

**OVERSIGHT REVIEW REPORT**

**INVESTMENT INDUSTRY REGULATORY  
ORGANIZATION OF CANADA**

**QUÉBEC DISTRICT**

**2009**

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## BACKGROUND

The Investment Industry Regulatory Organization of Canada (IIROC) was created through the merger on June 1, 2008, of the Investment Dealers Association of Canada (IDA) and Market Regulation Services Inc. (RS). IIROC was recognized by the *Autorité des marchés financiers* (AMF) as a self-regulatory organization (SRO) pursuant to *An Act respecting the Autorité des marchés financiers*, R.S.Q., c. A-33.2, under Order No. 2008-PDG-0126 on May 2, 2008 (“IIROC Recognition Order”).

The IIROC Recognition Order stipulates that IIROC will, among other things:

- regulate investment dealers, including alternative trading systems (Dealer Members);
- establish, administer and monitor its rules, policies and other similar instruments (Rules);
- enforce compliance with its Rules by Dealer Members and others subject to its jurisdiction;
- provide services to exchanges and quotation and trade reporting systems (QTRSs) that choose to retain it as a regulation services provider, as that term is defined under *Regulation 21-101 respecting Marketplace Operation*;
- if retained by an exchange or a QTRS, administer, monitor and/or enforce rules pursuant to a regulation services agreement between IIROC and that exchange or QTRS;
- conduct certain functions delegated to it by the securities regulators that have recognized it as an SRO (“Recognizing Regulators”), including registration functions.

The IIROC Recognition Order was issued by the AMF conditional upon, among other things, IIROC continuing to meet recognition criteria, which include issues related to governance, performance of regulatory functions, disciplinary matters, systems capacity and integrity, and a number of requirements specific to Québec. For example, in each jurisdiction where it has an office, IIROC must have sufficient resources, appropriate organizational structures and adequate technology systems. It must also maintain a Québec District that has clearly defined responsibilities in matters of regulation, membership, sales compliance, financial compliance, market surveillance, inspection of trade desks and application of rules regarding its Dealer Members and marketplace members.

The IIROC Recognition Order should be read concurrently with the Memorandum of Understanding regarding oversight of IIROC among the Recognizing Regulators (MOU). The MOU describes the terms and conditions of the oversight program, which includes periodic reviews of IIROC’s self-regulatory activities and regulation services. The Recognizing Regulators use their best efforts to carry out reviews of IIROC’s offices at least once every three years. The most recent review of the IDA by its Recognizing Regulators was performed in September and October 2006. The present oversight review of IIROC by the Recognizing Regulators therefore constitutes the first review of the new merged entity.

The main areas covered under the oversight review program conducted by the staff of the participating Recognizing Regulators at IIROC's regional offices in Calgary, Montréal, Toronto and Vancouver were:

- business conduct compliance;
- financial and operations compliance;
- complaints, investigations and enforcement;
- trading conduct compliance;
- market surveillance;
- trading review and analysis.

The review period for most areas covered by this report is September 1, 2006 to September 30, 2009. The review period for trading conduct compliance, market surveillance and trading review and analysis is September 1, 2004 to September 30, 2009.

This initial review report of IIROC Québec District sets out the AMF's review activities, findings and recommendations pertaining to the first three above-mentioned areas, the Québec District Council and information protection. The other three areas, covering trading conduct compliance, market surveillance and trading review and analysis, were reviewed by the AMF jointly with the Ontario Securities Commission at IIROC's Toronto office and are integrated into the consolidated report of IIROC regional offices, entitled *IIROC Oversight Review 2009*. The English version of this report of IIROC Québec District is also an integral part of the consolidated report.

## **BUSINESS CONDUCT COMPLIANCE**

### **1. Introduction**

IIROC's Business Conduct Compliance (BCC) department ensures that Dealer Members implement policies and procedures in order to ensure their compliance with all non-financial regulatory requirements, including those of IIROC, provincial securities acts and the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.

To do so, BCC conducts regular field reviews of Dealer Member firms. These on-site examinations focus on issues of supervision of accounts, employee supervision, internal controls, documentation, advertising and marketing, and anti-money laundering due diligence. For example, a sampling of client account opening files are reviewed to ensure that they are complete and that transaction suitability has been verified based on the client's profile; fee accounts and discretionary management are scrutinized; dealer manuals, procedures and forms are analyzed to ascertain whether they are up-to-date and correspond to their daily application; and client complaint reporting and handling procedures are reviewed. This list is not exhaustive, since the scope of the non-financial compliance requirements is very broad, as the different review modules and numerous related module sections show.

BCC reviews all Dealer Members at least every five years, i.e., annually for members serving retail clients, every two years for members with institutional clients and every five years for members trading for their own account. Dealer Members are selected for review using a risk-

based approach. Dealer Members considered high risk are reviewed more frequently than Dealer Members considered lower risk.

## **2. Purpose and scope**

The objectives of this section of the review were to:

- review and evaluate the structure and resources, including staff, of the BCC department to ensure it performs its regulatory functions effectively and efficiently;
- evaluate the adequacy of the performance measurement benchmarks for compliance examinations and determine whether they were met;
- assess whether BCC is focusing on current risks and regulatory concerns when conducting its field reviews;
- assess the adequacy, timeliness, and quality of compliance examinations performed by BCC staff;
- assess whether deficiencies reported in the last oversight review report were followed up and addressed by IIROC;
- assess whether results of sweeps are used appropriately in order to properly focus on risks and regulatory concerns.

To gather the information needed to understand the operations of the BCC department, AMF staff interviewed the BCC manager and the Director, Member Regulation – IIROC Québec District. AMF staff also reviewed BCC's *Policy, Procedure and Technical Guide*, the examination program modules used by examiners (currently, approximately 15 modules) and a sample of Dealer Member review files. Given that information is now computerized, AMF staff consulted databases such as SharePoint, UBSS and MIRA, which are described later in this report.

## **3. BCC activities**

The type of exam conducted by BCC depends on the purpose of the field exam. Five types of field exams are typically conducted:

- a general risk-based field exam scheduled for a Dealer Member;
- a general risk-based field examination of a branch office of a Dealer Member;
- limited reviews of Dealer Members who are able to demonstrate a high degree of compliance and therefore represent a lower risk;
- a follow-up review to verify that a Dealer Member has carried out procedures and addressed a previously identified critical supervisory shortcoming;
- sweeps: a new form of review conducted by selecting a specific type of Dealer Member, based on criteria established at the beginning of the sweep, to review a specific issue.

The business conduct examination process is broken down into five parts: Planning, Field Work, Report and File Preparation, and Response-Management and Monitoring.

### **3.1 Planning**

Good planning is the key to a successful business conduct examination. A planning checklist is prepared in consultation with other IROC departments, in particular, Financial & Operations Compliance, Trade Conduct Compliance and Market Surveillance. The checklist draws on the preceding business conduct compliance review report and the Dealer Member's response to the report, which may include points for follow-up during a future review.

In addition, the following data sources are used to obtain an up-to-date picture of the Dealer Member: ComSet (Complaints and Settlement Reporting System) and CTS (Case Tracking System, a national complaints and investigation database system), which enable IROC staff to identify potential compliance problems at a Dealer Member and the modules to be used when an enhanced compliance review is required; monthly financial reports and other regulatory filings; the BCC Risk Assessment Model, which gives an indication of the comparable risk assessed for each Dealer Member relative to all other firms and relative to other firms in a peer group (the Member Information Risk Assessment (MIRA) database reports the score obtained for a Dealer Member based on different risk types); the National Registration Database (NRD) and the list of individuals under strict supervision.

BCC staff then complete the planning checklist, an electronic form stored on Business Conduct Compliance's SharePoint site that maps out the major review objectives in advance. This checklist gives an historical and prospective overview of the Dealer Member, based on the information sources previously listed and all other useful information, and is used to assess the Dealer Member's risk. A planning table showing the modules and module sections to be used, the names of the assigned BCC staff and the allocated budget is also completed. The four core review modules are account opening, supervision of accounts, employee supervision, and branch audit compliance.

The planning file is generally prepared by a BCC technician. The lead examiner is responsible for analyzing the material collected. The BCC manager, who participates in different planning stages, reviews the plan. The final plan is approved by the Director, Member Regulation.

### **3.2 Field work**

The field work stage begins with an entrance meeting between the Dealer Member and BCC to, among other things, outline the examination process and the expectations of each party. Field work includes examining, testing and validating the Dealer Member's internal controls and procedures using the modules identified in the planning checklist. The examiner therefore conducts a physical review, which consists in performing substantive tests of systems, procedures, files, reports or other documents using a sample of approximately 20 accounts over a given period. Findings must be based on documented facts and reported on the finding form, which highlights a deficiency or concern with respect to a module section. When the field work is completed, findings are discussed and the Dealer Member provides feedback. BCC then formally presents its findings to the Dealer Member during an exit meeting.

### **3.3 Report and file preparation**

In preparing the examination file and report, the examiner must ensure that findings reported in the finding forms are clearly cross-referenced to the appropriate sections of the modules, as these modules are used to identify any weaknesses and detail discussions held between the

examiner and the BCC manager. The lead examiner then updates the Dealer Member's risk profile on MIRA. The examination report, which draws the Dealer Member's attention to regulatory weaknesses or violations and alerts it to potential control weaknesses, is submitted to several levels of review within IIROC Québec District. The final report is sent to the Dealer Member's designated compliance officers and senior management.

### 3.4 Response-Management and follow-up

The Dealer Member has one calendar month to respond to BCC's findings and recommendations. If the response is satisfactory, the file is closed. If the response is not satisfactory, a follow-up letter is issued to the Dealer Member and the process moves to the monitoring phase, which only ends when all issues have been resolved.

#### *Findings*

Whereas the module content is reviewed regularly as regards the module sections and underlying questions, it is not possible to see when changes are made, i.e., whether the change was an addition, a deletion or a change in module section. Since modules are now stored on SharePoint, each change in the content of a module permanently erases previously stored information.

IIROC does not have a tool for easily tracking updates to its examination programs and understanding the reasons for the updates.

#### *AMF recommendations*

IIROC should have tools that enable it to easily track updates to its examination programs and understand the reasons for the changes.

Priority – Medium

#### *IIROC's response*

IIROC will ensure that all changes are documented and explained.

#### *AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## 4. Benchmarks

BCC benchmarks are as follows:

- 70% of available staff time is to be spent directly on Dealer Member reviews;
- all mandated reviews must be completed during the year as established at the beginning of the year in the planning schedule;

- 60% of final examination reports must be issued to Dealer Members within 15 weeks of completion of field work;
- all final examination reports must be issued to Dealer Members within 26 weeks of completion of field work.

BCC – IIROC Québec District conducted an average of 20 reviews per year over the review period at the approximately 30 Dealer Members operating in Québec, including 17 head offices. Specifically, 20 reviews were conducted in 2006, 22 in 2007, 20 in 2008, and 19 in 2009, as well as 11 branch sweeps, which are discussed later in this report.

*Findings*

In 2007, one report was issued after the 26-week deadline, which violates the fourth benchmark above.

*AMF recommendations*

BCC - IIROC Québec District must ensure that its benchmarks are consistently met.

Priority – Low

*IIROC's response*

Benchmarks are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. IIROC notes that only one examination exceeded the benchmark during the Review Period.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained. No follow-up is required.

*Findings*

Also in 2007, five out of a total of 22 files did not meet the 15-week post-examination report issuance deadline. However, 77% of examination reports were issued to Dealer Members on time, exceeding the 60% threshold. For the other years under review, most reports were issued within the 15-week target deadline. AMF staff are concerned that this 60% threshold is easy to attain.

*AMF recommendations*

IIROC should re-evaluate the agreed-upon 60% threshold requiring that examination reports be issued to Dealer Members within 15 weeks of field work completion.

Priority – Medium



*IIROC's response*

Benchmarks are a management tool designed to assist management in tracking performance and program deliverables. Benchmarks function as an alert, which highlight for management areas that may benefit from review. IIROC intends to review all benchmarks across the compliance programs.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

These relatively lower outcomes in 2007 compared with the other years covered by AMF reviews correspond to the transition period between two BCC managers at IIROC Québec District. The situation has since stabilized.

**5. Examination file quality**

AMF staff reviewed a sampling of six examination files of BCC – IIROC Québec District, including one branch sweep file. These files were representative of the diversity of Dealer Members operating in Québec, i.e., two integrated firms, two retail firms and one discount brokerage firm.

*Findings*

Generally, the examination files tested were well documented. At each phase of the Dealer Member examination process (planning, field work, report and file preparation, follow-up), and despite the substantial amount of information, it was easy to trace and compare data and information, as references to each examination file were precise and supported by relevant documents. Tables of contents were sufficiently detailed to identify each topic.

The quality of examiners' work as regards selection of modules was highly satisfactory (linking points raised in the previous examination for follow-up), type of tests or size of samplings. Findings were explicitly detailed and recommendations referred to IIROC rules that were breached.

*AMF recommendations*

No action required.

**6. Changes since previous oversight review**

BCC's role has not changed substantially from the time of the review of the IDA by the AMF, and its report issuance benchmarks are the same.

However, IIROC has introduced new procedures since the previous oversight review. These changes relate to tools used, the examination process, types of examinations and determination of Dealer Member risks.

## **6.1 Tools**

BCC's *Policy, Procedure and Technical Guide* was fully reviewed and updated to August 2009. Because of the extent of the changes, there is no black-lined version of the guide.

BCC has refined its tools and now makes extensive use of computerized platforms. As a result, examination programs and reports and the contents of files are stored in UBSS, a management software system for tracking files and measuring utilization of examiners' time. This information is stored on BCC's SharePoint site, which is comparable to a national library.

One specific change is that all documents are now electronic; hard copies are automatically digitized and stored on SharePoint.

Since April 2008, BCC – IIROC Québec District has been using IDEA, a new software that allows users to select a sample of client accounts based on refined criteria in order to test trading activity such as order priority or multiple trading in an account. IIROC's Montréal office has developed expertise in using this software and its BCC examiners train staff in other IIROC regional offices. IDEA was designed to be integrated into TeamMate, a user-friendly platform containing IIROC's examination programs.

## **6.2 Examination process**

The examination process based on the four to five phases described above has not changed substantially. Nonetheless, for greater efficiency, some operational procedures were moved within the process.

Consequently, the entrance meeting is now conducted prior to, rather than after, finalizing the planning phase. Also, since early 2009, draft reports have not been issued to Dealer Members, a decision by IIROC senior management that applies to all regional Districts. Lastly, BCC – IIROC Québec District examiners no longer schedule the exit meeting on the date of the final field work, as was customary until 2007. The meeting is now held after the finding forms have been documented and reviewed by the BCC manager; in other words, after examiners return to IIROC's Montréal office.

## **6.3 Types of examinations**

BCC has developed a new type of examination called a "sweep." This examination consists in selecting a specific type of Dealer Member based on criteria established at the beginning of the sweep and reviewing a specific issue. A module was created for examinations of a branch office of a Dealer Member (branch sweep), which sets out procedures that focus on the effectiveness of a head office's supervisory controls of its branches. Branches are selected via a risk rating assessment questionnaire in order to obtain a representative sampling. The selection is guided by several criteria such as head office location, number of products offered, size of Dealer Member, retail clientele, and distance between branches and the head office.

In the first quarter of 2009, BCC – IIROC Québec District performed 11 branch sweeps of eight Dealer Members, representing just over one-third of all BCC examinations conducted in 2009.

## Findings

Only two lines in the August 2009 *Business Conduct Compliance Policy, Procedure and Technical Guide* are devoted to sweeps. No details on sweep procedures are provided.

### *AMF recommendations*

IIROC should develop and draft a complete and detailed section on sweeps, including procedures, in its *Business Conduct Compliance Policy, Procedure and Technical Guide*.

Priority – High

### *IIROC's response*

IIROC will develop a general procedure with some generic language and will develop, on an *ad hoc* basis, a detailed procedure targeted for each sweep. Given the particularities of each sweep, IIROC believes that adapted policies which include a set of criteria and project plan will be useful.

### *AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

Another new development in 2009 was the introduction by IIROC of integrated examinations at the pan-Canadian level. As part of this pilot project, the Business Conduct Compliance, Financial & Operations Compliance and Trading Conduct Compliance departments in IIROC's regional Districts performed joint examinations, i.e., concurrently at the same firm rather than separately at different times of the year, as was customarily done. In each District, these three departments worked together on planning, the entrance meeting, field work, the exit meeting and examination report production.

IIROC Québec District conducted its first integrated examination in the third quarter of 2009, which corresponds to the end of the review period.

## **6.4 Determination of risks**

During the review period, BCC performed an in-depth review of its risk model, including key risk assessment factors, definitions and guidelines. This initiative was carried out jointly with Financial & Operations Compliance so as to benefit from its experience with its own risk assessment model. A Risk Trend Report is created for every Dealer Member to encourage them to strengthen their governance and risk management practices and facilitate IIROC regulatory activities. Each Dealer Member is rated low, moderate-low, moderate-high or high based on an assessment of the business risks inherent in its operations and the manner in which those risks are managed. The report also provides comparisons of the member's peer group (nine peer groups; for example, integrated, retail, institutional, etc.) and the industry as a whole.

Since June 2008, this information has been stored in MIRA rather than on paper support. MIRA, which assesses a Dealer Member's overall risk profile, is one of the key components of the

planning checklist that examiners draw on to determine which modules they will use for the examination. Therefore, in order to guide examiners in the planning process, the planning checklist need only show one of three risk categories (low, moderate or high) for each area selected for review.

Prior to April 2009, a Dealer Member's risk rating was determined at the planning phase in order to select the sections to be completed for the scheduled inspection and then re-assessed when the field examination was completed. IIROC no longer determines a rating prior to the examination, preferring instead to now assign a general risk level (low, moderate, high) so as to determine the risk attributable to different aspects which, based on this determination, should be covered during the inspection. The risk rating is updated in MIRA only after the on-site examination is completed.

### *Findings*

It is difficult to draw a link between the information collected used to determine which module sections should be completed and the risk rating information on the planning checklist in a Dealer Member's file. In fact, the checklist provides no explanation of the information source used to determine the score obtained.

#### *AMF recommendations*

AMF staff recommend that IIROC Québec District provide the information source needed to detail each Dealer Member's risk score identified in the planning checklist.

Priority – Medium

#### *IIROC's response*

The risk score used in the planning checklist is calculated through a database called MIRA. MIRA can generate a report called "Internal Risk Assessment Report". We will make sure to include this report along with the planning checklist as back-up to the risk rating used in the planning checklist.

#### *AMF comments and follow-up*

AMF staff are satisfied with the response obtained. No follow-up is required.

## **7. Staffing and training**

BCC staff – IIROC Québec District increased from eight in 2006 to 10 in 2007. Staff remained at 10 in 2008 and 2009, with a turnover rate of 10% during the past year. In September 2009, BCC staff consisted of six examiners, plus one examiner position that became vacant during the same month, two technicians and one manager. IIROC's Montréal office also plans to hire a second BCC manager (new position) in 2010 to assist the current manager in rolling out the integrated examination approach. The vacant examiner position and the new manager position were filled in March 2010.

Technicians help prepare examination files, in particular during the planning phase; they also input data and carry out various tests on the samplings mentioned above.

### *Findings*

BCC examiners in Montréal have in-depth knowledge and are experienced in many fields, such as derivatives. They come from the brokerage or exchange industry and hold various professional designations.

IIROC Québec District has a significant annual training budget earmarked for improving examiners' knowledge through courses, mainly given by CSI Global Education Inc.

AMF staff are of the opinion that the quantity and quality of IIROC Québec District BCC staff are sufficient.

<i>AMF recommendations</i>
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No action required.
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## **FINANCIAL & OPERATIONS COMPLIANCE (FinOps)**

### **1. Introduction**

In 2008, the Canadian Investor Protection Fund (CIPF) discontinued its oversight of IIROC's financial compliance audits. This oversight is now the responsibility of the Recognizing Regulators. The review of FinOps – IIROC Québec District is therefore a first-time mandate for AMF staff, in keeping with the mandates assigned to staff of the other Recognizing Regulators, who conducted reviews in their respective regions.

The role of FinOps Compliance is to monitor the financial status of its Dealer Member firms and enforce compliance with IIROC rules. The main elements of the department's work are:

- Review of financial regulatory filings: FinOps staff review monthly financial reports and the audited Joint Regulatory Financial Questionnaires and Reports (JRFQR) to identify changes in trends, financial status, and profitability. Any Dealer Member firm that does not meet minimum capital requirements is referred to as capital-deficient and must immediately remedy its capital position or face possible suspension or termination of membership. All capital deficiencies are referred to IIROC's Enforcement department for possible disciplinary action. All clients of IIROC Dealer Member firms are covered by the CIPF, which protects clients in the event that a Dealer Member firm becomes insolvent.
- Annual and biennial "surprise" field examinations: FinOps staff conduct "surprise" examinations of Dealer Members' books and records to ensure the reliability of their unaudited regulatory filings.
- Review of audit working papers: Each Dealer Member firm is subject to a year-end audit by an approved panel auditor to validate the information filed by the firm with IIROC. To ensure the quality of the audit, FinOps staff review the panel auditor's

working paper files within three months of the filing date of the JRFQR by a high-risk firm or within six month for other firms.

At the time of the examination, FinOps – IIROC Québec District had 13 employees, compared with 11 in 2006 and 2007.

## **2. Purpose and scope**

The objectives of this section of the review were to:

- review and evaluate if FinOps has the appropriate structure and resources, including staffing, to ensure that it performs its regulatory functions effectively and efficiently;
- evaluate the adequacy of the performance measurement benchmarks for the financial compliance functions and determine whether they were met;
- assess the adequacy, timeliness, and quality of financial compliance examinations performed by FinOps;
- determine whether FinOps has appropriate review processes and procedures to perform its member regulation functions adequately;
- assess whether IIROC effectively enforces its rules and monitors its Dealer Member firms' compliance with securities legislation.

AMF staff examined the *Policies, Procedures & Guidelines* manual dated August 2009 and held discussions with the FinOps manager and the Director, Member Regulation – IIROC Québec District. Staff also consulted a sampling of Dealer Member examination files stored on TeamMate.

## **3. Benchmarks**

The benchmarks for FinOps are as follows:

- attain an average examiner project utilization rate of 70%, meaning 70% of available staff time is to be spent directly on Dealer Member firm examinations;
- examine every Dealer Member annually (except Dealer Members approved for biennial review) within a calendar year;
- complete and issue 60% of field examination reports within eight weeks to a maximum of six months for all examination reports;
- perform an audit working paper review within three months of the filing date for high risk firms;
- complete all other audit working paper reviews within six months of the filing date.

FinOps – IIROC Québec District met the benchmarks during the review period.

Following their review, AMF staff report the following four significant findings.

## *Findings*

When combined, non-significant file errors can become significant in respect of the pre-established materiality threshold. We have no indication that FinOps – IIROC Québec District measures this impact.

### *AMF recommendations*

FinOps – IIROC Québec District should demonstrate that the total number of non-significant file errors is taken into account when evaluating whether aggregate errors have an impact on the materiality threshold.

Priority – Medium

### *IIROC's response*

IIROC staff establishes a materiality threshold at the beginning of each examination. Any file error that could lead to a material impact is documented in a finding form. All findings and their capital impact are entered into a "Consolidated Summary of Errors" spreadsheet.

If the Manager responsible for reviewing the file encounters many non-material errors, he or she considers whether an adjustment to the Risk Adjusted Capital is required.

IIROC does not believe it is necessary to report all non-material errors that are non-systemic below the established materiality threshold, and believes that the current practice is sufficient to determine the need for adjustments to Risk Adjusted Capital. All findings that relate to internal control or procedural test, regardless of materiality, are reported.

### *AMF comments and follow-up*

The role of FinOps is to monitor the financial status of its Dealer Member firms and enforce compliance with IIROC rules. However, AMF staff observed that the main objective of FinOps' current procedure is to identify weaknesses having a material impact and determine the need for adjustments to Risk Adjusted Capital.

Material impact is of such importance to IIROC's current review procedure that only those weaknesses resulting in a material impact above the materiality threshold established in the file are documented in the Consolidated Summary of Errors spreadsheet.

We observed that internal control weaknesses, material weaknesses in procedures (i.e., not in compliance with IIROC rules) and weaknesses that could represent a significant systemic risk were, for the most part, less perceptible in the inspection reports because they did not result in a material impact and therefore do not require an adjustment to Risk Adjusted Capital, even though certain weaknesses were recurring.

Although AMF staff are of the opinion that it is not necessary to report all non-material weaknesses, they nonetheless are of the view that the identification of weaknesses should not be guided solely by material impact, but also by the need to ensure compliance with IIROC rules and identify weaknesses that could present systemic risk.

AMF staff will follow up this recommendation with IIROC.

*Findings*

AMF staff observed in one file that there was no justification by the Director, Member Regulation – IIROC Québec District for a change in the classification of a finding.

*AMF recommendations*

All classification changes should be justified in the finding forms.

Priority – Low

*IIROC's response*

IIROC will comply.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained. No follow-up is required.

*Findings*

Changes to the *Policies, Procedures & Guidelines* manual are made via e-mail; the manual is not updated immediately.

*AMF recommendations*

Changes to the *Policies, Procedures & Guidelines* manual should be reflected immediately in the document.

Priority – Low

*IIROC's response*

IIROC will comply.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

*Findings*

The checklist used for biennial reviews does not show that the examiner is required to consult BCC's most recent examination file or the most recent auditors' report, whereas, FinOps – IIROC Québec District examiners do in fact consult these documents.



*AMF recommendations*

The checklist used for biennial reviews should indicate that the information to be obtained includes the most recent BCC examination report and the most recent auditors' report.

Priority – Low

*IIROC's response*

Examiners do, as a matter of practice, consult these materials. IIROC will add this to the checklist.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## **COMPLAINTS, INVESTIGATIONS AND ENFORCEMENT**

### **1. Introduction**

In August 2008, the Complaints and Investigations division – IIROC Québec District was divided into two separate departments: Complaints and Investigations. Enforcement, which already existed, is a separate department.

IIROC's Enforcement department may conduct an investigation of individuals and firms under IIROC's jurisdiction as a result of a complaint, referral from a securities commission, other agency, or other sources where it is necessary to enforce compliance with IIROC rules. IIROC investigates complaints about IIROC-regulated firms and their registered employees and has established services to help investors who are seeking compensation. Investigations are most often the first phase of the enforcement process.

Since August 2009, cases examined by the Case Assessment manager (considered "complaints") have been reviewed by the Director, Member Regulation, whereas cases examined by the Investigations manager have been reviewed by the Vice-President, IIROC Québec.

As well, since the fall of 2009, Enforcement has been actively involved in investigations. Enforcement legal staff are involved in cases at the outset, helping to develop the investigation plan and attending interviews. IIROC Québec District's intention in introducing these changes was to improve Investigations' benchmarks and the quality of investigation files escalated to Enforcement.

These three departments have a total of 13 employees.

### **2. Purpose and scope**

The objectives of this section of the review were to:

- ensure that staff in place are sufficiently and properly experienced and have received appropriate continuing training;
- evaluate that benchmarks used appear reasonable and attainable;
- ensure that cases are processed adequately;
- ensure that decisions are well documented.

The review of the Complaints, Investigations and Enforcement departments was conducted by gathering information from the following sources: discussions with the Case Assessment manager and the Investigations manager, in the presence of the Director, Member Regulation – IIROC Québec District to understand the operations of the Complaints and Investigations departments; discussions with the Vice-President, IIROC Québec to understand Enforcement operations; examining the guides and policies and procedures manuals of the Complaints, Investigations and Enforcement departments; and, finally, examining a sample of complaint files (26 files), investigation files (6 files) and enforcement files (6 files) handled during the review period.

### **3. Benchmarks**

The benchmarks set out in the procedures manuals of each of the three departments covered in this section are:

- 80% of complaint files must be processed in less than 75 days;
- all standard investigation files must be completed within one year of being opened and investigations requiring more than one year must be identified to and approved by an IIROC officer;
- 60% of enforcement files must be completed in less than 10 months.

#### *Findings*

Benchmarks for complaint files were met for each review period: 87% of files were processed on time in 2006, 82% in 2007, 81% in 2008 and 83% for the period from January to August 2009.

However, Investigations benchmarks were not met for the review period. The number of files requiring more than one year to process was 37% in 2006; 42% in 2007, 50% in 2008 and 15% from January to August 2009.

In addition, Enforcement benchmarks were not met for much of the review period. In 2006, 83% of files were processed in less than 10 months, whereas in 2007, 2008 and for the first eight months of 2009, that number fell to 47%, 50% and 25%, respectively.

IIROC explains these results by the fact that until 2009, staffing was insufficient due to extended absences (illness, maternity leave, staff loans or resignations). As well, some major files were processed during this period.

In order to improve file processing times, IIROC's Montréal office made two changes to its structure and procedures. First, in August 2008, the Complaints and Investigations teams were split to specialize staff and meet benchmarks. Second, to improve Enforcement file processing timelines, Enforcement legal counsel have, since the fall of 2009, been involved in investigation files. This helps lawyers familiarize themselves with cases that they may be assigned and improves the quality of the evidence gathered during investigations.

Despite the changes made to improve productivity, AMF staff noticed that the Investigations and Enforcement departments – IIROC Québec District did not meet their respective benchmarks for the review period.

*AMF recommendations*

IIROC Québec District should take the necessary steps to ensure that Investigations and Enforcement comply with their respective benchmarks.

Priority – High

*IIROC's response*

Although the benchmark indicated in the Investigations Manual mentions that all investigations must be completed within a year, the benchmark that has always been applied is that 60% of the investigations files must be completed within one year. The Manual will be amended to reflect that fact. The practice also is that for files that will take more than one year, there is a specific scrutiny of the merits of a longer investigation and it has to be approved by the Vice-President, Quebec.

The benchmarks are a management tool applied on a national basis and designed to assist management with overall completion times for Enforcement files. They function as an alert, which allows management to take a closer look at the file in question. IIROC is satisfied with the benchmarks applied in Investigations in light of their purpose.

IIROC benchmarks are not designed to assist staff or management in prioritizing or ranking files. There is an ongoing process of prioritizing investigation and prosecutions files by management, and Enforcement is confident that all files are reviewed regularly by management with a view to ensure that priority files receive the adequate resources for timely completion.

IIROC agrees that it is important to complete investigations and prosecutions within the benchmarks established by IIROC and are working to that end. We have recently established an Integrated Enforcement Team model. Lawyers and Investigators will work closely together on a file as soon as it is opened in Investigations. IIROC believes that this will improve the time it takes to complete files, and expect better compliance with our benchmarks.

It is also important to note that we now have a full complement of three full-time Enforcement Counsels in the Montreal office. The priority is to clear the backlog of old files and also make sure that new files are prosecuted within the benchmarks, if possible.

*AMF comments and follow-up*

AMF are satisfied with the response obtained and will follow up this recommendation with IIROC, in particular, the new integrated Investigations and Enforcement teams model, to confirm whether this approach will have an impact on file processing times and benchmarks.

#### **4. File closings**

*Findings*

The reasons given for closing complaint files were not always in compliance with those set out in the complaints procedures manual, and certain justifications were, in our opinion, not valid. Therefore, several policy violation files (containing evidence) were closed instead of being escalated to Investigations. This is not in compliance with the *Case Assessment Procedures Manual* of July 2009.

We consider these closings to be premature. In fact, if proper procedures had been followed, some files would have been referred to Investigations. The premature closing of complaint files falls into two categories: closings based on criteria in the *Investigations Procedures Manual*, dated August 2009 (severity of violation, public interest, availability of evidence), and those based on criteria not set out in manuals but which IIROC has unofficially established (the main criteria considered when closing a complaint file are severity and repeat violations, availability of evidence, vulnerability of complainant and previous sanctions imposed on the representative by the dealer firm).

We observed that four complaint files were closed prematurely. These files stated that the dealer's representative had no disciplinary record or that the Dealer Member firm had sanctioned the representative in the past.

IIROC cites shortage of Enforcement staff at its Montréal's office as the reason for the premature closing of files. Enforcement staff are only able to process 10 to 15 files per year; therefore, procedures are relaxed based on staff availability.

*AMF recommendations*

AMF staff recommend that IIROC Québec District meet the file closure criteria set out in the *Case Assessment Procedures Manual* and the *Investigations Procedures Manual*.

AMF staff also recommend that personnel be hired as needed.

Priority – High

*IIROC's response*

IIROC acknowledges the importance of closing files using the criteria established in the *Case Assessment and Investigations manuals*. Files must be reviewed in light of the established criteria and closed in conjunction with the procedures set out in the manuals.

It is important to note that IIROC employs a risk based strategy, which means that we do not open an investigation for every complaint. We apply our limited resources to those matters that pose the greatest risk to investors and the capital markets.

We conducted staff training sessions with Case Assessment employees from February 28 to March 4, 2011 in which new case selection criteria were discussed. The file closing procedures are detailed in the case selection criteria document. We will remind Case Assessment employees to close files only when they meet the criteria for closure in the manuals.

We believe we have appropriate staffing for Case Assessment and Investigations. If this situation changes we will assess the situation and hire as appropriate.

#### *AMF comments and follow-up*

AMF staff are satisfied with the response obtained with respect to the recommendation on compliance with file closure criteria set out in the manuals.

As regards the staff hiring recommendation, IIROC Québec District should demonstrate that the new integrated team model will improve file processing times.

AMF staff will follow up these recommendations with IIROC.

## **5. Use of WatchBrief**

IIROC uses WatchBrief. This application will keep a file open in CTS, but does not record statistics on the length of time the file remains pending. A file can be opened directly in WatchBrief, or an open file can be transferred to WatchBrief. When a file is transferred, it is closed and re-opened under another file number, which brings the time counter back to zero. This same file can be closed while it is still pending, or it can be closed and re-opened as an active file under another number. There are no rules governing when a pending file under WatchBrief is reactivated.

### *Findings*

Procedures do not describe or define situations where use of the pending function is permitted under WatchBrief, yet we observed several instances where this function is used. For example, if a legal notice is requested for a file opened at a phase other than Enforcement, a file will be opened under WatchBrief so that when legal counsel completes its assessment, the accurate number of files processed is reflected, regardless of whether or not they are Enforcement files.

In addition, use of this function may skew statistics with respect to actual processing times and the number of processed files by impacting the benchmarks in two ways. On the one hand, processing times are not measurable because this function suspends processing, and on the other hand, a file is recorded twice: once when opened in WatchBrief and again when it is transferred from WatchBrief to active file status.

*AMF recommendations*

AMF staff recommend that IIROC Québec District evaluate the use of WatchBrief and describe this function in the procedures manual.

Priority – Medium

*IIROC's response*

IIROC recognizes the limited use of a WatchBrief for Enforcement matters and agree that there should be criteria established for how and when it will be used by staff. IIROC will develop criteria and amend the manual to address this issue.

We do take issue with the suggestion that we use the WatchBrief as a means to suspend benchmark tracking. We do not convert active files into watch briefs in order to stop benchmark times. Watch briefs are only opened for non-enforcement matters of particular interest to the Enforcement Department.

We will complete a review of the use of the WatchBrief and make any necessary amendments to the manuals by June 30, 2011.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained regarding the changes to be made to the procedures manual.

During its review of the use of WatchBrief in CTS, IIROC should determine whether the time a file spends as a WatchBrief file should be included in total processing times for benchmark purposes, and should reflect this decision in the procedures manual. CTS should adequately manage the WatchBrief function and generate the appropriate data.

AMF staff will follow up this recommendation with IIROC.

## **6. File amalgamation**

*Findings*

Files can be amalgamated for strategic reasons. However, when a file is combined, it is not clearly shown in the file or in CTS that it has been closed (in fact, the file is continued as part of another file). As a result, it is difficult to adequately monitor amalgamated files, since there is no tool for tracing them.

As well, closing files before they are completed reduces processing times and, consequently, benchmarks are met more quickly.

*AMF recommendations*

AMF staff recommend that the IIROC Québec District implement tools for tracing amalgamated files.

Priority – Low

*IIROC's response*

IIROC tracks the progress of all files on CTS. When two files are amalgamated, staff will track on CTS that one of the files has been closed and joined with another file. On each file summary page on CTS there is a section called "View Related" which tracks all related matters, including those that have been joined with others. CTS improvements are a priority project for IIROC in the coming year.

*AMF comments and follow-up*

AMF staff have noted the project to improve CTS.

IIROC should also ensure that physical files are complete and include closing details (date of amalgamation, number of files amalgamated and the reasons for the amalgamation) and that this information is also available in CTS.

AMF staff will follow up this recommendation with IIROC.

**7. Model letters in French**

*Findings*

The French version of the most recent model letters used for complaints is not included in the procedures manual.

*AMF recommendations*

AMF staff recommend that IIROC Québec District include the French version of model letters used to respond to complaints in the procedures manual.

Priority – Medium

*IIROC's response*

IIROC had modified model letters in French and will integrate them in the manual.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**8. Complaints procedures manual**

*Findings*

The complaints procedures manual does not reflect the fact that the Director, Member Regulation – IIROC Québec District has, since August 2009, reviewed all complaint files prepared by the Case Assessment manager, including closed files. Similarly, the manual does not reflect the fact that the Case Assessment manager has reviewed all investigators’ files related to complaints since 2008. Since this situation is specific to Québec, the procedure should be drafted into the complaints procedures manual.

*AMF recommendations*

AMF staff recommend that IIROC Québec District modify the complaints procedures manual so that it reflects managers’ duties.

Priority – Low

*IIROC’s response*

The basis of the staff finding is that the IIROC Case Assessment Manual does not outline the actual process in place in Quebec in terms of the management review when a file is closed by Case Assessment. Section 5.1 of the Case Assessment Manual provides that a file which is to be closed with no action must be reviewed by the Case Assessment Manager or higher Manager. If the file has been handled by that Manager, the file must be reviewed by the next more senior manager. IIROC therefore believes that the manual provides for appropriate management review. However, we agree with the AMF that there is an omission in Section 5 of the Case Assessment Manual in that it does not specify that the Director, Member Regulation in Quebec can approve the files done by the Manager, Case Assessment. It rather specifies only that the VP Quebec can perform such approval. We will change our Manual accordingly.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained regarding section 5 of the complaints procedures manual and will follow this up with IIROC.

Since the current process is specific to Québec and the Director, Member Regulation – IIROC Québec District is not among the managers authorized to approve file closings, AMF staff are of the opinion that IIROC should also modify section 5.1 of the manual to clearly stipulate that, in Québec, files prepared by the Case Assessment Manager are reviewed by the Director, Member Regulation – IIROC Québec District, as the immediate line manager.

AMF staff will follow up this recommendation with IIROC.

## **9. Delegation of powers**

*Findings*

At present, the Vice-President – IIROC Québec has no delegation of powers related to enforcement, such as the power to sign off on documents. We suggest that IIROC consider whether such delegation would be necessary in emergency situations.



*AMF recommendations*

AMF staff recommend that IIROC Québec District evaluate the need to establish delegation of powers for the Vice-President – Québec.

Priority – Low

*IIROC's response*

IIROC's Vice-President – Québec is working with the General Counsel's Office to implement a formal delegation.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## **10. Conflicts of interest**

### *Findings*

AMF staff observed a deficiency with respect to the identification and disclosure of a conflict of interest. In one complaint file dating back to 2008, there was a significant delay in identifying and reporting a conflict of interest involving a staff member of Complaints – IIROC Québec District, and the individual against whom the complaint was filed was working for a Dealer Member. In fact, 40 days elapsed between the time the file was received at IIROC and when it was transferred to the AMF.

The obligation to report conflicts of interest is set out in the *Case Assessment Procedures Manual*. The *Conflicts of Interest Policy*, which is part of IIROC's *Code of Conduct* (updated in September 2009), contains a procedure stipulating that conflicts of interest must be disclosed when employees are hired, when they make any changes to their conflict of interest statements and on an annual basis. A copy of this statement is given to the employee's manager and IIROC General Counsel Office.

*AMF recommendations*

IIROC Québec District must adhere to conflict of interest written policies in place in IIROC's *Code of Conduct* and the procedures manual.

Priority – High

*IIROC's response*

Employees are required to acknowledge and comply with the *Code of Conduct*, including the Conflicts of Interest Policy, at the commencement of employment and annually thereafter. In addition, employees are required to identify potential conflicts of interest with member firms and complete a disclosure form, and to update this disclosure annually. Conflicts of Interest Forms

were signed by all employees upon the merger in June 2008. The electronic annual acknowledgment was undertaken in October 2009 during which the employees were reminded to confirm or update the Conflicts of Interest Form. The annual renewals on a going forward basis are being conducted in January/February of each year.

A potential conflict of interest was identified by the Montreal Office with respect to an employee in connection with one file. IIROC management made a decision that the conflict was such that the file should not be reviewed by the Montreal Office and the file was transferred to the AMF. IIROC is of the view that the *Code of Conduct* and procedures were complied with and worked properly in this case.

To assist in the earlier identification of potential conflicts of interest, IIROC has implemented a process where employee disclosure forms and updates are retained by the VP of the employee's region and/or department, as well as at IIROC's head office.

#### *AMF comments and follow-up*

AMF staff are satisfied with the new process for disclosing and updating staff conflicts of interest under which the forms will be retained by the Vice-President – Québec. We will follow up this recommendation with IIROC.

## **REQUIREMENTS FOR QUÉBEC**

### **1. Introduction**

The IIROC Recognition Order (in French only) contains a number of conditions, set out in Schedule A, including the condition regarding requirements for Québec. Paragraph 13 a) of Schedule A states as follows:

[Translation]

“IIROC shall maintain a Québec District that has clearly defined responsibilities in matters of regulation, membership, sales compliance, financial compliance, market surveillance, inspection of trade desks and application of rules regarding its Dealer Members, marketplace members and authorized persons. Any decision concerning oversight of its self-regulatory activities and Dealer Members, marketplace members and authorized persons in Québec is principally made by persons residing in Québec.”

### **2. Trade desk supervision**

#### *Findings*

In connection with paragraph 13 a) above, paragraph 13 f) of Schedule A of the IIROC Recognition Order stipulates that IIROC Québec District must, within six months of the recognition order, report in writing on its plan and timetable for development of its expertise in the examination of trade desks.

The IIROC Recognition Order was signed on May 2, 2008. At the time of the oversight review of the activities of IIROC Québec District by AMF staff, namely, 17 to 18 months after the signing

of the order, this expertise in trade desk inspection had still not been developed. IIROC Québec District reported on its plans and timelines on a regular basis to the AMF and took concrete steps in the desired direction. It initially contemplated hiring a Director, Surveillance & Trading Review and Analysis, a position which was later converted into a Senior Investigative Trading Analyst position. The job posting process was completed in February 2010 and the aim was to have the position filled by the first quarter of 2010. However, at the time of drafting of this report, the position had still not been filled.

*AMF recommendations*

AMF staff recommend that IIROC Québec District finalize the development of this expertise by hiring a trade desk inspector.

Priority – High

*IIROC's response*

IIROC has added this expertise to the Montreal office. A senior investigative trading analyst began in September 2010 and is involved in Quebec market files. IIROC has also begun training sessions for Montreal staff, and two such sessions have taken place. BCC examiners will be trained to assist in TCC examinations and this function will be transitioned to the region once a full-time examiner has been trained.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

### **3. Mediation process**

*Findings*

AMF staff reviewed letters issued during the review period in connection with the closing of complaint files, investigations and enforcement matters and IIROC's website. Their findings show that IIROC was not promoting the AMF's mediation service.

The requirement to promote the AMF's mediation service is set out in paragraph 13 g) of Schedule A of the IIROC Recognition Order. Under this paragraph, IIROC undertakes to comply with and promote the complaint examination and dispute resolution process put in place by the AMF under the laws it administers. IIROC Québec District should be reminded of obligation to comply with this requirement.

File closing letters have since been modified. However, IIROC's website does not provide visible references to the AMF's mediation services, yet it clearly directs site visitors to the services offered by the Ombudsman for Banking Services and Investments. For example, the website contains a link to a section (including a guide) entitled *Getting Help With Your Complaint*, which does not present the AMF's services among the recourses offered to investors.

*AMF recommendations*

IIROC's website should provide clear information about the AMF's mediation services.

Priority – High

*IIROC's response*

IIROC's Public Affairs Department has amended the information appearing on the IIROC website in order to identify clearly the AMF's mediation services.

The guide "Getting Help With your Complaint" was prepared jointly by the MFDA, the OSC and IIROC for Ontario residents, explaining the lack of mention of the AMF's mediation services. IIROC notes on its website that this guide is intended for Ontario residents.

*AMF comments and follow-up*

AMF staff are satisfied with the changes made to IIROC's website further to its recommendation. No follow-up is required.

## **QUÉBEC DISTRICT COUNCIL**

### **1. Introduction**

In accordance with section 10.1 of IIROC General By-law No. 1, any geographic area in Canada may be designated as a District of IIROC. Ten geographic areas were designated as the initial Districts of the IDA (and subsequently continued), including the Québec District. Each District has its own District Council. A District Council is a local committee that addresses regional registration, membership and discipline matters, raises issues of regional interest and adds regional perspective to national initiatives during quarterly meetings of the National Advisory Committee, which is composed of the Chairs of the District Councils.

Each District Council is composed of four to 20 members, including a Chair and a Vice-Chair, but exclusive of *ex-officio* members, as may be determined at the annual meeting of Dealer Members of the District called to elect the District Council members. In 2009-2010, the Québec District Council had 18 sitting members. District Council members are appointed for a two-year renewable term. Standing Sub-Committees may be established on the initiative of the District Council; for example, the Québec District Council has established a Nomination Sub-Committee, a Continuing Education Sub-Committee, a Regulation Sub-Committee, an Approval Sub-Committee, and, recently, a Derivatives Sub-Committee.

AMF staff reviewed the minutes and related documents of all Québec District Council meetings for the review period. They also interviewed the Vice-President – Québec and the Director, Member Regulation – IIROC Québec District. Their findings are as follows.

### **2. Disclosure policy**

*Findings*

There is no written information confidentiality and conflict of interest disclosure policy or formal process for Québec District Council members establishing, for example, the conditions whereby a member of the District Council is required to withdraw from a meeting during discussions involving the firm where he currently works or a firm where he has previously worked.

*AMF recommendations*

IIROC's Québec District Council should establish a disclosure policy and process for members in order to maintain information confidentiality and manage potential conflicts of interest. In the near term, it should obtain a formal commitment from the members of the Québec District Council to comply with the confidentiality of information obtained.

Priority – Medium

*IIROC's response*

IIROC has developed a new Code of Conduct and Conflicts of Interest Policy which was approved by the IIROC Board on January 27, 2011. Council members will be required annually to acknowledge that they have read and understood the Policy.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

### **3. Quorum**

In accordance with IIROC's *Dealer Member Rules*, in particular, Rules 5, 6 and 8, prior approval of the District Council is required in the following situations: changes in Dealer Member ownership, Dealer Member holding companies, related companies and diversification, and Dealer Member amalgamations or acquisitions. In addition, under section 18 of Rule 20, the District Council has the power, which it may delegate to a sub-committee of the District Council, in matters pertaining to the registration of individuals.

*Findings*

Since the District Council has the above-described powers with respect to Dealer Members, the determination of a quorum for meetings and the reporting of the attainment of quorum in the minutes are intended to validate committee decisions.

Under section 10.4 of IIROC General By-law No. 1, two members of the District entitled to vote, present personally or by a partner, director or officer shall be a quorum for any meeting of the Dealer Members of the District. Compared with the quorum for the District Council, the Approval Sub-Committee is comprised of three industry members, pursuant to section 18 of Rule 20 of IIROC's *Dealer Member Rules*. The definitions of these two quorums are not consistent.

*AMF recommendations*

AMF staff recommend that IIROC revise the definition of quorum for any District Council meeting so that it is consistent with the definition of quorum for a District Council sub-committee meeting.

In order to validate decisions made with respect to Dealer Members, the minutes of the Québec District Council meetings should indicate that a quorum has been reached.

Priority – Medium

*IIROC's response*

IIROC is reviewing, on a national basis, the rules for quorum requirements and District Council Sub-committees, having regard to the composition, size and mandate of each. The minutes of Quebec District Council meetings have, since May 2010, recorded the presence of a quorum. Please note that the new requirements will specify that the quorum is achieved for District Council meetings when 50% + 1 of members represented on the Council is obtained.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

#### **4. Mandate**

*Findings*

Prior to the merger of the IDA and RS, IDA's *Dealer Member Rules* articulated the functions and responsibilities of the District Council and set out the sub-committees that could or should be created. Since the formation of IIROC, Rule 11 – *District Councils and Meetings* and Rule 13 entitled *Election of District Council Members*, have been repealed. Article 10 of IIROC General By-law No. 1 only briefly covers District Councils, and there is no information on committees or sub-committees.

*AMF recommendations*

AMF staff recommend that IIROC more fully document the roles, functions and responsibilities of the District Council, its committees and sub-committees.

Priority – Medium

*IIROC's response*

IIROC is updating, on a national basis, the mandates and procedures of the District Councils and District Council Sub-committees to accurately reflect their regulatory decision-making powers, as set out in IIROC's By-law and Rules.

IIROC will also ensure that the mandates of the District Council Sub-committees established in Quebec are properly documented.

The new draft District Council procedures will be presented to the IIROC Board in March 2011.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

**5. Nominee selection criteria**

According to the minutes of a meeting of the Québec District Council Nomination Sub-Committee held in 2009, the applications of individuals seeking nomination to the Québec District Council are evaluated using criteria developed in 2007. These criteria cover skills sets, availability, and jurisdiction and industry representation. In addition, the renewal of a sitting member is conditional on attendance at meetings, substantive contribution and representation by Dealer Member head office.

*Findings*

Despite the existence of these criteria, it is difficult to determine whether they are actually considered when evaluating a nominee. In fact, during the review period, AMF staff found that some members seeking renewal did not meet all the criteria.

*AMF recommendations*

AMF staff recommend that IIROC Québec District Council's Nomination Committee improve documentation of member nomination and renewal criteria to clearly show that these criteria have been applied.

Priority – Medium

*IIROC's response*

IIROC has drafted a new set of District Council Procedures that dealt with District Council governance. On the nomination process, the new procedures will require the Nominations Sub-Committee to ensure a proper balance of Council members who will collectively provide effective representation of the membership having regard to each nominee's disciplinary history, if any, skills, experience and expertise necessary to discharge his or her obligations as a Council member including regulatory responsibilities pursuant to IIROC rules and delegation orders. The new draft procedures will be submitted to the IIROC Board for approval in March 2011.

In the future, we will better document the application of the nominations process.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## **6. Minutes**

*Findings*

When documents are filed following approval by IIROC Québec District Council members, the minutes are brief. They do not contain the main points discussed prior to approval of the documents and the nature and the level of members' involvement in the discussions.

*AMF recommendations*

AMF staff would like to see more detailed minutes that reflect discussions, particularly when members are required to approve measures to be taken regarding a Dealer Member.

Priority – Low

*IIROC's response*

IIROC will comply.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained. No follow-up is required.

## **7. Hearing Committees and Hearing Panels Rule**

One of the mandates of the District Council is to identify competent nominees for hearing panels. Hearing panels play an essential role in the enforcement of rules. Each year, the District Council establishes a Nomination Committee that prepares a list of nominees recommended to sit on the Hearing Committee and the Hearing Panel. This list is then approved by the District Council and submitted to the governance of IIROC's Board of Directors for nomination purposes.

In accordance with IIROC's *Hearing Committees and Hearing Panels Rule* in Schedule C.1 to Transition Rule No. 1, one-third of the individuals nominated to the Hearing Committee must be public members and two-thirds must be industry members. The resulting Hearing Panel is composed of two industry members and one public member, who are appointed to the Hearing Committee. The definition of "industry member" includes a current or former director, officer, partner, or employee of a current or former member or access person. A public member means, for purposes of the Québec District Council, a person who is a current or retired member in good standing of the Law Society of Québec (Québec Bar). Furthermore, the District Hearing Committee chair must be a public member and the Hearing Panel chair must be a public member of the Hearing Committee.



## *Findings*

The rules governing the composition of the Hearing Committee and the Hearing Panel must be clear. The definitions of industry member and public member are such that the same person may act in both capacities at the same time. Regardless of an individual's functions, the fact that he is a member of the Law Society of Québec (Québec Bar) is sufficient to qualify him as a public member. This cancels the distinction between the two types of members, and as a result, the Panel Hearing may be composed exclusively of industry members.

### *AMF recommendations*

AMF staff recommend that IIROC amend the definition of public member to exclude any individual already eligible as an industry member, so as to clarify the composition of the Hearing Committee and the Hearing Panel.

Priority – High

### *IIROC's response*

IIROC has independently identified the desirability of reviewing the definition of public member. Proposed rule amendments resulting from the review will be published for public comment and filed with the CSA in accordance with the rule approval protocol.

### *AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.

## **INFORMATION PROTECTION**

### **1. Purpose and scope**

It is essential that an organization such as IIROC take the necessary measures to protect the information it receives. This applies to its premises, computer equipment and the training of key staff. These measures will ensure that operations are effective under all circumstances.

The objectives of this section of the review were to:

- ensure that IIROC Québec District has followed up on the AMF's recommendations made during the previous review of the IDA Québec District with respect to information protection;
- ensure that procedures for managing access, conservation, use and destruction of documents are adequate.

During its review, AMF staff visited IIROC's premises in Montréal, interviewed the individuals tasked with protecting information and examined current procedures.

## 2. Computer systems

In 2004, the IDA outsourced the management of its data centre to an independent specialized service provider and IIROC has continued this outsourcing. The service provider is responsible for the physical protection of and access control to servers, applications and data. Servers are installed in all of IIROC's regional offices so that systems, files and data are safeguarded using the same procedure in each office. These regional servers are managed remotely by the service provider and physical access is controlled by a designated IIROC staff member.

Therefore, at IIROC's Montréal office, the server and peripheral equipment is protected through limited access by a designated person (who is assisted by other individuals who assume this responsibility in her absence) and an uninterruptible power supply. Data is saved daily and kept on a cartridge (containing a high capacity tape) that the designated person must replace in accordance with a defined rotation order. This cartridge is kept in a closed room. In addition, the cartridge recorded on the last Friday of each month is designated as the monthly back-up and sent to the service provider in Toronto. These procedures were tested in August 2009 during a server breakdown in Montréal, and all files were recovered.

### *Findings*

AMF staff noticed that back-up tapes are placed on a shelf in the server room at IIROC's Montréal office. They are exposed to risks (water, fire, etc.) in this location. This is a recurrent finding from the previous review of the IDA.

### *AMF recommendations*

IIROC Québec District must ensure that cartridges and tapes are stored in a secure location.

Priority – High

### *IIROC's response*

IIROC will review the current process for backups in Montreal (frequency, accountability, overwrites, etc.). A secure storage cabinet has been put in place for backup materials and IIROC has instituted a process for storing cartridges and tapes in that secure cabinet. IIROC will develop, document and follow a process for transferring cartridges and tapes to secure off-site storage.

### *AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up on this recommendation with IIROC.

## 3. Documentation

### *Findings*

IIROC still does not have a written policy covering paper and electronic document archiving and destruction. This is a recurring finding from the previous review of the IDA. However, for some

years, the organization has stated that it would like to develop a national archiving and destruction policy.

Since moving to its new premises in June 2008, IIROC Québec District has been archiving its documents at an outside location.

IIROC Québec District has no written document management policy; each department has its own filing system.

*AMF recommendations*

IIROC must implement a written policy covering paper and electronic document management, archiving and destruction to ensure access to and the protection, retention and proper use of documents.

Priority – High

*IIROC's response*

IIROC implemented a national data retention policy in August 2010. This policy covers all hard copy documents, records and data.

Certain IIROC departments have procedures in respect of retention and destruction of electronic data (particularly for market surveillance data) and these continue to be in effect. IIROC is reviewing practices in other departments, and will assess electronic data storage capabilities and will consider extending electronic data retention and destruction guidelines to all other IIROC departments in FY11.

*AMF comments and follow-up*

AMF staff are satisfied with the response obtained and will follow up this recommendation with IIROC.