

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

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## **I. Executive Summary**

In accordance with their mandates under the securities legislation of their respective jurisdictions, the Recognizing Regulators<sup>1</sup> of the Investment Industry Regulatory Organization of Canada (IIROC) have jointly completed an annual risk-based oversight review (the Review) that targeted specific processes within IIROC's Equity Market Surveillance and Debt Market Surveillance functions (Equity and Debt Market Surveillance).<sup>2</sup>

Other than a finding noted below, staff of the Recognizing Regulators (Staff) did not identify concerns with IIROC meeting the relevant terms and conditions of the Recognizing Regulators' recognition orders (the Recognition Orders) in the functional areas reviewed. Staff make no other comments or conclusions on IIROC operations or activities that are outside the scope of the Review.

As a result of the Review, Staff have identified one low priority finding<sup>3</sup> regarding certain IIROC processes and procedures in place that were not integrated into its Equity and Debt Market Surveillance policies and procedures manuals.

Staff require IIROC to resolve the finding and will continue to monitor and follow up on IIROC's progress in taking specific and timely corrective action on the finding in accordance with the priority assigned to it. The finding is set out in the *Finding* section of the report.

Lastly, Staff acknowledge that IIROC made sufficient progress in resolving the findings which were cited in previous oversight reports and which were followed up by Staff prior to the Review.

## **II. Introduction**

### **A. Background**

IIROC is the national self-regulatory organization (SRO) that oversees all investment dealers and trading activity on equity and debt marketplaces in Canada.

IIROC is recognized as an SRO by the Alberta Securities Commission, the Autorité des marchés financiers, the British Columbia Securities Commission, the Financial and Consumer Affairs Authority of Saskatchewan, the Financial and Consumer Services Commission of New Brunswick, the Manitoba Securities Commission, the Nova Scotia Securities Commission, the Office of the Superintendent of Securities, Service Newfoundland and Labrador, the Ontario Securities Commission, the Prince Edward

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<sup>1</sup> See part II. Introduction, section A. Background for the regulators that recognize IIROC.

<sup>2</sup> See Appendix A, section 3 for a detailed description of the scope of the Review.

<sup>3</sup> See Appendix A, section 4 for the criteria used to prioritize findings.

Island Office of the Superintendent of Securities, the Northwest Territories Office of the Superintendent of Securities, the Nunavut Securities Office, and the Office of the Yukon Superintendent of Securities, collectively, the Recognizing Regulators.<sup>4</sup> IIROC's head office is in Toronto with regional offices in Montréal, Calgary and Vancouver.

This report details the Review's objectives and the key areas that formed the basis of the Review conducted by Staff. The Review covered the period from September 1, 2019 to August 31, 2020 (the Review Period). The methodology used, report format and scope are set out in Appendix A. A description of the applicable regulatory requirements and functional areas are set out in Appendix B.

## **B. Objectives**

The objectives of the Review were to evaluate whether selected regulatory processes were effective, efficient, and were applied consistently and fairly, and whether IIROC complied with the terms and conditions of the Recognition Orders.

## **III. Risk Assessment and Oversight Review**

### **A. Equity and Debt Market Surveillance**

As part of the annual risk assessment process, Equity and Debt Market Surveillance were determined to be areas with above average adjusted risk scores. In so determining, Staff identified the following processes within Equity and Debt Market Surveillance that became the focus of the Review:

#### *Equity Market Surveillance*

- Development and review of equity market surveillance alerts
- The Market Wide Circuit Breaker (MWCB) process

#### *Debt Market Surveillance*

- Development and review of debt market surveillance alerts
- IIROC's review of triggered debt market surveillance alerts
- Data integrity review of reported debt transaction data

To ensure that IIROC has the applicable controls in place, Staff:

#### *Equity Market Surveillance*

- Reviewed the processes to develop, regularly assess and update equity market surveillance alerts to ensure their alignment with prevailing market conditions,
- Assessed the adequacy of the MWCB process, and
- Reviewed the Equity Market Surveillance policies and procedures manual.

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<sup>4</sup> The three Canadian territorial authorities recognized IIROC on November 1, 2018.

### *Debt Market Surveillance*

- Reviewed the processes for developing, reviewing and updating debt market surveillance alerts,
- Reviewed, on a sample basis, triggered debt market surveillance alerts,
- Reviewed the data integrity assurance processes and procedures that ensure accuracy and consistency of the debt transaction data reported, and
- Reviewed the Debt Market Surveillance policies and procedures manual.

Based on the work performed, Staff are satisfied that IIROC has adequate processes and procedures in place in the identified areas, except for a low priority finding pertaining to certain processes and procedures not being integrated into the Equity and Debt Market Surveillance policies and procedures manuals. The finding is set out in the *Finding* section.

Also, Staff acknowledge that IIROC has made recent enhancements to the MWCB process and as part of IIROC's outreach to Canadian marketplaces, IIROC is currently assessing the need for any additional enhancements to the MWCB process (e.g. desirability to automate the MWCB process). Staff will continue to follow up with IIROC regarding any potential enhancement, if warranted, to the MWCB process.

## **IV. Finding**

### **A. Certain Processes and Procedures Not Integrated in the Policies and Procedures Manuals**

IIROC has processes and procedures in place to (i) review, test and update the equity and debt market surveillance alerts in its surveillance system, (ii) develop new equity and debt market alerts and (iii) review data integrity of reported debt transactions from its Dealers Members to ensure accuracy and consistency. However, given the importance and critical nature of the Equity and Debt Market Surveillance functions, Staff noted that those processes and procedures were not integrated into the Equity and Debt Market Surveillance policies and procedures manuals.

Furthermore, Staff were informed that IIROC Equity and Debt Market Surveillance management discuss and assess the effectiveness of alerts in production and trends of triggered alerts to determine if changes are necessary or if new alerts should be developed, amongst other processes, in their weekly, monthly and quarterly meetings. However, IIROC staff did not maintain applicable documentation of such meetings to evidence IIROC staff's discussions and assessment of the effectiveness of alerts, trends, and potential new alerts.

#### **Why this is Important**

Equity and Debt Market Surveillance are vital regulatory functions performed by IIROC and it is important that all key processes and procedures are properly documented to ensure the efficiency of the functions and to facilitate staff training, succession planning and business continuity. Equity and Debt

Market Surveillance staff's actions may become misaligned as a result of inadequate documentation.

**Priority**

**Low**

**Requirement**

Please describe how IIROC will resolve the finding.

**IIROC's Response**

We acknowledge the finding.

We have amended the Equity and Debt Surveillance policies and procedures manuals to reflect the points noted in the finding. The procedures have also been amended to include the requirement to hold regular Alert Review meetings to discuss trends and patterns in alerts seen by staff, to address possible changes to existing alerts and the development of new alerts, and the requirement to maintain minutes of these meetings.

**Staff Comments and Follow-up**

Staff acknowledge IIROC's response and note that the Equity and Debt Market Surveillance policies and procedures manuals have been adequately updated to address the finding. Staff have no further comments.

# APPENDIX A

## 1. Methodology

The Recognizing Regulators have adopted a risk-based methodology to determine the scope of the Review. On an annual basis, the Recognizing Regulators:

- Identify the key inherent risks<sup>5</sup> of each functional area or key process based on:
  - reviews of internal IIROC documentation (including management self-assessments and risk assessments);
  - information received from IIROC in the ordinary course of oversight activities (e.g. periodic filings, discussions with Staff);
  - the extent and prioritization of findings from the prior oversight review; and
  - the impact of significant events in or changes to markets and participants to a particular area
- Evaluate known controls for each functional area
- Consider relevant situational/external factors and the impact of enterprise-wide risks on IIROC as a whole or on multiple departments
- Assign an initial overall risk score for each functional area
- Collaborate with IIROC to identify and assess the effectiveness of other mitigating controls that may be in place in specific functional areas
- Assign an adjusted overall risk score for each area
- Use the adjusted risk scores to determine the scope of the Review

Once the scope of the Review was determined, Staff conducted a desk review which involved reviewing specific documents pertaining to the Review Period and interviewing appropriate IIROC staff in order to:

- Confirm that mitigating controls were in place for the key inherent risks identified, and
- Assess the adequacy and efficacy of those mitigating controls

## 2. Report Format

In keeping with a risk-based approach, this report focuses on two functional areas and key processes with higher risk that were deemed warranted to be part of the Review.

## 3. Scope

Considering the status of the resolution of findings from prior oversight reviews and the challenging issues that may impact IIROC, Staff utilized the risk assessment process to identify specific processes and activities within the above average risk areas as the focus for the Review. There were no functional areas identified as high risk.

### *Above Average*

- Equity Market Surveillance

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<sup>5</sup> Inherent risk is the assessed level of the unrealized potential risk, taking into account the likelihood of and impact if the risk was realized prior to the application of any mitigating controls.

- Debt Market Surveillance

The following above average risk area was not included within the scope of the Review as the area was subject to alternative oversight activities:<sup>6</sup>

*Above Average*

- Information Technology

Also, through the risk assessment process, Staff determined that the following moderate and low risk areas would not be examined during the Review:<sup>7</sup>

*Moderate*

- Business Conduct Compliance
- Data Analytics
- Enforcement
- Financial and Operations Compliance
- Financial Operations / Project Management
- Policy
- Risk Management
- Trading Conduct Compliance
- Trading Review & Analysis

*Low*

- Corporate Governance
- Membership and Registration

#### **4. Priority of Findings**

Staff prioritize findings into High, Medium and Low, based on the following criteria:

**High**      Staff identify an issue that, if unresolved, will result in IIROC not meeting its mandate, or one or more of the terms and conditions of the Recognition Orders, or other applicable regulatory requirements. IIROC must immediately put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to Staff. If necessary, compensating controls should be implemented before the finding is resolved. IIROC must report regularly to Staff on its progress.

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<sup>6</sup> In addition to ongoing oversight by the Recognizing Regulators through mandatory reporting by IIROC, as well as regularly scheduled and ad hoc meetings, Staff performed alternative oversight activities on this area to ensure adequate coverage (obtained additional information and followed up on selected IT processes, including but not limited to, information security operations and IT infrastructure, and reviewed the internal audit reports on IT vendor management, governance and access management).

<sup>7</sup> These areas continue to be subject to oversight by the Recognizing Regulators through ongoing mandatory reporting by IIROC as required by the Recognition Orders, as well as regularly scheduled and ad hoc meetings between the Recognizing Regulators and IIROC staff.



- Medium Staff identify an issue that, if unresolved, has the potential to result in an inconsistency with IIROC's mandate, or with one or more of the terms and conditions of the Recognition Orders, or with other applicable regulatory requirements. IIROC must put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to Staff. If necessary, compensating controls should be implemented before the finding is resolved. IIROC must report regularly to Staff on its progress.
- Low Staff identify an issue requiring improvement in IIROC's processes or controls and raise the issue for resolution by IIROC's management.
- Repeat Finding A finding that was previously identified by Staff and not resolved by IIROC will be categorized as a repeat finding in the report and may require that the level of priority be raised from the initial level noted in the previous report.

## **APPENDIX B**

### **Applicable Regulatory Requirements and Functions**

#### *Equity and Debt Market Surveillance*

Under Term & Condition 7(b) of the Recognition Orders, IIROC must monitor compliance with its Rules and provincial securities regulations by its Members and others subject to its jurisdiction, including ATs, and enforce compliance with its Rules.

Under Term & Condition 10 of its Recognition Orders, IIROC must ensure that its critical systems have appropriate internal controls to ensure integrity and security of information, and sufficient capacity to enable IIROC to properly carry on its business.

IIROC's Equity and Debt Market Surveillance staff, amongst other duties, conduct real-time monitoring of trading on all Canadian equity marketplaces; conduct post-trade monitoring of trading on eligible debt marketplaces; collect reported debt transactions information from Dealer Members on over-the-counter debt trading; may halt trading in particular securities or all securities, and may cancel or reprice unreasonable trades as part of its regulatory responsibilities; and currently use SMARTS, which is the system that generates equity and debt trading alerts and has features allowing customized views of market activity. In addition, Debt Market Surveillance staff conduct preliminary post-trade monitoring of debt trading activity that may potentially be in violation of applicable IIROC Rules or securities legislation, which is similar to the function that the Trade Review & Analysis department conducts for equity trading activity.