



British Columbia Securities Commission

## **BCSC Adviser Forum - 9<sup>th</sup> Session**

**June 20, 2007 (1:00 pm to 4:00 pm)**

**Suite 950, Canaccord Tower, 609 Granville Street, Pacific Centre  
Vancouver**

### **About the forum:**

The forum is an informal session hosted by the Capital Markets Regulation (CMR) division of the BCSC. The forum is open to all advisers and investment counsel in British Columbia. Attendance at this forum is kept to an optimal number to maximize discussion among the attendees.

### **Introduction**

Janice Leung welcomed participants and each participant gave a self-introduction. Sandy Jakab also welcomed participants on behalf of CMR. Janice clarified that this forum is meant to facilitate discussion, and not to provide specific guidance tailored to any individual firm. She encouraged the participants to contact the BCSC staff for specific questions.

### **Insider trading and front running provisions – Bill 20 CSA passport system update – National Instruments 11-102**

Brenda Benham, Special Counsel, Markets Relations, BCSC

Brenda provided an update on the new insider trading and front running violations set out in Bill 20 *Securities Amendment Act 2006*. She also discussed Phase 2 of the passport system (Passport), and commented on how the passport system will generally affect advisers.

- [Link to Brenda's presentation](#)
- [Link to Bill 20](#)
- [Link to the CSA passport system](#)

### **Questions from participants on insider trading:**

**Q:** Who can be sued under new insider trading rules? Advisers advise and trade on securities every day.

**A:** Insiders to the trade, meaning persons who have material, non-public information, are subject to the new insider trading rules.

**Q:** Can you clarify what insider trading and insider information are? As advisers can be in contact with invested companies, and in turn advise and recommend clients to invest in these companies.

*Comment by another participant:* Insider information is defined as non-disclosed, material information of an issuer.

**Q:** Adviser knows a director of a non-public issuer and receives information; is this a violation?

**A:** No, insider trading violations applies to reporting issuers only.

**Q:** What is the progress for regulators clamping down on insider trading? For example, before the Alcan news broke out, Alcan options increased dramatically in price and provided those investors with high returns. It seems obvious that people with insider information had traded before the news became public.

**A:** Prosecuting insider trading violations is very difficult. The Ontario Securities Commission (OSC) is attempting to take a more aggressive stance, but the results have been mixed. Insiders are using more complex securities and strategies (such as options and speciality derivatives) to hide the insider trades. This makes it very hard for regulators to trace these insider activities.

### **Questions from participants on Passport**

**Q:** Can you clarify Ontario's participation in Passport?

**A:** Initially, Ontario market participants did not even know about Passport and that a notice had been sent out for comment. On May 28, 2007, Doug Hyndman (Chair of the BCSC), together with the Chairs of the Autorité des Marchés Financiers, Manitoba Securities Commission, and the Alberta Securities Commission, held an information session about the passport system for Ontario market participants in Toronto. OSC has been invited to join in Passport. [See the press release about this event.](#)

**Q:** Under the passport system, if a BC-based firm wants to get registered in other provinces, will the firm or the individuals require registration? Or both?

**A:** Yes, both the firm and the individuals must be registered and fees must still be paid to each jurisdiction that a firm wants to become registered in.

**Q:** If National Instrument 31-103 *Registration Requirements* is delayed, will the adoption of Phase 2 of Passport also be delayed?

**A:** Yes, passport and NI 31-103 are linked and a delay in the NI 31-103 will possibly postpone the implementation of Passport.

### **Trade matching: National Instruments 24-101**

Meg Tassie, Senior Advisor, CMR Policy, BCSC

Janice Leung, Senior Securities Examiner, CMR Examinations, BCSC

Meg and Janice provided a high-level overview of National Instruments 24-101 *Institutional Trade Matching*. This instrument has been in effect since April 1, 2007. The trade matching requirements, transition details, and reporting requirements are set out in the rules and companion policy.

- [Link to the instrument](#)
- [Link to the companion policy](#)

### **Questions from participants on NI 24-101**

**Q:** 95% of mistakes made in trading are by brokers and custodians. What will the brokers need to do to be ready for NI 24-101?

*Comment from participant:* ISM will need to rewrite their software programs to be ready to match trades on T. Current programs are unable to fix trades, so a whole new system must be developed so that brokers can handle the new requirements. CDS will also be affected and needs to upgrade its systems for similar reasons. Custodians may not be able to handle the volume to match on T. By comparison, the US allows more time for trade matching than Canada.

**Q:** What percentage of firms is currently complying with NI 24-101?

**A:** Unknown at this time.

**Q:** Why are the regulators interested in trade matching?

*Comment from participant:* Pressure from the US was the primary reason for moving to T trade matching. If the US moved to T, then Canada would be at a disadvantage. 9-11 attack was the catalyst that caused the US to look into moving to T or T+1, but the US has been unable to do so at this time.

There is less trade risk with moving to T. Historical perspective of why regulators became involved: the IDA was the first to look into T trade matching, but the IDA does not regulate the buy-side or the custodians. The IDA realized that it cannot make industry match at T by doing it alone. Other regulators were needed to bring T to the entire securities industry. Before the current Canadian Capital Markets Association (CCMA) team started looking into matching at T, previous projects were created to bring the industry's matching standard from T+5 to T+3.

**Q:** Are the custodians causing any problems?

*Comment from participant:* Different custodians are using different systems and those systems are not able to "talk" to each other, and therefore causing delays. If you think about it, a broker only has to look at one block trade, but a custodian has to look at allocating the block trade to all the individual accounts. The custodian has a lot more transactions to handle.

**Q:** How do firms usually receive trade matching information from brokers?

**A:** Some brokers send confirmations very quickly by email. Some send verbal phone confirmations at T and follow-up with written details the next day.

**Q:** Would matching at T+1 be a more practical solution for trade matching instead of T?

**A:** NI 24-101 is already in effect and the securities market is international with 24/7 access.

**Q** Does NI 24-101 apply to fixed income and equity trades?

**A:** Applies to equity trades.

**Q:** What is the difference between trade matching and trade settlement?

*Comment from participant:* Trade matching is equivalent to saying that: “I agree with the order”. Trade settlement is the actual exchange of cash and securities. While trades have to be matched at T, advisers still have three days to come up with the cash to settle the order.

**Q:** Is there a difference in brokerage commissions from good and bad firms?

*Comment from participant:* Some brokers have bad back office administration, but you live with it because they can offer you better execution on the trade.

**Q:** Does NI 24-101 cover allocation of trades into client accounts?

**A:** Please refer to the companion policy for additional information.

**General comment from participants:**

- Brokers are at fault for not telling the advisers of problematic trades as soon as possible.
- Problems are usually with buy-side brokers as they fail to provide the information. We need to get the IDA involved. Potential problems could be coming from custodians and buy-side brokers that are not regulated by BCSC/IDA.
- Custodians in Ontario are closed for operation when BC advisers are trying to reconcile the trades at the end of the day, due to the time zone discrepancy.
- Brokers also rush out at the end of the trading day as the TSX closes. Will brokers and custodians hire more staff (e.g. a night crew) in order to meet T requirements?
- NI 24-101 will result in more work for the advisers in administrative duties, which will cut into the time available for trading. This will place the small advisers at a disadvantage.
- Brokers are responsible for getting the details of the trade to the advisers and let advisers know if there are any problems. As long as the advisers have the trade details, there should not be extra work on the buy-side. The extra work is on the brokers and custodians.
- T-Bills currently have same-day settlement. Some advisers only trade T-Bills prior to 10 am, in order to make sure that there is sufficient time to communicate and settle with the brokers that day.
- There is the concern that the timing for trading will be shortened as a result of the need to match by T. Are firms going to place orders only in the morning in order to have sufficient time for same-day communication with brokers and custodians?
- Most advisers match on T+1.
- Different brokers offer different services and timing. Maybe advisers need to shop around for better brokerage service.

## **How to survive your BCSC compliance examination**

Edwin Leong, Securities Examiner, CMR Examinations, BCSC

Edwin gave an overview and some useful tips of what firms can expect from a BCSC compliance examination.

[Link to Edwin's presentation](#)

### **Questions from participants on the BCSC exam process**

**Q:** How long are the BCSC compliance exams?

**A:** Exam time varies depending on the size of the firm. Normally, on-site time for an examination can range from 1.5 weeks for smaller firms, to 3-4 weeks for larger firms.

**Q:** What is the regulator looking for when looking at firm's research material? Are you judging the accuracy of our research?

**A:** We do not make a judgement call on the research. We discuss with the adviser to understand the research and analysis process. We want to know if the adviser has a process in place to ensure investment decisions are made with reasonable grounds and that, the adviser has evidences to support these grounds.

We look at how closely the investment choices ties into the client's KYC information (e.g. objectives and risk tolerance).

*Comment from participants:* We keep all our notes and backup for client investment choices because we know the regulators will want to see those documents to understand our process.

## **Designing your compliance program**

Nirwair Sanghera, Securities Examiner, CMR Examinations, BCSC

Nirwair talked about the components of a good compliance program, and gave tips on how to test the program. Many participants indicated that their firms do not formally test the compliance systems to ensure that the internal controls are working properly.

[Link to Nirwair's presentation](#)

### **Comments from participants on designing a compliance program**

- Asking external auditors to test our compliance programs cost too much money for small firms. Accounting firms that use to cater to small and mid-sized audits are disappearing and the big firms cost too much money.
- Our firm has an internal audit group that tests systems. We cannot test everything every year, but we can test a section at a time, such as account opening process and documentation.

- Some firms use the complaints log as a way to test their compliance. If complaints come in about something, maybe there is a weakness in that area.
- We create error reports, which the Compliance Committee reviews.
- Processes take time to develop and implement, but it is better for the firm and its staff over the long run to have proper processes in place.
- Our firm goes through a major audit to satisfy institutional clients. A firm from the US conducts this audit. This is standard amongst the institutional investment community.
- Principles-based regulation is great, but effective enforcement must be behind the principles. Serious abusers should be pursued aggressively.
- (*Response from BCSC*) BCSC is only at the beginning of adopting an outcomes-based approach to regulation, so it will take time to develop. Enforcement is an important initiative at the BCSC, as discussed in our annual reports and service plans.

## **2007 Adviser Report Card**

Michael Sorbo, Manager, CMR Examinations, BCSC

Michael talked about the [2007 Adviser Report Card](#).

### **Questions from participants on the report card**

**Q:** What makes up the compliance officers deficiencies in the Adviser Report Card?

**A:** It varies but normally, if the compliance officer is not carrying out the proper day-to-day compliance duties, we will note this as a deficiency.

Compliance officers may not need to conduct direct supervision if they have delegated some duties to other staff. Overall, the compliance officer must ensure that they know what the delegated staff are doing, and that the ultimate responsibility still resides with the compliance officer.

**Q:** How many firms were examined in 2006?

**A:** We examined about 15 firms in 2006.

## **ICPM Risk Matrix**

Michael Sorbo, Manager, CMR Examinations, BCSC

The examination team prepared a risk matrix to analyze and record potential ICPM risks. Participants are encouraged to send questions and issues to the examination team for discussion at future adviser forums. You can find [a copy of the risk matrix here](#).

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