confirmation that in future reports, IIROC plans to use rates based on actual staff.</li> <li>• the number of staff reported in</li> </ul>	<p><i>The turnover rate for future self-assessment reports will use actual headcount.</i></p>	<p>Staff acknowledge IIROC's response to address the matter. Going forward, Staff expect IIROC to provide relevant information regarding vacant positions for the self-assessment reports.</p>

Functional Area	Staff Findings	IIROC's Response	Staff Comments
	<p>various positions is also based solely on budgeted figures and not on actual working staff; and there is a lack of information for vacant positions.</p> <p>In the above contexts, the use of only budgeted figures may not afford full transparency.</p>		
<b>Enforcement</b>	<p><b>Publication of Decisions</b></p> <p>Staff did not find evidence in several cases to support the delay of up to six weeks between the time a decision was rendered and its publication.</p>	<p><i>The publication of decisions is a coordinated effort between Enforcement and Public Affairs. The delays noted by Staff are mainly the result of operational delays in the posting of the decisions. Enforcement and Public Affairs are currently considering new procedures which will reduce the operational delays in posting decisions. We anticipate those changes to take place in January 2015. In the interim, we will take the necessary steps to ensure timely postings within our current framework.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>
<b>Enforcement</b>	<p><b>Written Policies and Procedures</b></p> <p>Staff found that some information in the approved manual was out of date.</p>	<p><i>We are updating the Enforcement Manual. The dated information at issue relates to the manual's references to our previous case management system (CTS) which has since been replaced with ECM. Given that ECM was in its initial stages of operation during the last quarter of 2013, systems improvements were required, thus preventing us from updating the manual until very recently.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>

Functional Area	Staff Findings	IIROC's Response	Staff Comments
		<p><i>Notwithstanding that, clear instructions and training have been provided to Staff to ensure awareness and understanding of new procedures.</i></p> <p><i>We expect the updated manual to be completed by November 2014.</i></p>	
<b>Financial &amp; Operations Compliance</b>	<p><b>Written Policies and Procedures</b></p> <p>Written guidance requires enhancement for:</p> <ul style="list-style-type: none"> <li>• materiality calculations, to ensure that managers have the latitude to use the range between 5%-10% of the average RAC and EW levels in the past 6 months</li> <li>• non-trivial errors</li> <li>• the process surrounding actions to be taken once news articles are received from Market Surveillance; though Staff have confirmed that FinOps have subsequently updated their written policies and procedures.</li> <li>• when it is appropriate to fail a Form 1 / MFR, and to specify that a manager must document the reason</li> </ul>	<p><i>We have updated our policies and procedures manual and examination program with additional guidance on the latitude managers have to use the range from 5% to 10% of the average RAC and EW levels in the past 6 months in calculating materiality.</i></p> <p><i>Non-trivial errors identified in the course of an examination are summarized on a summary finding form and net RAC impact assessed on calculated materiality.</i></p> <p><i>We confirm that our policies and procedures manual has been updated to provide instructions on dealing with "News Alerts" and documenting the work-flow process of action taken and issue resolution in SharePoint.</i></p> <p><i>We have updated our policies and procedures manual to require managers to document the reasons for failing an MFR.</i></p>	Staff acknowledge IIROC's response and have no further comment.
<b>Financial &amp;</b>	<b>SIRFF - Filing System</b>	<i>We have updated our policies and procedures</i>	Staff acknowledge

Functional Area	Staff Findings	IIROC's Response	Staff Comments
<b>Operations Compliance</b>	Staff were informed that the original Form 1 / MFR filing is not maintained if it is failed on SIRFF and subsequently amended and refiled. Staff understand that there is an open text field within the manager filing review sign-off sheet to document the original information, though Staff found instances where the field was not completed.	<i>manual to require managers to save on SharePoint an electronic copy of any failed Form 1/MFR filing of a member.</i>	IIROC's response and have no further comment.
<b>Business Conduct Compliance</b>	<p><b>Examination File Standards</b></p> <p>Within the sample files, Staff did not find evidence that in all cases:</p> <ul style="list-style-type: none"> <li>• BCC staff performed the required exam procedures to support a Member's assertion that no client accounts were leveraged. Staff acknowledge that audit program procedures were amended in December 2013 to clarify to examiners that these steps are required, which may address Staff's concern going forward.</li> <li>• BCC staff performed required procedures to assess if the delivery of mutual fund prospectuses was adequate</li> <li>• adequate documentation was maintained to support the closing</li> </ul>	<p><i>Leveraged Accounts – In addition to amended examination procedures regarding leveraged accounts, staff were reminded to complete these steps. However, please note that in many instances, staff use professional judgement based on their knowledge of the firm to assess whether or not a Dealer Member's assertion is reasonable. As BCC uses a risk-based examination approach, additional testing will still be at staff's discretion based on risk levels.</i></p> <p><i>Mutual Fund Prospectuses – BCC has examination procedures to ensure that the Dealer Member has in place adequate policies and procedures with regard to the delivery of mutual fund prospectuses. Additional substantive tests would only be completed if warranted based on risk.</i></p> <p><i>In addition, with the introduction of Fund Facts, the delivery of mutual fund prospectuses is no longer mandatory. Mutual fund</i></p>	Staff acknowledge IIROC's response and have no further comment.

Functional Area	Staff Findings	IIROC's Response	Staff Comments
	<p>of a file</p> <ul style="list-style-type: none"> <li>the basis or methodology to determine the sample size selection was consistently documented as required by the procedures manual</li> </ul>	<p><i>prospectus will only be provided to a client if it is requested by the client. We have updated BCC's procedures to address the delivery of Fund Facts, including reviewing P&amp;P, ensuring the process is in place and substantive testing if required.</i></p> <p><i>Documentation of Closing of a File – BCC's policies and procedures manual requires staff to support all stages of the examination file with adequate documentation. This point has been reinforced with staff.</i></p> <p><i>Sample Size – BCC's policies and procedures manual require that the basis or methodology to determine the sample size selection be documented. This point has been reinforced with staff.</i></p>	
<b>Business Conduct Compliance</b>	<p><b>Examination Program Procedures</b></p> <p>The program should be amended to ensure that examiners assess a Member's due diligence procedures for related / connected issuers.</p>	<p><i>BCC has updated its examination procedures to ensure examiners assess a Dealer Member's due diligence procedures for related / connected issuers.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>
<b>Business Conduct Compliance</b>	<p><b>Written Policies and Procedures</b></p> <p>The written policies and procedures require updating regarding:</p> <ul style="list-style-type: none"> <li>risk rankings</li> </ul>	<p><i>BCC's written policies and procedures manual has been updated to include risk rankings and remove disabled URLs.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>

Functional Area	Staff Findings	IIROC's Response	Staff Comments
	<ul style="list-style-type: none"> <li>disabled URLs</li> </ul>		
<b>Membership &amp; Registration</b>	<p><b>Exception Report Approval Process</b></p> <p>Staff did not find evidence of management review and approval of the exception reports that track follow-up matters for registration officers, such as advisors under close or strict supervision. Staff acknowledge that IIROC subsequently revised its registration procedures to retain (i) all copies of Exception reports and (ii) evidence of management review and approval</p>	<p><i>Registration Staff has codified its practice in the manner described.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>
<b>Policy</b>	<p><b>Written Policies and Procedures</b></p> <p>The following issues were noted with the written policy and procedural manuals:</p> <ul style="list-style-type: none"> <li>two manuals are maintained, which in some instances were found to overlap or differ in the level of content detail from one another</li> <li>manuals were not reviewed and updated on a timely basis (e.g. last updated in January 2012, EMT process is out of date)</li> </ul>	<p><i>The market regulation policy team is reviewing the joint policy manual to ensure that all aspects covering the market regulation policy group's practices are addressed in the joint policy manual. This review is scheduled to be completed by the end of March 2015, after which time the market regulation policy team will use only the joint policy manual.</i></p> <p><i>The market and member regulation policy teams are currently reviewing the joint policy manual and will be updating the joint policy manual over the course of the next year. As part of this review, the teams intend to create and implement a mechanism for regular review of the joint policy manual's content.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>

Functional Area	Staff Findings	IIROC's Response	Staff Comments
<p><b>Québec Specific Requirements</b></p>	<p><b>Distinct Approval of Québec Section Budget</b></p> <p>Under T&amp;C 13(c) of the Québec recognition order, IIROC will develop a separate budget for Québec operations that must be approved by the Board.</p> <p>Staff did not receive evidence that IIROC's Board approved a separate budget for Québec operations during the review period.</p> <p>IIROC has since taken steps to resolve the issue.</p>	<p><i>A separate budget for the Montreal office was approved by the IIROC Board for FY15, and will be developed and presented to the Board annually for approval going forward.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>
<p><b>Québec Specific Requirements</b></p>	<p><b>Semi-annual Staffing Report</b></p> <p>Under T&amp;C 13(d) of the Québec recognition order, IIROC must provide a staffing report on a semi-annual basis to the AMF detailing staff by function, filled and vacant authorized positions and any reductions or material changes in staff by function.</p> <p>Staff did not receive evidence that the required reports were produced for the review period.</p> <p>IIROC has since taken steps to resolve the issue.</p>	<p><i>IIROC is now providing the required report.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>

Functional Area	Staff Findings	IIROC's Response	Staff Comments
<b>Québec Specific Requirements</b>	<p><b>Proficient TCC Staff</b></p> <p>Under T&amp;C 13(f) of the Québec recognition order, IIROC must ensure that it has an adequate complement of proficient TCC staff based in the province to perform examinations.</p> <p>Staff noted that the Québec regional office has taken steps to ensure the development of proficient TCC staff. However, IIROC and its Québec regional office should take the necessary steps to ensure that a succession plan is in place in the event that the current staff person is absent for an extended period of time or leaves the organization.</p>	<p><i>The Montreal office's staffing includes a knowledgeable examiner performing TCC examinations. To provide back-up and increased capacity, an existing vacant technician position will be turned into an examiner position that will also perform TCC examinations. Finally, the senior investigative trading analyst in the Montreal office will act as a back-up to these examiners.</i></p>	<p>Staff acknowledge IIROC's response and have no further comment.</p>