

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

Issued: April 18, 2019

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I. Executive Summary

In accordance with their mandates under the securities legislation of their respective jurisdictions, the Recognizing Regulators¹ 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 the following functional areas:²

- Business Conduct Compliance
- Trading Conduct Compliance
- Policy
- Membership and Registration

Other than the findings 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 three Low priority findings.³

The first finding relates to an examination module used in the Trading Conduct Compliance department that was not updated on a timely basis to assess new amendments to the Uniform Market Integrity Rule (UMIR) 6.2 *Designations and Identifiers*. The second finding relates to the maintenance of the edit-access functionality within the rule interpretation database not being restricted to Policy department and other applicable IIROC senior staff. The third finding relates to the Registration department's inadequate monitoring of an external service provider's re-accreditation of licensing and continuing education courses.

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

Staff have also set out certain other expectations in regards to various practices and procedures carried out by IIROC across the functional areas reviewed. These expectations are identified for IIROC to take note of and use as a basis for seeking improvements going forward. The expectations are set out in the *Risk Assessment and Fieldwork* section of the report.

¹ See Part II, Introduction Section A, Background for the regulators that recognize IIROC

² See Appendix A, Section 3 for a detailed description of the scope for the Review

³ See Appendix A, Section 4 for the criteria used to prioritize findings

Lastly, Staff acknowledge that IIROC has resolved the findings which were cited in previous oversight reports and which were followed up by Staff within the scope of the Review. All findings cited in the 2017 Oversight Report⁴ that were not within the scope of the Review have been separately tracked and assessed by Staff, and Staff have determined that IIROC has resolved the findings.

II. Introduction

A. Background

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

IIROC is recognized as an SRO by the Alberta Securities Commission, 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), the Prince Edward 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 Regulators⁵. IIROC's head office is in Toronto with regional offices in Montréal, Calgary and Vancouver.

The Review was conducted jointly by staff of the AMF, BCSC, FCAA, FCNB, MSC, NSSC and the OSC. The Review covered the period from September 1, 2017 to August 31, 2018 (the Review Period).

This report details the Review's objectives, the key areas that formed the basis of the fieldwork conducted by Staff, and Staff's findings. The methodology used, report format, scope and an explanation of the priority of findings 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.

⁴ Published on April 26, 2018

⁵ The three Canadian territorial authorities recognized IIROC on November 1, 2018.

III. Risk Assessment and Fieldwork

A. Business Conduct Compliance

As part of the annual risk assessment process, Business Conduct Compliance (BCC) was determined to be an area with an above average adjusted risk score.⁶ In so determining, Staff identified the following areas that became the focus of the on-site examination work:

- Resolution of prior oversight review findings⁷
- Written procedures within the following BCC examination modules:
 - Conflicts of interest
 - Order Execution Only (OEO)
 - Automated or online advice
- Staff training
- BCC staff examination files

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

- Assessed whether the findings from the 2016 oversight review report had been adequately resolved
- Assessed the adequacy of the updated procedures to the above three examination modules
- Assessed the timeliness and adequacy of staff training relating to the enhanced modules
- Assessed on a sample basis whether procedures within the enhanced modules were adequately performed and whether BCC staff took appropriate steps to ensure identified deficiencies were resolved in a satisfactory and timely manner

Based on the work performed, Staff are satisfied that IIROC has adequate processes in place in the identified areas. Staff found that enhancements to the Conflicts of interest and OEO modules were comprehensive, BCC staff's examination files were well documented and BCC staff took adequate action to ensure deficiencies raised were resolved in a satisfactory and timely manner.

While Staff did not identify any findings, on a going forward basis, as IIROC conducts more examinations of Dealer Members offering online advice, Staff expect IIROC to consider if any changes or additions to procedures within the online advice module are warranted. More specifically, taking into account CSA Staff Notice 31-342 *Guidance for Portfolio Managers Regarding Online Advice*, IIROC should consider procedures to:

- identify and assess the effectiveness of platform mechanisms in place to detect inconsistencies in client responses or other triggers during the collection of Know Your Client (KYC) information to ensure that an adequate system is in place for identifying circumstances when an advising representative is required to initiate contact with a (prospective) client; and

⁶ See Appendix A, Section 1 for a detailed description of the risk-based methodology used in all functional areas

⁷ http://www.osc.gov.on.ca/documents/en/Marketplaces/sro-iiroc_20160704_oversight-rev-rpt-investment.pdf

- observe, test and evaluate the functionality of the Dealer Member's online advice platform to ensure that the system is operating as designed.

B. Trading Conduct Compliance

As part of the annual risk assessment process, Trading Conduct Compliance (TCC) was determined to be an area with an above average adjusted risk score. In so determining, Staff identified the following areas that became the focus of the on-site examination work:

- Resolution of prior oversight review findings⁸
- TCC examination modules
- Written procedures within the following TCC examination modules:
 - Early warning reporting
 - Order designations and identifiers
 - Best execution
 - Amendments made to UMIR 7.1 principle-based supervision
 - Fair pricing for debt transactions
- Staff training
- TCC staff examination files
- Coordination between TCC and other applicable IIROC departments

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

- Assessed whether the findings from the 2014 oversight review report had been adequately resolved
- Assessed the completeness of the TCC examination modules to review (i) multiple asset classes and (ii) participant and non-participant Dealer Members that trade on equity and non-equity marketplaces
- Assessed the adequacy of the updated procedures to the above examination modules
- Assessed the timeliness and adequacy of staff training relating to examination module changes
- Assessed on a sample basis whether procedures within the enhanced modules were adequately performed and whether TCC staff took appropriate steps to ensure identified deficiencies were resolved in a satisfactory and timely manner
- Assessed the adequacy and timeliness of processes in place to update TCC examination modules resulting from approved market policy development and rule amendments

Based on the work performed, Staff are satisfied that IIROC has adequate processes in place in the identified areas. More specifically, Staff found that the completeness of the TCC examination modules, the enhancements to the modules and TCC staff's examination file documentation were adequate, with the one exception relating to amendments to UMIR 6.2

⁸ http://www.osc.gov.on.ca/documents/en/Marketplaces/sro-iiroc_20141204_oversight-rev-rpt-investment.pdf

Designations and Identifiers. Furthermore, based on Staff's sampling, TCC staff took appropriate action to ensure deficiencies identified were resolved on a timely basis.

Lastly, Staff acknowledge that there was adequate and timely communication between IIROC Market Policy and TCC departmental staff, that TCC staff were well trained and kept informed of market policy developments, and generally, examination modules were updated on a timely basis, except as noted above relating to amendments to UMIR 6.2, which is set out in the *Findings* section.

C. Policy

As part of the annual risk assessment process, the Policy department was determined to be an area with an above average adjusted risk score. In so determining, Staff identified the following areas that became the focus of the on-site examination work:

- Resolution of prior oversight review findings⁹
- Resource allocation
- Involvement or influence by other stakeholders
- Rule interpretation process
- Policy staff supporting working papers

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

- Assessed whether the finding from the 2014 oversight review report had been adequately resolved
- Assessed the adequacy of processes to allocate resources to policy initiatives or communication with internal and external stakeholders
- Assessed the adequacy and appropriateness of IIROC's Board, senior management or advisory committee involvement in the rule proposal development process
- Assessed the adequacy and appropriateness of written policies and their consistency with actual procedures in place to provide written rule interpretations in response to queries
- Assessed on a sample basis the adequacy of analyses completed to support proposed new rule or rule amendments

Based on the work performed, Staff are satisfied that IIROC has adequate processes in place in the identified areas, except for a Low priority finding pertaining to the maintenance of the edit-access functionality within the rule interpretation database. The finding is set out in the *Findings* section.

Staff does acknowledge that IIROC has policies and procedures in place to adequately manage rule interpretation inquiries. The types of queries are divided into three separate categories and the level of managerial review varies for each category. In certain

⁹ http://www.osc.gov.on.ca/documents/en/Marketplaces/sro-iiroc_20141204_oversight-rev-rpt-investment.pdf

circumstances novel queries may not easily be categorized into one of the three existing categories, therefore Staff expect IIROC Policy staff to review the written policies and actual procedures in place pertaining to the management of queries in order to determine whether any changes (e.g. new categories) would be beneficial.

Staff also acknowledge that IIROC has implemented controls designed to ensure that no rule interpretation given to Members would constitute a rule exemption. However, for one of the files reviewed, Staff noted that IIROC recently took steps to address an actual situation whereby a limited number of Dealer Members used and operationalized a 2009 proposed margin related rule amendment, although the proposed amendment was never approved by IIROC's Recognizing Regulators and was eventually withdrawn for consideration. To resolve the issue, and in consultation with CSA staff, IIROC required the affected Dealer Members to seek relief via the formal rule exemption process. In June 2018, IIROC's Board granted the applicable exemptions determining that they would not be prejudicial to Dealer Members, their clients or the public¹⁰. Going forward, Staff expect IIROC to continue to assess the controls in place to ensure that no informal rule interpretations are provided to Members where a formal exemption from IIROC Rules must be requested.

D. Membership and Registration

As part of the annual risk assessment process, Membership and Registration was determined to be an area with a low adjusted risk score. However, given that Staff examine each functional area at least once in a 5-year cycle, Staff ensured that mitigating controls are in place for the following:

- Resolution of prior oversight review findings¹¹
- Continuing Education (CE) processes
- Novel registration issues
- Support of other applicable IIROC departments

As a result, Staff:

- Assessed whether the finding cited in the 2014 oversight review report had been adequately resolved
- Assessed the adequacy of the processes to accredit, monitor compliance and approve exemption / extension requests pertaining to the CE requirements
- Assessed the adequacy of processes to handle novel registration issues and communication within IIROC or with the applicable securities regulatory authorities
- Gained an understanding of IIROC's policy work relating to advisor titles and proficiency

Based on the work performed, Staff are satisfied that IIROC resolved the finding cited in the

¹⁰ Each exemption granted as described in IIROC Notice 18-0147 may be voided under certain conditions, notably a five year end-date clause following approval of the exemption

¹¹ http://www.osc.gov.on.ca/documents/en/Marketplaces/sro-iiroc_20141204_oversight-rev-rpt-investment.pdf

2014 oversight review report. Staff acknowledge that IIROC has established a Digital Asset Working Group and a Membership Issues Committee that meet on a regular basis to handle novel membership or registration issues (e.g. fintech, robo advising, etc.). Furthermore, IIROC staff collaborates with and actively participates in a joint regulator working group focusing on Titles and Proficiency. Regarding CE, IIROC has adequate processes to monitor non-compliance and approve exemption or extension requests from CE requirements. IIROC's external accreditation process is administered through The Continuing Education Course Accreditation Process (CECAP) and IIROC adequately oversees CECAP's initial accreditation process; however, Staff found inadequate monitoring of CECAP's re-accreditation of courses which resulted in a Low priority finding as described in the *Findings* section.

IV. Findings

A. TCC Examination Module Not Updated to Assess New Requirements

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| <p>New amendments in UMIR 6.2 <i>Designations and Identifiers</i>, which require Participant Organizations to mark orders entered on a marketplace with new order identifiers for specific transactions such as derivative-related crosses or bundled orders, became effective on September 14, 2017.</p> <p>Though the order types are infrequently used, Staff noted that a TCC examination module was not updated to include procedures to assess the new requirements.</p> <p>Staff acknowledge that the TCC department does have a process to update examination modules to test compliance with new regulatory requirements and that TCC staff have taken steps to develop the new procedures.</p> | |
| <p>Why this is Important</p> | <p>Without procedures to test new order identifiers for specific transactions such as derivative-related crosses or bundled orders are properly identified, TCC staff may have difficulty in assessing if Member firm trading desks are complying with the new requirements.</p> |
| <p>Priority</p> | <p>Low</p> |
| <p>Requirement</p> | <p>Please describe how IIROC will resolve the finding.</p> |
| <p>IIROC's Response</p> | <p>We acknowledge the finding and have made the appropriate changes to our examination module to reflect the amendments to UMIR 6.2. In addition, we have introduced a procedure to track on-going policy matters and identify any examination module changes or enhancements that are required to address any rule change introduced.</p> |
| <p>Staff Comments and Follow-up</p> | <p>Staff acknowledge IIROC's response and have no further comment.</p> |

B. Unrestricted Edit-Access Within the Rule Interpretation Database

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| <p>IIROC Policy staff log rule interpretation requests and responses in a database.</p> <p>Staff found that the maintenance of the edit-access functionality within the rule interpretation database was not restricted to Policy and other applicable IIROC senior staff, which would ensure the integrity of the database. Staff acknowledge that we found no evidence of misuse of the edit-access functionality by other departmental IIROC staff, and</p> |
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| subsequently, IIROC took steps to resolve the issue by restricting edit and write access to current IIROC Policy staff. | |
| Why this is Important | Without restricting the edit-access functionality, rule interpretations in the database could have been modified without the approval of the required Policy staff. Maintaining the integrity of the rule interpretation database is essential since it is an important decision-making tool for Policy staff and can impact Member activities. |
| Priority | Low |
| Requirement | Please describe if IIROC intends to take any further action. |
| IIROC's Response | IIROC Policy staff acknowledges the finding and confirms that we have restricted edit and write (contribute) access on the database to current Policy staff only. IIROC staff outside Policy (including former Policy staff) are now limited to read only access. |
| Staff Comments and Follow-up | Staff acknowledge IIROC's response and have no further comment. |

C. Inadequate Monitoring of CECAP's Re-accreditation of Courses

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| <p>IIROC has retained the services of CECAP for accreditation of CE courses. Course providers may have their courses re-accredited by submitting to CECAP a fee and an attestation that there have been no material changes to the course content. Course providers are not required to resubmit the underlying course or program information to CECAP or IIROC as part of the re-accreditation process.</p> <p>IIROC may audit or ask CECAP to conduct an audit of the underlying courses, though to date, IIROC staff have not performed any audits nor asked CECAP to conduct any audits.</p> <p>Staff found that IIROC did not have a process in place to sufficiently oversee CECAP's re-accreditation of courses. For example, IIROC staff did not maintain information to track the number, the provider or the nature of the courses that were re-accredited by CECAP.</p> <p>Staff acknowledge that subsequent to the on-site portion of the Review, IIROC obtained the information to monitor CECAP's re-accreditation of courses.</p> | |
| Why this is Important | Without maintaining the information to track the number, the provider or the nature of the courses that were re-accredited by CECAP, IIROC may not be in a position to effectively monitor the re-accreditation process. |

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| Priority | Low |
| Requirement | Please describe if IIROC intends to take any further action. |
| IIROC's Response | IIROC acknowledges the finding and confirms that we currently obtain information to track the number and the provider or the nature of the course(s) re-accredited by CECAP. |
| Staff Comments and Follow-up | Staff acknowledge IIROC's response and have no further comment. |

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 risks¹² 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 on-site examinations at IIROC's Toronto, Montréal, Calgary and Vancouver offices. These on-site examinations 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 those functional areas or key processes with findings that require corrective action. While each finding may require 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 functional area or process was sampled for testing. However, as applicable, Staff require that IIROC take corrective action that will ensure nationwide consistency in IIROC's approach.

¹² 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.

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 following above average risk areas as the focus for the Review. There were no functional areas identified as High risk.

Above Average

- Business Conduct Compliance
- Trading Conduct Compliance
- Policy

However, as each functional area must be examined at least once in a 5-year cycle, the following Low risk area was included within the scope of the Review:

Low

- Membership and Registration

Also, through the risk assessment process, Staff determined that the following Moderate and Low risk areas would not be examined during the Review:¹³

Moderate

- Financial and Operations Compliance
- Data Analytics
- Enforcement
- Information Technology
- Equity Market Surveillance
- Debt Market Surveillance
- Trading Review & Analysis
- Risk Management
- Financial Operations / Project Management

Low

- Corporate Governance

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

¹³ 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.

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.

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

Business Conduct Compliance

Under Term & Condition 7(b) of the Recognition Orders, IIROC must administer and monitor compliance with securities laws and IIROC Rules by Dealer Members and others subject to its jurisdiction, including Alternative Trading Systems.

In order to ensure Dealer Member compliance with non-prudential requirements, IIROC's BCC staff (amongst other duties), are responsible for:

- conducting on-site examinations of Dealer Members
- working with Member Regulation Policy on rulemaking and guidance

Trading Conduct Compliance

Under Term & Condition 7(b) of the Recognition Orders, IIROC must administer and monitor compliance with securities laws and IIROC Rules by Dealer Members and others subject to its jurisdiction, including Alternative Trading Systems.

In order to ensure Member compliance with UMIRs and certain Dealer Member Rules, IIROC's TCC staff (amongst other duties) are responsible for:

- conducting on-site examinations of Participant and Non-Participant Dealer Members
- working with Market Regulation Policy on rulemaking and guidance

Policy

Under Term & Condition 4 of the Recognition Orders, IIROC must comply with the process for filing and obtaining Commission approval for by-laws, Rules and any amendments to by-laws or Rules.

As part of its framework, IIROC:

- has distinct Member Regulation and Market Regulation groups within the Policy department which are responsible for policy initiatives that address regulatory issues and interpretations of IIROC rules
- has established advisory committees that consist of internal and external stakeholders to help facilitate the rule proposal development process
- conducts an Initial Qualitative Policy Impact Assessment when formulating rule changes and the initial impact assessment is revisited throughout each project

Membership and Registration

Under Criterion 5 of the Recognition Orders, IIROC must have reasonable written criteria that permit all persons or companies that satisfy the criteria to access IIROC's regulatory services. The access criteria and the process for obtaining access should be fair and transparent.

IIROC's Registration department is responsible for developing proficiency, including CE requirements and the registration of individuals and firms. The General Counsel Office

coordinates the review of membership related applications and chairs the Membership Issue Committee that deals with applicable issues.