IIROC OCRCVM

Investment Industry Regulatory Organization of Canada

Organisme canadien de réglementation du commerce des valeurs mobilières

IIROC Submission to the Expert Panel on Securities Regulation

August, 2008

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August 6, 2008

Mr. David Murchison
Executive Director
Expert Panel on Securities Regulation
Ottawa, Ontario
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Dear Mr. Murchison:

On behalf of the Investment Industry Regulatory Organization of Canada ("IIROC"), I am pleased to respond to the request for submissions from the Expert Panel on Securities Regulation (the "Panel").

As a national self-regulatory organization ("SRO"), we work closely with the various Securities Commissions across Canada that have recognized us and oversee our regulatory activities. We set and enforce standards for our members and for those trading on Canadian marketplaces that will protect investors, enhance market integrity and promote confidence in our system. In undertaking our regulatory responsibilities, we face many of the challenges posed by the Panel in our efforts to enhance the efficiency and effectiveness of Canadian capital markets regulation. We welcome this opportunity to set out how we are addressing some of these issues and the important role of self-regulation within the Canadian securities regulatory system.

We support efforts to identify and implement improvements to the securities regulatory system in Canada. We believe that there are opportunities to further harmonize and streamline securities regulation and we look forward to continuing to contribute to these efforts.

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1. Overview of IIROC

1.1. Creation of IIROC

IIROC is incorporated as a non-profit, non-share capital corporation. Our members are the 211 investment dealers ("Dealer Members") and the ten marketplaces that have retained IIROC as their regulation services provider ("Marketplace Members").

IIROC is recognized as an SRO by all provincial Securities Commissions across Canada.[1] IIROC is also a regulation services provider ("RSP") as defined in National Instrument 21-101 – *Marketplace Operation* and National Instrument 23-101 – *Trading Rules* (together, the "ATS Rules").

IIROC was formed as an independent SRO as a result of the merger of Market Regulation Services Inc. ("RS") and the Investment Dealers Association of Canada (the "IDA") on June 1, 2008. The merger enabled us to consolidate market and dealer regulation within a single national SRO. Benefits resulting from the merger include:

- the elimination of potential regulatory gaps or overlaps arising from member regulation and market regulation being split between two SROs;
- the broader application of risk management principles to determine priorities and the allocation of resources, facilitating more cost-effective regulation;
- the supervision, within one organization, of a broader spectrum of trading activity, products and markets (including equities, certain derivatives, fixed income and other OTC trading) which facilitates the identification of trends and risks and the development of appropriate regulatory responses;
- a single interface for members and investors on regulatory issues;
- a reduction of investor confusion by enhancing visibility and clarifying the scope and purpose of self-regulation;
- the adoption of uniform principles of regulation in the face of rapid convergence; and
- a deeper and broader capacity, with the ability to attract and retain the best talent.

1 The legislation of the Yukon, the Northwest Territories and Nunavut does not currently provide for recognition of SROs.

The merger represents the latest in a series of significant changes in the SRO landscape (both exchange and non-exchange) over the past decade which have been focussed on achieving greater efficiencies and effectiveness. In 1995, the IDA was recognized as an SRO under provincial legislation in Ontario. At that time, the IDA regulated the financial condition and business conduct of approximately 60% of the investment dealers in Canada. There were four Canadian stock exchanges each regulating its own marketplace and a select number of investment dealers. Member regulation was transferred to the IDA from the TSE in 1997, CDNX in 1999 and the Bourse de Montréal in 2005.

Similarly, market structure has also evolved dramatically over this period of time. The demutualization of the TSE to become a for-profit public company resulted in the creation of RS as an independent SRO, to address the inherent conflict in a for-profit stock exchange performing market regulation. RS became the RSP to the stock exchanges and, over time, to alternative trading systems ("ATSs").

On April 1, 2006, the IDA and its members supported the creation of a separate independent trade association to represent the industry – the Investment Industry Association of Canada. This separation addressed the potential for conflicts, perceived and real, between an SRO's role as a trade association and its regulatory responsibilities. Merger discussions were also initiated in April 2006 to consolidate the regulatory operations of the IDA and RS. The merger of the IDA and RS on June 1, 2008 represents a significant step towards simplifying and strengthening the regulation of member firms, individual registrants and those trading on Canadian debt and equity marketplaces.

IIROC is uniquely positioned in the Canadian capital markets as an independent, national SRO undertaking both market and member regulation.

1.2. IIROC Governance

IIROC has a robust and balanced governance structure which includes independent public directors as well as member representatives. IIROC's Board of Directors is 50% independent and includes IIROC's Chief Executive Officer. The composition of the Board of Directors is regionally representative and reflects a broad spectrum of experience and knowledge of the organization's stakeholders, including public venture capital, institutional and retail business and traditional equity marketplace as well as ATS background. The composition and mandate of the Board of Directors and Board Committees are on IIROC's website (www.iiroc.ca).

1.3. IIROC Organization

IIROC regulates the business and operational conduct and financial adequacy of its Dealer Members and their partners, directors, officers and employees (as approved

persons). In addition, IIROC approves proficiency and education requirements for such individuals. There are currently 211 Dealer Members of IIROC.

As an RSP pursuant to the ATS Rules, IIROC regulates the trading conduct of those Dealer Members and other institutions and individuals ("Access Persons") that participate directly in a Canadian equity marketplace, as a member of an exchange, a user of a quotation and trade reporting system ("QTRS")[2] or a subscriber to an ATS. There are currently 10 marketplaces that have retained IIROC as their RSP.

Rules relating to dealer and market regulation of members and other persons subject to IIROC's jurisdiction are approved by the IIROC Board in accordance with its letters patent, by-laws and applicable securities legislation ("IIROC Rules"). The broad policy input solicited by the IDA and RS in the rule development process remains an integral part of IIROC through its District Councils and policy advisory committees.

IIROC's District Councils preserve the strong tradition of member engagement in the self regulatory structure. The mandate of the District Councils includes nominating individuals for appointment to IIROC's Hearing Committee, granting exemptions from registration and other regulatory approvals through its committees and providing recommendations to the Board of Directors on new Dealer Member applications. The National Advisory Committee comprises the Chairs of the District Councils and serves as a forum for members to discuss matters of interest and provide input on policy initiatives.

IIROC's policy advisory committees provide input in the development of member and market regulation policy and are a forum for communicating with members and the industry. Each of these committees includes a cross-section of industry members with specific knowledge and expertise relevant to the committee's mandate. It is proposed that each committee will also include non-member/industry participants to ensure that broader perspectives are considered in the policy development process within IIROC.

2. Commentary on Selected Items of the Expert Panel's Terms of Reference

2.1. Term of Reference #1: Objectives, Outcomes and Performance Measures for Securities Regulation

2.1.1. SRO Oversight

The role and benefits of SROs in the financial services industry have been considered on numerous occasions. Appendix A contains excerpted quotes relating to the role and benefits of SROs.

2 There are no QTRSs in operation at present.

IIROC's regulatory activities are overseen by the Canadian Securities Administrators ("CSA") pursuant to a Memorandum of Understanding which establishes three basic oversight elements:

1. periodic (quarterly, semi-annually and annually, depending on the subject matter) reporting to the statutory regulators of IIROC regulatory activity levels and outcomes;

2. periodic (at least every three years) on-site oversight audits of IIROC offices, with the potential for more frequent *ad hoc* audits; and

3. a requirement for IIROC to seek and obtain the approval of the statutory regulators for new IIROC Rules and proposed changes to IIROC's Rules.

An efficient and effective SRO oversight regime is an important element of securities regulation. We work closely and collaboratively with the statutory regulators in seeking to balance accountability and efficiency in the oversight relationship. We must work together to delineate our respective responsibilities so as to limit duplication in regulatory activities and eliminate any gaps in regulation. In order to effectively contribute to the securities regulatory framework, the SRO must have decision-making authority and be able to respond quickly and proactively to the rapid pace of changes in the industry.

The findings of the Report of the CSA SRO Project Oversight Committee (the "Oversight Report") support the possibility of greater reliance on SROs in Canada. The Oversight Report stated that "the Project Committee believes that the CSA should increase the degree of reliance on SROs and market infrastructure entities as long as they can clearly demonstrate that they meet their public interest mandate and the high level standards in their recognition orders and related documents."[3]

We discuss in more detail below the benchmarking and performance measures that we apply to our regulatory operations. The combination of RS and the IDA permits a more effective allocation of regulatory resources. IIROC is well positioned to take on greater responsibilities and invite greater reliance from the statutory regulators.

Rule Review Process

The review of IIROC Rules is governed by the Joint Rule Review Protocol, an appendix to the CSA Memorandum of Understanding regarding oversight of IIROC. The Joint Rule Review Protocol adopts a Principal Regulator model where the Principal Regulator has a role in coordinating the review of the other jurisdictions. IIROC must file rule proposals with every jurisdiction, address all of their comments and achieve consensus before any rule or amendment to any rule is approved.

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3 *Report of the CSA SRO Oversight Project Committee* (December 2006) (the "Oversight Report"), (2006) 29 OSCB 9462 at 9464.

The Joint Rule Review Protocol represents an incremental improvement on the rule approval protocols which applied to the IDA and RS prior to the merger. We believe that there is potential for further gains, and we are continuing to work with the CSA on this initiative.

In the U.S., the SEC recently introduced proposals to improve its SRO rule approval processes. In introducing these proposals, SEC Chairman Cox made the following statement:

> We've had a number of suggestions of ways in which competition in this area might be further strengthened. Most often, market participants have urged eliminating rule processing delays. They are not alone in pointing out that we can do better. This past spring, we received some very helpful recommendations in this area from the Commission's own Office of the Inspector General. In particular, the IG recommended that the Commission should improve its overall timeliness in processing proposed rule changes.[4]

In its release,[5] the SEC outlined several changes intended to facilitate more expeditious handling of proposed rule changes submitted by SROs, including providing interpretive guidance regarding the range of proposed changes to exchange trading rules that qualify for immediate effectiveness.

In response to the AMF's request for comments on its proposals for the regulation of derivatives markets in Quebec, the IDA submitted a comment letter supporting the concept of self-certification of rules and expressed the hope that this model could be made available to other SROs. The IDA noted that the U.S. Commodities Futures Trading Commission had already successfully implemented such a model with regard to SROs under its jurisdiction. The self-certification model adopted by the AMF for derivatives-related rules filed by the Bourse de Montréal offers the opportunity to make the process of promulgating SRO rules more efficient while maintaining appropriate regulatory oversight and accountability.

Effective regulation of financial markets requires greater co-ordination not just between the SRO and the CSA but also with other SROs and regulators in Canada and abroad. Co-ordination is critical to ensuring that there are no gaps in regulation or unintended consequences of policy decisions. It is critical that we build upon existing relationships with other SROs and regulators in the financial markets to better

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4 Statement at Open Meeting on Streamlining the Review of SRO Rulemaking by Chairman Christopher Cox, Securities and Exchange Commission (June 25, 2008).

5 Securities and Exchange Commission, *Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed by Self-Regulatory Organizations* (17 CFR Parts 200 and 241) July 11, 2008.

understand and address, collectively, emerging issues, trends and gaps in financial markets regulation.

SRO Performance Measures

Each of RS and the IDA has made significant progress in developing meaningful performance benchmarks to evaluate the performance of their respective regulatory responsibilities. These efforts will continue within IIROC. Pursuant to its recognition order, IIROC also performs an annual self-assessment of its performance, and reports the results of this self-assessment to the IIROC Board of Directors and CSA.

Benchmarks and performance measures both play an important role in measuring effectiveness. Benchmarks are direct measures of activity and productivity (an indirect measure of effectiveness). While benchmarks describe outputs, performance measures describe outcomes. They are aimed at demonstrating whether an organization is working on the right problems and whether it is being effective in solving them. In contrast to developing benchmarks, developing meaningful qualitative performance measures is a complex and difficult exercise.

Each of the IDA and RS tracked benchmarks and performance measures prior to the merger. Developing harmonized benchmarks and performance measures for the dealer regulation and market regulation functions of IIROC is a priority for the new organization. As we understand that the Panel is specifically interested in examples of benchmarks and performance measures currently in use, we have reproduced the IDA and RS measures in Appendix B.

IIROC will continue to maintain and refine existing benchmarks and performance measures. Robust performance measures could provide an objective, consistent foundation for stakeholders to assess the efficiency and effectiveness of our regulatory activities.

2.2. Term of Reference #2: Proportionate and Principles-Based Regulation

2.2.1. Proportionate Securities Regulation

IIROC's rules and regulatory operations reflect, to some extent, a proportionate securities regulatory approach. IIROC's rules do not adopt a "one-size-fits-all" approach. For example, where appropriate, our rules distinguish between large and small firms, institutional and retail investors, and trading as principal or agent.

IIROC also believes that there should be a demonstrated need for regulatory intervention before rules are adopted. It is important to assess the nature of a perceived problem and the various options available to deal with it. There will be circumstances where other regulatory tools will address the conduct in question more effectively than new rules. An example of reliance on other regulatory tools is the Guidance issued by the IDA on Principal Protected Notes ("PPN"). The Guidance is

intended to assist firms and their representatives in conducting due diligence on PPN products, assessing their risk and discharging suitability obligations to their clients. In conjunction with this Guidance, we launched a two-part educational broadcast which over 1,500 Dealer Member representatives attended.

IIROC applies a risk-based approach to dealer and market regulation in order to efficiently allocate internal resources to the most important and highest-risk matters. Member regulation implemented a financial compliance risk model in 2002, and a sales compliance risk model in 2004. Since 2006, market regulation has been undertaking a risk-based approach that focuses its regulatory operations on the top risks to market integrity (manipulation and deceptive trading practices, insider trading, front-running and best execution/best price/client priority).

Since 2005, dealer regulation has been undertaking dealer member risk assessments, in an effort to identify firms with a higher risk profile based on business model, nature of operations, severity of client complaints and other reportable events. The financial and business conduct compliance risk model identifies three risk types, seven risk categories and nineteen specific risks. These risks are assessed and weighted to determine an individual dealer's business risk score. The results of the risk ranking are used as a regulatory tool in IIROC's operations, including prioritizing and allocating staff resources in the examination cycle and determining priority of focus during such examinations. The results are also provided to each dealer and overall rankings and peer group comparisons are set out in a risk trend report.

In addition to the approach outlined above, IIROC also deals with systemic risk issues and emerging trends through special projects and targeted compliance reviews. For example, the IDA conducted a regulatory analysis of hedge funds, a survey of beneficial ownership of non-individual off shore accounts and, most recently, the ongoing compliance review of the manufacture and/or sale of third party asset backed commercial paper. On the market regulation side, RS undertook a compliance review of front-running and a study of short sales and failed trades.

2.2.2. Principles-Based Regulation

We believe that the move towards a more principles-based approach to regulation is desirable. However, we should avoid "easy labels" that do not, in practice, contribute to effective policies which combine pragmatism, creativity and balance. The balance between principles and prescriptive requirements in any particular policy formulation will inevitably depend upon the problem sought to be addressed.

Rules should clearly state principles or desired outcomes so that regulatory expectations are clear to market participants. In order to achieve certain outcomes or regulatory objectives, mandatory or minimum requirements may need to be established. To the extent possible, regulation should allow sufficient flexibility for

market participants to assume responsibility for determining how best to comply with clearly stated expectations to achieve the desired outcome in their particular circumstances. Rules should be supported by regulatory guidance notices and education sessions to promote compliance, communicate and share best practices and monitor the impact of regulatory initiatives in actual practice.

In October 2005, RS launched a strategic review of the market regulation rules ("Universal Market Integrity Rules") to ensure that UMIR:

- adequately addresses the risks to market integrity in the most effective and efficient manner;
- does not impose requirements that are no longer necessary to ensure market integrity;
- is sufficiently "marketplace neutral" so as not to impede the development of competitive marketplaces; and
- imposes requirements that differ from prevailing standards in international requirements only where justified by differences in Canadian market structure, industry practices and legal requirements.

The strategic review culminated in a number of principles that have been adopted and govern the rule formulation process for market regulation.[6] At the time of the strategic review, RS regulated the trading on four marketplaces – the TSX, TSX Venture Exchange, CNQ and Bloomberg Tradebook Canada. Since that time, a number of ATSs have emerged in the equity marketplace landscape,[7] bringing greater choice of different trading models and competition among trading venues, placing even greater importance on the principles relating to competitiveness and accommodating different forms of marketplaces.

In May 2006, the IDA launched a comprehensive rule book project to reorganize and reformat the IDA (now IIROC) rules in plain English to enhance comprehension,

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6 These principles state that IIROC will seek to ensure that UMIR:

- promotes the competitiveness of Canadian marketplaces and stakeholders in Canadian marketplaces;
- accommodates, to the extent necessary and appropriate, different forms of marketplaces;
- is harmonized with market integrity rules in other jurisdictions to the extent necessary to eliminate unnecessary regulatory burdens on stakeholders in Canadian marketplaces;
- is simplified in order to better clarify and communicate UMIR requirements and RS's standards to the regulated community and stakeholders;
- reflects, where appropriate, the different needs of institutional and retail investors; and
- accommodates and promotes electronic record-keeping and reporting mechanisms.

7 IIROC now regulates six other equity trading venues, including CNQ's Pure Trading facility, Chi-X Canada ATS, Liquidnet Canada, Perimeter Markets (operating BlockBook ATS and Omega ATS) and TriAct Canada Marketplace. In addition, IIROC proposes to enter into a regulation services agreement to regulate Alpha Trading Systems with its anticipated launch in the fall 2008.

accessibility and compliance. This exercise involves reviewing from first principles a number of key Dealer Member rules in an effort to achieve a better balance between principles and prescriptive rules. Regulatory objectives and core principles will be specifically set out at the beginning of each rule. Elements that are necessary to achieve the objective or comply with the principles will remain in the rule and elements that are permissive or interpretive will be contained in guidance notices that are complementary to the rules. While there will be a distinct focus on principles in the new Dealer Member rules, our fundamental goals are to achieve better balance between principles and prescriptive rules and better enable the regulated community to understand and comply with applicable requirements.

2.3. Term of Reference #3: Enforcement / Separate Securities Tribunal

2.3.1. IIROC Tribunal Structure

IIROC's hearing process demonstrates how SROs can provide a national platform, while maintaining the benefits of local organization and involvement. The Hearing Panels that adjudicate enforcement proceedings are separate and independent from IIROC.

IIROC's Hearing Committees are organized into ten provincial Districts. Hearing Committee members belong to the District Hearing Committee corresponding to the province in which they are resident.

District Hearing Committees are composed of Industry Members and Public Members. Industry Members are current or former directors, officers, partners or employees of Members or Access Persons (i.e., ATS subscribers), and any other individuals that are suitable and qualified. Public Members are individuals who are retired judges or lawyers.

Nominees for the Hearing Committees come from IIROC's District Councils and Marketplace Members. These nominees are considered and approved by the Corporate Governance Committee, composed of independent directors of IIROC plus the Chair of the Board. Each Hearing Panel, comprising three individuals from the Hearing Committee, is constituted to hear enforcement cases or consider for approval negotiated settlement agreements. The Chair of the Hearing Panel is a Public Member, being a retired judge or lawyer. The two other members of the Hearing Panel are Industry Members (typically retired Industry Members for lengthy hearings). The manner in which IIROC constitutes Hearing Panels that are separate and independent from IIROC and coordinates the hearing function on a national basis while maintaining strong regional representation could be considered as one possible model for a national enforcement tribunal.

2.3.2. IIROC Jurisdiction

The statutory regulators have recognized IIROC as an SRO under provincial securities legislation and, with recognition, comes the responsibility for IIROC to discharge its regulatory responsibilities in a responsive, effective and transparent manner. IIROC must have a clear and consistent foundation for its jurisdiction over regulated persons both contractually and supported by securities legislation nationally.

Dealer Regulation: Investment dealers are required by provincial securities law to be members of an SRO recognized under such law. Dealer Members agree contractually to comply with IIROC's Rules and other regulatory requirements.

In a recent Ontario Divisional Court decision involving Stephen Taub,[8] the Court held, by a majority, that the IDA did not have jurisdiction to discipline former members and former representatives of members of the IDA in accordance with its by-laws. IIROC intends to seek leave to appeal this decision to the Ontario Court of Appeal.

In rendering its decision, the Divisional Court noted that the legislation in Alberta specifically states that the authority of the SRO extends to any former member, any former representative of a member and any former representative of a former member, whereas the legislation in Ontario does not. This situation highlights the need for consistent and harmonized legislation relating to SROs in order to ensure that SROs can discharge their responsibilities in the public interest across Canada.

Market Regulation: In accordance with the ATS Rules, a marketplace that is a recognized exchange or a recognized QTRS may engage an RSP to monitor the trading conduct of its members or users and their compliance with the ATS Rules, and a marketplace that is an ATS must engage an RSP to monitor the trading conduct of its subscribers and their compliance with the ATS Rules.

Under the ATS Rules and its RSAs, IIROC has the responsibility to monitor and enforce compliance with trading rules of members of an exchange and subscribers of an ATS, including the directors, officers and employees of such members and subscribers. Currently, there is no direct contractual agreement between subscribers of an ATS or their representatives and IIROC whereby the firms and individuals agree to attorn to IIROC's jurisdiction and abide by its rules. However, such agreements are contemplated in the proposed revisions to the ATS Rules that have been published by the CSA for comment. In the meantime, IIROC and the CSA have implemented an interim solution to affirm IIROC's jurisdiction over ATS subscribers. Direct jurisdiction conferred pursuant to the ATS Rules would be more effective given that ATS subscribers include non-members of IIROC.

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8 Stephen Taub v. Investment Dealers Association of Canada and Ontario Securities Commission, Ontario Divisional Court, July 15, 2008, available at http://www.canlii.org/en/on/onscdc/doc/2008/2008canlii35707/2008canlii35707.html.

SRO Requests for Expanded Statutory Powers

There are opportunities to harmonize and strengthen the statutory powers granted to SROs in provincial securities legislation in order to permit SROs to more effectively discharge their responsibilities.

With the exception of the Alberta securities legislation (which confers upon SROs the powers identified in the first two bullet points below), SROs do not currently have the following statutory powers:

- the ability to enforce decisions of disciplinary panels as decisions of the court;
- the ability to compel witnesses to attend and to produce documents at disciplinary hearings;
- the ability to compel witnesses to attend and to produce documents for the purposes of an investigation;
- statutory immunity for SROs and their staff from civil liability arising from acts done in good faith in the conduct of their regulatory responsibilities; and
- the power to seek a court-ordered "monitor" for firms that are in chronic and systemic non-compliance, close to insolvency or for other appropriate public interest criteria.

In response to a joint submission filed by the IDA, MFDA and RS with regard to the above, the Five Year Review Committee,[9] noted in its Final Report that the "SROs' submissions merit further study and consideration". IIROC believes that the enforcement system in Canada would be strengthened if these powers were granted equally by all provinces to SROs to ensure that the SROs can discharge their responsibilities based on consistent jurisdiction and authority in all provinces where they are recognized.

Incomplete Delegation

IIROC has been delegated authority to grant registration under provincial legislation to Dealer Members and their approved persons in the provinces of British Columbia, Alberta and Newfoundland and Labrador. IIROC has delegated authority for individual registration only under the securities legislation in the provinces of Ontario and Quebec. We believe that greater efficiencies could be achieved if IIROC received a uniform delegation of registration for firms and individuals in all jurisdictions across

9 March 21, 2003, available at http://www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20030529_5yr-final-report.pdf.

Canada. Such an approach would also reflect, and be consistent with, the spirit and objectives of the passport system.

2.4. Term of Reference #4: Passport / Common Regulator

Oversight of IIROC is carried out under a "principal" regulator model, in which one regulator (the principal regulator) coordinates all comments from the other recognizing regulators and communicates them to the SRO. The principal regulator attempts to resolve inconsistent comments and recommendations and decides when disagreements should be escalated to the Commission Chairs for resolution. According to the Oversight Report, some recognizing regulators with limited staff resources rely completely on the principal regulator, and do not comment on or approve SRO rule proposals.[10]

The exchange SROs operate under a "lead" regulator model, in which all of the regulators rely on the lead regulator to review and approve a rule proposal. The non-lead regulators do not require that the SROs seek their approval, but they have the ability to raise material comments with the lead regulator.

In the IDA's response to the request for comments on proposed National Instrument 11-201 *Passport System*, we noted that the passport system could be extended beyond prospectus, registration and exemption requests to other areas including, but not limited to, SRO oversight. We continue to believe that the benefits of a Passport System could be extended to other areas of regulatory activity.

3. Conclusion

Thank you for this opportunity to offer our perspective on issues that are important for the effective regulation of the Canadian capital markets. We are committed to finding opportunities within our own organization, and in collaboration with our regulatory partners, to contribute to the efficiency and effectiveness of the regulatory system and the overall integrity of the Canadian capital markets.

Yours truly,

"Susan Wolburgh Jenah"

Susan Wolburgh Jenah
President and Chief Executive Officer

10 Oversight Report at 9483.

Appendix A
Role and Benefits of SROs

In 1938, former SEC Chairman and U.S. Supreme Court Justice William O. Douglas said:

> By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regulation but in fact too minute for satisfactory control, some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these large areas, self-government and self-government alone, can effectively reach.[11]

In its 2004 *Concept Release Concerning Self-Regulation*, the SEC set out the historical basis for securities industry self-regulation in the U.S. as follows:

> In enacting the Maloney Act in 1938, Congress stated that an approach to securities regulation relying solely on government regulation "would involve a pronounced expansion of the organization of the Securities and Exchange Commission; the multiplication of branch offices; a large increase in the expenditure of public funds; an increase in the problem of avoiding the evils of bureaucracy; and a minute, detailed, and rigid regulation of business conduct by law." ... The legislative history of the 1975 Amendments noted that, rather than adopt this purely governmental approach, Congress determined that it was "distinctly preferable" to rely on "cooperative regulation, in which the task will be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation." Similarly, in 1975, Congress stated that a principal reason for retaining a self-regulatory regime was the "sheer ineffectiveness of attempting to assure [regulation] directly through the government on a wide scale," and that, although the SROs had not always performed their role up to expectations, self-regulation generally was considered to have worked well and "should be preserved and strengthened."[12]

The SRO Consultative Committee of IOSCO explained the benefits of self-regulation as follows:

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11 Cited in Joel Seligman, *Cautious Evolution or Perennial Irresolution: Self-Regulation and Market Structure During the First 70 Years of the Securities and Exchange Commission*, 59 Business Lawyer (August 2004) 1347.

12 SEC, *Concept Release Concerning Self-Regulation* (Dec. 8, 2004) 69 Fed. Reg. 71256 at 71258.

> Self-regulation has proven to be efficient regulation. SROs by their very nature have greater flexibility to adapt regulatory requirements to a rapidly changing business environment. One of the biggest challenges that government faces in devising and administering a statutory oversight framework is to provide an appropriate level of government oversight of SRO activities without encumbering or usurping an SRO's ability to respond quickly and flexibly to changing market conditions and business needs. Self-regulation has also proven to be effective regulation. In self-regulation, the rules are drafted by market participants with an intimate knowledge of the market who know how to maximize the regulatory benefits (e.g., orderly markets, customer protection, reduction of systemic risk) while minimizing the business costs. This intimate knowledge of the market is essential for creating a self-regulatory framework, which is perceived as appropriate and reasonable by the regulated individuals and entities. This perception will in turn result in a tighter degree of compliance by the market participants operating within the self-regulatory framework."[13]

In a 2007 address, Ontario Securities Commission ("OSC") Chair David Wilson observed: "The effectiveness of self-regulation in Canada has been examined a number of times: The conclusion has always been the same – it works. It's an efficient and effective model of regulation for our capital market participants."[14]

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13 IOSCO SRO Consultative Committee, *Model for Effective Self-Regulation* (May 2000) at 3 ("IOSCO Model").

14 Remarks by David Wilson, International Council of Securities Associations Annual General Meeting, May 14, 2007, available at http://www.osc.gov.on.ca/Media/Speeches/2007/sp_20070514_dw_icsa-annual.jsp.

Appendix B

IDA and RS Benchmarks and Performance Measures

IDA Benchmarks and Performance Measures: The IDA previously had established 16 benchmarks for financial and operations compliance, business conduct compliance, registration and enforcement. By department, these benchmarks were:

- financial and operations compliance
    - project utilization rate[15]
    - examine every Dealer Member annually (except those approved for biennial review)
    - time-frames for
        - completion and issuance of final examination reports
        - completion of audit working paper reviews
        - issuance of preliminary report for new member applications
- business conduct compliance
    - project utilization rate
    - complete all mandated reviews according to annual schedule
    - time-frames for
        - completion and issuance of final examination reports
        - issuance of preliminary report for new member applications
- registration
    - time-frames for
        - approval of Dealer Member applications or issuance of deficiency letter
        - review of management suitability in connection with applications and issuance of deficiency letter
        - transfers of registration
- enforcement
    - project utilization rate
    - timelines for
        - resolution of closed complaints
        - resolution of closed investigations
        - resolution of closed prosecution files

The IDA also tracked performance measures that were more outcome-oriented, including the following:

- zero calls on the CIPF due to insolvency (excluding fraud as the proximate cause of the insolvency);

15 The "project utilization rate" is the percentage of staff time that is spent on core business activities.

- reduce and maintain at zero the number of capital deficiency occurrences for firms designated in early warning;
- reallocate enforcement resources to more serious / complex / high risk cases;
- financial and operations compliance and business conduct compliance to spend at least two-thirds of field examination time (for examinations requiring over 200 hours) on moderate and high risk activities of Dealer Member firms;
- reduce the number of high risk firms and reduce the residual risk scores of those high risk firms;
- reduce the frequency and severity of events reported by Dealer Member firms on ComSet;
- review in a timely manner all registrants with seven or more ComSet events; and
- monitor Dealer Member firm client complaint resolution performance.

RS Benchmarks and Performance Measures: RS previously adopted benchmarks in its regulatory operations in surveillance, trading review & analysis, trade desk compliance and enforcement. In addition, service levels were part of RS's "corporate scorecard" as a tool for the RS Board to assess management and staff's performance of RS' regulatory functions. The RS corporate scorecard was primarily a "benchmarking" approach, providing quantitative measures of the following activities:

- for Surveillance, violations resolved in real time per full time equivalent ("FTE"), the number of cases generated internally, and number of self-reported violations;
- for regulatory policy support, the number of UMIR exemption, interpretations and inquiries resolved in 24 hours or less, per FTE;
- for Trading Review & Analysis, the number of UMIR and insider trading investigations completed per FTE;
- for Investigations & Enforcement, the number of UMIR investigations completed per FTE;
- for Trade Desk Review, the number of trade desk audits completed per FTE;
- for timely disclosure services, the number of contacts with issuers and the number of press releases reviewed;
- for Human Resources, the level of regrettable turnover; and
- for Finance, operating cost efficiency (comparing operating expenses to target levels).

In addition to quantitative benchmarks, both RS and the IDA also adopted qualitative performance measures relating to key strategic objectives, as part of their respective strategic planning exercises. These would include, for example, implementing major technology initiatives (e.g., the multi-market monitoring

project), achieving desired outcomes in relation to Human Resources issues such as appropriate staffing levels, recruitment and succession planning, and the RS-IDA merger.