



2011 Examination Report Card

Examination findings and top deficiencies in the 2010-2011 fiscal year

We expect firms to take compliance seriously

We are still finding that some registrants are too casual with setting up an effective, top-down compliance culture and do not take seriously the role of the Chief Compliance Officer (CCO). A good compliance program not only protects the firm's reputation, but is also a good front-line defense against problems that range from poor advice given to clients, to vague investment strategies, through to conflicts-of-interest, and all the way to fraudulent activity that can victimize an unsuspecting public.

The Examination team

The Examination team directly monitors registered advisers (portfolio managers), investment fund managers, and dealers that are not self-regulatory organization members by carrying out compliance reviews. In addition, we monitor each firm's solvency through regular financial reviews. Our objective is for every registered firm to develop a well-designed compliance program that prevents security violations from occurring and is effective relative to your organization and operations.

Our findings

Examinations completed in 2010-2011

We targeted our examinations to higher risk areas of firm operations. We intend to continue this approach and increase our examination coverage, reaching more registrants over time. In 2011, we completed 34 reviews. We used to conduct mainly full compliance reviews. Using our new risk-based approach, we may perform a variety of reviews such as: limited scope reviews (exams), desk reviews, full investment fund manager reviews, exempt market dealer reviews, restricted dealer reviews, sweeps, and for-cause exams.

Deficiencies per examination

Fiscal year ending March 31 of	Registrants examined	Total deficiencies	Average deficiencies
2011	32 ¹	124	3.9
2010	16	120	7.5
2009	20	138	6.9
2008	19	127	6.7

The chart above shows an average deficiency of 3.9 per examination, which is a large decrease compared to 2010. We think the decrease is mainly due to staff conducting more limited scope examinations; spending less time reviewing a firm results in a fewer number of deficiencies.

¹ While we had a total of 34 exams, we used only 32 for stats purposes - we exclude for-cause exams for the calculation of average deficiencies.

We also think the decrease may reflect the mix of firms examined in previous years. We hope, as well, that our CCO Outreach programs are helping firms improve their compliance cultures.

The average number of deficiencies is only one of many measurements we look at when determining the compliance culture of a registrant. Examples of other measurements and indicators include:

- the quality of a registrant’s response to deficiencies or issues
- the regulatory history of the firm
- the registrant’s response to our risk questionnaire
- changes in officers, audit firms, or firm expansion into new products
- prior sanctions and warning letters
- the number and the nature of client complaints
- misleading marketing
- other leads we receive

Significant and repeat deficiencies

In 2011, approximately 21% of the firms we reviewed (7 of 34) had some significant deficiencies while 17% (6 of 34) of firms had repeat deficiencies. We are concerned about repeat and significant deficiencies because they indicate that a registrant’s compliance culture is weak and that the registrant has not learned from past mistakes.

Summary of significant deficiencies

2010-2011	Exams	Total deficiencies reported	Significant deficiencies (# of firms)	Total significant deficiencies identified	Repeat deficiencies
Q1	13	44	4	7	3
Q2	6	33	3	11	3
Q3	9	22	0	0	0
Q4	6	32	0	0	0
Total	34	131	7	18	6

You can reduce repeat and significant deficiencies by taking proactive steps to monitor and test your compliance programs. You should maintain documents that demonstrate evidence of work performed.

Highlights - common deficiencies

In 2011, inadequate policies and procedures remains the top deficiency. We group exam deficiencies in broad categories for reporting purposes. The table on the next page shows the top 16 common deficiencies.

Top 16 Compliance Deficiencies by frequency					
Rank	Type of deficiency	2011	2010	2009	3 year change
1	Policies and procedures	59%	75%	85%	-26%
2	Advertising, marketing and holding out	47%	44%	15%	32%
3	Performance presentation and benchmarking	38%	19%	15%	23%
4	Conflict of interest and personal trading	28%	44%	50%	-22%
5	Know-your-client and suitability	28%	63%	70%	-42%
6	Disaster recovery and business continuity	22%	50%	45%	-23%
7	Disclosures	19%	44%	45%	-26%
8	Trade execution	16%	31%	5%	11%
9	Records	13%	25%	30%	-18%
10	Capital monitoring	13%	50%	50%	-38%
11	Compliance officer function	9%	38%	15%	-6%
12	Administrative filings	9%	13%	10%	-1%
13	Networking and referral arrangements	9%	6%	5%	4%
14	Insurance coverage	9%	0%	5%	4%
15	Compliance program	6%	25%	10%	-4%
16	Registration administration	6%	25%	20%	-14%
Total firms used for these statistics		32	16	20	

Trends in common deficiencies

The largest increases in deficiencies in the past three years are:

- Advertising and performance presentation (32%)
- Performance presentation and benchmarking (23%)
- Trade execution (11%)

We think that deficiencies in advertising and performance presentation and in performance presentation and benchmarking are up because we took an intense look at these issues in our marketing and advertising sweep.

The largest decreases in deficiencies in the past three years are:

- Know-your-client and suitability (-42%)
- Capital monitoring (-38%)
- Issues related to fees (-29%)

Our expectations

We expect you to keep current on securities legislation and encourage others at your firm to comply. Some compliance tools you can adopt to achieve a culture of compliance include:

- assessing initial and ongoing proficiency for registered individuals
- identifying compliance risks and spending resources to mitigate them
- creating standardized processes such as new account approvals and reconciliations

- maintaining records to document your business, compliance, and risk management activities
- supervising your staff
- implementing and enforcing your established compliance procedures
- testing your compliance programs annually
- meeting capital and insurance requirements for solvency and bonding
- managing conflicts of interest
- setting out proper portfolio management processes to ensure consistency of portfolios with client’s investment objectives and plans, disclosures to clients, and regular rebalancing.
- providing meaningful disclosure to clients about your services and products
- managing the outsourcing services you have with service providers

CSA Marketing Sweep

BCSC Lead Examiner, Janice Leung, chairs the CSA Compliance Committee. The Committee organized a national marketing sweep, which the BCSC participated with seven other CSA jurisdictions. We conducted focused marketing practice reviews for a sample of firms, revealing many common marketing deficiencies. The CSA published [CSA Staff Notice 31-325 Marketing Activities of Portfolio Managers](#), which reports on the sweep findings and provides guidance on marketing practices.

Our risk model

We continued to develop our risk-based approach by creating a new risk assessment model. The risk model evaluates each registrant’s business, operational, compliance, financial risks², and their risk management and internal controls. We set out our examination plan at the beginning of our fiscal year using information from the risk model. We adjust the plan quarterly based on our ongoing risk assessment and our resources. The risk model takes information, initially, from a 46-question survey.

We assign each firm to one of four peer groups based on registration category and assets under management. The four peer groups are:³

Peer Group	# of Firms
1. Portfolio Managers	30
2. Multiple Registration (AUM<\$700M)	32
3. Multiple Registration (AUM>\$700M)	9
4. Dealers	3
	74

The initial risk ratings used are:

Risk level
Low
Med low
Med high
High

² BC-principally regulated registrants only

³ Currently we have approximately 94 registrants; 74 have been risk scored.

Other goals of the risk model include helping examiners:

- Focus resources on firms with higher risk
- Concentrate on business activities that are identified as higher risk within a registrant
- Determine the overall intensity of our regulatory review programs

Working with compliance and enforcement teams

We work closely with compliance and enforcement staff to take decisive action against significant non-compliance. In 2010-2011, we referred two cases of serious non-compliance to enforcement. We have three criteria for enforcement referral, which we summarize below:

1. Dishonesty and deliberate misconduct

- misappropriation or fraud
- misrepresentation to investors or regulators
- manipulative or deceptive trading
- facilitating abusive market conduct (breaching gatekeeper obligations)
- obstructing our efforts to test compliance or obtain information

2. Core business conduct or financial viability breaches

- compliance system failure, including failure to supervise
- breaching terms and conditions
- unsuitable recommendations
- dealing unfairly, dishonestly, or in bad faith
- advising without registration
- complaint handling system failure
- inadequate capital or insurance
- recordkeeping system failure
- failure to stay proficient
- failure to check unethical or reckless behaviour

3. Many small breaches can add up to significant non-compliance

We also will consider making an enforcement referral when we find a registrant has repeat deficiencies or when there are many smaller breaches in a single exam.

Looking forward

More firms are registering under the new EMD and IFM categories. Our examination focus will expand to include these registrants. The CSA Compliance Committee is developing standardized examination modules to use in examining these registrants.

Under the National Registration System and Passport regime, the Examination team focuses mostly on registrants with BC as the principal jurisdiction. However, we work regularly with other CSA jurisdictions through the CSA Compliance Committee on registrant and industry issues. We appreciate hearing from you, so please share your views, comments and questions to these staff:

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