

**Oversight Review Report of  
Investment Dealers Association of Canada**

**January - 2008**

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## I. Overall Summary

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### 1. *Background*

The Investment Dealers Association of Canada (IDA) is recognized as a self-regulatory organization (SRO) for investment dealers by the Alberta Securities Commission (ASC), Autorité des marchés financiers (AMF), British Columbia Securities Commission (BCSC), Manitoba Securities Commission, Nova Scotia Securities Commission (NSSC), Ontario Securities Commission (OSC), Saskatchewan Financial Services Commission (SFSC) and Securities Commission of Newfoundland and Labrador.

In September and October 2006, staff of the ASC, AMF, BCSC, NSSC, OSC and SFSC (together, CSA staff or we) conducted an oversight review of a number of departments in various IDA offices. AMF staff reviewed the IDA's Montréal office (IDA – Québec District), ASC and SFSC staff jointly reviewed the IDA's Calgary office (Calgary office), BCSC staff reviewed the IDA's Vancouver office (Vancouver office), and NSSC and OSC staff jointly reviewed the IDA's Toronto head office (Toronto head office).

### 2. *Purpose and scope of the oversight review*

The objectives of the oversight review were as follows:

- (a) To assess whether the IDA is in compliance with the relevant terms and conditions (T&Cs) of its recognition orders as an SRO;
- (b) To determine whether the IDA's regulatory processes are efficient, effective, consistent and fair; and
- (c) To evaluate whether the IDA has adequate staffing, resources and training processes to perform its regulatory functions effectively and efficiently.

We coordinated the timing of the oversight review and evaluated the different offices using one review program. This coordinated review covered the period from January 1, 2004 to August 31, 2006 (period under review).

CSA staff focused on the IDA's Registration, Enforcement and Sales Compliance departments, as well as the IDA's membership process. AMF staff also reviewed information protection as a whole by examining both computer system protection and document protection.

Due to the announcement of an intended merger with Market Regulation Services Inc., we did not review the IDA's corporate governance and its Regulatory Policy department. Further, in order to avoid duplication with the oversight activities currently conducted by the Canadian Investor Protection Fund, we did not review the Financial Compliance department at this time.

### **3. *Consolidated report***

While the timing and scope of the oversight review were coordinated amongst CSA staff, this report consolidates the reports of the AMF, BCSC, NSSC, OSC, and SFSC. ASC staff's report has been issued separately.

Further, the reports of those jurisdictions participating in this consolidated report have been included in their entirety without combining the common findings and recommendations across the jurisdictions. However, the findings and recommendations of NSSC and OSC staff were combined in a joint report in conjunction with their joint review, and SFSC staff did not reproduce their findings and recommendations in this consolidated report, but instead refer the reader to the ASC staff report.

### **4. *Prioritization of recommendations***

The recommendations in this report are prioritized into high, medium and low priority, based on the following criteria:

High – the issue is considered to be of significant importance or relates to a repeat finding of some significance and corrective action should be taken immediately; the IDA will report on a regular basis on its progress on the implementation of the recommendation.

Medium – the issue should be resolved within a reasonable timeframe; the IDA may be required to report on its progress on the implementation of the recommendation.

Low – these issues are brought to management's attention for review and consideration.

### **5. *Overall assessment***

Staff that contributed to this consolidated report were generally satisfied that the IDA is in compliance with the relevant T&Cs of its recognition orders as an SRO, that its processes are efficient, effective, consistent and fair, and that it has adequate staffing, resources and training processes to perform its regulatory functions effectively and efficiently.

However, the presence of high and medium priority recommendations in this report indicates that there are some areas where we believe that improvements are necessary, and require the IDA to take remedial action.

An area of concern that is shared across jurisdictions relates to the adequacy of the number of branch reviews performed by the IDA's Sales Compliance department for purposes of ensuring its members' compliance and protecting the investors that deal with members' branches, the vast majority of whom are retail investors.

The areas of concern particular to staff of each jurisdiction that contributed to this consolidated report are discussed in their respective sections below.

***Overall IDA Response:***

This is the first time the CSA staff conducted their field work in each of our four offices at the same time. Our comments in this report respond to the findings and recommendations of the British Columbia Securities Commission, the Saskatchewan Financial Services Commission, the Ontario Securities Commission, the Nova Scotia Securities Commission and the Autorité des Marchés Financiers concerning their review of the Vancouver, Toronto and Montréal offices (the Consolidated Report).

The Alberta Securities Commission has prepared a separate report concerning our Calgary office (the ASC Report). We provided a separate response to that report on July 11, 2007.

The Consolidated Report is written in the form of a “report card” which recognizes things we are doing well and things that require change or improvement. The Consolidated Report – Overall Assessment states that staff are generally satisfied that:

*“the IDA is in compliance with the relevant Terms and Conditions of its recognition orders, that its processes are efficient, effective, consistent and fair, and that it has adequate staffing, resources and training processes to perform its regulatory function effectively and efficiently. However, the presence of high and medium priority recommendations in this report indicates that there are some areas where we believe that improvements are necessary, and require the IDA to take remedial action.”*

We agree with this overall assessment and have responded to all the findings and recommendations.

In the CSA SRO Project Report (the Report), the CSA recommended the joint development of high level standards and qualitative and quantitative criteria or performance benchmarks to evaluate the SROs against those standards. To the extent that SROs already have performance benchmarks in place, the Report recommended that they should be considered.<sup>1</sup> We encourage the CSA to implement this recommendation. We have included our high level performance measures which demonstrate, we believe, outcomes of reducing industry risk and increasing the level of industry compliance, attached as Appendix I.

***Staff comments and follow-up:***

Implementation of the CSA SRO Oversight Project recommendations is underway. CSA staff will consider the IDA’s performance measures when developing high level standards, qualitative and quantitative criteria, or performance benchmarks to be used in the evaluation of SROs.

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<sup>1</sup> CSA Notice 24-303 – CSA SRO Oversight Project (2006) 29 OSCB 9485.



## II. Calgary Office

### A. Summary

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#### 1. *Background*

SFSC staff and ASC staff jointly conducted an oversight review of the IDA's Calgary office covering the period under review. SFSC staff reviewed the following IDA departments:

- Registration;
- Membership; and
- Sales Compliance.

Staff of the CSA jurisdictions participating in the oversight review of the IDA had agreed to issue a consolidated report with respect of the oversight review.

SFSC staff note that ASC staff have issued a separate report for their review of the IDA's Calgary office. We confirm our participation in the consolidated CSA report, but subscribe to the findings noted in the ASC report.

Because of this, SFSC staff do not feel it is necessary to reiterate their findings in this report. SFSC staff ask the IDA to forward a copy of its response to the ASC report to the SFSC.

### III. Montréal Office

#### A. Summary

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##### 1. *Background*

The oversight review (also referred to as an “inspection” in Québec) of the IDA – Québec District focused on the activities carried out during the period under review. This period was marked by several events that greatly affected the activities of all departments of the Québec District of the IDA.

These events included:

- the recognition by the AMF of the IDA as an SRO on July 13, 2004 (decision 2004-PDG-0084);
- the delegation by the AMF of certain functions and certain powers to the IDA on July 27, 2004 (decision 2004-PDG-0089);
- the authorization by the AMF, on December 30, 2004, of an agreement to consolidate the delegated functions and powers of the Montréal Exchange (Exchange) and of the IDA within a single self-regulatory organization. Under this consolidation agreement (Agreement), the Exchange transferred certain supervisory functions in respect of certified members to the IDA (decision 2004-PDG-0224). Following this authorization, the AMF amended its decision on delegation of powers so as to review the list of delegates (decision 2004-PDG-0225);
- the implementation, in January 2005, of the Agreement to consolidate the Exchange’s activities with the IDA. In addition to structural changes, this resulted in the IDA taking over responsibility for the staff dedicated to the activities transferred by the Exchange, completing all the pending registration files transferred by the Exchange, taking over the 62 active investigation cases and the 24 disciplinary cases at the Exchange and, finally, supervising the activities of 12 new members formerly under the Exchange’s review jurisdiction;
- the AMF’s decision to join the National Registration Database (NRD) on January 1, 2005. The IDA was directly impacted by this decision since it was required to perform its delegated powers related to the registration of representatives through the NRD and to train all registration staff according to the processes determined by the AMF. All the registration files are now processed via the NRD according to the established procedures; and
- the beginning of operations, in April 2006, of the new Investment Industry Association of Canada (IIAC). For Québec, this translated into the hiring of a Vice-President on April 3, 2006. All the files of the Montréal office related to the representation component were transferred by the Director, Member Services of the IDA to this new IIAC Vice-President.

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

The IDA is a Canada-wide organization composed of districts present in several regions of Canada, including the Québec District. In accordance with the conditions set out in the Coordination Agreement of the CSA, the results of the present CSA oversight review will be part of a joint report presented by the CSA. The results of the oversight review, unique to each region or district inspected, will be presented in a separate section of the joint report.

The general objectives of the review are to evaluate how the IDA – Québec District supervises its members' conduct; to assess compliance with the terms and conditions of the decision recognizing it as an SRO and the decision regarding the delegation of functions and powers; to present the results of the review of the activities of IDA – Québec District; and to make recommendations so that its SRO mission in matters related to Québec securities is fulfilled.

More specifically, AMF staff's review sought to:

- ensure that the IDA – Québec District had adopted procedures and adequate resources to assume the obligations related to its self-regulatory activities equitably and effectively;
- ensure that the principal self-regulatory functions of the members of the IDA – Québec District are performed satisfactorily and that the *Securities Act* and the IDA Rules are enforced correctly;
- ensure that the IDA – Québec District has the capacity to perform its functions and exercise its powers without being in a conflict of interest, while protecting the public; and
- identify any weaknesses in the operations of the IDA – Québec District regarding its SRO activities and ensure they are corrected.

The review focused on the following activities:

- registration and membership;
- sales compliance; and
- enforcement (including complaints, investigations and litigation).

AMF staff's review included the following points:

- review of the administrative structure and human resources;
- review of checklists and internal policies and procedures of the IDA – Québec District; and
- discussions with the executive officers in place exercising decision-making powers regarding SRO activities.

### **3. *Assessment of the findings related to the Montréal office***

Although AMF staff had concerns about certain procedures, they are generally satisfied with the measures implemented by the Québec District of the IDA and consider that the Québec District's current operational and decision-making structure provides proper supervision of the conduct of its members, their executive officers and their respective representatives regarding securities activities in Québec.

AMF staff, furthermore, are of the opinion that the IDA adheres to the terms and conditions of the AMF decision recognizing it as a self-regulatory organization as well as the decision regarding the delegation of functions and powers.

### III. Montréal Office

#### B. Registration and Membership

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##### 1. *Introduction*

As mentioned earlier, 2005-2006 saw the transfer of supervisory activities in respect of Exchange members to the IDA and Québec's participation in NRD. These events led to major delays in the processing of registration applications in 2005-2006.

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

This section's objectives are to:

- ensure that the staff in place is sufficient and properly experienced and has received appropriate continuing education;
- evaluate that the performance benchmarks used appear reasonable and attainable; and
- ensure that the various applications received by the Registration department are processed adequately and efficiently, and that the decisions are well documented and in accordance with the *Securities Act* (SA) and the IDA Rules.

AMF staff's review of the Registration department included the following points:

- discussion with the Manager of the Registration department to reach a good understanding of the department's operations;
- review of the checklists in the registration procedures manual, with cross-references to the IDA Rules;
- review of the reports used to record operations for the period under review;
- examination of a sample of registrations processed during the period under review; and
- examination of a sample of decisions made by the department.

##### 3. *Performance benchmarks*

The following benchmarks are specific to the Registration department regarding the registration of representatives and new membership applications:

- Within 5 business days, 80% of all applications are either approved or a first deficiency letter is sent to the candidate.
- All transfers of registration that presented no extenuating circumstances are completed within 2 business days.
- Within two weeks of the application date, Sales Compliance and Financial Compliance must complete an initial review of the new member and issue a preliminary report.
- The Registration department must complete and issue a preliminary deficiency letter within two weeks of receipt of the application, following a suitability review by an applicant's partners, directors and officers.

***Staff's findings***

Tests on the registration files and knowledge of the benchmarks showed substantial delays in processing applications received in 2005.

According to the benchmark, 80% of the applications received (registrations, amendments to a registration, etc.) should be approved within five business days or the applicants should be notified by mail of a deficiency within five business days. In reality, 11% of the applications received during the year were processed according to this benchmark. Moreover, compared with the benchmark whereby 100% of the non-deficient transfer applications are processed within two business days, in fact only 70% of the applications received were processed within this deadline in 2005.

However, this finding must be put into the context prevailing during the period under review. As already mentioned, several events marked this period. Among other results, these events meant that data had to be entered in NRD according to the parameters and schedules set by the AMF and that the IDA – Québec District simultaneously had to continue to update the AS/400 system. This also led the IDA – Québec District to train the new staff and properly supervise them.

A review of the files processed in 2006 showed that the application processing time improved considerably starting in March 2006. Thus, the percentage of files processed within five business days increased from 36% for January and February 2006 to 88% for the next six months. The percentage of non-deficient transfer applications processed within two business days rose from 73% for January and February 2006 to 91% for the next six months.

AMF staff found that as at August 31, 2006, all the applications were processed according to the established benchmarks.

According to our evaluation, the performance benchmarks used appear reasonable and attainable.

***Staff's recommendation***

No further action is necessary.

**4. *Condition related to an authorization***

The functions and powers delegated to the IDA are defined in decision 2004-PDG-0225. In general, these are the functions and powers stipulated in the *Securities Act* and the *Act respecting the Autorité des marchés financiers* (AMF Act) with respect to the registration of representatives and the review of IDA-member dealers.

All the applications for registration received at the IDA – Québec District are approved by the District Council, or a subcommittee of the District Council, according to the powers defined in Part 7 of By-law 20.

In April 2004, the Approval Committee, a subcommittee of the District Council, delegated some of its powers to the Registration department staff to impose specific, pre-approved conditions, without having to go back to the Approval Committee for authorization. These specific conditions are applied to an existing authorization in order to protect the public, in very specific circumstances. The circumstances are:

- declaration of bankruptcy;
- proposal to creditors;
- opening of an investigation;
- branch manager with experience in mutual funds only;
- extension to take the Effective Management Seminar;
- uniform notice of termination of employment with dismissal for cause;
- garnishment – Revenue Canada; and
- extension to participate in the Continuing Education Program.

#### **4.1 Powers**

##### ***Staff's findings***

By-law 20 does not cover the possibility for the IDA to impose a condition on an existing registration authorization. Consequently, the IDA currently must obtain the agreement of the firm and the individual concerned before imposing the appropriate condition for the situation. If the firm or the individual does not accept or fails to abide by the condition, the IDA is not able to impose the condition according to the current By-laws.

##### ***Staff's recommendation***

In the interest of avoiding uncertainty, AMF staff recommend that the IDA – Québec District amend its By-law 20 to enable the competent District Council to impose appropriate conditions for all existing authorizations.

AMF staff believe it would be appropriate to formally specify, in the text of By-law 20, the conditions regarding this person's continued authorization as well as the circumstances leading to the imposition of these conditions.

***Priority: High***

##### ***IDA's response:***

The IDA agrees. The power to impose conditions was inadvertently omitted in a complete revision of By-law 20 in 2004. While IDA Staff is of the opinion that the IDA has the authority to impose a term or condition on being apprised of a change affecting an Approved Person, we agree that it would be better to have it explicitly stated in the By-law. We plan to insert an explicit provision in the course of another set of revisions to By-law 20 that is currently the subject of consultation with the Members.

##### ***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA– Québec District.

## 4.2 *NRD update*

### *Staff's findings*

In connection with the previous finding, the IDA – Québec District does not carry out any NRD update when an individual voluntarily accepts the imposition of a condition.

According to staff at the IDA – Québec District, there is no possibility of making a distinction in NRD between a condition imposed at the time of a new registration application and a condition imposed voluntarily on an individual already registered.

### *Staff's recommendation*

AMF staff recommend to the IDA – Québec District that individual files in NRD be updated whenever conditions are imposed on an existing authorization.

**Priority: High**

### *IDA's response:*

Currently, when terms or conditions are imposed by the Registration Sub-Committee of the Quebec District Council they are entered on NRD in the Terms and Conditions section of the registrant's permanent record however, due to the restrictions of By-law 20, when the condition is accepted voluntarily by the Approved Person and the Member, a Regulatory Note is added to NRD, where the information about the term or condition is available to all regulatory participants in NRD. The IDA is currently looking at making the necessary changes to By-law 20 in order for conditions to be imposed on an Approval at any time. The IDA has avoided putting the terms and conditions accepted voluntarily under the Terms and Conditions section of NRD due to the fact these can be made public in some provinces and certain conditions make reference to information that is not of a public nature. The IDA has no issues with publishing the conditions as long as the information that is considered private is not made available.

### *Staff comments and follow up:*

AMF staff notes that these changes will be made to By-law 20 so as to enable the competent Québec District to impose the appropriate conditions on existing authorizations.

AMF staff notes that the IDA will now include in the “Terms and conditions” section of NRD the terms and conditions accepted voluntarily when such terms and conditions can be made public.

AMF staff will follow up on these issues through their meetings with the IDA – Québec District.

## 5. *Holding of Approval Committee meetings*

The Approval Committee is one of the Standing Committees of the District Council defined in Section 16 of By-law 11. On this basis, IDA By-law 20 empowers the IDA to approve or reject an application for registration or transfer, make recommendations to the Executive Committee of the Board of Directors and make appropriate decisions in exemption matters.

Currently the Approval Committee of the IDA – Québec District is composed of five members and holds its meetings on the basis of a quorum of three members.

According to the practice currently in force, the Committee uses e-mail and fax as means of communication to make decisions regarding exemption applications or applications for conditional registration.

For this purpose, the Registration department staff e-mail the application documents and a response form to each Committee member. The Committee members' responses are sent by fax. In the event of a disagreement among the Committee members, the department manager organizes a conference call to complete the study of the application.

### **5.1 Quorum**

#### ***Staff's findings***

Section 17 of By-law 11 stipulates that the Standing Committee “*shall consist of not less than three members, including one of the members of the District Council who shall be the Chair of such Standing Committee. The number of members of any Standing Committee which shall constitute a quorum at any meeting thereof shall be determined by the District Council.*”

However, the IDA – Québec District was unable to demonstrate that the quorum currently in force for the Approval Committee had duly been the subject of a formal resolution of the District Council.

Moreover, the IDA – Québec District was unable to demonstrate that the Approval Committee had obtained the power from the District Council to determine its operating rules on its own, as it sees fit.

### **5.2 Means of communication to hold meetings**

#### ***Staff's findings***

No District Council resolution authorizes the practice currently in force whereby the Approval Committee can use e-mail or a fax as a means for holding meetings.

Moreover, if one refers to the means of communication used to hold District Council meetings, as defined in Section 7 of By-law 11, the use of a fax as means of communication for holding Approval Committee meetings would be contrary to the spirit of Section 7. In other words, the means of communication currently used by the Approval Committee do not permit all persons participating in the meeting to communicate with each other simultaneously.

#### ***Staff's recommendation***

AMF staff recommend that the District Council adopt a resolution establishing the quorum for meetings and the means of communication that may be used by the Approval Committee in accordance with Sections 7 and 17 of By-law 11.

***Priority: High***



***IDA's response:***

A resolution of the District Council was passed on December 5, 2006 and on June 8, 2007 in which the District Council determined that three members of the Approval Committee form a quorum.

Furthermore, the IDA – Quebec District will draft rules of procedures covering the means of communication used for holding meetings. A copy of such rules of procedures shall be provided when available.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on the draft rules of procedures through their meetings with the IDA – Québec District.

**6. *Documentation of registration files***

Since January 1, 2005, the Registration department of the IDA – Québec District has been dealing with all the registration files in NRD according to the processes established by the CSA. This new registration and renewal process replaces the hard copy system that had been in place for several years.

In conjunction with this new process, the Agreement between the Exchange and the IDA has consolidated registration of representatives and approval of executive officers of dealers at the IDA, and this enhances the importance of keeping the data recorded in NRD in good order.

The Registration department of the IDA – Québec District now consists of nine persons (including the department manager). The department's various members divide the work arising from the functions and powers delegated to them under decision 2004-PDG-0225.

***Staff's findings***

A review of registration files showed a lack of uniformity in the documentation appended to the hard copy files of the different applications processed by the Registration department staff. In some cases, the checklist was the only document supporting the application.

Thus, the correspondence related to the applications was not always appended to the hard copy file. The procedures manual refers to the documents that must appear in the approval files but does not indicate that the correspondence must be part of the contents of a hard copy file.

Given that NRD is seeking to accelerate and optimize the registration and renewal process, AMF staff agree with the principle of limiting the number of documents to be placed in the registration hard copy file. However, AMF staff consider that at least the correspondence should be included in the hard copy file. The Registration department's procedures manual thus should be amended accordingly.

During AMF staff's review, the department manager was establishing a new procedure for placing all application-related correspondence on file.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District ensure that the new procedure is followed.

***Priority: Low***

***IDA's response:***

We agree with the recommendation. In its amendment of the procedures manual, the Registration Department has begun to include in each procedure a section entitled “Records to be kept” specifying which records, such as correspondence, must be kept in the physical file.

***Staff comments and follow up:***

AMF staff are satisfied with the response received. No follow up is necessary.

## **7. Processing of applications**

AMF staff examined a sample of registration files for the entire period under review.

### **7.1 Registration application in paper format**

***Staff's findings***

The tests performed on the registration files showed that an exemption application received on “paper” had been processed in NRD.

Yet under Section 11 of By-law 40 and section 5.1 of *Regulation 31-102 respecting the National Registration Database* (Regulation 31-102), an application must be submitted in paper format if and only if it is submitted under a temporary hardship exemption. This was not the case for the exemption application received.

***Staff's recommendations***

AMF staff recommend that the IDA – Québec District require that all applications in paper format not submitted under the temporary hardship exemption be resubmitted as an NRD application to comply with Regulation 31-102.

If the NRD filer wishes to apply for the temporary hardship exemption, it must comply with the provisions of Regulation 31-102.

***Priority: Low***

***IDA's response:***

We require the flexibility to review and provide a ruling on an exemption request prior to the filing of a registration approval submission through NRD because firms require guidance on the application before hiring and training the individual. A firm cannot submit an application for approval to the IDA until the applicant has undergone a 90 or 30-Day training program, which is a significant investment to make without even knowing if the applicant's alternate credentials will be accepted. NRD prevents an exemption request from being filed unless the applicant already has a permanent record on NRD or the firm is concurrently filing an application for

approval. As per IDA Member Regulation Notice 396, the OSC determined that it was acceptable for the IDA Ontario Office to accept paper exemption requests as long as when the application for registration approval is later submitted via NRD, it is accompanied by an exemption request submission, duplicating the information provided in the original paper request. The IDA Quebec Office suggests that the AMF review this procedure in order to determine if it would be an acceptable practice in Quebec.

***Staff comments and follow up:***

We understand that a so-called “preliminary ruling on an exemption request” is required by members so they can determine whether or not to hire and train a candidate who could rely on an exemption.

The current practice of the IDA – Québec District is completely different from the current practice of the IDA – Ontario District. The OSC in fact permits the IDA – Ontario District to submit paper exemption requests since the ruling by the Approval Committee of the IDA Ontario District is an opinion, not a ruling. This opinion is the first step in the process leading to the joint presentation through NRD of an official exemption request and a registration approval submission. The submission of these two requests results in an official ruling by the Ontario District Approval Committee.

Under current practice in Québec, the Approval Committee of the IDA – Québec District does not provide an opinion, or even a so-called “preliminary” ruling, but rather what is in fact a final ruling, because no other exemption request is required. This final decision is “unofficial” since it is not in compliance with Regulation 31-102.

Moreover, exemption requests are analyzed only once by Registration staff of the IDA – Québec District, well before a registration authorization request is made through NRD. In other words, Registration department staff do not take into account new facts that could influence the final official exemption ruling (e.g., non-integrity of candidate).

Accordingly, for this practice to be acceptable to the AMF, the IDA – Québec District must modify its exemption approval procedure and its approval letters in order to specify that rulings related to paper exemption requests take effect on the date the registration authorization request is approved and are conditional on the request being submitted jointly with an official exemption request through NRD.

The IDA – Québec District has just recently amended its procedure and its decision letters so as to make this practice acceptable in Québec. No follow up is necessary.

## **7.2 Verification of information submitted**

### ***Staff's findings***

The review of the files showed that during analysis of an application to open a sub-branch, certain information had not been verified.

An analysis of this type of application requires Sales Compliance department participation. The Sales Compliance department determines whether the member's remote supervision system is adequate and forwards its recommendation to the Registration department. However, there was no indication on file that the Sales Compliance department had properly verified that the system in place allowed the member to supervise the operations of the new sub-branch based in Montréal adequately from the Halifax head office. Moreover, in the case under consideration, it was indicated that an official would visit this sub-branch only once a year.

There was also no information regarding the level of training of the person registered as being responsible for supervision.

The CSA have already expressed their concerns that adequate supervision of a sub-branch<sup>2</sup> was not necessarily a matter of proximity or a matter of ability to visit the sub-branches, but rather a matter of procedures for control and oversight of operations.

AMF staff's discussions with the Manager of the Registration department and the Vice-President – Québec District provided reassurance that the member had remote control and oversight procedures. However, the Registration department did not have a procedure in place intended to confirm that the Sales Compliance department had considered the member's remote verification system to be adequate.

Given the fact that the IDA's Policies require that their members adopt written procedures reasonably designed to assure effective oversight of operations, AMF staff believe that a procedure for confirmation with the Sales Compliance department should be set up to ensure that the member firm's written remote verification procedures are examined when a branch is opened.

During AMF staff's review, the department manager updated the checklist used by the Registration department for "branch/sub-branch openings" applications. Thus, the checklist will now include the obligation to obtain a confirmation from the Sales Compliance Manager that the member's remote verification system is considered adequate. Failing this, a request for additional information must be made to the member.

### ***Staff's recommendation***

AMF staff recommend that the IDA – Québec District ensure that the new procedure is followed.

***Priority: Low***

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<sup>2</sup> Companion Policy 33-102, Part 2, section 2.3 ("Supervision of Sub-branches").

***IDA's response:***

The IDA agrees. The item will be checked during the sample reviews of staff members' work included in our Quality Assurance Peer Review Program initiated in 2007.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA– Québec District.

**8. *Becoming a member***

The Registration department of the IDA – Québec District is also charged with processing membership applications. Applications are reviewed in detail by the Sales Compliance department and the Financial Compliance department. Registration staff ensures that proposed supervisory managers, officers responsible and directors meet membership requirements. The Sales Compliance department ensures in particular that policies and procedures related to the supervision of activities comply with the requirements of Policy no. 2, while the Financial Compliance department is charged with ensuring compliance with Regulation 200 with respect to proper books and records and a review of financial disclosures.

During the period under review, the IDA – Québec District received only one membership application. AMF staff reviewed the application to determine whether controls ensure compliance with securities regulations. As well, AMF staff assessed the quality of analyses conducted, documentation and processing time.

***Staff's findings***

The analyses conducted by the three departments were adequate and the membership file contained proper documentation in support of decisions. AMF staff also found that the time period for processing applications and co-ordination among departments was adequate. The checklists and procedures in place are detailed and provide staff with effective support.

***Staff's recommendation***

No further action is necessary.

**9. *Decision letter***

The IDA – Québec District uses a number of formats for decision letters. Each format applies to a specific type of decision. For example:

- approval as member of the board of directors;
- approval as member of board of directors and management;
- approval as member of management; and
- registration as representative.

All decision letters from the IDA – Québec District are signed by the Manager, Registration or the registration officer, depending on the type of application.

***Staff's findings***

In AMF staff's review of the decision letters issued by the IDA – Québec District, it was noted that incorrect references to current legislative provisions are used.

***Staff's recommendation***

Given that approval letters are a reference source for ensuring compliance by registration applications, AMF staff recommend that the IDA – Québec District revise its approval letters and correct its legislative references to avoid any possible ambiguity.

***Priority: Low***

***IDA's response:***

The IDA agrees with the recommendation and has amended the standard decision letters.

***Staff comments and follow up:***

AMF staff have received the amended standard decision letters and are satisfied with the amendments made. No follow up is necessary.

***10. Supervision by Manager, Registration***

The nine persons (including the department manager) who make up the Registration department have an average of six to seven years of experience in the industry.

According to the procedures in place in the Registration department, the senior agents process and approve the majority of the applications received. Only approvals of applications for authorization or termination from persons designated as responsible for supervision of activities in Québec are under the department manager's responsibility.

AMF staff examined a sample of registration files for the entire period under review.

***Staff's findings***

AMF staff found that, in general, there was a sufficient number of well-trained staff at Registration. Moreover, the procedures manual, updated on a regular basis by the department manager, provided staff with effective support.

However, AMF staff found that there were no formal review procedures for the files processed by the Registration department.

Even though, according to AMF staff's discussions with the department manager, a random review would take place, it was found that only the more problematic and sensitive files showed evidence of review by the department manager.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District establish a review procedure for processed files, include it in the procedures manual and ensure that it is followed.

***Priority: Medium***

***IDA's response:***

The IDA agrees with the recommendation and implemented a formal review procedure by the Department Manager which became effective on January 10, 2007.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA – Québec District.

## **III. Montréal Office**

### **C. Sales Compliance**

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#### **1. *Introduction***

The Sales Compliance department of the IDA – Québec District has the responsibility of assuring its members' non-financial compliance, according to predetermined review cycles. More specifically, the Sales Compliance department verifies the extent to which the members have the necessary and adequate systems in place and whether the controls adopted allow them to comply with the securities regulations. The Sales Compliance department performs its functions by carrying out risk assessment, conducting on-site reviews and following up on the irregularities observed.

It must be mentioned that the implementation of the agreement for transfer of supervisory activities from the Exchange to the IDA led to the takeover by the Québec District of training of the staff from the Exchange and the review of twelve new members.

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

The objectives of this section are to:

- ensure that the staff in place is sufficient and properly experienced and has received appropriate continuing education;
- evaluate whether the performance benchmarks used appear reasonable and attainable;
- ensure the adequacy, timeliness and quality of the reviews performed by the staff; and
- ensure that the irregularities noted have been brought to the member's attention.

To gather the information necessary to understand the specific operation of the Sales Compliance department, AMF staff questioned the Manager of the Sales Compliance department, who had also held the position of Director, Member Regulation for one year. AMF staff also examined the review program modules used by the Sales Compliance Officers and tested a sample of review files and Risk Assessment Checklists (RACs).

#### **3. *Performance benchmarks***

The following benchmarks are specific to the Sales Compliance department regarding the final review report issued to the member:

- 60% of the review reports must have been issued to the members within 15 weeks after the end of the on-site review; and
- all the review reports must have been issued to the members within 26 weeks after the end of the on-site review.



The Sales Compliance department has set up two methods for monitoring deadlines and thereby meeting the benchmarks. First of all, a blue sheet is placed at the beginning of each review file on which all the deadlines to be observed are recorded based on the release date of the on-site review. Finally, the UBSS system, which is extensively used by the Sales Compliance department, is also a good method for communicating all review deadlines.

### ***Staff's findings***

According to our evaluation, the performance benchmarks used appear reasonable and attainable.

Nonetheless, AMF staff noted that two of the five selected files barely met the benchmark, while the final report for the other three files had been sent to the member after the established period of 26 weeks following the end of the on-site review. One of these three files significantly exceeded the benchmark.

The IDA – Québec District explained to AMF staff that the Sales Compliance department had proceeded with a large number of reviews as a result of the arrival of 12 members from the Exchange, but was unable to meet the schedule for issuing a final review report for a number of files.

### ***Staff's recommendations***

As mentioned in the next point (staffing and training), AMF staff recommend that the Sales Compliance department team be increased by at least one Sales Compliance Officer. This should provide the team with the necessary resources to ensure the department's efficient operations.

***Priority: High***

### ***IDA's response:***

As noted in point 4 below, an additional Sales Compliance Officer position has been added.

### ***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA.

## **4. *Staffing and training***

At the beginning of the period under review, the Sales Compliance department had two Sales Compliance Officers. During the period under review, the staff evolved as follows: a total of six Sales Compliance Officers joined the team, but two of them left. As at August 31, 2006, the Sales Compliance department team was thus composed of six Sales Compliance Officers.

### ***Staff's findings***

AMF staff's analysis of the schedule of reviews performed during the period under review showed that few branches had been reviewed. Indeed, out of a total of 20 reviews conducted in 2004, four branches were reviewed by the Sales Compliance department. Out of a total of 28 reviews conducted in 2005, five branches were reviewed. Finally, out of a total of 23 reviews conducted for the eight-month period ended on August 31, 2006, two branches were reviewed.

AMF staff's analyses showed that the staff in place is properly experienced and has received appropriate continuing education. However, in AMF staff's opinion the Sales Compliance department team should review a greater number of branches per year. It was also noted that review plans are very tightly scheduled, which does not leave much latitude to respond to emergencies.

***Staff's recommendations***

AMF staff recommend that the IDA – Québec District Sales Compliance department team be increased by at least one Sales Compliance Officer. This should provide the team with the necessary resources to ensure the department's efficient operations and more branch reviews.

***Priority: High***

***IDA's response:***

The IDA added a Sales Compliance Technician to provide support to the Sales Compliance Officers. This Sales Compliance Technician took up her post on January 15, 2007. An additional Sales Compliance Officer has been approved for the Montreal office in the 2007-08 budget. However, even with one more Sales Compliance Officer, we are not expecting this will allow us to do more branch reviews.

Our rules make it quite clear that the Member is responsible for ensuring that it is effectively supervising its business, including ensuring that supervision carried on in all its branches is effective. We expect Members to review their branches, on site as necessary, and review at the head office level the extent and effectiveness of their branch review programs.

The main purpose of our branch reviews is to ensure that Members' overall supervisory systems are effective. For this purpose, reviews of branches in other jurisdictions are just as useful as those in Quebec. We also review a branch where we have specific cause.

However, in order to ensure that we focus our branch review efforts to the best advantage, at the beginning of 2008 we will be requesting information from Members that will allow us to risk rank all branch offices conducting retail business across the country. We did a similar risk ranking in 2001. We will then endeavour as far as possible to review the highest risk branch or branches of the Member we are reviewing, again with the intent of ensuring that the Member's supervision of the branch is appropriate.

In 2006, changes were made to the Head Office Sales Compliance Review planning protocol to include, where applicable, a visit to at least one branch office in the local vicinity by way of examining more directly the interplay between the two levels of operation. Furthermore, a protocol for conducting "Pop-in visits" was introduced, whereby nearby branches of unrelated Members may quickly be visited in the course of conducting a stand-alone or head office-related Sales Compliance Review in a given locale.

***Staff comments and follow up:***

Generally speaking, AMF staff are satisfied with the new measures introduced by the IDA - Québec District as regards Sales Compliance resources, the changes made to the Head office SRC Planning Protocol and the introduction of branch “Pop-in visits”.

AMF staff are nonetheless concerned about the trend at the IDA regarding branch reviews since 2004. In fact, according to IDA – Québec District data, while branch reviews accounted for 20% of all reviews in 2004, this ratio fell to 18% in 2005. It then proceeded to drop to 8.7% for the eight-month period ending in August 2006.

AMF staff are convinced that branch reviews make it possible to verify the effectiveness of supervisory activities by head offices, and to subsequently enhance IDA reviews of members while improving knowledge in various areas, including overall compliance by members.

AMF staff understand that, beginning in 2008, the IDA will risk rank all branches across the country with the intention of ensuring that the Member’s supervision of branches is appropriate. AMF staff believe that the IDA should use this process to reassess whether more branch reviews should be performed in order to gain sufficient assurance regarding the level of protection afforded to investors.

AMF staff are awaiting the findings of the IDA’s reassessment and will follow up on this issue through their meetings with the IDA – Québec District.

## **5. *Review plans***

### **5.1 *Report on risk trends***

In April of each year, the Sales Compliance department performs a risk assessment of all members and they are assigned a rating. This assessment is based on a model using a quantitative approach and a qualitative approach. The quantitative criteria retained are: the level of supervision, the clients’ assets, the number of complaints and investigations, and the number of weaknesses already reported. The qualitative criteria considered are: the inherent risk, the external and internal factors, management and staff, and controls. For each member, this rating makes it possible to determine, among other matters, what level of monitoring is necessary throughout the year. Consequently, the results of this rating exercise will help to prepare the review schedule, because they allow for determining (1) the members who will need only to complete the RAC, (2) the members who will have to submit to a review, in addition to completing the RAC, and (3) the frequency of reviews (within 12, 18, 24 or 60 months).

#### ***Staff’s findings***

AMF staff believe that this rating exercise helps in acquiring a good understanding of the Sales Compliance department’s clientele, namely, its members. Consequently, this allows effective planning of the reviews to be conducted, because reviews are concentrated on risk members, leading to optimization of staff resources.

#### ***Staff’s recommendation***

No further action is necessary.

## 5.2 *Risk Assessment Checklist (RAC)*

As explained earlier, the RAC is completed by each member and, in many cases, this stage is followed by a review. When the Sales Compliance Officer fills out the RAC, he produces an accurate picture of the member's current status. The RAC explores many topics regarding the member, particularly the regulatory amendments that may have an impact on its activities, its financial results for the past 12 months, the results of the last Sales Compliance department review, the results of the last financial review, the results of the last review by Market Regulation Services Inc., complaints and investigations, registrants, supervisory staff, operations, clientele and products.

### *Staff's findings*

The RAC is an important stage, because, among other things, it serves to determine the type of review required (partial or complete). Indeed, the RAC identifies the risk issues and allows the Sales Compliance Officers to determine which review program modules they will have to carry out as part of their review. This improves the review's effectiveness and efficiency.

As explained above, the RAC involves a large number of steps that includes various searches and analyses. This measure can take up to one work week. Consequently, even if a member is not reviewed in a given year, AMF staff consider that the RAC alone provides assurance that the member's minimum compliance has been tested.

### *Staff's recommendation*

No further action is necessary.

## 5.3 *RAC – Head office vs. branch*

The Sales Compliance department has established two RACs: one for head offices and one for branches.

The head office checklist consists of a series of questions. For each question, the Sales Compliance Officers must select a risk level from 1 to 5. To help select a risk level associated with a question, very precise assessment criteria are associated with each of these risk levels.

The branch checklist is not as developed and does not contain as much precision. The risk levels associated with the questions are "low", "medium" or "high" and no criterion are specified. Thus, the Sales Compliance Officer must choose from among these three risk levels but has no guidance for making a choice.

### *Staff's findings*

AMF staff consider that the fact that the head office RAC attaches a precise score to each question assures some uniformity among the Sales Compliance Officers in selecting the different risk levels. This certainty cannot be obtained for the branch RAC, because it does not offer the same precision.

### *Staff's recommendation*

AMF staff consider that a revision of the branch RAC is required to ensure a precise score for each question and thus allow some uniformity in the evaluation of the branch risk levels.

***Priority: High***

***IDA's response:***

With the introduction a few years ago of its more extensive and numerically-based Member Risk Model, a checklist that IDA Sales Compliance had previously referred to as a head office "risk assessments" became a tool to help tailor the plan of an on-site examination to the place/entity to be examined. The Head Office version was, therefore, renamed the "SCR Planning Checklist"; however a similar re-titling of its Branch level equivalent was simply overlooked. This oversight will be corrected and the template in question should no longer be mistaken for a "risk assessment" along the lines of the Member Risk Model.

Although this document still refers to risk, it is designed to help the reviewer decide what steps to take in the review. There is no intention of suggesting, contrary to the head office risk assessment, that the rating in one branch review is comparable to that in another.

Furthermore, most of our judgments when completing a risk-assessment for our branch reviews are informed but subjective and altering the way we record them, be it using a score of 1 to 5 as with the head office risk-assessment or maintaining the "low-medium or high" score does not bring more subjectivity to the process.

We do believe in the necessity of conducting a risk assessment for branches. However, we do not believe that this risk ranking of branches should be done with the same level of detail as the head office. The main purpose of our branch reviews is to ensure that Members' overall supervisory systems are effective.

As a Member firm's head office and its network of branches are administered along the same lines, examining the head office allows the IDA indirectly to ascertain that there is compliance with the rules and regulations throughout the network of branches. Our approach to branch examinations is consistent with our overall belief that our oversight should be primarily tailored to the head office supervisory functions which will be responsible, as per the IDA's rules and regulations, to supervise in turn their own branches.

Consequently, the examination of specifically targeted branches by the IDA is meant to be an extension of the rigorous work performed at the head office level. Thus the process of determining the risk for a branch must be viewed as complementary, not comparable, to the more precise risk quantification approach used in connection with the examination of head offices which is our primary target of oversight.

To guide Member firms, the IDA provided them, during the annual conference of the Compliance and Legal Section (CLS) in December 2005, with a branch office supervision guide which provides concrete examples and analytical tables to advise them in the supervision of their own branch offices.

Nevertheless, as indicated previously, the Association acknowledges the role that branch-level examinations can and do play in its overall oversight endeavours; however, given the large number of branches that exist, it will benefit considerably from having more robust tools for determining where its on-site attentions and its limited resources would best be spent. Therefore, as noted in the response to item 4 above, the IDA will be undertaking, at the beginning of 2008, to gather information from Members and conduct a branch risk assessment for all branch offices conducting retail business across Canada. The cross-country risk assessment will be based mostly on objective facts, but the resulting numbers won't be 1 through 5: they will be a raw

score that could range from 1 to 1000. This result will assist us in assessing a Member's controls with regard to the relative risk levels of its branches.

***Staff comments and follow up:***

AMF staff agree that branch RACs do not need to have the same level of detail as head office RACs.

AMF staff are of the opinion however that branch RACs should continue to incorporate tailored indicators to ensure more accurate scoring and thereby enable a certain degree of uniformity as regards risk assessment. AMF staff will follow up on this issue through their meetings with the IDA – Québec District.

## **6. Review files**

In the course of their review, AMF staff examined a sample of sales compliance review files. The period under review covered by these files was supposed to begin on January 1, 2004 and the final review reports had to be delivered to the members before August 31, 2006.

### **6.1 Quality of review files**

***Staff's findings***

AMF staff consider that, in general, the review files they tested were very well documented. They are well referenced, which greatly facilitates the search for information, and all the documentation necessary to support decisions is included in the file. Altogether, the files are well organized.

Moreover, all the "draft" versions of the review reports are placed in the review files, including all the handwritten notes of participants. AMF staff consider that this procedure is a good way to monitor the progress of the decisions made regarding the findings.

Nonetheless, the tests showed that one of the files under review had not been documented sufficiently. None of the pages describing the findings (the "findings forms") contain any reference to the corresponding irregularity in the review report, although this procedure was used in all the other files under review.

The IDA – Québec District indicated that when this review was performed, the Sales Compliance Officers had only recently been hired.

***Staff's recommendation***

No further action is necessary.

## 7. *Review programs*

### 7.1 *Québec references*

#### *Staff's findings*

The review programs do not refer to Québec securities regulations, although references to the securities regulations of many other provinces are included. However, all the members of the IDA – Québec District are subject to Québec securities regulations.

AMF staff consider that the absence of references to the Québec securities regulations in the review programs does not reflect an in-depth knowledge of these regulations by the Sales Compliance Officers.

Including references to Québec securities regulations in review programs would ensure the required degree of knowledge and thereby significantly decrease the likelihood that regulatory non-compliance is missed during reviews by the Sales Compliance Officers.

AMF staff believe that adding these references to review programs would not only ensure a good understanding, but would also enable Sales Compliance Officers to reinforce these requirements on members. This is particularly important considering that Sales Compliance reviews over the past few years illustrate that certain members did not have updated policies and procedures.

AMF staff are nonetheless aware of the difficulties inherent in updating a review program for each of the jurisdictions with authority over a member with Canada-wide operations. However, AMF staff believe there is room for improvement, and would consequently be open to proposals regarding alternative measures for maintaining the degree of knowledge of Sales Compliance Officers.

#### *Staff's recommendation*

AMF staff recommend that the IDA – Québec District submit proposals regarding alternative measures for maintaining Sales Compliance Officers' degree of knowledge of Québec securities regulations and ensuring that members update policies and procedures.

***Priority: High***

#### ***IDA's response:***

We propose to conduct training sessions where we would mandate a securities lawyer to present to the Sales compliance group a specific training session on the relevant aspects contained in the Quebec securities regulations.

#### ***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA – Québec District.

## 7.2 *CanPX data*

### *Staff's findings*

There is no review program procedure enabling Sales Compliance Officers to verify the accuracy of data that members report to CanPX.

According to the IDA – Québec District, the debt market module is being modified accordingly.

### *Staff's recommendation*

AMF staff recommend that the IDA – Québec District quickly initiate its revision of the review programs for the purpose of including a procedure intended to verify the accuracy of data reported to CanPX.

***Priority: Medium***

### ***IDA's response:***

We agree.

### ***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA – Québec District.



### III. Montréal Office

#### D. Review of Two Member Firms

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##### 1. *Introduction*

AMF staff selected two IDA member firms with the aim of choosing large firms that were reviewed by the IDA – Québec District in the past year. This selection was made from the follow-up reports of the IDA – Québec District reviews of December 31, 2005 and April 19, 2006. By chance, AMF staff selected a new IDA member.

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

The objectives of the review were to ensure the quality of member reviews performed by the IDA – Québec District and the follow-up on irregularities found.

During AMF staff's review, discussions were held with the persons in charge for the purpose of gathering information needed to understand the procedures adopted by the member and the IDA with respect to the following points:

1. knowing the client and obligations related to suitability of transactions;
2. OTC trading;
3. distribution of new products;
4. trading in fixed-income securities;
5. research activities; and
6. corporate finance / investment banking / distributions and syndication.

##### 3. *Restricted trading lists*

The various procedures applied to restricted trading lists are found in various places in the IDA sales compliance review program, specifically in modules 3, 6 and 9.

Module 3 refers to question 5 B vii) of the "Physical Review" section. The purpose of the procedure in question is to review the activities in each of the selected accounts to ensure that there has been no "violation of trading restrictions". However, this section of the program only concerns option accounts, so the other types of accounts would not be covered by this procedure.

In module 6, the procedures stipulated in point 2, more specifically in question 2 c) of the "Physical Review" section, are performed regarding the restricted trading lists. The purpose of these procedures is to select employee accounts and ensure that the firm's supervision of these accounts is coordinated with the restricted trading lists.

The "Interview" section of module 9 provides for validation of the different procedures the member has in place for management of restricted trading lists: additions and removals of restricted securities, communication of lists, supervision of trading in relation to lists, etc.

***Staff's findings***

In the course of AMF staff's review of the two member firms, the tests showed that no work was performed regarding client transactions in securities on restricted trading lists.

In fact, according to the information obtained by AMF staff and observed in the two files, module 9 of the review program fails to specifically mention client transactions involving securities on restricted trading lists. Moreover, this finding was supported by the lack of documentation of the work performed for the two files considered.

AMF staff understand that certain review procedures may be implicit and may not ensue from questions or processes specifically outlined in module 9. But AMF staff believe that, to ensure the consistency of reviews, it would be appropriate to add explicit references to the IDA review programs regarding client transactions involving restricted trading lists, and to therefore ensure that test results are well documented.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District add explicit tests to its review programs, specifically concerning client transactions in securities on restricted trading lists.

***Priority: Medium***

***IDA's response:***

We agree and we are currently performing such tests.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will monitor the work done through their meetings with the IDA – Québec District.

#### ***4. Client authorized to trade on multiple accounts***

For one of the two files under review, an appendix to the review report indicated that the beneficial owner of an account was authorized to trade on multiple client accounts and had transferred funds from these accounts to one of his personal accounts.

***Staff's findings***

This point should have been analyzed in more detail. The review report indicated as a minimum requirement that the member had to review the appendices and take necessary actions to correct the deficiencies observed, but AMF staff did not find any reference to this point either in the member's responses to the review report or the follow-up provided by the IDA – Québec District.

***Staff's recommendation***

With respect to clients authorized to trade on multiple accounts, specific follow-up should have been provided on these situations to ensure adequate management by the firm, and this point should have been discussed directly in the review report.

***Priority: High***

***IDA's response:***

We agree.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will monitor the work done through their meetings with the IDA – Québec District.

## **5. Policy No. 11**

Based on the information we have obtained, the objective of module 10 of the sales compliance review program relating to research is to determine that all provisions of Policy No. 11, including the Guidelines, are applied.

***Staff's findings***

Under Policy No. 11, members must comply with the guidelines where practicable. However, module 10 of IDA's review program does not contain any procedures for verifying, at the time of member reviews, aspects of the Policy that can be verified through reasonable effort, including the verifiable aspects of the Guidelines.

***Staff's recommendations***

AMF staff understand that the Guidelines in Policy No. 11 refer to best practices that members must comply with where practicable. We therefore believe that module 10 of the sales compliance review program should be revised so as to include procedures for verifying all aspects of Policy No. 11 through reasonable effort, including the Guidelines.

***Priority: Medium******IDA's response:***

We agree that it would be desirable to focus on all aspects of Policy #11, including the firm's adherence to the guidelines, however, we anticipate significant practical problems in implementing this recommendation beyond the verification steps already provided in the Module for Guidelines 2, 4, 5 and 9. For example, Guideline 1 of Policy 11 states that: "Members should distinguish clearly in each research report between information provided by the issuer or obtained elsewhere and the analyst's own assumptions and opinions." It is nearly impossible to determine in an audit where a particular piece of information in a research report comes from. We would have to pick a report, look through all the background material compiled in the file by the research analyst plus any outside information sources that he or she might have consulted, then try to make fine distinctions as to whether particular facts or opinions, say a balance sheet analysis, was the analyst's own or borrowed from some other source that he might or might not have consulted and that might very well have come to the same conclusion as he did entirely independently. Furthermore, IDA staff may be required to reconstruct the process through which an analyst and his or her supervisor decided on presentation of materials that may involve much greater expertise and background research than a Sales Compliance Officer could ever bring to bear. We believe that some guidelines, in their own nature, are good guides to practice but are

not something readily amenable to audit. As statements of good practice they are nonetheless worth setting out in a policy. We would appreciate discussing with you how this recommendation could be implemented.

***Staff comments and follow up:***

Policy No. 11 was developed to promote the introduction of high standards of ethical behaviour, to ensure uniform practices among members and to control potential conflicts of interest when preparing and publishing research reports.

At the time of this policy's introduction, in October 2003, the IDA specified that these new provisions ensued from recommendations from the Securities Committee with regard to standards for analysts. It was also noted that these provisions constituted "minimum procedural requirements that Members must meet."

In other words, to the extent that these procedural requirements "must be met", AMF staff feel that they should be subject to audit.

AMF staff, in relation to this, note the information published by the IDA whereby all members must comply with the requirements and, where practicable, the guidelines defined as "best practices".

Consequently, and with the goal of helping consumers rely on analysts' recommendations while generating investor confidence, AMF staff recommend that the IDA review programs, where practicable, include procedures for verifying the degree to which members apply the guidelines. AMF staff will follow up on this issue through their meetings with the IDA – Québec District.

## **6. *Internal audit reports – planning of the file***

According to the information obtained by AMF staff during their discussions with IDA – Québec District staff, the internal audit reports produced by members are analyzed during planning of the file and copies of these reports are appended to the relevant section of the file.

### ***Staff's findings***

AMF staff did not find evidence in the files that the results of analyzing the internal audit reports had been taken into account in planning the file.

AMF staff believe that internal audit reports, when available, help improve the quality of IDA reviews. AMF staff are of the opinion that the information presented in internal audit reports provides some comfort regarding its member compliance process.

Moreover, AMF staff believe that internal audit reports are complementary to IDA reviews and should not result in overlapping, given that they result from work performed prior to the beginning of the IDA review.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District include procedures in its sales compliance review programs regarding the internal audit reports and clearly document the impact of these analyses on file planning.

***Priority: Medium***

***IDA's response:***

A review of internal audit reports is part of the Financial Compliance inspection program. We agree that Sales compliance staff should consult with the Financial compliance staff and inquire if such internal audit reports were obtained. If such reports are available, sales compliance staff will identify any sales compliance issues reported in order to do a proper follow-up.

***Staff comments and follow up:***

AMF staff are satisfied with the response received. No follow-up is necessary.

## **7. Branch reviews**

In one of the two files examined, a branch review deficiency was identified by IDA staff. According to the memo prepared by the IDA - Québec District, no branch review had been performed by this member since the end of 2002. However, at the time of the review performed in January 2005, the member had an action plan for 2005. A branch review schedule had been established and the branch compliance review program was considered adequate by IDA staff.

***Staff's findings***

The deficiency found regarding branch review was the subject of a planning point for the next sales compliance review, but no reference to this problem was included in the review report. In AMF staff's review of this firm, it was found that there was still a weakness regarding branch review. Thus, only one branch had been inspected over a two-year period and no planning in this regard had been carried out for 2006.

***Staff's recommendation***

AMF staff consider that the weakness identified regarding the branch compliance program should have been recorded in the review report and that this should be done for any other similar case. A planning point allows follow-up for the next review, but it is also necessary to inform the member clearly that a deficiency was noted and that corrective actions must be implemented. Even if the member has already established an action plan to correct the identified weakness, the inclusion in the review report makes it possible to formalize the process and ensure that the firm will honour its commitments.

***Priority: Medium***

***IDA's response:***

We agree that a reference should have been included in the report with respect to this particular weakness.

***Staff comments and follow up:***

AMF staff are satisfied with the response received. No follow up is necessary.

**8. *Fixed income – excessive mark-ups***

The IDA's approach to verification is not focused on a specific type of product but is rather an overall approach in terms of the member's quality of supervision and suitability of trades, for example. The sales compliance review approach is adapted according to each member's specific situation and the review program modules are not necessarily covered in their entirety during each review. Also, the "Debt Market" module is not applied very often. It is currently under review by the Toronto office. For these reasons, not much work was done on fixed-income securities in the files reviewed by AMF staff.

***Staff's findings***

Regarding the activities related to fixed-income securities, it was found that no tests were performed to determine excessive mark-ups for the two files examined. AMF staff did not find a test of any formal procedure that the two members might have put in place.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District revise its sales compliance review programs to include excessive mark-up testing.

***Priority: Medium******IDA's response:***

We agree. At the end of 2006, the IDA conducted a thorough survey on fixed income securities among major Member firms in the fixed income industry and suppliers of products. A certain number of improvements will be made to the examination modules with the intention that the internal fixed income specialist at the IDA will conduct follow up interviews and examinations in 2007. We are expecting a revision of the fixed income module by September 30, 2007.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on the work done through their meetings with the IDA – Québec District.

**9. *Corporate finance***

During the review conducted by the IDA in January 2005 at one of the selected members, it was not possible to complete all the sections of the corporate finance module due to a lack of documentation. This was the first review of this member, so the primary aim was to validate the procedures in place at the firm to ensure that they were adequate. Regarding corporate finance, the review report mentioned that the files were incomplete and that there was no written internal

procedure. This was noted as a significant point, which will require follow-up during the next sales compliance review.

### ***Staff's findings***

AMF staff's tests showed that the "corporate finance" module had been covered superficially:

- more than half of the "corporate finance" module was not completed;
- the analysis of financing is weak. There was no reconciliation of the list of client interests, and no test to validate whether the selected new issues in the sampling were in accordance with the clients' objectives;
- several other items that had to be validated, according to a memo on file, were not validated; and
- no test was performed on compartmentalization and on the possibility of conflicts of interest between corporate finance activities and the member's other activities.

However, we should mention that the review notes on file made reference to the fact that several sections of the module were incomplete.

During AMF staff's review, it was found that this member had no procedure, no client list, no list of interested clients vs. number of securities offered, etc.

However, even if the files were incomplete, AMF staff believe that the IDA should and could have performed certain tests using alternative means. IDA Sales Compliance Officers had access to some information, as all of the data gathered by the AMF came from records required under the Securities Act and the Securities Regulation. Using those records, AMF staff were able to perform certain tests that were not performed by the IDA – Québec District.

Beyond the fact that a member may fail to adhere to the rigorous requirements established by the IDA, the latter's mission and ultimate duty involve the public interest. AMF staff are of the opinion that the IDA's approach in reviewing the member's corporate finance operations was not sufficient and, given that the member was acting with no control system and inadequate documentation, did not help generate investor confidence.

AMF staff believe that performing certain alternative tests would have ensured that investors were not at risk. Subsequent to the AMF examination, questions remained regarding the member's corporate finance operations.

### ***Staff's recommendation***

AMF staff recommend that the IDA – Québec District use all available sources of information for the purpose of performing review program testing.

***Priority: High***

### ***IDA's response:***

We agree that the IDA could have performed alternative testing and could have drafted the finding in a way to identify clearly and with a greater emphasis the seriousness of the issues identified. This particular member firm is considered a high risk firm in terms of sales compliance and we have met this firm very recently to discuss the December 31, 2006 Risk Trend Report where we have given our recommendations in order for this firm to be rated in a lower

risk category. The IDA will follow-up closely the responses obtained for the January 2007 sales compliance report and will ensure to do an appropriate follow-up on the significant issues identified during our latest sales compliance review.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on the work done through their meetings with the IDA – Québec District.



### **III. Montréal Office**

#### **E. Enforcement**

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##### **1. Introduction**

Since January 2005, the Investigation department has been under the responsibility of a department manager responsible for case management and supervision of the investigators. Complaint and investigation cases are now supervised in Montréal. The team now consists of six investigators and a department manager. Despite the fact that staff at the Exchange's Investigation department were transferred to the Investigation department of the IDA – Québec District, processing of the IDA's cases by these persons actually began in June - July 2005. This is mainly due to the fact that the former Exchange staff had to complete processing the Exchange's 62 active investigation cases before they could begin processing the IDA – Québec District's own cases.

These events resulted in delays in processing of complaint and investigation cases opened by the IDA in 2005.

The Enforcement Litigation department was also affected by the consolidation of the activities of the Exchange and of the IDA. Two former staff members of the Exchange had to complete the Exchange's former registration files for nearly six months.

These two persons, trained as lawyers, had no training or experience in enforcement or litigation. Their integration required training and follow-up. One resigned in June 2005 and the other in May 2006.

Both were replaced by two new Enforcement counsel: one lawyer was hired in January 2006 but has only been on the job since September 2006. The second has been on the job since July 2006.

A third lawyer rounds out the Enforcement Litigation department, but this employee was on sick leave for a portion of the review period and gradually returned to work in December 2006.

All these events thus caused major delays in processing cases in 2005 and 2006.

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

This section's objectives are to:

- ensure that the staff in place are sufficient and properly experienced and have received appropriate continuing education;
- evaluate that the performance benchmarks used appear reasonable and attainable;
- ensure that the cases received by the Enforcement department are processed adequately; and
- ensure that the decisions are well documented.

AMF staff's review of the Enforcement department included the following points:

- discussion with the Investigation Department Manager, and the Vice-President, Québec, to reach a good understanding of the Enforcement department's operations;
- review of the Enforcement Litigation department's many guides and policies and procedures manuals;
- analysis of the documents used to record operations for the period under review, such as the "Summary of meetings with enforcement"; and
- examination of a sample of cases processed during the period under review.

### **3. *Employee Code of Conduct***

AMF staff analyzed the Code of Conduct for IDA staff. According to AMF staff's discussions, the Code of Conduct is signed by all IDA staff upon hiring.

#### ***Staff's findings***

At the start of AMF staff's review, the employee Code of Conduct did not deal with conflicts of interest or apparent conflicts of interest related to the study of complaint and investigation cases.

During AMF staff's review, the IDA – Québec District staff was amending their code of conduct, to the satisfaction of AMF staff, to provide for voluntary reporting of conflicts of interest or apparent conflicts of interest related to the study of investigation cases.

AMF staff are satisfied with the actions of the IDA – Québec District in this regard.

#### ***Staff's recommendation***

No further action is necessary.

### **4. *Benchmarks***

AMF staff analyzed the data gathered from the database of IDA complaint and investigation cases (CTS) and the most recent statistics from the IDA's quarterly reports. We found that the processing time for IDA – Québec District complaint cases was longer,<sup>3</sup> in 2005, than the processing time of national IDA complaint cases. The processing time of Québec District investigation cases was shorter,<sup>4</sup> in 2005, than the processing time of national IDA investigation cases.

Considering that it seemed unusual to have processing times both clearly shorter and clearly longer than the processing time at the national level, AMF staff questioned the department manager and requested the list of all cases processed during the period under review.

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<sup>3</sup> 72% of the complaint cases processed by the Québec District were closed within 75 days, compared with 89% of the cases for the IDA nationally. The benchmark is 80% of cases closed within 75 days.

<sup>4</sup> 94% of the investigation cases processed by the Québec District were closed within 365 days, compared with 84% of the cases for the IDA nationally. The benchmark is 60% of cases closed within 365 days.

***Staff's findings***

According to AMF staff's evaluation, the performance benchmarks used appear reasonable and attainable. Nonetheless, the analysis showed that case processing time statistics for the IDA – Québec District were not representative of reality in 2005. This was caused by two series of events that distorted performance statistics.

The first series of events results from the consolidation of the Exchange's activities with those of the IDA and, more specifically, the takeover of the Exchange's active investigation cases. To transfer the Exchange's investigation cases to CTS, Investigation department staff of the IDA – Québec District created new files in CTS, while repeating the numbering used by the Exchange. IDA – Québec District staff then created a new numbering system specific to the IDA, for each case transferred from the Exchange, before finally closing the cases in CTS using the Exchange's numbering system.

Consequently, the opening and closing of Exchange cases in CTS triggered an artificial closing of investigation cases. According to AMF staff's analyses, 45% to 50% of the cases were closed in this manner in 2005. This had a downward impact on statistics related to investigation case processing time.

The second series of events results from the combination of certain investigation cases with other investigation cases still active. This process occurs when the Investigation Department Manager decides to combine the processing of several common cases<sup>5</sup> into a single case to increase the level of disciplinary penalties.

According to the information gathered, CTS cannot exclude the processing time of cases recently combined from the calculation of the overall case processing time; this artificially closes investigation files and has a downward impact on processing time statistics. It was impossible for AMF staff to evaluate the exact number of cases closed in this manner. However, according to AMF staff's information, this practice extends to all IDA regional districts, but affects a small proportion of cases. Thus, it should not have a significant impact on statistics.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District adjust its 2005 statistical results to eliminate the downward impact resulting from the closing of the Exchange's investigation cases. Such an adjustment is necessary to allow the use of 2005 statistics as benchmarks for subsequent years.

***Priority: Low***

***IDA's response:***

The IDA agrees with the recommendation and has adjusted the statistical results for the year 2005 for the purpose of using them as a point of reference for subsequent years. According to our analysis, if we exclude the files transferred from the Montreal Exchange, the Investigations Department has processed 13 investigation files in 2005. Of these, 11 files, i.e., 84 % of the files were processed within 365 days, thereby exceeding the benchmark objective.

<sup>5</sup> Investigation cases pertaining to the same violation and concerning the same member firm or the same representative.

***Staff comments and follow up:***

AMF staff are satisfied with the response received. No follow up is necessary.

**5. *Closing letter***

AMF staff examined the various procedures manuals, examined a sample of complaint and investigation cases, and obtained a copy of the different letter formats used by the IDA – Québec District during the period under review.

***Staff's findings***

On the whole, AMF staff noted that effective procedures were in place. Some new procedures are very effective, in AMF staff's opinion. These are:

- checklists, which allow uniform processing of cases; and
- regular updates by investigators of the Case Summary.

However, AMF staff's tests of the complaint and investigation cases showed that the closing letters sent to complainants did not give explicit reasons to support the closing of the case. In the opinion of AMF staff, the closing letters addressed to complainants should contain enough information to inform them of the work performed by the IDA – Québec District and the reasons for the decision, regardless of whether the complaint is finalized at the case assessment or investigation stage.

From discussions with the department manager, AMF staff learned of the existence of a new closing letter format, established in summer 2005. AMF staff thus extended their tests to the complaint and investigation cases opened after summer 2005. It was found that for one of the cases consulted, despite the establishment of a new closing letter format, the closing letter did not detail the reasons for closing the case.

The 2006 cases all present the new closing letter format. This now details the reasons for closing a case.

***Staff's recommendation***

Considering that this weakness has already been corrected, other than with respect to an isolated case, no further action is necessary.

**6. *Complaint case processing time***

AMF staff examined a sample of complaint cases spread over the entire period under review.

***Staff's findings***

The test of complaints showed that the cases were well organized and well documented. Moreover, the department manager's supervision was well documented in the case files.

For seven complaint cases consulted, the processing time was clearly longer than the benchmark, established at 75 days. The average processing time for these seven cases, mostly from 2005, was 123 days.

The IDA – Québec District complaint case processing time for the period from January 1, 2006 to June 30, 2006 was better than the benchmark and in line with the national IDA processing time (86% in Québec compared with 89% at the national level, with a benchmark of 80% of cases processed within 75 days).

We also found that, for one of the complaint cases consulted, no acknowledgment of receipt had been sent to the complainant.

***Staff's recommendation***

Considering that most of the cases with a long processing time originate from cases processed in 2005, a period affected by several events, as mentioned previously, no further action is necessary.

However, AMF staff recommend that the IDA – Québec District take the measures necessary to ensure that acknowledgments of receipt are sent to complainants within a reasonable time period.

***Priority: Low***

***IDA's response:***

We agree.

***Staff comments and follow up:***

AMF staff are satisfied with the response received. No follow up is necessary.

**7. *Delay in internal communication of important information***

AMF staff examined a sample of investigation cases spread over the period under review.

***Staff's findings***

The test of investigation cases showed that the Investigation department had not transmitted to the Registration department, within a reasonable time, a copy of the opening letter for two investigation cases. As a result, the Registration department was required to place the representative's registration under close supervision. The transmission time was five months.

***Staff's recommendation***

Considering the fact that the exchange of this type of information is vital to protect investors, AMF staff recommend that the IDA – Québec District take the actions needed to forward investigation opening letters to the Registration department as promptly as possible.

***Priority: Medium***

***IDA's response:***

We agree.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this recommendation through their meetings with the IDA – Québec District.

**8. *Investigation processing time***

AMF staff analyzed the “Summary of meetings with Enforcement” and a sample of investigation cases for the entire period under review.

***Staff's findings***

The analysis of the “Summary of meetings with Enforcement” clearly shows that the investigator and the Enforcement counsel assigned to the case regularly discuss the progress of the investigation. The Enforcement counsel is therefore involved in the investigation process from the outset. According to AMF staff's findings, this contributed to improving the quality of the investigation files.

The test showed that the cases were well organized and well documented. Moreover, the department manager's supervision was well documented in the case files.

For four investigation cases examined, the processing time was clearly longer than the benchmark, established at 365 days. The average processing time for these four cases, mostly from 2005, was approximately 448 days.

The IDA – Québec District investigation case processing time for the period from January 1, 2006 to June 30, 2006 was better than the benchmark, set at 60% of cases processed within 365 days, and in line with the national IDA investigation processing time (71% in Québec compared with 68% at the national level).

It was also found that the staff in place were sufficient and properly experienced and had received appropriate continuing education.

***Staff's recommendations***

Considering that most of the cases with long processing times originate primarily from cases examined in 2005, a period affected by several events, as mentioned previously, no further action is necessary.

## **9. *Enforcement Litigation case processing time***

The procedure in place at the IDA – Québec District is for the Vice-President, Québec to approve the opening of disciplinary cases and assign the case to an Enforcement Counsel or an outside lawyer. This stage takes between 48 hours and one week. The delay is based on a reading of the investigation report or discussions regarding the recommendation of the investigator to open a disciplinary case.

Based on a recommendation from the lawyer assigned to the file (external or internal), a file may, after discussion with the Vice-President, Québec, be closed without action, be closed with a warning letter or trigger disciplinary proceedings.

The type of disciplinary actions contemplated will depend on the evidence gathered. Although evidence may support the appearance of an offence, it may not be sufficient for the purpose of taking disciplinary action.

In the case of closing a file or issuing a warning letter, an e-mail confirms the decision made by the Vice-President, Québec, and the Enforcement Counsel signs the closing or warning letter.

When the launch of disciplinary proceedings is agreed on, the Vice-President, Québec approves the draft notices of hearing, the charges and the draft settlement agreements.

AMF staff examined a sample of enforcement litigation cases extending over the entire period under review.

### ***Staff's findings***

Based on AMF staff's analysis of the summary of Investigation department meetings, it was found, as already mentioned, that the Enforcement counsel properly monitors the progress of the investigation. In the opinion of AMF staff, this contributes to improving the quality of the enforcement cases and to shortening the case processing time.

AMF staff's tests of enforcement litigation cases showed substantial delays in processing of cases, primarily due to various events occurring in 2005 that were beyond the control of the IDA – Québec District (two departures, a maternity leave and an extended sick leave). Thus:

- one case opened in January 2004 was delayed several months without valid explanation (time to authorize transfer of the investigation case to Enforcement Litigation, to send the case opening letter to the firm and to send the opening letter to the complainant). The case required a disciplinary hearing and was resolved by a settlement agreement in June 2006;
- one investigation case, processed in 2002, was opened in December 2003 by the Enforcement Litigation department and closed in June 2006 (the case was closed without action); and
- as at August 31, 2006, ten cases were still awaiting processing after the departure on sick leave of one of the three Enforcement counsel (five cases assigned in May-June 2006 and five cases assigned in December 2005).

AMF staff found that despite the substantial delays in 2005, the IDA – Québec District enforcement litigation case processing time for the period from January 1, 2006 to June 30, 2006 was better than the benchmark and slightly lower than the national IDA result (71% in Québec

compared with 76% at the national level, with a benchmark of 60% for cases processed within 10 months).

As well, there were a total of 16 cases still active as at August 31, 2006, an average of eight cases per Enforcement counsel. These cases were open for an average of six months.

There were seven cases with outside consultants and, of this number, three had been open since November 2003 and one since July 2004. The other three cases were more recent but exceeded the 10-month processing time.

***Staff's recommendation***

AMF staff recommend that the IDA – Québec District draw on an additional temporary resource so as to allow the gradual return of the Enforcement counsel on sick leave, integrate the new lawyer hired in September 2006 and have the necessary leeway to deal with lengthy and complex cases that could result in delay.

AMF staff believe it is important to alleviate the problem of insufficient resources quickly so as to be able to deal with contingencies and, above all, not undermine the effectiveness of disciplinary proceedings.

***Priority: High***

***IDA's response:***

We agree. The IDA will ensure the necessary resources to ensure the effectiveness of its disciplinary process.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on this issue through their meetings with the IDA – Québec District.



### III. Montréal Office

#### F. Information Protection

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##### 1. *Introduction*

It is essential for any organization to establish measures guaranteeing effective protection of the information received. These measures pertain to several aspects of operations, whether in terms of premises, computer facilities or training of key staff, for example. The ultimate purpose is adequate and well-documented information protection so as to ensure the permanence of crucial files and other elements essential to the recovery of activities in case of disaster, for example.

This section deals with two components of information protection as a whole, namely, computer system protection and document protection.

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

AMF staff consider that efficient operations depend on a solid information protection policy. Thus, this section's objectives are as follows:

- ensure that the IDA – Québec District adequately protects information and has a plan or measures that give it the capacity to maintain and restore, as the case may be, its essential operational activities so that it can satisfy the requirements related to its function as a self-regulatory organization; and
- ensure that the procedures for access management and document retention, use and destruction are adequate.

During AMF staff's review, they visited the premises and took note of the policies and procedures in place. AMF staff also had conversations with the persons responsible in order to gather the information necessary for an understanding of the information protection policy and the written procedures concerning the following points:

- protection of the physical environment of the computer facilities;
- data backup and off-site storage in a secure facility;
- the disaster recovery plan;
- the facilities maintenance and renewal plan; and
- the document management, archiving and destruction policy.

##### 3. *Information protection*

###### 3.1 *Computer system*

The IDA outsourced management of its data centre to a specialized provider in April 2004. This centre is operated by an independent company, which is responsible for physical protection and access control for the servers, applications and data. A server is kept in each regional office (Montréal, Calgary and Vancouver) for local file backup and printing services. These regional

servers are managed on a remote basis by the independent provider and physical access is controlled by the office managers in each region.

Protection of the Montréal server and the network peripherals is provided by limited access and an uninterruptible power supply. Antivirus software, which is updated automatically, is installed on each server, desktop and laptop.

***Staff's findings***

AMF staff's review showed that there is room for improvement, primarily in the physical environment of the computer facilities and the magnetic tape backup and storage procedures.

AMF staff also noted that funding for a backup site was approved in 2005 but that the funds had still not been received.

**3.2            *Documentation***

The IDA – Québec District manages and generates a multitude of daily information related to members and their representatives. This information is the nervous system of the IDA's activities.

***Staff's findings***

AMF staff found that the IDA – Québec District does not have a document management policy in writing or a document archiving and destruction policy in writing.

***Staff's recommendations***

AMF staff recommend that the IDA – Québec District set up written policies to ensure information protection, access, retention and use and, if applicable, the destruction of paper or electronic documents.

The IDA should also pursue its efforts to implement its backup site.

***Priority: Medium***

***IDA's response:***

We agree.

***Staff comments and follow up:***

AMF staff are satisfied with the response received and will follow up on the work done through their meetings with the IDA – Québec District.

## IV. Toronto Head Office

### A. Summary

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#### 1. *Background*

During September and October 2006, NSSC and OSC staff jointly conducted an oversight review of certain departments and activities of the Toronto head office. NSSC staff's review focused on the IDA's Enforcement department, while OSC staff reviewed the Registration, Sales Compliance and Enforcement departments, as well as the membership activities conducted by the Toronto head office.

#### 2. *Assessment of the findings related to the Toronto head office*

Based on interviews with IDA staff, and a review of the IDA's policies and procedures and of a sample of files, OSC staff are of the view that the IDA is generally in compliance with its T&Cs of recognition.

OSC staff are, however, concerned with the increased turnover experienced by the Registration and Sales Compliance departments and the Case Assessment group of the Enforcement department during the period under review. OSC staff are of the view that the IDA should, in addition to filling in existing vacancies, analyze and address the factors underlying the increased turnover levels.

OSC staff are also concerned that decisions by Registration staff to approve applications for transfer of individuals between IDA member firms may not always reflect an appropriate level of independent analysis from the views of Enforcement staff. OSC staff recommend that the IDA review its processes for reviewing and approving transfer applications.

Due to the low frequency of sales compliance reviews of Ontario branches of member firms, the IDA should reassess whether its processes for assessing a member's compliance at the branch level are adequate, including whether it has conducted an appropriate number of branch reviews to gain sufficient assurance regarding branch compliance in Ontario, and to ensure there is an adequate level of protection afforded to Ontario investors. OSC staff also queried the scope of the examination procedures performed as part of Sales Compliance reviews and recommended that they cover all relevant, high-risk areas of member firms' businesses.

NSSC and OSC staff also noted, through reviews of working files, that the IDA can make further improvements in its documentation of work performed in the various areas reviewed.

## IV. Toronto Head Office

### B. Registration

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#### 1. *Introduction*

Section 21.5(1) of the *Securities Act* (Ontario) (the Act) allows the OSC to assign any of its registration powers and duties under Part XI of the Act, subject to any terms and conditions it may impose, to an SRO recognized under the Act. Currently, the OSC delegates the following powers to the IDA:

- The review and granting of initial registration to individual applicants, as well as the imposition of any applicable terms and conditions;
- Renewal of registration for IDA member firms, provided that it is done on the terms and conditions originally imposed by the OSC;
- Renewal of the terms and conditions imposed by the OSC on registration of IDA members;
- The granting of exemptions from the proficiency requirements set out in OSC Rule 31-502 and from the requirement for full-time employment set out in section 127(1) of the regulations made under the Act; and
- The reinstatement of registration for individuals.

In addition, the OSC relies on the IDA to perform other registration functions, such as processing applications for opening or closing of branches of IDA member firms.

These functions are performed by staff of the IDA's Registration department, whose mandate is to protect the public and the integrity of the capital markets by ensuring that partners, officers and directors of member firms and their personnel conducting or supervising regulated activities are fit and proper, meet rigorous qualification standards and are properly approved by the IDA.

#### 2. *Purpose and scope*

The purpose of this part of the oversight review was to assess the adequacy of staffing and training of Registration staff of the IDA's Toronto head office, the adequacy of the department's performance measurement benchmarks and whether they are met, the overall effectiveness and efficiency of the review of applications received by the Registration department and the appropriateness of the decisions taken by Registration staff.

In order to accomplish these objectives, OSC staff reviewed Registration staff job descriptions and the department's organization chart, the department's policies and procedures database and checklists used to complete applications, a sample of applications processed during the period under review, and some additional application files where concerns had been identified by OSC staff during normal course activities prior to the commencement of the oversight review. In addition, OSC staff reviewed other internal quarterly reports generated by the IDA during the period under review and conducted interviews with the Director and Manager of Registration.

### **3.           *Benchmarks***

#### ***Background information***

The benchmarks used by the Registration department throughout the period under review were as follows:

- 80% of all applications are either approved or the applicant will be sent a first deficiency letter within 5 business days; and
- All transfers of registration are completed within 2 business days provided no extenuating circumstances (such as exemption requests) require a longer processing time.

In addition, the department has performance benchmarks for new member applications, discussed in **Section C - Membership** of this report.

#### ***Staff's findings***

In OSC staff's view, these benchmarks are adequate and set ambitious goals for the processing of registration applications.

OSC staff's review of quarterly internal reports prepared by the IDA showed that, during the period under review, the benchmarks for processing transfer applications were met, on average, over 90% of the time. The benchmarks for new application reviews were not met in the second and third quarter of 2005, due to factors that included the unavailability of staff during the summer holidays and a high level of turnover in the third quarter of 2005. However, OSC staff acknowledge the challenging nature of these benchmarks, and that it is important to ensure that meeting them does not compromise the quality of the review done by IDA Registration staff who must ensure they conduct sufficient analysis of complex issues and give priority to regulatory concerns. In addition, the benchmarks were met during most of the period under review.

#### ***Staff's recommendation***

No further action is necessary.

### **4.           *Staffing***

#### ***Background information***

At the time of the field review, the department included 20 staff members, including 10 Senior Registration Officers and 3 Registration Officers.

#### ***Staff's findings***

OSC staff noted that the Registration department experienced increased staff turnover levels during 2005 and in the first quarter of 2006, due to a large number of resignations. During the second quarter of 2006 the Registration department was operating at full staff complement but, at the time of OSC staff's field review, was again short one staff member. OSC staff were advised that the reasons for the resignations included, among others, departure of IDA Registration staff for better paid positions in the industry or for the OSC.

OSC staff's review of quarterly internal reports and discussions with the IDA Director and Manager of Registration show that IDA management monitor the turnover levels of the Registration department closely. In addition, it took active steps to fill the vacancies by hiring additional Registration staff and through internal promotions, and has raised concerns with the

IDA's Human Resources department regarding the departure of staff for better paid positions. OSC staff understand that a review of the positions and salary levels for the Registration department was commenced during the period under review, but had stalled.

***Staff's recommendation***

The IDA's Human Resources department should complete its review of Registration positions and salary levels, and the Registration department should take appropriate steps to follow any recommendations that result from the review to ensure it retains skilled and experienced Registration staff.

***Priority: Medium***

***IDA's response:***

We agree.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will monitor, through regular status update meetings<sup>6</sup>, the IDA's progress towards meeting this recommendation.

## **5. Training and supervision**

***Background information***

The Manager of Registration trains the Senior Registration Officers and maintains a checklist to ensure that all relevant topics are covered during the training period. A Registration Officer trains the Registration Officers and Registration Clerks.

In addition, the Registration department maintains a database of reference materials available to Registration staff. This database includes the links to rules and member regulation notices.

***Staff's findings***

Based on the description provided by Registration department management and a review of the database of reference materials, the training process is adequate.

However, OSC staff noted that there is no process in place to ensure that the Manager of Registration conducts a secondary review, on a test or random basis, of applications completed by Senior Registration Officers subsequent to their initial training period. OSC staff acknowledge that the Manager reviews all complex applications brought to her attention and is consulted when Senior Registration Officers identify issues or problems. However, this approach may not be sufficient to ensure that all issues are identified by Senior Registration Officers in situations where matters are not brought to her attention.

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<sup>6</sup> OSC staff plan to meet with IDA staff on a quarterly basis to monitor the IDA's progress towards implementing solutions to address the high and medium priority recommendations in OSC staff's report.

***Staff's recommendation***

The IDA should establish a process to ensure the Manager of Registration reviews, on a test or random basis, registration applications completed by Senior Registration Officers in order to ensure that all issues are properly identified, addressed and escalated, if necessary.

***Priority: Medium***

***IDA's response:***

The IDA has three processes for the management review of Registration staff work: 1) review by the Manager of applications reviewed by a Senior Registration Officer based on criteria intended to identify significant issues; 2) Quality Assurance program testing on a random basis that commenced in the third quarter of 2007; and 3) the Registration Manager will start random testing of Ontario registration files effective December 1, 2007.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will discuss with the IDA the details of the planned random testing at the next status update meeting.

## **6. Registration applications – specific issues**

### **6.1 Initial applications, terminations, applications for change in registration category and branch closings**

***Background information***

OSC staff reviewed a sample of 9 initial applications for registration, 3 terminations, 3 applications for change in registration category and 3 applications for branch closing from NRD.

Also reviewed was 1 initial application for registration where concerns had been identified by OSC staff during their normal course activities prior to the commencement of the oversight review.

***Staff's findings***

Based on the sample reviewed, initial applications for registration were reviewed by Senior Registration Officers on a timely basis. Applications with issues requiring secondary review identified by IDA registration staff were properly referred to the Manager of Registration for review. In addition, OSC staff's review of the sample of initial applications showed that Registration staff followed up on material deficiencies and ensured that individual applicants had met the proficiency requirements before approving their registration. Further, upon review and discussion with IDA staff of the initial application where OSC staff had pre-existing concerns, OSC staff identified issues in relation to the applicant's proficiency and, as a result, the exemption application was examined; this application is discussed in detail under section 6.2 below.

OSC staff's review of termination notices shows that these were also processed in a satisfactory manner. Similarly, the review of applications for change in registration category appeared adequate. Registration staff reviewed these applications promptly, and there was evidence that

they followed up on deficiencies. The applications for branch closings were also adequately processed.

However, OSC staff found that, in 3 of the 18 sampled files, documentation did not fully reflect the work done and therefore, in some cases, it was unclear to OSC staff whether the work was adequate:

- In two initial application files, the application checklists did not reflect deficiencies which had been identified and resolved, as reflected by correspondence in the file; and
- In one initial application file, the National Registration System checklist posted on NRD incorrectly stated that the applicant met proficiency requirements and had not been granted an exemption from these requirements.

***Staff's recommendation***

The IDA should ensure that all the registration application files are properly documented and NRD records complete in order to demonstrate that the required procedures were performed and that the NRD records are accurate.

***Priority: Medium***

***IDA's response:***

We agree and we are currently doing this.

***Staff comments and follow-up:***

OSC staff will follow up through regular status update meetings with the IDA to discuss the steps taken to ensure application files and NRD records are properly documented.

## **6.2 Adequacy of review of exemption applications**

***Background information***

Exemption applications are currently filed through NRD. They are assigned to Senior Registration Officers, who review them and make the initial recommendations to deny or grant the exemptions. The applications are then forwarded for a decision by a sub-committee of the District Council (Registration sub-committee) constituted in accordance with the requirements of IDA By-law 11 *District Councils and Meetings*. A decision by this sub-committee is usually communicated by email, within one to two days from the submission date.

Approval of certain exemption applications, such as exemptions from writing or re-writing certain proficiency courses, has been delegated to the Director of Registration.

OSC staff reviewed a sample of 9 exemption applications and reviewed 2 applications where concerns had been identified by OSC staff during their normal course activities prior to the commencement of the oversight review. One of these was related to the initial application discussed earlier in section 6.1 where OSC staff had identified issues with the applicant's proficiency.



***Staff's findings***

OSC staff's review of the sampled exemption applications shows that, overall, they were properly completed, and the decisions to grant or deny exemptions adequate. OSC staff also found that, even though the recommendations were appropriate, the memoranda provided to the Registration sub-committee did not always include sufficient information regarding the analysis performed to support the recommendations. For example, in one case, the memorandum included a recommendation for conditional registration, but did not indicate why the individual was not qualified for unrestricted registration. In two other cases, the memoranda did not indicate how the experience or education that the applicant described to support the exemption application was or was not equivalent to the required courses.

Regarding one of the two applications where OSC staff had pre-existing concerns, it was found that an exemption from rewriting the Canadian Securities Course was granted based on the completion of the Partners, Directors and Senior Officers Course, also a pre-requisite for the category of registration sought by the applicant, and based to a certain extent on unrelated and irrelevant work experience. OSC staff also found that this exemption had not been submitted through NRD, as required by the normal process. Since then, the IDA has clarified in Member Regulation Notice MR0396 the requirement that its member firms file all applications for exemptions from the proficiency requirements in NRD.

***Staff's recommendations***

a) The documents setting out IDA Registration staff's recommendations should include sufficient information to ensure that the reasons for the recommendations are properly documented.

***Priority: Medium***

***IDA's response:***

We believe that the recommendations did include sufficient information. In one of the cases noted the recommendation by Staff was made after discussions with District Council members in which the applicant's past experience was discussed. An email exchange between Staff and the District Council Members has now been placed in the file for future reference. In the other cases the equivalent course is well-known throughout the industry and is in fact a recognized proficiency for registration categories requiring greater educational attainments than the CSC.

***Staff comments and follow-up:***

One of the primary purposes of a recommendation memorandum is to provide decision-makers with sufficient information to determine whether staff performed adequate analysis to support the recommendation to grant or deny an exemption. It also provides a permanent record of the bases upon which an exemption was granted or denied.

In the cited findings, there were other facts known to IDA staff that performed the analysis that, in OSC staff's view, should have been included in the recommendation memo as reasons for granting the exemption, as these would have impacted the relevance of the well-known equivalent course cited by the IDA as the primary justification for granting the exemption. OSC staff will follow up with the IDA through regular status update meetings to ensure that the importance of including in the recommendation memo all relevant reasons in support of a

recommendation to grant or deny an exemption is re-emphasized to IDA staff.

b) The IDA must ensure that exemptions from proficiency requirements are only granted based on the successful completion of courses equivalent to prescribed courses and/or the existence of equivalent industry experience.

**Priority: High**

***IDA's response:***

The IDA agrees that exemptions from proficiency requirements should only be granted based on the successful completion of courses equivalent to prescribed courses and/or the existence of relevant experience. We will no longer consider non-securities related experience as relevant experience.

We require the flexibility to review and provide a preliminary ruling on an exemption request prior to formal submission through NRD because firms require guidance on the application before hiring and training the individual. We acknowledge that the IDA maintains the jurisdiction to make a final decision upon receipt of the application through NRD, and have communicated the NRD filing requirement to our member firms in April 2006 as published in Member Regulation Notice 396.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will discuss in more detail with the IDA at the next status update meeting the steps the IDA has taken to ensure OSC staff expectations regarding exemptions from proficiency requirements are met.

OSC staff do not disagree that IDA staff should be able to provide a preliminary opinion to a member firm on a proficiency exemption request, so long as it ensures that any exemption application relating to an exemption from OSC proficiency requirements is filed on NRD at the time registration is being sought, and that approval of that exemption is not granted until such filing has been made. OSC staff will discuss with the IDA in more detail its processes for providing preliminary rulings for proficiency exemption requests at the next status update meeting.

### **6.3 Adequacy of review of applications for transfers**

***Background information***

Transfer applications are reviewed by the Senior Registration Officers. The target completion time is 48 hours. The review involves checking the applicant's background and investigation history in order to determine whether there are concerns with the applicant and whether terms and conditions on registrations are warranted.

In order to complete a transfer application, the sponsoring firm from which the individual is departing (the terminating firm) must file a Uniform Termination Notice (UTN), which confirms the effective termination date of the individual, identifies whether or not the individual was

terminated for cause, and documents the reasons for termination. Registration staff may approve the transfer application prior to receipt of the UTN, based on review of information available in the Complaints and Settlement Reporting System maintained by the IDA (ComSet). If the ComSet search identifies open complaints and investigations conducted by the terminating firm at the time of the transfer, the current process is to approve the applicant's transfer application, but advise the applicant's new sponsoring firm of the concerns and request it to place the individual under voluntary, close supervision (voluntary supervision), which entails the completion of monthly supervision forms by the individual's new sponsoring firm. If the ComSet search shows that complaints are settled and closed by the firm, the transfer application is generally approved without conditions attached.

The UTN is also reviewed when received. If it raises additional concerns regarding the individual, the UTN is referred to the Enforcement department for further review and the IDA may request the applicant's new sponsoring firm to place the individual under voluntary supervision (assuming it is not already doing so) until the Enforcement department concludes its review. Registration staff relies on the decision taken by the Enforcement department in order to determine whether further conditions of registration should be placed on the individual. Generally, if the Enforcement department takes no action, no further terms and conditions are recommended by Registration staff.

OSC staff reviewed a sample of 10 transfer applications completed by IDA staff. Also reviewed and discussed with IDA staff were 9 applications where concerns had been identified by OSC staff during normal course activities prior to the commencement of the oversight review.

### *Staff's findings*

From the review of the sampled applications for transfer, OSC staff were satisfied that, overall, these transfer applications were processed on a timely basis, and that the level of independent analysis performed by Registration staff was sufficient to support the decisions made in these cases.

However, OSC staff identified issues relating to the level of independent analysis performed by Registration staff, and the consistency of information sharing between the Registration and Enforcement departments, in conjunction with the review of applications where OSC staff had pre-existing concerns. In one of these applications, OSC staff found that the IDA approved an application for transfer unconditionally, even though they were in possession of detrimental information regarding the individual. The decision was made on the basis that Enforcement staff that reviewed the UTN decided not to take any action against the individual.

In another case involving the applications where OSC staff had pre-existing concerns, it was found that the IDA only requested that the applicant's new sponsoring firm place the individual under voluntary supervision, even though the UTN raised serious concerns and an investigation against the individual by the IDA's Enforcement department was only in its preliminary stages.

OSC staff acknowledge the challenge in ensuring that decisions regarding the approval of transfer applications are fair to each applicant given the information available to Registration staff, and that applications are not unnecessarily delayed. However, such decisions should always balance fairness with the key objective that the applicant must display the integrity expected of a securities industry professional.

***Staff's recommendation***

The IDA should review its processes for reviewing and approving transfer applications, including the level of information sharing between the Registration and Enforcement departments, and must ensure that the decisions of IDA Registration staff are made independent of IDA Enforcement staff, but with due regard for their decisions and the factors related to the suitability and integrity of the applicants.

***Priority: High***

***IDA's response:***

We agree. We will change our process to provide registration staff with all information, including Enforcement information required to make an independent decision.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will discuss with the IDA its planned process changes at the next status update meeting, and will monitor through these meetings, the IDA's progress towards meeting this recommendation.

#### **6.4 Adequacy of review for applications for opening of sub-branches**

***Background information***

The IDA's policies and procedures require that the Senior Registration Officer reviewing an application for the opening of a sub-branch make inquiries on the frequency of visits by the branch manager to the sub-branch. In addition, Senior Registration Officers are required to notify the Sales Compliance department when a branch manager supervises its 21<sup>st</sup> sub-branch, and for each sub-branch added thereafter.

OSC staff reviewed a sample of 3 applications for opening sub-branches selected from NRD reports.

***Staff's findings***

OSC staff's review of the sampled applications for opening sub-branches identified the following areas where the file documentation was not as complete as it could be and therefore, in some cases, it was unclear to OSC staff whether the work done was adequate:

- In one case, the Senior Registration Officer was notified that the branch manager intended to visit the sub-branch at least once, but there was no documentation in the file of the Senior Registration Officer's analysis as to how it was determined that the frequency was adequate;
- In another case involving a branch opening, there was no evidence that the Sales Compliance department was notified about the addition of a sub-branch to the supervisory responsibilities of a branch manager already responsible for over 20 sub-branches; and
- In another case, a decision had been made that the branch manager supervising a sub-branch in Ontario did not need to be registered in Ontario, but there was no documentation in the file to support the IDA staff's reasoning that such registration was not required.

In addition, although discussions with the Manager of Registration showed that the standard procedure is to notify the Sales Compliance department when a branch manager supervises 21 sub-branches and for each additional sub-branch thereafter, the written policy is unclear in this respect and could create confusion.

***Staff's recommendations***

a) The IDA should ensure that documentation of the reasoning for approval recommendations is complete and supports Registration staff's decisions.

***Priority: Medium***

***IDA's response:***

In our view, in each of the cases cited, the decisions made were routine and reasonable, and the documented analysis was sufficient to support the decision. We do not believe that additional detailed written analysis of the decision would improve the result.

***Staff comments and follow-up:***

OSC staff do not disagree that these decisions were routine and reasonable, but disagree that they were documented properly. OSC staff will follow up with the IDA through regular status update meetings to ensure that the importance of documenting the analysis supporting recommendations is re-emphasized to IDA staff.

b) The IDA should consider clarifying its written policy to specify that the Sales Compliance department should be notified when a sub-branch is added to a branch manager's supervision, for each additional sub-branch in excess of 20.

***Priority: Low***

***IDA's response:***

Our written procedures have been clarified as suggested.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response.

## **IV. Toronto Head Office**

### **C. Membership**

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#### **1. Introduction**

OSC Rule 31-507 requires securities dealers and brokers to be members of an SRO recognized under section 21.1 of the Act (currently the IDA). IDA By-law 2 *Membership* (IDA By-law 2) states that any individual, firm or corporation is eligible to apply for membership with the IDA provided it meets certain conditions. In addition, IDA By-law 20 sets out the responsibilities and powers of the District Council and Executive Committee of the Board of Directors relating to the membership applications, as well as the approval process for such applications.

The Association Secretary is responsible for coordinating the application review process and is the key contact between the IDA and applicants for membership. New member applications are reviewed in detail by the Registration, Financial and Sales Compliance departments. Staff of the Registration department review the qualifications and backgrounds of Partners, Directors and Officers, and ensure that the proposed supervisory positions of the applicant are reviewed and approved. The Financial Compliance department is responsible for reviewing the financial reporting and operations infrastructure of the applicant, while the Sales Compliance department is responsible for reviewing the applicant's policies and procedures and its proposed supervisory structure. Once the review by each department is complete, the Association Secretary makes a submission to the Ontario District Council (ODC) for approval. After the ODC's approval, another submission is sent to the Board of Directors for final approval of an applicant to membership. Prior to April 2006, this final decision was made by the Executive Committee of the Board of Directors.

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

OSC staff's objective was to determine whether the IDA has fair and consistent processes for reviewing and approving membership applications and requests for member firm resignations. In addition, OSC staff assessed compliance with the applicable provisions of IDA By-law 2.

In order to accomplish these objectives, OSC staff reviewed: (1) the applicable IDA by-laws; (2) various internal policies and procedures documents, as well as checklists and programs used by IDA staff to process applications; and (3) a sample of files to determine the adequacy of review and the appropriateness of issue identification and resolution. OSC staff also interviewed staff of the Association Secretary, as well as a number of Financial Compliance, Sales Compliance and Registration staff.

#### **3. Policies and procedures**

##### ***Background information***

The policies and procedures used by the Financial Compliance, Sales Compliance and Registration departments set out the processes followed in reviewing applications for membership, as well as the procedures followed by the Financial Compliance and Registration

departments to process resignation applications. Each department has checklists and programs for the review of new member applications.

The process for conducting hearings is documented in Part D Approval and Exemption Review Hearings of the IDA's *Rules of Practice and Procedure*, as well as in Part 7 of By-law 20.

### ***Staff's findings***

The policies and procedures for processing new member applications and requests for resignations are comprehensive and provide adequate guidance to IDA staff involved in the review. The checklists and programs used by the various departments to review new membership applications also provide IDA staff involved in the review of applications with adequate guidance. Further, the process for conducting review hearings for membership approval decisions is also adequate.

### ***Staff's recommendation***

No further action is necessary.

## **4. *Benchmarks***

### ***Background information***

The benchmarks for new member application reviews are as follows:

- The Financial Compliance and Sales Compliance departments must complete the preliminary review and issue the preliminary report for new member applications within two weeks from receipt of the application; and
- The Registration department must complete and issue a preliminary deficiency letter upon review of suitability of an applicant's management (as required by By-law 7 *Partners, Directors and Officers*) and the applicant's submissions received through NRD within two weeks of receipt of the application.

In addition, the timeline set out in IDA By-law 2 (which states, in part, that if an application has not been completed within six months from the date the application was submitted to and accepted for review by the Association Secretary, the applicant shall be required to start the application process over), is also used as guidance by IDA staff.

As set out in IDA By-law 8, resignations generally take effect as of the close of business (5:00pm head office time) on the date the Association Secretary receives from the member firm's auditor a written statement certifying that the member firm has sufficient liquid assets to meet all its liabilities other than subordinated loans, if any, and if, to the knowledge of the Association Secretary, the member firm is not indebted to the IDA and there are no complaints or pending investigations.

### ***Staff's findings***

The existing performance benchmarks and timelines for new member application reviews are adequate for general monitoring purposes.

### ***Staff's recommendation***

No further action is necessary.

## **5.           *Review of new member application files***

### ***Background information***

OSC staff reviewed 3 of 15 new member applications received during the period under review, including the related files of the Association Secretary and the working paper files of the Sales Compliance, Financial Compliance, and Registration departments.

### ***Staff's findings***

OSC staff's review of the sampled files showed that, overall, the work performed by the staff of the Financial Compliance, Sales Compliance and Registration departments was adequate. The applications were reviewed on a timely basis. Final approval by the Executive Committee of the Board of Directors was received within approximately three months from the receipt of the applications. The internal benchmarks for new member application reviews were generally met. The conclusions in the working paper files were appropriate and properly supported by the documentation in the files.

### ***Staff's recommendation***

No further action is necessary.

## **6.           *Review of resignation files***

### ***Background information***

OSC staff reviewed 3 of 16 resignation files completed during the period under review, including the central files maintained by the Association Secretary and the working paper files of the Registration and Financial Compliance departments.

### ***Staff's findings***

The sampled files were adequately documented. The working paper files completed by the Financial Compliance department showed that the relevant requirements of IDA By-law 8 were followed. In addition, approvals for resignation were sufficiently supported.

### ***Staff's recommendation***

No further action is necessary.



## **IV. Toronto Head Office**

### **D. Sales Compliance**

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#### **1. Introduction**

The IDA is required by T&C #6 of the OSC Recognition Order to ensure it has adequate arrangements and resources for the effective monitoring and enforcement of its member firms' compliance with IDA rules, as well as Ontario securities laws.

The Sales Compliance department's key responsibility is to test whether member firms have implemented policies and procedures that ensure their compliance with all non-financial regulatory requirements, including those set out in IDA rules and Ontario securities laws. It meets this responsibility mainly by conducting on-site sales compliance reviews of IDA member firms.

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

The main objectives of this part of the oversight review were to assess the adequacy, timeliness and quality of sales compliance reviews conducted by the Sales Compliance department. In addition, OSC staff reviewed the adequacy of the department's performance benchmarks.

In order to accomplish these objectives, OSC staff reviewed the relevant provisions of IDA by-laws, regulations and policies. OSC staff also reviewed various policies and procedures documents and reports of the IDA's Sales Compliance department and interviewed several Sales Compliance staff. In addition, OSC staff conducted limited scope field reviews of three IDA member firms and compared the findings against the IDA's in order to check the adequacy of the IDA's sales compliance review procedures.

#### **3. Staffing resources and training**

##### ***Background information***

The planned staffing level for the Sales Compliance department at the Toronto head office during most of the period under review was 23 employees. Throughout this period, the Sales Compliance department had, on average, one to two vacancies, and during the field review had four vacancies.

Initial training provided to staff involves a combination of self-study and on-the-job training. Ongoing training generally entails attendance by Sales Compliance Officers at monthly staff meetings to discuss sales compliance issues and the use of an internal website that gives staff access to resources shared among the IDA departments.

***Staff's findings***

The written training materials were, overall, adequate and comprehensive. They included guidance on file documentation, on documentation of review findings and recommendations to address them, and guidance on how to complete risk assessments. The initial and ongoing training processes also appear thorough and adequate.

OSC staff noted, however, that the high staff turnover levels during the period under review, due to several factors, including sales compliance officers accepting positions with member firms, resulted in delays in issuing sales compliance review reports and prevented the Sales Compliance department from completing all the reviews scheduled. For example, while 81% and 79% of the sales compliance review reports issued in 2004 and 2005, respectively, were issued within 15 weeks of the completion of field work, only 33% of reports issued between January 1 and August 31, 2006 were completed within 15 weeks. In addition, of the 10 reviews still in progress where field work had been completed as at August 31<sup>st</sup>, 2006, in 50% of those cases 15 weeks had already passed from the completion of field work without the issuance of a final report.

OSC staff recognize that the IDA is making active efforts to address the turnover problem and that it is considering other measures to improve the efficiency of the Sales Compliance department.

***Staff's recommendation***

The IDA should continue with its efforts to hire and retain experienced Sales Compliance staff and should report to OSC staff, on a quarterly basis, on the progress to address the department's turnover issue.

***Priority: High***

***IDA's response:***

We agree with the recommendation. We are in active recruitment mode, looking to attract precisely such candidates who, experience is proving, are in short supply. With respect to retaining staff, steps were taken to identify and rectify compensation disparities in individual circumstances and (as discussed below) various automation projects and procedural changes have been and are being introduced to assist staff to operate more efficiently. In addition, a recommendation for 3 additional sales compliance managers was approved for the 2007-08 budget year.

We will keep you updated on our recruitment efforts until we are back to full complement.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will monitor the IDA's progress towards meeting this recommendation through the requested quarterly reporting.

#### **4.           *Benchmarks***

##### ***Background information***

The benchmarks for issuing sales compliance review reports are as follows:

- 60% of the reports must be completed (i.e. final reports must be issued) within 15 weeks of the completion of the field work;
- 100% of the reports must be completed within 26 weeks of the completion of the field work; and
- The sales compliance portion of reviews of new membership applications has to be completed (i.e. a response sent to the applicant) within two weeks from receipt of the applications.

The Director of Sales Compliance monitors whether these benchmarks are met on a monthly basis.

##### ***Staff's findings***

As explained earlier, the Sales Compliance department experienced difficulties in meeting its benchmarks in the last year, and this was mainly due to the high turnover levels experienced by the department.

OSC staff also noted that despite the turnover experienced that contributed to the Sales Compliance department not meeting its 15-week benchmark for reports issued during the eight months of 2006 ending August 31st, the department was still able to meet its target of issuing 100% of reports within 26-weeks for reports issued during that period. In light of the conditions that continue to exist in the current environment, OSC staff believe that the IDA should consider whether the 26-week benchmark continues to be appropriate.

##### ***Staff's recommendation***

The IDA should consider reviewing and reassessing the continued appropriateness of its sales compliance benchmarks.

***Priority: Low***

##### ***IDA's response:***

As has been the practice in the past, we will continue to reassess the appropriateness of all benchmarks, and advise you of any changes.

##### ***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response.

#### **5.           *Member firm selection for review***

##### ***Background information***

Member firms are currently selected for review based on an assigned review cycle, results from past sales compliance reviews, and risk. The process will change once the Sales Compliance

department completes the development and population of its risk-based model and uses the results of this model to select member firms for review.

In order to ensure that the activities of the branch offices of member firms are reviewed, the Sales Compliance department tries to coordinate the review of Ontario branch offices of member firms with head office reviews. The Sales Compliance department will also consider branch compliance in the course of a member's head office review by reviewing the effectiveness of the member firm's processes for conducting branch reviews, and by reviewing branch documentation centralized at head office in the course of its testing for compliance with IDA requirements, such as suitability.

### ***Staff's findings***

OSC staff acknowledge that the IDA's risk-based model has not been implemented for the selection of member firms and their branches for sales compliance reviews, but are concerned that the IDA's Toronto head office may not be conducting a sufficient number of sales compliance reviews of branch offices to adequately assess the member's compliance at the branch level in relation to the activities of branches located in Ontario. A similar concern was also raised in the previous two oversight review reports issued by OSC staff to the IDA.

For example, OSC staff's review of quarterly internal reports on member regulation used by the IDA show that only one branch review was scheduled and completed by the IDA's Toronto head office during the period under review. While branch offices of national dealers are reviewed by other IDA offices, which ensures a certain level of coverage of branches on a national basis and can help to give assurance as to the level of compliance of the member firm's branches in general, OSC staff are concerned that the number of branch reviews performed nationally and within Ontario may not be adequate to provide sufficient assurance as to the degree of compliance at the branch level for Ontario branches. OSC staff acknowledge, however, that staffing issues combined with the number of head offices situated in Ontario requiring review have likely affected the ability of the IDA to allocate resources for the performance of branch reviews in Ontario.

In addition, while OSC staff acknowledge that branch compliance can be partially assessed through head office reviews as a result of the centralization of documentation for many large member firms, and that an assessment of the branch reviews conducted by a member firm's compliance department can also provide some comfort regarding branch compliance, reliance on these assessments, however effective, does not allow IDA staff to make a full, independent assessment of a member's compliance at the branch office level.

### ***Staff's recommendation***

The IDA should reassess whether its processes for assessing a member's compliance at the branch level are adequate, including whether it has conducted an appropriate number of branch reviews to gain sufficient assurance regarding branch compliance in Ontario to ensure there is an adequate level of protection afforded to Ontario investors. This reassessment should include consideration as to whether more reviews of Ontario branches should be performed once staffing levels have recovered. The IDA will report back to OSC staff on the findings of its reassessment.

***Priority: High***

***IDA's response:***

We agree. In 2006 changes were made to the Head Office SCR planning protocol to include, where applicable, a visit to at least one branch office in the local vicinity by way of examining more directly the interplay between the two levels of operation. Furthermore, a protocol for conducting "Pop-in visits" was introduced, whereby nearby branches of unrelated Members may quickly be visited in the course of conducting a stand-alone or head office-related Sales Compliance Review in a given locale. We will include as part of our planning for the 2008 schedule a study and review by Sales Compliance management of the appropriate number of branches to review in conjunction with a head office review to make firm conclusions regarding the overall compliance system. We will also review the branch program to determine whether more targeted reviews of more branches, rather than full reviews of a smaller number, could be tested to see whether it would be a more effective means to the same end.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will monitor the IDA's progress towards meeting this recommendation and will seek updates from the IDA, through regular status update meetings, regarding the planned study and review to be conducted by IDA Sales Compliance management.

## **6. Adequacy of sales compliance review programs**

***Background information***

OSC staff reviewed the sales compliance review modules currently used by the Sales Compliance department in performing their reviews.

***Staff's findings***

OSC staff's review of the IDA's sales compliance review modules shows that they are generally comprehensive and regularly updated with examination procedures that address new by-laws or regulations. They also typically contain adequate guidance for IDA staff conducting the field reviews, in the form of explanatory notes or references and links to relevant documentation. OSC staff noted a few areas that were not adequately covered in the examination modules, as follows:

- Procedures in the SCR modules do not have sufficient focus on examining whether member firms have procedures to ensure that the firms and their approved persons understand the features of all the products they distribute, especially new and complex products, in order to ensure they are suitable for their clients;
- The modules also did not have procedures to specifically address structured products, and although the examination of these products could fall within some of the broader procedures contained in the existing modules, OSC staff did not find that they included adequate guidance and direction to the SCOs regarding the sampling and review of these products; and
- The *Supervision of Account Activity and Documentation Review* module does not require IDA staff to inquire about and assess the adequacy of the member's processes for updating know-your-client information (while OSC staff acknowledge that know-your-client information is examined in the course of a review of suitability, it may be difficult to

conclude on suitability when no assessment of the process to update such information has been made to provide assurance that the client information against which suitability is assessed is current).

In addition, OSC staff noted areas where additional steps and guidance could be provided to ensure consistency in the level of work performed for reviews:

- The *Corporate Finance/Investment Banking/Distributions & Syndication* module includes steps that require IDA staff to explain a member firm's due diligence process, and to review the due diligence and record the dates and parties involved in the due diligence from information in the examined deal file, but does not include any basic guidance on how to assess the general adequacy of the firm's due diligence practices and procedures;
- The same module requires IDA staff to ensure that pre-marketing certificates were filed no later than three business days after the preliminary prospectus is filed, and requires that correspondence is examined to determine if it pre-dates the grey list, but does not include an explicit requirement to extend this examination to include a determination of whether the correspondence might also suggest there were solicitations of interest prior to the filing of the preliminary prospectus or, in the case of bought deals, prior to the point at which an exemption for pre-marketing applies; and
- The same module also requires a physical examination of green sheets and other internal correspondence to ensure the material is clearly marked for internal use only, but does not include explicit steps requiring IDA staff to assess the reasonability of the information on the green sheet, including an assessment of the reasonableness of the comparables provided on the green sheet.

***Staff's recommendations***

a) The IDA should amend the sales compliance review modules to address those areas that were not adequately covered in the existing modules, and submit the revised modules to CSA staff.

***Priority: High***

b) The IDA should include additional steps and guidance in its sales compliance review modules in those situations cited above to ensure consistency in the level of work performed for reviews.

***Priority: Medium***

***IDA's response:***

We will review the sales compliance modules and address any areas that we believe are not adequately covered. We will advise of the results of our analysis.

***Staff comments and follow-up:***

OSC staff will discuss with the IDA the timing of its planned analysis at the next status update meeting. OSC staff will then follow up with the IDA regarding the results of the analysis, and will monitor its progress towards meeting these recommendations to ensure appropriate steps have been taken to address the issues identified during OSC staff's review of the sales compliance modules.

## 7. *Quality of sales compliance reviews*

### *Background information*

OSC staff reviewed a sample of 5 out of the 94 sales compliance reviews conducted during the period under review. In addition, OSC staff performed limited review procedures on a sample of 3 (small, medium and large-sized) IDA member firms.

### *Staff's findings*

OSC staff noted that, for all files reviewed, the member firms' risk assessment documents were completed and reviewed by the manager prior to the start of the field work. These files were well documented and identified the impact of regulatory changes and new rules on the member firms. There was evidence of communication with other IDA departments to identify issues. Findings from previous reviews that required follow-up were properly identified, as were high-risk areas that required additional testing during the field work. Finally, risk assessment documents were updated, as necessary, subsequent to the completion of field reviews.

OSC staff noted that, in order to increase the efficiency of the sales compliance reviews, IDA staff generally focused their review procedures on file reviews and carried out other steps of the sales compliance review modules, such as interviews or reviews of policies and procedures manuals, only if the findings from file reviews indicated potential issues. In OSC staff's view, however, completely omitting such procedures may not enable the Sales Compliance Officers to identify deficiencies in member firms' processes which may not necessarily be reflected in the files reviewed. As an example, reviews of a sample of IDA member firms conducted by OSC staff identified a couple of deficiencies in the firms' policies and procedures manuals that would not have been easily identified, or may not have been identified at all, without interviews or a review of policies and procedures:

- A member firm involved in the distribution of structured products did not have adequate policies and procedures in place regarding distribution of those products, for example it did not have policies and procedures to ensure the proper supervision of registered representatives involved in the distribution of structured products, or to ensure that registered representatives involved in such distribution were properly trained and possess a thorough understanding of both the risks and rewards of the products; and
- Another firm did not have procedures to monitor whether its sales representatives charged excessive mark-ups for fixed income products.

In addition, OSC staff noted two areas where inadequate procedures were performed by the IDA Sales Compliance staff in the files reviewed, as follows:

- Although a module including detailed procedures specifically designed to assess a member firm's fixed income trading exists, this module was not applied to member firms that carry on fixed income trading and it is OSC staff's understanding that it is not used at all; for this reason, IDA staff performing the sales compliance review did not identify that one of the member firms did not have policies and procedures to ensure compliance with IDA Policy 5; and
- While there are no set requirements for the frequency for updating know-your-client information, when IDA staff conducting sales compliance reviews identified stale-dated know-your-client (KYC) information for numerous accounts in a number of IDA member

firms, they did not assess and did not specifically comment on the adequacy of the member firms' processes to update KYC information.

***Staff's recommendation***

The IDA should take steps to ensure that review procedures are performed for all significant or high-risk areas, and not rely solely on file review for identifying issues for follow-up.

***Priority: High***

***IDA's response:***

While we may not agree with particular examples of deficiencies, we take the broader point that planning for our examination must involve more than a review of the previous SCR. We will take steps to ensure the planning procedures include a review of all significant or high risk areas.

***Staff comments and follow-up:***

OSC staff remain of the view that the findings are valid, and will monitor the IDA's progress towards meeting this recommendation through discussions with IDA staff, to be held during regular status update meetings, regarding the steps planned to be taken to ensure OSC staff's concerns are sufficiently addressed.

## **8. *Documentation of sales compliance reviews***

***Background information***

As set out above, OSC staff reviewed a sample of 5 out of the 94 sales compliance reviews conducted by the IDA during the period under review. In addition, OSC staff reviewed certain sections of a sample of 3 IDA sales compliance review files.

***Staff's findings***

OSC staff's review showed that the quality of documentation across sales compliance review files was inconsistent and, in some cases, it was unclear whether the work done was adequate. For example, in some of the files:

- Certain steps of the sales compliance review modules were not completed, with no explanation why they were not applicable or not completed;
- Some of the answers did not appear to address the questions of the sales compliance review modules;
- Conclusions were drawn regarding the adequacy of member firms' procedures, but no interviews or reviews of policies and procedures were done to support the answers; and
- In a number of cases, there were no conclusions regarding the adequacy of member firms' policies and procedures.

***Staff's recommendation***

As the IDA's Sales Compliance department is adding new staff, it should continue to train SCOs on documentation standards in order to ensure that the level of documentation is adequate and consistent across SCR files.

***Priority: Medium***



***IDA's response:***

We agree.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response, and will monitor through regular status update meetings the IDA's progress towards meeting this recommendation.

## **IV. Toronto Head Office**

### **E. Enforcement**

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#### **1. Introduction**

T&C #1 of the OSC Recognition Order and T&C #2(a) of the NSSC Recognition Order require the IDA to enforce compliance by its member firms and their approved persons with the rules of the IDA. In addition, T&Cs #4 and #5 of the OSC Recognition Order establish certain reporting requirements for the IDA. For example, T&C #4(b) requires the IDA to make prompt disclosure, including any written decision and reasons, to the public after a settlement proposal is accepted in full at a settlement hearing. T&C #5(e) requires the IDA to provide the OSC with detailed information concerning all investigations which lead to disciplinary or settlement proceedings, including the final investigation report, following the disposition of the enforcement action. Similarly, T&C #2(d) of the NSSC Recognition Order includes the reporting requirements from the IDA to the NSSC.

In order to carry out this responsibility, the IDA has organized its Enforcement department into the groups described below.

The Case Assessment group is responsible for handling public inquiries and complaints, for assessing referrals from various sources and, where necessary, for escalating cases to the Investigations group.

The Investigations group conducts investigations of IDA member firms and their approved persons. If necessary, the IDA's Investigations group coordinates investigation activities with other regulatory and law enforcement agencies.

The Enforcement Litigation group conducts disciplinary proceedings against IDA member firms and their approved persons. Enforcement Counsel also provide advice to Investigators and act as IDA counsel in disciplinary hearings.

The Intelligence & Analysts group maintains intelligence analysis tools and intelligence information. The group primarily provides support to Investigators by providing analysis of information and documentation, and may also assist Case Assessment Officers (CAOs) and Enforcement Counsel as required.

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

OSC staff's primary objectives were to assess the adequacy of the structure, staffing and resources of the Enforcement department, and to assess whether this department conducts its functions in an effective and efficient manner and complies with the applicable T&Cs of recognition.

In order to accomplish the objectives, OSC staff reviewed the relevant provisions of the IDA by-laws and regulations and various internal policies and procedures documents and interviewed staff of the IDA's Enforcement department.

In addition, NSSC and OSC staff reviewed a sample of files to determine the adequacy, timeliness and quality of the analysis of complaints, investigations and litigation proceedings.

### **3. Department structure**

#### ***Background information***

The Investigations and Enforcement Litigation groups are each managed by Directors, while the Case Assessment group is led by a Manager who reports directly to the Director of Investigations. The Intelligence & Analysts group is led by a Manager who reports directly to the VP of Enforcement, with an indirect reporting line to the Director of Investigations.

The Managers in the Vancouver, Calgary and Montréal regional offices of the IDA report directly to the Regional VPs and have an indirect reporting line to the Directors in the Toronto head office. The Toronto head office acts mainly in an oversight and advisory role in relation to the regional offices.

#### ***Staff's findings***

OSC staff are satisfied that the Enforcement department has an adequate reporting structure that establishes appropriate accountability.

#### ***Staff's recommendation***

No further action is necessary.

### **4. Benchmarks**

#### ***Background information***

The benchmarks used by the Enforcement department at the time of the field review were as follows:

- Case Assessment – 80% of cases are closed or escalated within 75 days;
- Investigations – 60% of investigations are closed or escalated within one year;
- Enforcement Litigation – 60% of cases are closed, settled, or the subject of an issued Notice of Hearing within 10 months.

#### ***Staff's findings***

OSC staff are generally satisfied that the benchmarks remain appropriate. However, OSC staff believe that, given the different priority and complexity levels of the files reviewed by staff of the Case Assessment group and given the standardized nature of the review, these benchmarks could be further refined to take into account these different factors. OSC staff understand that the Manager of Case Assessment will perform an initial assessment of the priority of the file and will consider its potential complexity before deciding who should be allocated the file. These could form the basis of a file's initial classification for sub-benchmark purposes, which could be revised if work performed on the file indicates that the initial classification was not appropriate.

***Staff's recommendation***

The IDA should consider establishing sub-benchmarks for Case Assessment based on the priority or complexity of the files, or some combination of the two. This could provide management with a tool to help monitor the group's performance and could help management assess the effectiveness of the resource allocation within the group.

***Priority: Low***

***IDA's response:***

The priority or complexity of a file cannot usually be determined prior to the commencement of the assessment. Therefore, we do not believe that establishing sub-benchmarks on this basis is feasible or practical.

***Staff comments and follow-up:***

No further action is necessary.

## **5. Staffing resources and training**

***Background information***

At the time of the field review, the IDA Enforcement department in Toronto was at full complement, with the exception of the Enforcement Litigation group, which had one vacancy.

During the review period, staff turnover in the Toronto head office was 12.5%<sup>7</sup> for 2004 and 9.5%<sup>8</sup> for 2005, relative to a 7.3% turnover rate for 2003. The increased turnover in 2004 had been experienced mostly by the Case Assessment group.

The initial and ongoing training processes for the various groups of the Enforcement department include an orientation process, peer and manager mentoring, ad-hoc, annual and bi-annual training sessions, as well as reimbursement programs for continuing education.

***Staff's findings***

OSC staff are generally satisfied that there are adequate mechanisms in place to monitor staffing levels. Staff are also generally satisfied with the initial and ongoing training provided by the Enforcement department.

However, OSC staff noted that the Case Assessment group did not meet its benchmarks in various quarters of 2004 and in the first quarter of 2005. While OSC staff acknowledge that, when assessed over the year, Case Assessment was just under its benchmark for 2004 and exceeded its benchmarks for 2005, the failure to meet the quarterly benchmarks led OSC staff to assess whether there were underlying causes that could resurface. OSC staff understand that the failure of the Case Assessment group to meet its quarterly benchmarks was partially due to increased turnover. During interviews with Case Assessment staff, additional reasons for

<sup>7</sup> 5 staff out of 40 at beginning of year.

<sup>8</sup> 4 staff out of 42 at beginning of year.

turnover in the Case Assessment department were raised, such as the fact that the CAO positions are entry-level, which makes CAOs more susceptible to recruiting efforts by IDA member firms once the CAO has gained some experience. In addition, OSC staff were provided with data of case assessment files opened and closed in each office during the period under review, which indicated that the Toronto head office Case Assessment group handled between 80%-90% more files during the period under review than the Calgary office, and the Calgary office has the same staffing complement (the Case Assessment function for the Western Canadian provinces is conducted through the Calgary Office).

As a result, while turnover does not appear to have significantly affected the overall benchmark performance, OSC staff are concerned that the workload for the Toronto Case Assessment group may reduce the opportunities for meaningful staff development and on-the-job training, which could lead to job dissatisfaction and could contribute to a reoccurrence of the increased turnover previously experienced.

***Staff's recommendation***

The IDA should reassess its current staffing levels for Case Assessment in the Toronto head office in relation to the group's workload, despite the current benchmark results, to determine if the levels remain appropriate.

***Priority: Medium***

***IDA's response:***

We will assess staffing levels, benchmarking and case load for the Case Assessment group in Toronto and advise you of the results of our analysis.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will discuss with the IDA at the next status update meeting the timing for the planned reassessment of staffing levels, and will follow up for the results.

## **6. Technology**

***Background information***

The Enforcement department uses four main systems, as follows: (1) CTS for case tracking; (2) Universal Business System Solution for time tracking and recording more detailed information regarding how time was spent; (3) ComSet for web-based member firm reporting of client complaints and internal disciplinary matters; and (4) Magellan to seek out, link and store information.

OSC staff discussed the systems with IDA Enforcement staff and viewed demonstrations of the various systems used by the Enforcement department.

***Staff's findings***

OSC staff are satisfied that the technology used by the Enforcement department is adequate to support the various functions and to allow for an appropriate level of monitoring by management. OSC staff also note that the Enforcement department is taking steps towards making further improvements to its systems such as by greater use of electronic storage of documents to facilitate accessing information and gathering intelligence.

However, OSC staff noted that documents stored in CTS can be modified after a file has been closed, which raises concerns regarding file integrity.

***Staff's recommendation***

The IDA should consider making alterations to CTS to prevent the modification of documents stored in the system after a file has been closed, in order to ensure file integrity.

***Priority: Low***

***IDA's response:***

CTS creates an electronic audit trail of all changes to any electronic record. This includes what the changes were, a copy of the original document, when the changes were made and who had made the change.

The system was created in order to permit documents to be modified to reflect changes in circumstance, error, etc. The electronic audit trail provides the ability to make changes while maintaining control and audit capabilities.

We will ensure that there is a continuing audit trail and where appropriate documents will be locked to ensure that no modification can take place. Even for documents that require ongoing revision, there is always an audit trail of the changes made, when they were made, what they were, and by whom.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. No further action is necessary.

## **7. Case Assessment – specific issues**

### **7.1 Case Assessment policies and procedures**

***Background information***

Inquiries and complaints may be received by phone, email, mail or fax, and are routed to the regional offices, as appropriate. Complaints are reviewed by CAOs and a secondary review is done by the Manager of Case Assessment. If an investigation is warranted, the complaint files are escalated to the Investigations group. If not, the file is closed by the CAO with either a cautionary letter or with no action. The file might also be referred to another regulator or authority if the matter or the subject of the complaint is outside of the IDA's jurisdiction.

The Case Assessment group may also open complaint files for matters reported by member firms through ComSet, through referrals from the securities commissions, other SROs, or other IDA departments, such as the Financial or Sales Compliance departments. For these cases, the CAOs generally follow the same procedures as those followed for inquiries and complaints.

OSC staff reviewed the policies and procedures manual for Case Assessment and the relevant update bulletins during the period and discussed the procedures for handling complaints and inquiries with relevant Enforcement staff.

### *Staff's findings*

Overall, OSC staff are satisfied with the processes for reviewing complaints. OSC staff's review of the policies and procedures manual and their discussions with IDA staff show that, generally, the policies and procedures and current practices are adequate for outlining the processes to be followed.

OSC staff noted that the policies and procedures manual for Case Assessment was dated September 2002 and, at the time of the field review, had not been revised to incorporate internal update bulletins issued in 2003 and 2004. However, even though not included in the policies and procedures manual, internal update bulletins are issued and readily available to all CAOs, and their content is understood to be the standard practice. IDA staff have advised that they were in the process of revising the manual to incorporate these bulletins during the period under review.

OSC staff also found that a practice put into place for approximately six months during the period under review to deal with a potential conflict of interest arising from the past employment of the Manager of Case Assessment did not appear to be adequate. The procedure put in place was for the Director of Investigations to perform a secondary file review only in those cases where the Manager disagreed with the CAO's recommendations. In OSC staff's view, this did not sufficiently mitigate the potential conflict of interest, as the Manager would still have had the ability to agree with an inappropriate recommendation made by the CAO, and this situation would not have been subject to independent review by the Director.

In addition, OSC staff found a number of areas where the group's policies and procedures could be improved or where further guidance was needed:

- While the policies and procedures manual in place during the period under review included guidance on documenting a complaint received by telephone in those cases where the complainant is unable to put a complaint in writing, there was no guidance in the policies and procedures manual regarding the maintenance of written notes of telephone conversations between CAOs and complainants and/or member firms that occur in the normal course of analyzing an open complaint;
- The file screening scorecard, while it took into account a number of relevant issues including the nature of the complaint, the potential dollar amount at risk, and the existence of other open complaints against the same subject, did not include consideration of past complaints resolved with no disciplinary action taken, or those where disciplinary action had been taken more than three years prior;
- There was insufficient guidance to CAOs on how to analyze common types of complaints, for example, on how to use and review evidence, such as account opening documents and statements, in order to assess suitability complaints;

- There was insufficient guidance to CAOs to help identify the common types of ‘operational matters’ that should be referred to the Financial Compliance and Sales Compliance departments for consideration in future reviews; and
- While the manual noted that matters outside the IDA’s jurisdiction must be referred to other regulatory authorities, there was no guidance or examples of such matters to assist CAOs with identifying the more common types of issues that should be referred to other regulatory authorities.

In addition, OSC staff were informed that, although the Case Assessment policies and procedures manual in use during the period under review indicates that a comprehensive exhibits log should be completed by the CAO for files that are referred to Investigations, in practice, the Investigator will create the log. This raises the concern that the CAO, the individual with the most knowledge regarding the evidence that exists at the point of referral to Investigations, is not the one responsible for ensuring the integrity of the referred file by creating this log.

***Staff’s recommendations***

a) The Enforcement department should consider revising its policies and procedures manuals on a timely basis to incorporate all internal update bulletins that were issued during the year that affect the processes followed by employees.

***Priority: Low***

b) The IDA should consider whether conflict of interest policies specific to each section of the Enforcement department should be created to ensure consistent and effective practices are applied in those instances where a potential conflict is identified.

***Priority: Low***

c) The Case Assessment policies, procedures and practices should be revised in order to address the gaps noted above. In addition, the IDA should ensure that these are followed.

***Priority: Medium***

***IDA’s response:***

We will update our policies and procedures manuals annually to incorporate internal update bulletins issued in the year.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA’s response. OSC staff will follow up with the IDA through regular status update meetings to ensure appropriate steps will be taken to address the gaps identified during OSC staff’s review of the Case Assessment policies, procedure and practices.

d) The IDA should consider whether it would be more appropriate for the CAO to prepare the exhibit log to help ensure the integrity of files referred to Investigations.

***Priority: Low***



***IDA's response:***

We will take into consideration the OSC finding and consider documenting receipt of exhibits on a special listing.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response.

## **7.2 Adequacy of analysis in Case Assessment files**

***Background information***

NSSC staff reviewed 32 files from a list of 60 complaint files involving Nova Scotia registrants and OSC staff reviewed 15 files from a list of 1,709 complaint files involving Ontario registrants that were both opened and closed during the period.<sup>9</sup>

***Staff's findings***

NSSC and OSC staff's review of the sample of files showed that the Case Assessment group's policies and procedures in place at the time each file was being completed were generally followed. In addition, the file recommendations were appropriate and supported by the evidence in the files. The secondary review process appeared effective, and the complaint files were resolved in a timely manner.

NSSC staff noted that, in one file involving unauthorized discretionary trading, the CAO relied on the member firm's internal investigation and did not refer the file to Investigations despite evidence in the file of additional instances of discretionary trading that were not investigated by the member firm. In this case, the decision by IDA staff to issue a warning letter to the member firm's approved person was based solely on the results of the investigation done by the member firm.

In another file, NSSC staff found evidence that the approved person was receiving trading instructions from a client's spouse when there was no limited trading authority in place to allow the spouse to direct the trading on the account. The CAO closed the file as he assumed that, given the time that had lapsed between the time the complaint was made and the alleged offense, the approved person would not recall the circumstances. Furthermore, there was no evidence in the file that a comprehensive response to the complaint had been received from the member firm at the time the file was closed.

***Staff's recommendations***

The IDA should provide additional guidance and training to CAOs covering, at a minimum, the following topics:

- Instances where the CAO should verify information received from internal findings from member firms; and

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<sup>9</sup> Due to the fact that the NSSC review was limited to the IDA's Enforcement department, the sample size selected by NSSC staff is larger relative to the total population than that selected by OSC staff.

- Closing case assessment files when information relating to the complaint is not received from the member firm, or when there have been significant time lapses between the time of the alleged offence and the filing of the related complaint.

**Priority: Medium**

***IDA's response:***

We agree.

***Staff comments and follow-up:***

NSSC staff are satisfied with the IDA's response. NSSC staff will monitor the IDA's progress towards meeting this recommendation.

### **7.3 Documentation of Case Assessment files**

***Background information***

As set out above, OSC staff reviewed a sample of 15 out of 1,709 complaint files opened and closed during the period under review and NSSC staff reviewed 32 files from 60 complaint files.

***Staff's findings***

OSC staff's review showed various file documentation issues, as follows:

- In three of the files reviewed, there were references made to telephone conversations in the closing memoranda, closing letters, or in the notes to the files, but no records of those telephone conversations were maintained in the file, although in one case, OSC staff acknowledge that documentation had been maintained in an individual's notebook;
- In one file, documents received from a member firm were referred to in the closing memorandum, but those documents were not maintained in the file;
- In one file, file screening guidelines were not completed for a complaint referral from an external regulator that was subsequently closed with no action; and
- In three files, documents received from external sources were not date-stamped.

***Staff's recommendation***

The IDA should ensure that CAOs include adequate documentation in their files in order to ensure that these files reflect a complete record of the work performed that can be easily produced if disclosure is required in the future. Such documentation should include records of telephone conversations and documents received from outside sources.

**Priority: Medium**

***IDA's response:***

We agree.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will follow up with the IDA through regular status update meetings to ensure that the importance of adequately documenting files is re-emphasized to IDA staff.

**8. *Investigations - specific issues*****8.1 *Policies and procedures******Background information***

The sources of investigation files are typically complaints received through the Case Assessment group, but there may be other sources, such as referrals by the securities commissions.

The investigation process includes gathering and reviewing document evidence, as well as interviews with subjects, member firms and complainants. Investigators prepare the regular summaries of the status of investigation files and have regular contact with the assigned Manager who monitors the file progress and provides guidance as needed. When closing the file, the Investigator prepares a report that is reviewed by the Manager, and reviewed and approved by the Director of Investigations. Investigations are either closed with no action, closed with a cautionary letter, or closed and referred to Enforcement Litigation.

OSC staff reviewed the policies and procedures manuals and the processes followed by the Investigations group.

***Staff's findings***

OSC staff are generally satisfied that the processes being followed by the Investigations group are adequate. However, OSC staff noted that the policies and procedures manual used by the Investigations department does not include standard interview preambles that can be used in those situations where the prospective interviewee is not subject to IDA by-laws, although OSC staff understand that IDA staff have at times, for example in those situations where a cooperative witness not subject to IDA by-laws comes forward during the investigation, given such a witness a preamble making reference to the Criminal Code in relation to perjury.

It was also noted that the manual had not been revised to include internal update bulletins issued since September 2002; one such bulletin was particularly important, as it provided information to Investigators regarding the process for dealing with criminal matters. OSC staff acknowledge that the policies and procedures manual for Investigations was, at the time of the field review, in the process of being updated, and the updated version was expected to be released by the end of the calendar year 2006. OSC staff also recognize that, even though not included in the policies and procedures manual, internal update bulletins are issued and readily available to all Investigators, and their content is understood by Investigators to be the standard practice. A recommendation was already made earlier in the report for the Enforcement department to consider revising its manuals on a timely basis to incorporate all significant internal update bulletins issued during the year.

***Staff's recommendation***

The IDA should consider including in its manuals standard interview preambles that can be used by Investigators in situations where the prospective interviewee is not subject to the IDA by-laws, in order to ensure that the warnings given to such individuals are consistent and appropriate.

***Priority: Low***

***IDA's response:***

We will consider this recommendation.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response.

## 8.2 *Adequacy of analysis in investigation files*

***Background information***

NSSC staff reviewed 10 out of 11 investigation files involving Nova Scotia registrants open and closed during the review period. OSC staff selected and reviewed 11 investigation files from a list of 108 files involving Ontario registrants that were closed during the period under review.

***Staff's findings***

Based on the sample of files reviewed, NSSC and OSC staff were generally satisfied that the level of analysis done by IDA staff was adequate and supported the actions taken, that the files were completed in a timely manner, and that the Investigations group's policies and procedures were followed.

However, OSC staff noted that in two files opened to investigate complaints made by clients to member firms that were reported to the IDA through ComSet, these clients were made aware of an IDA investigation when interviewed by an IDA Investigator, but were not notified of the outcome of the investigation. While OSC staff acknowledge that notice to a client from the IDA of the results of its investigation is not required in these cases, it should consider providing such notification where there might be a reasonable expectation on the part of the client to receive notice of the investigation's outcome.

***Staff's recommendation***

Consideration should be given to providing members' clients with notification of the outcomes of IDA investigations relating to cases opened to investigate complaints made to the firms and reported to the IDA through ComSet, in those situations where IDA Investigators make it known that the IDA is investigating the matter.

***Priority: Low***

***IDA's response:***

We agree and we are currently doing this.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response.

**8.3      *Documentation of investigation files******Background information***

As set out above, NSSC staff reviewed a sample of 10 out of 11 Investigation files open and closed during the period under review, and OSC staff reviewed a sample of 11 out of 108 Investigation files closed during the period under review.

***Staff's findings***

No deficiencies in file documentation were noted as a result of NSSC staff's review of its sample of Investigations files.

OSC staff's review of its sample showed a number of deficiencies in file documentation, as follows:

- In one file, the decision to extend an investigation past the one-year benchmark was not documented in the file; and
- Generally, because of the different filing methods used by different Investigators, it was difficult to track correspondence.

OSC staff acknowledge that the increased use of CTS for storing documentation will add some consistency to the documentation filing and storage methodologies used by the different Investigators.

***Staff's recommendation***

The IDA should ensure that investigation files contain an adequate level of documentation in order to reflect the work performed and to support any file-related decisions.

***Priority: Low***

***IDA's response:***

We agree.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response.

## **9.           *Litigation - specific issues***

### **9.1           *Policies and procedures***

#### ***Background information***

Litigation files are reviewed by Enforcement Counsel, who determine if there is sufficient evidence to proceed with the matter to a disciplinary hearing.

A hearing is conducted before a Hearing Panel pursuant to IDA By-law 20 *Approvals and Discipline* (IDA By-law 20). A respondent may appeal a decision of the Hearing Panel. A respondent may also wish to settle at any point before the conclusion of the disciplinary hearing. This may result in a settlement agreement and must be approved by a Hearing Panel at a settlement hearing.

The processes and timelines for conducting disciplinary hearings and settlement hearings are governed by the IDA's Rules of Practice and Procedure.

OSC staff reviewed the policies and procedures manual for the Enforcement Litigation group.

#### ***Staff's findings***

OSC staff were satisfied that the policies and procedures relating to Enforcement Litigation, and the processes for disciplinary and settlement hearings are adequate to ensure the firm, fair and effective enforcement of the IDA by-laws and regulations.

#### ***Staff's recommendation***

No further action is necessary.

### **9.2           *Adequacy of litigation files***

#### ***Background information***

NSSC staff reviewed 2 of 4 litigation files involving Nova Scotia registrants, and OSC staff reviewed 6 files from a list of 96 litigation files involving Ontario registrants that were concluded during the period under review.

#### ***Staff's findings***

Based on the files reviewed, NSSC and OSC staff were generally satisfied that the outcomes achieved were appropriate, that the composition of the Hearing Panels was in accordance with IDA By-law 20, and that the IDA's Rules of Practice and Procedures were followed. Staff also found that the files were concluded within a reasonable time period and the level of documentation was sufficient.

However, OSC staff noted the following instances where disclosure required to be made to the OSC under T&C 5(e) of Schedule A of the OSC Recognition Order was not made on a timely basis:

- In two files, details regarding the disposition of a settlement hearing were not provided to the OSC on a timely basis; rather, they were reported four months and one month from the date of each hearing, respectively.

OSC staff also noted the following instances where public disclosure made under T&C 4(b) of Schedule A of the OSC Recognition Order could possibly have been more timely, although OSC staff acknowledge that translation would likely have contributed to part of the delay:

- In five of the files reviewed, Discipline Bulletins, which provide transparency regarding the relevant facts of the approved settlement agreements, were issued two to three weeks after the dates the related settlement agreements were approved by a Hearing Panel; and
- In one file, the decisions and reasons were published a month after the settlement hearing.

***Staff's recommendations***

a) The Enforcement department should ensure that disclosure required to be made to the OSC is made promptly.

***Priority: Medium***

b) The Enforcement department should consider examining whether improvements could be made to the current processes for issuing Discipline Bulletins after the approval of settlement agreements, and for issuing the decisions and reasons, in order to improve the timeliness of disclosure to the public.

***Priority: Low***

***IDA's response:***

We agree and will undertake a review of the present policy of waiting for the release of reasons for a decision before publicizing the confirmation of a settlement.

***Staff comments and follow-up:***

OSC staff are satisfied with the IDA's response. OSC staff will discuss with the IDA the timing for the planned policy review during the next status update meeting, and will follow up for the results.

## V. Vancouver Office

### A. Summary

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#### 1. *Background*

Between August and November 2006, BCSC staff conducted an oversight review of the Vancouver office that covered the period under review. Previously, the BCSC conducted an oversight review of the Vancouver office that covered the period from January 1, 2000 to November 30, 2000. A separate Enforcement review assessed Enforcement activities for the period from September 2000 to December 2002.

The BCSC's review focused on the Vancouver office's functions related to:

- Registration approvals of firms and individuals;
- Membership terminations and new applications;
- Sales compliance examinations; and
- Enforcement investigations and litigation.

#### 2. *Assessment of the findings related to the Vancouver office*

The IDA Vancouver office established and implemented adequate processes, policies and procedures for all four departments. Files were generally complete and well organized, and checklists and review programs were comprehensive. In the Enforcement, Registration and Membership departments, reviews were generally of good quality. For most of the period under review, these departments met their performance benchmarks, which appeared to be reasonable. Staffing levels were relatively stable in all four departments and the majority of staff were experienced. Training programs and processes were well structured, however, training in specialized areas of expertise could improve. While each department had some deficiencies, the Sales Compliance department had some issues of greater concern to the BCSC. However, overall the Vancouver office is sufficiently meeting its regulatory responsibilities.



## V. Vancouver Office

### B. Registration

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#### 1. *Introduction*

The BCSC, under section 184(2)(e) of the *Securities Act* and the *Registration Transfer Rules* (RTRs), authorized the Vancouver office to register Investment Dealers, Underwriters, Trading Partners, Directors or Officers of Investment Dealers and Salespersons of Investment Dealers. As a result, the Vancouver office registers all IDA members, both firms and individuals, in British Columbia (BC).

The Registration department's mandate is to protect the public and the integrity of the capital markets by ensuring that the individuals employed by IDA member firms are approved and meet certain requirements. They must be fit and proper and meet qualification standards.

The Registration department handles a variety of applications including new applications, transfers, terminations, category changes and branch openings and closings. The Registration department also has a significant role in the new membership application process.

#### 2. *Purpose and scope*

The purpose of the registration review was to evaluate and assess:

- adequacy of staffing, resources and training;
- effectiveness and efficiency of the Registration department's application reviews;
- appropriateness of decisions; and
- adequacy of performance measures and if they were met.

BCSC staff reviewed checklists, policies and procedures and relevant IDA By-laws. BCSC staff interviewed the Manager of Registration and five registration officers (ROs), and reviewed a sample of Registration files.

#### 3. *Performance benchmarks*

##### *Background information*

Registration has performance benchmarks for applications and transfers. The benchmarks are:

- for 80% of all applications received, the Registration department will either approve the application, or the member will be sent a first deficiency letter within five business days; and
- for all registration transfers will be completed within two business days provided no extenuating circumstances require a longer processing time. Examples of extenuating circumstances are exemption requests or detrimental Notices of Termination.

***Staff findings***

In 2004 and 2005 the Vancouver Registration department exceeded the application benchmark. In 2004 it attained a rate of 89% and in 2005 it was 96%. On a national basis, the IDA surpassed the benchmark in 2004 for 86% of the applications. In 2005, it fell just short of the benchmark reaching 79%. In the first two quarters of 2006, the IDA met its benchmark for 82% of the applications.

For registration transfers, the Vancouver office attained a level of 92% in 2004 and 99% in 2005. In 2006, application benchmarks were on track and transfers benchmarks were just slightly below the 100% target.

Nationally, the IDA did not meet its transfer benchmarks for the period under review. In 2004 it completed 89% of transfers within the benchmark, 93% in 2005 and 94% for the first two quarters of 2006.

The Vancouver office is, for the most part, meeting its performance benchmarks. The performance benchmarks appear reasonable and attainable.

***Staff's recommendation***

No further action is necessary.

**4. *Staffing and training******Background information***

The Registration department consists of the Manager of Registration, six ROs and one clerk. The Manager of Registration reports to the VP, Western Canada.

Staffing levels were fairly consistent during the period under review. Due to the introduction of the National Registration Database (NRD), the Vancouver office eliminated one clerical position. Leaves of absence and internal promotions slightly impacted on the department during the period under review. However, overall there was minimal turnover.

New ROs are given a reading list and access to the policies and procedures manual. Training for a new RO is a lengthy process and the time it takes depends on the RO's individual needs. The Registration department finds on the job training to be the most effective training method. For the first three to six months, the Manager of Registration reviews every application that new ROs complete and then gradually oversight is reduced as the RO progresses. Periodically, the Manager of Registration conducts random audits of all staff's work.

***Staff's findings***

There were no concerns with staffing and training in the Registration department.

***Staff's recommendation***

No further action is necessary.

## 5. *Registration applications*

### 5.1 *Policies and procedures*

#### ***Background information***

Registration policies and procedures are part of the IDA's e-mail system. The policies and procedures provide guidance for applications and include specific examples and reference information such as bulletins. The information is national in scope and contains the requirements of all jurisdictions.

Submissions are filed through the NRD. ROs review the NRD submission and complete a checklist. If the matter is straight forward, no further management review is required. Registration relies upon the Regulatory Notes Summary (RNS), a matrix that provides guidance and direction for making registration decisions. If the RNS does not address the specific issue that the RO is reviewing, or if the application is contentious, the Manager of Registration reviews the application. All of the ROs review individuals' applications and only the Senior ROs and the Manager of Registration review firm applications.

The Registration department can impose conditions of registration and grant certain exemptions. For example, if a transfer involves a termination that the IDA is concerned about, they may impose supervision requirements through conditions of registration.

There is a guide to registration categories and there are checklists for most applications.

### 5.2 *Specific issues*

#### ***Background information***

BCSC staff selected the following 89 applications for the file sample:

- 5 exemptions;
- 9 change or surrender categories;
- 20 initial or reactivation;
- 4 registration in an additional jurisdiction;
- 2 registration with an additional sponsoring firm;
- 15 transfers;
- 10 terminations;
- 6 terminations sent to Case Assessment;
- 5 closing a location;
- 5 opening a location;
- 4 National Registration System (NRS), Non Principal Regulator; and
- 4 NRS Principal Regulator.

#### ***Staff's findings***

Registration files were generally very thorough and completed in a timely manner. BCSC staff found only minor deficiencies in the files. Files were well documented and contained evidence of managerial review, where applicable.

***Staff's recommendation***

No further action is necessary.

**5.3        *Registration - terms and conditions******Background information***

The Pacific District Council (PDC), or a sub-committee of the PDC, grants discretionary exemptions from registration requirements based on equivalencies. The PDC also reviews and approves the imposition of terms and conditions on registrations based on the IDA's recommendation. If an applicant does not agree with PDC imposed conditions of registration, the applicant has 10 days to appeal the decision.

The Registration department can impose registration requirements without PDC approval in three instances:

- supervision of a new salesperson for the first 6 months (By-law 18.5 & 18.6);
- completion of the Wealth Management Essentials Course for new retail salespersons (Policy 6, Part 1, A (3) (c)); and
- completion of the Effective Management Seminar for new branch managers Policy 6, Part 1 A(1) a (iii).

Failure to meet these requirements results in automatic suspension of registration approval. The IDA can impose these requirements without PDC approval because they are part of their By-laws as are the consequences of not fulfilling these requirements. These requirements appear as terms and conditions in the individual's notice of approval.

***Staff's findings***

BCSC staff do not take issue with the IDA's imposition of these requirements without PDC approval as they are really post registration requirements. However, BCSC staff believe it is inaccurate, and possibly confusing, to call these requirements terms and conditions.

In keeping with the requirements of sections 4(4) and 5(2) of the RTRs, the IDA must provide applicants an opportunity to be heard if they disagree with any IDA imposed terms or conditions. In contrast, the IDA's post registration requirements do not provide an avenue of appeal because the requirements are embedded within the By-laws, as are the consequences for not fulfilling these requirements. BCSC staff believe that by calling these post registration requirements terms and conditions, it may lead applicants to believe they are entitled to an opportunity to be heard.

***Staff's recommendation***

The IDA should consider changing the terminology on its approval notices for its post registration requirements.

***Priority: Low***

***IDA's response:***

We agree. We will implement the change and confirm to the BCSC once the terminology has been amended.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

**5.4 Registration - website inaccuracies*****Staff's findings***

The BCSC's official registration record is the registration database on the BCSC's website. During the review, staff found that some IDA registration information which appeared should be reflected in the BCSC registration database, was not.

In a variety of Vancouver office registration applications, BCSC staff found examples of conditions of registration imposed in other jurisdictions on approved persons that were also registered in BC. These conditions were not reflected in the BCSC registration database and it appeared that they should be. BCSC staff also found instances where non resident branch managers of BC based sub-branches were not reflected as branch managers on the BCSC registration database.

***Staff's recommendations***

The Registration department of the Vancouver office needs to consider if the conditions of registration imposed in other jurisdictions are appropriate for BC registrants. If so, the conditions should be imposed in BC and accurately reflected on the BCSC website. The Vancouver office must ensure that all BC registered branch managers appear on the BCSC website.

***Priority: Medium******IDA's response:***

It is not a requirement to register in BC a non-resident Branch Manager who oversees a sub-branch in BC. Therefore, it is not required to reflect the Terms and Conditions of these individuals. To record this information will require systems modification. We will meet with the BCSC to explain the challenges and explore methods of implementing the recommendation.

***Staff comments and follow up:***

The BCSC requires that our website includes branch managers who are responsible for BC sub branches, regardless of where the branch manager resides.

Regarding terms and conditions imposed on non-resident registrants, this recommendation is not specific to branch managers. BCSC staff require that the Vancouver office consider if conditions of registration should be imposed in BC to mirror conditions imposed in other jurisdictions. BCSC staff believe that no systems modifications would be necessary to comply with this requirement as the information could easily be copied and pasted from NRD. BCSC staff will contact the Vancouver office to set up the above mentioned meeting.

## V. Vancouver Office

### C. Membership

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#### 1. *Introduction*

Membership applications are sent directly to the Vancouver office and a copy goes to the Association Secretary. Unlike head office applications, the regional office is the key point of contact for membership applications. The Vancouver office Sales Compliance, Financial Compliance, Registration and Enforcement departments conduct detailed reviews of the applications.

The departments have two weeks to complete their initial review. Identified deficiencies are summarized in one letter and sent to the applicant. Once all issues are addressed, the Vice-President, Financial Compliance reviews and approves Financial Compliance's work and the VP, Western Region reviews and signs off on the work of the other departments. Throughout the process, the Vancouver office keeps the Association Secretary informed about the progress of the application.

The application then goes before the PDC. The PDC bases its decision on information gathered by the regional office and presented in the PDC application package. If the PDC makes a favorable recommendation, the application goes before the IDA Executive Committee of the Board of Directors for their consideration. Upon approval, registration is finalized and the IDA issues a bulletin announcing the new member.

#### 2. *Purpose and scope*

The purpose of the membership review was to assess the following:

- fairness, consistency, effectiveness and efficiency of the IDA membership review process by reviewing the process and examining a sample of IDA membership files;
- compliance with the applicable provisions of IDA By-law 2; and
- adequacy of performance measures and if they were met.

To gain an understanding of the membership process, BCSC staff reviewed the membership information on the IDA's website, general descriptions of the new member application process, checklists, the *Financial Compliance New Member Review Program*, By-laws relevant to the membership process and spreadsheets that outline the list of new members, resignations and membership hearings during the period under review. Staff also interviewed the managers of Sales Compliance, Financial Compliance, Registration and the VP, Western Canada.

#### 3. *Policies and procedures*

##### *Background information*

BCSC staff discussed the new membership application process with each of the managers and reviewed the checklists and review programs, where applicable.

***Staff's findings***

There is no policies and procedures manual or guidance specific to the Vancouver office for membership matters. Staff recognize that the process involves extensive coordination between a number of departments and individuals, and that membership related processes do not occur very often in the Vancouver office. However, some aspects of the process are unique to the Vancouver office and the files show that future membership related reviews may benefit from guidance specific to the Vancouver office.

***Staff's recommendation***

The IDA should consider a membership policies and procedures manual or guidance for the Vancouver office.

***Priority: Low***

***IDA's response:***

We agree and will provide a copy of the membership policies and procedures manual once completed.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

#### ***4. New membership applications and resignations***

***Background information***

The BCSC examined two new membership applications and one membership resignation. These were the only Vancouver office membership related activities that occurred during the period under review.

***Staff's findings***

On the whole, files were thorough and the file documentation supported the conclusions. The files showed evidence of coordination between the various member regulation departments. However, file documentation demonstrated that at times there was some confusion between the Association Secretary and the Vancouver office about the status of applications. In one instance, the Association Secretary was unaware that the PDC approved one of the new membership applications.

***Staff's recommendation***

The IDA should consider a membership policies and procedures manual or guidance for the Vancouver office.

***Priority: Low***

***IDA's response:***

We agree and will provide a copy of the membership policies and procedures manual once completed.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

**5. *Performance benchmarks******Background information***

There are two membership related benchmarks for new membership applications and they are as follows:

- within two weeks of the application date, Sales Compliance and Financial Compliance must complete an initial review of the new member and issue a preliminary report outlining deficiencies; and
- within two weeks of the National Registration Database receipt date of the application, Registration must complete a suitability review of the applicants' management and submissions.

These benchmarks apply on a regional and national basis.

***Staff's findings***

In both new application membership reviews, the Vancouver office met its benchmark to complete the initial review of the application and notify the applicants of the deficiencies within two weeks.

In the one resignation application, the bulletin to members was not sent within the benchmark timeframe, however, the explanation was reasonable. Overall, the Vancouver office processed all applications within acceptable timeframes and the benchmarks appear reasonable.

On a national basis, new membership applications met the performance benchmarks in 2004, 2005 and the first two quarters of 2006.

***Staff's recommendation***

No further action is necessary.



## **V. Vancouver Office**

### **D. Sales Compliance**

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#### **1. Introduction**

The IDA Sales Compliance department's primary responsibility is to monitor its members' adherence to IDA regulatory requirements, and other applicable securities legislation. The department fulfils this obligation through onsite sales compliance reviews (SCRs). The IDA Vancouver Office is responsible for examining sales compliance systems of IDA member firms' head offices and branch offices located in BC. Currently, 21 members have head offices under its jurisdiction.

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

The purpose of this part of the oversight review was:

- to review and evaluate the Vancouver office's staff levels and training;
- to evaluate the adequacy of the performance measurement benchmarks used in Sales Compliance and whether the Vancouver office met them; and
- to assess the adequacy, timeliness and quality of sales compliance reviews conducted by the Vancouver office.

BCSC staff interviewed local management and staff to gain an understanding of the staff levels, sales compliance training program, and the sales compliance review process. The individuals interviewed at the IDA Vancouver Office were the VP, Western Canada, the Sales Compliance Manager, and various sales compliance officers (SCOs). Further, BCSC staff examined the local sales compliance training program, written procedures, the review program and checklists, and a sample of SCR files.

#### **3. Staffing and training**

##### **3.1 Staffing**

###### ***Background information***

The Vancouver Sales Compliance department currently has one sales compliance manager, eight SCOs, and one sales compliance technician. The Sales Compliance Manager informed BCSC staff that the department exceeded its budgeted seven SCO positions when a permanent leave did not materialize in July 2005. As such, there was an extra SCO for a brief period until an SCO went on a leave of absence three months later.

During the period under review, the Vancouver department had relatively low staff turnover and few resource issues compared to the other IDA offices. In total, there were three leaves of absence and two resignations. In addition, the Sales Compliance Manager briefly assumed additional duties when a leave of absence started one month early in September 2005 and when the Calgary Sales Compliance Manager resigned in May 2006. At these times, the Sales

Compliance Manager conducted SCR fieldwork and managed the Calgary Sales Compliance department, respectively.

The IDA provided BCSC staff with employee activity records for the period under review. The records showed the start and departure dates for the Vancouver sales compliance staff during the period under review.

### ***Staff's findings***

During the period under review, the budgeted staff complement for the Vancouver Sales Compliance department was one Sales Compliance Manager, seven SCOs, and one sales compliance technician. For parts of the period under review, it was not operating at its full staff complement of SCOs. The department lost 1.3 full-time equivalents (FTEs) of experienced SCOs to prolonged absences and staff turnover in 2004, 1.5 FTEs in 2005, and 1.0 FTE in the first eight months of 2006. However, the department managed to maintain a relatively stable staff level throughout the period under review by contracting with a former SCO, hiring industry-experienced individuals, and promoting from within the department.

Although the absences, resignations, and additional manager's duties disrupted the normal operations of the department, it still had four experienced SCOs throughout the period under review. BCSC staff were satisfied that the Vancouver Sales Compliance department undertook adequate steps to ensure it continued to operate at relatively normal levels during the period under review.

### ***Staff's recommendation***

No further action is necessary.

## **3.2 Sales compliance training program**

### ***Background information***

Prior to August 2005, the SCO training program for the Vancouver Sales Compliance department combined self-study work with one-on-one SCR training. New SCOs learned from reading the *Sales Compliance Policies and Procedures Handbook* and the *IDA Rule Book*, and examining a completed SCR file. The Sales Compliance Manager or a senior SCO then assists the new SCO on actual SCRs according to their training needs. At this last stage, a new SCO begins to gain direct experience in how to conduct an SCR.

To enhance the existing program, the Vancouver department implemented the *Sales Compliance Training Manual* for its new SCOs starting in August 2005. The manual prescribes one-on-one training and includes self-study materials and a case study. The trainer, a senior SCO, customizes the training based on the trainee's industry experience and background. At the successful completion of this training, the trainee completes the case study at the end of the process. The trainer reviews the case study and further questions the trainee on any identified weaknesses. The trainee signs a written acknowledgement at its conclusion.

### ***Staff's findings***

The *Sales Compliance Training Manual* is a good precursor to the SCR training in the field. It provides a new SCO with background information, general guidance on the completion of various parts of an SCR, collection of materials or evidence for the file, standards of documentation, organization of a file, post visit procedures, and file closure procedures.

The one-on-one training in the field is an appropriate and effective approach to provide the knowledge and experience required for the job. Useful lessons learned in the field and reinforced by the manager during the file review are critical to a successful training program.

***Staff's recommendation***

No further action is necessary.

#### ***4. Performance benchmarks***

##### ***4.1 Benchmark monitoring process***

***Background information***

The VP, Western Canada informed BCSC staff that he monitors the achievement of benchmarks on a quarterly basis. He receives the SCR schedule at the beginning of the year and follows the progress of the reviews every quarter. He also reviews all draft and final reports prior to issuance.

The Sales Compliance Manager informed BCSC staff that he monitors local performance at the file level and at the departmental level. As part of the preparation of the quarterly reporting to the IDA Board, each department of each office receives their quarterly performance reports for review. The manager must provide comment on any unfavourable performance variances. In the summer of 2006, the Vancouver department implemented a benchmark tracking sheet to help prioritize its work better.

The IDA also has a Benchmark Committee chaired by the VP of Professional Standards. The VP, Western Canada is on this committee and represents the IDA Vancouver and Calgary offices. The committee regularly reviews all benchmarks for appropriateness. In addition, the IDA's strategic planning process includes an assessment of the benchmarks.

***Staff's findings***

The IDA has processes in place to monitor the appropriateness of the benchmarks and ongoing compliance with them.

***Staff's recommendation***

No further action is necessary.

##### ***4.2 Achievement of benchmarks***

***Background information***

The Sales Compliance department has the following benchmarks:

- to issue the final sales compliance report within 15 weeks from the end of fieldwork in 60% of the cases and within 26 weeks in all cases;
- to complete all mandated reviews, including branches, as established at the beginning of the year; and
- to achieve a project utilization rate of 70%.

Each IDA office is required to meet each of these benchmarks individually. The IDA as a whole must also meet these benchmarks. The IDA provided BCSC staff with SCR statistics for files that had fieldwork completed between January 1, 2004 and August 22, 2006 for each office. Further, BCSC staff received *Member Regulation Quarterly Reports* for quarters ending March 31, 2004 to June 30, 2006.

The IDA Vancouver Office provided BCSC staff with its SCR statistics, SCR time reports, and annual sales compliance schedules for the period under review.

### *Staff's findings*

#### **4.2.1 Reporting benchmark**

During the period under review, the Vancouver Sales Compliance department issued 30 final reports. In 2004, the Vancouver department easily achieved the 15-week benchmark with an 80% success rate and met the 26-week benchmark. In 2005, it met the 26-week benchmark but missed the 15-week benchmark with a 50% success rate. In the first eight months of 2006, it significantly underperformed and failed to meet either benchmark. It only issued 38% of its final reports within 15 weeks and issued one final report 29 weeks after the end of fieldwork.

BCSC staff is concerned over the worsening 15-week achievement rate from 80% for 2004 to 38% for the first 8 months of 2006 even though the department faced similar disruptions from staff turnover and absences for each of these periods. As much of the IDA membership have been through several SCRs, most should have an adequate compliance system in place. Further, with the IDA's continued refinement and automation of its SCR program, and with six of its eight SCOs having four to seven years of SCR experience, improving efficiencies should be evident in the performance indicators.

From BCSC staff's review of the time reports, it is apparent that additional managerial duties affected the timeliness of the manager's review of SCR files and reports, and can reasonably explain part of the poor performance in 2006. However, staff turnover and prolonged absences, and additional managerial duties do not fully account for the extent of the decline for 2005 and 2006 when compared with 2004 results.

#### **4.2.2 Completion of all mandated reviews**

BCSC staff reviewed the 2004 and 2005 SCR schedule and the SCR statistics for the Vancouver department's achievement of this benchmark. BCSC staff calculated the completion rates using the number of draft reports issued in the scheduled year. The Vancouver department did not complete all mandated reviews in 2004 or 2005. The completion rates were 46% and 57%, respectively.

BCSC staff is concerned with the low productivity. Staff turnover, leave of absences, and additional managerial duties do not reasonably explain the extent of the underachievement.

### 4.2.3 *Project utilization rate benchmark*

BCSC staff compiled project hours and the available hours for the Vancouver department from the *Member Regulation Quarterly Reports* for quarters ending March 31, 2004 to June 30, 2006. BCSC staff calculated the annual and the overall project utilization rates for the department. The department did not meet the 70% project utilization benchmark in 2004, as it only achieved 61% utilization. In 2005, it exceeded the benchmark by achieving 75% utilization. For the first six months of 2006, it slightly underperformed with 67% utilization. The overall rate over the 2.5-year period was 68%, which barely missed the benchmark.

However, BCSC staff verified two quarters' project utilization rates and noted they were overstated for the Vancouver department. The Vancouver department classified the sales compliance technician as a sales compliance officer in the time record system to account for their project time. BCSC staff found the calculated rates included the sales compliance technician's project time without including their available time as well. As such, the performance indicator was inaccurate.

From their review of the three benchmarks, BCSC staff are concerned about the low productivity of the Vancouver Sales Compliance department. As a result, there is some delay in the coverage of its membership, especially some of its higher risk BC members.

Further, with a maturing membership and the IDA's continued refinement and automation of its SCR process, the reporting benchmarks have remained unchanged since their implementation in 2001. The BCSC is concerned that these benchmarks may be outdated and inappropriate, and no longer good indicators of performance.

#### *Staff's recommendations*

a) The Vancouver Sales Compliance department should review its processes and productivity to determine the underlying reasons for the diminished productivity and take steps to address the identified root causes.

**Priority: High**

#### *IDA's response:*

We have recently reviewed all aspects of our sales compliance processes across the country and are monitoring our response times carefully. For the year 2006, slightly longer than the review period, 82% of BC reviews were completed within the 15 week benchmark and 80 % for the first six months of 2007. We have found our quarterly BCSC/IDA meetings to be a productive and convenient method of communicating our progress. We will ensure that all Sales Compliance benchmarks are included in our reports and discussions and will explain any significant deviations. We will also increase our reporting on the progress of specific reviews and brief BCSC staff on the results of our review of Sales Compliance processes.

#### *Staff comments and follow up:*

BCSC staff are satisfied with the IDA's response. BCSC staff will detail the expected content of these quarterly reports for the Vancouver Sales Compliance department. Further, BCSC staff will monitor this department's performance, including SCR response times (from V.D.6.5), starting with the first quarter of 2007.

b) The IDA should examine its project utilization calculation for the Vancouver Sales Compliance department to ensure it accurately reflects the project utilization of its examination staff. Reliable performance measures can signal potential problems for prompt attention and enable timely changes.

***Priority: Medium***

***IDA's response:***

We will review our project utilization rates to ensure the analysis is accurate. If project utilization rates are not being achieved, we will analyze the underlying reasons and provide you with our analysis and any steps taken at our quarterly meetings.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

c) The IDA should examine its reporting benchmarks for reasonableness after its staff levels have stabilized.

***Priority: Medium***

***IDA's response:***

We agree and continue to brief BCSC staff on any staffing changes at our quarterly meeting.

***Staff comments and follow up:***

When the IDA has completed its examination of its reporting benchmarks for reasonableness, please provide BCSC staff with a copy of this examination and its results.

## **5. Sales compliance review process**

### **5.1 Head office sales compliance review process**

#### **5.1.1 Member selection process**

##### ***Background information***

Every December, the Sales Compliance Manager prepares a two-year SCR schedule based on each member's assigned review cycle. He establishes the review cycles from his knowledge of each member's operations and results from past SCRs. However, the process will change starting with the 2007 schedule when he will use the IDA's risk profile system for assigning the appropriate review cycle.

The IDA's risk profile system assesses a member's level of business risk from its operations and from its ability to mitigate this risk. The system evaluates the adequacy of a member's supervisory, risk management, and internal control processes using information from the IDA's Financial and Sales Compliance departments, and from ComSet, a reporting system for complaints and settlements.

***Staff's findings***

The new approach is reasonable and appears to improve the present scheduling process.

***Staff's recommendation***

No further action is necessary.

***5.1.2 Sales compliance review program and written procedures checklists***

***Background information***

The IDA provided BCSC staff with a copy of the current SCR program. BCSC staff obtained the current version of the written procedures checklists from the IDA's public website.

In the first quarter of 2004, the SCR program changed to a more focused approach. The old process involved detailed interviews with the member regarding compliance processes followed by physical testing of these processes.

The new process begins with a brief interview to help locate relevant records and identify responsible persons, followed by more comprehensive physical testing of existing and new functions. It ends with an interview focused on problems identified during the physical testing. The IDA believes that this new process is more efficient because it eliminates repeat interviews about unchanged procedures and limits reviews of low risk areas or low risk members.

By the summer of 2004, the Vancouver department implemented a computer system to capture, analyze, and report certain physical test results.

***Staff's findings***

BCSC staff reviewed the current head office SCR program and written procedures checklists to ensure they adequately addressed recent regulatory issues identified as key concerns by the CSA. Of these concerns, the IDA had updated the SCR program and checklists to address the identification and verification of beneficial owners of non-individual entities, and research restrictions and disclosure.

***Staff's recommendation***

No further action is necessary.

***5.2 Branch sales compliance review process***

***5.2.1 Branch selection process***

***Background information***

The Sales Compliance Manager informed BCSC staff that he leaves openings in the annual examination schedule for adding branch SCRs during the year. Sales compliance managers at each of the IDA offices identify branches of concern during head office SCRs and communicate

them at biweekly managers' meetings. The responsible sales compliance manager will add these branches as well as those with numerous complaints to the schedule.

***Staff's findings***

BCSC staff acknowledge the importance of having the flexibility in the SCR schedule to deal with risky branches identified during the year. However, by not formally establishing the number of branches or the budgeted branch SCR time on the schedule, high-risk branches may not receive the attention necessary unless there is idle time or excess resources.

***Staff's recommendations***

BCSC staff acknowledge that priorities may change over the course of the year, but as part of its annual planning process, the Vancouver Sales Compliance department should predetermine the number of and the total budgeted time for branch SCRs on its annual SCR schedule.

***Priority: Medium***

***IDA's response:***

We will prepare an annual estimate of time for branch SCRs starting with the 2007 calendar year.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

## ***5.2.2 Examination of branch operations***

***Background information***

Sales Compliance's oversight of its members' branches is a two-part process. It includes head office reviews for effective self-governance of branch operations, and onsite branch SCRs. The IDA provided BCSC staff with SCR statistics for files with fieldwork completed between January 1, 2004 and August 22, 2006 for each office, and the head office SCR program.

***Staff's findings***

Nationally, the IDA completed ten out-of-province branch SCRs of six BC members over the period under review. The Vancouver office conducted four branch SCRs of non-BC members. BCSC staff are concerned that there is inadequate coverage of BC branches.

BCSC staff noted that the head office SCR program includes comprehensive review procedures related to the member's self-governance of its branch operations. It examines the adequacy of the member's internal branch review program and process, and, on a sample basis, tests account supervision at the branch. However, during the SCR file review, BCSC staff noted SCOs varied in the level of scrutiny or completeness of their work in this area. BCSC staff noted the following:

- some incomplete or improperly completed review program procedures. These issues were particularly apparent in the IDA's review of the adequacy of member's: internal branch



review process, follow-up and deficiency resolution procedures, or account supervision at the branch;

- inadequate follow-up of previous SCR deficiencies; and
- missing or insufficient evidence of the work performed.

BCSC staff support the two-part approach but are concerned over the small number of BC branch SCRs completed and the inconsistent quality of SCOs' work related to the member's branch governance process.

***Staff's recommendation***

To better oversee branch operations, the Vancouver Sales Compliance department should conduct more branch SCRs and ensure that its SCOs consistently and completely examine its members' branch governance process.

***Priority: Medium***

***IDA's response:***

The main purpose of our branch reviews is to ensure that Members' overall supervisory systems are effective. Branch reviews are done primarily to ensure that this is so and to assess the whole system is working effectively.

We do not review many branches across the country nor do we believe that branch reviews, except in targeted circumstances are a justified use of our resources. Our focus and expectation is that a firm is responsible for the supervision of all branches and sub-branches. We examine the head office processes in this area thoroughly when justified by the firm's circumstances. We test the firm's own audit program and procedures of their own branches. We review their findings and the follow-up on those findings.

Any deficiencies found may be the result of incomplete documentation or an isolated oversight. Our response to the Head Office review section 8, Documentation of Sales Compliance Reviews applies. We will provide additional training of new and existing Sales Compliance Officers on the need for good record keeping.

***Staff comments and follow up:***

BCSC staff remain concerned that the number of branch reviews performed nationally and within BC may be inadequate to ensure there is a sufficient level of supervision and compliance at the branch level. OSC staff also had similar concerns (see section IV.D.5). BCSC staff expect that the Vancouver Sales Compliance department follows the new 2006 planning and "pop-in visit" protocols for branch reviews described in the IDA's Toronto office response in section IV.D.5 of the report. BCSC staff expect to receive a copy of the 2008 SC management's 2008 study of the appropriate number of branch reviews and effective examination approaches, and that actions arising from this study will apply to the Vancouver office as well.

Regarding inconsistent and incomplete examination of members' branch governance process, BCSC staff recognize that some deficiencies may be due to poor file documentation. However, BCSC staff is concerned that significant findings could be overlooked, suggesting weaknesses in the examination process of some SCOs and the supervisory system at the Vancouver office. The

examination and supervisory processes should improve to ensure significant findings are not overlooked.

## **6. Sales compliance review files**

BCSC staff selected a sample of 3 SCR files from a population of 22 closed files to assess the adequacy of the risk assessment and review plan, file documentation, quality of work, and referral to enforcement process.

### **6.1 Risk assessment and review plan**

#### ***Background information***

During the planning process, the SCO gathers and analyses the information from internal and external regulatory sources. As well, the SCO completes the risk assessment checklist, which includes a review plan. The structured process helps SCOs systematically and objectively identify areas of concern and set the scope of the upcoming SCR. The SCO maps out a review plan from the results of the risk assessment.

#### ***Staff's findings***

All three SCR files had a completed risk assessment checklist and review plan, and supporting materials. The SCOs promptly completed the risk assessment checklist and review plan within the first week of fieldwork. Generally, the SCOs documented follow-up procedures arising from their evaluation of each risk assessment section. BCSC staff typically found the pre- and post-SCR risk scores, and the planned SCR procedures reasonable according to the analyses and supporting materials. Further, the review plan usually reflected the key risks and issues from the risk assessment. All three risk assessment checklists evidenced the first and second level of managerial review.

However, BCSC staff noted the following isolated but significant concerns:

- in one case, the risk assessment and review plan did not document any follow-up items or significant considerations arising from the membership application process for a first-time SCR; and
- in another case, a specific module was excessively scaled back, as the review plan did not recognize the module had undergone significant additions to address regulatory gaps.

Overall, the BCSC staff found the risk assessments and review plans were of good quality. Generally, SCOs will omit certain interview questions and/or a few specific tests, when they feel results of the current or past SCR justify it. However, the SCOs were hesitant at more rigorously omitting low risk areas from the review plan.

#### ***Staff's recommendations***

The Vancouver Sales Compliance department should review the two isolated issues to ensure the concerns are not systemic and require remedial action.

***Priority: Medium***

Further, it should try to develop more selective review plans by omitting identified low risk areas in a member with a strong compliance system, and a history of good SCR results.

**Priority: Low**

***IDA's response:***

We agree with both recommendations and will examine the two cases referred to, take remedial action if justified and inform the BCSC.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

## **6.2 File documentation**

### ***Background information***

The IDA provided BCSC staff with the *IDA Sales Compliance Policies and Procedures Handbook* (versions 1997 and 2001) and *IDA Sales Compliance Training Manual*. These contained the IDA's file documentation standards. BCSC staff reviewed a sample of three SCR files for adequacy of the file documentation.

### ***Staff's findings***

BCSC staff noted the extent of file documentation varied among SCOs. Generally, most had fair to good file documentation, which identified interviewees, listed file contents, documented work completion dates, specified the preparer, and evidenced lead SCO review. Supporting documents were on file and referenced in the modules. SCOs clearly noted and detailed the deficiencies in the file, and cross-referenced them to the modules and the report.

Working papers clearly documented the review or test procedures, evidenced the work and analyses performed, and stated the results and conclusion reached. The SCOs properly updated the file with issues identified from the manager's review. Managerial review was generally evident in all three files, which included first and second level approval of the risk assessment, and the draft and final reports.

However, some SCOs were inconsistent in documenting their work within a file. For these SCOs, the extent of documentation ranged from adequate to poor. Poor documentation included:

- inadequate or lack of evidence of the work performed to support the documented conclusion;
- inadequate or lack of description of the review or test methodology, including review period, and items tested or evidence examined;
- incomplete deficiency details (finding forms), as lacked reason for not including in the report, lacked description of underlying cause, or lacked manager-approved materiality scores;
- modules and/or deficiency details were not revised with issues identified from manager's file review and/or differed from the final report. Further, in some instances, the file copy of the module was not replaced with the updated version;
- incomplete follow-up responses to manager's review notes;

- lack of identity of the preparer of working papers for jointly completed SCR modules;
- retained previous versions of the modules, risk assessment, and finding forms on file. This practice resulted in extraneous materials in the file and made it difficult to quickly identify the final version; and
- missing certain documents or forms from the file.

Further, two of the three SCR files examined materially deviated from budgeted time, but the files did not include reasons for the unfavourable time variances, a required IDA procedure.

A properly documented file facilitates the supervision and review of the work performed, enables the identification of training needs, assists in the planning of the next SCR, serves as a guide in subsequent SCRs, helps identify improving and worsening trends, and provides insight into the member's compliance system for enforcement purposes.

***Staff's recommendation***

The Vancouver Sales Compliance department should ensure its SCOs adequately and consistently document their work, especially to address the above noted deficiencies.

***Priority: Medium***

***IDA's response:***

We agree that proper file documentation is important.

We consider the budgeted hours to be a planning tool and rely on the judgment of staff to shorten or lengthen an SCR depending upon the results in the field. We do not believe discrepancies have any regulatory impact. Nonetheless, we will ensure that deviations between budgeted and actual hours spent on a review are explained.

***Staff comments and follow up:***

One aspect of being an effective regulator is to use resources effectively to ensure proper coverage of your membership. Completing a variance analysis and documenting reasons for material deviations will help you to better plan for other SCRs and to better utilize your resources.

The IDA's action plan is adequate.

### **6.3      *Quality of sales compliance reviews***

***Background information***

The Vancouver office provided the working paper and permanent files for the three SCRs selected by the BCSC staff for review.

***Staff's findings***

BCSC staff reviewed the three files to ensure the Vancouver Sales Compliance department properly identified and reported regulatory issues. The quality of the work varied from good to poor among SCOs and for some, varied among the modules that were completed. Even in the

better quality files, BCSC staff were concerned that the files missed or inadequately addressed certain key issues.

BCSC staff found the following inadequacies in some of the files and reports examined:

- did not properly report some deficiencies;
- did not sufficiently follow-up on deficiencies from previous SCRs or issues identified in the risk assessment;
- did not properly apply certain regulatory requirements;
- did not sufficiently identify and examine potential regulatory issues;
- did not effectively select the test sample, which resulted in poor coverage of regulatory issues; and
- did not properly complete or had improperly omitted module questions or procedures.

***Staff's recommendation***

The IDA Vancouver Office should undertake to improve the quality of its SCRs to address the above noted inadequacies.

***Priority: Medium***

***IDA's response:***

We are constantly working to improve the quality of our SCRs. Some of your findings represent a difference in the judgement of BCSC staff versus IDA staff working in the field at the time. It is difficult to properly weight these findings.

Some examples of improvements that we are making to our SCRs are:

- All modules have been re-written
- There is greater use of technology
- Officers are being given more flexibility to exercise their judgment in the field
- Refinements are being made to our risk models and our reliance upon them

It should be noted that all Head Office SCRs started in 2007 will use the new electronic SCR program. Consequently, the files the Commission reviewed are no longer in use and are no longer relevant to our current sales compliance program.

Improving quality is a constant goal of the IDA, and it is unlikely that there is any one initiative that will improve standards. We will continue to consider new approaches to training and to supervision of Sales Compliance Officers.

***Staff comments and follow up:***

Re-writing the modules to provide more guidance will address problems associated with unclear review procedures. BCSC staff expect that any new approaches to training and supervision that the Vancouver Sales Compliance department implements will address all of the noted quality concerns. Further, these concerns should be addressed in a timely manner. Please keep BCSC staff informed of your progress at the BCSC/IDA quarterly meetings.

#### **6.4 Sales Compliance referrals to Enforcement**

##### ***Background information***

The IDA provided BCSC staff with its *Guidelines for Referring Sales Compliance Issues to Enforcement* (revised July 2006). In addition, the Vancouver office provided a list of sales compliance referrals to enforcement for the period under review.

##### ***Staff's findings***

BCSC staff reviewed the sample of three SCR files for compliance with sales compliance referral guidelines. One of the files resulted in a referral to the Enforcement department. In all three cases, the Vancouver department followed the referral guidelines.

##### ***Staff's recommendation***

No further action is necessary.

#### **6.5 Timeliness of the sales compliance reviews**

##### ***Background information***

The IDA provided BCSC staff with SCR statistics for files with fieldwork completed between January 1, 2004 and August 22, 2006 for the Vancouver Sales Compliance department. Further, the Vancouver department provided its SCR statistics and time reports, and access to its electronic SCR files.

##### ***Staff's findings***

During the period under review, the Vancouver Sales Compliance department closed 22 head office and 4 branch SCR files. BCSC staff reviewed the timelines and statistics for these files, and the sample of three files.

BCSC staff noted that two of the three sampled files materially exceeded the budgeted time by 18% and 34%. In both of these cases, the department did not complete the file preparation or issue the draft report in a timely manner, although the SCRs met the reporting benchmarks. For the complexity of these two SCRs, the time spent from file and draft report preparation to draft report issuance was lengthy. For these two files, the time to achieve this was 3.7 and 2.6 months. This was approximately 2.6 times the length of the time it took to complete the fieldwork.

BCSC staff noted that head office and branch SCRs took a long time to complete. They averaged 10.5 and 8 months, respectively, from start of fieldwork to file closure. In particular, there were eight head office SCRs and one branch SCR that took more than one year to complete. In addition, branch SCRs averaged 75% of the elapsed time of the more extensive head office SCRs to complete. For both types of SCRs, almost half of the elapsed time occurred in the response management stage, which was after the issuance of the final report.

As a result, BCSC staff further examined for timely resolution of significant deficiencies in four of the eight head office SCRs that exceeded one year to complete. Two of the four SCRs still had five significant items outstanding five and nine months after the issuance of the final report. Another SCR had three significant items outstanding ten months later. In three SCRs, the Vancouver department's first reply took 46 to 71 days to issue after receipt of the member's response. In two SCRs, there were significant delays with the members' responses. In one instance, BCSC staff found no evidence of IDA follow-up on the member's overdue response

and in the other the follow-up was not conducted until the response was already significantly overdue.

BCSC staff are concerned that significant deficiencies were not resolved in a timely manner for some SCRs. Although the member firms contributed to some of the delay, the IDA had lengthy response turnaround times and inadequately tracked and followed up on overdue member responses. Timely resolution of all deficiencies, especially significant items, is important to mitigate any harm to investors, the market, and its members.

***Staff's recommendations***

The IDA Vancouver Office should examine its head office and branch SCR processes for inefficiencies, and take appropriate steps to improve the timeliness of its reviews.

***Priority: Medium***

The IDA Vancouver Office should ensure more timely review and reply to member's responses to SCR deficiencies, and improve its tracking and follow-up of overdue member responses.

***Priority: Medium***

***IDA's response:***

We agree with both recommendations and in the normal course of our own actions are constantly taking steps to address them.

We have already taken one step to correct the problem by eliminating the requirement for Members to provide detailed responses on minor issues, instead permitting them to undertake to correct them. We will not follow up on the particular steps taken until the next review, cutting down on the time spent in follow-up and enabling us to concentrate on significant issues.

We are also developing a benchmark to ensure that follow-up procedures are completed on a timely basis and will inform you of our progress. As reported above, we will also keep you informed through our regular reporting of our other benchmarks, schedules and staffing changes.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response. Please refer to sections V.D.4.2.1 to V.D.4.2.3.

## **V. Vancouver Office**

### **E. Enforcement**

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#### **1. Introduction**

The Enforcement department is responsible for enforcing IDA By-laws, regulations and policies for its member firms and approved persons. It investigates possible regulatory violations and if a violation is established, it proceeds with disciplinary actions.

The Enforcement department is organized into three main groups: Case Assessment, Investigations and Litigation. Case Assessment is responsible for handling public inquiries and complaints and conducting initial case assessments on files. The IDA Calgary Office conducts case assessment reviews for all of Western Canada. The Investigation group conducts investigations of member firms and their registered representatives. The Litigation group conducts disciplinary proceedings against member firms and their registered representatives and provides advice to Investigators on their files.

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

The purpose of this part of the oversight review was to assess:

- adequacy of regional staffing, resources and training;
- efficiency and effectiveness of the regional investigation and litigation processes; and
- adequacy of performance measurement benchmarks and whether they were met.

BCSC staff interviewed the Vice President, Western Canada – Member Regulation (VP, Western Canada), the Manager of Investigations, two Investigators and two Enforcement Counsel. BCSC staff reviewed a sample of investigation and litigation files as well as the relevant policies and procedures manuals.

#### **3. Reporting structure**

##### ***Background information***

The VP, Western Canada is responsible for all member regulation functions in western Canada including Enforcement. The VP, Western Canada has regional autonomy to make Enforcement decisions while head office's role is to provide advice and oversee the overall activities of the IDA Vancouver office.

The Vancouver office Investigators report to the Manager of Investigations, who reports directly to the VP, Western Canada. The Manager of Investigations communicates and consults frequently with the Director, Enforcement Investigations and periodically with the VP Enforcement.



Vancouver office Enforcement Counsel report directly to the VP, Western Canada and take advice on all files from the Director, Enforcement Litigation. File decisions and dispositions ultimately rest with the VP, Western Canada.

***Staff's findings***

The reporting structure established appropriate accountability and appeared adequate.

***Staff's recommendation***

No further action is necessary.

#### **4.           *Staffing and training***

***Background information***

BCSC staff discussed staffing and training with the Manager of Investigations and the VP, Western Canada. During the period under review, turnover was limited to the departure of one Investigator and one Enforcement Counsel.

Training for new Investigators and Enforcement Counsel includes traveling to head office to attend an orientation program and meet head office personnel. The IDA encourages expertise sharing through mentorships and file pairing. Ongoing training includes securities related courses, file post mortems, case debriefings, and presentations about current topics of interest.

***Staff's findings***

The Vancouver office staffing levels were adequate and training programs and initiatives appeared reasonable with the exception of two specific areas that will be discussed in sections 6.2 and 6.8.

***Staff's recommendation***

No further action is necessary.

#### **5.           *Performance benchmarks***

***Background information***

BCSC staff discussed performance benchmarks with the Manager of Investigations and the VP, Western Canada. To assess performance benchmarks, BCSC staff reviewed file aging reports, Member Regulation Quarterly Reports and Member Regulation Self-Assessments.

Enforcement department performance benchmarks on both a regional and national basis are as follows:

- Investigations - to complete 60% of all investigations within one year;
- Litigation – to resolve 60% of litigation files by issuing a Notice of Hearing or obtaining a settlement agreement signed by all parties within 10 months of receipt of the file; and
- Enforcement – to achieve a project utilization rate of 70%.

***Staff's findings***

Regionally, Investigations met its performance benchmarks in 2004 and 2005 by completing 65% and 72% of its files within one year. In the first two quarters of 2006, Investigations met the benchmark in 60% of files.

Nationally, the Investigations department met its performance benchmarks by attaining levels of 73% in 2004 and 82% in 2005. In the first and second quarters of 2006, the Investigations department met its benchmark by closing 78% of the files within one year.

On a regional basis, in 2004 Litigation completed 56% of their files in under 10 months, slightly below the 60% benchmark. In 2005, Litigation surpassed its benchmark by completing 77% of their files in under 10 months. For the first two quarters of 2006, Litigation met its performance benchmark in 100% of its files.

Litigation achieved its performance benchmarks on a national basis by completing 60% of its files in under 10 months in 2004 and 76% in 2005. In the first two quarters of 2006, Litigation completed 69% of the files in under 10 months.

Nationally, the IDA Enforcement department exceeded its project utilization rate benchmark of 70% by achieving a rate of 76% in 2004, 77% in 2005 and 77% in the first two quarters of 2006.

Overall, the Vancouver Enforcement department appears to be adequately meeting its established benchmarks and BCSC staff think the benchmarks for Investigations and Litigation are appropriate. However, there was one issue that BCSC staff identified in relation to the calculation of the benchmarks. BCSC staff found that it was difficult to determine the Vancouver office's personnel performance as the benchmarks as presently calculated do not necessarily represent the work of the Vancouver office. When BC files are investigated or litigated in other regions, they are still reflected in the Vancouver Enforcement department's statistics even though Investigators and Enforcement Counsel in other regional offices have conduct of the files. The benchmark reflects how long it takes to complete BC files, but it does not necessarily reflect the timeliness of the Vancouver office's work.

***Staff's recommendation***

The benchmark for the completion of BC based files is an important performance indicator. However, a benchmark that reflects the work of the Vancouver Enforcement department would also be beneficial to BCSC staff's understanding of the IDA's performance in this area.

***Priority: Low***

***IDA's response:***

We agree and will meet with BCSC staff to design the CTS report.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

## **6. Investigations - specific issues**

### **6.1 Process - policies and procedures**

#### ***Background information***

BCSC staff discussed Vancouver office investigative procedures with the Manager of Investigations and the VP, Western Canada. BCSC staff also reviewed the *Investigations Policies and Procedures Manual*, which the IDA is in the process of updating.

The majority of investigation files originate as file escalations from the Case Assessment group. Case Assessment uses a scorecard to screen files and assign file priorities based on the severity and complexity of the file. Investigations and Litigation recently developed similar scorecards and they are currently testing these scorecards to establish baseline thresholds for files. The IDA will eventually use them to assist with the Investigation and Litigation department's file assignment and prioritization.

The average file load for Investigators is one complex, priority file and one or two relatively less complicated, lower priority files. Investigators work on their priority file first and when time permits, the lower priority files.

Investigators prepare investigation plans that outline the allegations and the proposed steps to complete the investigation. At the start of the investigation, each Investigator is paired with an Enforcement Counsel who provides Investigators with ongoing advice.

Investigators review and analyze information, conduct interviews and gather evidence to support violations. Analysts assist Investigators by reviewing and analyzing information and producing analytical reports.

Investigators inform management of the files progress through case summaries, weekly staff meetings and quarterly file review meetings with the VP, Western Canada. Management can also access the Investigators' work through the electronic databases.

Upon completion of an investigation, Investigators prepare investigation reports that summarize the investigator's findings and make recommendations to either close the file without action, close with a caution or escalate to Litigation. The Manager of Investigations signs off on the investigation report and forwards it to the VP Western Canada and the Director, Enforcement Investigations. The Manager of Investigations and the VP, Western Canada determine which files are escalated to Litigation.

#### ***Staff's findings***

Investigation processes appeared to be functioning well and the policies and procedures manual reflected how Investigations and management pursued files. Since the IDA was in the process of revising the policies and procedures manual, BCSC staff did not conduct a detailed review of the manual.

***Staff's recommendation***

No further action is necessary.

**6.2 *BC files investigated in other regions******Background information***

The Manager of Investigations assigns the Vancouver office investigation files based on the Investigator's expertise and file loads. If the Vancouver office does not have the resources to pursue a file, the manager consults with the Director of Investigations to assign it to another region with available resources. At times the IDA specifically assigns files to Investigators in other regions because of their expertise. The IDA also pairs Investigators on some files to allow for knowledge and skill sharing.

***Staff's findings***

BCSC staff noticed that other regions investigated a significant number of Vancouver office files. Furthermore, the Vancouver office had few high priority investigation files. For example, of the 12 high priority files opened after January 1, 2004, other regional offices pursued 10 of these files.

BCSC staff appreciate that assigning files to other regions is efficient resource allocation that allows for timely file assignment, as well as matching files to Investigators specialized areas of expertise. However, BCSC staff are concerned about the long-term implications of this practice. If Vancouver office Investigators lack exposure to a variety of violation types, it may hinder their ability to maintain, or gain, the necessary experience and knowledge to tackle some investigations. Ensuring that Vancouver office Investigators can use and maintain their knowledge of the local market, member firms and individuals is crucial.

***Staff's recommendations***

The Vancouver office must maintain regional expertise to allow it to handle most types of investigations. BCSC staff expect that file assignment to other regional offices, due solely to an Investigator's specialized knowledge or skills, would be an infrequent event.

BCSC staff encourage the IDA to continue to pursue training initiatives that further enhance Investigators knowledge and skills, including the pairing of Investigators to encourage skill and expertise sharing.

***Priority: Medium******IDA's response:***

We agree. The IDA will update the BCSC regarding training of the Vancouver office and our efforts to maintain regional expertise.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

### 6.3 *Documentation standards*

#### *Background information*

BCSC staff chose a sample of 24 files out of a population of 140 open and closed files. Within the file sample, two were open files.

#### *Staff's findings*

In general, the investigation files were well organized and documentation was good. However, there were a few problems with conflicting priority levels, documentation of decision rationales and evidencing of managerial review.

#### 6.3.1 *Priority levels*

In three files, there were different priority levels within the file documents. There was no indication in the file that the priority levels changed and no reasons provided. Priority levels are important because they indicate the focus of Investigators' time and effort.

#### *Staff's recommendation*

The IDA should ensure consistency in investigation file priorities. If file priorities change, the IDA should document the change and include the reasons for the change.

**Priority: Medium**

#### *IDA's response:*

We agree.

#### *Staff comments and follow up:*

BCSC staff are satisfied with the IDA's response.

#### 6.3.2 *Managerial decisions and approvals*

#### *Staff's findings*

It was not always clear what managerial decisions were taken and why. For example in three files there was no documentation explaining why a file was transferred to another IDA office. In one file, the file did not explain why the file was held in abeyance.

In four files, there was no evidence of managerial review and approval of the investigation plans. In one of these four files, there was no evidence of approval to extend the investigation beyond the one year performance benchmark.

Investigations retains most of its documents in an electronic format in the CTS. There does not appear to be a system in place to document managerial approvals for documents retained only in CTS.

***Staff's recommendation***

The IDA should review documentation standards to ensure that Investigation files include managerial decisions and evidence of managerial review in CTS documents.

***Priority: Medium***

***IDA's response:***

We agree.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

## **6.4 Approach to files**

### **6.4.1 Delays in commencing investigations**

***Staff's findings***

BCSC staff noticed a pattern in many investigation files that showed that Investigators did not start to work on a file until it approached its one year performance benchmark deadline. These files contained mostly Case Assessment's work and often the only investigative work completed in Investigations was an interview.

In some files, it appeared that performance indicators were the driving factor in determining when Investigators started to work on a file. Postponing work on files may not leave sufficient time to pursue lengthy or complex investigations. Also, delays can cause files to lose momentum, and witnesses and complainants may forget important details.

***Staff's recommendation***

The IDA should ensure it reviews files in the early stages of an investigation to allow sufficient time to complete thorough investigations.

***Priority: Medium***

***IDA's response:***

We agree.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

## 6.5 *Supervision files*

### ***Background information***

In the 2002 BCSC IDA Enforcement Oversight Review, staff found that the Vancouver office was not conducting many supervision investigations. Since that time, the IDA completed a comprehensive review of its approach and focus on supervision investigations. Supervision is now a primary strategic objective for the Enforcement department. The IDA now pursues more supervision investigations and specifically tracks and reports on these types of investigations.

### ***Staff's findings***

BCSC staff acknowledge that the IDA took significant steps to address the lack of supervision investigations. However, supervision investigations are presenting some challenges because they can be more difficult and time consuming to investigate than other violation types.

BCSC staff found that the Vancouver office intentionally delays opening supervision files to ensure they have a full year under their performance benchmark to investigate. In addition, some Investigators believe it is more appropriate to assess the approved person's activities first. If they establish violations against the approved person, then the Investigator opens a separate supervision file with a new one year benchmark at that time.

This is contrary to the supervision report's assertion that there should be no time lags between the investigation of the approved person's conduct and supervision. The report states that these should be parallel investigations. Furthermore, BCSC staff believe it is more efficient to conduct these investigations at the same time. Since performance benchmarks state that only 60% of files must be completed within a year, it is reasonable to expect that supervision investigations would often be part of the 40% of files that take more than a year to complete.

### ***Staff's recommendation***

The Vancouver office should review its approach to supervision files and reconsider its decision to delay the opening of separate supervision files.

***Priority: Medium***

### ***IDA's response:***

We agree that the opening of supervision investigation files should not be delayed.

Our investigation manual provides that in the normal course of an investigation into the conduct of a registrant, sufficient information must be requested by the investigator to adequately review supervision at all appropriate levels.

### ***Staff comments and follow up:***

During the oversight review the investigations policies and procedures manual was in the process of being updated. BCSC staff will ask the Vancouver office to outline any changes to supervision investigation procedures subsequent to the review period and will request a copy of the revised policies and procedures manual.

## 6.6 *Quality of investigations*

### *Staff's findings*

The IDA is pursuing a wide variety of violation types and overall the quality of the investigative work was good. Staff noted that unsuitable investment advice and discretionary trading investigations were particularly well done.

From a population of 24 investigation files, 5 files had insufficient or inadequate work. Of the five files:

- two files did not contain evidence of an assessment about the approved person's suitability for continued registration;
- one file had insufficient evidence and as a result, Litigation made a recommendation to refer the file back to Investigation; and
- two files had little or no work completed, and the files were closed without providing explanations for the lack of work.

### *Staff's recommendation*

The Investigations department should make certain that its analysis considers possible violation patterns across files to ensure it assesses the impact of the cumulative actions. When a file is not pursued, the file should document the reasons.

***Priority: Medium***

### ***IDA's response:***

We agree with the recommendation and we believe we do this. We do not agree with the findings for the following reasons:

1. A warning letter was issued on the first file. The suitability for continued registration was not an issue;
2. On the second file, there was no evidence of any wrongdoing and the file was closed. The suitability for continued registration therefore cannot be an issue;
3. A warning letter was issued on this file. This was considered the appropriate disposition. The file was not returned to investigation for lack of evidence;
4. Management decided to issue a caution letter; further investigation was not warranted and the file was closed. The reasons for management conclusions are documented on the file;
5. An investigation was completed and the file closed for lack of evidence of any regulatory violations.

### ***Staff comments and follow up:***

1. & 2. This deficiency relates to the assessment of information and documentation of work at the investigative stage, as opposed to the eventual outcome of the files. This recommendation speaks to the process of reviewing the individual or firm for suitability of registration given their entire history. Investigators should be assessing all the previous violations as a matter of course



to see if there are any trends, and then documenting this analysis in the investigation file.

3. We acknowledge the ultimate disposition of this file, however, that is not what the recommendation is referring to. The issue here is that Enforcement Counsel recommended that the file be returned to Investigations because there was insufficient evidence to proceed with a specific allegation.

4. & 5. The findings relate to the fact that the files contained few documents, or evidence of work completed, and no reasons to explain why.

## 6.7 *File conclusions and recommendations*

### *Staff's findings*

For the majority of files, BCSC staff agreed with the ultimate disposition of the files. However, there were three files that staff thought had inappropriate conclusions:

- one file had inconsistencies between the initial allegations and the ultimate reasons for closing the file;
- one file was closed based on evidence in a transcript that was not sufficient to address the allegations in the IDA investigation; and
- one file was closed citing insufficient evidence, however, the reason did not appear to support the conclusion for closing the file.

### *Staff's recommendation*

The IDA should ensure that evidence addresses allegations and is consistent with conclusions. If the allegations or the focus of a file changes, the file should clearly document this change.

**Priority: Medium**

### *IDA's response:*

We agree.

### *Staff comments and follow up:*

BCSC staff are satisfied with the IDA's response.

## 6.8 *Interviewing*

### *Staff's findings*

BCSC staff acknowledge that it is difficult to assess the adequacy of an interview and an Investigators interviewing skills based on a transcript and file information. Regardless, BCSC staff were able to make several observations. First, some Vancouver office Investigators did not conduct interviews where it appeared they were necessary. For example, compliance personnel and victims were not interviewed as often as we expected they would be. Second, some Investigators did not probe enough in their interviews and they appeared to stick to a specific set

of questions regardless of whether or not the interview responses suggested a different line of questioning or additional follow-up.

***Staff's recommendation***

Investigators should continue to pursue interviewing courses and interview in pairs when possible. The IDA should continue its ongoing interview training efforts.

***Priority: Medium***

***IDA's response:***

We agree. One of the reasons we video record all interviews is for training purposes. Through our quarterly meetings with BCSC staff, we will update the BCSC on our training initiatives.

***Staff comments and follow up:***

BCSC staff are satisfied with the IDA's response.

## **7.           *Litigation – specific issues***

### **7.1           *Policies and procedures***

***Background information***

BCSC staff reviewed the policies and procedures, *Rules of Practice and Procedures* and the *Enforcement Counsel Orientation Manual* and BCSC staff interviewed the VP, Western Canada and two Enforcement Counsel.

The VP, Western Canada decides if files are escalated to Litigation in consultation with the Manager of Investigations and the Investigator who has conduct of the file. Enforcement Counsel then reviews the evidence and recommendations and provides an opinion on how to proceed. If the evidence shows a regulatory infraction, disciplinary outcomes are considered. Typically, the outcomes include closing a file without action, issuing a warning or entering into a settlement.

If a settlement agreement is successfully negotiated, the agreement is put before a hearing panel who decides to accept or reject the agreement. If the respondent does not agree to the settlement, a contested hearing is held and a notice of hearing and particulars is issued.

Hearing panels are composed of one public member and two industry members. The Association Secretary in head office convenes the panels. All hearings are public except settlement hearings, which become public after the hearing panel accepts the settlement agreement.

For all of the disciplinary outcomes, a disciplinary bulletin is issued. Bulletins outline the regulatory infractions and the penalties imposed. The IDA can impose a range of penalties including reprimands, fines, prohibitions for specified time periods, suspensions, terms and conditions on registration and expulsion from the IDA.

***Staff's findings***

The Litigation process appears to be reasonable and the policies and procedures were comprehensive.

***Staff's recommendation***

No further action is necessary.

**7.2      *Adequacy of Litigation files******Background information***

BCSC staff chose a sample of 9 files from a population of 58 closed Litigation files to review the adequacy of the Vancouver office Litigation group's work.

***Staff's findings***

In general, BCSC staff agreed with most file outcomes. File documentation was adequate, files were completed in a timely manner and there was evidence of secondary review. The District Council members complied with requirements and the hearing processes were appropriate and in accordance with the *Rules of Practice and Procedures*.

***Staff's recommendation***

No further action is necessary.

**7.3      *Prompt notification******Staff's findings***

During the period under review, BCSC staff noted that the IDA was not promptly notifying the BCSC and the public of some disciplinary actions. The *Litigation Policies and Procedures Manual* states that the public and media are to be advised of any disciplinary or settlement hearings by way of a press release no fewer than 10 business days prior to the date of the hearing. Based on this standard, for three of the nine files, the IDA did not promptly communicate to the public the statement of allegations.

In four of the nine files the IDA did not notify the public in a timely manner of disciplinary outcomes. The time periods that it took the IDA to post these four notifications to the IDA's website ranged from two weeks to in excess of two months from the date of the outcome.

***Staff's recommendation***

The IDA must ensure that the public and the BCSC are notified about impending disciplinary actions and disciplinary outcomes in a timely manner.

***Priority: Medium***

***IDA's response:***

With respect to publication of settlements, please see our response in Part IV, Section E, Subsection 9.2. With respect to publication of contested decisions, we believe it is more efficient to await the reason of the discipline panel before publishing a summary of the decision.

***Staff comments and follow up:***

The IDA's response about the publication of settlements that was referred to above in Part IV, Section E, Subsection 9.2 is as follows:

*We agree and will undertake a review of the present policy of waiting for the release of reasons for a decision before publicizing the confirmation of a settlement.*

Please inform BCSC staff of the results of your review.

Regarding publication of contested decisions, our findings do not relate solely to contested decisions but rather to a variety of outcome notifications. BCSC staff will continue to monitor the timeliness of notifications about disciplinary outcomes.

NOTE: THIS APPENDIX IS PART OF THE IDA'S RESPONSE (SEE PAGE 3 OF THE OVERSIGHT REVIEW REPORT)

**APPENDIX I**

**MEMBER REGULATION BENCHMARKS AND PERFORMANCE MEASURES  
AS AT JUNE 30, 2007**

The performance of Member Regulation will be measured by enhanced investor protection through increased industry compliance with regulatory standards measured by:

- Achievement of all Member Regulation Benchmarks:

No.	Department	Benchmark	Results this quarter
2.4	Financial Compliance	Achieve a project utilization rate of 70%.	Achieved 69.5% <sup>1</sup>
2.5	Financial Compliance	Examine every Member annually (except for firms approved for biennial review).	Financial Compliance is on track to achieve this benchmark.
2.6	Financial Compliance	Completion and issuance of final examination reports: <ul style="list-style-type: none"> <li>• within 8 weeks of completion of fieldwork for 60% of reports,</li> <li>• within 6 months for all reports.</li> </ul>	<ul style="list-style-type: none"> <li>• Achieved 92%</li> <li>• Achieved 100%</li> </ul>
2.7	Financial Compliance	Complete audit working paper reviews within 3 months of the filing date for firms with a risk level greater than 2.5 (high risk).	Achieved 100%
2.8	Financial Compliance	Completion and issuance of preliminary report for new member application within 2 weeks.	There were no new applicants this quarter.
3.2	Sales Compliance	Achieve a project utilization rate of 70%.	Achieved 71.8%
3.4	Sales Compliance	Complete all mandated reviews (including scheduled branch reviews) as established at beginning of year.	Sales Compliance is on track to achieve this benchmark.
3.5	Sales Compliance	Completion and issuance of final examination reports: <ul style="list-style-type: none"> <li>• within 15 weeks of completion of fieldwork for 60% of reports,</li> <li>• within 26 weeks for all reports.</li> </ul>	<ul style="list-style-type: none"> <li>• Achieved 79%</li> <li>• Achieved 100%</li> </ul>
3.6	Sales Compliance	Completion and issuance of preliminary report for new member applicant within 2 weeks.	There were no new applicants this quarter.
4.3	Enforcement	Achieve a project utilization rate of 70%.	Achieved 75.3%
4.8	Enforcement – Complaints Resolution Rates	Resolve 80% of closed complaints within 75 days	Achieved 89%
4.12	Enforcement – Investigations Resolution Rates	Resolve 60% of closed investigations received within 365 days	Achieved 70%
4.16	Enforcement – Prosecutions Resolution Rate	Resolve 60% of closed prosecution files within 6 months of receipt of the file.	Achieved 70%
5.3	Registrations Performance Benchmarks – Applications	80% of all applications will be either approved or the Member will be sent a first deficiency letter within 5 business days.	Achieved 72% <sup>2</sup>
5.4	Registrations Performance Benchmarks – Transfers	All transfers of registration will be completed within 2 business days provided no extenuating circumstances require a longer processing time (i.e., exemption request).	Achieved 94% <sup>3</sup>
5.5	Registrations Performance Benchmarks – New Member Applications	Completion and issuance of a preliminary deficiency letter on review of suitability of management as per By-law 7 and applicant submissions received through NRD within 2 weeks of receipt.	Achieved 100%

<sup>1</sup> See Section 2.4 for details.

<sup>2</sup> See Section 5.3 for details.

<sup>3</sup> See Section 5.4 for details.

### 1.2.1 PERFORMANCE MEASURES

#### Capital Related:

- Zero calls on the CIPF due to insolvency (excluding fraud as the proximate cause of the insolvency)
  - *There were no claims made on the Fund in the quarter. There are still three pending insolvencies, namely Essex Capital Management, Rampart Securities Inc., and Thomson Kernaghan & Co. Limited. See Section 2.2 for more details.*
- Reduce and maintain at zero the number of capital deficiency occurrences for firms designated in early warning
  - *No Members in early warning became capital deficient in the quarter.*

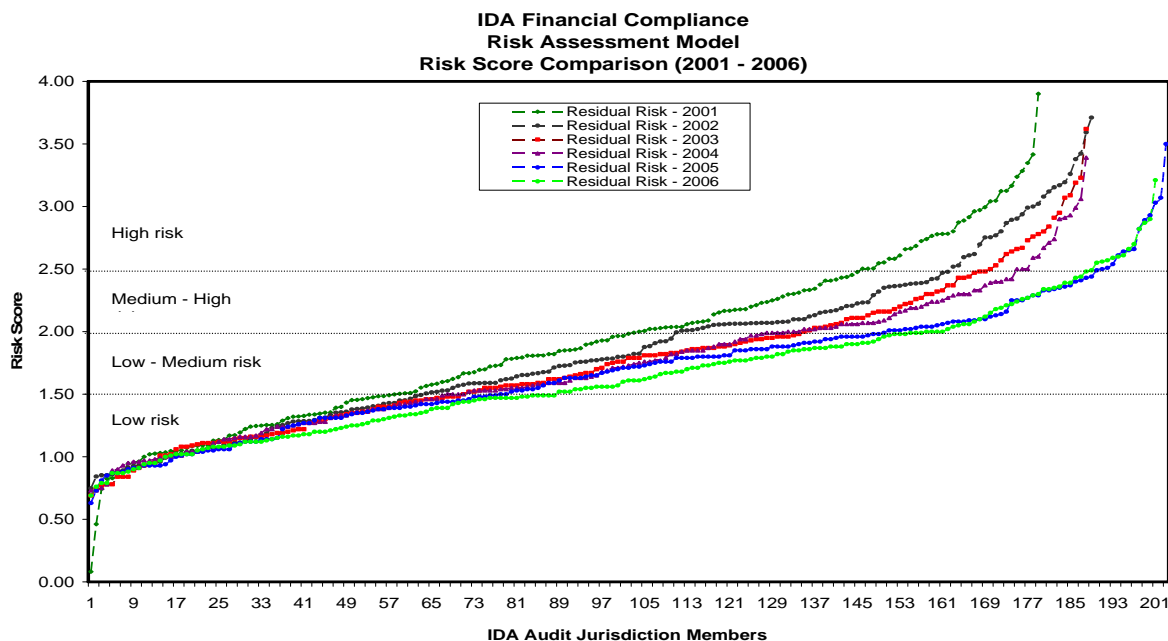
### 1.2.2 RISK BASED REGULATION

- Reallocate Enforcement resources to more serious / complex / high risk cases
  - *Complexity rating has been developed and is being tracked over time to demonstrate staff resources dedicated to complex cases. See Section 4.13 and 4.17 for more detail.*
- Financial Compliance and Sales Compliance will spend at least two-thirds of field examination time on moderate and high risk activities of Member firms
  - *100% compliance has been achieved.*

### 1.2.3 LEADING RISK INDICATORS

- Reduce the number of high risk firms and reduce the residual risk scores of those high risk firms in Financial and Sales Compliance

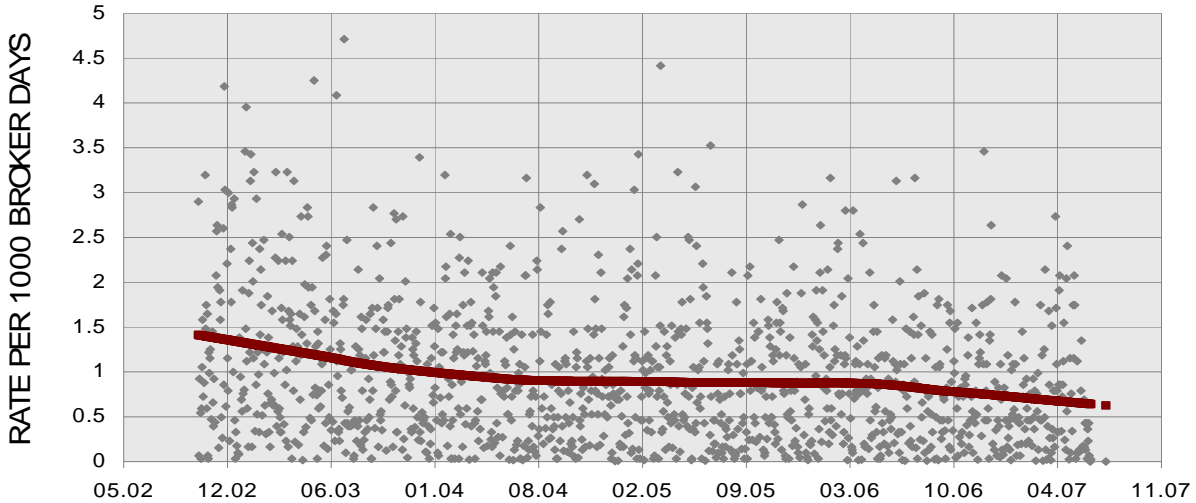
## • Residual Risk Scores for Financial Compliance



This graph shows the Financial Compliance residual risk scores for all member firms from 2001-06. The Financial Compliance residual risk score for each firm is calculated by assessing the firm's internal, inherent and external risks and deducting from that the firm's risk control score. See Section 2.11 for more information concerning the factors that have influenced the shift in the linear graph.

- **Reduce the frequency and severity of events reported by Member firms on ComSet**

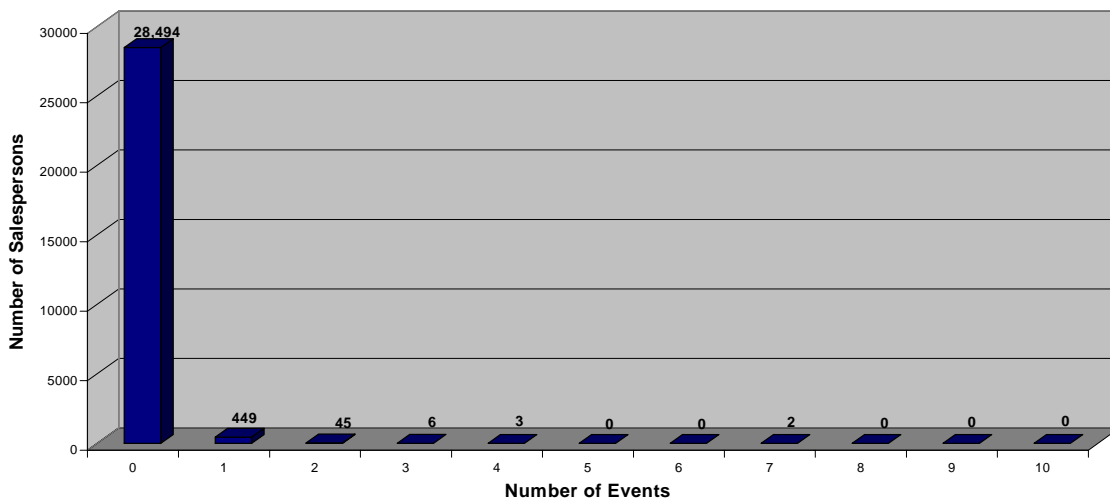
**Industry ComSet Event Frequency and Severity Graph  
Oct 15, 2002 to Jun 30, 2007**



This graph shows the event rates for all the Member firms who reported in ComSet during the indicated period of time. It is normalized for the different firm sizes by considering the number of registrants at a firm and takes into account the severity of the event and the intervals between recorded events. The line is extrapolated one month into the future to estimate the direction of the industry based on the current data we have from the firms.

- **Review in a timely manner all registrants with three or more complaints**

**Number of ComSet Events per Salesperson  
January 1, 2007 to June 30, 2007**



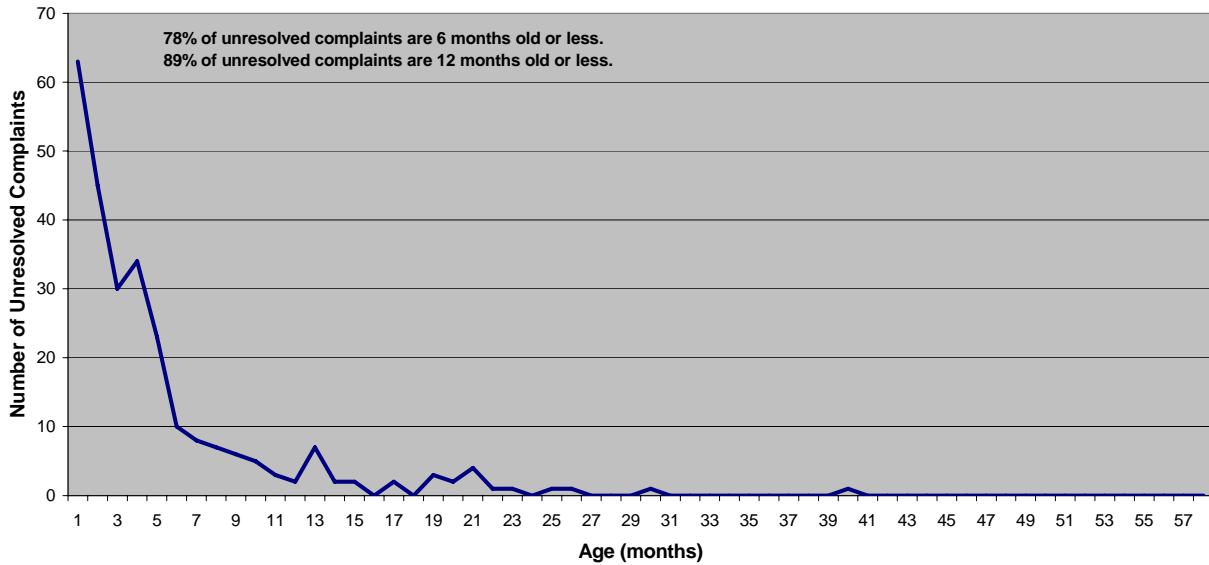
This graph covers the first two quarters of 2007. Of the five individuals who have four or more events in ComSet, two are currently registered, and three are not registered:

- Three individuals are currently being investigated;
- Two individuals' activities are currently being reviewed by Case Assessment.

• **Monitor Member firm client complaint resolution performance**

**Member Firm Pending Client Complaints**

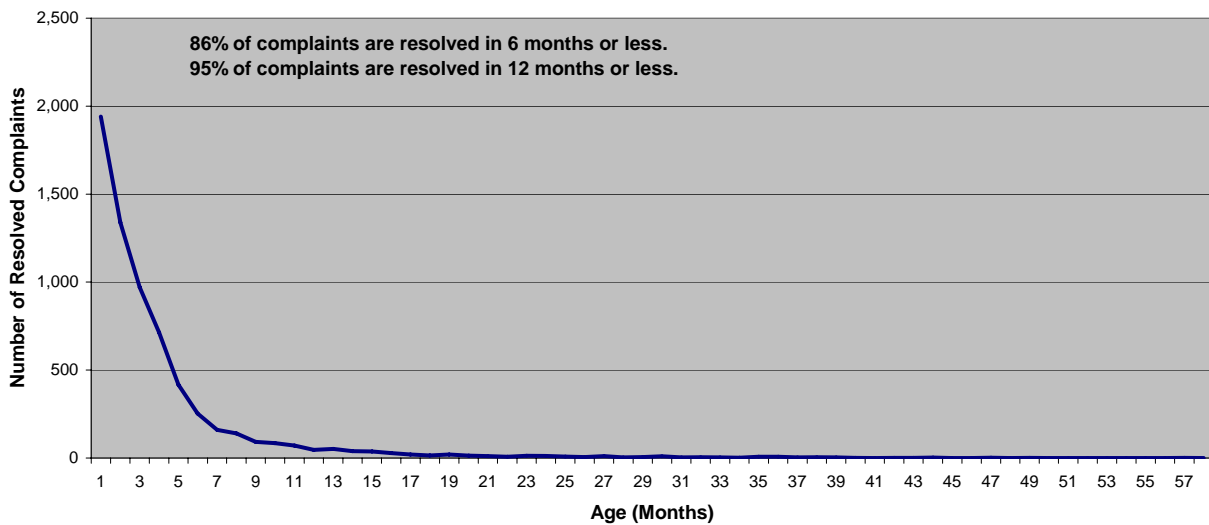
Unresolved Customer Complaints Reported by IDA Member Firms as at June 30, 2007



As of June 30, 2007, there are 264 Customer Complaints with a Pending/Unresolved status in ComSet. This number does not include those Customer Complaints that are In Litigation, In Arbitration, In Mediation or where an offer of settlement is pending. Approximately 78% of the Pending/Unresolved Customer Complaints in ComSet are six months old or less.

**Member Firm Resolved Client Complaints**

Resolved Customer Complaints Reported by IDA Member Firms as at June 30, 2007



There were 6,584 resolved complaints in ComSet as at June 30, 2007. Approximately 86% of the Customer Complaints reported in ComSet were *resolved* in six months or less.