

**Oversight Review Report of
the Investment Industry Regulatory Organization of
Canada**

Issued: August 5, 2020

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I. Executive Summary

In accordance with their mandates under the securities legislation of their respective jurisdictions, the Recognizing Regulators¹ of the Investment Industry Regulatory Organization of Canada (IIROC) have jointly completed an annual risk-based oversight review (the Review) that targeted two areas within IIROC's Enforcement function.²

No findings were identified during the Review, and staff of the Recognizing Regulators (Staff) did not identify concerns with IIROC meeting the relevant terms and conditions of the Recognizing Regulators' recognition orders (the Recognition Orders) in the functional area reviewed. Staff make no other comments or conclusions on IIROC operations or activities that are outside the scope of the Review.

Staff have set out two expectations respecting various practices and procedures carried out by IIROC in the functional area reviewed. These expectations are identified for IIROC to take note of and use as a basis for seeking improvements going forward. The expectations are set out in the *Risk Assessment and Oversight Review* section of the report.

Staff acknowledge that IIROC made sufficient progress in resolving the findings which were cited in previous oversight reports and which were followed up by Staff prior to the Review.

II. Introduction

A. Background

IIROC is the national self-regulatory organization (SRO) that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada.

IIROC is recognized as an SRO by the Alberta Securities Commission, the Autorité des marchés financiers, the British Columbia Securities Commission, the Financial and Consumer Affairs Authority of Saskatchewan, the Financial and Consumer Services Commission of New Brunswick, the Manitoba Securities Commission, the Nova Scotia Securities Commission, the Office of the Superintendent of Securities, Service Newfoundland and Labrador, the Ontario Securities Commission, the Prince Edward Island Office of the Superintendent of Securities, the Northwest Territories Office of the Superintendent of Securities, the Nunavut Securities Office, and the Office of the Yukon Superintendent of Securities, collectively, the Recognizing Regulators.³ IIROC's head office is in Toronto with regional offices in Montréal, Calgary and Vancouver.

This report details the Review's objectives and the key areas that formed the basis of the Review conducted by Staff. The Review covered the period from September 1, 2018 to

¹ See part II. Introduction, section A. Background for the regulators that recognize IIROC.

² See Appendix A, section 3 for a detailed description of the scope of the Review.

³ The three Canadian territorial authorities recognized IIROC on November 1, 2018.

August 31, 2019 (the Review Period). The methodology used, report format and scope are set out in Appendix A. A description of the applicable regulatory requirements and functional area are set out in Appendix B.

B. Objectives

The objectives of the Review were to evaluate whether selected regulatory processes were effective, efficient, and were applied consistently and fairly, and whether IIROC complied with the terms and conditions of the Recognition Orders.

III. Risk Assessment and Oversight Review

A. Enforcement

As part of the annual risk assessment process, Enforcement was determined to be an area with an above average adjusted risk score. In so determining, Staff identified the following areas that became the focus of the Review:

- The functionalities and capabilities of the new Integrated Case Management (ICM) system
- Criteria for closed session hearings

To ensure that IIROC has the applicable controls in place, Staff:

- Reviewed the functionalities and capabilities of the ICM system,
- Assessed the written criteria (guidance for hearing panels) for determining when it is appropriate to have a closed session hearing,⁴ and
- Reviewed the Enforcement policies and procedures manual

Based on the work performed, Staff set out the following two expectations relating to (i) user access to the ICM system, and (ii) enhanced training and written guidance for determining when a closed session hearing is appropriate.

User Access to the ICM System

The ICM system was designed to integrate the workflow processes of four departments (Enforcement, Complaints & Inquiries (C&I), Equity Surveillance and Trading Review & Analysis (TR&A)). This enabled the departments to transfer/move a file or event from one department to another within the same case management system. It also permitted certain IIROC staff to access file information across departments. Specifically, given the nature of their work, IIROC has determined that staff in

⁴ Under Term & Condition 9 of the Recognition Orders, IIROC must ensure that disciplinary and settlement hearings are open to the public and the news media and may, on its own initiative or on request, order a closed-door hearing or prohibit the publication or release of information or documents if it determines that it is required for the protection of confidential matters. IIROC must establish written criteria for making a determination of confidentiality.

Enforcement and C&I should have read/edit access privileges to files within the Enforcement Case and Enforcement Case Assessment categories in the ICM system. Furthermore, read only access privileges have been provided to TR&A and Registration staff to enable those users to efficiently perform their respective responsibilities.

As the ICM system is now fully operational, and considering the sensitivity of information contained in the Enforcement Case and Enforcement Case Assessment categories, Staff expect IIROC to complete a comprehensive review of user access capability, which would include assessing user access and use to identify trends and anomalies based on the minimum requirement for their functional roles (“need-to-know basis”) to determine if levels of access continue to be appropriate and take appropriate measures if necessary. Staff will continue to engage and follow-up on IIROC’s review and assessment until satisfied.

Closed Session Hearings

Staff expect IIROC’s General Counsel’s Office to consider enhanced training for new and current hearing panel members (with examples) based on the criteria in IIROC Rule subsection 8203(5). Furthermore, IIROC should update its Enforcement Policies and Procedures Manual to ensure that IIROC’s Enforcement counsel refer to IIROC Rules (i.e. subsection 8203(5)) and consider jurisprudence when making a submission for confidentiality to an IIROC panel.

APPENDIX A

1. Methodology

The Recognizing Regulators have adopted a risk-based methodology to determine the scope of the Review. On an annual basis, the Recognizing Regulators:

- Identify the key inherent risks⁵ of each functional area or key process based on:
 - reviews of internal IIROC documentation (including management self-assessments and risk assessments);
 - information received from IIROC in the ordinary course of oversight activities (e.g. periodic filings, discussions with Staff);
 - the extent and prioritization of findings from the prior oversight review; and
 - the impact of significant events in or changes to markets and participants to a particular area
- Evaluate known controls for each functional area
- Consider relevant situational/external factors and the impact of enterprise wide risks on IIROC as a whole or on multiple departments
- Assign an initial overall risk score for each functional area
- Collaborate with IIROC to identify and assess the effectiveness of other mitigating controls that may be in place in specific functional areas
- Assign an adjusted overall risk score for each area
- Use the adjusted risk scores to determine the scope of the Review

Once the scope of the Review was determined, Staff conducted a desk review which involved reviewing specific documents pertaining to the Review Period and interviewing appropriate IIROC staff in order to:

- Confirm that mitigating controls were in place for the key inherent risks identified, and
- Assess the adequacy and efficacy of those mitigating controls

2. Report Format

In keeping with a risk-based approach, this report focuses on a functional area and key processes with higher risk that were deemed warranted to be part of the desk review.

3. Scope

Considering the status of the resolution of findings from prior oversight reviews and the challenging issues that may impact IIROC, Staff utilized the risk assessment process to identify specific processes and activities within the following above average risk area as the focus for the Review. There were no functional areas identified as high risk.

⁵ Inherent risk is the assessed level of the unrealized potential risk, taking into account the likelihood of and impact if the risk was realized prior to the application of any mitigating controls.

Above Average

- Enforcement

The following above average risk areas were not included within the scope of the Review as the areas were subject to alternative oversight activities:⁶

Above Average

- Data Analytics
- Information Technology
- Equity Market Surveillance
- Debt Market Surveillance

Also, through the risk assessment process, Staff determined that the following moderate and low risk areas would not be examined during the Review:⁷

Moderate

- Business Conduct Compliance
- Financial and Operations Compliance
- Trading Conduct Compliance
- Trading Review & Analysis
- Policy
- Risk Management
- Financial Operations / Project Management

Low

- Corporate Governance
- Membership and Registration

4. Priority of Findings

Staff prioritize findings into High, Medium and Low, based on the following criteria:

High Staff identify an issue that, if unresolved, will result in IIROC not meeting its mandate, or one or more of the terms and conditions of the Recognition Orders, or other applicable regulatory requirements. IIROC must immediately put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable

⁶ In addition to ongoing oversight by the Recognizing Regulators through mandatory reporting by IIROC, as well as regularly scheduled and ad hoc meetings, Staff performed alternative oversight activities on these areas to ensure adequate coverage (obtained additional information and followed up on selected IT processes, including but not limited to, information security operations and IT infrastructure, acquired an understanding of the new surveillance system and reviewed the internal audit report on Data Analytics).

⁷ These areas continue to be subject to oversight by the Recognizing Regulators through ongoing mandatory reporting by IIROC as required by the Recognition Orders, as well as regularly scheduled and ad hoc meetings between the Recognizing Regulators and IIROC staff.

to Staff. If necessary, compensating controls should be implemented before the finding is resolved. IIROC must report regularly to Staff on its progress.

Medium Staff identify an issue that, if unresolved, has the potential to result in an inconsistency with IIROC's mandate, or with one or more of the terms and conditions of the Recognition Orders, or with other applicable regulatory requirements. IIROC must put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to Staff. If necessary, compensating controls should be implemented before the finding is resolved. IIROC must report regularly to Staff on its progress.

Low Staff identify an issue requiring improvement in IIROC's processes or controls and raise the issue for resolution by IIROC's management.

Repeat Finding A finding that was previously identified by Staff and not resolved by IIROC will be categorized as a repeat finding in the report and may require that the level of priority be raised from the initial level noted in the previous report.

APPENDIX B

Applicable Regulatory Requirements and Functions

Enforcement

Under Terms & Conditions 6 and 7 of the Recognition Orders, IIROC must monitor compliance with its Rules and provincial securities regulations by its Members and others subject to its jurisdiction, including ATSS, and enforce compliance with its Rules, subject to a provision for due process.

Under Term & Condition 9 of the Recognition Orders, IIROC must ensure that disciplinary and settlement hearings are open to the public and the news media and may, on its own initiative or on request, order a closed-door hearing or prohibit the publication or release of information or documents if it determines that it is required for the protection of confidential matters. IIROC must establish written criteria for making a determination of confidentiality.

In order to ensure Member compliance with IIROC requirements, IIROC's Enforcement staff (amongst other duties) are responsible for: assessing and investigating complaints, inquiries and referrals about possible regulatory misconduct; and conducting disciplinary actions where there is evidence that misconduct has taken place.