

IIROC NOTICE

Rule Notice Guidance Note

Dealer Member Rules
UMIR

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18-0015

January 18, 2018

IIROC Compliance Priorities

We are pleased to present IIROC's annual Compliance Priorities Report for 2017/2018. This report deals with current issues and challenges that Dealer Members (dealers) should address to improve investor protection and foster market integrity. Together with our guidance notes, day-to-day contact, annual compliance conferences and other forums, this report helps dealers focus their supervision and risk-management efforts to comply with our regulatory requirements in a way that is appropriate for their unique business models.



IIROC's compliance priorities stem from:

- new risks and trends
- recurring/significant examination deficiencies
- the results of our targeted reviews and surveys.

Of Note

IIROC uses risk models to inform the frequency and content of our compliance examinations, allowing us to focus on dealers and areas that present the highest risk. In FY17, we conducted a comprehensive review of our risk models to ensure they remain current and achieve their intended predictive purpose. The review resulted in recommendations – which we will implement over the next year – to recalibrate some of the risk factors, measurements and/or weightings.

We are also working on improvements to our examination program to continue to enhance our risk-based framework. Among other things, we are strengthening our planning process, refining our exam modules, focusing on corporate governance within dealers and enhancing training of examiners.

Dealers' cybersecurity preparedness continues to be a high priority for IIROC. This past year, IIROC visited small and mid-sized dealers to review their 2016 self-assessments for cybersecurity preparedness. During these visits, we provided a cybersecurity self-assessment report (CSR) to help dealers identify opportunities for improvement. Going forward, we will also continue to work with the Investment Industry Association of Canada (IIAC) to help dealers make improvements.

We continue to focus on and take action against dealers that fail to address significant compliance findings and/or fail to demonstrate a commitment to the development of a strong compliance culture. Section 9208 of IIROC's Consolidated Enforcement, Examination and Approval Rules (the Consolidated Rules) enables IIROC staff to impose terms and conditions on dealers to ensure continuing compliance with IIROC's requirements. We are focusing more on this regulatory measure and will continue to recommend terms and conditions on dealers where we consider it appropriate.



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1. Financial and Operations Compliance

1.1. Cybersecurity

In 2017, we visited small and mid-sized dealers to discuss the results of their 2016 CSRs and the actions they had taken on our recommendations for improvement. These visits helped dealers to map the touch-points of sensitive customer information in their systems, identify any vulnerabilities and potential solutions. Our most common recommendations to dealers to improve their cybersecurity preparedness were to:

- maintain adequate policies and procedures to safeguard the confidentiality, integrity and availability of the dealer's data (including clients' personal information)
- conduct regular due-diligence of third-party information technology (IT) vendors and service-providers to evaluate the adequacy of safeguards against cybersecurity incidents
- use encryption and strong passwords to protect data and sensitive information stored on all computers, storage servers, web server portals and mobile electronic devices
- maintain software-patch-management systems to fix identified security vulnerabilities on a timely basis
- develop a cybersecurity incident-response plan that includes: a description of the different types of possible incidents; procedures to stop an incident and eliminate the threat; procedures for recovery of data; investigation of an incident; and incident notification and reporting obligations.

Recognizing the importance of proactive management of cyber-related risks to ensure the stability of Dealer Members, initiatives for 2018-19 include:

- table-top simulations of cyber-incident scenarios that may occur in a small to mid-sized dealer's business environment to help participants develop and improve their own cyber-incident response plans
- 2nd self-assessment survey to assess firm and overall industry preparedness to guide our regulatory focus.

In partnership with IIAC, we will continue to support and provide best-practice guidance to dealers to improve their cybersecurity preparedness. For example, refer to the recent IIAC publication on Due Diligence Procedures on Data Security by Third-Party Service Providers dated July 2017.



1.2. Client Relationship Model (CRM2)

Effective July 15, 2016, we completed the implementation of IIROC's CRM2 client reporting requirements. In March 2017, we surveyed dealers on the status of their CRM2 rollout. Following is a summary of our survey findings:

- The vast majority of dealers issued annual performance reports and fee/charge reports to clients as at December 31, 2016.
- Delivery of the annual reports by dealers varied; some sent the reports with the quarterly client statements and others sent them separately.
- When reports were sent out with the quarterly client statements, the delivery date was later than usual.
- Quality-assurance practices consisted of testing the report's program logic and comparing report output to source documents.
- Challenges identified by dealers in the rollout included:
 - timing or cutoff dates when back-dating entries and trailing-commission files
 - difficulty with allocating fees among client accounts
 - operational constraints when printing reports.

Our examinations now include a review of dealers' accounting systems for compliance with the CRM2 reporting requirements.

1.3. Portfolio Manager Service Arrangements

CSA Staff Notice 31-347 Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members, issued on November 17, 2016, provides information and guidance to Portfolio Managers (PMs) on their arrangements with IIROC dealers for outsourced services such as trading, clearing and settlement, and custody. We are conducting a survey to assess dealers' compliance with their regulatory responsibilities in these service arrangements. This includes assessing whether the service arrangements are properly supported by a written agreement, and whether the roles and responsibilities of both the PM and the dealer are properly disclosed to end customers.

1.4. T+2 Settlement

All participants in the Canadian capital markets successfully transitioned to trade-date-plus-two-days (T+2) settlement on September 5, 2017. An important strategic priority for IIROC was to give dealers regulatory certainty through IIROC rule amendments (see [IIROC Notice 17-0133](#)) and



oversight, to invest in the necessary system changes. Leading to the transition date, self-clearing dealers participated in industry-wide testing facilitated by CDS to assess their T+2 readiness.

2. Trading Compliance

2.1. *Trading Supervision Obligations under UMIR 7.1*

On September 22, 2017, amendments to UMIR 7.1 and 7.13 were approved and take effect March 27, 2018. As part of our consultation with the industry, we struck a working group when developing these amendments.

The entire dealer, not just supervisors and compliance departments, is responsible for compliance with these requirements. Each Participant must have a reasonably designed supervision system in place, which include both compliance and supervisory functions, to effectively prevent and detect violations. Dealers must review the principal risks of their business considering elements such as size, business model, experience of staff, and training provided. Dealers should focus their testing on areas determined to be higher risk. While a dealer cannot ignore low risk activities, they may consider the low risk nature when allocating compliance resources.

While dealers must have certain specific procedural elements in place, documented alternate approaches to meeting supervision and compliance expectations may be acceptable. Dealers must document their policies and procedures in a way that a reasonably knowledgeable individual can understand and follow.

Each dealer must report the testing results regularly or at a minimum, annually, to its board of directors or equivalent.

During a trade desk review, we will review policies and procedures and the internal testing conducted, and will request any internal reporting provided to the board or equivalent.

2.2. *Best Execution*

Changes to key requirements for best execution came into force on January 2, 2018. Each dealer when acting for a client must make efforts to obtain the most advantageous execution terms available under the circumstances.

IIROC held workshops in late September 2017 to outline our expectations. Each dealer must develop and implement policies and procedures that consider all the requirements. Dealers must also regularly evaluate and test the policies and procedures to assess they are followed and remain



effective. Each dealer must provide public disclosure of some elements of their best execution approach under the new requirements.

Non-executing dealers are also subject to best execution requirements. While they may rely on others for execution, they must have sufficient understanding of the process used by their executing dealer to achieve best execution to determine whether it is effective for their clients.

We will be reviewing the procedures and testing in place to confirm that dealers are making reasonable efforts to comply with the requirements of best execution.

2.3. *Electronic Trading*

IIROC continues to find issues with Participants' electronic trading controls required under the electronic trading rules. As previously reported, a number of Participants have yet to implement effective pre-trade risk controls, creating the potential for market disruptions and significant financial loss.

We have seen some improvements but continue to see deficiencies. We will remain focused on pre-trade risk controls, ensuring dealers have documented who is responsible for determining and setting individual capital or credit limits for trading staff and/or each direct access client. We will also confirm that dealers have taken reasonable steps to prevent the entry of an order that could trigger a Single Stock Circuit Breaker.

2.4. *Expanded Scope of Trading Conduct Reviews*

As noted in previous Compliance Priorities Reports, Trade Conduct Compliance (TCC) now conducts limited reviews of activities related to market integrity at all non-executing IIROC dealers. This permits Business Conduct Compliance (BCC) to focus strictly on business conduct matters. Any dealer conducting secondary market trading is subject to a TCC examination, regardless of whether they access markets directly or through another dealer. We will integrate our reviews where appropriate with either Financial and Operational Compliance (FinOps) or BCC examinations to minimize their impact.

2.5 *Fair Pricing*

All dealers must ensure that prices for over-the-counter securities are fair and reasonable based on prevailing market conditions. We have found that some dealers fully rely on executing dealers to fulfill this requirement. Some dealers do not have reasonable procedures in place to evaluate hard-to-value securities and/or those with stale prices.



We will continue to review dealer procedures and testing for fair pricing and encourage review of Dealer Member Rule 3300 and related notices for clarification and guidance.

2.6. *Supervision of Over-the-counter Debt Trading*

Each dealer that engages in over-the-counter debt trading must have adequate policies and procedures in place and conduct testing to confirm that activity is fair and equitable for their clients and counterparties with whom they transact. They must also comply with the requirements of Dealer Member Rule 2800.

We have found that some dealers do not have adequate procedures in place and/or cannot prove that a reasonable level of monitoring and review of OTC debt activity is occurring. We will continue to request and review the controls in place for this activity.

3. Business Conduct Compliance

3.1. *Conflicts of Interest*

IIROC Guidance Notice 17-0093, published in April 2017, summarizes our review of compensation-related conflicts at dealers. Our key findings relate to disclosure, review and monitoring of compensation programs, and fee-based and managed account issues.

We also sent a letter in April 2017 to dealers that offer fee-based or managed accounts asking them to consider IIROC Dealer Member Rule 42 concerning conflicts of interest, and conduct a self-assessment of their practices. Specifically, we asked them to review their policies, procedures, disclosure and potential reimbursement practices, and to report significant deficiencies to IIROC.

In May 2017, we sent a survey to order-execution-only dealers (OEO dealers), asking questions regarding the sale of series A mutual funds. These are generally understood to be mutual funds that embed a trailing commission to compensate the dealer for providing advice. We are considering how OEO dealers can meet their obligations under Rule 42 when offering series A mutual funds.

As a result of our work in this area we have added questions and testing related specifically to compensation-related conflicts to our examinations. We also continue to review the sale of Series A mutual funds by OEO dealers and intend to provide guidance about this practice.

Dealers should maintain policies and procedures that identify real and potential conflicts of interest. Where a conflict of interest is unavoidable, there must be ongoing review as well as clear and meaningful disclosure. Dealers' policies and procedures should address the potential conflicts



in the following compensation-related practices, and should include the associated review processes:

- compensation programs
- recruitment practices, including signing bonuses, and the criteria for paying signing bonuses
- referral programs, including cross-selling
- sales targets.

3.2. *Automated/Online Advice*

We continue to see growth in the number and types of online-advice offerings, including the development of proprietary technology, white labeling, and strategic alliances and/or licensing arrangements with other dealers.

We will continue to work closely with the CSA and will consider the work related to targeted reforms.

We are developing a flexible testing module for automated/online-advice service offerings that will look for:

- clear disclosure about the (limited) products and services being offered
- an appropriate account-opening process, including adequate online know-your-client (KYC) and risk-tolerance assessments relative to the complexity of the products offered
- sufficient registrant supervision and oversight.

3.3. *Order-Execution-Only Platforms*

In November 2016, IIROC published proposed guidance to provide:

- our views on the scope of tools, services, products and account types that we consider consistent with the OEO regulatory framework
- an update of our expectations.

Once the guidance is finalized, OEO dealers will need to determine whether their business activities are consistent with the guidance. BCC examiners will likewise be looking for consistency.

3.4. *Client Relationship Model (CRM2)*

We continue to identify compliance concerns with two aspects of CRM2:

- KYC information – investment time horizon



- pre-trade disclosure of charges.

During our examinations, we continue to find dealers failing to collect investment-time-horizon information. Historically, a registered representative needed to understand a client's:

- financial situation
- investment knowledge
- investment objectives
- risk tolerance.

With the implementation of CRM2, dealers are also required to collect and consider a client's investment time horizon as part of the KYC process.

During our examinations, we noted many instances where dealers did not maintain documented evidence that the required pre-trade disclosure of charges had been made. We also identified instances where dealers lacked policies and procedures governing pre-trade disclosure. Retail clients must be informed of all fees/charges associated with an instruction to purchase or sell a security in an account *before* the trade takes place.

Please refer to Dealer Member Rule 29.9 and 1300.1(p) through (r) for the requirements related to pre-trade disclosure of charges and suitability-assessment reviews, taking into consideration the client's time horizon. In addition, [IIROC Notice 16-0113](#) provides guidance on the collection of time-horizon information and pre-trade disclosure of charges.

4. Registration

4.1. *Responsibility for Compliance with Registration Requirements*

IIROC's Registration function is a critical element of our public-interest mandate. Registration acts as a gatekeeper to the securities industry. Registration requirements ensure that all Approved Persons meet minimum standards of proficiency, experience, integrity, and financial soundness to conduct and/or supervise regulated activities. Ultimate Designated Persons (UDPs) and Chief Compliance Officers (CCOs) are responsible for ensuring dealers comply with IIROC's requirements, including registration requirements.

This section highlights significant deficiencies that we have identified with specific types of Registration filings. In particular, we have noted deficiencies with Notices of Terminations and filings relating to outside business activities. We have also identified late and incomplete or misleading disclosures with respect to regulatory, civil, criminal and financial disclosure items. We discuss these issues below.



We also noted:

- dealers with repeated and persistent deficiencies in the timeliness, accuracy and completeness of routine filings
- personnel who did not respond promptly or cooperatively to our requests for additional information or corrected filings.

We have therefore begun a pilot project to require the Authorized Firm Representatives (AFRs) and CCOs of dealers with repeat deficiencies to attend a training session with our Registration team to ensure they understand their obligations. We will review basic registration functions, as well as issues specific to the dealer, in order to ensure that our expectations are clear and to outline the consequences of future non-compliance.

Once we have met with a dealer, we will take a strict approach to compliance with our requirements and may take any or all of the following steps:

- reject deficient filings in their entirety
- impose terms and conditions on the dealer
- refer matters for potential disciplinary action.

This same training will be available to other dealers upon request. As this includes a review of basic registration functions, IIROC will also provide it to all new dealers, either during the new membership process or shortly thereafter.

4.2. Notices of Termination

Many dealers are not making reasonable efforts to provide true and complete information in their Notice of Termination (NOT) filings. Dealers must carefully consider the questions contained in the NOT and must accurately state the reason(s) for the cessation/termination of employment. The cessation date should reflect the day on which the individual ceases to have authority to act as a registered individual with the dealer. Where the NOT relates to a dealer's only Registered Representative, Investment Representative or Supervisor, the dealer must consider whether it still has the appropriate number and category of Approved Persons to carry out its activities. We expect dealers who are not in compliance with IIROC requirements to notify us immediately.

Dealers that continually provide incomplete information in their NOT filings may be referred to the training session pilot program outlined above.



4.3. Outside Business Activities

Approved Persons must disclose their Outside Business Activities (OBAs) under item 10 of Form 33-109F4 (Form 4) Registration of Individuals and Review of Permitted Individuals. Many dealers are not disclosing the OBAs of their Approved Persons, or changes to previously disclosed OBAs, within the 10-day filing deadline. The Companion Policy to NI 31-103, [IIROC Notice 13-0163](#) Disclosure and Approval of Outside Business Activities and CSA Staff Notice 31-326 Outside Business Activities, all contain guidance on what is a reportable OBA. Dealers should require Approved Persons to provide periodic attestations regarding OBAs and to notify them of any material change to their OBAs.

Dealers must provide sufficient detail when describing an OBA and must address the potential for conflicts of interest or client confusion that may arise in the specific case (instead of providing “boilerplate” disclosure). If the dealer determines the OBA does not result in any conflicts of interest or client confusion, the dealer must outline their reasons for this conclusion.

4.4. Late Disclosure

Approved Persons must disclose material changes concerning items 13 (regulatory disclosure), 14 (criminal disclosure), 15 (civil disclosure) and 16 (financial disclosure) on a timely basis. They must also provide timely updates to their disclosures when more information becomes available. Dealers must ensure that the Form 4 changes are accurate and filed with IIROC within 10 days.

Dealers should file supporting documentation with the material change notice, rather than wait for IIROC to request this information. These delays affect our ability to conduct a “fit and proper” review.

4.5. False and Misleading Disclosure

We continue to see applications for approval that are missing financial disclosure, criminal disclosure and regulatory reporting of disciplinary actions, including those levied by other licensing agencies (e.g. insurance). The CSA recently published CSA Staff Notice 33-320 The Requirement for True and Complete Applications for Registration. IIROC shares the view set out in this Notice that a false or misleading application is a serious regulatory issue.

Dealers need to ensure their applicants and Approved Persons understand the questions in Form 4 in order to provide accurate and complete information when submitting filings. Individuals must also ensure they have an opportunity to discuss the questions in Form 4 with the dealer to ensure they respond to questions correctly. Carelessness or misunderstandings are not satisfactory explanations for non-disclosure.



4.6. Discretionary Exemptions for Portfolio Management

On December 4, 2017, we sent dealers an update on what applicants need to provide if they are seeking exemptive relief from taking courses in order to conduct discretionary portfolio management activities on managed accounts. Dealers should review this update before submitting an application. This approval category has the most onerous proficiency requirements because of the discretion it affords. Individuals who seek an exemption must demonstrate a high level of experience that is clearly relevant to discretionary portfolio management activities.

An individual seeking approval in this category may either (a) meet IIROC's current requirements under Dealer Member Rule 2900, Part I. A. 6, or (b) seek exemptive relief from Dealer Member Rule 2900, Part I. A. 6 on the basis that he or she has both:

- a CIM (either the Canadian Investment Manager or Chartered Investment Manager) designation in good standing
- 48 months of Relevant Investment Management Experience (RIME), with 12 months gained in the 36-month period before applying for registration.

We also remind dealers that IIROC has arranged a 50% enrolment price discount for certain people rewriting courses within 10 years of previously writing them. For more information, please visit the applicable course enrolment page at www.csi.ca.

4.7. Post-licensing Requirements

Approved Persons and dealers must be aware of their post-licensing requirements. IIROC automatically suspends anyone who does not complete the requirements within the relevant time period.

Registered Representatives (RRs) must complete the Canadian Securities Course, Conduct and Practices Handbook Course and 90-Day Training Program to be eligible for approval. RRs have 30 months after approval to complete the Wealth Management Essentials course. If incomplete, dealers should be aware that suspension is automatic under Dealer Member Rule 18.4. Similarly, Supervisors have 18 months to attend the Effective Management Seminar. RRs and Supervisors should schedule attendance at a seminar well in advance of the expiration of 18 months. This is particularly critical for dealers that do not have other Supervisors to cover the functions of a suspended Supervisor. If incomplete, dealers should be aware that suspension is automatic under Dealer Member Rule 38.3(b).

Our view is that RRs and Supervisors have adequate time to complete these requirements and that dealers have more than enough time to ensure that they do so. However, we receive an



unacceptable number of applications for extensions without compelling reasons. We are unlikely to grant extensions unless there are extreme extenuating circumstances. We will not grant extensions simply because a dealer does not have another Supervisor to assume the functions.

4.8. Continuing Education Program

On January 1, 2018, we repealed existing Dealer Member Rule 2900 *Proficiency and Education: Part III – The Continuing Education Program and the Guidelines for the Continuing Education Program* and implemented Rule 2650 – *Continuing Education Requirements for Approved Persons* (CE Rules).

IIROC transitioned to a two-year cycle as of January 1, 2018. A shorter cycle with mandatory CE requirements allows for greater retention of training, and more immediate application of learning and acquired skills within the industry.

As set out in the CE Rules, the purpose and scope of CE is to enhance and further develop an individual’s baseline licensing proficiencies. The CE Rules indicate a broadening of IIROC’s perspective on what should qualify as CE. We will implement a principles-based approach to determine what topics and training qualify as CE.

We will publish guidance to outline our expectations and requirements applicable to all dealers and Continuing Education Participants.

5. Membership Issues

We continue to see deficiencies in filings relating to the matters we highlighted in past Compliance Priorities Reports.

Specifically, we continue to receive late and incomplete filings requesting approval for:

- significant equity interests in a dealer
- related and associated companies.

If we continue to see deficiencies in these areas, we will consider taking stronger measures to ensure compliance. This includes but is not limited to requiring dealers to unwind transactions that were completed without the required approvals, imposing terms and conditions, and/or referring matters to IIROC Enforcement.