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Investment Industry Regulatory Organization of Canada
Organisme canadien de réglementation du commerce des valeurs mobilières

IIROC NOTICE

Rule Notice
Guidance Note
Dealer Member Rules
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Annual Consolidated Compliance Report

IIROC is pleased to present the Annual Consolidated Compliance Report for 2013/2014. This report is designed to assist IIROC-regulated firms (Dealers) in ensuring that their compliance systems and controls satisfy regulatory requirements. This year's Report also incorporates common deficiencies from Registrations and certain findings from Trading Review & Analysis.

Every year, we enhance the information in this Report to be proactive in our regulatory efforts. This Report is a significant tool that we use to promote higher industry standards, improve investor protection and strengthen market integrity. In addition, communicating our regulatory expectations to Dealers and stakeholders is important and we continue to issue timely, clear and relevant guidance notes throughout the year. Our guidance note and rule initiatives are set out in the Policy Priorities Update Report that is accessible on our website (Policy Priorities Update) and published quarterly.

IIROC continues to enhance our compliance program to reflect changes in market structure, business risks, investment products, demographics and corporate priorities. IIROC uses a risk-based methodology in its regulatory operations and in assessing the financial condition, business conduct and trading conduct of Dealers. This risk-based approach to regulation allows IIROC to allocate regulatory resources to Dealers and issues that have a higher potential to cause risk to the public. This also helps Dealers identify areas where they should be devoting more of their supervision, compliance and risk management efforts.

IIROC's regulatory approach also recognizes that there may be different ways to implement an effective supervision, compliance and risk management framework to monitor and comply with IIROC rules and applicable securities laws, and adopt industry best practices. Our compliance program incorporates an appropriate measure of regulatory flexibility in the ways in which a Dealer may demonstrate compliance and supervision of their regulatory responsibilities.

IIROC's Financial and Operations Compliance, Business Conduct Compliance and Trading Conduct Compliance departments all use a top-down approach in conducting compliance examinations. More time is spent on the planning stages of an examination, where examiners determine the level of substantive testing required to confirm the existence of a proper and effective supervision system at the Dealer. Examiners are able to focus on the areas of greatest impact and concern and be more efficient in performing an on-site assessment of the Dealer's controls and supervisory infrastructure.

At IIROC, we are committed to continuously looking for opportunities for operational improvements, including streamlining processes, adopting technological improvements and providing training and guidance to examiners to facilitate consistency in the examination process. We have also reviewed, updated and strengthened our business policies, procedures and protocols on the collection and retention of confidential information. We have made progress in ensuring that our requests for information and/or data are streamlined and targeted to information that we reasonably require to conduct our testing and monitoring.

In the interest of further improving efficiency and effectiveness, IIROC has scheduled more integrated Financial and Operations Compliance, Trading Conduct Compliance, and Business Conduct Compliance examinations in 2013/14. Integrated examinations occur when at least two Compliance Departments review a Dealer at the same time. This approach provides IIROC

with a holistic risk assessment of the Dealer's business activities, but also reduces the number of information and document requests that the firm receives. Dealers are provided with a consolidated examination report at the completion of each integrated examination.

This Report outlines the key areas that the Compliance teams will focus on in the current round of examinations, including:

Financial & Operations:
- Balance Sheet Leverage
- Liquidity
- Outsourcing

Surveillance and Trading Conduct:
- Unreasonable / Clearly Erroneous Trades
- Electronic Trading Rule Requirements
- Best Execution

Business Conduct:
- Client Relationship Model Implementation
- Personal Financial Dealings with Clients and Outside Business Activities
- Social Media

The Report also lists common deficiencies noted in the previous Compliance examination cycle and in the Registration area. IIROC staff expects Dealers to ensure they have adequate systems for supervision, compliance and risk management to address these issues and to ensure that repeat findings do not occur.

IIROC staff recognizes that in the current economic environment, there are challenges on a Dealer's resources and business activities. However, Dealers still have an obligation to have strong and effective compliance and risk control systems in place. As many Dealers are now reviewing their current business models and looking for ways to effectively contain and reduce costs or alter business lines to meet the changing business environment, it is important for all firms to maintain a robust, effective compliance and risk management framework. For additional guidance on our expectations, please consult IIROC Notice 09-0100 "Maintaining an effective compliance regime during economic and market downturns".

Table of Contents

Key IIROC Priorities for 2013-2014

Outlined below are the key areas of focus for Financial and Operations Compliance, Business Conduct Compliance, Trading Conduct Compliance and Trading Review & Analysis groups. New risks that have emerged in the challenging and continuously evolving capital market landscape have been integrated into the scope of IIROC's regulatory programs and are addressed in this Report.

FINANCIAL AND OPERATIONAL COMPLIANCE

1. Balance Sheet Leverage

With interest rates at historic lows, some Dealers have continued to increase their balance sheet to compensate for the lower net-interest revenue. Dealers must pay adequate attention to the maturity mismatch of assets and liabilities. Excessive balance sheet leverage can present substantial risk to the orderly wind down of any self-clearing Dealer Member faced with financial distress.

New examination modules have been developed and implemented in the current examination cycle to review and assess the balance sheet leverage and repo book financing risk management practices of Dealer.

2. Liquidity

The IIROC capital formula is designed to ensure that Dealers have sufficient liquid assets to meet their obligations, but remain flexible enough so as to not prohibit or severely restrict any particular type of transaction within the bounds of good business practice.

The management of the sources and uses of liquidity, also referred to as "cash management", is critical to a self-clearing firm to ensure that it has sufficient funds to meet client obligations on demand and withstand any unexpected business disruptions in its normal daily operations.

Given the current volatile economic environment, the Financial and Operations Compliance group has developed and implemented new examination modules that focus on the cash management processes in place at Dealers. These procedures are specific to all self-clearing and type 4 introducing brokers, as they are responsible for financing their firms' business activities.

3. Use of Free Credit Balances

IIROC Financial and Operations Compliance staff has recommended that Dealers limit their client free credit balance usage to 12 times their current early warning reserve (EWR) level as a more restrictive standard than the current rule set out in Statement D of Form 1. All Dealers with customer free credits have indicated they are in compliance with this limit and IIROC has

developed an alert to its regulatory financial reporting system (SIRFF) to flag any firm that exceeds the revised "12 times EWR" client free credit usage limit.

4. Outsourcing

IIROC has issued proposed Guidance Notice 12-0311 for public comment. This Notice assists Dealers in identifying regulatory functions that may be outsourced and the risks that must be effectively managed with any outsourcing arrangement. The Notice lists critical issues that must be addressed in any outsourcing agreement and also provides examples of domestic and international industry best practices to help firms establish an appropriate risk management infrastructure for outsourced functions. IIROC staff expects that the guidance will be issued by year end.

IIROC examination procedures include a review of all outsourcing arrangements as part of understanding the business structure of Dealers. Dealers must properly supervise any outsourced activity and must have adequate written risk management policies and procedures in place.

5. Books and Records

There is increasing focus on client books and records data of Dealers that reside on accounting systems that are physically located on computer servers outside the control of the Dealer. Some of these servers may be shared with an affiliate or third party. IIROC will continue to focus on identifying these arrangements and the regulatory concerns that may arise.

For Dealers that have entered into these arrangements, IIROC examination procedures review the Dealers' maintenance of client records using the same brokerage accounting operating system and whether a back-up is maintained on a server located at the central office location of the Dealer. A Dealer's access to and control over books and records is crucial to facilitating an orderly transfer of client accounts and liquidation, in the event such actions are required.

SURVEILLANCE AND TRADING CONDUCT COMPLIANCE

1. Unreasonable / Clearly Erroneous Trades

Market Participants continue to enter stop loss orders with trigger prices "clustered" at certain price levels. When triggered, the cascading effect of simultaneous market orders impacting order books with no time interval to allow for liquidity replenishment continues to cause market disruptions, trigger single-stock circuit-breakers and result in unreasonable trades requiring IIROC intervention[1].

[1] For example, see IIROC Notice 13-0067 and press release

IIROC issued additional guidance[2] on this subject on July 11, 2013 which encourages Participants that have automated the handling of triggered stop loss orders to assign reasonable limits or collars on these order types or modify their order handling process to prevent unreasonable trades. The guidance also reminded Participants that the Electronic Trading Rule (ETR)[3] effective March 1, 2013 requires Participants to apply electronic, pre-trade filters on all orders. While many Participants perform automated reviews of stop loss orders upon receipt, few subject those orders to additional controls when they are triggered. Due to the time between the entry of a stop loss order and a triggering trade, market depth and liquidity may be significantly different than when the order was initially entered.

IIROC has noted similar issues related to the entry of odd lot orders. Many marketplaces that support odd lot trading do not prevent trades at unreasonable prices. Notwithstanding this risk, some Participants have made a practice of systematically entering deep limits on odd lot orders, sometimes resulting in executions at unreasonable prices. In the past, IIROC has intervened in the case of unreasonable odd lot trade prices that are not voluntarily amended.

Odd lot executions do not impact the last sale price, volume-weighted average price (VWAP), closing price or other common benchmarks and market integrity is not impaired by the existence of unreasonable or erroneous odd lot trades. As a result, IIROC has reevaluated its practice of regulatory intervention in these cases, and will no longer cancel or vary unreasonable odd lot trades. If no agreement between Participants can be reached, Dealers may be required to settle odd lot trades at the price of execution. IIROC expects that any Participant that enters an odd lot order with an unreasonable price will ensure their clients are not disadvantaged, in accordance with best execution rules.

Finally, a number of erroneous trades have resulted from input or "fat finger" errors by traders with pre-trade risk controls that were set improperly for the typical size of order entered. In more than one case, the filter level was set very low requiring the trader to override the control frequently throughout the day. Although the pre-trade volume/value filter alerted the trader to a potentially erroneous order, the trader ignored the warning and submitted the order causing a large price movement and requiring surveillance intervention.

Participants are reminded of the requirement to have pre-trade risk controls in place, and ensure the settings are appropriate given the type of business normally conducted.

[2] See press release of July 11, 2013
[3] See IIROC Notice 12-0363

2. Electronic Trading Rule (ETR) Requirements

In March 2013, the first phase of the ETR came into effect. It is important for all Dealers to recognize that electronic trading rules apply to all firms, not just those that offer Direct Electronic Access. All trading executed in any part electronically is subject to this rule, including proprietary as well as intermediated client trading.

The Trading Conduct Compliance program now includes a comprehensive examination module on this important regulatory change. The areas of particular focus include marketplace access, supervision, pre-trade filters and delegation of controls as well as the use of automated (algorithmic) order systems.

In July 2013, IIROC announced further rule amendments[4] and related guidance[5] dealing with third-party electronic access. The amendments require, among other things, Dealers to develop and implement adequate supervisory policies and procedures, assign unique client identifiers and include these identifiers on every direct electronic access order. The amendments also expand the regulatory framework governing third-party electronic access to capture investment dealers and also expand the types of entities that qualify for direct electronic access, to include retail clients under certain conditions.

The amendments will become effective on March 14, 2014. IIROC will be expanding its compliance modules to cover these rule amendments.

3. Best Execution

Universal Market Integrity Rule (UMIR) 5.1 requires Participants to "diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances". Policy 5.1 and additional guidance have been issued to assist Dealer Members in complying with this obligation.

As described in further detail below, IIROC recently conducted a survey of Participants' best execution practices to assess compliance with the Rule. IIROC intends to continue its focus on compliance with the requirements in the current examination cycle. In particular, IIROC will be considering Participants' procedures to access liquidity on marketplaces to which they have subscribed, review the rationale supporting decisions to not seek price improvement opportunities in dark markets, and review Participants' decision-making and supervision of order handling.

4. Cyber-Crime

Cyber-crime has been identified by international regulators as an increasing threat to the financial services industry. The costs of cyber-crime to the industry, and the investing public,

[4] See IIROC Notice 13-0184 Provisions Respecting Third-Party Electronic Access to Marketplaces (July 4, 2013).
[5] See IIROC Notice 13-0185 Guidance Respecting Third-Party Electronic Access to Marketplaces (July 4, 2013).

continue to grow. Cyber-attacks have continued to evolve and become more sophisticated and now pose a systemic threat. Apart from the risk of theft directly from clients, there are also significant concerns about exposure to market manipulation and general attacks on the infrastructure of the financial system. The Canadian Securities Administrators recently issued CSA Staff Notice 11-326 which notes several risks posed by inadequate cyber-security and identifies steps that market participants can take to reduce these threats. Dealers are expected to have appropriate measures in place to safeguard themselves and their clients with respect to their business activities, including the risk of cyber threats.

Account intrusions are one form of cyber-crime. As noted in IIROC's 2012 Annual Compliance Report, IIROC staff conducted a Dealer survey in 2011 looking at the policies and procedures for the detection and prevention of on-line account intrusions. The 2012 Report highlights the requirement for Dealers to file Gatekeeper Reports whenever an account intrusion is found. This is important for IIROC to assess any potential harm to clients and/or market integrity.

Throughout 2013, IIROC received a significant number of Gatekeeper Reports regarding client account intrusions, many of which involved trading in multiple securities. Dealers are reminded to take all appropriate steps to prevent compromised accounts, including:

- real-time alerts and post-trade compliance reviews to detect abnormal deviations from a client's normal trading patterns;
- two-factor authentication;
- optional client participation in more robust security such as secure transaction programs;
- free downloads of software for clients to install on their computers to provide extra protection;
- procedures for remedial steps to be taken once an account has been identified as compromised, including controls such as suspending accounts and requiring clients to set new passwords or create new accounts;
- blocking access or requiring further authentication if an unrecognized IP address is used; and
- monitoring lists of known fraudulent IP addresses and blocking access by such addresses to the Dealer's systems.

Business Conduct Compliance

1. Client Relationship Model (CRM) Implementation

CRM represents significant regulatory reforms to enhance the advisor-client relationship by improving transparency through the disclosure of fees, account performance and potential conflicts and by strengthening suitability assessments. IIROC has undertaken and will

continue to focus on initiatives to assess how Dealers are complying with CRM provisions, gather information on current and best practices, and explore ways in which IIROC can assist Dealers in the successful implementation of CRM. The results of these initiatives will also inform policy development.

Know-your-client (KYC) documentation and the suitability assessment obligation:
To identify the approaches used by Dealers to meet these obligations under the new Rules, IIROC conducted a review of a broad cross-section of small, medium and large Dealers' KYC information collection processes. The results of the review will help IIROC staff provide guidance on industry practices in collecting the KYC information elements used for suitability assessments. A precise, comprehensive and well documented KYC process will enable Dealers to more efficiently and effectively comply with their obligations. It will also help to enhance industry standards and strengthen the client's relationship with his/her advisor generally.

Relationship Disclosure:
IIROC Rule 3500 establishes the minimum industry standards for relationship disclosure to retail clients. Relationship disclosure must be provided when a client opens an account and when there are significant changes to relationship information previously provided. Among other prescribed elements, the relationship disclosure must describe:

- the products and services offered by the Dealer;
- the nature of the account and the manner in which the account will operate; and
- the responsibilities of the Dealer to the client[6].

Rule 3500 does not mandate a specific format for the disclosure, but does require that the information be provided to the client in plain language. The Rule came into effect on March 26, 2013 for new clients and will come into effect on March 26, 2014 for existing clients.

Phase 1 of this project included a targeted review of Dealers' relationship disclosure documentation. Phase 2 of the review in the coming year will look at the processes Dealers have in place for compliance with the acknowledgement and other provisions of the Rule.[7]

While the review is ongoing, we have noted that many firms are using the same relationship disclosure document for different types of client accounts, including advisory accounts, order-execution service accounts and managed accounts. The relationship disclosure should be meaningful and relevant to the client. At the very least, a Dealer should tailor the relationship disclosure document to the client account type.

[6] As detailed in Dealer Member Rule 3500 – Relationship Disclosure.
[7] See Rule 3500.

Conflicts of Interest:
Under IIROC Rule 42, Dealers must have written policies and procedures in place for identifying and addressing material conflicts of interest and must effectively apply these policies and procedures.[8]

The Business Conduct Compliance department has noted several findings regarding these requirements. In examinations conducted between March 2012[9] and March of 2013, IIROC staff raised conflict of interest issues in almost 1/3 of the reports issued. The top 5 findings were:

- Inadequate evidence of reviews being conducted to identify and manage material conflicts of interest
- Inadequate disclosure of conflicts of interest
- Inadequate policies and procedures for the identification and management of conflicts of interest

In the coming year, IIROC staff will conduct a review of conflicts of interest – how Dealers identify and analyze the conflicts that they face and how they implement a conflicts management framework appropriate to the size and scope of their business. The results of the review will inform policy development in this area.

2. Personal Financial Dealings with Clients and Outside Business Activities

Recent rule amendments and guidance[10] issued by IIROC have clarified that:

- any personal financial dealings with clients, subject to limited exemptions, are considered inappropriate conduct, a conflict of interest and a violation of the general business conduct standards; and
- Registered Representatives and Investment Representatives must disclose any outside business activities to the Dealer and obtain the approval of the Dealer before engaging in any outside business activities. This is required to allow the Dealer to ensure that the outside business activities are not inappropriate and do not give rise to a conflict of interest that cannot be appropriately managed.

Business Conduct Compliance examinations will focus on these issues in the next examination cycle.

[8] See also IIROC Notice 12-108 Client Relationship Model - Guidance (March 26, 2012)
[9] Rule 42 came into force effective March 26, 2012
[10] See IIROC Rules Notice 13-0162 and 0163, and Dealer Member Rules 43 and 18.14 which will be in force as of December 13, 2013.

3. Social Media

IIROC Rule 29.7 sets out requirements regarding the review, supervision and retention of advertisements, sales literature and correspondence used to promote the business of Dealers, including through social media. Rules Notice 11-0349 provided guidance to Dealers on developing and implementing policies and procedures for the review, supervision, retention and retrieval of communication materials, and focused on the nature of "business purpose" communications through various social media.

IIROC's expectation is that all Dealers will have robust policies and procedures for communicating though social media with clients and the public for business purposes. IIROC's Business Conduct Compliance department will be reviewing the social media policies and procedures of Dealers in the next examination cycle. The results of this review will inform policy development in this area.

4. OSC Mystery Shopping Project

The Ontario Securities Commission ("OSC") in its Statement of Priorities announced a Mystery Shopping Project that will focus on registrants directly regulated by the OSC (exempt market dealers and portfolio managers), as well as those regulated by the Self-Regulatory Organizations (SROs), including IIROC. The objective of this initiative is to conduct research into the quality of investment advice currently provided to retail investors in Ontario and gain first-hand knowledge of investors' experiences. Mystery Shopping has been undertaken by a number of regulatory bodies both internationally and domestically and can be informative in assessing compliance with regulatory requirements. The results of a mystery shopping initiative can also be a useful input, amongst others, to the policy formulation process with the proper context.

As IIROC registrants will be involved, we have agreed that this will be a joint initiative that we can help shape, including the development of appropriate methodology, communication, analysis and reporting of results.

Results of recent targeted reviews and surveys

Non Arm's Length Investment Products

IIROC has completed a targeted review of Dealers engaged in the manufacture and distribution of non-arm's length investment products. This review focused on a representative sample of IIROC-regulated Dealers, which included:

- Dealers whose primary business involved managed accounts for proprietary funds manufactured by affiliates, and
- Dealers that act as both manager and distributor of proprietary products

The objective was to determine the extent to which Dealers that distribute non-arm lengths products have adequate controls for the distribution, suitability assessment and supervision of these products to mitigate the following regulatory concerns:

- A conflict of interest assessment, as required by IIROC Rule 42 (and CRM guidance 12-0108);
- Product due diligence, (Guidance Notes 09-0087 and 10-0234); and
- Client specific suitability (CRM Guidance 12-0107, 12-0108 and 12-0109).

Overall, we found the majority of Dealers reviewed had appropriate controls with respect to their suitability obligations and accredited investor determination in the sale of non-arm's length products. Dealers generally had adequate written policies and procedures that identified the distribution of non-arm's length products as posing a conflict of interest and that provided for a process to assess and manage the conflict of interest. Conflicts of interest were often addressed through the use of disclosure although, in some cases, the disclosure was not clear and lacked specificity. The policies and procedures also provided for a product due diligence process to be undertaken prior to distribution to clients, particularly relevant where such products were manufactured by affiliated third parties. Some Dealers did not maintain sufficient written evidence of their due diligence process and analysis. BCC staff will be meeting with some of the Dealers to proactively provide specific feedback and to encourage enhanced practices in this area.

Some Dealers engaged in the practice of reviewing and approving "bundles" of like products together. The use of a bundled approval process may hinder a product due diligence committee from considering the unique and complex characteristics of any individual products.[11]

The distribution of non-arm's length products will continue to be an area of focus during regular compliance examinations for those Dealers engaged in this business activity. The scope of the recently completed review was limited to the disclosure to the clients that the products being sold were manufactured and/or distributed by the Dealer and/or its affiliate, and the arrangements that are in place to effect that distribution. The broader issue of conflicts of interest will be further reviewed in 2014.

Order-Execution Only Platform

IIROC Rule 1300.1(t) and 3200 set out the documentary, procedural and system requirements for Dealers to accept orders from a client without a suitability determination. Approval for a Dealer to provide an order-execution only service is predicated on the requirement that no recommendation be provided by the Dealer. While IIROC recognizes that Dealers wish to assist clients in providing information and improving their investment knowledge, order-

[11] See IIROC Notice 09-0087

execution only Dealers must ensure they are not providing recommendations or giving advice. Whenever a recommendation is made or advice given, a suitability determination is required[12].

Business Conduct Compliance has completed a survey of Dealers that currently offer order execution only services and has conducted on-line testing of some sites to gain a better understanding of the type of services, tools and products being offered to clients. The results of the survey indicate that there is a wide array of information and tools available to clients, including asset allocation and model portfolios. Some Dealers are collecting and using various elements of client KYC information in the provision of some of these tools. The types of products have also evolved, where initially "plain vanilla" products and listed securities were sold to clients. Today, this channel distributes more complex products and, in some cases, exempt products. IIROC staff hosted a national meeting on October 22, 2013 to provide general feedback to all the Dealers that participated in the review.

IIROC staff are continuing to consider the results, identify and discuss regulatory issues and consider next steps, including future policy development in this area.

Titles and Designations

IIROC reported on the results of its review regarding the use of titles and designations in a draft Guidance Note issued for public comment in January 2013.[13] IIROC's Business Conduct Compliance has enhanced its modules to monitor firms' activities in this area in the next cycle of compliance examinations. IIROC staff expects to publish final guidance on the use of titles and designations in March, 2014.

Also, in an effort to help investors make more informed choices when selecting an advisor, IIROC has published a glossary of over 40 commonly used designations on our website. The glossary provides greater transparency regarding the different designations which may be used at Dealers and includes information about the financial designation, the issuing organization and relevant educational requirements.

Balance Sheet Leverage

Aggregate industry financial results show that the weighted average leverage ratios between 2003 and 2013 have ranged between a low of 8 (in 2008) to a high of 15 (in 2003) and is currently 13[14]. This is well within the 20:1 ratio benchmark used by other domestic and international regulatory authorities.

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[12] Member Regulation Notice 0098 (September 6, 2001) addressing the issue of what constitutes a "recommendation"
[13] See Rules Notice 13-005 Request for Comments (January 8, 2013)
[14] Balance Sheet Leverage Ratio = (Total Assets less customer monies held in trust / Total Regulatory Capital)

The Financial and Operations Compliance department conducted a review of Dealers to examine the risk management practices of firms with individual firm balance sheet leverage ratio greater than 20:1. The review consisted of: a) reviewing the Dealer's policy on leverage; b) reviewing the risk management processes in place to monitor leverage; and c) analyzing the quality of collateral received in its leverage activities.

The results of the review indicate that Dealers with balance sheet leverage in excess of 20:1 are actively engaged in balance sheet financing activity (repos/reverse repos). Further review has shown that the underlying collateral used by such Dealers for this business activity is predominantly highly liquid US and Canadian government debt securities.

Further examination work continues on assessing the mismatch of financing terms which can present liquidity risk in the event of an immediate need to quickly unwind these financing arrangements to meet increases in firm liquidity requirements.

Portfolio Manager Business Serviced by Dealer Members

Some Dealers (often referred to as "Carrying Brokers") play a critical role in the back-office operations of a significant number of Introducing Dealers. These Carrying Brokers may also provide custody and other services to Portfolio Managers that are registered with and directly regulated by provincial securities commissions in Canada ("Portfolio Managers"). These services to Portfolio Managers have evolved over time. IIROC conducted a survey of Dealers engaged in this activity to better understand: (i) the extent of the involvement of Dealers providing such services to Portfolio Managers; (ii) the legal structure and/or contractual terms of those service arrangements; and (iii) how client accounts of the Portfolio Managers are opened and operated on the books and records of the Dealer.

Carrying Brokers that provide back-office operations to Introducing Dealers are governed by a comprehensive set of requirements under IIROC Rule 35. In contrast, the results of the review indicated that there were inconsistent practices in the arrangements between Carrying Brokers and Portfolio Managers, including in the written service agreements between the Carrying Broker and the Portfolio Manager and the terms of those agreements. From a regulatory and investor protection perspective, it is important for the service agreement to clearly demarcate the responsibilities between the Dealer as custodian of client assets and the Portfolio Manager as discretionary investment manager to clients. In addition, while IIROC Rules permit Carrying Brokers to provide custody and certain other administrative services to third parties, Carrying Brokers are not permitted to act as agent and/or to provide books and records (in addition to custody) for any party that is not also an IIROC-regulated firm.

IIROC staff has met with the Dealers who participated in the survey to communicate the results. The survey results will inform future policy development. IIROC staff and staff from the provincial securities commissions continue to meet and discuss the results of the review and to co-ordinate next steps. This will include consultations with industry and other stakeholders.

Best Execution

Earlier this year, IIROC conducted a survey of Dealers' best execution practices, with the goals of assessing the current state of compliance, and developing guidance to assist Dealers' compliance efforts. IIROC used a third party to conduct this review and participation was mandatory, encompassing all Dealers that conduct secondary trading in Canadian-listed securities on behalf of clients. Dealer responses were provided to IIROC in aggregate only.

Some initial areas of concern have been identified and will be addressed during Trading Conduct Compliance examinations. These include:

- Variations in Dealer processes for determining order routing preferences, ranging from Participants with formalized best execution committees meeting regularly and documenting the results of committee meetings to Dealers not having a process at all to review best execution. Guidance[15] published by IIROC reminds a Participant to "regularly review its order routing choices to ensure that such choices continue to satisfy its "best execution" obligations ... arising as a result of the use of ... a Directed Action Order...". Further, "a Participant may wish to consider maintaining a written order routing methodology or table" and establish a "formal process, such as a committee that regularly reviews the methodology that determines order routing choices". At a minimum, IIROC expects Participants to perform an annual review.
- Variations in levels of client communication. Many Dealers have made decisions regarding the default routing of orders received prior to 9:30 a.m. (ET) or after 4:00 p.m. (ET) or where passive orders are posted, yet this information is not available to clients.
- Failure to seek price improvement opportunities that may be available for clients in dark markets. Policy 5.1 Part 1 describes the general factors to be considered including price, speed and certainty of execution, as well as the overall cost (to the client) of the transaction. Specific factors to be considered include:
    - considering "orders on a marketplace that has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of a client order";
    - considering non-transparent marketplaces if the volume displayed on a lit marketplace "is not adequate to fully execute the client order on advantageous terms"; and
    - whether a dark market has "demonstrated that there is a reasonable likelihood (of) ... liquidity for the specific security".

  National Instrument 23-101 *Trading Rules* imposes similar requirements.
- The practice of passing marketplace active trading fees onto their retail clients while retaining passive order rebates, with inadequate disclosure.

[15] See IIROC Rules Notice 11-0113 (March 30, 2011)

- Failure to perform post-trade supervision and testing to ensure clients are receiving best execution.

IIROC intends to publish a full report on the results of the Best Execution Survey, and to develop guidance to assist Dealers' compliance with best execution rules.

Third-Party Risk Controls

Effective March 1, 2013, in accordance with the Electronic Trading Rule, all Dealers employing, or contracted to, a third party to provide risk management or supervisory controls must advise IIROC as to the name of that third party and provide contact information.

Examples of third-party risk controls could include risk management features included in order and execution management systems, as well as separate software applications designed to prevent erroneous trades, control credit risk or intercept an order prior to entry on a marketplace for further review. Many standard trader workstations provided by vendors have built in "fat finger" and other risk controls, and would meet the definition of a third-party risk management system.

IIROC staff has contacted all Dealers that failed to comply with these requirements within the appropriate timeframe. In some cases, the Dealer was not aware that the requirements were applicable to them.

Dealers are reminded to notify IIROC of the commencement or termination of any agreements with a third party further to these controls. Submissions should be made via EMX to etrreporting@iiroc.ca.

Stop Loss Order Handling

IIROC is currently conducting a targeted review of Dealers whose stop loss orders have contributed to market disruptions or otherwise impaired fair and orderly trading. Dealers are being asked to describe how stop loss orders are handled, whether any automated or manual controls are in place to prevent market disruptions and what changes, if any, are planned in response to the guidance issued on July 11, 2013.

Dealers that participated in the review will be provided with a letter detailing the results along with a deadline to resolve any deficiencies noted.

Other common/significant deficiencies noted in the Compliance 2012-2013 examination cycle

Summarized below are several common deficiencies that our Financial and Operations Compliance, Business Conduct Compliance and Trading Conduct Compliance teams noted

over the previous examination cycle. In addition to the key objectives noted above, staff will continue to focus on these issues as part of their regular reviews.

It is important to note that the deficiencies noted below are a compilation of deficiencies encountered across the membership. These deficiencies have not been found at all firms reviewed and no single firm has received a report containing all or even most of these deficiencies. Most findings are resolved by Dealers within the time periods prescribed by IIROC.

Books and Records

Deficiencies regarding books and records included the following:

- The trial balance generated for monthly financial reporting purposes did not include all month-end adjustments and there was no process in place to evaluate the related margin impact of the adjustments.
- Client free credits were not properly reported on Statement D of Form 1.

Margin Requirements for Dealers Engaged in Underwriting

Underwriting deficiencies included the following:

- The Chief Financial Officer failed to review the supporting underwriting agreements to verify accuracy of the underwriting margin provision.
- Public/private partnership deals were not properly considered as a commitment requiring capital at the "request for financing bid" stage of the project.
- Underwriting concentration was not considered for commitments where margin was reduced for expressions of interest or the use of a standard form new issue letter.
- Margin was reduced for sales assumed to be ticketed by the lead underwriter without receiving appropriate confirmation from the lead.

Internal Controls

Adequate internal controls were not established and maintained in accordance with the internal control policy statements in Rule 2600. For example:

- Weekly risk adjusted capital (RAC) calculations were incomplete or were not prepared on a timely basis.
- There were inadequate policies and procedures for setting intra-day inventory trading capital limits or monitoring for violations of established limits.
- There was no evidence of review and approval of internal control policy statements or credit policies by senior management or statements were not updated to reflect changes in business operations.
- Failure to perform security price verification testing to independent sources.

- Lack of audit evidence of the review of clearing and settlement operational account reconciliations by a designated senior officer.

Custody of Assets

Deficiencies regarding safekeeping and custody of customer and firm securities included the following:

- Written custodial agreements were missing.
- Omnibus trading accounts with futures/commodities correspondent brokers were used as segregated custody locations.
- Failure to monitor margin deposits held at a broker to support derivatives trading.
- Physical gold and silver bullion was not held at an acceptable securities location.

Wash Trades

IIROC has noted some instances where Participants may have an incorrect understanding of what is considered to be a wash trade. Some Participants have incorrectly interpreted certain trades as a change of beneficial or economic ownership on the basis that each order is entered by a different employee of the client utilizing a different trading strategy.

Regardless of the trading strategy behind each order entered, any trade that does not result in a change of beneficial ownership is considered a wash trade and may be considered manipulative and deceptive trading activity. Participants are expected to take steps to prevent and detect wash trades, which may include use of marketplace-offered wash trade prevention features. Wash trades that are detected by a firm should be cancelled as soon as possible after the trade, and the firm should file a gatekeeper report if it determines that a wash trade was intentional.

Policies and Procedures for Supervision of Business and Trading Conduct

IIROC continues to see instances where policies and procedures have not been appropriately customized to the Dealer's current business activities and risks. It is important that these written policies and procedures include detailed procedures covering the internal controls, supervision and testing within the Dealer. We expect a step-by-step methodology including the frequency of review, sample sizes if applicable, information sources and actions that will be taken if an issue is identified. In addition, these procedures should be accessible and understood by the firm's compliance and supervisory staff and there should be adequate training around these procedures.

It was also found that, in some cases, Participants were not conducting all of the required testing or did not have sufficient documentation to evidence the completion of that task.

Policies and procedures were lacking in the following areas:

- Participants did not have an effective system in place to properly supervise debt trading and were not conducting any surveillance of debt trading for potentially manipulative activity;
- Participants failed to ensure that all applicable disclosures were included on trade confirmations; and
- Extended Failed Trades Reporting (EFTR) / Trade Variation or Cancellation Reporting (TVCR) – Participants were found to not have sufficient procedures in place to ensure that IIROC is advised of applicable settlement failures.

Manipulative and Deceptive Trading Practices

IIROC published Notice 13-0053 – Guidance on Certain Manipulative and Deceptive Trading Practices on February 14, 2013. Since that time, IIROC has detected a large number of instances of potential spoofing. It is IIROC's position that an Access Person, Participant or any client that manipulates the market by any means, including spoofing, has engaged in misconduct that is prohibited under UMIR, or otherwise under securities legislation. Further, Participants are reminded of their obligation to monitor for this type of behavior; as gatekeepers to the securities market they must develop and implement appropriate policies and procedures to effectively address, detect, prevent and report manipulative and deceptive activity, in accordance with the requirements of Policy 7.1.

Inadequate Supervision of Employee/Agent Accounts

IIROC staff continues to see instances where Dealers have not adequately supervised the activity within its employee / agent accounts[16], specifically for accounts which are at other Dealers. The supervision of employee account activity needs to be comprehensive and include all transactions. Controls over the use of external accounts need to be effective and all accounts need to be reviewed against the grey and restricted lists.

It is up to each Dealer to establish a supervisory structure that is appropriate for its line of business. For employees who are more likely to come into possession of sensitive information, a higher level of supervision is required. Employees in such positions include, but are not limited to Investment Bankers, Research Analysts and Portfolio Managers. For Dealers who allow such individuals to have accounts external to the firm, it must have a stringent process to ensure it is aware of all accounts and to ensure it receives all confirmations and/or month end statements in a timely basis in order to supervise their personal activity in light of the sensitive information they possess. Alternatively, some Dealers have imposed additional trading restrictions on such employees to complement the supervision of their external accounts.

[16] See Rules 38.1 and 2500 III B.7

Client Complaint Handling

IIROC staff continues to see instances where Dealers have not adequately complied with Rule 2500B. Specifically, the substantive response letters issued by the Dealer Member must address all issues required under the Rule. IIROC reminds Dealers to ensure that the substantive response to the client complaint is presented in a manner that is fair, clear and not misleading to the client, and must include the information prescribed by Rule 2500B, Section 4.

Accredited Investor Qualification

IIROC staff noted instances where there was lack of adequate controls around the sale of private placements to Accredited Investors. In some cases, clients indicated on the subscription agreement that they qualified for the private placement based on a financial exemption. However information contained on the New Client Application Form (NCAF) did not support the exemption. In addition, there was no further documentation in the clients' files to substantiate the clients' qualification as Accredited Investors.

Dealers are reminded of their obligation to verify the qualification of Accredited Investors based on the NCAF and any additional information available prior to permitting a client to participate in private placements.

Common/significant deficiencies noted by IIROC's Registration Department

IIROC's Registration Department is responsible for, among other things, assessing the fitness of individuals and firms for initial and ongoing registration (where that authority has been delegated to IIROC by a securities commission) and for overseeing IIROC's individual approval scheme which is a pre-requisite for provincial and territorial registration.

Registration requirements under IIROC Rules and securities laws help to protect investors from unfair, improper or fraudulent practices by participants in the securities markets. The information required to be filed by individuals and firms seeking IIROC approval or registration assists IIROC Registration in assessing whether the applicant is "fit and proper" for registration, including an individual's integrity, proficiency, and solvency. Fitness for registration and IIROC approval is not only assessed at the time of initial application but on an ongoing basis based on regular filing requirements and other regulatory intelligence.

Registration Applications and Changes of Registration Information – Form 33-109F4 and Form 33-109F5

Registration approvals may be delayed if a registration application is incomplete or lacks sufficient detail. IIROC's Registration department undertook a review of the most common deficiencies encountered through our review of individual related filings over the last year. The most common deficiencies are highlighted below, together with reminders about filing requirements and/or suggested practice tips or sources that can be used to assist firms and individuals in addressing these deficiencies.

Disclosure regarding current employment, other business activities, officer positions held and directorships (Form 33-109F4 - Item 10, Schedule G)	
Late Filings	Disclosure of other business activities (OBAs) or changes to an already disclosed business activity are not being provided to IIROC within the filing deadlines prescribed in section 4.1(1) (b) of NI 33-109. *Filing Requirements* *Provide details of new outside business activities or changes to an existing outside business activity by submitting a Current/Previous Employment Change Notice in accordance with Section 4.1(1)(b) of NI 33-109. An Approved Person must notify IIROC of changes to information previously submitted in a Form 33-109F4, within 10 days of the change. To meet the filing requirements, in addition to periodic attestations regarding outside business activities, firms should require Approved Persons to notify them in the event of a material change to their business activities and frequently remind them of this requirement.*
Reportable Outside Business Activities	There is still confusion among Dealers as to what activities should be reported (i.e. volunteer positions, positions of power or influence) resulting in these types of OBAs not always being disclosed. *Filing Requirements* *To determine if the activity is reportable, Dealers should carefully review the guidance set forth in the Companion Policy to National Instrument 31-103, IIROC Notice 13-0163 and CSA Staff Notice 31-326. Firms and Approved Persons are reminded that the following must be reported as "outside business activities" under NI 33-109:*

	• *any business or employment activity with an entity other than the individual's sponsoring firm – this would include any business or employment activity with an affiliated firm;* • *acting as an officer, director or in an equivalent position for a company other than the individual's sponsoring firm – officer and director positions with affiliated firms must also be reported as an outside business activity;* • *being an officer or director or a significant owner of a holding company or personal corporation; and* • *having a paid or unpaid position of influence within a charitable, social or religious organization.*
Description of Duties / Conflicts of Interest	Insufficient detail is being provided when describing the nature of the outside business activity, the duties of the individual and the relationship to the business. Boilerplate disclosures are often provided when responding to question 5 of Schedule G of the Form (i.e., disclosure of conflicts of interest and potential for client confusion arising from outside activity). However, answers to the different parts of the question should be tailored to the specific activity at issue. <u>*Filing Requirements*</u> *Disclosures should provide sufficient detail to demonstrate that the Dealer has thoughtfully considered the potential for client confusion and conflicts of interest that may arise as a result of the outside business activity and how this will be managed by the Dealer. In this context, firms should be considering whether the activity will (i) interfere with or otherwise compromise the Approved Person's responsibilities to the Dealer and/or its clients; or (ii) be viewed by clients or the public as a part of the Dealer's business based upon, among other factors, the nature of the activity and the manner in which it will be conducted or offered. If a Dealer does not believe that an outside business activity will result in any potential for client confusion or potential conflicts of interest the basis for this conclusion should be provided.*
Supervisors	Relevant and meaningful information regarding a Designated Supervisor's responsibilities and authority in managing the day-to-day activities of employees and Approved Persons of the Dealer is not being provided in some cases. As a result, IIROC staff is unable to determine if appropriate IIROC approval is being sought and whether applicable proficiencies have been

	met. *<u>Filing Requirements</u>* *Dealers Members should clearly describe the supervisory responsibilities, authority and functions assigned to the Designated Supervisor. Including the rule reference under which the individual has been designated specific supervisory functions (i.e. designated to be responsible for the opening of new accounts under Rule 1300.2) is encouraged.*
Registration Jurisdiction (Form 33-109F4 - Item 5, Question 1)	
Passport verses Non-Passport	There continues to be some confusion as to which filings may be submitted under the Passport system for regulatory review. Passport can only be used for submissions involving an application for registration, surrender or termination in a category specified under securities legislation (i.e., Dealing Representative, Ultimate Designated Person and/or Chief Compliance Officer). A submission involving an IIROC approval or change in an IIROC approval category, business or product type cannot be submitted under Passport unless it also involves an underlying registration category. *<u>Filing Requirements</u>* *Dealers should familiarize themselves with the Passport system by referring to National Policy 11-204 'Process for Registration in Multiple Jurisdiction', and Part 6 'Filing under the Passport System' of the Guide to IIROC Categories. The Guide to IIROC Categories in particular provides a good overview of the types of IIROC filings that can be made under the Passport system and which cannot be filed as such.*
Individual Categories (Form 33-109F4 - Item 6, Schedule C)	
Unclear and/or inconsistent individual categories for registration, IIROC approval or review as a	There continues to be applications filed for registration and/or IIROC approval where categories are unclear or inconsistent, particularly in the selection of the "permitted individual", "Executive" and "Supervisor" categories. *<u>Filing Requirements</u>*

"permitted individual"	*Dealers should refer to National Instrument 31-103, National Instrument 33-109, IIROC Notice 09-0307 and Parts 1-3 of the Guide to IIROC Categories before filing an application to ensure that appropriate registration and IIROC approval category selections are made.*
Changes to Registered Individual and Permitted Individual Information	
Material Changes	Disclosure of material changes and the supporting documentation with respect to the change is not being provided to IIROC within the filing deadlines prescribed in section 4 of NI 33-109. *Filing Requirements* *Provide details of all changes to the information previously submitted in an individual's Form 33-109F4 by submitting a Form 33-109F5 in accordance with Section 4.1 of NI 33-109. An Approved Person must notify IIROC of changes to information previously submitted in a Form 33-109F4 (Registration of Individuals and Review of Permitted Individuals), within 30 days for a change in items 4 (Citizenship) and 11 (Previous employment), and within 10 days of any other changes. To meet the filing requirements, in addition to periodic attestations regarding material changes, firms should require registered or permitted individuals to notify them in the event of a material change to his or her Form 33-109F4 and frequently remind them of this requirement.*
Chief Compliance Officer (CCO) Applications	
Dealer Member Rules 38 and 20; NI 31-103 3.4, 5.2, and 11.3	From time to time, we receive applications from Dealers for an individual seeking to be approved as the firm's CCO without the experience required to competently perform the role. In reviewing any CCO application, IIROC Registration will consider the experience of the individual applicant and the business model of the sponsoring firm. We look for meaningful and recent industry experience, including strong operational and compliance/ supervisory experience given the significant regulatory responsibilities placed on a CCO. In applying the "fit and proper" test, we will also consider the particular firm, the

	supporting infrastructure at the firm and the firm's compliance record. CCO applicants must demonstrate that they can effectively maintain and oversee a firm's compliance system. Past CCO experience, while helpful, is not considered a prerequisite for approval.
Exemption Requests from Proficiency Requirements	
Proficiency Exemptions	Not enough meaningful information or the analysis that the firm conducted is provided in order for IIROC to evaluate the exemption sought and determine if granting the relief is appropriate. Often the information provided simply lists the courses the individual completed and his/her employment experience (i.e. resume experience), but does not explain how this relates to the exemption or how it demonstrates equivalency. IIROC Registration's role is to evaluate the submission and make a recommendation to the applicable District Council, not make the "case" for the firm/applicant. The onus is on the firm/applicant to clearly state the basis for the exemption by demonstrating equivalency through experience and/or alternative education. <u>*Suggested Practice*</u> *If the exemption request is based on other courses the individual has taken, the request should provide a comparative analysis of the topics and information covered in those courses with the topics and information covered in the course for which exempted relief is sought. If the exemption request is based on the individual's relevant experience, the request should provide details of what that experience is/was and how it kept the individual current with the topics and content covered in the course for which exempted relief is sought. The exemption should demonstrate that individual has the required competencies through his/her practical experience. It is expected that the Dealer review the individual's experience to meet the requirements under section 5.1(1) of NI 33-109 to make reasonable efforts to ensure truth and completeness of registration information.*

Notices of Termination of Registered Individuals and Permitted Individuals – Form 33-109F1

We have noted the following common deficiencies with respect to the filing of Notices of Termination:

Termination of Employment, Partnership or Agency Relationship	
Notice of Termination	The reasons for the cessation/termination are not always clearly provided. To the extent any of the 9 sub-items requiring a "yes" or "no" response listed in Item 5 on Form 33-109F1 form the basis for the termination, this should be made clear in the disclosures (i.e. in addition to checking the "yes" or "no" boxes). *Filing Requirements* *Dealers should provide enough information to clearly describe the reason an individual is no longer with the firm, as well as ensure that all 'yes' responses to the questions contain sufficient detail for IIROC to understand exactly what occurred (i.e. if a ComSet event has been referenced, details must be provided). Dealer Members can refer to 'How to complete a Notice of Termination' in the NRD User Guide found at www.nrd-info.ca.*

Ownership Changes and other Dealer Filing Requirements

IIROC Registration is also involved in the review of filings made in connection with approvals sought from District Councils under IIROC Dealer Member Rules 5.4 (proposed ownership changes) and 6.3 (affiliated and related companies). We have outlined below some common deficiencies associated with the filings we receive together with some suggested practices that will help to facilitate our reviews and minimize delays.

Changes in Dealer Member Ownership	
Rule 5.4	Under IIROC Rule 5.4, Dealers must seek District Council approval of any transaction that permits an investor, alone or together with its associates and affiliates, to own a significant equity interest in the Dealer or to own special warrants or any other securities that are convertible, at any time in the future, to

	a significant equity interest in the Dealer. "Significant equity interest" is defined in IIROC Rule 5.4(2) as including 10% or more of the Dealer Member's or holding company of the Dealer's voting or outstanding participating securities or 10% or more of the total equity of the Dealer. IIROC staff requires IIROC Rule 5.4 requests for District Council approval to be filed at least 20 days in advance of the transaction so that staff has a sufficient period of time to review the transaction and any Investor Application Forms, as applicable (see also Member Regulation Notice MR0308 dated September 14, 2004 – *Investor Notification and Approval Process*). IIROC staff's recommendation to District Councils is dependent upon an examination of whether the transaction is: a) likely to give rise to conflicts of interest, b) likely to hinder the Dealer in complying with IIROC rules and securities legislation, c) inconsistent with an adequate level of investor protection, or d) otherwise prejudicial to the public interest. We often find the request for approval from Dealers does not provide sufficient information for IIROC staff to make a proper examination of the transaction which may result in delays before a recommendation is finalized. Dealers must also consider in any such transaction whether a "permitted individual" filing is required under NI 33-109 and/or whether a written notice must be filed with the applicable securities regulatory authority under sections 11.9 and/or 11.10 of National Instrument 31-103. *Suggested Practice* *The following are suggested practices to prepare IIROC Rule 5.4 requests for approval. We acknowledge some of these suggested practices may not be relevant depending on the type of transaction or specific facts.* ***Suggested Practices:*** 1. *Provide details about the business reasons for the transaction.* 2. *Provide details concerning the Dealer's operations and business plan after closing. The information regarding any*

	changes to business operations should include details required in Item 3.1 of the Form 33-109F6 Firm Registration (i.e. primary business activities, target market, and the products and services the Dealer provides to clients). 3. *Provide details of any changes to the UDP, the CCO, key management, directors, officers, permitted individuals and Approved Persons. If no personnel changes are contemplated, confirm this is the case.* 4. *Provide details of the Dealer's policies and procedures in place to address conflicts of interest that may arise as a result of the transaction.* 5. *If there is a potential conflict of interest arising from the transaction, explain how this conflict of interest has been addressed.* 6. *Provide details as to whether the parties to the transaction have adequate resources to ensure compliance with all applicable conditions of registration.* 7. *Provide details as to whether directors, officers, partners and Approved Persons of the Dealer, if applicable, will be in compliance with section 4.1 of NI 31-103 (restrictions on acting for another registered firm) and whether any cross registrations arise from the transaction.* 8. *Provide details of any client communications that have been made or are planned. If the Dealer does not propose to communicate with clients about the transaction, advise us and explain why.* 9. *Provide a copy of the press release announcing the transaction. If the Dealer does not plan on issuing a press release, advise us and explain why.* 10. *Confirm the proposed closing date.* 11. *Provide detailed pre/post transaction corporate organization charts that include all affiliated companies and subsidiaries of the Dealer. The charts provided must identify any companies or affiliates which are registered under provincial/territorial/foreign securities and commodity futures legislation and specify their category of registration. Any other financial services related entities must also be identified.* 12. *Provide details where any individuals are shown on corporate organization charts as holding an interest in a company, partnership or trust, as to whether such holdings are held directly or through a holding company, trust or other entity (a "Holdco"). If ownership his held through a*

	Holdco, provide the name of the Holdco and its ownership structure.
Related Companies	
Rule 6.3	Under IIROC Rule 6.3, no Dealer or partner, director, officer, investor or employee of a Dealer shall form, maintain or have any interest in a related company or associate without the prior approval of the applicable District Council. "Related company" is defined in IIROC Rule 1 and "associate" is defined in section 1.1 of IIROC By-Law No. 1. IIROC staff requires IIROC Rule 6.3 requests for District Council approval to be filed at least 20 days in advance of the transaction so that staff has a sufficient period of time to review the transaction and any Investor Application Forms, as applicable. IIROC staff's recommendation to District Council is dependent upon an examination of whether the transaction is: a) likely to give rise to conflicts of interest, b) likely to hinder the Dealer in complying with IIROC rules and securities legislation, c) inconsistent with an adequate level of investor protection, or d) otherwise prejudicial to the public interest. We often find the request for approval from Dealers does not provide sufficient information for IIROC staff to make a proper examination of the transaction which may result in delays before a recommendation is finalized. <u>*Suggested Practice*</u> *A Dealer seeking Rule 6.3 approval should address the suggested practices noted above, as applicable.*

Conclusion

Building a strong culture of compliance and striving for high standards of Dealer conduct and market integrity benefit all stakeholders – investors, the industry and the capital markets overall. IIROC will continue to be proactive in our regulatory efforts to protect investors and maintain fair, efficient and competitive capital markets. We continue to update and enhance our compliance and examination programs to reflect changes in market structure, business risks, investment products, demographics and corporate priorities. At IIROC, we recognize that there are different ways in which Dealers can implement an effective compliance, supervision and risk management framework that properly protects investors, but is appropriate for the size and scope of their business. We continue to engage in discussions and extensive consultation with the industry and other stakeholders on emerging issues and best practices. This Report and guidance notes issued throughout the year can help Dealers of all sizes improve their practices. We will also continue to look closely at, and take appropriate action against Dealers that have failed to address significant findings or demonstrate an appropriate "tone-from-the-top" compliance culture. In all of our regulatory initiatives, we look to elevate standards of practice within the industry and enhance confidence in the integrity of Canada's capital markets.

We will continue to enhance the information in and effectiveness of this Report and we encourage comments, suggestions or questions. Please do not hesitate to contact any member of our Compliance or Registration groups.