



CANADA

FINANCIAL SECTOR ASSESSMENT PROGRAM

March 2014

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION—DETAILED ASSESSMENT OF IMPLEMENTATION

This Detailed Assessment of Implementation of IOSCO Objectives and Principles of Securities Regulation on Canada was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in February 2014.

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IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES

REGULATION

DETAILED ASSESSMENT OF IMPLEMENTATION

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in Canada during June 2013, led by Aditya Narain and Simon Gray, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

AASB	Audit and Assurance Standards Board
AIF	Annual Information Forum
AMF	Autorité des Marchés Financiers
AMF SA	Securities Act of the Autorité des Marchés Financiers
ASB	Accounting Standards Board
ASC	Alberta Securities Commission
ATS	Alternative Trading System
BCSC	British Columbia Securities Commission
BDR	Bureau de Décision et de Révision
CanPX	CanPX Inc.
Canadian AS	Canadian Accounting Standards
CDCC	Canadian Derivatives Clearing Corporation
CDRP	Continuous Disclosure Review Program
CDRS	Continuous Disclosure Review System
CDS	Canadian Depository for Securities Limited
CEO	Chief Executive Officer
CIS	Collective Investment Schemes
CNQ	Canadian Trading and Quotation System, Inc., Canada's New Stock Exchange
CPAB	Canadian Public Accounting Board
CPP	Canada Pension Plan
CPSS	Committee on Payment and Settlement Systems
CSA	Canadian Securities Administrators
CSF	Chambre de la Sécurité Financière
EMDs	Exempt Market Dealers
GAAP	Generally Accepted Accounting Principles
IDs	Investment Dealers
IIROC	Investment Industry Regulatory Organization of Canada
IFIC	Investment Funds Institute of Canada
IFMs	Investment Fund Managers
IFRS	International Financial Reporting Standards
IMETs	Integrated Market Enforcement Teams
IMM	Intelligent Market Monitor
NI	National Instrument
IOSCO	International Organization of Securities Commission
IPO	Initial Public Offering
IRC	Independent Review Committee
MFDA	Mutual Fund Dealers Association of Canada
MMoU	Multilateral Memorandum of Understanding
MoU	Memorandum of Understanding

CANADA

MX	Montreal Exchange
NA	National Instrument
NAV	Net Asset Value
NRS	National Registration System
ONT SA	Securities Act of Ontario
OSC	Ontario Securities Commission
RS	Market Regulation Services Inc.
RSP	Regulation Service Provider
SMARS	Stock Monitor, Alert, and Research
SROs	Self Regulatory Organizations
TSX	Toronto Stock Exchange
TSXV	TSX Venture Exchange
UMIR	Universal Market Integrity Rules

SUMMARY

1. This assessment has been conducted under the methodology for targeted assessments.¹ A full assessment was conducted in 2007 based on the methodology approved by IOSCO in 2003. As a result Canada met the threshold for a targeted assessment. Based on the due diligence conducted the assessment covered principles 1, 2, 3, 6, 7, 8, 9, 12, 19, 20, 22, 23, 24, 28, 29, 30, 31, 32, 34, and 35 in their entirety while principles 25 and 37 were partially reassessed. Nothing in the due diligence suggested the need to reassess the remaining principles. The guidance for targeted assessments requires the assessor to carry over the description of the principles that have not been assessed in order to provide a complete view.

2. The Canadian framework for the regulation and supervision of securities markets demonstrates a high level of implementation of the IOSCO Principles. The securities regulatory agencies have been given broad powers to regulate and supervise the markets. Furthermore, in a few areas such as enforcement powers, such powers could be considered leading practices. The provincial regulators have increasingly achieved a high degree of harmonization of their regulatory frameworks and significant efforts have been made at the supervisory front to coordinate, and streamline processes and procedures and to achieve convergence in supervisory practices. Robust arrangements have also been developed for the supervision of many categories of market participants, and use of enforcement powers by the largest provincial regulators has been strengthened significantly.

3. Despite these gains, developing an integrated and robust view of risks to support supervisory actions remains a key challenge. Further action would be beneficial on several fronts, as detailed below.

- **Stronger coordination:** Within the current framework, several different regulatory agencies and SROs are in charge of the supervision of different components of the securities markets, which makes it challenging to have a “full” view of risks. The regulators have developed arrangements for coordination; however it is key that such arrangements continue to be further strengthened to ensure that a two way communication exists.
- **Additional capacity in very specialized areas.** As many other securities regulators in industrialized countries, the four agencies face resource challenges which have arisen from the increased complexity of their securities markets. The agencies are aware of this challenge and in recent years have incorporated other profiles in their staff (such as staff with expertise in trading, management and manufacturing of products, and more generally staff with market experience, as well as economists) to ensure a full understanding of the risks posed

¹ See Guidance Note for Staff on Undertaking Targeted (Risk-based) Reports on the Observance of Standards and Codes (ROSCs) in Financial Regulation and Supervision, International Monetary Fund, October 2010, available on the IMF website.

by different activities and products, as well as their implications for the whole financial sector.

- **More robust use of quantitative analysis.** Quantitative analysis is not only necessary for the identification of systemic risks, but it can also enrich discussions on emerging risks, even at the conduct level. However, currently the collection and use of quantitative data by the regulatory agencies varies, and thus there is a need to ensure that the right type of data is collected in a uniform and consistent manner and is available for analysis to the provincial regulators, and in particular to the CSA Committee on Risk. **Additional work “on the ground:”** On-site inspections are a key tool for early detection of poor practices and conduct problems, as well as weaknesses on internal controls and risk management, and to assess whether regulated firms are compliant with their respective regulatory perimeters. Thus, they are a key tool for risk identification, along with other tools such as reporting, complaints and market intelligence. The on-site inspection programs of the securities regulatory agencies are developed based on a risk-based approach. This approach has resulted in a more focused use of on-site inspections by the regulators with the largest populations. While overall the supervision of intermediaries is adequate, it is important that the authorities continually consider measures to increase the number of on-site inspections and refine their risk-based approach.

4. Use of enforcement powers in connection with criminal offenses remains a second key challenge. In spite of several efforts to improve criminal enforcement, including efforts by the provincial regulators to engage with the criminal authorities, results in this area are mixed and are visible in only in some of the largest provinces. While the challenges are partially mitigated by the increased use of quasi-criminal powers by the securities regulators, the fact remains that, cases involving the most egregious conduct, such as boiler rooms, major frauds and repeat offenders should be prosecuted by the criminal authorities, and that the investigation and prosecution of certain of these cases requires the use of exceptional powers only available to the criminal authorities. The SROs have taken important steps to ensure that they have in place strong enforcement strategies, in particular in connection with compliance reviews. It is important that such efforts continue.

5. Finally, the securities regulators should continue to take steps to ensure timely decision making in policy formulation. By its own nature policy making requires time to allow for consultation so that the impact of policy proposals can be evaluated and incorporated. However, the current governance arrangements, based on a consensus building approach across several entities, might affect timeliness of decision making.

INTRODUCTION AND SCOPE

6. A targeted assessment of the Canadian Securities Market was conducted June 3–28, 2013, as part of the Financial Sector Assessment Program by Ana Carvajal, Monetary and Capital Markets Department. A full assessment was conducted in 2007 based on the methodology approved by IOSCO in 2003. As a result Canada met the minimum threshold for a targeted assessment. Based on the due diligence² conducted the assessment covered principles 1, 2, 3, 6, 7, 8, 9, 12, 19, 20, 22, 23, 24, 28, 29, 30, 31, 32, 34, and 35 in their entirety while principles 25 and 37 were partially reassessed³. Nothing in the due diligence suggested the need to reassess the remaining principles. The guidance for targeted assessments requires the assessor to carry over the description of the principles that have not been assessed in order to provide a complete view.

7. Such due diligence took into consideration (i) risks and vulnerabilities of the securities markets in Canada, (ii) regulatory developments that have taken place in Canada since 2007, (iii) areas where deficiencies were found in 2007, (iv) new areas of emphasis in the new IOSCO Principles and Methodology,⁴ and (v) the lessons from the crisis, both in terms of areas that require deeper attention as well as in regard to the need for assessors to take a more critical look at both the regulations in place to determine whether they are adequately capturing the risks of the system, and the intensity of supervision and enforcement, to determine the extent to which the regulatory framework is being implemented in practice. Information and Methodology Used for the Assessment.

8. The assessment was conducted based on the IOSCO Principles and Objectives of Securities Regulation approved in 2010 and its Methodology adopted in 2011. Principle 38 is not assessed as this Principle now is covered under the Principles for Financial Market Infrastructure; as a result issues related to CDCC as an SRO are not covered in this assessment.

9. The recent global financial crisis has reinforced the need for assessments to be more critical, both in terms of the robustness of regulation as well as the intensity of supervision. On the regulatory side, assessors are been required to look more closely at the extent to which

² The regulatory authorities provided two supporting documents: (i) a report on major regulatory developments that occurred after the 2007 assessment, and (ii) a principle by principle matrix with their views on whether the corresponding principle required reassessment or not, and the rationale for their views. In addition, the assessor conducted independent research on potential areas of concern based on publicly available information, and held discussions with the authorities. Based on this due diligence a proposal of scope was submitted by the mission to the authorities, who accepted it.

³ Initially principles 1, 2, 3, 29, 30, 31, 32 and 35 were selected for partial reassessment; however in practice the scope of the issues selected led to a full reassessment as all the issues included in the methodology were analyzed. The assessment of principle 25 focused on custody requirements; while the assessment of principle 37 focused on failed settlements and shortselling.

⁴ The most significant change brought by the revision of the Principles and methodology adopted in 2010–2011 was the addition of eight new principles, while overall the existing principles remained unchanged—although in a few cases additional questions were added to the methodology. In addition, the existing principle 16 was split into two principles (now principles 18 and 21).

regulations in place adequately capture the risk undertaken by different participants. On the supervisory side, assessors are required to look more deeply into the licensing process, the off-site monitoring and onsite inspection programs as well as how the supervisor follows-up on findings, including the use of enforcement actions, to make an informed judgment on the overall quality of supervision. In jurisdictions that rely extensively on SROs such critical analysis has also applied to them. In many jurisdictions this enhanced approach has had an impact on grades. In addition, experience has been gained in connection with principles 6 and 7 which allows assessors to delve deeper into the analysis of the processes in place to identify emerging and systemic risk. Furthermore through the Assessment Committee, IOSCO itself is developing further guidance to assess these Principles.

10. The assessment largely relies on an analysis of the regulatory framework and supervisory practices of the four largest provinces (Ontario, Québec, British Columbia and Alberta) to draw inferences on the level of implementation of the Principles for the country as a whole, given the challenge of assessing 13 frameworks. As will be further explained below, securities regulation in Canada is under provincial regulation. Given that the legal and regulatory framework has been largely harmonized via national instruments and the fact that these four provinces comprise roughly 95 percent of the activity of the Canadian securities market; the assessor believes this to be a reasonable approach. When relevant, the assessor has made the necessary distinctions in the legal and or regulatory framework, and practices of specific regulatory agencies are mentioned to provide examples as to how a particular requirement has been implemented in practice.

11. The assessor relied on (i) a self-assessment and a report on market data, which were prepared by the OSC, AMF, BCSC and ASC; (ii) the review of relevant national instruments, laws, regulations, and other documents provided by the regulatory agencies including registration, inspection and enforcement files; (iii) meetings with the chairs of the OSC and the ASC, the president of the AMF, and the executive director of the BCSC and staff of the OSC, AMF and BCSC, and other public authorities, in particular representatives of Finance Canada; as well as (iv) meetings with SROs (IIROC, MFDA, CSF, MX); CIPF; market participants including securities firms, market operators (both exchanges and ATSS), auditing firms, credit rating agencies and law firms.

12. The assessor wants to thank staff of the OSC, AMF, BCSC, ASC and CSA Secretariat for their full cooperation as well as their willingness to engage in very candid conversations regarding the regulatory and supervisory framework in their provinces. The assessor also wants to extend her appreciation to all other public authorities and market participants with whom she met.

DESCRIPTION OF REGULATORY STRUCTURE AND PRACTICES

13. Securities markets in Canada are under a system of provincial regulation and supervision. As a result there are 13 regulatory authorities each one administering a separate set of securities laws and regulations. Overall securities legislation in all the provinces and territories have the same underlying objectives—the protection of investors and ensuring fair, efficient capital markets—and the regulatory authorities share the same core responsibilities. However, actual regulations developed by each province to address these core set of goals and responsibilities can differ. As a result, the specific powers of the authorities can differ (although a set of basic powers is available to all of them), and in a few instances, the specific requirements for a particular category of market participants can differ (although as will be explained below there is currently a high degree of harmonization).

14. The nature, structure, resources and powers of the provincial regulators vary. The assessor was informed that in particular in the smallest provinces the regulator might still be part of the government, funded by it and with limited resources. That is not the case for the four largest provinces—Alberta, British Columbia, Ontario and Québec—which roughly supervise 95 percent of the market. These regulatory agencies are operationally independent and fully self-funded by levies imposed on market participants. They have comprehensive powers, including rulemaking, registration, recognition, designation, supervision and enforcement authority—not only administrative but also quasi-criminal authority. In the case of the AMF, the adjudication of administrative cases is carried out through an independent tribunal, the Bureau de Décision et de Révision (BDR).

15. Under the umbrella of the CSA, provincial regulators are seeking to harmonize laws and regulations and coordinate their supervisory and enforcement activities. The CSA is a non-statutory association that brings together all Canadian securities regulatory authorities with the objective of improving regulation and supervision of Canadian securities markets. A Secretariat, located in Montreal, was established in 2004. The Secretariat currently has 6 staff in charge of providing logistical support to the CSA committees and managing national databases in the area of securities markets.

16. The CSA has undertaken several initiatives to harmonize securities regulation via the adoption of national (and a few multilateral) instruments. There are currently 40 national instruments and multilateral instruments, covering a wide variety of areas including issuers, CIS, market places and registrants. As confirmed by the authorities and market participants, most aspects of securities regulation have been harmonized. However, there are a few important differences that remain in connection with the enabling legislation for derivatives, certain prospectus exemptions, registration exemptions for EMDs in the northwest jurisdictions, and registration of non-resident Investment Fund Managers (IFMs), as will be explained in the assessment.

17. On the supervisory front, different initiatives have been implemented to eliminate duplication and ensure coordination. In particular, a passport system has been implemented for issuers, CIS, securities intermediaries and credit rating agencies. Under the passport system a decision to issue a receipt or a registration/designation decision taken by the principal regulator (usually the regulator of the province where the issuer/CIS/securities firm/CRA is domiciled) is automatically extended to the other provinces. Ontario has not joined the passport system; however the provinces created an interface, whereby decisions taken by the OSC as the principal regulator are automatically extended in the rest of the provinces. In cases where Ontario is not the principal regulator, the principal regulator acts as the liaison with the issuer/CIS/securities intermediary/CRA so that vis-à-vis the participant the system works as a single “window”. The principal regulator approach also applies to on-going supervision, including review of periodic filings and on-site inspections. The provincial regulators have also worked on the development of a coordinated approach for SROs. In the case of IIROC and MFDA coordination is based on a principal regulator approach, whereby one regulator acts as coordinator of actions on behalf of all regulators; and in the case of the exchanges is based on a lead regulator approach, whereby one regulator recognizes the exchange, while the others grant exemptions. In the area of enforcement, regulators have made use of joint investigations, joint adjudications and reciprocal orders to coordinate their actions. Finally, a system of committees serves as a forum to coordinate and discuss topics, including on novel issues, and to set up national priorities.

18. Provincial regulators rely largely on self-regulatory organizations (SROs) for the regulation and supervision of the market and its participants. The regulation and supervision of investment dealers and market surveillance of all equity markets is under the Investment Industry Regulatory Organization of Canada (IIROC), the regulation and supervision of mutual fund dealers except in Québec is under the Mutual Fund Dealers Association of Canada (MFDA), mutual fund dealers in Québec are under the supervision of the AMF and the discipline and education of individuals who act on behalf of mutual fund dealers in Québec is a responsibility of the Chambre de la Sécurité Financière (CSF), and all other non-equity exchanges are primarily responsible for market surveillance, including MX and NGX for derivatives markets.

19. A recent decision of the Supreme Court of Canada ratified the provincial nature of securities regulation but recognized a role for the federal government on “matters of genuine national importance and scope going to trade as a whole in a way that is distinct from provincial concerns, including management of systemic risk and national data collection.”⁵

⁵ The decision related to the constitutionality of the federal government’s proposed Securities Act, which sought to create a federal regime for securities regulation in Canada. The Supreme Court ruled that the proposed Act was beyond the federal government’s powers and therefore unconstitutional. However it noted that “specific aspects of the Act aimed at addressing matters of genuine national importance and scope going to trade as a whole in a way that is distinct from provincial concerns, including management of systemic risk and national data collection, appear to be related to the general trade and commerce power. With respect to these aspects of the Act, the provinces, acting alone or in concert, lack the constitutional capacity to sustain a viable national scheme [...]” Reference Re Securities Act, 2011 SCC 66, [2011]3,

MARKET STRUCTURE⁶

A. Markets

Equity exchanges

20. The total market capitalization of the Canadian equity market at the end of 2012 was nearly \$2.2 trillion, or about 121 percent of GDP. There are four equity exchanges in Canada: TSX, TSXV, Canadian National Stock Exchange (CNSX), and Alpha Exchange Inc. (Alpha).⁷

21. The TSX and TSXV, owned and operated by the TMX Group have a combined market capitalization of \$2.18 trillion and over 3,800 listed companies, making the TMX Group the eighth largest exchange group worldwide by market capitalization. The TSX, with 1,567 listed companies, is the senior equities market, representing approximately 98 percent of the total aggregate Canadian market capitalization. The majority of the largest companies listed on the TSX operate in the financial sector or extractive industries. The TSXV, with 2,257 listed companies, is the junior equities market and public venture capital marketplace for emerging companies. Approximately 57 percent of listed companies on the TSXV operate in the mining sector.

22. CNSX is an alternative stock exchange for smaller issuers that offers simplified disclosure requirements and a market structure tailored for micro-cap and emerging companies that do not have the financial resources to list on other major exchanges. At the end of 2012, total market capitalization of equity listings was \$1.18 billion with 189 listed companies. CNSX also operates Pure Trading, a facility which provides an alternative marketplace for the trading of securities listed on recognized Canadian stock exchanges other than CNSX.

Debt markets

23. The major components of the Canadian bond market are the market for Government of Canada bonds, Canada Mortgage Bonds, provincial bonds and corporate bonds. The nominal value of total bonds outstanding at year-end 2011 amounted to just under \$2.2 trillion (approximately 122 percent of GDP, both in local and foreign currency). Of those, corporate bonds amounted to \$631 billion, of which a little more than 50 percent was issued by non-financial corporations.

24. The amount of corporate bonds issued in Canada has continued to increase since 2008, while the issuance of money market instruments, such as commercial paper and bankers' acceptances, declined following the financial crisis up until 2010. In 2011 and 2012, net issuance of both commercial paper and bankers' acceptances showed signs of recovery. Canadian chartered

⁶ All data in this section is drawn from the report on market data provided by the securities regulators.

⁷ Alpha Exchange, formerly Alpha ATS, was recognized as an exchange in April 2012. However it does not presently list issuers' securities for trading.

banks are major investors in CAD-denominated bonds, with these instruments representing approximately 40 percent of their total assets.

Derivatives markets

25. The MX is Canada's financial derivatives exchange, listing equity, currency, index and interest rate derivatives. The over-the-counter (OTC) derivatives market is concentrated amongst the big six Canadian banks and the majority of transactions involving Canadian market participants are entered into with foreign counterparties. Globally, Canada accounts for US\$18 trillion in OTC derivatives, or approximately 2.8 percent of the global market in 2012, with interest rate swaps and foreign exchange contracts being the dominant products.

26. The Natural Gas Exchange (NGX) is Canada's largest energy exchange based in Calgary. It provides electronic trading, central counterparty clearing and data services to the North American natural gas, crude oil and electricity markets. NGX offers physical spot and forward natural gas and crude oil contracts deliverable in Canada and the U.S., and financial natural gas and electricity derivatives contracts.

27. Intercontinental Exchange (ICE) Futures Canada is Canada's agricultural exchange. It was established in 1887 as the Winnipeg Grains and Produce Exchange and has been facilitating futures contract trading since 1904. ICE Futures Canada offers futures and options contracts for the global benchmark Canola contract.

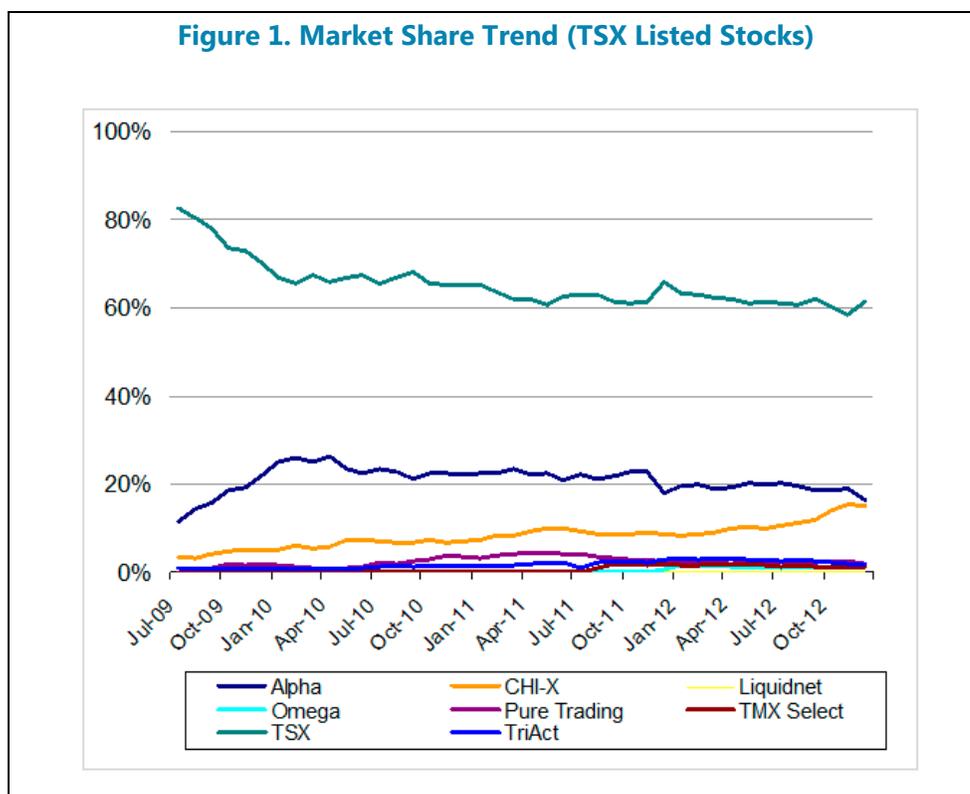
ATS

28. There are currently seven ATS trading in equity securities in Canada. There are also three ATS trading debt securities; however, most of the debt trading is done over the counter. There is also one securities lending ATS.

Table 1. ATS

Equity ATS	Debt ATS	Securities Lending ATS
Bloomberg Tradebook Canada	CanDeal	Equilend Canada Group
Chi-X Canada / CX2 Canada	CBID	
Instinet Canada Cross (ICX)	MarketAxess	
Liquidnet Canada		
MATCH Now (operated by TriAct)		
Omega ATS		
TMX Select		

29. ATS have grown in number and significantly increased their share of trading volume in the last decade. The chart below shows the relative market share of ATSs, as measured by trading volume, for TSX listed stocks.



30. Dark pools operate as ATS. Currently Liquidnet, Matchnow, Instinet and IntraSpread—Dark pool activity reached a high of 5.67 percent of volume traded in September 2012 before declining sharply, down to 1.73 percent as of December 2012. This decline has been attributed to regulatory changes that mandate a minimum level of price improvement for dark trades and give priority to lit orders over dark orders, at the same price on the same market place.

B. CIS

31. Canadian investors access the market through a diverse range of product channels, but continue to favor financial advice over making self-directed investment decisions. At the end of 2011, 91 percent of investment fund assets were acquired and held by investors through distribution channels involving the intermediation of an advisor.

32. Mutual funds remain a popular investment vehicle for Canadians, accounting for about 27 percent of total financial wealth in Canada. As of December 2012, the mutual fund industry had assets under management of \$849.7 billion, surpassing pre-downturn highs. Since February 2009, the low point for industry assets during the crisis, mutual fund assets have increased by \$298.8 billion or 54 percent. Total mutual fund net sales for 2012 were \$30.4 billion, up from

\$21.2 billion in 2011. In addition, annual long-term fund sales in 2012 were the highest they have been since 1997.

33. In reaction to the GFC, the fund industry has seen a shift from equity funds to balanced and fixed income funds. Money market funds have also experienced a decline of assets, as a reaction of investors to lower yields paid by MMFs relative to their alternatives such as high interest savings accounts.

Table 2. Fund Type by AUM (CAD millions)

	Dec-06	Dec-11
Money Market	47,711	37,374
Fixed Income	100,045	202,296
Balanced	130,950	159,497
Equity	435,311	401,362
Other	3,969	5,133
Total	717,986	805,662

ETFs

34. While still small, ETFs have grown markedly in recent years. They reached a quoted market value on the TSX of \$56.4 billion from 265 funds listed in 2012, up from \$19.4 billion from 77 funds in 2008. At the end of 2012, ETFs accounted for 6 percent of total investment fund and managed fund assets. As of December 2012, in Canada, the assets of leveraged and inverse ETFs constituted approximately 2.5 percent of all ETF assets. As of December 2012, synthetic ETFs held approximately 5 percent and physical replication ETFs held 95 percent of total ETF assets under management. At September 2012, approximately 58 percent of Canadian-listed ETF assets were held by retail investors, with the difference accounted for by institutional clients. In addition to Canadian listed ETFs, Canadian retail investors also held \$10.1 billion in U.S. listed ETFs which represented 16 percent of all ETF investment by Canadians at September 2012.

Hedge funds

35. The Canadian hedge fund industry is relatively small. Canadian hedge fund assets were estimated at \$31 billion, or about 2 percent of the global hedge fund industry, which was estimated to be about \$2.6 trillion in 2012. In 2012, there were 275 hedge funds in Canada, which also includes funds of funds. As compared to mutual funds, HFs are only about 4 percent of the total size of mutual funds in Canada. Individual Canadian hedge funds also tend to be small, with more than 80 percent of all hedge funds having less than \$100 million in assets under management. The hedge fund industry is concentrated within a few firms.

C. Intermediaries

36. Canada has a system of specialized securities intermediaries. As a result banks and insurance companies that want to provide securities markets services must do it through a subsidiary. There are three main categories: dealers, advisers and investment fund managers (IFMs). Within the dealer category there are five subcategories: investment dealers (IDs), mutual fund dealers (MFDs), scholarship plans dealers, exempted market dealers and restricted dealers. IDs and MFDs must be members respectively of IIROC and MFDA, except mutual fund dealers in Québec which are subject to the oversight of the AMF.

As of December 2012, there were 1,498 active firms registered to carry out investment activities in Canada, of which 1,365 were headquartered in Canada. There are 202 registered firms that are IIROC members and another 119 are MFDA members. The remaining registrants are directly overseen by the securities regulators. Out of such number 543 were IFMs.

37. Some of the largest securities firms are subsidiaries of major Canadian banks. Further, through their subsidiaries the six major banks play an important role in securities markets. Below is some data on the importance of bank-subsidiaries.

- The six bank-owned dealers accounted for 93 percent of the revenue in Ontario of the top 10 firms.
- As of December 2012, the six bank-owned dealers accounted approximately for 80 percent of all trading volume.
- Canadian bank-owned asset management subsidiaries exercise control of 60 percent of AUM of the top 10 asset management firms and 27 percent of the sector's total AUM.
- The subsidiaries of the six Canadian banks accounted for 92 percent of the total number of sales representatives of IDs and 64 percent of the sales representatives for MFDs.⁸

GENERAL PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION

38. The assessment conducted in 2007 included the following findings in regard to preconditions: ***“There are a number of general preconditions necessary for the effective regulation of securities markets that appear to be in place in Canada. Those preconditions relate to sound macroeconomic policies, appropriate legal, tax and accounting frameworks, and the absence of entry barriers to the market.”*** Preconditions were not reassessed during this assessment. The assessor notes, however, the existence of modern contract and company law at the provincial level.

⁸ This indicator is used as a proxy of number of clients' accounts.

Accounting and auditing standards are of high international quality; further IFRS have been implemented for issuers that offer securities to the public and auditors have to comply with the International Auditing Standards. There is in place a system of oversight of the auditing profession. There are alternative dispute resolution mechanisms and an impartial judiciary.

MAIN FINDINGS

39. Principles related to the regulator—Current governance arrangements in the four regulatory agencies provide them a high degree of independence from the government, while at the same time subject them to strong accountability. The existence of part-time commissioners can pose conflict of interest, which are mitigated by the selection process established in the provinces and on an ongoing basis by the obligation of members to recuse themselves on decisions where they face conflicts. Under the umbrella of the CSA the provincial regulators have made significant progress in coordination and in ensuring a level playing field; however a few challenges remain. They have also made significant progress in the development of arrangements for the identification of emerging and systemic risk, although the availability of data and use of quantitative analysis is currently a challenge. Finally the regulators are aware of key conflicts of interest prevailing in the market, and are currently reviewing the sets of actions needed to address them. **Carry from the 2007 assessment:** *“They are subject to a high degree of transparency, including public consultation on regulations and published policy statements. At the same time, they abide by high standards of ethics that have been codified into an ethics code, with certain reporting obligations. They are active on investor education”.*

40. Principles for SROs—SROs are subject to recognition based on eligibility criteria that among others address issues of financial viability, capacity to carry out their functions, governance, and fair access. Supervision is based on a set of mechanisms that include off-site reporting, on-site inspections, as well as regular meetings and close contact with SRO staff to discuss ongoing issues. There has been a significant evolution on governance arrangements in all SROs; but some challenges remain vis-à-vis conflict of interest.

41. Principles for enforcement—Canada has established a credible system for the supervision of the market and its participants in which SROs play a significant role. Current arrangements include both offsite monitoring and on-site inspections. While overall the regulatory agencies have in place an adequate risk-based approach to on-site inspections, in the agencies with the largest populations such risk based approach has resulted in a more focused use of on-site inspections. Enforcement by the regulatory agencies has experienced significant progress in recent years and is currently robust. The SROs are taking important steps to ensure timely response of firms to the deficiencies found in their compliance reviews (MFDA) and to strengthen the nexus between their compliance reviews and their enforcement activity (IIROC). Material challenges remain in connection with enforcement of criminal laws by government departments and law enforcement agencies.

42. Principles for cooperation—**Carry from the 2007 assessment:** *“The largest regulatory agencies have explicit and comprehensive powers to share information with both local and domestic*

authorities and can do so without the need of any external approval. The four largest jurisdictions are signatories of the IOSCO Multilateral Memorandum of Understanding (MMoU). They have the power to obtain information that is not in their files on behalf of foreign regulators. They have shown clear a commitment to exchange information and assist other regulatory agencies both domestically and internationally”.

43. Principles for issuers—Carry from a 2007 assessment: *“Issuers are subject to disclosure obligations at the moment of authorization and on an ongoing basis, fully in line with IOSCO standards. The regulatory agencies have developed a system for review of the prospectus as well as continuous disclosure obligations. Liability provisions are in place to ensure issuers’ responsibility for the prospectus”.*

44. Principles for CIS—CIS operators are subject to registration based on fit and proper requirements. While requirements have been harmonized, the process to review applications varies in important ways across provinces. Current arrangements for the supervision of intermediaries—which include both off site monitoring as well as on-site inspections—are adequate; however the use of a risk-based approach has resulted in a more focused use of onsite inspections, particularly for the agencies with the largest populations. Hedge Fund managers are subject to the same regulatory regime than other CIS operators. All CIS that are offered to the public are required to have a custodian. Although custody can be provided by a related party, additional safeguards are in place, including the requirement that custodians are themselves regulated entities, the existence of the IRC, and disclosure to investors. **Carry from the 2007 assessment:** *“Public offerings of CIS are subject to disclosure requirements at the moment of authorization and on an ongoing basis, fully in line with IOSCO principles. There are rules in place on separation of assets”.*

45. Principles for market intermediaries—Market intermediaries are subject to registration based on fit and proper requirements. While requirements have been harmonized, the process to review applications varies in important ways across provinces. Overall requirements are robust, however prudential requirements for investment dealers need to better capture the risks associated with the use of un-invested moneys of clients. Current arrangements for the supervision of intermediaries include both off site monitoring as well as on-site inspections. These arrangements are adequate; however the use of a risk-based approach has resulted in a more focused use of onsite inspections, particularly for the agencies with the largest populations. There are early warning systems in place; however there is a need to improve coordination arrangements in the event of a failure of large investment dealers.

46. Principles for secondary markets—Carry from the 2007 assessment: *“The operation of an exchange is subject to an authorization regime based on eligibility criteria that include financial viability, capacity, governance, and fair access. Alternative Trading Systems (ATS) are regulated as dealers subject to certain market requirements; however the framework allows the regulatory agencies to regulate them as exchanges once they reach a certain threshold. There are plans to deal with market disruptions, although in one of the agencies these should be further developed [...]. The two main clearing entities, one for securities and the other for derivatives, have developed reasonable mechanisms to manage large exposures including selection criteria for clearing members, margins and*

collateral". There are robust mechanisms in place for market surveillance. Exchanges and ATS are subject to pre-trade and post-trade transparency provisions. Dark orders are allowed; but the current framework incentivizes transparency. Arrangements to minimize failed settlements are reasonable, and there are robust reporting requirements in connection with shortselling.

Table 3. Summary Implementation of the IOSCO Principles—Detailed Assessments

"Only principles 1,2,3,6,7,8,9,12,19,20,22,23,24,28,29,30,31,32,34,and 35 have been fully assessed, while principles 25 and 37 were partially reassessed. The summary of key findings for principles 4, 5, 10, 11, 13, 14, 15, 16, 17, 18, 22, 26, 27, 33, 36, and partially from principle 25 and 37 has been carried over from the assessment conducted in 2007 in order to provide a complete view."

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	BI	Securities markets are regulated and supervised at the provincial level. The responsibilities and mandate of the four regulatory agencies analyzed are clearly established by law. There is a high degree of harmonization of the regulatory framework for securities markets; although a few important differences remain. Different arrangements have been put in place to foster coordination among the provinces (such as the committee system of the CSA) and streamline processes and procedures (such as the passport system for issuers, CIS registrants and CRAs) and to achieve convergence in supervisory practices across the provinces (such as the development of templates, manuals, and training), though there are particular areas where differences in supervisory approaches exist. <i>Vis-à-vis</i> the SROs' supervision, several coordination mechanisms have been put in place. All such arrangements should continue to be strengthened to ensure that a "full" view of risks is developed. There are also coordination mechanisms with other financial authorities, via the HoA; however there is a need to deepen such arrangements including in connection with crisis management.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	BI	The four regulatory agencies work under a robust framework of independence from the government, both operational and financial. At the same time there are mechanisms for accountability to the Government via the MoF, and decisions of the regulatory agencies are also subject to judicial review. The existence of part time members on the boards of the agencies that have a commission structure, and in particular the possibility currently allowed by the legal framework that they can be

		<p>directors of issuers and registrants poses concerns vis-à-vis commercial interests. In practice, such concerns are mitigated by the selection processes in place in the respective jurisdictions, which looks at skills, integrity and confidentiality issues and the existence and application of strong conflict of interest rules which require members to recuse themselves from decisions where they face a conflict. In practice the effects of the recusal range from abstaining from voting in a decision, where the conflict is more remote to not receiving any document nor participating at all in the decision, where the conflict is more direct.</p>
<p>Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.</p>	FI	<p>The four regulatory agencies have robust powers to regulate and supervise the markets, including rulemaking authority, registration, recognition and designation authority, power to request information, and conduct on-site inspections and the power to impose administrative sanctions and to pursue quasi-criminal offenses. Resources in the four agencies have increased over time to respond to market growth and the growing regulatory perimeter. The agencies should continue their efforts to recruit staff with specialized expertise.</p>
<p>Principle 4. The Regulator should adopt clear and consistent regulatory processes.</p>	FI	<p>Carry from the 2007 assessment</p> <p><i>The regulatory agencies are subject to a high degree of transparency including public consultation regarding regulations and policy statements. They are active on investor education.</i></p>
<p>Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.</p>	FI	<p>Carry from the 2007 assessment</p> <p><i>The regulatory agencies have developed codes of ethics. Reporting obligations on investment activities are in place as well as mechanisms to monitor compliance.</i></p>
<p>Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.</p>	BI	<p>The securities regulators have developed a definition of systemic risk, and a methodology to identify and monitor such risks. There are also mechanisms in place for accountability, including follow up and periodic reporting on progress. However the analysis is still mostly qualitative, and data availability is currently a challenge. The HoA has served as a forum to engage in systemic risk discussions; however there is a need to deepen such coordination, in particular in</p>

		connection with crisis management.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	BI	The Committee system of the CSA is the main mechanism to identify emerging risks; and their work is supported by internal arrangements within the provincial regulatory agencies—some of which have established emerging risk committees. However, the analysis is currently mainly qualitative, and data availability is a challenge.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	FI	Several areas have been identified where important conflict of interest exist, including trailing commissions. The authorities are currently analyzing regulatory actions.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	BI	Canada makes extensive use of SROs both for the supervision of securities intermediaries (investment dealers and mutual fund dealers and their representatives), as well as for market surveillance. SROs are subject to a strong framework of oversight, starting with the recognition process, and including approval of their rules, periodic reporting and on-site inspections. However, a few challenges remain in connection with their governance structures vis-à-vis their ability to manage conflict of interest.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	FI	Carry from the 2007 assessment <i>The regulatory agencies have broad investigative and surveillance powers over regulated entities. In particular, they can conduct on-site inspections, including of books and records without prior notice; obtain books and records and request data or information without the need for a judicial action; and supervise exchanges and regulated trading systems.</i>
Principle 11. The Regulator should have comprehensive enforcement powers.	FI	Carry from the 2007 assessment <i>The regulatory agencies have broad enforcement powers. These include the power to seek injunctions; bring an application for civil proceedings; order the suspension of trading and the freezing of assets; compel information,</i>

		<i>documents, records and testimony from third parties (non-regulated entities) in the course of their investigations; impose administrative sanctions; seek quasi criminal actions; and refer matters to the criminal authorities.</i>
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	BI	Intermediaries are subject to both off site monitoring and on-site inspections. The on-site inspection programs developed by the securities regulatory agencies and the SROs follow a risk-based approach. This approach has resulted in a more focused use of on-site inspections by the regulatory agencies with the largest populations. Enforcement by the four provincial regulators analyzed has significantly improved over time and is currently robust. The SROs are taking important steps to ensure timely response by firms to their compliance reports (MFDA) as well as to strengthen the nexus between compliance reviews and the enforcement function (IIROC). Important challenges remain in connection with enforcement by the criminal enforcement authorities. Although, the regulatory agencies have enhanced coordination and taken concrete steps to get the criminal authorities more engaged, the results are mixed, with progress being achieved only in some of the largest jurisdictions.
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	FI	Carry from the 2007 assessment <i>The regulatory agencies have broad authority to share information with both domestic and foreign regulators and have done so even in cases where no memorandum of understanding (MoU) was in place.</i>
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	FI	Carry from the 2007 assessment <i>The four largest regulatory agencies are signatories of the IOSCO MMoU. They also have bilateral MoUs, including a MoU with the U.S. Securities Exchange Commission and the U.S. Commodity Futures Trading Commission.</i>
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and	FI	Carry from the 2007 assessment <i>The regulatory agencies have authority to assist foreign regulators in obtaining information that is not in their files.</i>

exercise of their powers.		
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	FI	Carry from the 2007 assessment <i>Issuers are subject to disclosure requirements at the moment of authorization and on an ongoing basis.</i>
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	FI	Carry from the 2007 assessment <i>The framework for corporations addresses issues of shareholders' rights, including notice of meetings; and special majorities for the approval of major changes. A mandatory tender offer is required for the acquisition of control of a listed company.</i>
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	FI	Carry from the 2007 assessment <i>Issuers are required to submit financial information in accordance with Canadian Generally Accepted Accounting Principles (GAAPs). Audits have to be conducted in accordance with Canadian Accounting Standards (Canadian AS).</i>
Principle 19. Auditors should be subject to adequate levels of oversight.	BI	Auditing firms of reporting issuers are subject to the oversight of CPAB, which is a body independent from the audit profession. CPAB has put in place a robust plan of on-site inspections. CPAB mainly uses recommendations—which implementation is mandatory—to address deficiencies found, and currently it cannot impose fines.. In addition, there are limitations on the level of transparency that CPAB can give to its enforcement decisions, which can impact their deterrent effect. There are also limitations in the information that CPAB can share with audit committees, and the regulatory agencies. Finally, not all provincial statutes provide CPAB with legal protection and non-compellability.
Principle 20. Auditors should be independent of the issuing entity that they audit.	FI	The codes of conduct of the provincial accounting bodies, to which all auditors must abide, contain robust provisions on independence. There are several mechanisms in place to monitor compliance with independence requirements, starting at the firm level, and including the audit committees for reporting issuers (i.e. issuers of public offering), and

		CPAB's reviews.
Principle 21. Audit standards should be of a high and internationally acceptable quality.	FI	Carry from the 2007 assessment <i>Issuers are required to submit financial information in accordance with Canadian Generally Accepted Accounting Principles (GAAPs). Audits have to be conducted in accordance with Canadian Accounting Standards (Canadian AS).</i>
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	BI	There is a designation process in place for credit rating agencies who wish to have their ratings used for regulatory purposes. The requirements for designation are built around the IOSCO Code of Conduct. The designation process followed by the principal regulator was robust. However, a system of on-site inspections is not yet in place.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	FI	Sell side analysts and more generally investment dealers are subject to robust conflict of interest rules in connection with research, which were developed by IIROC. In addition, technical reports for mining issuers and valuations of certain type of transactions concerning issuers are also subject to a framework aimed at addressing potential conflict of interest, including the need that they be prepared by qualified professionals.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.	BI	Operators of CIS (IFMs) as well as their distributors and advisers are subject to registration. Registration requirements are robust. In the case of shareholders and directors the system does not require explicitly that they be fit and proper; however information on integrity, solvency and proficiency must be provided by them at the moment of registration and on an ongoing basis and the regulators can seek substantively similar outcomes by way of denying registration of the firm, imposing conditions or even suspending the firm if they believe that the lack of qualifications of a shareholder or director may cause harm to investors. The registration process has important differences across provinces, as in some provinces the review of internal controls and risk management is left to a later stage through the on-site inspection program. IFMs are subject to off-site monitoring and on-site inspections. On-

		<p>site inspection programs are developed based on a risk based assessment by the regulators. While adequate, the current approach has resulted in a more focused use of on-site inspections in the provinces with the largest populations.</p>
<p>Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	FI	<p>Partially carry from the 2007 assessment</p> <p><i>The legal form and structure of CIS have to be disclosed in the prospectus, along with investors' rights. There are provisions on separation of assets.</i></p> <p>Aspects reassessed in 2013</p> <p>CIS that are offered to the public must have a custodian, which can only be a bank or a trust company. Custody by a related party is not prohibited however there are safeguards in place to mitigate the potential conflict, including the fact that custodians are themselves regulated entities, the obligation of all CIS to have an IRC which must review all transactions involving conflict of interest, and disclosure to investors.</p>
<p>Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>	FI	<p>Carry from the 2007 assessment</p> <p><i>CIS are subject to disclosure obligations at the moment of authorization and on an ongoing basis. The regulatory agencies have developed a system to review prospectuses. A continuous obligations review system has been implemented recently.</i></p>
<p>Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.</p>	FI	<p>Carry from the 2007 assessment</p> <p><i>CIS are required to value their portfolios at fair value. There are rules for disclosure of prices, subscription and redemption, and best practice regarding pricing errors</i></p>
<p>Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.</p>	FI	<p>Operators of HFs are subject to registration, as any other category of IFM. HFs themselves are not subject to registration. The agencies have sufficient powers to require information from IFMs of HFs and to share it both domestically and internationally. IFMs of HFs are subject to</p>

		the general supervision program of the securities regulatory agencies, which includes off site monitoring and on-site inspections. In addition, the agencies have conducted thematic reviews on the HFs themselves.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	BI	Firms that provide investment services are required to register. Registration requirements are based on fit and proper criteria. As explained in Principle 24 shareholders and directors are not explicitly required to be fit and proper, but they are required to submit information to this regard and there are remedies that the agencies can seek if the lack of fit and proper requirements of a shareholder or director can cause harm to investors. Also as explained in Principle 24 the processes for reviewing applications for firm registration varies across provinces.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	BI	Capital requirements for all types of intermediaries are based on a net capital formula, although differences exist mainly due to the differences in activities that each category is authorized to conduct. However, a unique feature of the Canadian system is that investment dealers are allowed to use un-invested cash from clients, which arguably constitute deposits. The use of such funds is subject to certain prudential requirements, some of them already imbedded in the capital formula, as well as additional provisions including a leverage ratio, and the fact that IDs must contribute to a compensation fund. The analysis conducted as a result of MF Global insolvency shows the need to strengthen such prudential requirements so that they adequately capture the risks of such "authorization" and therefore ensure adequate investor protection as well as smooth winding down of an ID.
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the	BI	Securities intermediaries are required to have in place a system of compliance that covers both internal controls and risk management and compliance with laws and regulations. The firms are also required to have in place appropriate policies and procedures to deal with conflicts of interest. In practice, the sole proprietorship feature of the bulk of securities firms may pose challenges to the implementation of robust internal controls and risk management. There are appropriate rules on fair dealing, segregation, know your customer and suitability, and customer information.

intermediary accepts primary responsibility for these matters.		Intermediaries are subject to off-site monitoring and on-site inspections. The program for on-site inspections is risk based, and overall can be considered adequate. However in the provinces with the largest populations it has resulted in a more focused use of on-site inspections.
Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	BI	There are early warning systems in place for IDs and MFDs. For the rest of the intermediaries there are also basic arrangements in place that allow the regulators to monitor their solvency, including quarterly reporting and notification of capital shortfalls. Currently there is no comprehensive protocol to deal with the insolvency of securities firms; in particular a large ID; but a crisis management group was constituted recently, as a result of lessons learned from the insolvency of MF Global Canada.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	FI	Carry from the 2007 assessment <i>Exchanges are subject to an authorization regime based on eligibility criteria that include integrity, financial viability, and capacity. ATS are regulated as dealers; however the framework allows the regulatory agencies to regulate them as an exchange once they reach a certain threshold.</i>
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	FI	IIROC and the derivatives exchanges have developed robust automated systems that allow for both real time and post trade surveillance. There is a MoU between IIROC and MX that seeks to ensure collaboration in cross markets surveillance, and in practice referrals do take place. An automated system to further enhance cross market surveillance is being developed.
Principle 35. Regulation should promote transparency of trading.	FI	Equity markets are subject to robust pre-and post-trade transparency requirements, including a consolidated tape. While dark orders are allowed, current obligations imposed on them incentivize transparency. Debt markets are subject to pre and post-trade transparency that appear adequate in light of the current market structure.
Principle 36. Regulation should be designed to detect and deter	FI	Carry from the 2007 assessment

manipulation and other unfair trading practices.		<i>The Universal Market Integrity Rules (UMIR) contain provisions that prohibit market manipulation and other unfair practices. Similarly, the MX also has trading rules that cover manipulative or deceptive methods of trading. Practices that RS or MX could not pursue—such as insider trading—are in the framework of the regulatory agencies. Some also constitute criminal offenses (for example insider trading).</i>
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	FI	<p>Partially carry from the 2007 assessment</p> <p><i>The Canadian Depository for Securities Limited (CDS) and the Canadian Derivatives Clearing Corporation (CDCC) have developed mechanisms to manage large exposures, including capital requirements for clearing members, margins, collateral and caps on the transactions that can be entered for settlement.</i></p> <p>New issues assessed in 2003</p> <p>Mandatory buy in for failed settlement is not required; however rules in place provide sufficient incentive to ensure timely settlement. There are reporting obligations in place for shortselling.</p>
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	Not assessed	
Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA)		

Table 4. Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 1	<p>The securities regulators should continue to consider the differences that remain in connection with derivatives, prospectus exemptions, registration exemptions for EMDs in the northwest jurisdictions and registration of non-resident IFMs and work towards achieving further harmonization.</p> <p>The securities regulators should continue to foster convergence of supervisory practices. Consideration should be given to undertaking peer reviews on a more frequent basis as part of the toolkit.</p> <p>Coordination arrangements among the provincial regulators, and the SROs, should continue to be strengthened to ensure that a full view of risks is developed. By the same token coordination with other financial authorities should be strengthened, including crisis management, as described in Principle 32.</p> <p>The Canadian authorities and governments should work towards ensuring a level playing field between all investment products, in particular by ensuring that distribution obligations are applicable and monitored in connection with segregated funds.</p> <p>The securities regulators should continue to pursue arrangements that allow for timely decision making.</p>
Principle 2	<p>The agencies with a commission structure that have not done so should consider adopting internal policies that restrict the possibility that directors of issuers and registrants seat on the board.</p>
Principle 3	<p>The regulatory agencies should continue to hire staff with specialized expertise.</p>
Principle 6	<p>The securities regulators should continue to deepen their framework for systemic risk identification by making more use of quantitative analysis. To this end, a strategy towards data and resources should be devised.</p> <p>The securities regulators should continue to work towards ensuring a two way communication with the SROs.</p> <p>Coordination arrangements with other financial authorities should be strengthened, including crisis management, as described in Principle 32.</p>
Principle 7	<p>The securities regulators should continue to deepen their framework for emerging risk identification by making more use of quantitative analysis. At the same time, the assessor encourages the authorities to review whether the current</p>

	<p>decentralized structure to look at risks should be further strengthened, for example, by providing more structured means for accountability (as such in place for systemic risk monitoring).</p> <p>The securities regulators should continue to work towards ensuring a two way communication with the SROs. In such context they should also review whether stronger arrangements for identification of emerging risk are also needed at the SRO level.</p>
Principle 8	The securities regulators should continue to give priority to the identification of conflicts of interest. Appropriate regulatory actions should continue to be taken including in connection with the areas identified in this assessment, such as trailing fees.
Principle 9	The securities regulators should continue to focus on governance issues on their oversight of SROs.
Principle 12	<p>The securities regulators should continue to pursue efforts to build cooperative arrangements with the criminal authorities.</p> <p>The MFDA should continue its efforts to ensure timely response of firms with their compliance reviews.</p> <p>IIROC should continue its efforts to strengthen the nexus between their compliance reviews and their enforcement function.</p> <p>The securities regulators should continue to apply tools at their disposal to ensure coordination in enforcement, including via joint investigations and adjudications, as well as reciprocal orders, as necessary and appropriate.</p>
Principle 13	The 2007 assessment included the following recommendation, which was implemented by the authorities: <i>"The AMF and the Government of Québec should work together on defining an efficient procedure for the approval of MoUs". This recommendation was implemented</i> ".
Principle 16	<p>The 2007 assessment included the following recommendations, which were both implemented.</p> <p><i>"The assessor encourages the Government of Québec to give prompt approval to the new framework for derivatives markets.</i></p> <p><i>The assessor encourages all provincial regulators to expand liability to continuous disclosure obligations".</i></p>

Principle 19	<p>The use of different types of enforcement tools by CPAB should be kept under monitoring; at the same time consideration should be given to including fines as part of CPAB's toolkit, and to strengthen the transparency of disciplinary measures</p> <p>CPAB and the securities regulators should continue to work towards achieving greater sharing of information with the audit committees and the regulators.</p> <p>Changes to the legal framework of the remaining provinces should be made to ensure legal protection of CPAB staff as well as non-compellability.</p>
Principle 22	<p>The regulatory agencies should finalize the implementation of an on-site inspection program for DROs.</p>
Principle 24	<p>The regulatory agencies, in particular those with the largest population of intermediaries, should continue to monitor the efficacy of the risk-based approach with a view towards enhancing the use of on-site inspections (on individual firms and/or thematic inspections)</p> <p>The regulatory agencies should consider to explicitly require integrity and solvency requirements for shareholders and integrity, solvency and experience requirements for directors so that the regulatory authorities have an indisputable authority to refuse shareholders or directors when such requirements are not met.</p>
Principle 25	<p>The 2007 assessment included the following recommendation: <i>"The provincial regulators should require all CIS to have a custodian. Approval of the proposed National Instrument 41-101 would achieve this goal"</i>. This recommendation was implemented as all CIS that offered securities to the public are required now to have a custodian.</p> <p>Consideration should be given to extending custody requirements to all CIS.</p>
Principle 29	<p>The regulatory agencies should consider to explicitly require integrity and solvency requirements for shareholders and integrity, solvency and experience requirements for directors so that the regulatory authorities have an indisputable authority to refuse shareholders or directors when such requirements are not met.</p> <p>The regulatory authorities are encouraged to follow up on the differences in requirements of the PM and EMD categories versus the ID and MFDA categories, and determine the extent to which in light of the findings from their targeted review it is advisable that they be subject to similar requirements in connection with the SRO membership and the contribution to a contingency fund.</p> <p>The AMF should continue to work towards harmonization of the MFD category.</p>

Principle 30	The prudential framework for the use of un-invested cash from clients should be strengthened to ensure that risks are adequately captured.
Principle 31	The regulatory agencies, in particular those with the largest population of intermediaries, should continue to monitor the efficacy of the risk-based approach with a view towards enhancing the use of on-site inspections (on individual firms and/or thematic inspections).
Principle 32	<p>Crisis management arrangements should become more institutionalized, a specific protocol establishing the roles of each party should be developed and simulation exercises be included as a regular plan of the crisis management framework. In addition, given that the largest IDs are part of banking groups it is important that coordination arrangements include OSFI.</p> <p>The securities regulators should work towards implementing portability requirements.</p>
Principle 34	<p>The 2007 assessment included the following recommendation, which was implemented: <i>"The MoU between RS and MX should be finalized"</i>.</p> <p>The securities regulators should continue to give priority to the development of an automated system for cross markets surveillance.</p>
Principle 35	<p>The 2007 assessment included the following recommendation, which has not been implemented: <i>"The provincial regulators should explore whether additional transparency is needed in the government debt market"</i>.</p> <p>The authorities in coordination with IIROC should continue to review the need to establish a minimum size for dark orders.</p> <p>Consideration should be given to expanding post-trade transparency requirements in the corporate bond market. In addition the authorities should consider post trade transparency for the government bond market.</p>

A. Authorities' Response to the Assessment

47. The Canadian securities regulators participating in the FSAP (the regulators) welcome the IMF's review of the Canadian framework for the regulation and supervision of securities markets. We appreciate the significant time and effort the IMF Mission Team dedicated to complete the assessment, as well as their thoroughness and professionalism in assessing our system against the IOSCO Principles.

48. We are pleased that the IMF recognizes and concludes that "the Canadian framework for the regulation and supervision of securities markets demonstrates a high level of implementation of the IOSCO Principles." In particular, we are pleased that the IMF recognizes and concludes that in a few areas, such as enforcement, the securities regulators have powers that can be considered at the forefront of securities regulation.

49. The IMF's recommendations in its 2007 FSAP were carefully considered and we continue to develop and implement reform initiatives consistent with our G-20 commitments and with IOSCO reform initiatives, policies and standards.

50. We will carefully consider the findings and recommendations from this FSAP, and we will continue to improve our oversight and supervision of the securities markets. In fact, several of the IMF's recommendations are in line with a number of projects we have underway and help to highlight the importance of this work.

We would also like to take this opportunity to comment on certain other aspects of the assessment, as detailed below.

Additional Comments

On-site inspections

51. Over the years, the regulators have devised and implemented an on-site inspection program of regulated firms based on a comprehensive risk-based model. This approach to on-site inspections permits the regulators to efficiently and effectively supervise the conduct of regulated firms. By focusing on the firms and the areas of their operations that are considered to be the highest risk, the regulators use resources more efficiently and more effectively and are able to target problematic conduct on the part of registrants. The regulators are continuously assessing the risks posed by each regulated firm in light of all available information and reviewing the factors utilized in the risk-based model, as well as considering any other enhancements that may be made to the risk-based inspection program.

52. Given the comprehensive nature of the risk-based model, coupled with the continuous review and adjustment process, the regulators believe that the current level of on-site inspections is appropriate. As with all securities regulatory matters, the regulators will continue to assess the efficacy of the on-site inspection program and make justified adjustments as necessary.

Enforcement of criminal laws

53. We welcome the IMF's conclusion that there has been significant progress in enforcement by the provincial Canadian securities regulators. The regulators are also pleased that the IMF has recognized their increased efforts to support the enforcement of criminal laws by the relevant criminal authorities. While the broadly worded opinion in respect of the effectiveness of the criminal law branch of the Canadian justice system goes beyond the scope of an assessment of the securities sector, the regulators want to emphasize that cases involving criminal activity in the capital markets are in fact prosecuted. As part of regulating the capital markets efficiently and effectively, the securities regulators will continue to cooperate with the criminal authorities and assist them in pursuing their responsibilities to prosecute such matters

Commentary on Supreme Court of Canada reference

54. The Canadian securities regulators welcomed the opportunity to provide a comprehensive description of the Canadian securities regulatory regime as part of the IMF's FSAP assessment and rating of financial market supervision against accepted international standards. In order for such assessments to be viewed as objective, it is important for the IMF to focus on the substantive elements of the securities regulatory regime, as opposed to constitutional and political considerations as to how the responsibilities for implementing the regime have been delineated. As such, the Canadian securities regulators feel comments respecting the observations of the Supreme Court of Canada in a constitutional matter concerning securities regulation go beyond the scope of the assessment against the IOSCO Principles. In addition, the reference to the Court's decision included in the assessment is a short excerpt of a summary and does not provide the full extent and meaning of the Court's unanimous decision.

Part-time commissioners

55. As is evidenced by the IMF's assessment, the Canadian securities regulators take the risks attached to the existence of conflicts of interest seriously. We are pleased that the IMF recognized that we have comprehensive and robust policies for managing potential conflicts that work well, and that there is no evidence of interference.

56. In considering and addressing situations where conflicts of interest may arise, the regulators weigh the benefits and risks of permitting situations where a conflict may arise. In respect of the decision on the part of the OSC, BCSC and the ASC to permit, as a matter of law, the inclusion of part-time Commissioners who may be directors of an issuer or registrant, the regulators each engaged in a thoughtful analysis and ultimately decided that the automatic exclusion of otherwise qualified persons on this basis may be detrimental to the ability of those Commissions to effectively and efficiently regulate the capital markets. In respect of the OSC and ASC, the current inclusion of a small number of Commissioners who sit as directors of an issuer, coupled with strong conflicts of interest policies, provides a significant benefit to the collective ability of each Commission to engage in analysis and decision-making. We also note that our conflict management

policies and procedures are intended to capture all types of potential conflict situations, and are not specifically tied to a Commissioner's status as a director of a market participant.

Harmonization

57. As a result of much hard work on the part of the Canadian securities regulators, the Canadian securities regulatory regime is highly harmonized. The regulators recognize the benefits to the capital market of having a highly harmonized securities regulatory regime. However, each Commission has the authority to implement non-harmonized securities laws where doing so is of benefit to that jurisdiction's capital market, given the size, history and geographic realities of Canada. This is an important element and a strength of the Canadian securities regulatory regime. It permits the regulators to, in the vast majority of cases, implement harmonized securities laws while also permitting each Commission to tailor those laws, where appropriate, in order to achieve the overarching objectives of investor protection and efficiency in that capital market. The regulators will continue to ensure that highly harmonized securities laws are implemented where appropriate, but not where doing so would be to the detriment of any jurisdiction's capital market.

Direct supervision of shareholder and directors of registrants

58. The Canadian securities regulators implemented an oversight regime for registrants that includes ongoing substantive consideration of the integrity and solvency of shareholders of registrants and of the integrity, solvency and experience of directors of registrants. Such matters are given careful consideration at the time of an application for registration and while the registrant continues to be registered. As a result of the regulators' legal authority to deny registration on such grounds, and the legal authority to attach conditions to suspend or terminate such registration, the regulators already have the requisite indisputable authority over shareholders and directors of registrants.

Regulatory regime for portfolio managers and exempt market dealers

59. The regulators are mindful that there may be a perception by some market participants that an unlevel "playing field" exists. However, in promoting an efficient capital market that provides robust investor protection, the regulators have advised the IMF that we must, and do, consider the differences in permitted activities, standards of care applicable to each category, scope of operations (including custody), business model, and types of clients. Such differences will result in substantively distinct, but equally balanced and fair, regulatory requirements for the affected market participants. While the regulators do not feel that, at this time, Portfolio Managers and Exempt Market Dealers should be required to become members of an SRO or should be required to contribute to a contingency fund, they will continue to assess the appropriate regulatory requirements for such entities.

Conclusion

We wish to thank the IMF assessor, Ms. Ana Carvajal, for her professionalism, openness and availability to discuss thoroughly all aspects of this assessment.

DETAILED ASSESSMENT

60. The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles. The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and used as a basis for establishing priorities for improvements to the current regulatory scheme.

61. The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories: fully implemented, broadly implemented, partly implemented, not implemented and not applicable. The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

Table 5. Detailed Assessment of Implementation of the IOSCO Principles

Only principles 1, 2, 3, 6, 7, 8, 9, 12, 19, 20, 22, 23, 24, 28, 29, 30, 31, 32, 34, 35 have been assessed in their entirety, while Principles 25 and 37 were partially reassessed. The description, comments, and grades for principles 4, 5, 10, 11, 13, 14, 15, 16, 17, 18, 21, 26, 27, 33, and 36, and the description for principles 25 and 37 have been carried over from the most recent full assessment conducted in 2007 in order to provide a complete view. The selection of the principles that have been reassessed was done by the mission team based on an analysis of the risks and vulnerabilities of Canada, informed by the findings from previous assessments, as well as country work, bilateral, multilateral, and regional surveillance. The process followed for the identification of the principles that needed reassessment did not suggest the need to reassess other principles.

Principles Relating to the Regulator

Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>Authority</p> <p>Securities regulation in Canada is a matter of provincial and territorial jurisdiction. Each of the ten provinces and three territories has adopted a <i>Securities Act</i> that is administered and enforced by a local securities regulator. Some have also adopted specific legislation dealing with commodity futures and/or derivatives. With the exception of the AMF, the three other regulatory agencies are specialized regulators; while the AMF is an integrated regulator. In all four cases, the agencies have a legal</p>

mandate to protect investors and to foster fair and efficient capital markets.

Power to interpret laws and regulations

All four agencies have rule making powers; as well as power to issue policy. A consultation process must be followed for rules and in some jurisdictions, for policy. In addition, the agencies have the authority to issue notices. Finally they all have the power to grant exemptive relief from the requirements prescribed by laws and regulations. The four agencies, except the OSC, can grant blanket exemptive relief orders which would apply to a whole category of intermediaries. The OSC may grant exemptive relief orders that apply to a category of intermediary in certain circumstances. The Exemptive relief orders granted are available on the websites of the agencies.

Coordination across provinces

The Canadian Securities Administrators (CSA) is a non-statutory association constituted by the provincial securities regulators to foster collaboration and coordination. The CSA does not have direct regulatory or supervisory functions. However, under its umbrella the provincial regulators agree on policy and supervisory initiatives, with the overall goal of achieving harmonization in laws and regulations, and streamlining processes and procedures.

The CSA has a Chair and Vice-Chair, each of whom is elected by members for a two-year term (one renewal is permitted).

The CSA mainly works through committees composed of staff of the provincial regulators that meet periodically. Standing committees include Enforcement, Market Oversight, Registrant Regulation, Investment Funds, Compliance, Systemic Risk and Investor Education. In addition, project committees are formed to work on specific policy projects; for example there are project committees dealing with over-the-counter (OTC) derivatives, securitization and financial innovation, credit rating agencies and take-over bids.

The Chairs of each CSA member meet quarterly in person and bi-monthly by conference call. In addition, the CSA established the Policy Coordination Committee (PCC) in August 2003. Its members are the Chairs of eight regulators (British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick and Nova Scotia). The PCC oversees the CSA's policy development initiatives and facilitates decision-making. It acts as a forum for timely resolution of policy development issues, monitors ongoing issues and provides recommendations to the CSA Chairs for their resolution.

The CSA established a permanent Secretariat in March 2004 in Montréal. The main function of the Secretariat is to help to keep policy initiatives on track by providing logistical support, including reports on progress, and to manage the national databases.

Differences in regulatory requirements or practices across provinces

Regulation

There are currently 40 national instruments and four multilateral instruments covering a broad range of areas, including (i) issuers; (ii) CIS, (iii) registrants and (iv) marketplaces, which overall ensure that products/entities and markets are subject to a similar set of requirements across provinces.

There are three areas where important differences among provinces remain:

- **Derivatives:** Derivatives are overseen differently in various Canadian jurisdictions, with regulatory authority being derived through a variety of legislative regimes. The agencies informed, however, that legislative reforms are currently underway in certain provinces to more closely align the regulatory framework for derivatives across Canada, and a harmonized approach to OTC derivatives regulation is being developed at the CSA level by the CSA Derivatives Committee. The committee is drafting “model” rules. Due to differences in the enabling legislation, the text of the final rules adopted in each province or territory may not be identical. However, the objective is to ensure that the substance of the rules will be the same across the jurisdictions, and that market participants and derivative products are treated similarly across Canada.
- **Prospectus Requirements—Exemptions:** Members of the CSA have implemented virtually identical requirements in respect of distributions of securities, and a set of 41 exemptions from the prospectus requirements. The bulk of the exemptions apply equally in all provinces, but two exemptions are not applicable in Ontario, one related to the use of an offering memorandum as a substitute for the requirement of a prospectus, and the other related to offerings to certain classes of individuals who are considered to be close to the issuer and certain of their close family, friends and business associates (Ontario has a more restricted exemption). The OSC is currently undertaking a review of the exempt market to determine, among other things, whether it should adopt these two exemptions.
- **Registration Requirements :** Members of the CSA implemented a virtually identical registration regime, and developed a set of 28 exemptions from the registration requirements which apply equally to all provinces, except for two key differences:
 - **Northwest EMD Exemption:** In Alberta, BC, Manitoba, the Northwest Territories, Nunavut and the Yukon Territory (the Northwestern jurisdictions), a person or company is exempt from the requirement to register as an EMD when trading in securities distributed in reliance of

certain prospectus exemptions (accredited investor exemption, friends, family and close business associate exemption, offering memorandum exemption and \$150,000 minimum amount exemption). To rely on the exemption a person or company must meet certain conditions and confine the permitted trading activities to their local jurisdiction or the Northwestern jurisdictions.

- **Registration of Non-Resident IFMs:** Ontario, Québec and Newfoundland and Labrador require non-resident IFMs to register if the IFM is managing one or more investment funds that distribute or have distributed securities to residents in those jurisdictions, unless the IFM can satisfy one of two exemptions.
 - i. An exemption in circumstances where there are no security holders of any of the investment funds managed by the IFM or active solicitation, of residents in the local jurisdiction
 - ii. An exemption available only to international IFM, where the distribution of the securities in the local jurisdiction is restricted to permitted individuals.
- The remaining jurisdictions have issued guidance for determining whether the non-resident IFM is required to register in the jurisdiction; the distribution of securities in the jurisdiction is not determinative.

The authorities have highlighted that harmonization and avoidance of regulatory differences and gaps does not necessarily require identical requirements across jurisdictions. Further, in appropriate circumstances their system allows them to accommodate local needs and regional differences.

Overall stakeholders recognized the progress achieved in harmonization under the umbrella of the CSA. Nevertheless, some market participants expressed particular concern for the differences in connection with registrants (EMDs and foreign IFMs) and the extent to which they are allowing for an unlevel playing field due to the way that they are being used in practice.

Finally, a concern remains in connection with timely policy formulation. The authorities have highlighted that at the international level Canada fares similar to other G-20 jurisdictions in connection with the implementation of important policy commitments. In regard to domestic proposals, the authorities have highlighted that in cases where proposals have taken time to be approved such time has been necessary to allow for meaningful consultation with stakeholders and particularly in respect of such policy matters where market participants have strongly held diametrically opposed views; and in these cases, therefore it takes significantly more time, to find a proper balance and

allow buy-in from all stakeholders. In addition, time has also been needed to align policy responses with US, given the level of integration of the markets.

Registration

The provincial regulators have developed a set of arrangements that are aimed at streamlining the registration process. In particular, a passport system was developed for the review of prospectus filings; discretionary relief applications; dealer, adviser and IFM registrations; and credit rating organization designations. All provinces except Ontario have adopted this system. Overall the passport system gives a market participant automatic access to the capital markets in other Canadian jurisdictions by obtaining a decision only from its “principal regulator” and meeting the requirements of one set of harmonized laws. Generally, the market participant’s principal regulator is the regulator of the jurisdiction of its head office within Canada. All CSA members have adopted policies to provide an interface between Ontario and the other Canadian jurisdictions. Under these interface policies, if a market participant’s head office is in Ontario the OSC will act as principal regulator and its decision will be effective in the other Canadian jurisdictions. In addition, market participants based in other Canadian jurisdictions that also want to access the Ontario capital market may generally do so by dealing with their principal regulator. In these situations, the OSC will typically coordinate its review and raise any concerns it may have directly with the principal regulator.

Ongoing supervision

They have also developed processes and procedure to coordinate ongoing supervision.

- Ongoing supervision of issuers, registrants and CRAs also follows a principal regulator approach; that is, continuous disclosure obligations of an issuer would be reviewed by its principal regulator.
- Principal regulator approach for IIROC and MFDA: Both SROs are recognized by nearly all provincial regulators (the main exception is the MFDA which is not recognized in Québec). However one regulator acts as the coordinator and channels all requests from the different provincial regulators to the SRO. In the case of IIROC these coordination arrangements have been formalized in a MoU signed in 2008. A similar MoU has been developed for MFDA and is in the process of being finalized. Under this approach, the OSC is the principal regulator for IIROC and BCSC for MFDA.
- Lead regulator approach for the exchanges: under this approach the lead regulator, typically the securities regulator in the jurisdiction of the head office of the exchange, will recognize the exchange, while the regulators in the other jurisdictions in which the exchange operates will grant an exemption from recognition based on principles of mutual reliance. Under this approach the OSC is the lead regulator for TMX, the BCSC and Alberta for TSX Venture, the

AMF for MX, Manitoba for ICE, and ASX for NGX.

- A coordinated approach to the supervision of CDCC: the authorities informed that BoC, AMF and OSC are currently working on a MoU to ensure coordination in the oversight of CDCC. As other regulatory authorities get jurisdiction over CCPs, they will become signatories of the MoU.

Systemic Risk

As will be further explained in Principle 6, the CSA has created a committee on systemic risk which is in charge of identification and monitoring of systemic risk at a national level. The CSA has developed a definition and a methodology to identify systemic risks. This work relies heavily on the work of the four largest agencies.

Enforcement

Provincial regulators keep each other informed of important enforcement investigations via the CSA Enforcement committee. This in turn allows them to determine the extent to which a joint investigation and joint hearing should be pursued. In addition, the provincial regulators can also issue reciprocal orders. Use of these mechanisms has been further discussed under Principle 12.

Convergence in supervisory practices

Several practices have been developed to foster consistent interpretation and convergence in supervisory practices, including:

- Consulting on novel applications, products or distributions: as part of the passport protocol the regulators have committed to elevate to the respective CSA committee any novel issue under their review
- Development of standardized checklists, and best practices guides: in many areas the committees have developed standardized forms and checklists (for example on registration) and manuals (for example in connection with the on-site inspections of registrants).
- Training: under the coordination of the CSA staff of the provincial regulators receive specialized training every two years.

Peer reviews are not a tool used frequently to assess supervisory convergence. However at least one peer review has been conducted in connection with the review of prospectuses.

As will be further explained in Principles 12, 24 and 29, in specific areas supervisory practices across provinces differ. For example, the information to be provided to the

regulatory agencies as part of the registration process of a securities firm differs, and so does the level of review conducted. The risk-based frameworks to determine the intensity of supervision are also different, and the frequency of on-site inspections also varies.

Differences in requirements across products supervised by different sectoral regulators

As per the information provided, the disclosure requirements applicable to segregated funds are similar to the “fund facts” document applicable to investment funds. On the distribution side, some provinces appear to have implemented similar distribution obligations (for example Québec through the Distribution Act) but not all. Many participants expressed concern about this difference in approach and the extent to which in practice this is leading to an unlevel playing field as segregated funds have similar characteristics to CIS.

Coordination with SROs

There are several mechanisms that the agencies have put in place for purposes of ensuring coordination of their work vis-à-vis- the SROs. These include:

- The obligation of the SROs to provide their on-site review plans to the regulators
- The obligation of the SROs to provide periodic reports on the investigations opened.
- The obligation of the SROs to provide notification of any sanctions imposed
- Periodic meetings at different levels of the organizations.
- Participation of the SROs in specific CSA committees (such as the CRM2 committee and the Registrant Regulation committee), as well as joint projects (such as dark pools) and specifically of IIROC in the inter-agency calls described in Principle 6.

Coordination across the financial sector

Head of Agencies

The major financial regulators in Canada participate in meetings of the Heads of Agency (HoA). The HoA is an informal body which includes the Chairs of the four largest provincial securities regulators in Canada (Alberta, British Columbia, Ontario and Québec), the Governor of the Bank of Canada, the Superintendent of Financial Institutions, and senior government officials from the federal Department of Finance. The HoA serves as a forum for the securities and other financial regulatory agencies to

	<p>coordinate policy in areas of shared responsibility, including systemic risk.</p> <p>Currently, the HoA's work is being driven by Canada's efforts to implement its G20 commitments, which are intended to address issues of systemic risk. The HoA is engaged in discussion and coordination relating to OTC derivatives, shadow banking, hedge funds, and more recently, financial benchmarks.</p> <p>Joint Forum</p> <p>The Joint Forum was established in 1999 by the CSA, the Canadian Council of Insurance Regulators and the Canadian Pension Supervisory Authorities with the objective of helping pension, securities and insurance regulators to coordinate and harmonize the regulation of financial products and services. Senior representatives from the three parent organizations meet once a year to discuss cross-sectoral issues. If necessary, they will form working groups to undertake specific projects. An example of work developed under the umbrella of the Joint Forum has been the development of disclosure obligations for insurance companies.</p> <p>MoUs</p> <p>The OSC and OSFI entered into an Accord in 1987 to address potential overlap in the regulation of federal institutions and their subsidiaries and affiliates that engage in securities related activities. In addition, a MoU was signed in 1998. The AMF also signed a MoU with OSFI in 1998 to ensure proper coordination.</p> <p>The authorities informed that in practice the more regular exchange of information takes place with IIROC, as it is the front line supervisor of the IDs. IIROC share with OSFI findings from its on-site reviews.</p>
Assessment	Broadly Implemented
Comments	<p>The main reason for the grade relates to the need to continue working on coordination of supervision and to a lesser extent the need to continue harmonization efforts in a few areas, in connection with questions 2a), b) and d) of the methodology.</p> <p>Through an incremental approach the provincial regulators have made significant progress in coordinating actions, streamlining processes and procedures and achieving convergence in supervisory practices.</p> <p>On the supervisory front, the passport system is of more recent creation in connection with registrants thus this is an area that the securities regulators should keep monitoring to ensure a robust level of supervision across the provinces. As noted in the description, and further explained in principles 12, 24, 29 and 31, the supervisory regime for securities intermediaries differs in important ways across provinces, and vis-à-vis the</p>

SROs. It is important that the regulators and SROs have a common understanding on risk appetite vis-à-vis the actual risks of different categories of participants, to ensure that as much as possible any difference in the intensity of supervision derives from differences in the risks posed by the entities, rather than on availability of resources. The assessor encourages the securities regulators to conduct further analysis on this topic. These issues have been taken into consideration for the grade of principles 12, 24, 29 and 31, as appropriate.

Regarding supervisory convergence the securities regulators should consider whether additional tools should be added to the mechanisms to ensure convergence in supervisory practices, such as making more frequent use of peer reviews.

In enforcement, as will be further explained in principle 12, the assessor encourages the securities regulators to continue to strengthen arrangements for coordination, including for example by making more use of joint hearings and/or reciprocal orders, or even considering other types of arrangements.

In addition, the assessor also notes that several channels have been established to ensure appropriate coordination with the SROs. In this regard, it is key that communication between SROs and the regulatory agencies flows two ways to ensure that (i) both parties have a comprehensive understanding of the risks posed by participants, that is, that not only the SROs provide information to the regulatory agencies, but also that the regulatory agencies share information with them in respect to issues of common interest, and (ii) that the priorities of the securities regulators and SROs are consistent with such view of risks. There are indications that communication is fluid. Thus the recommendation here is to encourage the authorities to consider further ways to ensure robust dialogue, including for example via permanent participation of SROs in different committees, as well as via discussions on strategic priorities.

In sum, the assessor encourages further efforts to coordinate supervisory actions not only across provinces but also with the SROs with the main objective of ensuring that a comprehensive and integrated view of risks of the securities markets is developed.

Finally, it is important that coordination mechanisms at the financial sector level be strengthened, as further explained in Principle 6.

In regard to harmonization, the assessor acknowledges that the principles and methodology require the existence of “similar” not identical requirements. From a substantive perspective any difference should be assessed in the context of the extent to which it can create a gap or unlevel playing field. From that perspective, the assessor acknowledges the progress that the provinces have already made. It is important that the final regulations on OTC derivatives achieved the objective of ensuring that the substance of the rules will be the same across the jurisdictions, and that market participants and derivative products are treated similarly across Canada—as envisioned

	<p>by the authorities. Finally, it is important that differences that remain in connection with prospectus exemptions and registrants be further reviewed against such objective. From the anecdotal evidence gathered it seems that the differences in registrants raise more concerns from an unlevel playing field perspective.</p> <p>At the CSA level, ensuring responsive policy making should remain a key goal of the CSA. The assessor acknowledges that at the international level Canada fares similar to other countries in connection with the adoption of major global policy initiatives (such as G-20 commitments). Nevertheless, at the national level examples can be found of important policy projects that have taken long (for example initiatives related to mutual fund disclosure, or trailing fees). Indeed, as explained by the authorities such time might have been necessary to allow for meaningful consultation with stakeholders, find a proper balance and allow buy-in from all stakeholders, as well as to align policy responses with US. At the same time, it is key that policy making remains responsive to market challenges. Recent initiatives, as described in Principle 3, such as the project manager and the committee of four to solve differences are steps to ensuring such objective. This issue has not been taken into consideration for the grade.</p> <p>The assessor encourages the Canadian authorities and governments to develop a level playing field in connection to the distribution of investment products by insurance firms.</p>
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>Independence</p> <p><i>Legal status of the agencies</i></p> <p>The four agencies are separate legal entities.</p> <ul style="list-style-type: none"> • The OSC is a crown corporation with a board of directors of at least nine and no more than 15 commissioners. The board has a Chair, and up to three Vice Chairs, who are all full time members. There is one Secretary to the Commission. • The AMF is a legal person and a mandatory of the state with a single person governing body (the president and chief executive officer—CEO). • The BCSC is a government agency. It is governed by a board which must have at least two members (a chair and at least one Vice-Chair) and can have no more than 11 members. Currently the BCSC has eight members. The Chair is also the CEO. • The ASC is a crown corporation. It has a Chair and two Vice-Chairs, who are full time members. The Chair is also the CEO. The law does not set a number of

commissioners. Currently the ASC has 12 members.

Appointments

Terms of appointment vary.

- In the case of the AMF, pursuant to the AMF Act, the president and CEO of the AMF is appointed by the government, for a five year period and cannot be removed without valid reason.
- In the case of the OSC, BCSC, and ASC the Commissioners are appointed by Order in Council of the Lieutenant Governor. To some degree the process of appointment varies depending on the type of member to be appointed (whether the chair, vice-chair, or a commissioner), and across agencies. But generally, in all three cases there is a Governance Committee in charge of reviewing and assessing the collective skills and qualifications of the members of the Commission. Thus prior to a vacancy, the Committee reviews the composition of the commission, identifies the skills for the new member and prepares a position profile, and later on is involved in the review of candidates and the recommendations to be made to the Minister. There is a goal in all three agencies to have a board that collectively has knowledge/experience in all important areas for securities regulation as well as in management. In addition to the review of skills the selection process also involves a review of integrity and confidentiality issues, as well as an ex-ante review of the type of conflict of interests that the applicant would face.
- For the OSC, the length of appointment is established in the ONT SA. According to this Act the term of office of the commissioners may not exceed five years, but they may be re-appointed. The appointments are made, and the terms fixed, by the Lieutenant Governor in Council. According to judicial precedents and recent amendments to the legal framework fixed term appointments cannot be rescinded except with due cause.
- For the BSSC, the length of appointment is subject to a range set by the Administrative Tribunals Act. A member other than the Chair or Vice-Chair is appointed for an initial term of two to four years, while the initial term for the chair or vice-chairs is three to five years, and is eligible for reappointment for additional terms of up to five years, as is the case for the Chair and Vice-Chair. The BCSC practice is to seek three year initial appointments for board members, with staggered terms. Pursuant to the Administrative Tribunal Act the Lieutenant Governor may remove Commissioners for cause
- For the ASC, the law does not set the length of appointment as a member. However, pursuant to the ASC Governance Policy the ASC shall not seek

appointment or reappointment of a member for a period longer than three years, and shall not seek reappointment of a member who will have served for six or more years upon the expiration of that member's term. Typically the chair is appointed for a term of five years, whereas the Vice-Chairs are appointed without a specified end to the appointment. As the Lieutenant Governor in Council appoints a member to the ASC by Order in Council, the Lieutenant Governor in Council may remove a member by issuing an order that revokes such an Order in Council. Since the Chair and each Vice-Chair are also officers and employees of the ASC, additional terms may exist, as set out in their respective employment contracts, which address the termination of the appointment in question. According to judicial precedent emanating out of the courts in Alberta, a person appointed to a fixed term as a member of an agency, such as the ASC, may not be removed for arbitrary reasons or at the pleasure of the Lieutenant Governor in Council. In addition, the government policy is that removal will only occur with due cause (i.e. not for arbitrary reasons). Lastly, the ASC is not aware of any instance in which the revocation of an appointment was pursued by the Government of Alberta.

Protection of staff

All four agencies have similar statutory provisions that protect the board/chair and staff for acts/omissions in the good faith exercise of their functions. In addition, in Québec the statute expressly states that the AMF assumes the defense of the personnel. A similar provision does not exist in the case of the other agencies, but through administrative decisions in all of them the legal defense of staff (including former employees) is assumed by the regulatory agency

Mitigation of influence of commercial interests

In all the three agencies with a commissioner structure, part time commissioners can carry other professional activities, and can be directors of issuers and registrants. However, in all three cases the respective codes of conduct require them to disclose any conflict of interest and recuse themselves from being part of such decisions.

In the case of the OSC and the BCSC, the Commissions have adopted a policy of not permitting Commissioners to act as directors of registrants. It was determined that a different treatment for registrants was necessary given the OSC's direct oversight of them. Further it was determined that the types of conflicts that may arise in the case of registrants can be more difficult to manage and could result in the Commissioner being in a constant state of recusal. In the case of acting as a director of an issuer, the Commissioner must notify the Chair in advance and obtain the Chair's approval. Such policy does not exist in the case of the ASC, however senior staff from the ASC emphasized that through the selection process (and the screening for conflicts conducted therein), the agency has achieved the same result. In the case of the OSC

three out of its 12 part time commissioners sit on the board of reporting issuers. In the case of the ASC, 3 of its 9 part time commissioners sit on the board of reporting issuers. In the case of the BCSC, currently no commissioner holds a senior or board seat on an issuer or registrant. The BCSC informed that typically commissioners are retired and are not working full time in the private sector.

While specific aspects might differ from agency to agency, overall, from an operational perspective, based on the items on the agenda of the board, the member is required to disclose any potential conflict to the secretary of the board. At the time of the board meeting, such conflict would be disclosed also to the board itself. If the member does not recuse him/herself the secretary and/or the chair can request him/her to do so. In all three cases the recusal cover any type of decision where the member has an interest that could affect his/her unbiased position. This means that it is not limited to individual cases (for example enforcement, or approvals of particular actions) but also to policy. The effects of the recusal vary depending on whether the conflict is "direct" or more "remote". For example, in individual cases where the member might have an interest (for example an enforcement case that involves a client in the case of a lawyer, or that involves the issuer in the case of a board member that seats in the board of an issuer), the recusal would mean that the member does not receive any documentation concerning such case, nor participates at all in such decision. In policy (for example a review of requirements for issuers) the member would participate in the discussions but abstain to vote from the decision. Senior staff from the agencies emphasized also that in the case of policy decisions, additional safeguards are in place as regulations are subject to consultation as well as a approval by the respective Minister. Further, policy in Canada is mostly done through national instruments, which means that in practice the potential influence that an individual member can have is very limited.

In the case of the AMF, the head of the AMF pursuant to the Code of Conduct has to perform its functions exclusively unless the Government names or designates him/her to other functions. The only other exceptions is that he is allowed to exercise educational activities for which he can receive remuneration and activities for non for profit organizations with no remuneration.

Government involvement in regulatory issues

According to the legal framework of the four agencies, the issuance of regulations requires Ministerial approval. In the case of the BCSC such approval is required to initiate a rulemaking proposal (approval in principle), as well as of the final rule. All agencies indicated that it is very rare for the Minister to make substantial changes to the rules proposed by the regulators. They all indicated that there is a good communication with the Ministry office, so that policy initiatives are discussed in advance, so that by the time of the final approval the MOF is well informed and no major issues arise.

In addition the OSC, the ASC and the AMF are required to obtain ministerial approval of

	<p>MoUs for exchange of information.</p> <ul style="list-style-type: none"> • In the case of the OSC approval from the MoF is required for MoUs with another securities, derivatives or financial regulatory authority; any self-regulatory organization; or any jurisdiction. OSC staff indicated that the approval process is not cumbersome; further there is a 60 day statutory revision period. If the Minister does not approve nor reject the MoU within such period it is considered approved. The OSC indicated that the MoF has never rejected to approve a MoU. • In the case of the AMF and the ASC approval of intergovernmental MoUs is required by the Minister of Intergovernmental affairs. There are specific procedures to this effect. A timeframe for the response of the Minister exists in the case of the AMF; as for the ASC staff indicated that while there is no set timeframe the Minister has acted promptly to their requests. Furthermore AMF staff explained that an Order in Council of the Minister specific to the AMF (OIC 300-2013) excludes certain categories of agreements from the approval process, such as agreements of administrative and technological nature. Most of the agreements signed by the AMF fall under this OIC. In any case, both agencies indicated that the Minister has not rejected any MoU. <p>While the BCSC is not subject to such requirement, as a matter of practice it does inform in advance the Minister whether it intends to enter into an MOU.</p> <p>Other than in those areas, the government does not have a direct role in day to day operation of the regulatory agencies.</p> <p><i>Funding</i></p> <p>The four agencies are fully self-funded. Their main source of income is fees paid by market participants.</p> <ul style="list-style-type: none"> • In the case of the OSC and BCSC, the OSC and the BCSC respectively set their fees by way of a rule, which is subject to approval by the MoF. The rule is published for comment; changes may be made as a result of the consultation process. The final rule is delivered to the MoF for his/her approval. The Minister can approve the rule, reject the rule or return it for further consideration. To date the Minister has not returned a final fee rule to the OSC or the BCBS for further consideration. • In the case of the AMF also a proposal for fees must be submitted for comments, changes may be made following the comment period and the final rule will then be submitted for Governmental approval. The Government has
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never refused a fee proposed by the AMF.

- In the case of the ASC, the requirement to pay fees and the quantum are set by the Lieutenant Governor in Council. However the recommendations of the ASC are taken into consideration. In general the ASC through staff will submit a business case to the MoF requesting the creation or adjustment of a fee. Such a request would include the justification. The Minister will make the determination whether or not to pursue the requested fee. Staff is not aware of any instance where cabinet has not approved a recommendation.

The budgets of the four agencies are independent from the Government budget. However, in all four cases the budget has to be approved by the MoF (in the case of the AMF the government must also approve the appointment of key personnel, both based on a recommendation of the advisory committee).

In recent years two of the agencies (OSC, and BCSC) have been subject to limitations in connection with the salaries that they can pay to staff and/or management.

- In the case of the OSC, limits in salaries of public employees are being applied to them.
- In the case of the BCSC the government recently imposed a freeze in salaries of management and ordered the dismantling of the system of bonuses.
- In respect of the ASC, it is not subject to a salary cap, but the ASC and its senior management have practiced restraint in setting remuneration levels, given that the labor market is moving in the same direction and given that it needs to be responsible in setting its budget.
- In the case of the AMF, salaries are determined by negotiated collective contracts that are authorized by the Treasury. The salary levels are higher than those of the civil service and the system allows for flexibility when needed.

In all cases staff of the agencies stated that these limitations have not affected their capacity to attract personnel.

Accountability

In all four cases the agencies are accountable to the Government through the MoF. In each case there are different types of arrangements where such oversight is delineated:

- In the case of the ASC, the Mandate and Roles Document executed by the Minister and the Chair on November 22, 2010 delineates the oversight role of the Minister. The main mechanism of accountability is the review and approval

	<p>of the strategic direction of the ASC by the Minister.</p> <ul style="list-style-type: none"> • In the case of the BCSC, the Chair on behalf of the BCSC signs annually a shareholder’s letter of expectations with the Minister that describes the BCSC mandate as its responsibilities. The main mechanism of oversight is the submission for approval by the MoF of a three year service plan, which includes identification of strategic risks, goals and a summary of the financial outlook of the BCSC. • In the case of the OSC, a MoU delineates roles and responsibilities of both entities. This MoU has to be renewed every five years. Pursuant to such MoU the Minister does not approve the statement of priorities of the OSC but does approve the annual business plan. • In the case of the AMF the strategic plan must be approved by the Government. Prior to sending it to the MoF, the plan must be sent to the advisory committee, which in turn, provides a recommendation to the Government on its approval. <p>In all four cases the agencies are required by law to produce and submit to the MoF an Annual report, and their annual financial statements which must be audited by the Auditor General. Both the annual report and the financial statements are available in their respective websites. In all cases the annual report is also submitted to the legislative body, which has the power to summon the head of the regulatory agency.</p> <p>Finally in all four cases their decisions are subject to judicial review.</p> <p>Procedural fairness</p> <p>These issues have been discussed under Principle 3.</p>
Assessment	Broadly implemented
Comments	<p>The main reason for the grade relates to the potential for interference of commercial interest resulting from the inclusion of part time members in the agencies that follow a commission structure, in connection with question 1 b) of the methodology.</p> <p>The commission structure allows the agencies to bring to the table different types of expertise that can enrich the decision making process. e Allowing part-time members can potentially enlarge the pool of expertise that the commissions can draw from. At the same time it can give rise to conflict of interest. As detailed in the description these conflicts are managed mainly by two mechanisms. At the entry level, by the selection process established in each of the provinces which emphasizes skills, integrity and confidentiality. On an ongoing basis, by the conflict of interest policies that require a member to recuse themselves in decisions where the conflict is present. In practice such recusal applies not only to individual cases but also to policy, although the effects of the</p>

recusal vary.

In principle the assessor considers that these two mechanisms can work effectively in connection with part-time commissioners that are not directors of issuers or registrants. For example, a strong selection process should be able to discourage the selection of candidates whose private practice is exclusively composed of regulated entities; so that on an ongoing basis the need for recusal would be relatively limited.

The question that remains is whether the potential participation of directors of registrants and issuers should be treated in the same way, and thus address in practice through the same mechanisms. The assessor concurs with the authorities that the potential for conflict is even larger in connection with directors of registrants. In her opinion in those cases a recusal policy would not be sufficient to manage conflicts (and perceptions of conflict) well while at the same time allowing for an effective participation of the member in the board. Thus, the assessor considers that in such cases additional safeguards such as those implemented by the OSC and the BCSC are warranted. The final issue to consider is whether a similar treatment should exist for directors of issuers. The regulatory agencies consider that in such cases the conflicts can be well managed through the conflict of interest policy. There is no clear cut answer to this issue. In principle the assessor considers that directors of issuers should not be members of the regulatory agency, to avoid any perception of conflict, given the fact that issuers are subject to regulations issued by the agencies. If they were to be members of the board, then they should be excluded from participating in any policy decision affecting issuers. The views of issuers can still enrich policy views through the consultation process and the constitution of advisory committees.

The assessor wants to emphasize that current management of potential conflicts by the three agencies has worked well, and the assessor did not find any evidence of interference. Thus the broadly implemented grade. .

As for the government, the line between independence and accountability is difficult to draw. The assessor notes that the Government (via a Ministry) does not have any role in day to day operations of the agencies, and the approval of MoUs do not seem to interfere with the ability of the agencies to share information both domestically and internationally. Further, staff from all the agencies indicated that the relevant Minister has never rejected a MoU submitted for approval. The role of the Government in setting the level of fees (either directly or because the rules of the agencies require their approval) has not interfered either with their ability to have the necessary stable funding to carry out their functions. Finally the approval of the budget as well as strategic priorities is consistent with an oversight role. However, it is important that the limitations in salaries be monitored. Thus, overall the assessor considers that the current framework strikes an appropriate balance between independence and accountability.

Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>Powers</p> <p>The legal framework for the four agencies provide them with sufficient powers to regulate and supervise the market and its participants (issuers, CIS, SROs and exchanges, and securities intermediaries).</p> <p>Each securities regulator has the authority to:</p> <ul style="list-style-type: none"> • <i>Make legally binding rules, and adopt policies and guidance.</i> As indicated in principle 2, in the four agencies, rulemaking is generally subject to ministerial approval (in the case of the BCSC, it requires approval of the Minister to initiate a rule-making process, as well as final approval of the rule and in Alberta, ministerial approval is only required for prescribed matters). They may also adopt policies of a non-binding nature. Similar to the process for rulemaking, the agencies, other than the ASC, are generally required to follow a public consultative process prior to adopting a policy. • <i>Grant discretionary exemptions.</i> The <i>Securities Acts</i> empower the agencies with the authority to grant discretionary exemptions from securities laws. (The <i>Commodity Futures Acts</i> and <i>Derivative Acts</i> have similar provisions). These discretionary exemptions are issued as “orders”. Other than the OSC, the agencies have the ability to issue these discretionary exemptions on the basis of a “blanket order”, such that the order would apply to an entire class of market participant or transaction. The OSC may grant discretionary exemptions that apply to a class of market participant or transaction if it determines that the order sought does not constitute a prohibited blanket order. • <i>Review prospectuses and issue prospectus receipts.</i> • <i>Grant registration/recognition/designation for securities intermediaries, exchanges and SROs and credit rating agencies, respectively.</i> In all cases the agencies can impose terms and conditions. They also can revoke the “authorizations” given, following a due process. • <i>Monitor compliance.</i> The agencies have the authority to review books and records, conduct on-site inspections, and request information, on a periodic and on an ad-hoc basis. • <i>Conduct investigations.</i> Each securities regulator has the statutory authority to conduct investigations into possible violations of provincial securities laws. To this effect they all can subpoena documents (including banking records,

telephone records, records from internet service providers) and require testimony. They also all have available emergency relief, including freeze of assets, cease trade orders and officer or director bans.

- *Impose enforcement actions:* In all four cases the agencies have a wide set of enforcement tools at their disposal, including administrative fines (that are generally up to \$1 million) and disgorgement. In all cases, except the AMF, the Commissions are the adjudicative body, via hearing panels. In the case of the AMF the adjudicative function is conducted by a separate administrative tribunal, the BDR. The BDR members are appointed by the government for fixed terms and can only be removed with due cause.
- *Quasi-criminal authority:* Pursuant to their respective Securities Acts, the four agencies have quasi-criminal authority to prosecute persons and companies for the commission of offences, which can be sanctioned with imprisonment of up to five years less a day and/or fines of up to \$5 million. In one case, the agency itself can directly prosecute the cases in the courts (OSC), while in another dedicated prosecutors have been assigned to these cases (AMF).

Budget

As indicated in Principle 2, the four regulatory agencies are funded by fees levied on market participants.

Market conditions resulted in falling revenues (i.e. annual deficits) at some of the agencies in recent years (chart 1). However, the agencies retain reserves to maintain necessary capacity during periods of market turbulence.

Regulator Revenues and Expenses—Chart 1

Regulator	Year	Revenues	Expenses
OSC	2012	\$85,638,000	\$90,025,000
	2011	\$72,955,000	\$84,047,000
	2010	\$61,466,000	\$79,450,000
AMF	2012	\$88,818,000	\$84,140,000

	2011	\$84,849,000	\$105,957,000
	2010	\$152,334,000	\$84,953,000
ASC	2012	\$31,344,000	\$31,688,000
	2011	\$30,087,000	\$32,413,000
	2010	\$32,733,000	\$28,392,000
BCSC	2012	\$36,872,000	\$36,244,000
	2011	\$34,889,000	\$31,216,000
	2010	\$31,409,000	\$30,845,000
IIROC	2012	\$84,999,000	\$92,662,000
	2011	\$80,478,000	\$77,402,000
	2010	\$76,517,000	\$72,741,000
MFDA	2012	\$30,700,000	\$30,200,000
	2011	\$29,400,000	\$28,900,000
	2010	\$25,200,000	\$26,500,000
	<ul style="list-style-type: none"> From 2003 to 2008, the OSC accumulated operating surpluses. A portion of these were returned to market participants through rebates, subsidized fee rates, or refunds. In addition, in light of the economic climate and in order to deplete the operating surplus, the OSC froze its rates of participation and activity fees in 2009 and limited its increases in 2010 to a rate that would see the OSC deplete its surplus over a three-year fee cycle. As a result, revenues were not sufficient to fully recover the OSC's projected costs of regulating the market in each of the fiscal years of 2010 to 2012; and the OSC's surpluses from 		

previous years were carried forward to cover the deficit. In April 2013, the OSC established a new fee rule that increased fees to levels designed to address the operating deficit and return the OSC to cost recovery and to build a small surplus by the end of the three-year fee cycle in 2016. The new fees will cover the costs to meet expanded regulatory responsibilities.

- In fiscal 2011, AMF expenses included \$20,600,000 payments to settle investor claims related to fraud, as the AMF has functions in connection with investor restitution.
- In fiscal 2012, IIROC expenses increased to strengthen IT infrastructure and add staff to expand operating capabilities.

Human resources

The table below shows staff headcount by broad functional category for the period 2010 to 2012 for each regulator. In all cases, the number of staff has grown since 2010.

Functional Areas	Year	OSC	AMF	ASC	BCSC	Category Total
Corporate Finance/Investment Funds	2012	85	65	46	50	246
	2011	88	64	45	47	244
	2010	85	65	43	47	240
Registrants and Compliance	2012	70	18	17	31	136
	2011	69	19	13	28	129
	2010	64	20	12	28	124
Market Regulation and Derivatives	2012	27	15	7	6	55
	2011	21	17	7	6	51
	2010	18	15	6	5	44

Enforcement	2012	126	131	46	54	357
	2011	118	112	46	50	326
	2010	117	104	44	47	312
Advisory and Support Offices	2012	147	177	60	98	482
	2011	128	166	65	84	443
	2010	133	162	59	83	437
Permanent Employees—Total	2012	455	406	183	239	1,283
	2011	424	378	183	215	1,200
	2010	417	366	171	210	1,164
3-year growth average		5%	2%	4%	5%	

In addition, the two national SROs—IIROC and the MFDA—act as front-line regulators in respect of dealers (including mutual fund dealers).

In 2012, IIROC had 422 employees, of which approximately 270 were engaged in enforcement, registration and compliance oversight activities. The MFDA had 171 employees, with approximately 130 engaged in enforcement, registration and compliance oversight activities. Adding these staff figures to the staff at the OSC, AMF, ASC and the BCSC produces a total of 1,876 staff engaged in securities regulation in 2012.

Staff of the four agencies indicated that overall the agencies are able to pay competitive salaries. In the case of the OSC, ASC, and BCSC, surveys are conducted to have a benchmark. In the case of the BCSC and the ASC, the salaries are aimed at the 50th percentile of their comparative market. IIROC also conducts surveys, and its salaries are aimed at 75th percentile. Salaries at the AMF are established on the basis of the Québec Treasury Department guidelines given to the AMF when collective contract negotiations

are ongoing.

The professional staff of the four agencies is comprised of lawyers and accountants, as well as staff with industry experience and expertise, including derivatives, trading, clearing and risk specialists and, in Alberta and BC, specialists in mining, oiling and/or gas. In recent years, the agencies have also hired several economists to enhance their risk and research units.

All four agencies have training programs for their staff.

Annual Aggregate Training Budgets	2010	2011	2012
OSC	\$535,000	\$576,000	\$851,000
AMF	\$694,675	\$1,180,025	\$1,527,214
ASC	\$300,000	\$300,000	\$300,000
BCSC	\$290,000	\$418,000	\$478,000
Total	\$1,819,675	\$2,474,025	\$3,156,214

Turnover is low. ASC staff indicated that turnover is somewhat higher than the other regulators due to strong labor market competition from the Alberta oil and gas industry.

Average Voluntary Turnover rate	OSC	AMF	ASC	BCSC
2012	5.91%	5.8%	10%	3.3%
2011	4.34%	4.2%	13%	7.8%
2010	3.61%	3.5%	11%	7%

Technological resources

The agencies collectively spent more than \$60,000,000 on information technology in fiscal 2012. In addition, there are several national electronic filings and systems for the official filing of documents by different market participants, including: (i) official filings by public companies and investment funds, (ii) filing of registration forms for dealers and

advisers, (iii) filing and dissemination of insiders reports, (iv) a repository of cease trade orders, (v) a disciplined persons list, and (vi) the National Registration Search (NRS), which contains the names of all registrants (individuals and firms) in Canada, with the exception of those registered solely with the OSC.

The CSA plans to invest about \$100,000,000 to replace the National Systems in phases over the next five years. CSA will integrate the standalone systems into a single, intuitive, secure filing system for regulators and market participants. As part of the renewal, CSA will implement technology advancements, such as XBRL, Web 2.0 and user interface improvements.

There are also important “provincial” initiatives including the development by the AMF of a market surveillance system that would allow for automated surveillance across the equity and derivatives markets.

Governance and priority setting

Provincial level

As indicated in Principle 2, the OSC, ASC and BCSC have adopted a Commission structure for their organizations. Under this structure, Commission members, in addition to performing their regulatory responsibilities, also act as the board of directors. As board members, they are responsible for the overall stewardship of the agencies, including setting up their strategic priorities. The AMF has adopted a Superintendent structure for its organization. Under this model, the president is responsible for the overall functioning of the agency, including setting priorities.

All four agencies prepare strategic plans (usually with a three year horizon) that outline the priorities of the agencies. With varying degrees the development of such plans not only involves senior management but also staff and consultation with stakeholders.

All four agencies have established mechanisms to ensure that day to day operations are in conformity with the strategic direction set up by the governing body.

- In the case of the OSC, BCSC, and the ASC, they have all established Governance, Audit and Human Resource Committees.
- In the case of the AMF, there is an advisory committee that supports the chairperson.

All four agencies have internal audits in charge of reviewing whether the agencies are properly discharging their functions. They all have established risk management frameworks (the OSC is in the process of establishing it) to help the agencies to identify and manage material risks to the mandates of the institutions.

	<p><i>CSA level</i></p> <p>The CSA has a Chair and Vice-Chair, each of whom is elected by members for a two-year term (one renewal is permitted).</p> <p>The Chairs of each CSA member meet quarterly in person and bi-monthly by conference call. In addition, the CSA established the Policy Coordination Committee (PCC) in August 2003. Its members are the Chairs of the eight regulators (British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick and Nova Scotia). The PCC oversees the CSA's policy development initiatives and facilitates decision-making. It acts as a forum for timely resolution of policy development issues, monitors ongoing issues and provides recommendations to the CSA Chairs for their resolution.</p> <p>In addition, recently a committee of the Chairs of the four largest agencies was formed to serve as a body to solve differences among the provinces.</p> <p>The CSA develops a Business Plan every three years, which identifies common priorities and proposed projects for all members of the CSA, including key deliverables. The CSA recently finalized a Business Plan for 2013-2016. The Business Plan will assist in promoting continued coordination and harmonization in CSA policy initiatives and rules.</p> <p>The CSA established a permanent Secretariat in March 2004 in Montréal. The main function of the Secretariat is to help to keep policy initiatives on track by providing logistical support, including reports on progress, and manage the national databases. A project manager was recently added to the staff, to provide further support to the committees in ensuring that projects are delivered on schedule.</p> <p>The Secretariat currently has 6 staff. The CSA is funded by its members on a per capita basis.</p> <p>Investor Education</p> <p>These issues have been discussed under Principle 4.</p>
Assessment	Fully Implemented
Comments	<p>As many other securities regulators in industrialized countries, the four agencies face resource challenges arisen from the increased complexity of their securities markets. The agencies are aware of this challenge and in recent years have taken steps to add professional staff with different profiles (such as staff with experience on ratings, trading, and more generally staff with market experience, as well as economists to complement the existing cadre of lawyers and accountants) to their respective organizations. This effort should continue so that the agencies are well equipped to understand and identify risks, both at the macro-level and micro-level. At the same time, it is critical that the agencies keep their commitment to operational work, both in the areas of supervision</p>

	<p>(compliance) and enforcement.</p> <p>In terms of governance, the current structures at the provincial level appear robust. Of particular importance are the efforts of the agencies in the area of enterprise risk management and their connection with their internal audit units.</p>
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	<p>Assessed in 2007</p> <p>Overall, all regulatory agencies work under a high degree of transparency that requires them to submit their regulations to public consultation, and their decisions are subject to judicial review.</p> <p>Consultation process</p> <p>Both the OSC and the AMF are subject to a statutory mandated process of consultation with the public of their regulations and policies. Draft regulations and draft policy statements are published in their respective bulletins with a consultation notice, and a notice is also published in the official newspaper. All comments along with the explanation of the position taken by the respective agency are also published in their bulletins. Changes to regulations and policy statements are also subject to the same consultation process. In addition both the OSC and the AMF have made use of consultative committees and groups to gather input for market participants on important issues.</p> <p>They are required by statute to take into account the economic impact of regulations before their adoption. In particular the OSC has made significant progress in this area, through the creation of the Economic Analysis, Strategy and Project Branch whose function is to prepare a cost-benefit analysis for significant policy projects (for example, detailed cost benefit analyses were prepared for proposals regarding auditor oversight; certification of disclosure in issuers' annual and interim filings; and mutual fund governance).</p> <p>Procedural fairness</p> <p>Both regulatory agencies are required by their legal frameworks to act in a fair manner. AMF is required to provide reasons in the case of unfavorable decisions (Section 319 of the AMF SA and Section 8 of the Act respecting administrative justice), while the OSC must provide written reasons upon request (Statutory Powers Procedure Act). However, as a matter of practice both institutions provide reasons for the major decisions they adopt.</p> <p>Persons directly affected by a decision taken by the AMF—except those taken based on the Distribution Act—can seek review of the decision by an independent tribunal the BDRVM (Section 318 of the AMF SA). SROs can also appeal before this tribunal (Section</p>

	<p>322 of the AMF SA).</p> <p>Decisions taken by both the AMF and the OSC are subject to judicial review (Section 324 of the AMF SA; Section 9 of the ONT Act and Section f of the Ontario Commodity Futures Act).</p> <p>Criteria for granting licenses</p> <p>The legal and regulatory framework of both the OSC and the AMF establish the criteria for granting, denying or revoking licenses.</p> <p>Investor education</p> <p>Both regulatory agencies play an active role in investor education. Their investor education programs include community outreach via seminars and presentations; exhibitions at trade shows and events; publishing information brochures and similar publications; preparing investor alerts on hot topics and public advertising. They both have sections on their web sites that highlight educational resources as well contact centers. Finally, they both have investor education funds constituted with resources from administrative penalties, to provide support for various initiatives related to investor education and protection and improving financial literacy.</p>
Assessment	Fully implemented
Comments	
Principle 5.	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.
Description	<p>Assessed in 2007</p> <p>Overall, all regulatory agencies have developed a code of ethics and professional conduct for their staff that deals with issues of honesty and integrity; procedural fairness; prevention of conflict of interest and confidentiality.</p> <p>Transactions in securities</p> <p>Under the current framework of both agencies staff can invest in securities; however specific conditions, restrictions and prohibitions do exist (for example staff is prohibited from carrying out transactions on securities that are being investigated; buy securities in margin; and sell securities short).</p> <p>Both regulatory agencies have established certain reporting obligations.</p> <p>In the case of the OSC, commissioners and staff are required to file an undertaking</p>

	<p>that they understand their obligations and to sign a certificate of compliance annually. This certificate includes a detailed list of investments. In addition, they must report all securities trades, other than in exempt securities, within five days. Directors are required to periodically review trading of the staff under their supervision and provide a certification of their compliance with the OSC Bylaws. The OSC is subject to the provisions of the recently enacted Public Service of Ontario Act 2006 dealing with ethical conduct, and disclosure and investigation of wrongdoing. This Act enables OSC staff to make disclosure of wrongdoing externally to a third party. The OSC is also in the process of setting up a system for the disclosure of wrongdoing within the organization, which will include a process for the investigation of reports under the system.</p> <p>The AMF's president and personnel with delegated authority are required to provide a detailed report of their assets on an annual basis. This report has to be updated every time that a material change occurs. These reports are analyzed by the secretariat of the CEO. The assessor was informed that in the past on a few occasions the secretariat has given orders to staff in relation to investments, including setting up blind trusts for the management of their investments.</p> <p>Confidentiality</p> <p>The current legal framework for both regulatory agencies contains explicit provisions that require the staff to maintain the confidentiality of information obtained in the course of their functions (OSC By Law No. 2 and Section 16 of the AMF).</p> <p>Investigations of violations of the code of ethics</p> <p>Their respective code of ethics contains the procedures to investigate and resolve allegations of violations of the code. The nature of an investigation or alleged violation of the OSC Code of Conduct or By Law No.2 and the person who will conduct the investigation will depend on the nature and seriousness of the violation</p>
Assessment	Fully implemented
Comments	
Principle 6.	The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
Description	<p>CSA Systemic Risk Committee</p> <p>The Systemic Risk Committee of the CSA constituted in 2009 serves as the main mechanism for CSA members to identify and monitor systemic risk arising from the securities markets. The SRC is composed by staff of the largest CSA provinces. Thus, in practice the identification of systemic risk is done by a coordinated effort of staff of the largest securities regulatory agencies. The SRC meets via conference calls every two</p>

weeks and in person once a year.

Definition

The SRC's definition below is the test by which systemic risks are identified and documented by the SRC. Systemic risk is the risk of a shock:

- affecting a significant number of market participants contemporaneously,
- which may directly or indirectly result in:
 - a broad decrease in the availability, or a significant increase in the cost, of capital for issuers and individuals; and/or
 - a significant erosion of investor confidence in the fairness and efficiency of the capital markets.

Identification

The SRC currently conducts a comprehensive assessment of risks at least once every two years. The SRC process to identify systemic risk is a top-down exercise that starts by identifying all major categories of capital markets activities and participants (e.g. investment dealers, OTC derivatives and clearing houses). Categorization is performed without initial consideration of regulatory responsibilities, to better understand the structure of the markets. This exercise has led to the SRC identifying more than 50 categories of activities and market participants. Each of the categories is then prioritized with a high, medium or low priority rating.

Currently such prioritization is mainly qualitative—mainly due to data challenges—and relies on the criteria proposed by the FSB/IMF/BIS report to the G-20 finance ministers and Central Bank Governors in October 2009 (particularly size/significance, level of interconnectedness, and availability of substitutes), with the added criteria of considering the level of regulation in place and the jurisdiction of Canadian securities regulators. That is, the focus of the CSA is on risks that are within the mandate of the securities regulatory authorities.

All high and medium priority categories are analyzed in depth by the SRC members, as well as any previously outlined systemic risks (through previous comprehensive assessments). The CSA also hypothesize additional risks and vulnerabilities that could have systemic implications. Each risk and vulnerability are then analyzed and assessed in detail by gathering information, data or reports from academic sources, other regulators or international organizations, such as IOSCO or the FSB.

Each category reviewed is also evaluated for systemic importance on a scale of 1 (low) to 5 (high) using the criteria of size/significance, interconnectedness and availability of

substitutes. The purpose of this rating is to confirm the relative potential for systemic risk in each category assessed, independent of the level of regulation.

The analysis of each category and risk is then discussed by the SRC as a committee. Documented risks and vulnerabilities are evaluated against the SRC's working definition of systemic risk.

Monitoring

For each risk, the SRC proposes a risk owner. The risk owner may be another regulatory jurisdiction or a committee within the CSA that is closely tied with the functioning of a particular category. The SRC also monitors progress of risk mitigation by other regulatory agencies through quarterly inter-agency meetings. Those findings, issues or mitigation plans are then incorporated into the SRC's analysis.

Reporting

The SRC is accountable to the CSA Chairs.. Similarly, CSA committees that are deemed risk owners and are working on mitigation strategies for outstanding risks are also accountable to the Chairs.

The SRC delivers an annual report to the CSA Chairs that documents all risk monitoring findings identified during the most recent risk monitoring cycle. All outstanding risks are reported to the Chairs and recommendations made, if necessary, on steps to either mitigate a particular risk or to monitor it more closely.

Practice

The SRC identified the repo market as an important source of funding liquidity and a potential conduit of systemic risk. A potential risk identified through the process is the lack of transparency of the repo markets. As a result a number of initiatives are underway to improve the transparency and integrity of this market:

- CDCC is developing a fixed-income CCP, which includes repos;
- IIROC is enhancing the current Market Trade and Reporting System (MTRS) with a trade-by-trade reporting system to increase regulatory transparency of the repo market, among other markets; and
- In addition, the CSA Investment Funds Committee is proposing enhanced disclosure of investment funds that engage in securities lending.

The SRC may also make general recommendations within its mandate. For example, in the SRC's first report to the CSA Chairs, the SRC recommended that a permanent body be established within the CSA to address systemic risk. The Chairs agreed and

transformed the SRC, which had been a project committee, into a permanent standing committee of the CSA. In the SRC's second report, the SRC recommended the establishment of regular meetings between staff of the agencies that participate in the HoA to discuss matters related to systemic risk. These meetings have been ongoing approximately on a quarterly basis. More details are provided below.

HoA

In addition to reporting to the CSA Chairs, the SRC shares findings with other federal financial authorities through the HoA. The HoA serves as a forum for regulators to coordinate policy and discuss matters of mutual interest including systemic risk. The HoA is composed of the Chairs from the four largest provincial securities commissions (Alberta, British Columbia, Ontario and Québec), the Governor of the Bank of Canada, the Superintendent of Financial Institutions, and senior members from the Department of Finance. The HoA is currently chaired by the Governor of the BoC.

The HoA meets at least quarterly, or more frequently as necessary, to discuss issues of common concern to the various agencies represented within the HoA. The HoA is supported by a "Sub-HoA" Committee composed of senior staff level representatives. The Sub-HoA also meets regularly and seeks to promote collaboration between the respective financial sector regulatory agencies.

Currently, the HoA's main focus includes ensuring a sound regulatory framework established for OTC derivatives, including trading and clearing of such products.

Interagency communication

The SRC also participates in inter-agency staff-level calls with the Bank of Canada, Department of Finance (Canada), IIROC and OSFI. The purpose of these calls is to ensure that each regulator has an opportunity to share information related to potential new systemic risks that may cross regulatory boundaries, to inform the other regulators of what developments may be taking place within each regulator's jurisdiction pertaining to systemic risk (research, publications, econometric and financial model development), and facilitate general discussion and knowledge sharing regarding systemic risk. For example in 2011 four interagency calls took place and staff held discussions on shadow banking, securitized instruments, hedge funds, ETPs, MMFs, the potential shortage of safe assets collateral and global macroeconomic conditions.

In this regard a potential systemic risk that has been identified through the inter-agency meetings is the possible future shortage of safe assets for collateral, although neither the SRC nor the other Canadian agencies have concluded that the risk is systemic. The risk is being monitored and analyzed by the Bank for International Settlements Working Group on Bi-lateral Margining and the Committee on the Global Financial System, in

	<p>which the BoC participates.</p> <p>Expertise</p> <p>The CSA relies on the work performed by the SRC as the primary resource tasked with identifying and monitoring systemic risk within the remit of Canadian securities regulators.</p> <p>The initial focus of the SRC members was to develop a methodology to identify risk in securities markets. To this end, considerable research was conducted on the work of other securities regulators in this area. More recently, SRC members conducted an extensive review of academic literature on funding liquidity risk and market liquidity risk measurement techniques.</p> <p>In practice, as the SRC is composed of staff of the provincial agencies, the expertise on systemic risk is being built at the provincial level, in particular in the largest securities agencies. Furthermore, some of the agencies have constituted units whose functions would contribute to the work of the SRC. For example, the AMF recently created the Strategic Oversight responsible for systemic risk and economic analysis. The unit is currently working on developing a risk dashboard with key indicators for securities markets, and it plans to issue periodic publications on risk.</p> <p>Staff also highlighted that through cooperation of domestic agencies, the SRC is able to leverage additional experience and expertise related to risk measurement and analysis. For example, the development of policies and rules for the clearing of OTC derivatives has been a joint effort between Canadian agencies, which has been supported by quantitative analysis performed by the Bank of Canada.</p> <p>On an international level, the SRC staff participates in IOSCO's SCRR, which is responsible for developing systemic risk assessment methodologies and to provide a forum for economists and risk analysts of securities regulators. Thus, SCRR provides an opportunity to learn from the expertise of securities regulators outside of Canada.</p>
Assessment	Broadly Implemented
Comments	<p>The initial assessments conducted by the IMF under the new methodology focused on the analysis of three high level issues in connection with the existence of a process to identify systemic risk or to review the perimeter of regulation, which is required pursuant to question 1 of the respective principles: (i) whether the arrangements in place allow for a holistic (across products, entities, and markets) view of risk, (ii) whether they allow for periodic reassessment of risk (iii) and whether they allow for proper follow up (actions). The experience gained over the last year allows assessors to delve deeper into these issues, for example, by looking at the type of data and analysis that is used by the authorities to identify such risks, and the degree to which the processes</p>

	<p>implemented allow for proper accountability. Such rigorous analysis is in line with the recommendations included in the report of the Assessment Committee of IOSCO.</p> <p>Accordingly, and based on question 1 and question 3 in the methodology, this principle has been graded broadly implemented. The regulatory agencies have made a good start in their efforts to contribute to the identifications, management and mitigation of systemic risk. The working definition developed by the agencies focuses on the areas that are under the purview of the securities regulators. While simple, the current methodology allows for a holistic view of risks, as well as its periodic reassessment. The process also involves proper mechanisms of monitoring and accountability. It is important, however, that the current approach which is mainly qualitative, be complemented with more use of quantitative analysis to make the assessment more robust. As stated in the description, the authorities are making efforts in this regard, including for example, the development of a risk dashboard. Further it is important to acknowledge that this challenge is not unique to the Canadian securities regulators, although in their cases an additional challenge has been the limited amount of quantitative data currently available. The assessor encourages the authorities to consider how to best address current data challenges and data collection—in particular whether it would make sense to have a centralized database at the CSA level— as well as expertise—in particular whether it makes sense to have specialized staff at the CSA level, or whether the current approach based on a network of specialized staff using and sharing common databases and information suffice.</p> <p>In addition, the assessor encourages the authorities to further analyze whether current arrangements allow for an optimal engagement of the agencies with the SROs for purposes of risk identification, and whether the SROs have themselves proper mechanisms in place for risk identification. For example, whether the strategic issues management meetings that IIROC has added to its arrangements—as further described in Principle 7 are sufficient—or whether additional data mining should be considered?.</p> <p>Finally, it is important that coordination mechanisms at the financial sector level be strengthened, both in connection with risk identification—for which data is a challenge—as well as in connection with crisis management and resolution involving the large IDs, as will be further explained in Principle 32</p>
Principle 7.	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p>Identification of emerging risks</p> <p>The Committee system of the CSA constitutes the primary vehicle used by the securities regulatory agencies to raise within the CSA issues of concern arising from the activities of both regulated and unregulated entities, including emerging risks.</p>

The CSA committees are structured by topics; and thus they are integrated by staff from the different provinces with responsibilities in the respective area. Examples of committees that are important for purposes of identifying risks, including those arisen from new products and unregulated entities are the Securitization and Financial Innovation Committee; and the Unregulated Market Service Providers Committee.

The concerns raised by committee members can lead to different type of actions, for example agreements on sweeps that would be conducted by one or more provinces (to determine the extent to which a concern is widespread) or policy proposals. In the latter case, a project proposal is sent to the policy coordination committee, for approval via a mandate form that would clearly state the issue that needs to be studied/analyzed/reviewed, and the resources that would be needed. The CSA can introduce requirements under rulemaking powers. If the issue is best addressed through legislative amendments, staff would initiate discussions with provincial government officials to advance the necessary amendments.

An example of the former has been the sweeps conducted on EMDs. One example of the latter is the policy proposal on the table in respect of non-bank ABCP—which will be further described in Principle 8.

The work of the CSA in turn is supported by arrangements that the provincial regulators are developing in their respective jurisdictions to identify and monitor emerging risks. For example, the OSC has established a Policy Review Committee, an Emerging Risk Committee and a Novel Products, Structures and Financial Innovation Committees. These committees complement the regular informal meetings of executive management where emerging regulatory issues are discussed. The PRC provides a forum to discuss policy priorities and to identify potential overlap or gaps in ongoing policy work. The ERC was established recently to help identify potential emerging risks. The NPSFIC acts as a forum for cross-branch discussions of files or matters that involve new products or market based innovations (e.g. new business structures and/or distribution channels) and acts as a source for identifying potential changes that may be required to the regulatory perimeter.

In Québec, the AMF has also structured some internal groups with similar objectives and created a risk management committee last year, which oversees risk identification, monitoring and the AMF's action plan. Furthermore, a new team was recently created in the market surveillance department that is responsible for identifying new products and market trends. These groups work in collaboration with the newly created department of Strategic Oversight responsible for systemic risk and economic analysis.

Identification of emerging risk is also supported by the work of IIROC, which after 2007 holds strategic issues meetings on a monthly basis with the main objective of discussing trends and emerging risks.

	<p>Review of rules and exemptive relief</p> <p>The CSA committees also review rules, typically a year after a rule has come into force and also as a result of new information coming to light. Such reviews may lead to amendments depending on the experience of working with the rule and its impact.</p> <p>In addition, it is common practice for staff of the agencies to review exemptive relief applications to identify trends and areas that require further policy changes. In addition, CSA members often issue exemptive relief orders containing a “sunset” provision. The sun-setting of the decision promotes a review of the desirability of maintaining the relief. Alternatively, industry participants may bring forward evidence of changing conditions and how past regulatory policy decisions may no longer be addressing a particular issue or how there have been unintended consequences of past decisions. Evidence that circumstances of past decisions have changed may lead to policy changes, if appropriate.</p> <p>For example, a new registration category for IFMs was created after a number of potential risks particular to fund managers were identified. These risks included: (i) incorrect or untimely calculation of NAV; (ii) incorrect or untimely preparation of financial statements and reports; (iii) incorrect or untimely provisions of transfer agency or record-keeping services; and (iv) conflicts of interest between the fund manager and the investors.</p>
Assessment	Broadly Implemented
Comments	<p>As stated under Principle 6, the experience gained from the conduction of assessments relying on the new methodology allows assessors to delve deeper into the key elements that the processes in place must meet. Accordingly and based on question 1 of the methodology this principle has been graded broadly implemented.</p> <p>It is important that the agencies deepen their approach for the identification of emerging risks by making more use of quantitative analysis. In addition, as stated on Principles 1 and 6, it is critical that identification of risks be built on a system of two way communication with the SROs, in particular IIROC in light of its broader mandate</p> <p>Finally, the assessor encourages the authorities to consider whether the current arrangements, which largely rely on a decentralized process (via the CSA committees), require further strengthening by, for example, establishing more structured mechanisms for follow up (as was done in the context of systemic risk identification via the CSA Systemic Risk Committee).</p>
Principle 8.	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.

Description	<p>Regulated entities</p> <p>The existing regulatory framework requires regulated entities to put in place mechanisms to identify, monitor and mitigate conflicts of interest.</p> <p>Overall the framework for securities intermediaries is principles based, and establish three type of actions that intermediaries can take to address conflict of interest, avoidance, control and disclosure (see Principle 31). In the case of public CIS additional safeguards were put in place, by requiring all public CIS to establish a IRC, with independent members in charge of reviewing conflicts of interest, with the authority to approve transactions, in some cases, and provide recommendations in others (see Principle 24)</p> <p>Conflict of interest obligations exist also for other type of participants including auditors (Principle 20), credit rating agencies (see Principle 22), sell side analyst (principle 23), and SROs (principle 9).</p> <p>Through the discussions with market participants and the regulatory agencies, a few issues were identified as sources of conflict of interest that require a regulatory action:</p> <ul style="list-style-type: none"> • Trailing commissions: The regulatory authorities are aware of this risk, and a policy proposal is currently on consultation, which considers different alternatives to mitigate this risk from better disclosure to banning trailing commissions. • Distribution of securities of related issuers: Compliance inspections conducted in Ontario resulted in the OSC taking regulatory action against a number of EMDs. Notably, 13 EMDs were suspended or referred to the OSC's Enforcement Branch as a result of compliance inspections conducted from early 2010 to date. In addition, staff in Ontario have commenced an initiative to address the issues associated with the distribution of related issuers, including ensuring that investors are provided with more reliable information and imposing notification and ongoing disclosure requirements. Both IIROC and the MFDA also have concerns with their members selling related issuer products. They have also issued staff notices that outline their regulatory concerns and expectations of members. (see for example IIROC Notice 13-0039 in connection with best practices for distribution of non arms length investment products). • Sale of mutual funds to investors via borrowing: OSC staff issued a notice [expand]. <p>Issuers</p> <p>In the case of issuers, overall the main mechanism used to address misalignment of</p>
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	<p>incentives is disclosure to the public. For example, the current framework for issuers who offered securities to the public requires that the prospectus includes information on related party transactions, and compensation arrangements for certain executive officers and directors.</p> <p>Through the discussions with market participants and the regulatory agencies, a few issues were identified as sources of conflict of interest that require a regulatory action:</p> <ul style="list-style-type: none"> • The non-bank ABCP market pre-crisis. The CSA Securitization and Financial Innovation Committee (SAFI) is currently finalizing a proposal to address the misaligned incentives it has identified with non-bank ABCP. While there are no longer any non-bank ABCP conduits participating in the short term debt market, the SAFI is concerned that this product may return to the market in the future. SAFI therefore is working on amendments to the short term debt prospectus exemption (which enables short-term debt to be issued without a prospectus and without any restrictions on who can invest) so that it cannot be used to issue non-bank ABCP with synthetic assets. • Another area of potential misalignment of incentives relates to the public offering of emerging market issuers in the Canadian markets: the OSC's Emerging Markets Issuer Review assessed the quality and adequacy of the disclosure and corporate governance practices of 24 emerging markets issuers and examined the manner in which they accessed Ontario's markets. The review raised significant concerns relating to governance, auditing and listing practices and has resulted in collaborative work with other regulators and gatekeepers.
Assessment	Fully Implemented
Comments	<p>As indicated in the description, there are several areas that exhibit important conflicts of interest. It is important that both policy and enforcement actions be taken on a timely manner, as necessary. In the area of trailing commissions it is key that through coordination with other financial authorities a level playing field solution could be adopted; that is that any solution adopted be applicable also to like-products sold by other intermediaries (for example, segregated funds, but also banking products as long as there is also an issue of imbedded trailing commissions)</p>
Principles for Self-Regulation	
Principle 9.	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated

responsibilities.	
Description	<p>Existing SROs</p> <p>Canada’s regulatory system makes use of SROs.</p> <p>IIROC and the MFDA are the two key SROs that operate across jurisdictions in Canada and are recognized as such in most jurisdictions (usually they are called the national SROs). They are responsible for regulating the business conduct and setting minimum prudential and other operational requirements for investment dealers and mutual fund dealers respectively. Both IIROC and the MFDA establish rules of eligibility, enforce binding rules of trading, business conduct and qualifications, and establish disciplinary rules and/or conduct disciplinary proceedings. Pursuant to NI 31-103 firms wanting to become an investment dealer or mutual fund dealer must mandatorily become an IIROC and MFDA member respectively and their representatives must be approved by and are subject to the jurisdiction of the applicable SRO—with the exception of MFD in Québec and their mutual fund dealers, which are under the direct supervision of the AMF (the firm) are under the CSF (the individuals).</p> <p>IIROC is recognized by the securities regulators of Ontario, Québec, British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Newfoundland, Nova Scotia and Prince Edward Island, and operates in all Canadian jurisdictions. It regulates the business and trading conduct of investment dealers and the trading conduct of other participants on equity marketplaces.</p> <p>The MFDA is recognized by the securities regulators of Ontario, British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia and PEI, and operates in all Canadian jurisdictions, other than in Québec. It regulates the business conduct of mutual fund dealers. In Québec, mutual fund dealers are regulated directly by the AMF.</p> <p>Exchanges –other than the equity exchanges and NGX—are also recognized as SROs as they regulate trading by participants on their trading facilities and conduct market surveillance. The operations of the exchange SROs are mainly described in Principle 34. While the three equity exchanges and NGX also have self-regulatory responsibilities, they are not separately recognized as SROs. The three equity exchanges outsource to IIROC for market surveillance and surveillance of members compliance with trading rules. NGX conducts its own market surveillance.</p> <p>In Québec, the CSF is responsible for discipline and regulating and ensuring compliance with continuous training of its members (individuals only) who work as mutual fund dealer representatives and scholarship plan dealer representatives in Québec and is limited to regulating in those areas. It is recognized directly under the <i>Distribution Act</i> (Québec) (Distribution Act) and not by the AMF.</p>

Recognition

Applicable securities and derivatives legislation give the securities regulators the authority to recognize an entity as an SRO if it would be in the public interest. This is done by the issuance of a RO, which by law can include terms and conditions in addition to those contained in legislation.

An application for recognition must set out detailed information sufficient to clearly demonstrate that the entity can meet the criteria for recognition. These are whether the entity:

- has an appropriate corporate governance structure: fair and meaningful representation on its governing body and committees of the governing body, in the context of the nature and structure of the SRO;
- will regulate to serve the public interest;
- is able to identify and manage conflicts of interest;
- has fees that are equitable, fair and transparent and do not create unreasonable barriers to access;
- has reasonable criteria to permit all persons who meet its membership criteria to become members;
- is financially viable;
- has sufficient financial, technological, human and other resources to perform its regulatory functions;
- can ensure the capacity, integrity and security of its technology systems;
- has rules that are comprehensive, designed to promote investor protection, provide appropriate discipline and do not impose an inappropriate burden on competition or innovation;
- has a fair and transparent disciplinary process;
- is able to and will share information and co-operate with securities commissions (domestic and foreign) and other entities such as other SROs, exchanges, clearing agencies, law enforcement and investor protection or compensation funds.

In many cases the RO will establish terms and conditions to ensure compliance with the issues listed above. One example is reporting obligations for the SROs in connection

with their investigations and enforcement actions. Another example has been the RO of IIROC or the RO of the MFDA which require them to submit for approval any changes to their corporate governance structure.

Recognition Process

A recognition process starts with the applicant filing a draft application setting out its ability to meet the above identified recognition criteria and providing any necessary supporting documentation, including documents (such as corporate by-laws), organizational charts, board mandates and board committee charters and their composition, rule books and membership requirements, annual reports and financial statements, and reports of any independent reviews of its critical systems, including technology systems.

In the case of IIROC, which was formed by the merger of the Investment Dealers Association of Canada and Market Regulation Services Inc., CSA staff formed a committee comprised of 14 persons from eight commissions to review the merger. The committee met with representatives of the IDA and RS and asked for supporting documentation and information it considered necessary to determine whether IIROC would meet the criteria for recognition.

The staff review concentrates primarily on those areas of greatest concern, which typically include corporate governance, management of conflicts of interest, membership and access, the SRO's ability to perform its regulatory functions and its financial viability. Staff will follow up with the applicant as necessary to seek clarifications on the materials provided or to obtain additional information. Staff will also, as appropriate, discuss issues and seek input from senior leadership within the securities regulatory authority. In the case of IIROC, this review took approximately one year.

After all issues are resolved to the securities regulators' satisfaction, the applicant is asked to file its application in final form. Once approved for publication, the comment period typically lasts 30 days. If significant comments are received or material issues are raised during the comment period, it may result in further revisions to the draft order and a second round of public consultations. When all comments and issues have been resolved to the satisfaction of the securities regulators, a final order recognizing the entity as an SRO will be issued.

Recognition of a SRO in Multiple Jurisdictions

Where an entity seeks to be recognized as an SRO in multiple jurisdictions, it will file applications with all the relevant securities regulators. Staff from different securities regulators would work closely to coordinate their reviews, by sharing issues, discussing resolution of those issues, harmonizing terms and conditions of recognition, and

developing and following a common timeline for processing of the application. For example, IIROC filed its recognition application with eight jurisdictions initially, and staff from these jurisdictions formed a committee to coordinate their reviews. Throughout the review process, the staff committee provided regular updates to the CSA Chairs to keep them informed of issues and their resolution.

In the case of the MX, the AMF held hearings over two days in November 2011 on the proposed acquisition of the TMX Group Inc. (the MX's holding company) by Maple Group Acquisition Corporation. Apart from the public hearing, the process followed in recognizing the MX as an SRO is similar to that set out above. The AMF issued a RO on May 2, 2012.

Corporate Governance

The terms and conditions of recognition require IIROC and the MFDA to have a fair representation of members on its board of directors and board committees to ensure a diversity of representation and a proper balance between the interests of its different members. In addition, they are required to have a certain number of independent, "public" directors who are not associated or affiliated with the SRO or any of its members (a minimum of 50 percent in the board and then there are also rules for representation of independent directors in different relevant committees). IIROC and the MFDA are also required to ensure that their directors and officers are fit and proper persons, that is, they act honestly and in good faith and are competent to perform their functions.

The exchange SROs have similar obligations to promote a fair representation of members in selection of its board of directors and administration of its affairs. For example, the MX board must be comprised of at least 50 percent independent directors and the Chair of the board must be independent.

In the case of the CSF, two members of the CSF board are appointed by the Québec Minister of Finance for a term of three years. The other members of the board are elected by its members.

Conflicts of interest

In general SROs are required to identify and manage their conflict of interest. In addition, their recognition criteria require that the written policies in connection with conflict of interest be filed with the regulators. In addition, SROs are required to periodically assess the effectiveness of their governance arrangements. Changes to the governance structure are subject to prior approval by the recognizing regulators.

In addition, the recognition criteria for the SROs require the SRO to have a governance

structure that minimizes the potential for conflicts by requiring a minimum number of independent or “public” members of their boards of directors as defined in the entity’s by-laws or by requiring that the board have a proper balance between, and effective representation of, the public interest and the interests of members and the interests of different types of members. In the context of IROC, the recognition criteria established additional requirements aimed at addressing the concern that TSX, which was a shareholder of RS (one of the predecessor organizations) and which is one of the markets for which IROC performs market regulation, have a disproportionate role in the governance of IROC. This was achieved by requiring that the board contain at least one director from a marketplace other than one owned by the TSX.

The recognition criteria do not impose conditions in regard to the governance of the enforcement function. The current governance structure of IROC allows for participation of industry representatives in the hearing panels (which are the adjudicative body for purposes of enforcement), as they are currently composed by two industry representatives designated by the district councils and one independent member. It also allows limited participation of the district councils in the licensing process (as they are required to provide an opinion in connection with the admission to membership). In the case of MFDA, the regional councils also have a role in connection with the enforcement function, as well as policy matters.

As will be explained below, in particular in connection with governance arrangements, the AMF has requested improvements to CSF in connection with its relationship with the sections. In addition, some stakeholders expressed concerns about the need for rules to be approved by members of the MFDA.

Separation of regulatory functions (for exchanges SROs)

The RO of TSX does not require full separation of listing regulation operations from business operations. As part of the ongoing oversight by the securities regulators, the management of conflicts of interest from the listing function was analyzed and recommendations made.

MX Regulatory Division’s functions and operations are independent and structurally separated from the for-profit operations of the MX. The Division performs its functions and operations based on the principle of self-financing and shall not be for-profit. Pursuant to the MX’s RO and rules governing the Division, the MX must ensure that the Division is provided with sufficient resources and funds. Furthermore, no regulatory fees, fines or penalties collected by or on behalf of the Division may be distributed or transferred to the MX for commercial purposes or for payment of dividends. The Division funds its programs and activities, including surveillance, investigations and examinations, through distinct regulatory fees assessed directly on approved participants of the Exchange. Regulatory fees collected are for the exclusive use of regulatory operations. Also, under RO, fines and other sums received by the Division

pursuant to out-of-court settlements with the Division or disciplinary proceedings are treated under specific provisions.

Oversight approach

As IIROC and the MFDA are recognized by multiple regulators, the CSA has established oversight committees for each entity to coordinate their oversight and to ensure that issues are identified and resolved in a consistent manner. The IIROC oversight committee is chaired by the OSC and the MFDA's is chaired by the BCSC.

The oversight committees meet quarterly in two sessions, one with just the committee members and one with SRO staff; they also hold ad hoc meetings as appropriate. The purpose of these meetings is to discuss matters relating to the oversight of the SRO, regulation of the SRO's members and other matters of interests. The oversight committees report annually to the CSA Chairs on their activities.

As described in Principle 1 coordination arrangements follow a principal regulator approach whereby one regulator acts as the coordinator to channel all queries to the SRO. These arrangements have been formalized in a MoU (the one for MFDA is awaiting Ministerial approval in Ontario).

Oversight Program

The oversight program of an SRO includes: (i) approval of rules, (ii) periodic reporting, (iii) periodic meetings (at least quarterly), and (iv) on site reviews.

For IIROC and MX, it also includes an automation review program (including Independent System Review (ISR)): An SRO with key technology systems and processes, i.e. IIROC and MX, is also subject to an automation review program (ARP) in order to assess the system's capability and reliability of an SRO. The key components of an ARP are: (i) Annual independent system review, which requires an SRO to annually engage an independent qualified party to conduct a review of its systems and relevant controls and to report on such review; (ii) notification of material system failure, malfunction or delay; and (iii) Regular reporting on recent and anticipated systems changes.

In addition, where there are events that could have a significant impact on investor protection or the capital markets in general, and where SROs have a role to play, CSA staff will liaise with the SROs and monitor how the SROs are dealing with the situation. Examples of these types of events include the MF Global bankruptcy and Penson Canada's closure of business. In these cases, CSA staff received periodic updates from IIROC to assess the potential impact to the market (e.g. number of clients or number of introducing dealers), any risk with respect to end clients or the market in general, and IIROC's response.

Review of governing instruments and rules

Under their ROs, SROs are required to obtain approval of the recognizing regulator(s) for, among other things: (i) changes in the corporate governance or organizational structure; (ii) fees; and (iii) rules, policies and by-laws and amendments to rules, policies and by-laws. As will be further explained in Principle 34 in the case of MX its rules are subject to a self-certification process –which in practice incorporates steps designed to ensure that the AMF reviews the rules and is satisfied with the way the MX has addressed comments by stakeholders during the consultation period.

In Ontario and Québec, IIROC rules and by-laws and any amendments are published for public comment. MFDA rules, by-laws and amendments are similarly published for comment in British Columbia and Ontario. Comments received are shared with the other recognizing regulators.

For purposes of ensuring efficiency in the review process, the regulators have developed a classification of rules in substantial changes and housekeeping rules. Substantial changes are subject to pre-approval, and consultation; while housekeeping only need to be notified. The regulators can “contest” the classification made of a rule, and the information provided shows that there have been cases where they have done so, thus subjecting a rule initially classified as housekeeping to the full process of a substantial change.

Reporting requirements

Each SRO is subject to certain periodic reporting requirements. For example, it needs to submit to the recognizing securities regulators, its financial statements, strategic plans, information and statistics about its compliance and enforcement programs. Both IIROC and MFDA are required to undertake a self-assessment of their regulatory functions on an annual basis (IIROC must submit within 90 days, and MFDA within 120 days of the end of the fiscal year). In addition, the ROs establish the authority of the regulators to request ad hoc reporting. An example of this is the MF Global bankruptcy matter.

Details of specific reporting obligations are as follows:

IIROC

IIROC’s ROs contain extensive reporting obligations that include:

- prompt notification of material violations of securities laws of which it is aware;
- prompt notification of misconduct by members and approved persons where investors, clients, creditors, other members, Canadian Investor Protection Fund (CIPF) or IIROC may be expected to suffer serious damage, including fraud and

serious deficiencies in internal controls;

- prompt notification if a member's financial viability is uncertain;
- providing the schedule for its financial, business conduct and trading conduct on site reviews
- providing quarterly reports of terms and conditions imposed on the registration of approved persons;
- providing quarterly reports of exemptions granted from IIROC's UMIR; and
- providing detailed ad hoc, monthly, quarterly and annual reports of enforcement activities.

MFDA

The ROs set out extensive reporting requirements, including a requirement for the MFDA to report:

- any material changes to the MFDA's organizational structure;
- any disciplinary or settlement hearing including the resolution of the hearing of members in financial difficulty;
- actual or apparent misconduct by member firms or member employees;
- if any member has failed to file on a timely basis any required financial, operational or other report;
- any conditions that exist with respect to a member firm which, in the opinion of the MFDA, could give rise to payments being made out of an investor protection fund; and
- members whose rights and privileges will be suspended or terminated or whose membership will be terminated.
- annually a report of its regulatory staff complement to each of its recognizing regulators.

CSF

The supervision plan contains disclosure and reporting requirements for the CSF. For example, the supervision plan provides that:

- Report to the AMF any fraud or serious irregularity brought to its attention and

committed by one of its employees in the supervision, internal controls or compliance with its rules or applicable laws;

- Submit a notice to the AMF of any material change to its administrative structure or in the way it conducts its functions and powers of SRO, except requirements specifically provided for in the Distribution Act;
- Notify the AMF upon receipt of a written complaint, deemed relevant and involving the CSF;
- Notify any modification to the amount of the annual contribution of its members or to the charges required from the members;
- Notify information related to syndic's activities;
- Notify information related to the Discipline Committee's activities; and
- Submit its annual report and financial statements.

Exchange SROs

The exchange SROs, equity exchanges and NGX also have specific reporting requirements, including those described in the response to Principle 34.

Inspections and periodic reviews

For IIROC and the MFDA, the recognizing regulators carry out an on-site inspection at least once every three years.

The recognizing regulators perform a risk assessment of all functional areas of the SROs (i.e. all regulatory divisions) and its governance structure and processes and develop an oversight review program to review key, high risk areas. Higher risk areas receive more in-depth reviews, while low risk areas are subject to a more cursory form of review. Key areas of review will include the operation of all regulatory divisions and corporate governance.

The review team typically comprises lawyers, accountants and subject-area specialists from the jurisdictions participating in the review. Once the review plan is finalized, the SRO will provide a list of documents requested by the inspection team. The inspections take place in the SRO's offices in Montréal (for IIROC only), Toronto, Calgary and Vancouver. The review is coordinated among the recognizing securities regulators, with a uniform review program and uniform performance benchmarks.

The field work typically lasts four to eight weeks and consists of meetings with the Chair of the board or board committees, members of the board, senior management and

staff, and review of documents (including corporate records, agendas and minute books of the board and committees, operational files, and other relevant documents).

After the field work is completed, a consolidated report is drafted with the SRO's responses. A final version of the report is drafted and provided to the recognizing securities regulators for approval. A follow-up plan is developed to monitor the correction of any issues and the implementation by the SROs of recommendations made by the recognizing securities regulators.

IIROC

For IIROC the first on-site review after the merger was in 2009 and covered the review period for member regulation from 2006-2009 and market regulation from 2004-2009. The inspection was conducted by staff of the OSC, AMF, ASC, BCSC, MSC, NBSC, NSSC and SFSC. The review encompassed the following areas: corporate governance; Fees and resources; Policy; Enforcement (case assessment, investigations and litigation); Business Conduct Compliance; Financial and Operations Compliance (FinOps); Trading Conduct Compliance; Market Surveillance; Trading Review and Analysis; Membership and Business Continuity Planning. In the report, the participating regulators concluded that IIROC was substantially compliance with the terms and conditions of its ROs, though in particular areas it was requested to prepare a plan of action to address deficiencies. For example, a key finding was that the focus of the Enforcement Department's work remained on Dealer Members' retail activities (complaints) with relatively few cases sourced from referrals from other IIROC departments, such as the Compliance groups. This issue will be further discussed in Principle 12.

Also, in March 2010, staff of the AMF, BCSC and OSC conducted a targeted review of IIROC's registration functions in light of newly-adopted CSA registration rules. The review was conducted in IIROC's Montréal, Vancouver and Toronto offices. Staff of the examining regulators found that IIROC was carrying out its registration mandate in accordance with the requirements of the various ROs. The examination made a number of recommendations, mainly with respect to ensuring better communication between IIROC and the commissions of issues with registrants and tracking of public complaints

IIROC provided quarterly updates to CSA staff on the status of implementation of the recommendations of the 2009 and 2010 oversight reviews; CSA staff monitored progress in the implementation and held discussions with IIROC management regarding any issues noted.

An on-site review of IIROC is planned for early 2014. It is currently in the early planning stages and is intended to be a risk-based review similar to the 2012 MFDA review.

	<p><i>MFDA</i></p> <p>An oversight review of the MFDA was conducted in 2009. In that review, approximately 30 staff from the recognizing regulators reviewed every functional area and each MFDA office. Staff were generally satisfied that, during the review period, the MFDA operated in the public interest and, for the most part, it complied with the respective ROs. However, in particular areas the regulators instructed the MFDA to set up a plan to address deficiencies found. One of these areas has been in connection with the need to ensure timely response from registrants to the findings of compliance reviews. This issue is further discussed in Principle 12. Additionally, the CSA just completed an oversight review of the MFDA. The report covered the period from January 1, 2009 to June 30, 2012. The review was conducted using a new risk-focused assessment and review methodology developed by the CSA for application to the SROs. The new review methodology involved an assessment and risk rating of every aspect of the MFDA's operations and a determination, based on a predetermined risk analysis, of the areas that required review. The oversight review covered a limited scope in each of the following functional areas that were assessed (utilizing the model) as higher risk: Corporate Governance, Sales compliance; Financial Compliance, Enforcement, Policy, and Membership.</p> <p><i>CSF</i></p> <p>Under the supervision plan the AMF inspects the CSF every three years. In the last five years, the AMF conducted two on-site inspections of the CSF. An inspection report was published regarding the first inspection which covered the period from 2004 to 2007. The AMF inspection program includes four major sections: governance structure, including internal rules, policies and procedures; financial allocation assets and allocation budget; activities of the syndic, the discipline committee and their members; and compulsory professional development activities.</p> <p>The main governance issues resulting from the inspection included the lack of supervision, by the CSF, of its sections. The CSF's members are divided into sections on a territorial basis, as the province of Québec is divided into 20 sections. The sections facilitate the exchange of information between the members and the CSF, as well as access to continuing training activities. They also support the CSF compliance initiatives and organize networking activities.) The AMF also recommended changes to the CFS's policies and procedures. CSF filed an implementation plan with closing dates for each of AMF recommendations. AMF meets on a regular basis with CSF to discuss various matters, including follow-ups to the implementation plan.</p> <p><i>Exchange SROs</i></p> <p>Details of oversight inspections of the exchange SROs, the equity exchanges and NGX</p>
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are contained in our response to Principle 34.

Authority of the regulators

Securities regulators retain ultimate jurisdiction over members of an SRO and their representatives as they must be registered with the applicable securities regulators.

The securities regulators have the authority to revoke a recognition order or impose terms and conditions if they consider it to be in the public interest.

The ROs also require an SRO to cooperate in a substantial manner with each of its recognizing regulators and, further, to provide each recognizing regulator with unrestricted access to the books and records, management, staff and systems.

Decisions of IIROC and the MFDA may be appealed to the applicable securities regulators (and in Québec, decisions of the CSF may be appealed to the Court of Québec). In addition, exemptions given to SRO members under NI 31-103 require the exempted party to comply with applicable SRO rules. If the party does not comply, the exemption is not available and the party is directly subject to NI 31-103.

Professional standards for the SROs

Through the terms of their ROs, SROs are required to follow professional standards of behavior equivalent to those expected of its recognizing regulators relating to confidentiality and procedural fairness. In carrying out its day-to-day operations and in connection with any examination or investigation undertaken by the SRO with respect to its members, the SRO must comply with applicable laws relating to privacy and the collection, use and disclosure of personal information, and to the additional requirement that the SRO provide its recognizing regulators with unrestricted access to its books and records, management, staff and systems.

With respect to procedural fairness, an SRO must ensure that:

- its requirements relating to admission to membership, the imposition of limitations or conditions on membership, denial of membership and termination of membership are fair and reasonable, including in respect of notice, an opportunity to be heard or make representations, the keeping of a record, the giving of reasons and provision for appeals; and
- any and all fees imposed on its members are equitably allocated and bear a reasonable relation to the costs of regulating members, carrying out the SRO's objects and protecting the public interest.

SRO rules determine eligibility to sit on disciplinary hearings, notices and information to

	<p>be given to parties and rules for conduct of hearings. Respondents may be represented by counsel. Disciplinary and settlement hearings must be open to the public and news media unless a hearing panel determines that a closed-door hearing is required to protect confidential information. Disciplinary decisions may be appealed to the appropriate commission (or court in Québec).</p> <p>To mitigate the possibility that SROs may bring enforcement actions for improper purposes, they may only use fines and payments collected in enforcement actions as permitted in its RO.</p> <p>SROs must also use reasonable efforts to ensure that confidential and personal information is maintained in confidence and not shared inappropriately.</p> <p>With respect to use of information, an SRO is expected to follow a high professional standard of behavior. The ROs achieve this by requiring the SRO to:</p> <ul style="list-style-type: none"> • have an effective corporate governance structure that balances the interests of different regulated entities; • serve the public interest in protecting investors; • effectively identify and manage conflicts of interest; and • ensure that it does not impose any unnecessary burden or restriction on competition or innovation. <p>The recognizing regulators' authority over SROs allows them to investigate any complaints of improper use of information by the SRO and take appropriate action.</p>
Assessment	Broadly Implemented
Comments	<p>The reason for the grade relates to the need to continue improving corporate governance of the SROs, in connection with question 6 of the methodology.</p> <p>From the conversations held with both authorities and stakeholders and the files reviewed it can be concluded that the securities regulators have put in place a robust framework for the oversight of each of the SROs, appropriately tailored to the functions that each of them fulfils in the Canadian market. In particular the on-site reviews have revealed areas where conflicts of interest could detract the SROs from fulfilling their mandates. Recommendations have been made, plans of actions have been requested and sufficient follow up has been given to such plans.</p> <p>As for the SROs themselves, as noted in the findings of the on-site reviews, corporate governance and enforcement are particular areas where some of the SROs need further</p>

	<p>improvement—the latter will be further explained in principle 12.</p> <p>On the former, the assessor acknowledges an evolution towards stricter governance in all SROs. However it is important that additional actions are implemented. In particular in connection with the CSF, the relationship with the sections should be addressed, and the composition of its board with additional members appointed by the Government and/or independent could be considered. In this regard, the authorities highlighted that on June 14, 2013 the Québec National Assembly adopted An Act to amend various legislative provisions, including section 288 and 289 of the Distribution Act, which requires the CSF to be administered by a board comprised of 13 members, 5 of whom will have to be independent. As for IROC and the MFDA, the assessor encourages the authorities to review the role of membership in the enforcement function and in the case of MFDA in rulemaking too.</p>
Principles for the Enforcement of Securities Regulation	
Principle 10.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	<p>Assessed in 2007</p> <p>Inspection, investigative and surveillance powers depend on the legal framework of each of the 13 regulatory agencies. Most of the agencies have comprehensive investigation and surveillance powers, including the four largest jurisdictions.</p> <p>Powers</p> <p>Both regulatory agencies have sufficient legal powers to conduct surveillance, undertake investigations, obtain information and take the corresponding enforcement actions on regulated entities. In particular, both regulatory agencies can:</p> <ul style="list-style-type: none"> a) conduct on-site inspections, including books and records, without prior notice, (Sections 13, 19, 20 of the OSC Act and Section 9 of AMF Act); b) obtain books and records and request data or information without the need for a judicial action (Sections 19 and 20 of the OSC Act and Section 10 of AMF Act); and c) supervise exchanges and regulated trading systems. <p>Record keeping obligations</p> <p>Market participants are subject to book and record keeping obligations both by statute, rules and regulations of the regulatory agencies as well as of the respective SROs. In general the regulations of RS, IDA and the MFDA require members to keep books and records for a period of seven years. NI 21–101 requires market places to keep records</p>

	<p>also for seven years.</p> <p>Regulated entities are also required to maintain records of clients' identity, as well as records that permit tracing of funds and securities, both under federal law (Proceeds of Crime and Terrorist Financing Act) and provincial regulation. They are also required to put in place mechanisms to minimize money laundering.</p> <p>Access to information</p> <p>Both regulatory agencies have authority to access the identity of all customers of regulated entities. They both have full access to the information kept by the SROs under the applicable terms of their recognition orders. They can impose terms and conditions on the SROs, and in fact have done so in their respective recognition orders. SROs are subject to similar confidentiality requirements as those applicable to the regulator (Section 16 of the AMF Act).</p>
Assessment	.Fully implemented
Comments	
Principle 11. The regulator should have comprehensive enforcement powers.	
Description	<p>Assessed in 2007</p> <p>Enforcement powers depend on the legal framework of each regulatory agency. Most of the agencies have comprehensive enforcement powers. A few of them have quasi-criminal authority.</p> <p>Both OSC and AMF have the power to conduct investigations to ensure compliance with laws and regulations (Sections 11 and 12 of the OSC Act and Section 12 of the AMF Act).</p> <p>The OSC has also been provided with power to impose administrative sanctions as well as seek quasi criminal sanctions (Section 127 of the OSC Act). In the case of the AMF, most of the administrative sanctions are imposed by an independent tribunal, the BDRVM, upon request by the AMF. For intermediaries governed by the Distribution Act and for specific topics, for example, delays in filing insider trading reports (Section 274.1 of the AMF Act), the AMF has direct enforcement powers. As for quasi criminal sanctions, they are imposed by the provincial court.</p> <p>Both the OSC and the AMF have:</p> <ul style="list-style-type: none"> • the power to seek injunctions; • bring an application for civil proceedings; • order the suspension of trading, and the freezing of assets;

	<ul style="list-style-type: none"> • compel information, documents, records and testimony from third parties (non-regulated entities) in the course of their investigations. This information includes information on bank accounts; and • refer matters to the criminal authorities. <p>In the case of the OSC, information obtained through compulsory powers (for example bank accounts of a non-regulated entity) can only be shared if the Commission orders so, prior notification is given to the party that provided the information and an opportunity is given for that party to be heard. The authorities informed that this procedure altogether is relatively fast (around a week).</p> <p>Private persons can seek their own remedies for any misconduct related to securities laws, the main one being a right of action for damages.</p> <p>Both the OSC and the AMF can share information with SROs for the purpose of enforcement. They can also share information that they have obtained in the course of their functions with the police. At least in the case of the OSC, some restrictions apply, however, to the exchange of information obtained under compulsion. (Sections 16 and 17 of the OSC Act).</p>
Assessment	Fully implemented
Comments	<p>Comments carry from the 2007 assessment: “The assessor considers that the existence of restrictions on sharing with the police information obtained under compulsion should not affect the grade of this Principle. These cases covered information obtained from non-regulated entities (third parties). Thus the assessor believes that the existence of additional safeguards is reasonable.»</p> <p>Comments made in the context of the 2013 assessment</p> <p>After the 2007 assessment the regulators contributed to the enactment of a specific “Fraud-on-the-market” offence which allows them to sanction any person or company who, directly or indirectly, engages in or participates in conduct relating to securities (including derivatives), if the person knows or reasonably should have known, that the conduct perpetrates a fraud on any person or results or contributes to a misleading appearance of trading or an artificial price for a security. Such a provision allows the regulators to increase their ability to deter conduct leading to fraud or misappropriation of funds, without having to refer these types of cases to criminal authorities.</p>
Principle 12.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

Description	<p>Compliance</p> <p>Pursuant to NI 31-103 registered firm must have a system of controls and supervision to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and manages the risks associated with its business in accordance with prudent business practices.</p> <p>Although NI 31-103 provides a principles-based approach in respect of compliance systems, the guidance in 31-103CP outlines that an effective compliance system includes internal controls, day-to-day supervision and systemic monitoring (each of these concepts is expanded upon in the guidance). Specifically, this guidance provides that the regulators and the SROs expect a registrant to have detailed written policies and procedures to:</p> <ul style="list-style-type: none"> • identify the internal controls the firm will use to ensure compliance with legislation and to manage risk; • set out the firm’s standards of conduct for compliance with securities and other applicable legislation and the systems for monitoring and enforcing compliance with those standards; • clearly outline who is expected to do what, when and how; • allow access by everyone who is expected to know and follow them; • get updated when regulatory requirements and the firm’s business practices change; and • take into consideration the firm’s obligation under securities legislation to deal fairly, honestly, and in good faith with its clients. <p>Securities legislation also requires the registration of individuals who hold certain positions within the firm: the UDP and the CCO. The UDP is the person ultimately responsible for supervising that the firm has a system of compliance in place. The CCO monitors and oversees the firm’s compliance system, and must report non-compliance issues to the UDP. In addition, the CCO must submit an annual report to the firm’s board of directors, or individuals acting in a similar capacity for the firm, for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation.</p> <p>During full scope registrant inspections, the regulators and the SROs will review the compliance manuals, interview the CCO and the UDP, and review evidence of their supervisory records.</p>
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On-site inspections

As will be described in Principles 24, 29 and 31 the current supervisory regime for registrants includes on-site inspections. Given the current division of responsibilities, such inspections are conducted by IIROC for IDs and MFDA for MFDs (other than in Québec, where MFDs are inspected by the AMF) and directly by the securities regulators for all other types of registered firms. As stated in principle 1, on-site inspections are a responsibility of the principal regulator

In practice, this means that roughly 1200 registered firms are under the direct supervision of the securities regulators, 200 under IIROC and 100 under MFDA. Of the 1500 registered firms in Canada, the OSC is the principal regulator for approximately 65 percent of the firms (approximately 975 firms), the AMF is the principal regulator for 14 percent (approximately 210 firms), British Columbia is the principal regulator for 9 percent (approximately 135 firms), and Alberta is the principal regulator for 8 percent (approximately 120 firms) (96 percent of the firms in total).

Each of the regulators and SROs has dedicated teams for on-site reviews.

Overall the regulators and SROs follow a risk based approach to select the firms that will be subject to on-site inspections. While both use risk frameworks to determine the frequency and scope of the inspections, SROs put all firms on a fixed schedule. In the case of the securities regulators, those with the largest population of registrants will inspect the firms categorized as high risk, and conduct also a limited number of random inspections on medium and low risk firms.

In general in both cases, once the inspection is completed, the inspection team will issue a deficiency letter outlining the areas in which the registrant fails to meet the regulatory requirements. Except in the case of the MFDA, the inspection team will also highlight the “significant” deficiencies that pose bigger compliance risks and will require the registrant to address those significant deficiencies sooner. In its response to the deficiency letter, the registrant is required to detail how it plans to address the significant deficiencies or, in some jurisdictions, all of the deficiencies. The regulators will review the registrant’s response, and may test the registrant’s actions at a subsequent inspection. In its deficiency letters the MFDA does not distinguish between significant and other types of deficiencies. Staff of the MFDA consider that this approach might lead to firms not paying sufficient attention to “less significant” findings which might lead to eventually there becoming more substantial problems.

When deficiencies are found, the regulators and SROs can refer the cases to the enforcement teams.

As indicated under Principle 9, the inspection of MFDA conducted in 2009 concluded on the need to strengthen MFDA follow-up of deficiencies with unresponsive or

uncooperative members. Staff identified a few instances where members were unresponsive or uncooperative when dealing with deficiencies identified during the examination process. The regulatory agencies consider that in cases that do not warrant a referral to enforcement, the MFDA lacked the necessary regulatory tools to adequately deal with these members. To address this issue the MFDA has proposed charging fees to firms.

Market surveillance and other surveillance techniques

As will be described in Principle 36, IIROC and the derivatives exchanges are the front-line supervisors for the purpose of market surveillance. They all have established automated systems that allow for real time as well as post-trade surveillance. In general when anomalous trading is detected, the system would generate an alert that then is followed up by the staff. As the SROs and exchanges can only impose enforcement actions on members, when a breach involves third parties, they make referrals to the securities regulators. Their RO's have clear provisions in place regarding communication of investigations opened, and referrals to the regulators.

At the level of market surveillance, IIROC constitutes the main source of referrals for the securities regulators; that is, the cases built in connection with market trading wrongdoings primarily originate from a referral by IIROC, based on an alert generated by IIROC's surveillance system.

The regulatory agencies also have automated systems, but in their cases they are not designed for real time surveillance in light of this allocation of responsibilities. They complement the systems of the SROs and exchanges. For example, the agencies monitor media and issuer news releases, and assess collected information together with referrals from IIROC, exchanges, and other securities regulatory authorities or law enforcement agencies.

In addition, some of the agencies have developed a formal cyber surveillance initiative to mainly counter the illegal solicitation of funds by use of the internet or social networking sites. As an example, the AMF cyber surveillance team, created in 2010, uses enhanced technological tools enabling on-line and live surveillance of over 1000 sites and search engines on the internet. Cyber surveillance tools can also allow regulators to create watch lists. For example, the AMF created a list of repeat offenders or of individuals which were formally warned to cease a specific activity or conduct. In both cases, the AMF can monitor their activities and act rapidly if an offence is committed.

Regulators also review recordings of infomercials, and troll websites and other media for advertisements.

Intelligence from complaints and alerts

All the regulators and SROs have established a Contact or Complaint Center through which complainants may report their concerns via telephone, e-mail, online or through the regulators' website and in person. Each complaint is acknowledged (generally within two to five business days) and the complainant is provided with contact information of the staff assigned to his complaint. An initial assessment of each complaint is completed by staff of the Contact Centre. If there are substantive indications of a potential violation, the matter will be referred to the appropriate investigation branch for further review and to decide the proper course of action.

Number of complaints						
Regulator	2008	2009	2010	2011	2012*	5 years
AMF	1,027	1,751	1,412	1,532	1,011	6,733
ASC	688	799	984	795	734	4,000
BCSC	1,388	1,261	1,053	1,417	1,133	6,252
OSC	1,491	1,469	1,290	1,203	925	6,378
Total	4,594	5,280	4,739	4,947	3,803	23,363

Intelligence can also be gathered by the regulators from specialized intelligence units composed of regulators and police forces, such as the Joint Securities Intelligence Units (JSIUs) and, in Québec, the Équipe intégrée de renseignements financiers (ÉIRF). The mandate of these units is to gather information and to develop intelligence on fraudulent securities related activity; to provide the intelligence for enforcement activity by the appropriate law enforcement or regulatory agency, and to use intelligence, where appropriate, to pre-empt planned fraudulent securities related activity.

Aside from these joint intelligence units, the regulators have also established processes or in-house teams to ensure that intelligence will be properly gathered, analyzed and disseminated to those who will be able to act upon it. For example, the AMF has established an Intelligence and Analysis Centre, whose function is to gather and analyze intelligence, in order to assist and support the investigations teams and also to facilitate the identification of new trends and threats to the financial sector.

Once received by a regulator or an SRO, most intelligence will either be gathered by specialized surveillance units which are part of the enforcement or market regulation

	<p>divisions, by staff responsible for compliance reviews or examinations or by specialized teams within an SRO such as IIROC, the MFDA or the CSF.</p> <p>Enforcement</p> <p><i>Enforcement by IIROC</i></p> <p>Enforcement by IIROC can originate in complaints or on internal referrals.</p> <p>Senior staff from IIROC highlighted that the bulk of enforcement actions come out of complaints, and affect individuals. However staff highlighted that in such cases, in addition to the investigation of the complaint against the individual, IIROC would review whether a problem of supervision or internal controls is also involved, and in such case an enforcement actions would be pursued also against the supervisor and/or the firm.</p> <p>As indicated in Principle 9,</p> <p>the inspection conducted by the securities regulators on IIROC in 2009-2010 (which covered the review period for member regulation 2006-2009 and market regulation 2004-2009) revealed the existence of challenges in connection with the necessary nexus that should exist between their on-site reviews (compliance reviews) and enforcement actions, in particular the extent to which referrals were being made and enforcement actions taken to deal with important deficiencies found during the compliance reviews.</p> <p>These findings were first brought to the attention of IIROC's management during the field review in 2009. IIROC has taken a series of steps to address this challenge, all of them under the oversight of the CSA. In particular, there was a concerted focus on the approach regarding referrals to enforcement as part of an overall review of the program of the Business Conduct Compliance (BCC).</p> <p>IIROC staff has highlighted that after an annual cycle of inspections, the enhanced process in BCC has led to a significant increase in the number of referrals, as well as in greater depth and complexity of the cases being referred. As per the internal protocol in place, a pre-referral meeting takes place with the enforcement department; to assist the referring department to determine which cases to refer. All internal referrals are investigated by the Enforcement Department.</p>
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BCC					
Year of Referral	Number of Referrals	Number of Referral Issues	No. forwarded to Prosecution	Disciplinary Action	Notes
2010	1	2	0	n/a	
2011	8	14	4	3	2 of 8 referrals are currently open in investigations; 1 of 8 referrals is open in prosecution
2012	12	36	2	1	8 of 12 referrals are currently open investigations; 1 of 12 referrals is currently an open prosecution-no disposition yet
2013*	4	35	n/a	n/a	All 4 referrals are currently open in investigations
Fin OPS					
Year of Referral	Number of Referrals	Number of Referral Issues	No. forwarded to Prosecution	Disciplinary Action	Notes
2010	1	1	1	1	
2011	6	6	4	2	
2012	4	4	3	3	The 3 disciplinary actions eventually resulted in all 3 firms being permanently suspended from IIROC membership
2013*	3	3	3	2	Due to magnitude of matters, all 3 referred directly to prosecutions. 2 of 3 prosecutions resulted in firm terminations/suspensions from IIROC membership.
TCC					
Year of Referral	Number of Referrals	Number of Referral Issues	No. forwarded to Prosecution	Disciplinary Action	Notes
2010	13	13	4	4	10 of the 13 referrals related to one systemic issue identified by TCC during their field examinations. The issue related to ensuring the execution of orders at best price - 4 firms were ultimately disciplined, while the other 6 were cautioned
2011	4	4	2	2	remainder one file still open in investigations
2012	3	3	0	0	1 of 3 referrals still open in investigations
2013*	1	1	1	0	The 1 file forwarded to prosecutions still open-no disposition yet

As can be seen from the statistics above, the bulk of BCC referrals in 2012 and 2013 are still under investigation and/or in the process of being prosecuted, so the results of those matters are still to be determined. However, IIROC staff highlighted that in 2012 and 2013 the nature of FinOps referrals required swift enforcement actions resulting in significant and permanent sanctions against a number of firms, namely suspension/termination of IIROC membership.

IIROC has a wide array of enforcement actions at its disposal, including money penalties, remedial actions, and suspensions. Settlements are commonly used, and as in the case of the regulators, they require admission of guilt.

IIROC staff highlighted that there has been a rebalancing on the sanctioning strategy, whereby the percentage of cases where firms are sanctioned has steadily increased. In 2010, 84 percent of disciplinary actions relate to individuals, 12 percent to firms and 4 percent to supervisors. In 2012 70 percent refers to individuals, 23 percent to firms and 8 percent to supervisors. In pursuing enforcement action against firms, remedial actions are an important consideration when determining the appropriate action. Where appropriate, remedial actions will serve as a mitigating factor on penalty (if implemented prior to any disciplinary action) and/or form part of the sanction itself. For example in recent cases, in addition to money penalties, firms have been required to submit to a review of their practices by an independent person.

Year	Total # of Decisions (against FIRMS and all INDIVIDUALS)	Total # of Decisions (against FIRMS only)	FIRM % of Total Decisions	Total # of Decisions (against INDIVIDUAL Supervisor/Mgmt only)	INDIVIDUAL Supervisor/Mgmt only % of Total Decisions	Total # of Decisions (against FIRM & INDIVIDUAL Supervisor/Mgmt only)	FIRM & INDIVIDUAL Supervisor/Mgmt only % of Total Decisions
2010	51	6?	11.76%	2	3.92%	8	15.69%
2011	71	17?	23.94%	5	7.04%	22	30.99%
2012	78*	18?	23.08%	12	15.39%	30	38.46%
2013 as at Sept 30	47	9?	19.15%	4	8.51%	13	27.66%

FIRMS	Total Fines Imposed	Costs	Disgorgement	Total Penalty Imposed	Total Decisions	Perm. Suspensions	Terminations
2010	\$1,297,500.00	\$85,000.00		\$1,382,500.00	6	1	0
2011	\$1,015,000.00	\$90,000.00	\$1,768.00	\$1,106,768.00	17	1	0
2012	\$1,661,666.67	\$459,333.34		\$2,121,000.01	18	4	0
2013 as at Sept 30	\$1,360,000.00	\$40,000.00		\$1,400,000.00	9	2	2

INDIVIDUALS Spvr/Mgmt	Total Fines Imposed	Costs	Disgorgement	Total Penalty Imposed	Total Decisions	Permanent Bar	Suspension	Conditions
2010	\$70,000.00	\$13,500.00		\$83,500.00	2	1	1	1
2011	\$212,000.00	\$43,000.00		\$255,000.00	5	1	1	2
2012	\$1,358,333.34	\$330,833.34		\$1,689,166.68	12	1	6	1
2013 as at Sept 30	\$2,085,000.00	\$174,000.00		\$2,259,000.00	4	1	3	2

Enforcement by the MFDA

As is the case for IROC, MFDA enforcement actions can originate in complaints and internal referrals. A significant proportion of the enforcement work of the MFDA comes as a result of complaints against individuals. Senior staff of MFDA highlighted however, that in such cases, in addition to the review of the specific complaint against the individual the MFDA reviews whether a problem with supervision or internal controls is involved, and if that were the case, then an enforcement action would be started also against the supervisor, and/or the firm.

In connection with referrals stemming from compliance reviews, the MFDA has established criteria to guide the compliance review teams in determining the type of deficiencies that should be referred to the enforcement division. Thus, while the MFDA has not instituted a classification of deficiencies (in material, repetitive, etc.) the criteria developed achieved a similar objective.

MFDA staff highlighted that for those deficiencies that are sent to enforcement, the MFDA has similar enforcement tools than those of IROC, including suspension, monetary penalties and remedial actions (such as the imposition of monitoring). In general, cases end with a settlement, with admission of guilt.

MFDA senior staff commented that during the first cycle of on-site inspections the emphasis was on « educating » the firms rather than on imposing disciplinary actions. This approach changed for the second cycle of reviews (2002–2005) when more disciplinary actions were taken. Further during this second cycle a significant number of participants dropped out of the market as they were not able to maintain registration requirements. Senior staff highlighted that the second cycle of inspections, and the corresponding enforcement actions, resulted in significant improvements in internal controls and risk management. As a result the number of referrals for the third cycle of inspections (2009–2011) has decreased. In general in all these cases enforcement actions

are directed towards the firm.

Completed prosecutions against members					
	2008	2009	2010	2011	2012
Arising from Compliance Examinations	3	8	5	5	5
Arising from All Sources	5	9	5	6	5

	2010	2011	2012
Aggregate			
Total number of Orders	46	38	43
Total fines ordered	3,698,765	3,131,900	3,608,750
Total costs orders	237,500	201,000	253,500
Members			
Total number of Orders	5	6	5
Total fines ordered	100,000	112,500	330,000
Total costs ordered	40,000	12,500	37,500
Other			
Terminations	0	0	0
Suspensions pending resignation	2	1	0
Remediation Plan with Independent monitor	2	0	0
Remediation plan with MFDA Staff monitor role	2	5	5
Reprimand	0	0	0
Specific undertakings	1	0	0
Approved Persons			
Total number of Orders	41	32	38
Total fines ordered	3,598,765	3,019,400	3,278,750
Total costs ordered	197,500	188,500	216,000
Other			

Permanent Prohibition	21	21	19
Completion of training	0	1	3
Supervisory ban or suspension	6	3	2
Suspensions	13	5	12
Length of suspensions (in years)			
Longest	10	5	10
Shortest	0.08	0.25	0.08
Average	3.71	2.68	2.83

Compliance Examination Results Referred to Enforcement

MFDA staff informed that during the years 2010, 2011 and 2012, there were referrals to Enforcement from 19 Sales Compliance Examinations, relating to deficiencies identified in Member and Approved Person conduct during the examination.

Commenced Prosecutions Against Members			
2010	2011	2012	2013 to Sept 30
35	36	48	37

MFDA estimates that a total of 55 to 60 prosecutions will be commenced in the full calendar year 2013.

Enforcement by the provincial regulators

Number of resources

In all four agencies there are dedicated teams for enforcement composed of lawyers, accountants and forensic accountants, IT specialists and investigators (some of which are former police investigators, CFA members or traders). As the chart below indicates, there has been an increase in the resources dedicated to enforcement.

Category / Organization	AMF	OSC	BCSC	ASC	Total
Organizational total (2012)	406	455	239	183	1,284
Enforcement Staff Level					
2010	104	117	47	44	311
2011	112	118	50	46	324
2012	131	126	54	46	351
Enforcement/Organizational total	32%	28%	23%	25%	27%

Some jurisdictions have established specialized investigation teams to address specific cases, tailored to the needs of their markets and investors and the goals of their enforcement program. For example:

- The OSC Enforcement Branch has a specialized Joint Serious Offences Team which specifically targets fraudulent and recidivist behaviour that harms retail investors and a team dedicated to insider trading and market manipulation. In addition, a recent increase in cases involving issuers from emerging markets has led to the adaptation of a team to address these issues and their inherent challenges.
- In 2007, the BCSC commenced a project to investigate cases to the criminal standard with a view to producing reports to crown counsel recommending charges under the Criminal Code and quasi-criminal charges under the provincial *Securities Act*. In January 2010 a separate BCSC Criminal Investigations Team that works closely with the RCMP and municipal police agencies was formalized.
- In 2006, the AMF restructured its Enforcement Division. The main focus was to create different teams to maximize expertise, promote cooperation with external bodies and better prioritize the files. Since the restructuring, enforcement staff have grown from 65 to 150 members. Today, the Enforcement Division is composed of the following units: pre-investigations, investigations, market surveillance, specialized insider trading and market manipulation investigations, economic crime investigations, cyber surveillance, intelligence analysis centre, and, lastly, a specialized unit in support to all the Enforcement Division, composed of financial industry specialists. The AMF has also created an integrated team composed of staff from the provincial police forces (QPP), the RCMP and the AMF.

Number of sanctions

The following chart contains information on enforcement activities conducted by all CSA members. In 2012, 83 percent of concluded cases in Canada were concluded by the four agencies under analysis.

	Illegal Distribution	Misconduct by Registrants	Illegal Insider Trading	Disclosure Violations	Market Manipulation	Other Cases	Total
Number of investigations opened	324	109	690	14	91	191	1,419
Number of investigations closed	241	64	609	24	53	165	1,156
Number of proceedings initiated	282	48	36	35	10	36	447
Number of cases concluded	260	67	48	35	8	44	462
Number of companies sanctioned	200	62	3	26	4	41	336
Number of persons sanctioned	406	66	63	60	15	71	681

Type of proceedings

An important number of cases are settled; however in the Canadian contest there is no "no contest-settlement". This means that there is an admission of wrongdoing by the firm and/or person involved in the case.

Cases Concluded (Breakdown by Type)				
	2009	2010	2011	2012
Contested Hearing	37	39	47	62
Settlement Agreement	69	71	53	35
Court Proceeding (includes quasi-criminal proceedings)	35	64	24	39
Total	141	174	124	136

Type of sanctions imposed

Monetary penalties (for the firms and individuals) and bans (for the individuals) are common sanctions used. Senior staff of the four provinces indicated that the amount of fines has increased. For example staff of the OSC indicated that over the past four years

the amount of monetary sanctions assessed by the OSC has increased markedly due to an increase in the number of proceedings taken and concluded; proceedings involving larger and more complex fraudulent schemes; and the imposition by the Commission of sanctions that include administrative penalties and disgorgement, sanctions that were made available by way of legislative amendment in 2005.

In addition, as indicated under Principle 3 the four agencies have quasi-criminal authority. In one case (OSC), the agency can directly prosecute the cases, while in another (AMF), there are dedicated prosecutors assigned to pursue them. As indicated in principle 3, these offenses can be sanctioned with imprisonment, without the possibility of conditional sentencing. In practice, the statistics indicate that this power is being used increasingly by the four agencies.

Quasi criminal sanctions imposed since April 1, 2008			
Province	Number of persons	Jail term	Significant jail term
OSC	14	1.5-36 months	In 8 of the cases imprisonment was of 18 months or more
AMF	12	2-60 months	In 7 of the cases imprisonment was of 12 months or more
ASC	2	24-36 months	
BCSC	5	2-24 months	In 3 of the cases imprisonment was of 12 months or more

In addition, freeze orders have been imposed, as well as interim cease orders.

The Disciplined Persons List established by the CSA allows SROs and the public to obtain information about individuals which have been subject to disciplinary actions, as far back as 2003.

Staff sees as an important challenge—which is not unique to the Canadian regulators—the need to increase speed so that “things get done while they are still fresh and relevant for the market”, as the potential deterrent effect increases.

Level of Cooperation between provincial regulators

As indicated in Principle 1, the regulators share information via the CSA Enforcement Committee. It meets via teleconference monthly and in person twice a year. Its members include the Enforcement Directors of each regulator (or a similar position) plus additional senior staff members, as appropriate.

The committee has developed a Multi-jurisdictional Enforcement Guide, which sets out procedures for identifying, investigating and prosecuting multi-jurisdictional cases by

members of the CSA, and a Joint Assessment Committee has been established with a view to identifying potential multijurisdictional cases, and ensuring a coordination effort so that the use of resources is optimized and duplication of efforts avoided. Also, a new case-sharing database facilitates the identification of multi-jurisdictional cases.

The agencies provide a number of examples where joint investigations have been conducted. For example, in 2010 the AMF, OSC and IIROC collaborated closely in investigations into the asset backed commercial paper market. In another case, related to an Alberta company, the ASC has received assistance from the BCSC and AMF in summoning witnesses for interviews, as well as assistance from international regulators, including the US SEC, the FSA and the SCB (Securities Commission of The Bahamas). In practice, the number of joint investigations and hearings is limited. The agencies highlighted that this is a result of the limited number of extraterritorial cases and is not as a result of a lack of coordination. Further, staff indicated that in practice, in light of the level of integration of the Canadian and the US market, many times assistance is more critical from the US SEC.

In addition, provincial regulators are making use of reciprocal orders, which allow them to extend an order given in a province to another. In this case, the investigation is conducted by one jurisdiction. Upon the discretionary orders being issued by that jurisdiction, other jurisdictions, at a hearing, but without the need to conduct their own investigations, can rely upon the decision and orders of the originating jurisdiction to obtain reciprocating orders. . Below are statistics on the use of reciprocal orders.

Reciprocal Orders				
	2009	2010	2011	2012
Number of Cases	46	52	37	9
Number of Individuals	54	57	60	11
Number of Companies	19	13	13	10

Staff have highlighted that in their experience it is not typically the case that a malfeasor will move from province to province breaching their respective laws, until orders are issued in these other provinces. However, in cases where there is a real and demonstrable concern that a malfeasor may carry out activity that may cause harm in other provinces, they will typically issue reciprocal orders to ensure the matter is fully addressed. Finally, staff highlighted that all orders are public via a national database on disciplined persons, which in practice makes the "local" orders have a "national" impact. For example, an applicant for registration in one province would likely be

refused, if they were disciplined in another province. Further, this list allows for proper monitoring of activities. If a malfeator crosses to another province, he/she can be efficiently detected and would be subject to immediate attention.

Finally, the CSA Enforcement Committee adopts priorities to enhance the enforcement effectiveness of CSA members on a yearly basis.

Level of cooperation with law enforcement bodies and crown prosecutors

Generally, the RCMP and local and provincial police bodies investigate securities-related criminal offences. Collaboration at this time is achieved through IMET groups within the RCMP, comprised of specialized investigators, which also investigate capital market offences), Joint Securities Intelligence Units (JSIUs or the ÉIRF in Québec), various local, regional and provincial police forces and the Prosecutor's Affiliation.

Different stakeholders considered that the efforts on criminal enforcement have had mixed results, and that this is still an area where significant challenges remain. Some of the challenges mentioned relate to the autonomy of the police to decide what cases to pursue, vis-à-vis the attorney general offices (which have equal autonomy to decide what cases they will prosecute); limited skillfull resources dedicated to financial crime, including at the court level (as there are no dedicated courts). Current limitations to the information that can be shared by the securities regulators with the criminal authorities was also mentioned as an issue that needs to be addressed.

However there is a recognition that in a few provinces the securities regulators have been able to build strong cooperative arrangements with the police, and with the prosecutors' offices although the number of "successful" cases is still limited.

IMETS

In 2003, the federal government created IMETs to investigate and prosecute capital market fraud that is of national significance and that involves actions of publicly traded companies. IMET units are comprised of RCMP investigators, legal advisers from the Public Prosecution Service of Canada, and other staff investigators from the regulators that help to support the investigation of capital market fraud. Currently, there are ten IMET teams operating in Vancouver, Calgary, Toronto and Montréal.

As of 2012, the IMET program had charged, since its creation, 47 individuals with Criminal Code offences. Thirteen individuals had been convicted, receiving sentences ranging from 18 months to 13 years. Seven cases remained before the courts. Overall stakeholders interviewed considered that while there have been efforts to improve the functioning of IMETs, their performance remained mixed; although there are a few provinces where they seems to be more effective. In this regard, for example, in Québec, the AMF and RCMP cooperate through an agreement where the AMF has assigned two

	<p>of its investigators on a full-time basis to the Montréal IMET.</p> <p>Since September 2010, the AMF has established a joint investigation unit task force with the Sûreté du Québec (SQ): the Comité sur les crime contre les marchés financiers (CCMF), which is similar to the IMET. Both organizations have 10 members who work at the SQ office. The DPCP also participates in this unit. In relation with this partnership and with the partnership which the AMF has with the IMETs, the AMF created two different committees: the first one analyzes cases that the AMF wants to transfer to law enforcement bodies for the purpose of a criminal investigation and the second one, to which the Public Prosecution Service of Canada also participates, decides which task force (IMET or CCMF) will investigate the case. The structure is subject to a protocol that was adopted by all parties. In 2012–2013, criminal proceedings were pending regarding three cases through the CCMF while two others were the object of criminal investigations.</p> <p><i>JSIU</i></p> <p>The OSC and RCMP are partners in the Joint Securities Intelligence Unit (JSIU), whose mandate is to collect, disseminate and investigate international, inter-provincial, and provincial securities frauds, thefts and forgeries. The provincial securities commissions and key regulatory stakeholders participate in the JSIU.</p> <p>The primary objectives of the JSIU are to gather information and develop intelligence on fraudulent securities-related activity, to provide the intelligence for enforcement activity by the appropriate law enforcement or regulatory agency and to use intelligence, where appropriate, to pre-empt planned fraudulent securities-related activity.</p> <p>For the year ending March 31, 2011, 109 JSIU investigative files were opened. For the year ending March 31, 2012, the JSIU opened 27 cases. This decrease was largely due to a reorganization at the OSC whereby files are now more often opened within the Commission's Case Assessment area.</p> <p>The AMF has also created an integrated team composed of staff from the provincial police forces, the RCMP and the AMF (ÉIRF). The mandate and primary objective are the same as stated by the OSC for its partnership with the RCMP. For the year ending March 31, 2011, the ÉIRF opened 178 investigative files and responded to numerous requests for information and intelligence. Again in 2012, the EIRF responded to many requests for information and intelligence and opened 146 investigative files. Since April 2012, 72 investigative files have been opened.</p> <p><i>Prosecutors Affiliation</i></p>
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	<p>The National Securities Fraud and Economic Crime Prosecutors Affiliation (Affiliation) was instituted in 2007 with the specific mandate of examining and making recommendations as to the best way to investigate and prosecute large economic crime cases. Its membership includes senior staff from most of the provincial Attorneys General offices and senior staff from each major securities regulator. The Affiliation, among other things, provides a venue for identifying, reviewing and arranging for the research of complex practical legal issues of common concern and possible innovative reforms to Canadian investigation and prosecution practices. Training sessions are also held. The Affiliation members now hold regular conference calls with the aim of rapidly identifying matters in which collaboration could be warranted and discussing issues of common interest, such as information sharing. A website will be created shortly to foster increased discussion between members.</p>
Assessment	Broadly implemented
Comments	<p>The grade is mainly a result of remaining challenges in enforcement, in connection with question 9 of the methodology. To a lesser extent the grade also takes into consideration issues related to the intensity of supervision, in particular in connection with the securities intermediaries that are under the direct supervision of the provincial regulators, which relates to question 1 of the methodology.</p> <p>Based on the conversations held with both regulators and stakeholders and the data provided, the assessor concludes that there has been significant progress in enforcement by provincial regulators, and in particular by the four agencies analyzed. This has been the result of a sustained commitment of resources as well as the development of a clear strategy towards enforcement which seeks to use all tools at the disposal of the regulators to incentivize correct behavior and deter wrongdoings.</p> <p>Indeed on one hand there is more use of guidance as a way to ensure that regulated entities understand what is required and expected from them, and at the other end, the agencies are imposing more significant fines in their administrative proceedings and using their quasicriminal powers to a greater extent. In this regard a credible threat of imprisonment plays a key deterrent role. Thus, especially in a context where criminal enforcement still shows mixed results the use of this authority cannot be overstated.</p> <p>Given the type of intermediaries that are directly under the supervision of the SROs (i.e. those that cater to retail investors more directly), it is key that SROs also have in place a strong enforcement strategy. Based on the conversations held with the authorities and SROs, and the information provided by them, the assessor concludes that the SROs have taken important steps to strengthen their enforcement strategy. In this regard, significant efforts have been made by IROC to strengthen the nexus between its compliance reviews and its enforcement activity. Such efforts appear to be bearing fruits as demonstrated mainly by the increase in referrals, and in the enforcement actions</p>

against supervisors and firms. Such efforts should continue. More generally, it is also important that regulators continue to actively oversee enforcement strategies by the SROs and whether they are achieving their deterrent effect by an effective use of the wide array of tools at their disposal. Finally, it is important that efforts by the SROs be effectively communicated to the public. In this regard, the assessor encourages the development of detailed statistics of the use of enforcement actions in connection with compliance reviews, as well as on the imposition of sanctions against firms and individuals, as this is an area where stakeholders might not be fully aware of all the efforts undertaken.

As indicated above criminal enforcement is still in need of improvement. The assessor acknowledges the efforts made by the largest regulatory agencies to coordinate with law enforcement agencies. For example, several members of JSOT have been designated as special constables by the Ontario Provincial Police, which will allow access to offences and tools in the *Criminal Code* when working in conjunction with the police and in Québec a similar unit exists.

However, as described in this Principle the results are still mixed, although in some provinces criminal enforcement does exhibit progress. That has been the case, especially, in provinces where there has been a clear strategy to create integrated teams that even assess cases together to ensure coordination of efforts. To some extent, the use of quasi criminal authority mitigates some of the limitations observed in criminal enforcement, especially in the provinces where the regulatory authority can directly prosecute the case (OSC, ASC and AMF). However, in some provinces prosecution is still dependent on the priorities of the attorney general's office—which can be challenging. Also, the fact remains that the investigation of the most egregious cases, such as boiler rooms, major frauds and repeat offenders, should be prosecuted by the criminal authorities, and that certain extraordinary powers (such as wiretapping) that could be useful in particularly complex cases are only available to the criminal authorities.

Finally, there is a perception that additional coordination in enforcement is needed at the provincial level. At the outset this perception appears to be validated by the limited number of joint investigations and reciprocal orders—although in the latter case the use of reciprocal orders is increasing overtime. The authorities have provided valid arguments that contradict such perception. It would be important, however, to conduct further analysis on whether in practice malfeasors tend not to relocate. The findings from such analysis could help to eradicate any unfounded perception. In the meantime, the assessor encourages the authorities to continue to leverage on the existing arrangements and tools, including joint inspections and reciprocal orders and evaluate whether additional arrangements could be established.

On supervision, the assessor acknowledges that a risk based approach constitutes a reasonable and acceptable approach to implement an inspection plan for securities

	<p>intermediaries, when it is sufficiently robust (i.e. sources for risk identification are themselves robust; there is back testing of risk assumptions; and there are mechanisms to take into consideration the effect of the accumulation of small clusters of risks across a particular sector or industry).</p> <p>Taking the supervisory program for all intermediaries as a whole (including both the intermediaries under the supervision of the SROs as well as those under the direct supervision of the securities regulators) the program can be considered adequate. However, the use of on-site inspections especially by the jurisdictions with the largest population of registered firms is more focused. This is an aspect that it is important that the regulatory authorities follow up on given the role that on-site inspections have for risk identification.</p> <p>In the assessor's view, on-site inspections (whether on individual firms or thematic) are a key tool—perhaps the most important tool—to uncover poor conduct practices early on, as supervisors are able to look through individual investors' files to see how obligations are being complied with in practice. Signals of such poor conduct do not usually manifest in regular reporting by firms, and emerge only in a partial way through indirect means such as complaints (that could trigger for cause inspections) or other intelligence. A similar argument could be made in connection with prudential requirements, as on-site inspections are a better tool—than desk reviews of financial statements and capital calculations—to detect operational risks, including weaknesses in governance, internal controls and risk management. This also applies to the connection between prudential requirements and conduct obligations, as on-site inspections can reveal to what extent internal compliance and other control procedures are in fact working in accordance with a firm's formal documented procedures. This is particularly important in critical conduct areas such as selling practices and compliance with suitability requirements, and transparency to clients.</p> <p>Thus the assessors recommend that the securities regulators continue to consider measures to increase the number of on-site inspections and refine their risk-based approach.</p> <p>Finally it is important that efforts by the MFDA to ensure that members address deficiencies found in its compliance reviews in a timely manner continue and that the tools devised to this end be effectively implemented.</p>
Principles for Cooperation in Regulation	
<p>Principle 13. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.</p>	
Description	Assessed in 2007

	<p>Both regulatory agencies have been provided with the authority to share information with both domestic and foreign regulators (Section 153 of the OSC Act and Section 297 of the AMF SA). There are no limitations on the type of information that they can share, and thus, they can share information in connection with authorization and licensing, surveillance, market events, client identification, regulated entities, listed companies and companies that go public.</p> <p>This information can be shared without the need for external approval. Moreover, the existence of a MoU is not a precondition for sharing information and thus both regulatory agencies can share information even in the absence of a MoU with the jurisdiction that has requested the information. Existence of an independent interest—i.e. the case under investigation by the foreign authority also constitutes a misconduct in Canada—is not a precondition for the exchange of information.</p> <p>Both the OSC and the AMF can share information on an unsolicited basis.</p>
Assessment	Fully implemented
Comments	
Principle 14.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>Assessed in 2007</p> <p>Both regulatory agencies have the authority to enter into MoUs to establish the conditions for the exchange of information and cooperation. However, in the case of the OSC, MoUs both with local and foreign authorities have to be approved by the Minister (Section 143.10 of the OSC Act). In the case of the AMF, approval is required for the signature of the MoU at the local level. (Section 3.8 of the Act respecting the Minister du Conseil executif). The AMF informed that it is currently exploring ways to streamline the authorization process.</p> <p>Both regulatory agencies, as well as the regulatory agencies in Alberta and British Columbia, are signatories of the IOSCO MMoU.</p> <p>In addition, both authorities have signed bilateral MoUs with many regulatory agencies including the US SEC. Both the IOSCO MMoU as well as the bilateral agreements contain provisions to protect the confidentiality of the information shared between the signatories. MoUs are published in their respective bulletins.</p> <p>The OSC is the jurisdiction that receives the largest number of requests for information. The OSC Surveillance team is responsible for responding to requests for information</p>

	and assistance from local and foreign regulators. In the fiscal year 2005–2006 it has responded to approximately 16,000 requests for information, of which 775 were from foreign regulators. In addition, there were nine ongoing enforcement related investigations of mutual interest to the OSC and other regulators.
Assessment	Fully implemented
Comments	Comments carried from the 2007 assessment: “Only the four largest jurisdictions are signatories of the MMoU. However the assessor believes this is sufficient since in almost all cases foreign regulators would be able to channel their requests to Canada via these regulators”.
Principle 15.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>Assessed in 2007</p> <p>Both the OSC and the AMF are able to provide assistance to foreign regulators in obtaining information that is not already in their files. This information includes records of brokerage accounts, and in particular client records for securities and derivative transactions that identify the name of the account holder; the name of the person authorized to transact business; the amount purchased or sold; the time of the transaction; the price of the transaction; the individual and the bank or brokerage house that handled the transaction. The provision of banking account information obtained under compulsion is subject to the limitations stated under Principle 9.</p> <p>Ontario is the jurisdiction that receives the largest number of requests for assistance. During last year the OSC provided assistance in over 45 cases. In roughly 10 of those cases there was no MoU with the jurisdiction that requested the assistance</p>
Assessment	Fully implemented
Comments	
Principles for Issuers	
Principle 16.	There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors’ decisions.
Description	<p>Assessed in 2007</p> <p>The regulatory framework for public offerings (“distribution of securities” in the Canadian system) has been harmonized via a set of National Instruments. The main instruments include: NI 41–101 Prospectus Disclosure Requirements; 44–101 Short Form Prospectus Distributions, NI 44–102 Shelf Distributions; NI 45–106 Prospectus and</p>

	<p>Registration Exemptions; NI 51–102 Continuous Disclosure Obligations; NI 71–102 Continuous Disclosure and Other Exemptions Relating to Foreign Issuers.</p> <p>Under the current framework, distribution of securities is not permitted until the regulator has issued a receipt for the prospectus. Overall, the prospectus must include: general business and financial information about the issuer, details about the terms of securities the issuer is offering, use of the proceeds and the risk factor associated with the purchase of securities.</p> <p>Continuous disclosure requirements include:</p> <ul style="list-style-type: none"> • Annual financial statements, with an audit report and the Management Discussion and Analysis report within 90 days of the end of the fiscal year—120 days for venture issuers. • Annual Information Form (except venture issuers) that includes updated information on the company, its operations, prospects, risks and other external factors that can impact the issuer. The deadline is the same as that for financial statements. • Management proxy circulars: management must send an information circular to each holder entitled to vote at an annual meeting or any special meeting. • Quarterly financial statements and related Management Discussions and Analysis, within 45 days after the interim period ends—60 days for venture issuers. • Material changes report: issuers must immediately issue and file a press release and then file a formal report within 10 days of the date on which the change occurs. In addition under TSX rules issuers must disclose material information, which is more broadly defined to include also material facts. <p>Prospectus review</p> <p>Under the MRRS, issuers who want to raise capital in more than one jurisdiction are assigned a “principal regulator” based on the location of their head office. The principal regulator is in charge of carrying out the review of the prospectus. The other jurisdictions have the right to opt out of the decision made by the principal regulator. For that purpose they have a five-day deadline to provide comments. However, the non-principal regulators can opt out at any time before the receipt for a prospectus has been issued. The authorities noted that the number of “opt outs” has decreased to very few or no cases at all.</p> <p>Under the umbrella of the CSA, the 13 provinces have also developed guidelines for the review of the prospectus to ensure that a similar type of review is done by all the</p>
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provinces in their function as principal regulator.

OSC and AMF

All prospectuses filed at the OSC and the AMF are subject to some level of review. Both use a risk-based approach for reviewing the preliminary prospectuses. At the OSC a senior lawyer and an accountant determine the level of review that is suitable, which could be a full review, an issue oriented review or a basic review. A full review is carried out on all initial public offerings (IPOs) as well as other prospectuses identified using the risk based approach. The AMF conducts two types of review: a full review for IPOs and new issues when the AMF is the principal regulator and for novel structures or issues when the AMF is a non-principal regulator; and a limited review for other prospectuses.

Continuous disclosure review

Provincial regulators created the CSA Continuous Disclosure Review Committee in 2000 to coordinate and streamline the review of issuers' continuous disclosure obligations. Under the continuous disclosure review system (CDRS) the principal regulator is in charge of the review of all documents submitted by issuers under their disclosure obligations (annual financial statements, quarterly financial statements, Annual Information Forum (AIF), material changes). The goal set by CSA members is to review 25 percent of the large issuers and 10 percent of the smaller issuers (by number)—the AMF has set up stricter goals: a three year cycle for the 30 largest issuers, 25 percent of the remaining large issuers that are all to be covered on a four-year cycle and a ten-year cycle for the rest. Provincial regulators have also conducted cross jurisdictional peer review as part of the CDRS program. In addition they have conference calls every two weeks to discuss any issue of concern. Jurisdictions have also coordinated targeted reviews, for example on issues such as disclosures and accounting of related party transactions and implementation of the audit committee requirement.

OSC and AMF

Both regulatory agencies have two mechanisms in place for the review of issuers' compliance with continuous disclosure obligations:

- "Fast review" by financial examiners, when the information is filed. This is a first level of review basically aimed at ensuring that the information has been filed in time and in the prescribed formats. If a deficiency is found then the examiner filters it and sends it to senior personnel. Both the AMF and the OSC, for example, have developed basic templates for the examiners.
- In depth/full review: Personnel is divided into industry specialized teams. In the case of the OSC, at the beginning of each year each team determines the issuers that will be subject to review based on a risk based approach. The OSC has

	<p>developed a quantitative risk model, which along with information on the news, and the team's knowledge of the industry, helps to determine the "level of risk" of the issuer. Team reports are also subject to peer review within the OSC. The AMF has adopted a different approach and has set up stricter goals on its Continuous Disclosure Review Program (CDRP), notably a more frequent review of its 30 largest issuers. It is important to note that the AMF has senior personnel in charge of the internal quality control review.</p> <p>In addition, the Continuous Disclosure Review (CDR) Committee has implemented industry specialization teams composed of representatives of jurisdictions that share information on the selected industries and work to develop approaches to specific issues.</p> <p>Responsibility for the information in the prospectus and for continuous disclosure</p> <p>Liability provisions have not yet been harmonized across the provinces. However all provinces do have liability provisions for issuers and underwriters for the prospectus. Issuers are subject to a system of strict liability while underwriters are subject to a due diligence regime. In the case of Ontario, Alberta and Québec (new legislation adopted November 9th, 2007), recent legal amendments have extended liability to continuous disclosure obligations. Other provinces are in the process of adopting similar provisions.</p> <p>Derivatives</p> <p>Currently new products are subject to approval by the AMF. However the AMF informed that there is legislation under consultation that would change the system to a system of "self certification" of products by the derivatives exchange</p>
Assessment	Fully Implemented
Comments	<p>Comments made as part of the 2013 assessment</p> <p>As per data provided by the regulators, the level of capital raised in the exempted markets is significant. Thus it is critical that the regulators exercise close monitoring of these markets. The inclusion of this monitoring as part of the strategic priorities of the BCSC for 2013 is welcome. In addition, the OSC regularly monitors the reported activity in the exempt market, as well as actively oversees the registrants in the exempt market using a risk-based approach.</p> <p>The assessor notes the existence of a policy proposal that seeks to update the framework for exempted markets. The assessor emphasizes the importance that a careful balance be sought.</p>
<p>Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.</p>	

Description	<p>Assessed in 2007</p> <p>The majority of the issues related to shareholders' rights have not been harmonized via a National Instrument; thus, they have to be assessed in relation to the provincial framework for corporations. However the authorities informed that a significant number of the issues are treated in a similar manner throughout the provinces. In addition the framework for takeover bids and proxies are highly harmonized</p> <p>The framework for corporations in Ontario and Québec contains explicit provisions that deal with the fair treatment of shareholders.</p> <ul style="list-style-type: none"> • Election of directors: in general voting is subject to the rule of one share one vote; although the articles of incorporation could provide for cumulative voting. • Approval of changes affecting the terms and conditions of their securities: in general these changes have to be approved in meetings of the shareholders of the respective type/class of shares. • Approval of other fundamental changes: there are statutory voting requirements, usually two-thirds votes are required and dissenting shareholders are entitled to be paid a fair price for their shares by the corporation; minority approval may be requested if the transaction is an acquisition by an insider or an insider is getting preferential treatment when the issuer is being acquired. • Timely notice of shareholders' meetings: there are obligations to provide notice to shareholders. • Proxies for voting: NI 54–101 sets out extensive procedures that reporting issuers must follow in sending proxy-related material. • Receipt of dividends. • Takeover bids: A mandatory tender offer is required when a person wants to exceed a 20 percent threshold. However, acquisitions of not more than five percent during a 12 month period do not require a tender offer. Tender offers can be partial. Tender offers by insiders are subject to an independent valuation requirement. • Accountability of directors and management: in generally shareholders have certain statutory rights of actions against the issuer, director and officers for misrepresentations in the prospectus. • Winding-up.
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	<p>Substantial and insider holdings disclosure</p> <p>Both the framework for issuers in Ontario and Québec have disclosure obligations for substantial and insider holdings.</p> <p>A person that directly or indirectly beneficially owns, or has control or direction over 10 percent (it drops to five percent if a formal bid is outstanding) or more of an issuer's voting securities must file a press release and issue a report when they reach 10 percent and each time they or a person controlled by them acquires an additional two percent (early warning requirements).</p> <p>Directors and officers are insiders with the following disclosure obligations:</p> <ul style="list-style-type: none"> • within 10 days of becoming a director or officer of a reporting issuer, they must file an insider report disclosing any direct or indirect beneficial ownership over securities of the reporting issuer; • any change in their holdings, within 10 days of the change; and • in the case that they own or have control or direction over more the 10 percent of issuers' voting securities they are subject to the early warning requirements. <p>An issuer must include in the prospectus information about substantial holdings and insider holdings. In addition, this information must be updated annually in the AIF. Also, insiders must file their reports via an electronic database called System for Electronic Disclosure by Insiders (SEDI). The information gathered in this database is available to the public.</p>
Assessment	Fully implemented
Comments	<p>Comments made in the context of the 2013 assessment</p> <p>The assessor notes the existence of a policy proposal to streamline and tailor disclosure and governance requirements for venture issuers. The assessor emphasized the importance that a careful balance be maintained.</p>
Principle 18.	Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.
Description	<p>Assessed in 2007</p> <p>The regulatory framework for accounting and auditing has been harmonized in NI 52–107 Acceptable Accounting Principles, Auditing Standards and Foreign Currency.</p> <p>Under the current framework, issuers have to prepare their financial statements</p>

	<p>according to Canadian GAAP that are issued by the Accounting Standards Board (ASB). Canadian GAAP provides a comprehensive set of standards for preparing financial statements. In the past the goal of the ASB was to seek convergence with U.S. GAAP; however this goal was reassessed and now the goal is to minimize differences with and implement International Financial Reporting Standards (IFRS) by 2011. Convergence with IFRS does pose certain challenges for the Canadian market given that IFRS does not address specific standards for oil, gas and mining/extraction activities.</p> <p>Under the current framework, audits have to be prepared in accordance with Canadian AS issued by the Audit and Assurance Standards Board (AASB) of the Canadian Institute of Chartered Accountants. However, the AASB's goal is to adopt the international auditing standards.</p> <p>Auditor's independence</p> <p>NI 52–108 Auditors Oversight and NI 52–110 Audit Committees have put in place mechanisms to ensure auditors' independence:</p> <ul style="list-style-type: none"> • the auditor must report directly to the audit committee, which is responsible for overseeing and must pre-approve all non-audit services; and • the auditor must comply with the rules established by the Canadian Public Accounting Board (CPAB), which has issued rules on independence. <p>The CPAB is an independent corporation, whose mandate is to oversee external auditors that provide auditing services to listed companies throughout the country. Its governing body is a council of governors on which securities regulators are represented. The CPAB conducts on-site inspections of auditing firms, which are obliged to correct any deficiency found by the CPAB.</p> <p>In addition, if a regulatory authority believes that the financial statements of an issuer do not comply with the accounting standards, it can order the issuer to amend the statements. In addition, it can suspend trading of an issuer and impose sanctions on it.</p> <p>Also both the OSC and the AMF make public the list of issuers with deficiencies in their reporting obligations. Once the issuer corrects the deficiency, it is removed from that list. In Ontario, if the deficiency is identified as a result of a continuous disclosure review the issuer is placed on an errors and refile list.</p>
Assessment	Fully implemented
Comments	
Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers	

Principle 19. Auditors should be subject to adequate levels of oversight.	
Description	<p>Requirements for auditors</p> <p>Pursuant to provincial legislation, the provincial professional accounting bodies govern accountants including those providing auditing services to reporting issuers (i.e. issuers that offer securities to the public). They govern the use of the applicable professional designation and grant licenses to practice as public accountants. They are also responsible for setting up ethical standards, including the quality control environments in which auditors operate.</p> <p>Each provincial accounting body sets minimum requirements for education and practical experience for accountants. Individuals wishing to become accountants must (i) complete an undergraduate university or college degree; (ii) complete several specified courses sponsored by the applicable provincial accounting body or university, (iii) meet a minimum time of practical experience ranging from 24 months to 36 months and (iv) complete specified comprehensive examinations. Also, each provincial accounting body requires a member to complete a minimum of 120 hours of professional development in a three-year cycle. These requirements are also applicable to the auditors that want to audit reporting issuers.</p> <p>Provincial bodies exercise a first level of oversight over accountants/auditors and have established quality control reviews to that effect.</p> <p>CPAB</p> <p>Pursuant to NI 52-108 auditors of reporting issuers are subject to the oversight of CPAB. CPAB is a federally incorporated, not-for-profit corporation constituted in 2003. CPAB is independent from any other professional or regulatory body and from the auditing profession. CPAB's by-laws establish two classes of members: (i) Council of Governors; and (ii) Provincial Audit Regulator Members.</p> <p><i>Council of Governors</i></p> <p>The Council of Governors votes on CPAB's by-law amendments, has the primary oversight responsibility over the CPSB board of directors and appoints CPAB's directors, and also selects the board Chair and Vice-Chair. The Council of Governors can also remove any directors that it has appointed.</p> <p>The Council of Governors comprises six members: the Chair of the CSA, the Chair of the OSC, the Chair of the AMF, the Superintendent of Financial Institutions of Canada, a fifth governor selected by the CSA and a person selected by the other five Governors, (upon consultation with the Provincial Audit Regulator Members) who is a professional accountant and has audit oversight experience. The Council of Governors carries out a</p>

high-level assessment of CPAB's board of directors against its duties and objectives on an annual basis.

While the Council is the primary body in charge of the oversight of CPAB, some of the provinces have enacted statutes for CPAB that have made it accountable to their respective governments. The first province was Ontario, with the enactment of the Ontario Canadian Public Accountability Board Act, and now six provinces also have a similar provision. In practice such accountability is taken the form of a certification by the Council to the MoF that CPAB is fulfilling its mandate. It is expected that other provinces will follow the same approach.

Provincial Audit Regulator Members

The Provincial Audit Regulator Members vote on CPAB's by-law amendments, appoint CPAB's external auditor, and receive CPAB's annual financial statements and the auditor's report. Provincial Audit Regulator Membership is available to provincial audit regulators who oversee audit firms whose aggregate Canadian audit fee revenue from reporting issuers in the province is at least \$7,000,000 and whose disciplinary processes and codes of ethics meet standards established by the board of directors.

Board of Directors

The board is appointed by the Council of Governors and has the overall responsibility for managing and supervising the management of CPAB's activities, and affairs. In accordance with CPAB's by-laws, the board of directors consists of 11 directors who have been appointed based on the following criteria:

- At least four directors (but no more than five) must be professional accountants to ensure that the board has members with technical accounting expertise; and
- At least two directors must have oversight regulatory experience, including at least one professional accountant and at least one person with audit oversight regulatory experience.

Directors are appointed annually, and are eligible to serve on CPAB's board for up to three periods of three years each. There are two standing committees of the board—an Audit Committee and a Corporate Governance Committee.

CPAB's funding structure

CPAB's fees are established by the board. CPAB's management annually prepares a strategic plan and budget and proposes an Annual Participation Fee percentage designed to enable CPAB to recover its annual operating costs. The Annual Participation Fees are allocated by the board amongst the participating audit firms in proportion to such firms' total fees charged to their reporting issuer clients in respect of audit services.

	<p>This fee is currently 2.0 percent of the audit fees charged by each participating audit firm to its reporting issuer clients (firms in certain foreign jurisdictions are charged a rate of 0.2 percent). Fees are mandatory for participating audit firms, and while CPAB invoices audit firms for the fee, the firms in turn bill their reporting issuer audit clients.</p> <p>The participating accounting firms are also required to pay a one-time flat fee, upon becoming a participating firm, which is calculated based on the number of reporting issuer clients that they audit. This fee is administrative in nature; the more substantial source of ongoing funding is the annual participation fee.</p> <p>Authority</p> <p>CPAB derives its oversight authority through “Participation Agreements” with auditing firms, which auditing firms are required to enter into under NI 52-108. In addition, CPAB’s By-law No. 1 requires each participating audit firm to co-operate with CPAB, and comply with all of CPAB’s by-laws, rules and any requirements, restrictions and sanctions that may be imposed by CPAB.</p> <p>As indicated above, some provinces have enacted specific laws for CPAB, for example Ontario, Québec and British Columbia. Such Acts provide CPAB staff with legal protection against suits for actions/omissions conducted as a result of their functions and include a provision on non-compellability—so that staff cannot be obliged to provide confidential information.</p> <p>Responsibilities and Powers</p> <p>CPAB conducts its oversight in accordance with its rules and by-laws which set out the specific responsibilities, powers and duties of CPAB pertaining to its oversight function. CPAB’s rules generally give the board powers to:</p> <ul style="list-style-type: none"> • Establish and maintain requirements for the participation of public accounting firms that audit reporting issuers; • Publish and maintain on its website, a register of public accounting firms that are subject to the board’s oversight program; • Conduct inspections of participating audit firms directly or in co-operation with the provincial accounting bodies; • Conduct investigations of participating audit firms and impose, where appropriate, requirements, restrictions, or sanctions to upgrade supervision, training or education; • Conduct review proceedings when required under the prescribed
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circumstances;

- Assist provincial accounting bodies in their supervision of public accounting firms, including referring cases of individual conduct to a provincial accounting body, and coordinating its disciplinary measures for a designated professional or an audit firm with those of the provincial accounting bodies;
- Assist and receive assistance from foreign auditor oversight bodies in investigations of participating audit firms; and
- Provide comments and recommendations on accounting and assurance standards to provincial accounting bodies and other relevant standard setting and oversight bodies.

Remedial Measures and Disciplinary Proceedings

Following each inspection, CPAB sends the audit firms a private report that includes its findings, recommendations and other observations. CPAB staff highlighted that recommendations are not voluntary that is, auditing firms are obliged to implement them to CPAB's satisfaction within a prescribed period of time—normally 180 days. However, depending on the severity of the findings, the deadline for implementing CPAB's recommendations may be shorter than 180 days. CPAB's recommendations generally entail one or more of: performing additional audit work in the current year, adding evidence to the audit file with respect to work that was carried out, but not properly evidenced, or changing the audit approach in future audits to remedy the deficiency.

Usually CPAB requests a plan of action and follows up on it on an on-going basis, so that if there is an issue they would not wait until the next inspection to request its correction. Failure to implement the recommendations to CPAB's satisfaction could give rise to disciplinary action on the audit firm or designated professional in the form of a requirement, restriction or sanction.

In more serious situations, CPAB may impose requirements, restrictions or sanctions on an audit firm. Pursuant to CPAB's Rule 601 requirements, restrictions or sanctions may include one or more of the following:

- Additional professional education for some or all of the designated professionals of a participating audit firm;
- The design, adoption or implementation of policies by a participating audit firm to ensure compliance with CPAB's rules;
- A reviewer or supervisor to oversee the work of one or more designated

	<p>professionals of a participating firm;</p> <ul style="list-style-type: none"> • Termination of one or more audit engagements of a participating audit firm; • Appointment of an independent monitor to observe and report back to the board on a participating audit firm’s compliance with CPAB’s rules; • Prohibition of a participating audit firm from accepting new reporting issuer clients for a period of time; • Prohibition of a participating audit firm from assigning one or more designated professionals to audits of financial statements of reporting issuers for a period of time or permanently; • Public censure; • Monetary assessment to recoup the board’s anticipated cost of monitoring the participating audit firm’s compliance with the terms of any requirement, restriction or sanction; • Termination of a firm’s status as a participating audit firm; or • Other remedial actions. <p>NI 52-108 establishes that if CPAB imposes restrictions on a participating firm, then the firm must provide notice in writing to the regulators. If CPAB imposes sanctions the firm must provide notice to the regulator and the audit committee.</p> <p>In spite of confidentiality provisions in Section 11 of the Ontario Canadian Public Accountability Board Act, Section 13 of CPAB Act allows CPAB to provide information to securities regulators if it has reasonable grounds to believe that there has been a breach of laws. Staff indicated that CPAB is currently working on a MoU with CSA members to further clarify the provision of cooperation and information sharing between CPAB and CSA members.</p> <p>Process for regular reviews</p> <p>CPAB has developed a program of quality-control reviews that covers all firms who audit reporting issuers. These reviews cover audit procedures performed on specific files, as well as the general quality control practices of the accounting firms.</p> <p>All firms are covered on a cyclical basis ranging from one to three years. CPAB’s Rule 403 and Rule 404 specify the required frequency of inspections:</p> <ul style="list-style-type: none"> • If a firm has 100 or more reporting issuer clients—an annual inspection of the
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firm is conducted

- If a firm has 50–99 reporting issuer clients—it must be inspected at least every two years; and
- If a firm has less than 50 reporting issuer clients—it must be inspected at least every three years. For this segment, CPAB relies also to a certain extent in the audits conducted by the provincial bodies.

In the case of foreign firms, CPAB determines the extent to which it can rely on that country's auditor oversight body. For example, for foreign firms based in the US, CPAB relies primarily on the PCAOB's review program. To this end, CPAB signed an updated agreement with the PCAOB in April 2011 that allow the two bodies to share inspection methodologies and inspection findings.

To determine the number of audit files to inspect at each firm, CPAB uses a risk-based approach which considers reporting issuer's information, such as liquidity, solvency, earnings, and quality of assets. In the selection of files to review from an auditing firm CPAB seeks to stratify the population, to make sure that it is getting a good coverage of the risks (for example, in the case of inspections on the big four, they select files from the regional offices, and select files from small issuers). Additional issues are included if specific concerns have arisen in regard to a particular set of issuers. For example, recently issuer's exposure to particular countries that are under stressed, has been a factor included in the risk assessment framework. Also recently in light of concerns regarding issuers from emerging countries, the CPAB conducted a sweep specifically targeted to engagements for such type of issuers.

On an annual basis, CPAB publishes a report highlighting inspection findings from the previous year, which is available on its website.

Reliance by CPAB on the provincial bodies

While CPAB performs most of its own inspections, it has entered into MOUs with certain provincial accounting bodies that perform inspections of some of the smaller audit firms (generally those with five or fewer reporting issuers). The MOUs set forth the mutual commitments of CPAB and the provincial accounting bodies.

As other stakeholders, CPAB staff considers that there is room for improvement in the overall quality of the oversight work conducted of the provincial bodies. However, in connection with the reviews of reporting issuers, CPAB staff highlighted that it maintains control over the scope of the auditing firms reviewed by providing a reporting issuer risk ranking analysis to the provincial accounting SGBs on a quarterly basis to assist them in identifying those reporting issuer files that CPAB is most interested in having the provincial accounting SGBs inspect. In addition, CPAB receives the review report

and thus is able to satisfy itself that the matters reviewed by the accounting SGBs during an inspection are substantially similar to the scope of the matters that CPAB would review during an inspection. The provincial accounting bodies also provide timely access to all related working papers. CPAB's Director of Interprovincial Affairs reviews the provincial inspection reports and CPAB can supplement a provincial inspection with its own direct review. CPAB can, at any time, choose to perform its own direct reviews of the smaller audit firms. The actions and measures taken by the provincial accounting bodies do not constrain CPAB from pursuing its own *outcomes* and taking its own actions with respect to the same audit firm.

Practice

CPAB has 42 accountants directly involved in inspections (4 staff in Montreal, 7 in Vancouver and 26 in Toronto and 5 contractual). CPAB staff highlighted that a significant effort on recruitment of qualified staff has been made and became more visible after 2010. CPAB staff highlighted that it has been able to recruit professionals with a significant number of years of experience, including retired partners from national and regional firms. CPAB staff considers that at this moment it has sufficient resources to fulfill its mandate. Overall stakeholders share a similar view on the quality of its staff.

Staff is subject to rules on conflict of interest, which among other things include rotation (typically on 3-4 year cycle for team leaders, and the staff that reviews the firms). Stakeholders indicated that these rules are respected in practice.

In terms of its own, site review program, below is a summary of current market share for 2011

- there were 14 firms in the category of 100 or more reporting issuer clients and these firms audited 99.5 percent of reporting issuers measured by the total market capitalization;
- Four firms in the 50–99 reporting issuer clients;
- And 158 firms with less than 50 clients; of these 158 firms, 146 had less than 20 reporting issuer clients.

During 2011 (i.e. CPAB's review of 2010 audits), CPAB inspected 88 firms (69 in 2010) and 245 audit engagements (232 in 2010), including follow-up inspections as detailed below. Also based on its risk analysis, CPAB carried out inspections of audits performed by three foreign firms in other countries. In addition, provincial accounting bodies inspected 62 firms (this is in addition to the 88 inspected directly by CPAB in 2011). For the large auditing firms the review team usually involved around 10 staff. For the top 15 firms there are team leaders assigned on a cyclical basis –and as stated above subject to

rotation.

	Number of Firms	Number of Engagements
Big Four Firms	4	114
Other Firms with over 100 reporting issuers	10	41
Other Firms	56	87
Follow up Inspections	18	3
Total	88	245

As a result of its 2011 inspections, CPAB has required action plans including from some of the big eight firms. CPAB staff stated that there is now a more continuous follow up of actions plans (and 1–2 staff are designated to that effect) CPAB staff indicated that firms are not contesting the recommendations; but working on their implementation.

In addition CPAB placed a requirement on seven firms—in addition to the cases where it has required a plan of action to address recommendations. One of those requirements was converted into a restriction in 2012 because the firm did not comply with the requirement. During 2011, CPAB did not place a sanction on a participating firm and there were no review proceedings or any other proceedings conducted in respect of CPAB's disciplinary decisions in either 2011 or 2010. There were no appeals, applications for judicial review or arbitrations in respect of decisions made by a review panel during the year. A summary of results for the preceding four years is provided below:

Year	Requirement	Restrictions	Sanctions
2011	7	1	-
2010	3	-	-
2009	2	-	-
2008	9	-	-

All the information provided indicates that action plans are the most frequent enforcement tool used by CPAB. CPAB staff commented that especially in connection

	<p>with the big firms' reputation is a strong motivator to ensure compliance.</p> <p>Stakeholders interviewed considered that the quality of CPAB's inspections has improved over the years and that inspections are thorough and the staff is generally experienced enough. Comments also ratified the fact that follow up on actions plans is now more continuous. There was also agreement that rules of conflict of interest were respected. As to the effectiveness of CPAB's actions, stakeholders indicated that some firms are internally affecting compensation of partners based on the results of CPAB's inspections; but that is not the case for all.</p>
Assessment	Broadly Implemented
Comments	<p>The grade is mainly due to the enforcement issues described below in connection with question 7 of the methodology.</p> <p>Based on the conversations held with CPAB and stakeholders the assessor concludes that the quality of CPAB inspections is robust. The area that raises some questions is enforcement.</p> <p>First, as indicated above CPAB has relied mainly on recommendations especially for the largest firms, only in a few cases has imposed requirements (such as a third party review) and only in one case has used restrictions. The question that this raises is whether this approach is strong enough, or whether CPAB should make more use of the tools at its disposal, and whether pecuniary sanctions should also be part of the toolkit—as is the case in many other jurisdictions. From the information gathered it appears that the continuous monitoring that CPAB is exercising is delivering results, in terms of changes in processes but more importantly in the quality control “culture” of some of the large auditing firms. However, use of other tools beyond recommendations might be more important for the smaller firms, as in those cases reputation might not be in itself a strong incentive to change. Finally, the limited transparency given to enforcement actions can affect their deterrent effect.</p> <p>Second, there is a need to improve the sharing of information with audit committees and the regulators. The assessor acknowledges that there is currently dialogue between the regulators and CPAB aimed at addressing these limitations.</p> <p>Finally, the assessor encourages the provinces that have not addressed the issue of legal protection and non compellability of CPAB staff to do so. As is the case for securities regulators, lack of adequate legal protection may have a chilling effect on staff making necessary decisions, and be a disincentive to their taking robust action, especially in difficult or complex situations. That is why this is a key requirement for supervisory agencies, under Principle 2 of the Methodology. As CPAB is the supervisory agency for purposes of supervision of external auditors, this requirement should be in place for it. The assessor notes that this issue is mitigated</p>

	by the fact that some of the largest jurisdictions have already made these changes.
Principle 20.	Auditors should be independent of the issuing entity that they audit.
Description	<p>Independence requirements</p> <p>As indicated above, securities legislation requires that annual financial reports be accompanied by an auditor’s report prepared in accordance with Canadian Generally Accepted Auditing Standard which includes compliance with the rules of professional conduct. Each applicable provincial accounting body in the four jurisdictions has built independence standards into their applicable rules of professional conduct/code of ethics.</p> <p><i>Financial, business and other relationships</i></p> <p>The applicable rules of professional conduct contain detailed requirements for members and audit firm independence addressing financial interests, loans and guarantees, close business relationships, family and personal relationships, employment with a reporting issuer audit client, recent service with an assurance or audit or review client, serving as an officer or a member of the board of directors of a reporting issuer audit client, religious associations, social clubs, and long association with senior personnel with a reporting issuer audit client.</p> <p>The rules of professional conduct describe circumstances and activities which members and firms must avoid when performing an assurance engagement, because adequate safeguards do not exist that would, in the view of a reasonable observer, eliminate a threat or reduce it to an acceptable level. Accordingly, the member or firm will not be independent of the client as required for an assurance engagement, and therefore will be prohibited from performing the assurance engagement. The requirements to avoid these circumstances and activities are referred to as “prohibitions”. Some prohibitions apply to all assurance engagements while others only apply to audits of reporting issuers</p> <p>Prohibitions applicable to all assurance engagements include:</p> <ul style="list-style-type: none"> • Members of the engagement team (and immediate family members) may not have a financial interest, as defined, in an assurance client or its related entities. • The firm and members of the engagement team may not have a loan, or a loan guarantee, to or from an assurance client or a related entity. • The firm and members of the engagement team may not have a close business relationship with an assurance client. • Members of the engagement team may not have an immediate family member

	<p>in a position with the client during the period covered by the engagement where that person would be able to influence the subject matter of the assurance engagement.</p> <ul style="list-style-type: none"> • Members of the engagement team must not be an officer or director of the client, or an employee of the client in a position to influence the subject matter of the assurance engagement, during the period covered by the engagement. Members and firms are prohibited from performing management functions including a list of services such as bookkeeping and accounting services, including the preparation of the financial statements; Financial information systems design and implementation unless it is reasonable to conclude that the results of the services will not be subject to audit procedures; Actuarial services; valuation services; Internal audit services; Expert services including litigation support for the purpose of advocating a client's position; Legal services; Management functions; Human resources services including recruiting; and Tax planning and tax advisory. • Members and firms may not provide legal services that involve dispute resolution of matters that are material to the financial statements of audit and review clients. • Members and firms may not provide corporate finance services such as dealing in, promoting, or buying/selling an assurance client's securities. Members and students on the engagement team and the firm may not accept other than clearly insignificant gifts or hospitality from an assurance client. <p>Where no prohibitions exist, the member or firm must identify and address any threats to independence that are not clearly insignificant, and where such threat(s) cannot be reduced to an acceptable level, refuse to accept or continue the engagement.</p> <p><i>Self interest</i></p> <p>Professional conduct rules contain prohibitions in respect of self-interest including direct or indirect financial interest in a reporting issuer audit client, loan or guarantee, close business relationships and employment with an audit client. Other specific threats of self-interest, which are referred to in the rules, or supporting documentation from the provincial accounting bodies, include dependence on fees, undue concern about losing the engagement and compensation for non-audit services to an audit client.</p> <p><i>Self review</i></p> <p>The rules contain prohibitions in respect of self-review situations, including when there is an officer or director relationship, an employee is able to exert direct and significant influence on the engagement, or on a member or firm providing other services</p>
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	<p>impacting the engagement or preparing original data impacting the engagement.</p> <p><i>Advocacy</i></p> <p>The rules contain prohibitions in respect of advocacy, including dealing in or promoting shares or securities of a reporting issuer audit client, or acting as an advocate on behalf of a reporting issuer audit client in litigation or otherwise in resolving disputes with third parties.</p> <p><i>Familiarity</i></p> <p>The rules contain prohibitions in respect of familiarity, including when a person on the engagement team has:</p> <ul style="list-style-type: none"> • an immediate or close family member as a director or officer of the reporting issuer audit client, or as an employee or shareholder able to exert direct and significant influence; • a former partner as a director, officer or employee with a long association with a senior person on the engagement team for the reporting issuer audit client; or • has accepted gifts or hospitality from the reporting issuer audit client unless the value is clearly insignificant. <p><i>Intimidation</i></p> <p>The rules address the threat of intimidation. Examples may include the threat of being replaced due to a disagreement, or the application of pressure to inappropriately reduce the extent of work performed or reduce or limit fees.</p> <p><i>Non audit services</i></p> <p>The independence standards which are built into the rules of professional conduct for each provincial accounting body also contain prohibitions and guidance related to non-audit services. For example, there are specific prohibitions respecting providing services to reporting issuer audit clients respecting:</p> <ul style="list-style-type: none"> • the preparation of accounting records and financial statements; and • valuation, actuarial, internal audit, IT systems, litigation support, legal or human resources, corporate finance, taxation, or other expert services. <p>In addition, the standards of each applicable provincial accounting body require consideration of threats to independence, including due to the provision of non-audit services. Each applicable accounting body provides guidance on an auditor's ability to</p>
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	<p>provide services that are not prohibited if threats to independence have been reduced to an acceptable level.</p> <p>In addition, in the case of reporting issuers NI 52-110 <i>Audit Committees</i> requires an issuer's audit committee to pre-approve all non-audit services to be provided to the issuer or its subsidiary entities by the issuer's external auditor.</p> <p><i>Appearance</i></p> <p>The independence standards require an auditor to continuously be, and be seen to be, independent of the entity being audited. This includes what some provincial accounting bodies refer to as "independence of mind" and "independence in appearance". The rules specify that the assessment of independence should be considered from the "view of a reasonable observer."</p> <p><i>Rotation</i></p> <p>Rotation is mandatory at partner level after seven years, and requires a five year lag [what about team members?].</p> <p>Compliance with independence requirements</p> <p><i>Review by the own firm</i></p> <p>Canadian Standard on Quality Control 1—<i>Quality Control for Audit Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements</i> (CSQC 1) and Canadian Auditing Standard 220—<i>Quality Control for an Audit of Financial Statements</i> (CAS 220) require auditors to have controls in place to address threats to independence. In particular, CSQC 1 requires auditors to identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.</p> <p>CAS 220 requires an engagement partner to form a conclusion on compliance with independence requirements that apply to the audit engagement and specifically do the following: obtain information from the firm and network firms to identify and evaluate circumstances and relationships that create threats to independence; evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards or withdraw from the audit engagement.</p> <p>CAS 260 Communication with Those Charged with Governance requires an auditor to</p>
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confirm the independence of the auditor.

Audit Committee

NI 52-110 *Audit Committees* requires the audit committee of a reporting issuer (other than an investment fund) to have specific responsibilities including the following:

- recommend to the board of directors the external auditor to be nominated for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the issuer;
- recommend to the board of directors the compensation of the external auditor,
- be directly responsible for overseeing the work of the external auditor engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the issuer, including the resolution of disagreements between management and the external auditor regarding financial reporting;
- pre-approve all non-audit services to be provided to the issuer or its subsidiary entities by the issuer's external auditor;
- review and approve the issuer's hiring policies regarding partners, employees and former partners and employees of the present and former external auditor of the issuer.

The assessment of the independence involves considering prescribed "bright lines" respecting current or past employment, current or past employment of family member, relationships with the auditor (for example, employment or partnership), compensation committee conflicts, quantum of direct compensation, direct or indirect consulting, advisory or compensatory fees and whether or not the director and the auditor are affiliated entities. The assessment of independence also involves otherwise determining whether or not a director has a relationship which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of a member's independent judgment.

NI 52-110 requires the external auditor to report directly to the audit committee, as opposed to management. NI-52-110 requires audit committees to be made up of independent members (except for the venture issuers).

As in many other countries, stakeholders consider that there is room for improvement in connection with the role that audit committees especially for the smaller issuers. In this regard, stakeholders consider that for the larger issuers (top 400-500) there is sufficient engagement from the audit committee, for mid size firms the quality of engagement is mixed, while for the smaller firms, audit committees are considered ineffective. In all

cases stakeholders consider that there is room for audit committees to move from overseeing the quality of the audit to more actively evaluating the quality of such work. CPAB staff informed that it has worked on the development of tools to assist audit committees to perform this more active role.

NI 81-107 *Independent Review Committee for Investment Funds* and NI 81-102 *Mutual Funds* require an IRC for a mutual fund (an investment fund under NI 81-102) to approve the change of auditor for the fund.

Other controls

In addition, Canadian companies that are registered under the Canada Business Corporations Act must follow certain legal provisions concerning auditors. This includes:

- requiring shareholders to appoint the auditor annually;
- requiring shareholders to fix the remuneration of an auditor in certain circumstances; however, if the remuneration of the auditor is not fixed by the shareholders, it may be fixed by the directors;
- requiring that the auditor ceases to hold office when removed by the shareholders, dies or resigns;
- other requirements including communications, duties and obligations between the auditor and shareholders, directors, the audit committee and predecessor auditors (when there is a change of auditors).

There are similar provisions in provincial corporate legislation in certain jurisdictions for companies registered under these acts.

Reviews by CPAB

CPAB's reviews, as described in Principle 19, include evaluating whether the audit firms have adequate processes in place to assess the appropriateness of undertaking non-assurance services for audit clients, the identification of threats to independence and factors which mitigate such threats, and more generally, their compliance with the various features of Rule 204 Independence Standards.

Resignation

NI 51-102 requires a reporting issuer to notify a change of auditor, including information about the reasons for the resignation or reassignment. It must also include information about any modified opinion expressed by the predecessor auditor, any difference of opinion and any unresolved issues. Finally, the notice must include a summary of advice from the successor auditor and the predecessor auditor if the issuer

	<p>consulted with the successor auditor about a financial reporting matter. The notification must be approved by the audit committee or board of directors of the reporting issuer and be filed with the securities regulatory authority within 30 days after the date of a termination or resignation of the auditor and upon 30 days after the appointment of a successor auditor</p> <p>Part 13 of NI 81-106 requires public investment funds to follow the “noisy withdrawal” regime set out under NI 51-102.</p>
Assessment	Fully Implemented
Comments	The challenges on the effectiveness of audit committees are not unique to Canada. The assessor encourages the authorities to continue working on developing tools to facilitate their role.
Principle 21.	Audit standards should be of a high and internationally acceptable quality.
Description	<p>Assessed in 2007</p> <p>The regulatory framework for accounting and auditing has been harmonized in NI 52–107 Acceptable Accounting Principles, Auditing Standards and Foreign Currency.</p> <p>Under the current framework, issuers have to prepare their financial statements according to Canadian GAAP that are issued by the Accounting Standards Board (ASB). Canadian GAAP provides a comprehensive set of standards for preparing financial statements. In the past the goal of the ASB was to seek convergence with U.S. GAAP; however this goal was reassessed and now the goal is to minimize differences with and implement International Financial Reporting Standards (IFRS) by 2011. Convergence with IFRS does pose certain challenges for the Canadian market given that IFRS does not address specific standards for oil, gas and mining/extraction activities.</p> <p>Under the current framework, audits have to be prepared in accordance with Canadian AS issued by the Audit and Assurance Standards Board (AASB) of the Canadian Institute of Chartered Accountants. However, the AASB’s goal is to adopt the international auditing standards.</p> <p>Auditor’s independence</p> <p>NI 52–108 Auditors Oversight and NI 52–110 Audit Committees have put in place mechanisms to ensure auditors’ independence:</p> <ul style="list-style-type: none"> • the auditor must report directly to the audit committee, which is responsible for overseeing and must pre-approve all non-audit services; and • the auditor must comply with the rules established by the Canadian Public

	<p>Accounting Board (CPAB), which has issued rules on independence.</p> <p>The CPAB is an independent corporation, whose mandate is to oversee external auditors that provide auditing services to listed companies throughout the country. Its governing body is a council of governors on which securities regulators are represented. The CPAB conducts on-site inspections of auditing firms, which are obliged to correct any deficiency found by the CPAB.</p> <p>In addition, if a regulatory authority believes that the financial statements of an issuer do not comply with the accounting standards, it can order the issuer to amend the statements. In addition, it can suspend trading of an issuer and impose sanctions on it.</p> <p>Also both the OSC and the AMF make public the list of issuers with deficiencies in their reporting obligations. Once the issuer corrects the deficiency, it is removed from that list. In Ontario, if the deficiency is identified as a result of a continuous disclosure review the issuer is placed on an errors and refiling list.</p>
Assessment	Fully implemented
Comments	
<p>Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.</p>	
Description	<p>Use of ratings</p> <p>Securities legislation includes numerous references to credit ratings. In many cases, a credit rating may confer differential treatment upon market participants. For example:</p> <ul style="list-style-type: none"> • Short-term debt with a specified credit rating can be distributed exempt from the prospectus and registration requirements that would otherwise apply. • An issuer can file a short-form prospectus in respect of a distribution of debt if the debt has a specified credit rating. • Short-term debt with a specified credit rating can be eligible for investment by money market mutual funds. <p>Designation</p> <p>Pursuant to NI- 25-101 any credit rating organization that wishes its ratings to be eligible for use for regulatory purposes must be registered as a designated rating organization (DRO).</p>

	<p>The regulatory requirements for a credit rating organization applying to become a DRO are set out in NI 25-101. Staff from the agencies commented that a goal when developing this NI was to be internationally consistent (in order to allow for recognition of the local CRAs by the European authority –ESMA).</p> <p>The provisions listed in NI 25-101 are based substantially on the IOSCO Code and require a DRO to establish, maintain and comply with a code of conduct which includes policies and practices related to the following:</p> <ul style="list-style-type: none"> • policies and procedures related to the quality and integrity of the rating process; • governance requirements related to the board of directors and the compliance officer to be responsible for monitoring and assessing the DRO’s compliance with its code of conduct and securities legislation; • policies and procedures reasonably designed to identify and manage any conflicts of interest that may arise in connection with the issuance of credit ratings; • policies and procedures related to the transparency and timeliness of ratings disclosure and prescribed information to be disclosed in rating reports; and • policies and procedures reasonably designed to prevent the inappropriate use and/or dissemination of certain material, non-public information, including a pending undisclosed rating action. <p>Under section 6 of NI 25-101, a credit rating organization that applies to be a DRO must file a completed Form 25-101F1 <i>Designated Rating Organization Application and Annual Filing</i> (Form 25-101F1). Form 25-101F1 requires information about:</p> <ul style="list-style-type: none"> • the organizational structure of the credit rating organization; • a list of credit rating affiliates; • a copy of the code of conduct that incorporates each of the provisions set out in Appendix A to NI 25-101; • a description of the procedures and methodologies used in determining credit ratings; • a description of the policies or procedures adopted and implemented to prevent the misuse of material, non-public information; • a description of the policies and procedures adopted and implemented to
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	<p>address and manage conflicts of interest;</p> <ul style="list-style-type: none"> • certain information regarding the credit rating organization's credit analysts and credit analyst supervisors; <p>certain information regarding the credit rating organization's designated compliance officer;</p> <ul style="list-style-type: none"> • a list of the largest users of credit rating services by the amount of net revenue earned from the user during the fiscal year ending immediately before the date of the initial application; • financial statements for each of the three fiscal or calendar years ending immediately before the date of the initial application; and • information regarding revenues for the fiscal or calendar year ending immediately before the date of the initial application. <p>A credit rating organization already registered as an NRSRO with the SEC, may, instead of filing a Form 25-101F1, file its most recent Form NRSRO, which provides substantially the same information.</p> <p><i>Quality and integrity of ratings</i></p> <p>Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to the quality and integrity of the rating process:</p> <ul style="list-style-type: none"> • A DRO must adopt, implement and enforce procedures in its code of conduct to ensure that the credit ratings it issues are based on a thorough analysis of all information known to the DRO relevant to its analysis according to its rating methodologies. • A DRO must include a provision in its code of conduct that it will use only rating methodologies that are rigorous, systematic, continuous and subject to validation based on experience, including back-testing. • Each ratings employee involved in the preparation, review or issuance of a credit rating, action or report must use methodologies established by the DRO. Each ratings employee must apply a given methodology in a consistent manner, as determined by the DRO. • A credit rating must be assigned by the DRO and not by an employee or agent of the DRO. • A credit rating must reflect all information known, and believed to be relevant,
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to the DRO, consistent with its published methodology.

Monitoring and updating ratings

Appendix A to NI 25-101 includes the following requirements:

- The DRO will ensure that adequate personnel and financial resources are allocated to monitoring and updating its credit ratings. Except for ratings that clearly indicate they do not entail ongoing monitoring, once a rating is published, the DRO will monitor the rated entity's creditworthiness on an ongoing basis and, at least annually, update the rating.
- The DRO will establish a committee to be responsible for implementing a rigorous and formal process for reviewing, on at least an annual basis, and making changes to the methodologies, models and key ratings assumptions it uses. This review includes consideration of the appropriateness of the DRO's methodologies, models and key ratings assumptions if they are used or intended to be applied to new types of structures, instruments or securities.
- In addition, the DRO must initiate a review of the accuracy of a rating upon becoming aware of any information that might reasonably be expected to result in a rating action (including termination of a rating), consistent with the applicable rating methodology and must promptly update the rating, as appropriate, based on the results of such review.
- If the DRO uses separate analytical teams for determining initial ratings and for subsequent monitoring, the organization will ensure each team has the requisite level of expertise and resources to perform their respective functions competently and in a timely manner.

Records

Section 13 of NI 25-101 requires a DRO to keep books and records for a period of seven years from the date the record was made or received, whichever is later;

in a safe location and a durable form; and in a manner that permits it to be provided promptly to the securities regulator upon request.

Resources

Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to the quality and integrity of the rating process:

- The DRO will ensure that its ratings employees and agents have appropriate

	<p>knowledge and experience for the duties assigned.</p> <ul style="list-style-type: none"> • The DRO will ensure that it has and devotes sufficient resources to carry out high-quality credit assessments of all rated entities and rated securities. • A DRO must also adopt all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality to support a credible rating and is obtained from a source that a reasonable person would consider to be reliable. <p><i>Independence</i></p> <p>Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to independence and conflicts of interest:</p> <ul style="list-style-type: none"> • The DRO will not refrain from taking a rating action based, in whole or in part, on the potential effect (economic or otherwise) of the action on the DRO, a rated entity, an investor, or other market participant. • The DRO and its employees will use care and professional judgment to remain independent and maintain the appearance of independence and objectivity. • The determination of a credit rating will be influenced only by factors relevant to the credit assessment. • The DRO will not allow its decision to assign a credit rating to a rated entity or rated securities to be affected by the existence of, or potential for, a business relationship between the DRO or its affiliates and any other person or company including, for greater certainty, the rated entity, its affiliates or related entities. • The DRO will not rate a person or company that is an affiliate or associate of the organization or a ratings employee. The DRO must not assign a credit rating to a person or company if a ratings employee is an officer or director of the person or company, its affiliates or related entities. • The DRO will not permit a ratings employee or an associate of such ratings employee to buy, sell or engage in any transaction involving a security, a derivative or an exchange contract based on a security issued, guaranteed, or otherwise supported by any person or company within such ratings employee's area of primary analytical responsibility, other than holdings through an investment fund. <p>Appendix A to NI 25-101 also includes requirements addressed to the board of directors and its oversight responsibilities. For example:</p>
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- The DRO will not issue a credit rating if a member of its board of directors participated in any deliberation involving a specific rating in which the member has a financial interest in the outcome of the rating.
- The DRO will not compensate an independent member of its board of directors in a manner or in an amount that a reasonable person could conclude that the compensation is linked to the business performance of the DRO or its affiliates.

Conflict of interest

Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to independence and conflicts of interest:

- The DRO will identify and eliminate or manage and publicly disclose any actual or potential conflicts of interest that may influence the opinions and analyses of ratings employees.
- The DRO will disclose the actual or potential conflicts of interest it identifies in a complete, timely, clear, concise, specific and prominent manner.

Compensation

Section 3.9 Appendix A to NI 25-101 provides that a DRO will publicly disclose the general nature of its compensation arrangements with rated entities.

In addition:

- If the DRO or an affiliate receives from a rated entity, an affiliate or a related entity compensation unrelated to its ratings service, such as compensation for ancillary services, the DRO will disclose the percentage that non-rating fees represent out of the total amount of fees received by the DRO or its affiliate, as the case may be, from the rated entity, the affiliate or the related entity.
- If the DRO or an affiliate receives directly or indirectly 10 percent or more of its annual revenue from a particular rated entity or subscriber, including revenue received from an affiliate or related entity of the rated entity or subscriber, the organization will disclose that fact and identify the particular rated entity or subscriber.

In addition, the prospectus and CD rules require companies to provide complementary information about their dealings with credit rating organizations by disclosing whether they paid the credit rating organization that provided a credit rating and whether they paid for any other services provided by the credit rating organization during the last two years.

	<p><i>Timely distribution of ratings</i></p> <p>Section 4.1 of Appendix A to NI 25-101 provides that the DRO will distribute in a timely manner its ratings decisions and any updates regarding the entities and securities it rates.</p> <p><i>Non selective disclosure</i></p> <p>Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to the transparency of ratings disclosure:</p> <ul style="list-style-type: none"> • The DRO will publicly disclose its policies for distributing ratings, ratings reports and updates. • Except for a rating it discloses only to the rated entity, a DRO will disclose to the public, on a non-selective basis and free of charge, any ratings decision regarding rated entities that are reporting issuers or the securities of such issuers, as well as any subsequent decisions to discontinue such a rating, if the rating decision is based in whole or in part on material non-public information. <p><i>Disclosure of procedures, methodologies and assumptions</i></p> <p>Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to the transparency of ratings disclosure:</p> <ul style="list-style-type: none"> • The DRO will publicly disclose the methodologies, models and key rating assumptions (such as mathematical or correlation assumptions) it uses in its credit rating activities and any material modifications to such methodologies, models and key rating assumptions. This disclosure will include sufficient information about the DRO's procedures, methodologies and assumptions (including financial statement adjustments that deviate materially from those contained in the issuer's published financial statements and a description of the rating committee process, if applicable) so that outside parties can understand how a rating was arrived at by the DRO. • The DRO will assist investors in developing a greater understanding of what a credit rating is, and the limits to which credit ratings can be put to use in relation to a particular type of financial product that the DRO rates. The DRO will clearly indicate the attributes and limitations of each credit rating. <p>Appendix A to NI 25-101 also includes requirements regarding the content of credit rating reports that are publicly disseminated. There are additional information requirements in connection with securitized products.</p>
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Information on past performance

Section 4.13 of Appendix A to NI 25-101 provides that the DRO will publicly disclose data, on a yearly basis, about the historical default rates of its rating categories and whether the default rates of these categories have changed over time. The requirement also provides that the information will include verifiable, quantifiable historical information about the performance of its rating opinions, organized and structured, and, where possible, standardized in such a way so as to assist investors in drawing performance comparisons between different DROs.

Protection of non public information

Appendix A to NI 25-101 provides that a DRO must comply with the following requirements related to the treatment of confidential information:

- The DRO and its employees will take all reasonable measures to protect the confidential nature of information shared with them by rated entities under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. Unless otherwise permitted by the confidentiality agreement or required by applicable laws, regulations or court orders, the DRO and its employees will not disclose confidential information.
- The DRO and its employees will not use confidential information for any purpose except for their rating activities or in accordance with applicable legislation or a confidentiality agreement with the rated entity to which the information relates.
- The DRO and its employees will not share confidential information entrusted to the DRO with employees of any affiliate. The DRO and its employees will not share confidential information within the DRO, except as necessary in connection with the DRO's credit rating functions.

Non public information related to pending actions

Section 4.21 of Appendix A to NI 25-101 provides that the DRO and its employees will not selectively disclose any non-public information about ratings or possible future rating actions of the DRO, except to the issuer or its designated agents.

Foreign CRAs

NI 25-101 includes the concept of a "DRO affiliate" for foreign entities that are subject to regulatory oversight in other jurisdictions. A DRO affiliate is defined as "an affiliate of a DRO that issues credit ratings in a foreign jurisdiction and that has been designated as

a DRO affiliate under the terms of the DRO’s designation.”

The suitability of an affiliate to be designated as a DRO affiliate is determined on a case-by-case basis at the time of designation. To make such a determination the designating securities regulator considers the legal and supervisory framework of the foreign jurisdiction, including whether the credit rating organization is authorized or registered in that foreign jurisdiction and whether the credit rating organization is subject to effective supervision and enforcement. A DRO affiliate is not required to comply with all of NI 25-101, although, where appropriate, references to a DRO affiliate are included in NI 25-101. For example, a DRO, or a DRO affiliate that is a parent of the DRO, must have a compliance officer that monitors and assesses compliance by the DRO and its employees with the organization’s code of conduct and with securities legislation.

Cooperation with foreign regulators

The agencies have entered into the following MoUs

- The OSC, AMF and the BCSC, entered into a MoU with ESMA concerning the regulatory cooperation related to the supervision of credit rating organizations that operate in both the European Union and Canada. The Supervisory MOU sets forth the terms and conditions and a framework for consultation, cooperation and information sharing related to the day-to-day supervision and oversight of credit rating agencies that operate across our jurisdictions.
- The OSC, AMF, ASC and BCSC have a MoU with the US SEC regarding mutual assistance in the supervision and oversight of regulated entities (which include credit rating organizations) that operate on a cross-border basis in the United States and Canada (the SEC MOU).
- The OSC, AMF, ASC and BCSC have a MoU with ASIC regarding mutual assistance in the supervision and oversight of regulated entities (which include credit rating organizations) that operate on a cross-border basis in Australia and Canada (the ASIC MOU).
- The securities regulators are currently in the process of negotiating other MOUs with the FSA and the CFTC that deal with supervisory cooperation.

Application process

NP 11-205 describes the process for the filing and review of an application to become a DRO in more than one jurisdiction of Canada. An application to become a DRO in multiple jurisdictions is prepared under the passport system. Therefore, the application to become a DRO is filed only with, and fees paid only to, the principal regulator. The principal regulator will review the application and its decision to grant the designation

automatically results in a deemed designation in the notified passport jurisdictions. Generally, the principal regulator is the regulator in the jurisdiction where the DRO's head office is located, or, if the DRO does not have a head office in Canada, the jurisdiction where the DRO's largest branch office is located.

Powers

The securities regulators may, subject to providing the credit rating organization the right to be heard, (i) refuse to designate a credit rating organization, (ii) cancel the designation of a credit rating organization or (iii) impose or change the terms and conditions of the designation.

The securities regulators have the power to bring proceedings against a DRO. For example, a securities regulator may resort to the following remedies:

- order that a DRO enact changes to its practices and procedures;
- order that a DRO be reprimanded;
- order that a DRO that has not complied with securities legislation pay an administrative penalty for each failure to comply;
- revoke its designation order; or
- launch an enforcement investigation and quasi-criminal proceeding.

Ongoing oversight

No later than 90 days after the end of its most recently completed financial year, each DRO must file a completed Form 25-101F1 with the securities regulators, which includes prescribed information about the business and operations of the DRO and includes a narrative explanation of the policies, practices and internal controls adopted by the DRO to ensure compliance with the requirements of NI 25-101.

In addition, securities legislation authorizes the security regulators to designate, in writing, one or more persons to review the books, records and documents required to be kept by a DRO for the purpose of determining whether the DRO is complying with securities legislation. Finally, as a market participant, DROs are subject to compliance reviews.

Practice

To date, the securities regulators have received applications from four credit rating organizations. The applicants were DBRS Limited, Fitch, Inc., Moody's Canada Inc., and Standard & Poor's Rating Services (Canada). Since the head office of each credit rating

	<p>organization or affiliate is located in Toronto, Ontario, the OSC was identified as the principal regulator.</p> <p>On April 30, 2012, the OSC granted designation orders to each of the applicants, but exempted the applicants from the application of NI 25-101 for six months to allow the applicants to review and amend, if necessary, their policies, practices and internal controls in order to be compliant in all material respects with NI 25-101. The April 30th designation orders were granted to satisfy the endorsement requirements in the European Union (EU) regarding the use of credit ratings issued by Canada-based rating agencies.</p> <p>During the summer of 2012, OSC staff reviewed the information provided by the applicants pursuant to Section 6 of NI 25-101 to ensure that it was complete and to ensure that the applicants' policies, practices and internal controls were compliant in all material respects with the requirements of NI 25-101. As part of this process, three staff members and a manager reviewed the filings provided by the applicants and met with the applicants to discuss concerns or discuss policies and practices that would have to be implemented or revised in order to be compliant in all material respects with NI 25-101. This process began in May 2012 and concluded with the granting of the designation orders on October 31, 2012. As a result of the review, changes were requested to the applicants, including, for example:</p> <ul style="list-style-type: none">• One applicant adopted a board governance charter which sets out the duties and responsibilities of the board and incorporates the requirements of NI 25-101.• One applicant adopted a compliance mandate which sets out the duties and responsibilities of the CCO.• One applicant made changes to its organizational structure to appoint a designated compliance officer for the purpose of compliance with NI 25-101.• One applicant revised its outsourcing policy and its worldwide securities trading and conflicts of interest policy to incorporate the requirements of NI 25-101.• All of the applicants adopted new internal procedures and provided a sample presentation of credit ratings (PCR) to outline how they have incorporated the requirements in Sections 4.4 to 4.7 of Appendix A to NI 25-101. <p>Pursuant to the passport system described above, the designation orders issued by the OSC were deemed to have been issued in all of the other Canadian provinces and territories.</p>
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	<p>DRO Compliance Review Program</p> <p>Given that the regulatory regime for DROs was recently implemented, the OSC has not yet conducted on-site compliance reviews of any DRO. However, staff with specific expertise in CRAs was hired, and the OSC is currently developing a compliance program based on the requirements set out in NI 25-101. It is anticipated that the compliance program will be in place by the summer of 2013.</p> <p>The on-site program will use a risk-based approach. Certain topics have already been identified for the first inspection, including independence and reporting lines of chief compliance officers, and new business. The frequency of on-site compliance reviews will vary depending on what risks are identified and whether the risks identified require immediate action. OSC staff will monitor and consider areas for review on an annual basis.</p> <p>Under the Supervisory MOU with ESMA, OSC staff currently participate in quarterly conference calls with ESMA staff to share information about the supervision of DROs that are also registered in the European Union. For example, ESMA staff completed a compliance review of DBRS Ratings Limited (a UK affiliate of DBRS registered in the European Union) during the summer of 2012 and shared the results of their review with OSC staff. OSC staff have also provided progress reports to ESMA staff concerning the applications for designation for each of the applicants.</p>
Assessment	Broadly Implemented
Comments	The grade is mainly the result of the fact that an on-site review program for DROs is not yet in place in connection with question 2b) of the methodology. The assessor acknowledges that the authorities have committed the resources and have a credible plan for the implementation of on-site reviews.
Principle 23.	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.
Description	<p>Sell side analysts</p> <p>National Instrument 31-103 <i>Registration Requirements, Exemptions and Ongoing Registrant Obligations</i> (NI 31-103) does not provide for a distinct category of registration for individuals or firms that are engaged in providing analytical or evaluative services. The registration regime is generally based on whether an entity or individual provides advice in relation to the trading of securities, or that trades in securities. If so, they must be registered either as an adviser or as a dealer. NI 31-103 exempts from registration persons who provide advice in securities if the advice is not</p>

	<p>individualized. In such case, however the NI requires disclosure of conflict of interest.</p> <p>Portfolio managers that manage individual accounts and make recommendations to clients could be fulfilling an analyst's role for which they are subject to the regulatory requirements set out in NI 31-103. On the other hand, sell-side analysts are usually employed by investment dealers that are required to be members of IIROC.</p> <p>As per NI 31-103 all registered dealers and advisers, and the registered individuals acting on their behalf, are required by securities legislation to deal fairly, honestly and in good faith with their clients. They are also required to put in place policies and procedures to address conflicts of interest.</p> <p>In addition, investment dealers are subject to the additional rules established by IIROC. In connection with research the main provisions are imbedded in Rule 3400 <i>Research Restrictions and Disclosure Requirements</i>. This Rule relates to the elimination, avoidance, management and disclosure of the conflicts that can arise in connection with the participation in research activities by IIROC members or research analysts (including sell-side analysts). This Rule establishes the minimum requirements that analysts must follow when publishing research reports or making recommendations.</p> <p>Pursuant to such rule, each Dealer Member shall have written conflict of interest policies and procedures, in order to minimize conflicts faced by analysts.</p> <p>Each Dealer Member must prominently disclose in any research report:</p> <ul style="list-style-type: none"> a) any information regarding its, or its analyst's business with or relationship with any issuer which is the subject of the report which might reasonably be expected to indicate a potential conflict of interest on the part of the Dealer Member or the analyst in making a recommendation with regard to the issuer. The rule provides examples of the type of information that should be included. b) the Dealer Member's system for rating investment opportunities and how each recommendation fits within the system and must disclose on their websites or otherwise, quarterly, the percentage of its recommendations that fall into each category of their recommended terminology; and c) its policies and procedures regarding dissemination of research <p>Where an employee of a dealer makes a public comment (which includes an interview) about the merits of an issuer or its securities, a reference must be made to the existence of any relevant research report, or it must be disclosed that such a report does not exist.</p> <p>Where a dealer Member distributes a research report prepared by an independent third party to its clients under the third party name, the dealer must disclose any items</p>
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which would be required to be disclosed as indicated above.

There are several rules designed to address potential conflict of interest:

- From the investment banking activities:
 - Dealers must have policies and procedures in place reasonably to prevent recommendations in research reports from being influenced by the investment- banking department or the issuer. Such policies and procedures shall, at minimum:
 - (1) prohibit any requirement for approval of research reports by the investment banking department;
 - (2) limit comments from the investment banking department on research reports to correction of factual errors;
 - (3) prevent the investment banking department from receiving advance notice of ratings or rating changes on covered companies; and
 - (4) establish systems to control and keep records of the flow of information between analysts and investment banking departments regarding issuers that are the subject of current or prospective research reports.
 - No Dealer Member may pay any bonus, salary or other form of compensation to an analyst that is directly based upon one or more specific investment banking services transactions. Further, dealers must disclose in research reports if in the previous 12 months the analyst responsible for preparing the report received compensation based upon the Dealer Member's investment banking revenues.
- From the relationship of officers or staff with the issuers
 - Dealers are prohibited from issuing a research report prepared by an analyst if the analyst or any associate of the analyst serves as an officer, director or employee of the issuer or serves in any advisory capacity to the issuer.
 - No individual directly involved in the preparation of the report can effect a trade in a security of an issuer, or a derivative instrument whose value depends principally on the value of a security of an issuer, regarding which the analyst has an outstanding recommendation for a period of 30 calendar days before and 5 calendar days after issuance of the research report, unless that individual receives the previous written approval of a designated partner, officer or director of the

	<p>Dealer Member. No approval may be given to allow an analyst or any individual involved in the preparation of the report to make a trade that is contrary to the analyst's current recommendation, unless special circumstances exist.</p> <ul style="list-style-type: none"> ○ Dealers who distribute research reports to clients or prospective clients must have policies and procedures reasonably designed to prohibit any trading by its partners, directors, officers, employees or agents resulting in an increase, a decrease, or liquidation of a position in a listed security, or a derivative instrument based principally on a listed or quoted security, with knowledge of or in anticipation of the distribution of a research report, a new recommendation or a change in a recommendation relating to a security that could reasonably be expected to have an effect on the price of the security. <ul style="list-style-type: none"> ● From services and/or the relationship of the firm with the issuer: <ul style="list-style-type: none"> ○ No Dealer Member may directly or indirectly offer favorable research, a specific rating or a specific price target, a delay in changing a rating or price target or threaten to change research, a rating or a price target of an issuer as consideration or inducement for the receipt of business or compensation from an issuer. ○ Dealer Members must disclose in research reports if and to what extent an analyst has viewed the material operations of an issuer. Dealer Members must also disclose where there has been a payment or reimbursement by the issuer of the analyst's travel expenses for such visit. ○ No Dealer Member may issue a research report for an equity or equity related security regarding an issuer for which the Dealer Member acted as manager or co-manager of an initial or a secondary public offering within certain deadlines. ○ Dealer Members must issue notice of their intention to suspend or discontinue coverage of an issuer. However, no issuance is required when the sole reason for the suspension is that an issuer has been placed on a Dealer Member's restricted list. <p>Monitoring compliance with Rule 3400</p> <p>IIROC monitors compliance with Rule 3400 by carrying out its normal-course business conduct examinations through its Business Conduct Compliance Department (BCC).</p> <p>BCC reviews a sample of the research and analysis publications issued by:</p> <ul style="list-style-type: none"> ● IIROC members,
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- their registered individuals (approved persons), including research analysts, and
- any third parties whose services are retained to perform similar services on behalf of IIROC members.

The degree to which an IIROC member complies with Rule 3400 is a component of the firm's risk rating. Risk rating determines the frequency of compliance examinations by BCC. The rating categories are high, moderate and low, as follows:

- if the research promotes maximum results while, at the same time, minimizing risks and excluding mandatory disclosures, the IIROC member's risk model is rated *high*;
- if the research accurately reflects the risks and return of a security, the research component of that IIROC member's risk model is rated *moderate*; and
- the research component of an IIROC member's risk rating is *low* if the IIROC member does not engage in research.

Where IIROC examiners identify deficiencies relating to the research activities of an IIROC analyst, the severity of the deficiencies ranges from *low* to *high*. From a practical perspective:

- an example of the low rating of the deficiency is where the IIROC member has not implemented satisfactory policies and procedures concerning research, and
- an example of the high rating of the deficiency is where the IIROC member has knowingly omitted material disclosures which are required by Rule 3400, which scenario is exceptional.

In many cases, the *low* and *moderate* research deficiencies observed are highlighted on IIROC reports and the IIROC member must inform IIROC of the steps it will take to resolve the situation.

IIROC's compliance examination modules test the activities relevant to Rule 3400, and this testing covers different fact scenarios and business models. Although there are deficiency findings on occasion, examination results over time indicate that Rule 3400 is an adequate regulatory framework for research activities.

Other analysts

Qualified persons under NI 43-101

NI 43-101 *Standards of Disclosure for Mineral Projects* (NI 43-101) requires that all disclosure of scientific or technical information made by an issuer, including disclosure

	<p>of a mineral resource or mineral reserve, be either:</p> <ul style="list-style-type: none"> • prepared by or under the supervision of a qualified person, or • approved by a qualified person. <p>A technical report required to support an issuer's first time disclosure of mineral resources, mineral reserves or the results of a preliminary economic assessment must be prepared by qualified persons that are independent of the issuer.</p> <p>Qualified persons must comply with the professional standards of competence and ethics of their professional association and generally use procedures and methods that are consistent with industry best practices and standards. NI 43-101 defines a qualified person, in terms of both of education and competence. Where the regulators have concerns that a qualified person does not have relevant experience, they may challenge the qualified person to explain or justify their relevant experience, or failing that, ask for a revised technical report from additional qualified persons.</p> <p>Valuators under multilateral instrument 61-101</p> <p>MI 61-101 <i>Protection of Minority Security Holders in Special Transactions</i> (MI 61-101), requires that, when formal valuations are required, they are to be provided by a valuator who is independent of all interested parties in the transaction and who has appropriate qualifications. Whether a valuator is independent of an interested party or has appropriate qualifications is a question of fact, assessed on a case-by-case basis, but the MI provides examples of situations that would be deemed the valuator not to be independent.</p> <p>Proxy advisors</p> <p>On June 21, 2012, the CSA published a consultation paper on the issue of proxy advisory firms. The paper provides an overview of the services provided by proxy advisory firms, identifies broad categories of concern regarding these firms, including issues related to conflicts of interest, lack of transparency, limited engagement with issuers, corporate governance implications and reliance by institutional investors, and outlines possible securities regulatory responses to these concerns. The responses to this consultation are currently being reviewed.</p>
Assessment	Fully Implemented
Comments	The rules for research analysts are in line with international best practices. The assessor notes also that review of their compliance is part of IIROC's review program.
Principles for Collective Investment Schemes	

Principle 24.	The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.
Description	<p>Pursuant to NI-31-103:</p> <ul style="list-style-type: none"> • CIS operators are required to register in the category of IFM. Individuals carrying out activities on behalf of a registered IFM are not required to register. • Advisers that provide portfolio advice to a CIS must be registered in the category of PM. • Dealers that market or sell a CIS must be registered in the category of dealer. A dealer who markets securities of conventional CIS must be a member of IIROC or the MFDA except in Québec. A dealer who markets securities of non-conventional CISs must be an IIROC member. A dealer who markets securities of prospectus-exempt CISs to investors under a prospectus exemption must be registered as an EMD or an IIROC dealer member. <p>The description in this Principle will focus on the category IFMs, as the other categories would fall under Principle 29.</p> <p>Operation of a CIS</p> <p>An IFM is required to register if it directs the business, operations or affairs of one or more investment funds, as provided in securities legislation. Jurisdictions have adopted different approaches/interpretations to determine when registration is required for non-resident IFMs. These interpretations have been set forth in MIs.</p> <p>Registration requirements</p> <p>A firm that wants to be a CIS manager must apply for registration as an IFM and demonstrate that it meets the minimum entry standards (“fit and proper requirements”) for registration in the applicable category. These standards include proficiency, solvency and integrity requirements</p> <p><i>Minimum capital</i></p> <p>Overall NI 31-103 imposes a minimum capital requirement of \$100,000 on all IFMs. The calculation of minimum capital is based on a formula contained in Form 31-103F1 <i>Calculation of Excess Working Capital</i> (Form 31-103F1). Section 12.1(2) of NI 31-103 requires that the excess working capital of a firm as calculated on Form 31-103F1 must not be less than zero for two consecutive days.</p>

	<p><i>Insurance</i></p> <p>NI 31-103 requires the maintenance of insurance. The amount of insurance required is based on calculations that take into account various factors, including the assets under management. The IFM must take into account the likely changes in its assets under management (AUM) when assessing the level of insurance coverage required.</p> <p><i>Internal controls</i></p> <p>NI 31-103 requires a registered firm to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and manage the risks associated with its business in accordance with prudent business practice. An IFM should establish policies and procedures that are appropriate, based on the size, complexity and risks associated with its business and the CIS that it manages. Internal controls should mitigate the risks and protect the assets of the firm and the CIS.</p> <p><i>Human resources (approved persons and permitted individuals)</i></p> <p>NI 31-103 specifically requires registrants, including IFMs to designate a UDP and a CCO. These are considered “approved” individuals; and therefore pursuant to the relevant NIs they are subject to integrity, proficiency and solvency requirements.</p> <ul style="list-style-type: none"> • Overall the UDP is the maximum authority in charge of ensuring that the firm is run prudently and in compliance with laws and regulations. • The CCO is the person in charge of establishing and maintaining policies and procedures to assess the firm’s compliance with securities laws and regulations, monitoring and assessing such compliance, and informing the UPD of any non-compliance. On an annual basis the CCO must submit a report to the board on compliance matters. <p>Every registered firm, including IFMs, is required to give the UDP and CCO the ability to directly access the firm’s board of directors, or equivalent, whenever the UDP or CCO consider this access necessary or advisable. This will ensure that important issues related to compliance can be brought to the highest levels of the firm.</p> <p>In addition, the firm must also have its permitted individuals apply for review by the regulators. National Instrument 33-109 <i>Registration Information</i> (NI 33-109) defines a permitted individual as an individual who:</p> <ul style="list-style-type: none"> • is a director, CEO, CFO or chief operating officer, or performs the functional equivalent of any of those positions or
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- beneficially owns, directly or indirectly, or exercises control or direction over 10 percent or more of the voting securities of the firm.

The registration form requires extensive information on their integrity, solvency and proficiency but from a legal perspective they are not approved individuals. This distinction means that the regulators do not have a direct power over shareholders and directors, as is the case for regulators in other jurisdictions where they are subject to specific fit and proper requirements and thus the regulator can deny their "appointment" if they do not meet such requirements. Staff highlighted that they can achieve this same result both at the entry point and on-an going basis through other means. At the entry point they can refuse to register the firm, and on an on-going basis, they can seek remedies against the firm, for example suspension of the firm or the imposition of terms and conditions on the firm's registration.

Registration process

To register an applicant must complete Forms 33-109F4 and 33-109F6, which require extensive information on the firm, including:

- the identity of the applicant, its location and contact information;
- the identity of its UDP and CCO;
- its business history and structure, including organization and ownership chart;
- its registration history in any jurisdiction whether in or outside Canada, including any exemptions from securities registration, information as to whether registration was refused, information on SRO membership and details on registration or licensing;
- information on the financial condition of the applicant, including the sources and calculation of capital, bonding and insurance and general solvency information;
- a description of any significant conflicts of interest;
- information on all regulatory actions, namely settlement agreements, disciplinary history and ongoing investigations; and
- information on criminal convictions, outstanding criminal charges, legal actions and judgments against the applicant in the past seven years.

In addition in BC, Alberta and Manitoba, the applicant is required to submit policies and procedures and a business plan to the consideration of the regulatory agency.

<p>The regulators will assess individuals by initially reviewing the information provided in their application for registration Form 33-109F4 <i>Registration of Individuals and Review of Permitted Individuals</i> (Form 33-109F4). The regulators' review processes include:</p> <ul style="list-style-type: none"> • background checks, including obtaining information on any criminal offences, civil actions alleging fraud, theft, deceit, misrepresentation or similar misconduct, financial information on prior bankruptcies, and other detrimental information from other securities regulatory proceedings or investigations; and • an examination of the individuals' relevant securities industry experience, including employment history. <p>As for the firm itself, the amount of time and resources involved in the review of a registration application varies. As indicated above in all cases the information provided in the form would be reviewed by staff so that the agency will come to a view as to whether the applicant fulfills all requirements. In cases where the information in the application raises concerns, then agencies might require them to submit policies and procedures and the business plan. In some provinces (BC, Alberta and Manitoba) this additional information is requested as a matter of practice. In some provinces it is also more common that a meeting with the principals of the applicant would be conducted as part of the application process, and a visit to see the premises would also take place. Staff of the agencies that take the former approach indicated that a few years ago they conducted a review of the registration process and came to the conclusion that in many cases at the moment of application firms were still uncertain about the business that they were going to undertake, and therefore the policies and procedures that they presented were very general/"canned", which in turn did not add significant value to the registration process. That was the reason for streamlining the process. They highlighted however that when concerns arise, which happened in some cases in connection with conflict of interest, they would then explicitly require such policies, and in some cases have requested changes to them.</p> <p>In addition, in some provinces there is an established practice to conduct a "light" on-site review of a new firm within 6–12 months of registration to "test" whether the firm is starting its operations in a good footing. In some jurisdictions it is also an established practice that a new firm would get a full on-site inspection roughly 18 months after registration. In other provinces, such practice does not exist, although the agency does review a sample of new firms. The specific number varies from year to year. On average, roughly 19 percent of new firms get inspected early on. The agencies taking the latter approach highlighted that these practices are in line with a risk-based approach.</p> <p>The agencies informed that there are not many cases of refusals to grant a registration; as applicants usually work on addressing questions raised by staff—which in many cases relate to conflict of interest—as indicated above. In exceptional cases the applicant</p>
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withdraws the application.

Each regulatory agency, under their respective laws, has the power to impose terms and conditions on registrants to, for example, restrict their activities or require supervision of those activities. In these cases, registrants, or applicants for registration, have an opportunity to be heard before the regulator prior to the terms and conditions becoming final.

Changes to registration

Registrants must also notify the regulators of a change to any information previously submitted in Form 33-109F6 and Form 33-109F4 within a prescribed period of time.

Duty of care

An IFM is subject to a statutory standard of care whereby, in exercising its powers and discharging its duties related to the management of the CIS, it must:

- act honestly, in good faith and in the best interests of the CIS and
- exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

Under Section 4.4 of NI 81-102, an agreement or declaration of trust must state that the IFM is responsible for any loss that arises out of the failure of the IFM, or of any person or company retained by the IFM, to carry out its responsibilities according to the standard of care as set out in NI 81-107. A CIS cannot relieve its IFM from liability for loss that arises out of the IFM's failure to carry out its responsibilities according to the standard of care.

Conflict of interest

Securities legislation prohibits a series of transactions that are likely to give rise to conflict of interest. Aside from the specific prohibitions, NI 81-107 requires publicly offered CISs to have an IRC to oversee the IFM's handling of conflict of interest matters relating to the operation of the CIS. The IRC must be made up of at least three members that are independent of the CIS, its IFM or an entity related to the IFM.

IRC members are not subject to the approval of the regulator; rather the IFM is responsible to ensure that the members meet the NI requirement. However, in one case, staff challenged the inclusion of one member through a prospectus review and the name was withdrawn. In any case, staff highlighted that the review of the IRC is part of their compliance inspections, as will be further detailed below.

Under NI 81-107, an IFM must receive the approval of the IRC before proceeding with

	<p>certain specific transactions and consider the recommendation of an IRC before proceeding with any other actions that involves, or that a reasonable person would consider to involve, a conflict of interest of the IFM.</p> <p>The IRC must prepare and file an annual report to the security holders and provide a copy to the regulator, which must:</p> <ul style="list-style-type: none"> • describe each instance where the IFM acted in a conflict matter without the positive recommendation of the IRC; • describe each instance when the IFM acted in a conflict matter, but failed to meet a condition imposed by the IRC in its recommendation or approval; and • summarize any recommendations and approvals the IFM relied on during the period in the operation of the CIS that gave rise to a conflict of interest for the IFM. <p>In addition, when an IFM does not meet a condition, the IRC must notify the regulators in writing as soon as possible.</p> <p>Overall staff of the agencies considered that the IRC is providing value. IRC members tend to be seasoned retired professionals who take their function seriously. Notifications of breaches have occurred, and in their inspections staff have found instances also where the IRC raised concerns which were then addressed by the IFM.</p> <p>In addition, there are also disclosure obligations for the CIS, in the prospectus, as well as in their CD documents.</p> <p>Other obligations</p> <p>There are specific obligations concerning best execution, trading, churning, due diligence that apply to the adviser in connection with the investments made for the CIS.</p> <p>There are also very specific obligations related to the disclosure of fees. Information on fees and expenses must be included in the prospectus, in a specified format. In addition, the management expense ratio is reported semi-annually as part of the MRFP, and also in the Fund Facts for conventional CIS on an annual basis.</p> <p>Obligations concerning the distribution of CIS (sales practices) are addressed in NI 81-105. The intention of NI 81-105, by prohibiting certain sales practices and compensation arrangements, is to reduce conflicts between the interests of investors and those of dealers, their sales representatives and managers.</p> <p>Both authorities and market participants stated that trailing commissions is an issue of concern in Canada, as they induce dealers and their sales representatives to sell CIS</p>
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securities based on the incentives they receive rather than on what is suitable for, and in the best interests of, investors. The agencies informed that there is currently a CSA consultation proposal on trailing commissions that includes different alternatives to address this problem, from better disclosure to banning trailing commissions.

Outsourcing

Section 7.3 of 31-103CP states that an IFM may delegate or outsource certain functions to other service providers. However, the IFM is responsible for these functions and must supervise the service provider. Part 11 of 31-103CP discusses general business practices for outsourcing arrangements. There should be written, legally binding contracts in place with each service provider that includes the expectations of the outsourcing arrangement. Further, IFMs should follow prudent business practices and conduct a due diligence analysis of prospective third-party service providers, including those that are affiliates of the IFM. The due diligence should include an assessment of the service provider's reputation, financial stability, relevant internal controls and ability to deliver the services. In addition, an IFM should maintain a detailed business continuity plan and review those of its service providers to ensure there is no disruption in the performance of its key business functions.

The regulators, the IFM and the IFM's auditors should have the same access to the work product of a third-party service provider as they would if the IFM itself performed the activities. IFMs should ensure this access is provided and include a provision requiring it in the contract with the service provider, if necessary.

Generally, delegation arrangements should be disclosed to investors in the prospectus of a publicly offered CIS.

The agencies indicated that delegated functions, such as fund accounting and valuation, are generally "available for hire" in Canada. There are numerous service providers available and an IFM would not have difficulty in making alternative arrangements should the need arise. The agencies stated that they have not encountered any circumstances where alternative arrangements for key functions could not be organized by the IFM.

Staff of the agencies highlighted that delegation of functions is a strong point in their reviews. In fact, in some cases they have imposed terms and conditions, and in some instances require the hiring of a third party to review the arrangements.

Obligation to keep records

Pursuant to NI 31-103 a registered firm must maintain records for a period of seven years from the date the record is created, and be maintained in a safe location and in a durable form. The records must also be maintained in a manner that permits them to be

	<p>provided to the regulators in a reasonable period of time.</p> <p>Advisers who manage the portfolio of CIS assets are also subject to the requirements in NI 31-103 in relation to the transactions involving those assets. Registered advisers must have a complete record of the assets belonging to the CIS to ensure the orderly and timely transfer of these assets to other registered advisers if the adviser winds up its business.</p> <p>Powers</p> <p>As for any other registrant NI 31-103 gives the authority to the regulators to request periodic information from them, as well as to make ad-hoc requests, and to conduct on-site inspections.</p> <p>They also have the power to conduct investigations. The outcome of an inspection, CD review or an investigation may uncover deficiencies or breaches that may lead to a recommendation for regulatory actions, such as terms and conditions being imposed on a registrant's registration, suspension of the firm's and its individuals' registration, or a referral to the enforcement area for the imposition of a sanction. Sanctions can be imposed both on individuals and the firms. Sanctions can include an order:</p> <ul style="list-style-type: none"> • that the registration or recognitions granted to a person or company be suspended, restricted or terminated; • that a person or company cease trading in securities for a period of time or permanently; • barring an individual from serving as an officer or director of an issuer or a registrant; • prohibiting a person or company from becoming or acting as a registrant or a promoter; • if the person or company has not complied with securities legislation, that the person or company disgorge any amounts obtained through non-compliance with securities legislation; and • if the person or company has not complied with securities legislation, that an administrative penalty be imposed for each failure to comply. <p>If the regulators believe that the length of time necessary to conclude a hearing could be prejudicial to the public interest, they may impose a variety of temporary orders. This includes temporarily ordering a person or company to cease trading in securities.</p> <p>If the regulators consider it expedient, they may direct a "freeze" of funds, securities or</p>
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other property until they or the applicable provincial court orders otherwise.

If it appears that there has been a criminal offence, staff will refer the matter to the appropriate police service for further investigation.

Compliance inspections

The CSA regulators conduct on-site inspections of registered firms, including IFMs on a regular basis. Overall the framework is risk-based. The risk-based approach is intended to identify those registrants most likely to have material issues, including risk of harm to investors. Staff normally conduct compliance inspections on-site at a registrant's premises, but may also perform inspections from the regulators' offices, which are known as desk reviews. Annual desk reviews of registrant financial statements and capital calculations are done by the regulators to assess compliance with the working capital requirements.

The four agencies have risk assessment frameworks that allow them to classify the firms usually in three categories, high, medium and low risks. In some cases, especially those agencies with larger registrant population, a risk assessment questionnaire is used to obtain information from all registrants on their internal controls and risk management.

The frequency of reviews depends on each regulator's registrant population and its available resources. Some jurisdictions are able to review all registrants within a prescribed time frame, or cycle, although the higher risk firms would be subject to more intense/frequent monitoring. In certain jurisdictions, especially those with the higher number of registrants, not all firms are put on a schedule. In their case the inspection program usually covers the firms classified as higher risk, and a number of other risk level firms are also covered, including sometimes lower risk firms, as a means to test the framework. Staff highlighted that this work is complemented also by the work performed on the product side (CD reviews), and that a number of low risk firms are also covered as a way to test the system

Through the CSA the agencies have developed common "templates" for the different modules of an inspection, which then can be tailored to the specific risk of the firm. In this regard, the modules for IFM inspections cover the following areas: transfer agent and security holder accounting, fund accounting, trust accounting, financial condition of the IFM, marketing and sales practices, referral arrangements, use of service providers, offering documents, IRC, conflicts of interest, compliance and supervision, including assessing the adequacy of the policies and procedures and the overall compliance structure.

The agencies also perform inspections on a for-cause basis where staff are aware of a potential compliance issue, e.g. from a complaint or a referral from another branch, an

SRO or another regulator.

Finally, the agencies also conduct sweeps, or targeted reviews. The most recent sweep conducted by staff in Ontario was on the review of IFMs of flow-through limited partnerships (FTLP managers). A review of six major FTLP managers with a head office in Ontario was performed and deficiency letters were issued to all. Further, terms and conditions were imposed on one FTLP manager due to significant compliance issues. Overall, staff in Ontario found that the other five FTLP managers have adequate compliance systems and controls in place, and did not identify any industry-wide compliance issues. Please see the response to Question 8 for information on additional sweeps conducted on IFMs in the past five years.

Inspection type	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
Regular inspections	13	11	11	12	21
Targeted inspections/sweeps:					
Valuation and expenses of CIS	26	-	-	-	-
Labour-sponsored and venture capital CIS	5	-	-	-	-
High risk registrants	-	15	-	-	18
Exchange traded CIS	-	6	-	-	-
Money market CIS	-	18	-	-	-
Hedge funds	-	7	32	1	-
IFMs of flow through limited partnerships	-	-	-	-	6
For-cause inspections	3	7	2	-	-
Total	47	64	45	13	45

In addition, from time to time, the regulators may prepare and distribute a questionnaire or survey on a particular area of concern for information gathering or to assess whether follow-up work is required. In October 2012, a survey was sent to IFMs to understand, among other things, their exposure to the sovereign debt of, or corporate debt of issuers domiciled in, certain countries within the Eurozone, specifically Greece, Italy, Ireland, Portugal and/or Spain.

CD reviews

Under National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106), CISs that are reporting issuers (i.e. all CIS that offer securities to the public) are required to file CD documents with the regulators, including annual and interim financial statements, the Management Report of Fund Performance (MRFP) and AIFs.

	<p>The regulators review these documents as part of their CD reviews which may vary in scope and detail among the jurisdictions. Certain CSA regulators conduct both planned and ad hoc CD reviews. In addition, some jurisdictions perform full reviews of CIS issuers on a regular basis.</p> <p>CISs are selected for such reviews based on a combination of, among other things, their size, type, investment strategies and risk rating. For planned reviews, staff generally contact IFMs and ask them to provide certain information relevant to the focus of the review, while ad hoc reviews tend to involve analysis of information already available to staff through mandated filings.</p> <p>Examples of planned reviews that regulators are currently doing or have completed recently are:</p> <ul style="list-style-type: none"> • a review of portfolio composition disclosure; • a review of advertising and marketing materials produced by CISs; • an examination of whether conventional CISs were understating their risk rating in their Fund Facts; • a review of financial statement disclosure relating to securities lending; and • a review of dollar cost averaging funds. <p>Examples of “ad hoc” reviews that staff have completed recently are:</p> <ul style="list-style-type: none"> • a look at the exposure of Canadian CISs to potentially problematic European debt; • a review of linked notes that offer exposure to either LIBOR or another benchmark that could have similar problems (e.g. not independently checked); and • a review of exposure of Canadian money market funds to downgraded US Treasury debt.
Assessment	Broadly Implemented
Comments	<p>The main reasons for the grade relate to the registration process combined with the intensity of on-site work, in connection with questions 3 and 8 of the methodology.</p> <p>As indicated in the description, practices in connection with the registration and supervision of IFMs, as well as for all other category of registrants directly under the oversight of the provincial regulators, differ in important ways across provinces. In many</p>

provinces, including those where the majority of the IFM population is located, the review focuses on ensuring that the key individuals comply with the integrity, solvency and proficiency test and that the minimum capital requirements (including insurance) have been met, leaving to the regular on-site inspection program the review of internal controls and risk management. The assessor acknowledges that this would be acceptable under principle 24, provided that the on-going review adequately cover the fact that these new firms are allowed into the system with a more basic level of review. As per the conversations held with these agencies, in the provinces with the largest population of IFMs new firms would be subject to the risk-based approach developed for the supervision of firms. This means that not all new firms would get an inspection early on in their "life". This poses the question of whether this approach to registration allows for the build-up of more significant problems in firms than more conservative approaches. There is no information on this topic, thus the assessor encourages the authorities to further analyze the pros and cons of each system. In the end, as will be discussed more broadly below, what approach a regulator uses is a reflection of its risk appetite.

In this regard, the assessor acknowledges that a risk-based approach is a reasonable and acceptable approach to implement an on-site inspection program for IFMs, as explained in Principle 12. However, in practice the use of such approach has resulted in a more focused use of on-site inspections in connection with IFMs. Work on the product side (CD reviews), however, works as a complement. An additional safeguard vis-à-vis investors is the fact that assets must be held by a custodian.

Given the role of on-site inspections in early identification of risks, the securities regulators should continually consider measures to increase the number of on-site inspections (via inspections on individual firms and/or thematic/sweeps) and refine their risk-based approach.

A final issue relates to shareholders and directors. The Methodology clearly requires that the licensing process allows for a comprehensive assessment of those in a position to control or materially influence the decisions of the firm that addresses a demonstration of appropriate knowledge, business conduct, resources, skills, and ethical attitude. On an ongoing basis it requires that the regulator has the power to withdraw, suspend or impose a condition when material changes result in a failure to comply with such requirements. The assessor notes that for registrants subject to the direct oversight of the securities agencies, there is a legal difference in the regime applicable to shareholders and directors than that applicable to the UDP or the CCO, as the former are not "approved" individuals. It is important that shareholders be explicitly subject to integrity and solvency criteria and that directors be subject also to a minimum set of experience requirements and that the agencies have indisputable powers to request the change of a shareholder or director if such requirements are not met. As stated in the description, the agencies contend that they can achieve this result both at the entry

	<p>point and on-an going basis through other means. However, recent experiences from other jurisdictions indicate that when this power is not available in such a direct way, decisions by the authorities might be questioned, delaying prompt corrective action, or the authority itself might delay acting in view of the lack of direct powers. Thus the assessor encourages the authorities to follow up on this issue. The assessor acknowledges that small firms—which in her understanding composed the bulk of registrants in this category—tend to be sole proprietorship firms, which means that they would not have a board. This in turn creates another type of challenges related to the quality of internal controls and risk management and potentially also, conflict of interests—although in the case of IFM the requirement of the IRC and a custodian acts as an additional safeguard. From that perspective also the assessor considers important that the securities regulators continually consider measures to increase the number of on-site inspections and refine their risk-based approach.</p>
<p>Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	
<p>Description</p>	<p>Assessed in 2007</p> <p>Legal form</p> <p>The current framework does not contain provisions on the legal form of CIS; rather there is freedom to use different legal forms (trust, a corporation or limited partnership) as long as the structure and rights of unit holders are described in the prospectus. In practice there is no substantial difference in the rights of investors due to the legal structure. The majority however are set up as trusts largely due to a favorable tax treatment.</p> <p>Segregation of assets</p> <p>All conventional funds (open-ended funds) must have a custodian. Banks, trust companies with capital of at least \$10,000,000 and a company that is an affiliate of a bank or trust company with a capital of not less than CAN\$10,000,000 are the only entities authorized to provide custodial services to CIS. According to this framework the CIS operator cannot be the custodian and cannot relieve the custodian or sub-custodians from liability. The custodian could be part of the same financial group. This risk has been mitigated by the creation of the IRC and the fact that the custodian is subject to supervision.</p> <p>Non conventional funds are not required to have a custodian; however the authorities noted that as a matter of practice they do.</p> <p>Record keeping</p>

	<p>In general, books and records must be kept for seven years, with the first two years in a readily accessible place.</p> <p>Winding up</p> <p>CIS operators are obliged to give notice to the regulator if the CIS is part of a merger, amalgamation arrangement, winding up, reorganization or other transaction that will result in the CIS ceasing to be a reporting issuer. Also the framework requires the CIS to give notice to unit holders.</p> <p>Reassessment of custody requirements conducted in 2013</p> <p>Public CISs must have portfolio assets held by a custodian that satisfies the requirements of Part 6 of NI Instrument 81-102 <i>Mutual Funds</i> (NI 81-102) or Part 14 of National Instrument 41-101 <i>General Prospectus Requirements</i> (NI 41-101), as applicable (Custody Rules). The requirements under Part 6 of NI 81-102 and Part 14 of NI 41-101 are identical. Under these Custody Rules, entities qualified to act as a custodian for assets of Public CISs must be:</p> <ul style="list-style-type: none"> • a bank listed in Schedule I, II or III of the <i>Bank Act</i> (Canada); or • a trust company that is incorporated under the laws of Canada (or a provincial jurisdiction), and that has shareholders' equity of not less than \$10,000,000; or • an affiliated company (incorporated under the laws of Canada or a provincial jurisdiction) of such a bank or trust company if the affiliate has shareholders' equity of not less than \$10,000,000 (or the bank/trust company has assumed responsibility for all of the custodial obligations of the affiliated company). <p>In addition, a sub-custodian of a CIS that holds portfolio assets outside of Canada must generally be either an affiliate of a Canadian bank or trust company (meeting the criteria described above), or a foreign company, with shareholders' equity of not less than the equivalent of \$100,000,000, regulated as a banking institution or trust company by the government of the foreign country.</p> <p>The IFM is strictly prohibited by these rules from acting as custodian or sub-custodian for any CIS that it manages.</p> <p>The primary custodians used by Public CISs in Canada are concentrated among relatively few firms federally or provincially regulated financial institutions (FI Custodians). The securities regulators estimate that 90 percent of Public CIS assets in Canada are held by three firms: CIBC Mellon Trust Company; RBC Investor Services Trust; and State Street Trust Company.</p> <p>Prospectus exempt CIS are not subject to the custody requirement. However OSC staff</p>
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informed that in practice, IFMs of a prospectus-exempt CIS generally retain, as a custodian, an entity qualified to act as a custodian for assets of a Public CIS. Furthermore staff informed that the securities regulators are reviewing custodial arrangements as part of ongoing amendments to NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, which would codify the existing business practice to require registered dealers, advisers and IFMs to use a prescribed custodian to hold client assets, including prospectus exempt CISs.

Custody by related affiliates

The current framework does not prohibit an IMF from engaging as a custodian a related bank, and in practice some of the entities noted above act as a custodian for one or more CISs created and managed by a related IFM.

The custodians and IFMs are separate legal entities and their operations are functionally independent. In general, the scale of the FI Custodians' operations is larger by AUM than the affiliated IFM clients they serve. In addition, the following safeguards are in place to mitigate the potential conflict of interest that this relationship entails:

- **Standard of Care:** Under the Custody Rules, the custodian and each sub-custodian of a Public CIS is subject to a standard of care that requires it to exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances, or at least the same degree of care as it would exercise with respect to its own property of a similar kind, if this is a higher degree of care. The CIS cannot relieve its custodian from liability to the CIS or to a security holder of the CIS for a loss that arises out of the failure of the custodian to exercise the mandated standard of care.
- **Oversight of the custodians:** Custodians are subject to oversight by a banking supervisor (OSFI or AMF in this case). As regulated entities they are required to be audited themselves.
- **Compliance report on custody:** Under section 6.7(3) of NI 81-102, and section 14.6 of NI 41-101 conventional and non conventional CISs, respectively, must file a custodial compliance report within 30 days after the filing of their annual financial statements. The custodian of the CIS must include the following in the report: (i) the names and addresses of all sub-custodians of the CIS;(ii) whether the custodian and sub-custodian agreements are in compliance with the custodial requirements under the Custody Rules; and (iii) whether, to the best of the knowledge and belief of the custodian, each sub-custodian satisfies the eligibility criteria for sub-custodians under the

	<p>Custody Rules.</p> <ul style="list-style-type: none"> • Conflict of interest requirements: Under NI 81-107 <i>Independent Review Committee for Investment Funds</i> (NI 81-107), an IFM of a Public CIS must have written policies and procedures for “conflict of interest matters”, which include the use of affiliated service providers, including custodians. In addition, this arrangement must be submitted to the IRC of the CIS for its review and recommendation. The IRC must conduct an annual review of the adequacy and effectiveness of the IFM’s conflict of interest policies, and report any breaches of those policies to the IFM for correction. • Disclosure requirements: The AIF of a Public CIS must disclose whether any person or company that provides services to the CIS, or to the IFM in relation to the CIS, is an affiliated entity of the IFM, and must show the relationships of those affiliated entities in the form of a diagram. The disclosure must also refer the reader to the audited financial statements of the CIS where amounts paid to affiliated entities by the CIS are shown. Any individuals, who are both a director or senior officer of the CIS, or partner, director or officer of the IFM, and also of the affiliated entity of the IFM, must be identified in the form. Disclosure of related party transactions is required in a Public CIS’s annual and interim MRFP in addition to the disclosure in the financial statements. The MRFP contains the management discussion and analysis that accompanies the CIS’s financial statements. If a CIS has engaged in a related-party transaction, it must disclose the identity of the related party, the relationship to the CIS, the purpose of the transaction and any ongoing commitment to the related party. It must also disclose the basis on which any compensation to the related party was calculated. All CISs (regardless of whether or not they use a related custodian) that are subject to NI 81-106 <i>Investment Funds Continuous Disclosure</i> must disclose the custodial fees paid by the CIS in their financial statements. • Audits and compliance oversight reviews: Conventional and non-conventional CISs must be independently audited on an annual basis. The audit includes reconciliation between the portfolio records of the CIS and the custodian’s records. Custodians are required by Canadian Auditing and Assurance Standards to prepare third-party assurance reports in accordance with the Canadian Standard on Assurance Engagements 3416 (CSAE3416) and to provide copies of these reports to the IFM. Staff of the regulatory agencies review the contents of such reports, including testing of the internal controls conducted regarding the safekeeping of the assets of a CIS and any exceptions reported by the auditors. Compliance reviews of IFMs undertaken by securities regulators also cover the relationship between the IFM and the custodian. In addition to the review of policies and procedures, and contracts,
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	<p>on-site inspections of an IFM also include a high level review of the books and records of the custodian or sub-custodian in relation to the custodial agreement. Custody arrangements have also been the subject of issue-oriented reviews by securities regulators. On-site inspections of an IFM in relation to the custody of assets would include: (i) interviews of key personnel involved in daily decision making governing the portfolio assets of the CIS and (ii) a high level review of the books and records of the custodian or sub-custodian in relation to the custodial agreement.</p>
Assessment	Fully Implemented
Comments	<p>Principles 24 to 27 apply to CIS that are offered to the public. Thus the requirement of custodianship as established in the Canadian framework is compliant with the Principles, since it applies to all public CIS. However, the assessor encourages the authorities to extend such requirement to all CIS, as currently foreseen in the policy proposal on the table.</p> <p>The IOSCO methodology does not prohibit custody by a related party, but does require that additional safeguards are in place. As indicated in the description, those safeguards appear to be in place in Canada. In particular, custodians themselves are regulated entities subject to oversight by a financial regulator, related party custody arrangements must be reviewed by the IRC, and disclosure must be provided to investors.</p>
Principle 26.	<p>Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>
Description	<p>Assessed in 2007</p> <p>Disclosure requirements for CIS have been harmonized via NI 81-106.</p> <p>Public offering of CIS requires the submission of a prospectus to the regulatory authority. In general, the prospectus must include information about the legal constitution of the CIS; the rights of unit holders; the CIS operator; the custodian; investment objectives; investment strategies; risks; suitability of the CIS to particular investors; valuation; subscription and redemption issues; fees and expenses.</p> <p>On an ongoing basis CIS are subject to disclosure obligations that include:</p> <ul style="list-style-type: none"> • Annual financial statements. • Semi-annual financial statements. • Management Report of Fund Performance that provides a discussion of a fund's performance along with the analysis and explanation of the fund manager. The

	<p>report has to be provided with the annual financial statement as well as the semi-annual statement.</p> <ul style="list-style-type: none"> • Portfolio composition on a quarterly basis. • Net asset value at least once a week or if the CIS uses derivatives on a daily basis. • Annual report by the independent review committee <p>Financial statements have to be prepared in accordance with Canadian GAAP. Audits have to be conducted in accordance with Canadian AS.</p>
Assessment	Fully implemented
Comments	<p>Comments made in the context of the 2013 assessment</p> <p>The assessor encourages the authorities to give priority to the initiatives on the table aimed at (i) eliminating any potential unlevel playing field in the regulation of conventional versus non conventional CIS, in particular in connection with the investment framework, and (ii) modernizing the framework for alternative CIS.</p>
Principle 27.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Assessed in 2007 assessment</p> <p>NI 81-106 has harmonized provisions regarding valuing the assets of publicly held CIS. This includes how the value is calculated, how often it is calculated and in what currency.</p> <p>Currently the net asset value (NAV) must be calculated in accordance with Canadian GAAP. The CICA Accounting Guideline 18 specifies that CIS should value all their assets at fair value and present them on this basis in the financial statements. Specific rules on the calculation of the fair value of liquid assets were changed in October 2006: under the new rules, investments in an active market must be valued at the bid and ask price, rather than at closing price. This change will have an impact on CIS information technology systems as well as on the NAV of CIS. As a result, the regulators provided a one year exemption. However, the financial statements still have to be calculated based on Canadian GAAP.</p> <p>Valuation of illiquid assets is covered in the Investment Funds Institute of Canada (IFIC) guidance.</p> <p>Transparency</p>

	<p>The NAV has to be calculated at least once each week if the CIS does not use derivatives and every business day if it does. If a CIS publishes its prices in the financial press it must provide its current price to the financial press in a timely manner. The Companion Policy specifies that the CIS should attempt to meet the publishing deadlines of the financial press to ensure that the NAV is available to the public as soon as possible. The market prices of CIS that are traded on the exchanges are also available through the exchange.</p> <p>Pricing errors</p> <p>The current regulatory framework does not include explicit provisions on pricing errors. However IFIC has developed voluntary industry standards that are based on the understanding that, due to its fiduciary duty, the manager is ultimately responsible for valuing the CIS, whether it does the valuation itself or contracts it to a third party. The standards address topics of determining if there has been an error, material thresholds, processing errors and assigning the cost of errors.</p> <p>Suspension of redemption</p> <p>CIS may suspend redemption when normal trading is suspended on the exchange or with the approval of the regulator. While redemption rights are suspended, CIS can postpone paying redemptions and cannot accept purchases.</p>
Assessment	Fully implemented
Comments	Comments carried from the 2007 assessment: "The authorities informed that they are currently considering delinking the calculation of the NAV from Canadian GAAP for purposes of subscription and redemption. The result would be that subscription and redemption would be calculated with the closing price. However, financial statements will still have to be calculated in accordance with Canadian GAAP".
Principle 28.	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.
Description	<p>In Canada, hedge funds do not constitute a distinct category of CIS. There is no global, agreed-upon definition of hedge funds. The securities regulators introduced a working definition of HFs in CSA Staff Notice 81-316 <i>Hedge Funds</i> (2007 Hedge Fund Notice), following a sample-based review of hedge funds in Canada. According to such definition HFs are pools that use alternative investment strategies not generally available to traditional mutual funds, such as taking long and short positions and using arbitrage, leverage, options, futures, bonds and other financial instruments to capitalize on market conditions.</p> <p>In practice, as indicated in the section on market structure the HF industry in Canada is</p>

relatively small. As of June 2012 HFs AUM represented about four percent of the total size of MFs in Canada, and two percent of the global HF market. Individual Canadian HF are relatively small, with more than 80 percent of all hedge funds having less than \$100 million in assets under management

Entities involved in the operation of a HF

The operation of a HF typically involves several entities, many of which are required to register under NI 31-103.

Operators must registered under the IFM category, advisers that provide portfolio advice to a HF under the PM category, dealers that market or sell its securities under the ID or the EMD categories, and prime brokers to the hedge fund must be registered under the IC and are subject to the regulatory requirements in NI 31-103. They are also required to deal fairly, honestly and in good faith with their clients under securities legislation.

Requirements for IFMs that manage HFs are the same than for any other IFM, and have been explained in Principle 24. Accordingly an applicant must demonstrate:

- Fit and proper requirements for individuals that perform the UDP and CCO position
- Financial resources: the minimum capital is \$100,000 as calculated according to Form 31-103F1. An IFM must maintain insurance based on either one percent of its assets or the assets it has under management, with a minimum per clause of \$200,000 and a maximum of \$25,000,000 or a higher amount set by the board of directors, the same insurance as is required for portfolio managers. From a practical perspective, the majority of registered IFMs in Canada are also registered as portfolio managers.
- A system of compliance, which in Canada includes both the (i) system of compliance with rules and regulations and the (i) internal controls and risk management
- Policies and procedures to address conflict of interest

The HF custodian is not required to register under NI 31-103 if the custodian is not in the business of trading or advising. However NI 41-101 contains requirements relating to custodians for hedge funds that offer securities under a prospectus.

Fund

In the majority of cases, HFs are distributed in Canada on a prospectus exempt basis, through private placements. Most of the prospectus exemptions are set out in NI 45-

106. As a result the HFs themselves are not subject to any review by the securities regulatory agencies. However, where the hedge fund becomes a reporting issuer by distributing its securities under a prospectus, regulatory requirements apply to the hedge fund itself in respect of its operations and distribution. These include comprehensive requirements related to (i) prospectus filing and disclosure and (ii) operational requirements in areas such as investments of the fund; conflicts of interest; custodianship of assets; CD; purchases and redemptions; and sales practices.

Segregation of assets

IFMs are required to keep assets segregated.

IFMs of HFs (other than those that offer securities under a Prospectus) are not by law required to use a separate custodian. However based on a review conducted in 2006 Staff Notice 2007 HF indicated that client assets were held in safekeeping predominantly by large, reputable third parties such as banks, dealers and trust companies.

HFs that offer securities under a prospectus are required to use the services of a custodian, as described in Principle 25.

Powers of the regulators

The regulatory authorities have the same powers in regard to IFMs of HFs that they have in connection with any other IFM, as described in Principle 24.

Information to the regulators

The regulators receive information, both qualitative and quantitative, about the operations of hedge funds through the following filings:

- information provided at the time of registration of the IFM and the adviser;
- information provided during compliance reviews; information provided at the time of filing a prospectus (if such is the method of distribution) on risks
- ongoing information requirements (if the securities have been distributed by prospectus) by filing CD documents, including: annual and interim financial statements; MRFP; AIFs; on a quarterly basis, the hedge fund's top 25 holdings;
- information required in the reports of exempt trades (if the securities have been distributed on a prospectus exempt basis), including the name and address of the hedge fund; the name of the investor; a description of the securities; the date of the trade; the particulars of the trade, such as the

	<p>number of securities sold and the purchase price. In the jurisdictions with the largest populations, the regulators obtain periodic information of all IFMs, including those that manage HFs, via risk-assessment questionnaires.</p> <p>In addition, regulators can request ad-hoc information if issues of concern arise. An example of this case was the survey sent to all IFMs in 2012 to obtain a better understanding of their exposure to the Eurozone.</p> <p><i>Information to investors</i></p> <p>The level of disclosure to investors varies depending on the method of distribution of the securities of the hedge fund. Hedge funds sold under a prospectus are required to provide full, true and plain disclosure about the fund. Those hedge funds become reporting issuers and are therefore subject to CD requirements.</p> <p>However, as indicated above HFs in Canada are mainly distributed on a prospectus exempt basis. The exemptions under NI 45-106 contain conditions that limit either the distributions to persons that have sufficient investment knowledge or the resources to obtain expert advice, and accordingly may not need or wish to have the same level of protection as other investors or require substituted disclosure.</p> <p>Ongoing supervision of IFMs of HFs and the HFs themselves</p> <p>Ongoing supervision of IFMs that manage HFs is carried out by the regulators as part of the general program of supervision for IFMs. In practice this means, that off-site, an important amount of information comes from the self-assessment questionnaires that all intermediaries are required to submit on an annual basis to the OSC (as is the province with the largest population of IFMs that manage HFs). In addition, they are subject to on-site inspections. The frequency of their on-site inspections would depend on their risk classification. OSC staff explained that in their case, the IFMs that manage HFs would tend to fall in the high risk category based on the nature of the products they manage and the nature of their business operations as dictated by these products. As a result, they would be included in regular routine inspections of IFMs that are chosen for review based on risk. Similarly the AMF has found that on the basis of its methodology, IFMs that manage HFs are not expected to fall in the low risk category. As an example, 8 out of the 25 HF managers identified in the 2009 thematic review were inspected in the last 2 years, based on the AMF risk score. The authorities also highlighted that the IFMs that manage HFs would also fall under the thematic reviews carried out on IFMs.</p> <p>In addition to the inspections of the IFMs, the authorities have conducted thematic work on the HFs themselves. A thematic inspection was conducted in 2007. Its main objective was to gain understanding of the possible risks posed by HFs managers. The inspection focused on valuation methodologies, portfolio holdings exposure to illiquid</p>
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	<p>assets, counterparty risk, ability to meet investors' redemptions requests and procedures and controls to monitor investment portfolio. There has been a more recent thematic inspection of HFs, which involved Canada's participation in the second IOSCO Hedge Fund Survey that was sent to a sample of HF managers in 2012, with the parameters developed by IOSCO. It is anticipated that a report will be produced by IOSCO based on the findings of this survey as a whole (from all the participating member jurisdictions).</p> <p>Cooperation with foreign regulators</p> <p>The laws of the four agencies specifically provide them with the ability to collect and share information amongst themselves and internationally and with law enforcement agencies, governments, governmental authorities, financial regulatory authorities or a person with whom they have entered into an arrangement or agreement relating to the sharing of information. In addition, they are all signatories of the IOSCO MMoU.</p> <p>Results of compliance reviews are also occasionally shared with foreign financial regulatory authorities, including the SEC.</p>
Assessment	Fully Implemented
Comments	
Principles for Market Intermediaries	
Principle 29.	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>Registration requirement for firms</p> <p>NI 31-103 requires that firms must register if they are:</p> <ul style="list-style-type: none"> • in the business of trading or advising; • holding themselves out as being in the business of trading or advising; • acting as an underwriter; or • acting as an IFM, namely directing the business, operations or affairs of an investment fund. This category has been discussed under Principle 24. <p>Dealer and adviser categories</p> <p>NI 31-103 harmonized and simplified the various dealer and adviser categories according to the firm's activities and services. A firm may register in more than one category, and a substantial proportion of Canadian registrants are registered in several</p>

categories. There are no residual provincial categories for securities intermediaries.

There are five dealer categories for firms trading in securities:

- investment dealers, who must be members of IIROC;
- mutual fund dealers, who must, except in Québec, be members of the MFDA;
- scholarship plan dealers;
- EMDs; and
- restricted dealers.

Advisers that advise others about investing in or buying and selling securities are designated as portfolio managers under NI 31-103. There are two adviser categories:

- portfolio manager, and
- restricted portfolio manager.

31-103CP provides criteria to be considered in determining whether a person or a firm is engaged in a business when trading in securities or providing advice with respect to investing in, buying or selling securities.

Fitness for registration of firms

All applicants for registration must demonstrate fitness for registration at the time they apply for registration, and they must continue to do so throughout the period during which they are registered. Fitness for registration of a firm and individual is assessed by the regulators through proficiency, integrity and solvency criteria. The standards for these criteria vary according to the type of activity that the applicant intends to conduct.

NI 33-109 prescribes all forms which must be used by applicants for registration, as well as registered firms and individuals. The information to be provided has been discussed under Principle 24. The registration process is identical to that described in Principle 24.

Finally, as explained also in principle 24, each regulatory agency, under their respective laws, has the power to impose terms and conditions on registrants to, for example, restrict their activities or require supervision of those activities. In these cases, registrants, or applicants for registration, have an opportunity to be heard before the regulator prior to the terms and conditions becoming final.

Specific requirements for each category of firm registration

From a practical perspective, firms registered in several categories do not need to meet capital and insurance requirements separately or cumulatively; meeting the highest standard is sufficient.

Investment dealer

Scope of Activities and IIROC Membership Requirements

An investment dealer may act as a dealer or an underwriter in respect of any security, and must be a member of IIROC. NI 31-103 exempts the investment dealer from certain requirements, such as minimum capital requirements, insurance, the filing of annual financial statements and interim financial information with the regulators, certain requirements pertaining to the KYC obligation and the suitability obligation conditional upon compliance by the investment dealer with the corresponding rule of IIROC.

Investor Protection Fund

IIROC members must participate in CIPF. CIPF covers customers of IIROC dealer members who have suffered or may suffer financial loss solely as a result of the insolvency of a member dealer. Such loss must be in respect of a claim for the failure of the dealer member to return or account for securities, cash balances, commodities, futures contracts, segregated insurance funds or other property, received, acquired or held by, or in the control of, the member for the customer, including property unlawfully converted. The maximum coverage is \$1,000,000. According to CIPF, there have been 18 CIPF member insolvencies since CIPF's inception in 1969. CIPF has made payments of \$36,000,000, net of recoveries, and no eligible customers have suffered a loss of property.

Minimum Capital and Insurance Requirements

IIROC also establishes minimum capital and insurance requirements. IIROC members disclose their sources of capital in monthly financial reports and IIROC Form 1, *Joint Regulatory Financial Questionnaire and Report*.

An investment dealer must, under IIROC rules, maintain a financial institution bond and keep in force insurance against losses arising through dishonesty of their employees out of forgery or alteration, whether on the premises or in transit or any loss of securities or other written instruments that have been forged, counterfeited, raised or altered, or lost or stolen, among other things.

<p><i>Mutual fund dealer</i></p> <p><i>Scope of Activities and MFDA Membership Requirements</i></p> <p>A mutual fund dealer may act as a dealer in respect of any security of a mutual fund or an investment fund that is a labor-sponsored investment fund corporation or labor-sponsored venture capital corporation. Except in Québec, mutual fund dealers must be members of the MFDA. As is the case for investment dealers, NI 31-103 exempts mutual fund dealers from certain requirements, such as minimum capital requirements, insurance, and the filing of annual financial statements and interim financial information with the regulator conditional upon compliance by the mutual fund dealer with the corresponding rule of the MFDA.</p> <p><i>Investor Protection Funds</i></p> <p>MFDA member firms must participate in the MFDA Investor Protection Corporation (IPC), which provides protection to eligible customers of MFDA member firms on a discretionary basis to prescribed limits if securities, cash and other property held by any such member firm are unavailable as a result of the member's insolvency. Coverage of customer accounts commenced on July 1, 2005. As is the case with CIPF, the maximum IPC coverage is \$1,000,000.</p> <p>Clients with accounts in Québec at MFDA member firms, and whose assets are held by MFDA member firms in Québec are not entitled to protection by IPC. Generally, an account is considered to be in Québec for these purposes if the office serving the client is located in Québec.</p> <p>Mutual fund dealers and scholarship plan dealers registered in Québec must make mandatory annual contributions to the Fonds d'indemnisation des services financiers (FISF), established pursuant to the Québec <i>Act Respecting the Distribution of Financial Products and Services</i> (DFPSA) in order to compensate victims of fraud, fraudulent tactics (dishonest practices) and embezzlement. The AMF assesses claims, renders a decision on their eligibility to receive an indemnity through the FISF and determines the amount of the indemnity to be paid to the victim.</p> <p><i>Minimum Capital and Insurance Requirements</i></p> <p>The MFDA requires minimum capital and insurance for its member firms. Mutual fund dealers must provide audited financial statements reflecting a prescribed minimum working capital. Mutual fund dealers must be insured under a financial institution bond in a prescribed minimum amount per employee or any larger amount that may be necessary.</p> <p>Mutual fund dealers registered in Québec are required to maintain professional liability</p>
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insurance to provide coverage against the monetary consequences of their civil liability in case of professional errors, fault, negligence, or omissions committed in the pursuit of their activities. Failure to maintain such professional liability insurance may lead to a suspension or revocation of registration.

Representatives of mutual dealers must be members of the CSF, established under the DFPSA with the power to take disciplinary action and oversee continuing education requirements for individuals in the mutual fund and scholarship plan sectors.

Scholarship plan dealer

A scholarship plan dealer may act as a dealer in respect of a security of a scholarship plan, an educational plan or an educational trust. There are no SRO membership or contingency fund requirements for these dealers.

Minimum Capital and Insurance Requirements

A scholarship plan dealer must maintain minimum capital in the amount of \$50,000 as calculated according to Form 31-103F1 and insurance covering any loss (loss coverage item) arising from different events including fraud, and robbery. The amount of insurance coverage is the highest of the following amounts:

- the lesser of \$50,000 per employee, agent and dealing representative or \$200,000;
- 1 percent of the dealer's total assets; and
- the amount determined appropriate by a resolution of the board of directors.

Québec's legislative framework provides for the following specific requirements for scholarship plan dealers, which are the same as for mutual fund dealers:

- mandatory contributions to the FISF;
- maintaining professional liability insurance; and
- membership of the individual representatives in the CSF.

EMD

An EMD may act as a dealer in respect of securities distributed under a prospectus exemption. An EMD may also act as a dealer in respect of securities distributed to "exempt purchasers" (including accredited investors with defined levels of income or assets). This category was introduced, on a national level, by NI 31-103. EMDs are not authorized to provide margin to their clients, or to act as underwriters in prospectus

	<p>qualified distributions.</p> <p>There are no SRO membership or contingency fund requirements for these dealers.</p> <p><i>Minimum Capital and Insurance Requirements</i></p> <p>An EMD must maintain minimum capital in the amount of \$50,000 as calculated according to Form 31-103F1. The insurance requirements are the same as for scholarship plan dealers, except that EMDs registered in Québec do not have to maintain professional liability insurance.</p> <p>Restricted dealer</p> <p>A restricted dealer may act as a dealer or an underwriter in accordance with the terms, conditions, restrictions or requirements applied to its registration. There are no specific requirements in NI 31-103 relating to these dealers. Rather, the requirements are imposed in the registration decision. Restricted dealers may therefore be restricted to carrying out their activities under very precise terms and conditions.</p> <p>This category is not intended for trading activity which could be the object of another category of registration; rather, it is used in exceptional circumstances. From a practical perspective, the CSA monitors the occurrences of the use of this category.</p> <p>Portfolio manager</p> <p>A portfolio manager may act as an adviser in respect of any security. This category is intended for full advisory services and portfolio management on a discretionary basis. IIROC member firms are also authorized to provide full advisory services and portfolio management on a discretionary basis under the IIROC rules, and NI 31-103 provides for an adviser registration exemption to these IIROC members.</p> <p>There are no SRO membership or contingency fund requirements for portfolio managers.</p> <p><i>Minimum Capital and Insurance Requirements</i></p> <p>Portfolio managers must maintain minimum capital in the amount of \$25,000 as calculated according to Form 31-103F1.</p> <p>The amount of insurance coverage for a portfolio manager depends on whether or not it holds or has access to client assets. If the portfolio manager does not hold or have access to client assets, it must maintain coverage in the amount of \$50,000 for each loss coverage item. If, on the other hand, it does hold or has access to client assets, the insurance coverage must be the highest of the following amounts:</p>
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- 1 percent of the AUM that the adviser holds or has access to, or \$25,000,000, whichever is less;
- 1 percent of the portfolio manager's total assets;
- \$200,000; or
- the amount determined appropriate by a resolution of the board of directors.

Restricted portfolio manager

A restricted portfolio manager may act as an adviser in respect of any security in accordance with the terms, conditions, restrictions or requirements applied to its registration. The regulators may impose terms and conditions on a restricted portfolio manager's registration that limit the portfolio manager's activities, for example in terms of the type of securities on which it can advise. As is the case for the restricted dealer category, the CSA monitors the occurrences of the use of this category.

Assessing fitness for SRO membership of a firm

IIROC and the MFDA examine the requirements for their members during the firm's application process. Investment dealers and, except in Québec, mutual fund dealers, must be members of IIROC and the MFDA respectively.

IIROC

IIROC uses criteria similar to those used by the CSA in deciding to grant membership status to investment dealer firms. IIROC consults with the regulators when it has concerns about an applicant's suitability. IIROC staff carry out site visits and review the policies and procedures of applicants before granting them membership. Applicants for membership must submit the following documents to IIROC:

- *Corporations and Partnerships* application form;
- certificate of sponsors;
- articles of incorporation or any other documents that apply;
- corporate organization chart;
- *NRD Form 1 Enrolment of Firm Form* if the firm is new to the NRD;
- investor application form for each shareholder holding 10 percent or more of the applicant firm's shares,

- procedures manual;
- business continuity plan;
- business continuity plan comfort letter from an approved third-party reviewer for firms that do not introduce firms to one another;
- account opening documents, monthly statements and trade confirmations;
- five-year business plan;
- any introducing/carrying dealer agreement;
- if the applicant is a member of a Canadian SRO: monthly unaudited financial reports for the previous 6 months and letter relating to its last examination of the firm.
- if the applicant is not a member of a Canadian SRO: audited Form 1, prepared not more than 90 days before submitting the application by a qualified panel auditor and letter from the applicant's auditors indicating that the applicant maintains a proper system of books and records;
- subordinated loan agreements;
- evidence of insurance coverage;
- internal control policy statements; and
- any financial statements for the three years immediately before the application.

In addition, to the UDP and CCO the IIROC regime requires additional categories of individuals to be approved including all directors and more generally any person regardless of the title of the position who has a position of influence in the decisions of the dealer member; that is, in the case of IIROC, directors are an approved category rather than only a permitted category, and are subject to experience (competence) requirements. Shareholders (and partners for firms that have a partnership structure) must also be approved by IIROC.

MFDA

The MFDA also uses criteria similar to those used by the CSA in deciding to grant membership to firms. During the membership application process, the MFDA reviews the policies and procedures of applicants to make sure they meet MFDA requirements. The MFDA also conducts field interviews to confirm a firm's policies and procedures, and certain information disclosed in the information package.

Applicants for membership must submit the following documents to the MFDA:

- application form;
- articles or other documents that confirm a firm’s formation;
- description of capitalization;
- description of subordinated debt;
- business plan;
- policies and procedures manual;
- account opening documents and disclosures, including:
 - audited MFDA *Financial Questionnaire and Report* dated not more than 90 days before the date of application for membership;
 - unaudited monthly *Financial Questionnaire and Report* for any month end after the date of the audited *Financial Questionnaire and Report*;
 - most recent audited financial statements and any financial statements for the three years before the date of the application;
 - auditor’s report confirming that the applicant maintains a proper system of books and records;
 - letter of acknowledgement from the audit engagement partner;
 - complete copy of the financial institution bond, including riders, evidence of the coverage and limits of liability and deductible amounts; and
 - information about errors and omissions or surety bonding insurance, including type, limits of liability and deductible amounts.

Differences in registration requirements among different categories of participants

Overall many participants expressed concerns about the PM and EMD categories and the extent to which the “lighter” regime that applies to them (in particular in connection with the lack of a requirement to be a member of a SRO and to contribute to a compensation fund) leads to an unlevel playing field vis-à-vis the ID and MFD categories. In both cases these concerns are compounded by a perception that there are problems of misconduct across these categories—though more acute for EMDs, while at the same time they are subject to less frequent on-site inspection than the

	<p>intermediaries that fall under IIROC or MFDA. Participants consider that the findings from the targeted review conducted by the OSC (OSC Staff Notice 33-470) provide support to their concerns.</p> <p>Registration requirement for individual representatives</p> <p>Individuals must register if they trade, underwrite or advise on behalf of a registered dealer or adviser. Individuals acting for a registered dealer are designated as dealing representatives, whereas individuals acting for a registered adviser are designated as advising representatives or associate advising representatives, as the case may be.</p> <p>For individual representatives, proficiency, integrity and solvency are the fundamental criteria for entry into the registration regime.</p> <p>Information about registrants</p> <p>NRD contains information about all registrants and permitted individuals throughout Canada. As a first step towards registration, the firm must file its Form 33-109F6 in paper format and enroll to use NRD since National Instrument 31-102 <i>National Registration Database</i> requires all firms to enroll to obtain a unique NRD number. This allows firms to submit applications and notices, and to update their information through the internet-based NRD system. A procedure for enrolment in NRD is set out on a dedicated NRD information website.</p> <p>Changes to registration information</p> <p>Once registered, firms and individuals must report changes in the information they provided at the time of registration. Form 33-109F5 <i>Change of Registration Information</i> (Form 33-109F5) is used by firms and individuals to notify regulators of any change to their registration information.</p>
Assessment	Broadly Implemented
Comments	<p>The grade is mainly a result of the issues identified in connection with the registration process of securities firms in connection with Question 1 of the Methodology, as explained in Principle 24.</p> <p>As explained in the description, there are some differences in requirements in connection with MFDs that are domiciled in Québec vis-à-vis those under the SROs. The assessor encourages the authorities to continue working towards further harmonization of the regimes.</p> <p>Finally, the assessor encourages the authorities to follow up on the issue of the</p>

	differences in requirements of the PM and EMDs categories, and determine the extent to which in light of the findings from the targeted review conducted by the OSC it is advisable that they be subject to similar requirements to that of the ID and MFD categories in connection with the SRO membership and the contribution to a contingency fund.						
Principle 30.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.						
Description	<p>Capital requirements are risk based. The table below summarizes current capital requirements.</p> <table border="1"> <thead> <tr> <th>Category</th> <th>Capital Requirement</th> </tr> </thead> <tbody> <tr> <td>Investment dealer, member of IIROC</td> <td> <p>Exempted from NI 31-103 requirements on the condition that these dealers comply with the corresponding IIROC rules.</p> <p>Carrying brokers and introducing brokers (Types 2, 3 and 4) to have minimum capital of \$250,000. Type 1 introducing brokers are required to have minimum capital of \$75,000.</p> </td> </tr> <tr> <td>Mutual fund dealer, member of the MFDA</td> <td> <p>Exempted from NI 31-103 requirements on the condition that these mutual fund dealers comply with the corresponding MFDA rules, except</p> <p>Level 1: \$25,000 for a member firm that</p> <ul style="list-style-type: none"> • is an introducing dealer • is not a Level 2, 3 or 4 member firm, and • is not otherwise registered in any other category of registration under securities legislation <p>Level 2: \$50,000 for a member firm that does not hold client cash, securities or other property</p> <p>Level 3: \$75,000 for a member firm that does not hold client securities or other property, except client cash in a trust account</p> <p>Level 4: \$200,000, for any other member firm, including a member firm which acts as a carrying dealer</p> <p>A member firm that is registered as an IFM under securities legislation and is a Level 2 or 3 dealer must maintain minimum</p> </td> </tr> </tbody> </table>	Category	Capital Requirement	Investment dealer, member of IIROC	<p>Exempted from NI 31-103 requirements on the condition that these dealers comply with the corresponding IIROC rules.</p> <p>Carrying brokers and introducing brokers (Types 2, 3 and 4) to have minimum capital of \$250,000. Type 1 introducing brokers are required to have minimum capital of \$75,000.</p>	Mutual fund dealer, member of the MFDA	<p>Exempted from NI 31-103 requirements on the condition that these mutual fund dealers comply with the corresponding MFDA rules, except</p> <p>Level 1: \$25,000 for a member firm that</p> <ul style="list-style-type: none"> • is an introducing dealer • is not a Level 2, 3 or 4 member firm, and • is not otherwise registered in any other category of registration under securities legislation <p>Level 2: \$50,000 for a member firm that does not hold client cash, securities or other property</p> <p>Level 3: \$75,000 for a member firm that does not hold client securities or other property, except client cash in a trust account</p> <p>Level 4: \$200,000, for any other member firm, including a member firm which acts as a carrying dealer</p> <p>A member firm that is registered as an IFM under securities legislation and is a Level 2 or 3 dealer must maintain minimum</p>
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Mutual fund dealer, member of the MFDA	<p>Exempted from NI 31-103 requirements on the condition that these mutual fund dealers comply with the corresponding MFDA rules, except</p> <p>Level 1: \$25,000 for a member firm that</p> <ul style="list-style-type: none"> • is an introducing dealer • is not a Level 2, 3 or 4 member firm, and • is not otherwise registered in any other category of registration under securities legislation <p>Level 2: \$50,000 for a member firm that does not hold client cash, securities or other property</p> <p>Level 3: \$75,000 for a member firm that does not hold client securities or other property, except client cash in a trust account</p> <p>Level 4: \$200,000, for any other member firm, including a member firm which acts as a carrying dealer</p> <p>A member firm that is registered as an IFM under securities legislation and is a Level 2 or 3 dealer must maintain minimum</p>						

		capital of at least \$100,000.
	Mutual fund dealer, non-member of the MFDA (Québec)	In Québec, mutual fund dealers are not required to be MFDA members. They are required to comply with the <i>Regulation respecting the Trust Accounts and Financial Resources of Securities Firms</i> , a local regulation. A mutual fund dealer registered in Québec must maintain minimum capital (expressed as <i>net free capital</i>) at least equal to the sum obtained by adding \$50,000 to the deductible applicable to the firm's liability insurance policy.
	Scholarship plan dealer	\$50,000 calculated using Form 31-103F1.
	EMD	\$50,000 as calculated using to Form 31-103F1.
	Restricted dealer	Requirements, including capital requirements, are imposed in the decision to register on a case-by-case basis through terms and conditions of registration.
	Portfolio manager	\$25,000 where not also a registered dealer or a registered IFM, calculated using Form 31-103F1.
	Restricted portfolio manager	Requirements, including capital requirements, are imposed in the decision to register on a case-by-case basis through terms and conditions of registration.
	IFM	\$100,000 calculated using Form 31-103F1.
	Non SRO members	
	Under NI 31-103, registrants are required to:	
	<ul style="list-style-type: none"> • deliver annual (audited) financial filings • registered dealers not registered in any other category (except EMD) and IFMs must also file quarterly (unaudited) financial filings, and • calculate excess working capital, using Form 31-103F1 <i>Calculation of Excess Working Capital</i> (Form 31-103F1). 	
	<i>The Calculation of Excess Working Capital using Form 31-103F1</i>	
	Form 31-103F1 must be prepared using Canadian GAAP as explained in Principle 29. It	

provides an account of the working capital of a registered firm by assessing the following components:

- current assets, excluding those that are not readily convertible into cash,
- deductions for current liabilities,
- deductions for long-term related party debt unless the registered firm and the lender have executed a subordination agreement to subordinate the debt to the claims of other creditors of the registered firm,
- deductions for minimum capital requirements of the registration category, according to the amounts set out in the chart above,
- deductions for market risk calculations as determined by multiplying the fair value of a security included as a current asset by the margin rate for that security as set out in Schedule 1 of Form 31-103F1, with the resulting amounts for all of the securities held then being added to become the “market risk” entry on the form,
- deductions for bonding and insurance requirements under Part 12 of NI 31-103,
- deductions for guarantees, and
- deductions for unresolved differences.

The result of the calculation of the above components results in the determination of the *excess working capital* of a firm. Excess working capital of a registered firm must not be less than zero for two consecutive days. The registrant must notify the regulators as soon as possible if, at any time, the excess working capital of a firm is less than zero, as calculated in accordance with Form 31-103F1.

Registered firms are expected to know their working capital position at all times. This may require a firm to calculate its working capital every day. The frequency of working capital calculations depends on many factors, including the size of the firm, the nature of its business, and the stability of the components of its working capital.

Leverage

For registrants borrowing to fund the firms’ operations, any debt that is classified as current liabilities must be included in Form 31-103F1. Any related party borrowings, regardless of the repayment terms, must be included in Form 31-103F1 and deducted from current assets.

Review by regulatory agencies

	<p>The regulators monitor registrants' compliance with capital requirements as follows:</p> <ul style="list-style-type: none"> • Review of quarterly financial filings: the regulators review all the quarterly financial statements and Form 31-103F1 from registered dealers and IFMs. The regulators adopt a risk-based approach in reviewing these quarterly financial filings. Firms with adequate working capital usually warrant simply a high-level, overall review. Firms with inadequate or minimal working capital will be reviewed more closely and the regulators may request more detail to support the calculation. • Review of annual financial filings: the regulators review all annual financial statements and Form 31-103F1 from all registrants. The inspection teams will compare a registrant's current financial conditions and working capital to that of the prior year. This often allows the regulators to assess the firm's financial viability and to become aware of any financial deterioration. A checklist may be in place that requires the inspection teams to review the balance sheet, income statement, cash flow statement, and notes to the audited financial statements for any unusual items. The inspection teams will often ask for backup to the working capital calculations. • Inspections: during inspections, the regulators will review the registrant's written accounting and working capital calculation policies. The inspection teams will test for controls, such as management's review process for financial and working capital records preparation. The inspection teams will examine the registrant's accounting and capital records. As of March 2013 in Ontario, there were five registrant firms on terms and conditions related to capital inadequacies that were identified during compliance inspections. <p><i>Breach of Capital Requirements</i></p> <p>When the regulators become aware of a breach of the working capital requirement, the registrant is required to:</p> <ul style="list-style-type: none"> • explain why it failed to meet its working capital requirement; • resolve the deficiency within 2 days; and • provide evidence that it has resolved the working capital deficiency. <p>The regulators have imposed terms and conditions on registrants requiring them to submit a Form 31-103F1 on a more frequent basis, such as monthly for a period of time (generally six months). This allows the regulators to closely monitor registrants with working capital issues.</p> <p><i>Books and Records</i></p>
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A registered firm must maintain records to accurately record its business activities, financial affairs, and client transactions, and to demonstrate the extent of the firm's compliance with applicable requirements of securities legislation. Records required under securities legislation must be kept for seven years from the date the record is created in a safe location and a durable form.

With regard to capital requirements, the required records must permit timely creation and audit of financial statements and other financial information required to be filed or delivered to the regulators, the determination of the registered firm's capital position, and demonstration of compliance with the registered firm's capital requirements.

SRO members

IIROC and the MFDA both require their members to:

- file monthly (unaudited) and annual (audited) financial filings;
- calculate adjusted working capital, for MFDA member firms; and
- calculate net allowable assets, for IIROC member firms.

IIROC

IIROC – Net Allowable Assets

IIROC's capital formula is designed to quantify risks associated with the various levels of business activities in which an IIROC member firm is engaged. The specific methodology supporting the capital adequacy calculation is referred to as the Uniform Capital Formula.

In general, the capital formula measures the solvency of the firm based on the liquidity of balance sheet assets available to discharge current liabilities. This calculation is referred to as "net allowable assets", defined as being assets readily convertible into cash or equivalent minus current liabilities. This calculated balance sheet amount is adjusted by "cushions" or reserves of capital used by the firm to ensure the ongoing solvency of the firm against possible future losses that may be incurred due to market volatility of the value of assets leveraged by the firm. These leveraged assets may consist of both the firm's inventory and the client assets purchased on loan.

The Uniform Capital Formula

The capital formula defines assets that can be classified on the balance sheet as "liquid assets" and deducts balance sheet liabilities, margin, and capital charges to quantify the residual capital resources available to address liquidity risk. The basic steps and components of the capital are described below.

STEP 1	Net allowable assets
	Regulatory Financial Statement Capital
<i>Less</i>	Non Allowable Assets
<i>Equals</i>	Net Allowable Assets

The capital formula classifies all assets as being either *allowable* or *non-allowable*.

- Allowable assets are conservatively valued and emphasize the liquidity necessary to successfully operate in a short-term trading environment. The assets are considered to be balances that are readily convertible into cash or cash equivalents, in a short period of time. Non-allowable assets are assets that cannot be disposed of in a short time frame or where no current realizable value is readily known. They include potentially uncollectible receivables and allowable receivables being limited to those where there is no risk of non-payment.
- Items that are considered to be “non-allowable” for capital purposes include investments in subsidiaries, fixed assets (such as plant, property, and equipment), inter-company receivables, cash deposits at non-acceptable locations, or non-trading account receivables, such as commissions and fees from certain counterparties. These assets are considered to be balances that are not readily convertible into cash or cash equivalents in a short period of time. Net allowable assets are allowable assets net of all liabilities (except subordinated loans and non-refundable leasehold inducements), or capital employed (share capital, retained earnings) adding subordinated loans and non-refundable leasehold inducements net of all non-allowable assets.

STEP 2	Risk Adjusted Capital (RAC)
	Net Allowable Assets
<i>Less</i>	Minimum Capital and Margin Required (for risk & liquidity)
<i>Plus</i>	Applicable Tax Recoveries
<i>Less</i>	Securities Concentration Charge (net of applicable tax recoveries)
<i>Equals</i>	RAC

RAC is calculated by starting with net allowable assets, deducting the applicable minimum capital and margin requirements, adding any tax recoveries, and subtracting

the securities concentration charge (net of applicable tax recoveries).

Minimum Capital Required (Subtract)

To cushion against un-measurable risk not necessarily covered by other parts of the formula, firms are required to put up a minimum amount of capital. This amount varies by type of broker. The minimum capital required under IIROC rules is \$250,000 for carrying brokers and introducing brokers (Types 2, 3 and 4) or \$75 000 in the case of Type 1 introducing brokers (see working capital requirements chart above).

Margin Required (Subtract)

The margin rates prescribed by IIROC rules vary by type of security and are not issuer specific. The two general categories set out in IIROC Rule 100 are debt and equity. The margin rates represent the maximum percentage change that the price movement of a security over a three-day trading period will not be exceeded based on a confidence level of 95percent.

Firms must have a mechanism in place to manage their principal trading activities by assigning capital limits to the equity and bond trading departments of the firm. These trading limits represent the maximum amount or aggregate margin permitted on all the security holdings, based on an allocation of the available capital resources of the firm.

Tax Recoveries (Add)

Margin is a capital provision for contingent market losses on client and inventory positions. If a market loss was realized in either instance, the loss would result in a lower current tax provision for a profitable firm and could permit the application of a loss carry-back for an unprofitable firm that had previously paid taxes.

If a firm has been profitable and paid taxes during the last three years, the recovery of these tax amounts is a known and quantifiable contingent asset. To allow for reassessment risk, the amount of recovery permitted as an add back in the capital formula will be 75 percent of the amount determined as described.

Securities Concentration Charge (Subtract)

A securities concentration charge has been introduced to account for exposure to securities of an issuer beyond specified limits in relation to RAC. Currently the concentration charge applies only to equity holdings.

RAC

After the securities concentration charge has been subtracted, the resulting figure represents RAC, which should never be less than zero. If at any time, the RAC of a

member firm is less than zero, the member firm must immediately notify IIROC.

Upon IIROC becoming aware that a member firm is capital deficient, it is provided no more than 24 hours to correct the problem or face suspension of membership that may lead to the appointment of a trustee in bankruptcy.

IIROC Compliance Systems

FinOps

FinOps monitors firms for compliance with IIROC financial rules to reduce the possibility of financial failure due to excessive leverage or risky business practices.

FinOps has conducted the following on-site examinations for the past five years:

Exam Year	Time Period	Number of
F12	April 1, 2011 to March 31, 2012	159
F11	April 1, 2010 to March 31, 2011	165
F09/F10	January 1, 2009 to March 31, 2010	169
F08	January 1, 2008 to December 31, 2008	169
F07	January 1, 2007 to December 31, 2007	159

All member firms are subject to an annual full-scope field examination, except for member firms that have a low residual risk score, calculated as at March 31.

Member firms rated low risk are subject to a biennial full-scope field examination.

The *Financial & Operations Compliance Risk Assessment Model* is a risk management tool to help identify, define, assess and weigh risks in respect of IIROC member firms and determine priority focus in IIROC's examination cycle of member firms. Essentially, the model gives an indication of the comparable risk assessed for each IIROC-regulated firm relative to its peers and all other firms under IIROC's jurisdiction.

The objective of the FinOps Risk Assessment Model is to identify regulated firms having a higher than average probability of incurring a capital deficiency. With this information, IIROC ensures that regulatory focus is placed on higher-risk firms.

Books and Records

Member firms must have the ability to capture all trading activity to produce the necessary books and records. This method of accounting is unique to the securities

industry, as it involves the processing of money, as well as security transactions. The required books and records include trade tickets, confirmation of trades, trading blotters, general ledger accounts and security records.

This system is referred to as double entry accounting. It involves maintaining two databases that can generate a money general ledger *and* a security stock record. From these two databases, the firm must be able to produce additional reports to manage its capital position, such as inventory and client margin reports.

Breaches of IIROC's Minimum Capital Requirements

IIROC has in place an early warning system. The system is designed to provide an advance warning of a member firm encountering financial difficulties. The objective of the early warning system is to measure the characteristics that are likely to identify a firm heading into financial trouble and to impose a series of restrictions and sanctions to reduce further deterioration. Early warning measures include capital, liquidity and profitability or frequency tests. In addition, a firm may be designated in early warning at the sole discretion of IIROC. This may be for intangible reasons, such as lack of a qualified CFO, late regulatory filing, system conversion, reorganization or windup.

Free Credit Segregation Limit

Under the current framework IDs are allowed to use un-invested moneys of clients. As per IIROC regulations a statement to that effect must be included in the statements received by investors.

To address the risk that member firms may excessively leverage their activities based on client cash, a limit based on a firm's financial position is set. The free credit limit for a firm is *Net Allowable Assets* times a factor of 8, plus *Early Warning Reserve* times a factor of 4. The factors of 8 and 4 are commensurate with the leverage ratios established for financial institutions under the Basel Accord. Excess free credit balances must be segregated in the form of government securities with a term of one year or less, or in the form of cash in a trust account with an acceptable institution.

The regulatory authorities have highlighted that the recent insolvency of MF Global has led to a review of the prudential framework for IDs, and in particular to the framework for the use of un-invested money of clients. IIROC has proposed a set of reforms, which are currently being analyzed by the securities regulators .

MFDA

Adjusted working capital

MFDA regulatory capital is determined on a working capital basis, adjusted for certain risks, and is intended to address the operational requirements of the dealer by ensuring

a minimum level of liquidity is maintained. It includes only “allowable assets” which are assets determined to be readily convertible into cash or cash equivalents within a short period of time. Consequently, “allowable” assets are cash, securities and receivable balances held at, and receivable from, entities that are considered creditworthy with minimal counterparty risk.

Regulatory capital is derived from taking “allowable assets” and deducting all current liabilities, and 10 percent of non-current liabilities. The offset of an allowable asset, such as cash, may be a capital injection through a subordinated loan or issuance of share capital. Subordinated loans are approved loans by the MFDA, generally from related parties, which have been subordinated to the claims of all other creditors in the event the member firm becomes insolvent. The loans are subject to a prescribed agreement which requires the member to obtain approval from the MFDA prior to any repayment of the loan to the creditor.

Other forms of regulatory capital include contributed surplus and retained earnings generated from the ongoing operations of the firm.

MFDA Form 1

Similar to IROC, the MFDA’s capital formula classifies all assets as being either *allowable* or *non-allowable*. As noted above, allowable assets are those that are readily convertible into cash or cash equivalents within a short period of time. Non-allowable assets are those that are given no value within the capital formula because they are not determined to be readily convertible to cash or cash equivalents, with a high degree of certainty, in a short period of time; examples of *non-allowable* assets include capital assets, intangible assets, and receivable balances from counterparties that are not considered “acceptable entities”, as defined by the MFDA.

MFDA rules require members to maintain RAC in an amount not less than zero at all times. RAC is calculated using an adjusted working capital approach whereby total current liabilities, which include liabilities owing to related parties that are not subject to subordinated loan agreements, are deducted from total allowable assets.

The formula is as follows:

RAC	
	Total Allowable Assets
Less	Total Current Liabilities (including all balances owing to related parties)
<i>Equals</i>	ADJUSTED ALLOWABLE WORKING CAPITAL
Less	Minimum Capital
Less	10% of Non-current Liabilities
Less	Margin Required
<i>Equals</i>	RAC

The following are the key categories in the MFDA RAC calculation:

- allowable assets: these are assets which are considered readily convertible into cash or cash equivalents within a short period of time;
- minimum capital: this is a cushion imposed to address non-measurable risks not necessarily captured by other parts of the formula. As noted above, depending upon the operations of the member, different minimum capital levels are required;
- liabilities: these balances represent the debts and obligations of the firm; and
- margin: these amounts are intended to address specific operational and other risk factors, for example guarantees, financial institution bond policy deductible, and market risk of securities held.

All related party debt is considered a current liability within the capital formula unless it is subordinated by the creditor executing a prescribed subordinated loan agreement.

Each member must have and maintain at all times RAC greater than zero.

MFDA Compliance Systems

The primary objective of the Financial Compliance oversight function at the MFDA is to assess and monitor the member's overall financial position and related internal controls with the intent of protecting client assets from loss. One core financial compliance process is the performance of regular on-site examinations of members' financial reporting functions by MFDA staff. Members who are permitted to hold client securities and other property are examined on an annual basis and all other members are examined on either a two-year or four-year cycle, based upon certain risk factors. The following number of regular on-site compliance examinations of members' financial operations was performed during the past five years:

Calendar Year	Members Permitted to	All other Members	Total
2007	42	28	70
2008	39	44	83
2009	37	22	59
2010	37	36	73
2011	36	37	73

For those members subject to the two-year/four-year cycle, the numerical score calculated by the MFDA's Risk Model is used as a key component in the assessment of whether a member firm should be subject to an examination every two or every four

years. Targeted financial examinations will be performed when solvency concerns arise.

Books and Records

Each member is required to maintain books and records and other documents that are necessary for the proper recording of its business transactions and financial affairs and transactions that it executes on behalf of clients. This includes a back office trading system that has the ability to capture all trading activity executed on behalf of clients and the related cash and securities positions held for the clients by either the member or the issuer directly. In addition, each member must have a general ledger system to capture and report its own operating activities.

All client cash is to be held in a trust account in the name of the member at a financial institution. If the member holds securities in nominee name on the behalf of clients, the assets are to be fully segregated.

MFDA rules require members to provide the MFDA with access to all their books and records and other information required to be maintained. The MFDA is also to be allowed to make copies of the members' records and retain such copies as considered necessary to properly fulfill the MFDA's regulatory oversight of the dealer.

Early Warning System

In addition to the capital deficiency test which is triggered when RAC is less than zero, there are three other early warning tests within the capital formula framework: liquidity, profitability and frequency. They are summarized as follows:

- *liquidity test*: this requires the Early Warning Excess (EWE) balance to be greater than or equal to zero. EWE is calculated by taking RAC and deducting liquid assets and adding back non-current liabilities previously deducted in the RAC formula. The EWE balance captures the most liquid assets net of current liabilities and other margin factors.
- *profitability test*: this requires each member to maintain RAC which is at least as great as the total net operating losses of the firm over the prior three month period. In this way, a member is required to maintain capital sufficient enough to cover its estimated losses for at least another quarter before a RAC deficiency is incurred.
- *frequency test*: this test is triggered when the member has triggered any one of the other early warning tests more than two times in the past 12 months. It is intended to ensure closer monitoring of a firm that may not be able to maintain its minimum capital levels on a consistent basis.

In the event a member firm triggers one of the early warning tests, it is automatically

designated in early warning, which then results in restrictions on the distribution of firm assets, and more timely financial reporting. MFDA rules also provide for the MFDA to designate a member in early warning at the discretion of the MFDA. Discretionary early warning may be imposed in situations where staff have concerns about the member's books and records, the member has not filed its financial report as required and/or any other matter that causes concerns regarding the solvency or ability of the firm to continue to operate as a going concern.

Once designated in early warning, a member is required to inform the MFDA of the reasons causing the capital issue and to provide a plan as to how they intend to resolve it. In the event a member is unable to resolve the capital issue, the MFDA may take regulatory action to impose additional restrictions, or suspend the member.

Risk arising from non regulated affiliates

NI 31-103

Registrants are required to prepare annual and interim financial statements according to Canadian GAAP, except that any investments in subsidiaries, jointly controlled entities and associates must be accounted for as specified for separate financial statements in International Accounting Standards 27 Consolidated and Separate Financial Statements (IAS 27). This framework means that registrants must prepare non-consolidated financial statements. A registrant must also prepare a Form 31-103F1 on the same basis as the financial statements. The requirement to prepare non-consolidated financial statements and working capital calculations prohibit registrants from using unlicensed affiliates to support a registered entity.

IIROC

IIROC's member firm rules impose restrictions on the extent to which a member firm is exposed to risk through an unlicensed affiliate. Under IIROC Member Firm Rule 6.7, no member firm or related company of a member firm may carry on any business other than securities related activities (i.e. acting as a securities dealer) without IIROC approval. A member firm or its holding company may own an investment in a corporation that carries on activities other than securities related activities, provided that the member firm is not responsible for any of that corporation's liabilities, and the member firm or holding company has given written notice to IIROC prior to acquiring an investment in such a corporation.

IIROC's rules require each member firm to file a monthly financial report containing prescribed information as at the end of each fiscal month, and the member firm's audited financial statements as at the end of the member firm's fiscal year, also in prescribed form. The prescribed form requires that investments in subsidiaries and affiliates are to be valued at cost and reported as a non-allowable asset.

	<p>With the prior approval of IROC staff, the member firm may consolidate the information of a related company in calculating the member firm's RAC, so long as the related company is subject to either IROC's member firm rules or the rules of the MX, and the member firm and the related company are parties to an unlimited cross-guarantee in a form acceptable to IROC staff. This consolidation must eliminate any inter-company accounts between the member firm and the related company and any minority interests in the related company. All calculations between the member firm and the related company must be as of the same date.</p> <p><i>MFDA</i></p> <p>MFDA members are required to prepare financial statements based upon IFRS, as modified by the MFDA. One departure from IFRS required by the MFDA is that the financial statements are to be prepared on a non-consolidated basis—only the member's financial position and operations are reported. Any investment in a subsidiary must be reported at cost.</p> <p>To address cases where a member has provided guarantees on third-party loans to any of its affiliates, members are required to report the guarantee within the Form 1 as a 100 percent capital deduction in the capital formula.</p> <p>Service arrangements with affiliated companies which result in revenues and/or expenses of the member will be reviewed and considered during the on-site compliance examinations of the member firms. In addition, transactions and/or economic dependency concerns with affiliated companies are required to be disclosed in the Notes to the annual audited financial reports.</p>
Assessment	Broadly Implemented
Comments	<p>The reason for the grade relates to the prudential framework for IDs and the need to ensure that it adequately captures the risk of the activities undertaken by the IDs, as required by Question 2 of the methodology, in particular the risks arisen from the authorization given to them to use un-invested monies from clients.</p> <p>As per the IOSCO Methodology both a Basel framework and a net capital rule are reasonable approaches to capital. Canada uses a net capital rule for its capital and liquidity requirements. As described above the capita formulas are different depending on the type of registrant. In particular, the capital formula for IDs appears to be stricter both in terms of the liabilities to be deducted as well on the margins; on the latter for example it includes a margin for concentration risk that does not exist in the other formulas. These differences appear justified by the simpler business models of the other categories of registrants.</p> <p>However a unique feature of the prudential framework for IDs is the fact that, as</p>

	<p>described above, they are allowed to use free cash held on behalf of clients. Arguably these un-invested moneys may be seen as “deposits” as the ID must be able to give them back to the clients on demand. To the extent that they are considered deposits, IDs in Canada are allowed to perform a bank-like activity, which in turn would require “bank-like” regulation. To a large extent such bank-like regulation exists, as these liabilities are considered for purposes of capital and liquidity requirements, a leverage ratio is in place and IDs must be part of a compensation fund. However, the lessons from the insolvency of MF Global, lead to conclude on the need to further strengthen it to ensure that firms can withstand a situation of stress that could prompt investors to withdraw their cash and subject the intermediaries to a liquidity squeeze. Areas to consider include strengthening of the concentration limits, and the leverage ratio for un-invested monies, as well as the inclusion of a general leverage ratio on the balance sheet. All such issues are included in IIROC’s proposal. The assessor encourages the authorities to conduct a thorough analysis to determine whether they are in fact sufficient.</p> <p>A second issue that at the outset raises a question is the extent to which the current framework adequately addresses risk from affiliates. The IOSCO methodology does not require a framework for consolidated supervision. As described above there are tools that the regulators and SROs can use to limit the risk arising from affiliates that are not regulated entities. Thus, this issue currently does not give rise to concerns, in particular also, in light of the fact that these types of structures—where the holding company is not in itself a regulated entity—are not frequent. However, in the long term it is important that the authorities consider whether a framework for consolidated supervision (in cases where there is not a bank at the top) is needed.</p>
Principle 31.	Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Internal controls, risk management and compliance</p> <p>NI 31-103 requires registrants to establish, maintain and apply policies and procedures that establish a system of controls and supervision that:</p> <ul style="list-style-type: none"> • provides reasonable assurance that the firm and the individuals acting on its behalf comply with securities legislation and • Manages the risks associated with its business in accordance with prudent business practices. <p>The approach under NI 31-103 is principles based. However, securities regulators</p>

	<p>provide guidance in 31-103CP on general best practices in respect of effective compliance systems. In particular, there is guidance outlining that an effective compliance system includes internal controls, day-to-day supervision and systemic monitoring (each of these concepts is expanded upon in the guidance).</p> <p>There is also guidance by IIROC for their members that provides clarifications on the difference between supervision and compliance and on the expectations of the SRO in connection with the roles of the dealer member, its board of directors, management, the UDP, the CCO, the CFO as well as other individuals that are not approved persons (including the compliance officer).</p> <p><i>UDPs and CCOs</i></p> <p>The guidance in the 31-103CP emphasizes that compliance is a firm-wide responsibility, and NI 31-103 makes it clear that senior management of all categories of registrants is responsible for maintaining appropriate standards of conduct and adhering to proper procedures. In addition, as stated in Principles 24 and 29, every registered firm is required to designate a UDP and a CCO, who are subject to registration.</p> <p>The UDP is the person ultimately responsible for ensuring that the firm manages its systems of compliance effectively. The CCO monitors and oversees the firm's compliance system, as described in Principle 29. Among its regulatory obligations, the CCO must report serious non-compliance issues to the UDP. In addition, the CCO is required to submit an annual report on compliance to the board of directors of the registrant.</p> <p><i>External evaluation</i></p> <p><i>Registrants other than IIROC and MFDA members</i></p> <p>The current framework for registrants does not require an external evaluation of the internal controls and risk management. As for any audit, as per GAAPs, the auditors must consider the internal controls relevant to the registrant's preparation and fair presentation of the financial statements. For example, auditors may test internal controls and risk management systems as they relate to the segregation of client and firm assets and the daily processes of trading financial products. There are currently no regulatory requirements for auditors to report material breaches in the controls of the operations of a registered firm to the securities regulators. However, if an auditor discovers a material breach during the normal course of an audit and the material breach is not in the best interest of the public (for example, fraudulent activity), the auditor must report it to the securities regulators immediately. Under Canadian GAAP, an auditor must report all findings, including material breaches in controls, to senior management of the registered firm during the normal course of an audit.</p>
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MFDA and IIROC Member Firms

Under MFDA Rule No. 3.6.4 and IIROC Dealer Member Rule 300.1, independent auditors must conduct a review of the member's systems (under IIROC rules, this review is annual) including the accounting system, the internal accounting controls and the procedures for safeguarding client assets. The audit opinion that accompanies the financial statements of an MFDA or IIROC member firm must include an opinion on the integrity of the three items noted above. If the auditor finds a material breakdown in internal controls and the accounting system during the audit, it must bring these issues to the attention of the management of the member firm and the MFDA or IIROC.

Under MFDA Rule No. 3.6.6 and IIROC Dealer Member Rule 300.6, auditors must report to the MFDA or IIROC any material breach of rules, by-laws and policies they observe during the regular conduct of the audit related to calculating a member's financial position, its handling and custody of securities and its maintenance of adequate records.

Organizational requirements—Fair dealing Practices

All registered firms and their representatives are required to deal fairly, honestly and in good faith with their clients.

Organizational requirements—Segregation of key duties and functions

As indicated above NI-31-103 follows a principle based approach. Thus, there are no specific rules on segregation of key duties and functions; beyond the need for firms to have a UDP and a CCO. The CP to NI 31-103 does set up the expectation that in principle these two functions should be carried out by different persons, and that larger firms should have larger resources. Staff indicated that in respect of larger firms, the regulatory expectation is that firms will segregate the key duties and functions within the firm, particularly those which, when performed by the same individual, may result in undetected errors or may be susceptible to abuses which expose the firm and its clients to inappropriate risks. In practice, stakeholders indicated that the bulk of registrants are small firms where such segregation is not possible.

Segregation of assets***31-103 Registered Firms***

All registered firms with a head office in Canada (other than IIROC and MFDA member firms) are required to hold client assets in trust and separate and apart from the firm's own property. Any cash held for a client must be held by a prescribed financial institution or with a member of IIROC or the MFDA.

Non-resident registered advisers and dealers that hold client assets must hold those

<p>assets in client name, on behalf of a client by a prescribed custodian, or by a registered dealer that is a member of an SRO and that is also a member of a compensation fund or contingency fund, essentially insuring the client's assets. These non-resident firms are also required to provide disclosure to clients related to the risks of dealing with a foreign firm.</p> <p>In addition, securities regulators have provided guidance to industry stating that registrants who are not members of an SRO should hold client assets in client name only. Reviews undertaken by the regulators indicate that this practice is broadly being met.</p> <p>Staff of the agencies indicated that in practice registered advisers and dealers (other than IIROC and MFDA members) normally hold assets with a custodian who is a separate legal entity from the adviser or dealer. Further, there is currently a proposal to extend custodial requirements to these categories of registrants.</p> <p>Registered firms are required to maintain books and records that record their business activities, financial affairs, and client transactions. These records must permit the identification and segregation of client cash, securities and other property. The record-keeping obligation also includes keeping track of securities held in safekeeping for clients.</p> <p>MFDA and IIROC member firms</p> <p>Under MFDA Rule No. 3.3.1 and IIROC Dealer Member Rule 2000.2, all assets that MFDA and IIROC members hold for clients must be segregated from all other assets and kept in separate trust accounts clearly labelled as trust accounts.</p> <p>MFDA members typically do not hold mutual fund securities in bulk segregation or in omnibus accounts.</p> <p>IIROC IDs typically hold customer assets in the name of the dealer (nominee name) while the dealers' books and records identify the customer and account to which the securities belong. The customer assets are segregated from the assets of the dealer and pursuant to IIROC rules are permitted to be held in bulk segregation. In bulk means that the customer assets are commingled in one separate account (bulk), but as per IIROC rules all securities positions must be identified for each customer. Under IIROC Dealer Member Rule 2000.4, IIROC dealer members must perform regular value calculations for each class of securities they hold in bulk form for clients. These rules apply also for derivatives positions.</p> <p>IIROC Form 1 Schedule D allows use by the firm of any un-invested client monies (free credits) up to a calculated limit based on capital thresholds of the firm. Any un-invested client monies over such calculated limit for the firm must be held on deposit</p>
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in a designated bank account or invested in qualified securities (such as government guaranteed debt instruments) and held in segregation. As explained in Principle 30, based on recent market events, IROC has reviewed current rules and recommended firms to comply with more stringent capital threshold calculations until a rule is codified.

Organizational requirements—conflicts of interest

Under NI 31-103, all categories of registered firms are required to take reasonable steps to identify existing and expected material conflicts of interest between the registered firm, including individuals acting on the firm's behalf, and a client. Once identified, registered firms are required to respond to them. Where an investor would expect to be informed of the conflict, the firm must disclose the nature and extent of the conflict, in a timely manner, to the client whose interest conflicts with that of the firm, or one of its individuals acting on its behalf.

31-103 CP identifies three primary methods to respond to conflicts: avoidance, control and disclosure. The guidance also outlines that, in order to control conflicts of interest, firms need to tailor the design of their organizational structures, lines of reporting and physical locations with a view of effectively controlling conflicts. There is also guidance for firms as to when and how to disclose a conflict.

KYC and suitability obligations

As part of their KYC obligations, registered firms are required to take reasonable steps to:

- establish the identity of a client (including enquiring into the reputation of the client if there is cause for concern),
- establish whether the client is an insider of an issuer whose securities are publicly traded,
- ensure that they have sufficient information to make a determination of the suitability of a trade or investment for a client, including information regarding the client's needs and objectives, financial circumstances and risk tolerance, and
- establish the creditworthiness of the client if the registered firm is financing the client's acquisition of a security (applies only to investment dealers as other types of registered firms are prohibited from making loans to clients).

Registrants are required to keep this information current, based on the frequency of trading or advising being conducted by the registrant.

	<p>Registered firms are also required, among other anti-money laundering and anti-terrorist financing requirements, to identify clients prior to opening an account. This includes determining beneficial ownership, when applicable, under the federal <i>Proceeds of Crime (Money Laundering) and Terrorist Financing Act</i> (PCMLTFA) and its regulations. They must also keep records to show that they have complied with these client identification requirements and must have policies and procedures in place to ensure that these requirements are met consistently.</p> <p>Registered firms are also required to ensure that a purchase or sale of a security is suitable for a client before making a recommendation to, or accepting an instruction from a client to, buy or sell a security.</p> <p>In June 2012, the OSC began a targeted review (sweep) of 87 registered EMDs and advisers to assess their compliance with their KYC, KYP and suitability obligations under NI 31-103. This sweep introduced a new approach of contacting a sample of a dealer's or adviser's clients as part of a normal course compliance inspection. A sample of clients for each registrant being reviewed were telephoned and asked a number of questions about the firm or the representative, including the completeness and accuracy of their KYC information obtained by the firm and the investment recommendations and advice provided to them. Going forward, some jurisdictions are incorporating this approach of contacting clients directly into all compliance inspections. In May 2013, OSC staff issued a report summarizing the results of the sweep. A further report providing guidance and best practices will be issued in late 2013.</p> <p>IIROC has also issued guidance in connection with best practices for distribution of non arms length investment products (Notice 13-0039)</p> <p>Know your product obligations</p> <p>Know your customer obligations have been complemented with know your product obligations. In this regard IIROC issued guidance in connection with best practices for product due diligence (Note 09-0087). Essentially this guidance requires members to take a proactive approach to review and monitor new product before they are offered for sale to their clients. In 2010 IIROC conducted a targeted review of compliance with this obligation by members who distribute structured products. The Note 10-0234 summarizes main findings from such review. In addition IIROC sent letters to the firms requesting corrective actions from them.</p> <p>The securities regulators similarly issued guidance to registrants to meet their know your product obligations under CSA Staff Notice 33-315 <i>Suitability Obligation and Know Your Product</i>.</p>
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Relationship disclosure information

NI 31-103 requires that clients be provided with all information about the client's relationship with the registrant that a reasonable investor would consider important.

This information includes:

- a description of the nature or type of the client's account;
- identification of the products or services the registered firm offers to a client;
- a description of the types of risks that a client should consider when making an investment decision;
- a description of the risks to a client of using borrowed money to finance a purchase of a security;
- a description of the conflicts of interest that the registered firm is required to disclose to a client under securities legislation;
- disclosure of all costs to a client for the operation of an account;
- a description of the costs a client will pay in making, holding and selling investments (securities regulators confirm in guidance that these costs include commissions and fees and the description of these costs must include the potential impact on the investment),
- a description of the compensation paid to the registered firm in relation to the different types of products that a client may purchase through the registered firm;
- a description of the content and frequency of reporting for each account or portfolio of a client;
- if the firm is subject to the dispute resolution and mediation services provisions of NI 31-103, disclosure that independent dispute resolution or mediation services are available at the registered firm's expense;
- a statement regarding the registered firm's obligation to assess the suitability of an investment for a client prior to executing the transaction or at any other time; and
- the information a registered firm must collect in respect of KYC obligations in NI 31-103.

From November 2011 through 2012, several CSA members participated in a sweep that

specifically targeted the relationship disclosure information maintained by registered dealers and advisers and provided to their clients. Out of the 120 firms that were selected across the participating CSA jurisdictions, a number of deficiencies were identified and the relevant firms were asked to address those issues in the deficiency reports issued. In addition, staff that participated in the sweep are currently preparing a notice that will provide a summary of the results of the sweep and guidance to registrants for each element of the relationship disclosure information that should be provided to clients.

Statements of account

Registered dealers and advisers are required to provide client account statements at least once every three months. Clients may direct their registered advisers to provide account statements more frequently.

Staff informed that there is a currently a CSA proposal to amend NI-31-103 aimed at improving information given to investors in connection with costs, as well as on the performance of their portfolio, and providing a common baseline across registration categories. Certain specific disclosures are being added to the scholarship category in light of the risks of the product.

Fair allocation of trades

Registered dealers are required by NI 31-103 to make sure that they act fairly when allocating investment opportunities among their clients. In addition, as noted above, all registered advisers and their representatives are required by securities legislation to deal fairly, honestly and in good faith with their clients.

Record retention obligations and accessibility

Pursuant to NI 31-103 a registered firm must maintain records for a period of seven years from the date the record is created, and be maintained in a safe location and in a durable form. The records must also be maintained in a manner that permits them to be provided to the regulators in a reasonable period of time.

Obligations concerning electronic trading

NI 23-103 imposes requirements on marketplace participants that electronically send orders to marketplaces. It requires marketplace participants to have policies, procedures and controls reasonably designed to manage the risks associated with electronic trading.

To assist in early detection of erroneous or non-compliant trades, these risk management and supervisory controls, policies and procedures must be reasonably designed to ensure all orders are monitored and include both automated pre-trade

controls and regular post-trade monitoring that systematically limit financial exposure and ensure compliance with applicable marketplace and regulatory requirements.

As part of the framework for electronic trading NI 23-103 also requires marketplace participants to take all reasonable steps to ensure that the use of automated order systems, by itself or any client, does not interfere with fair and orderly markets. NI 23-103 requires a marketplace participant to have controls in place to immediately and, at any time, disable the automated order system to prevent orders generated from such a system from reaching a marketplace.

IIROC has implemented amendments to UMIR that reflect and support various provisions of NI 23-103.

In addition, IIROC has issued guidance stating what type of trading activities would be considered market manipulation. IIROC is currently conducting research in connection with HFT.

Mediation services

The regulatory framework provides for mechanisms to address investor complaints, including requirements for dispute resolution and mediation services.

As a first step, pursuant to NI 31-103 all registered dealers and advisers (other than IIROC and MFDA member firms) are required to document and respond to client complaints about any product or service offered by the firm or one of its individual representatives, in an effective and fair manner. Securities regulators have provided additional guidance to firms in 31-103CP regarding securities regulators' expectations in respect of appropriate complaint handling procedures.

To the extent that client complaints cannot be resolved internally, NI 31-103 requires all registered dealers and advisers (including IIROC and MFDA members) to ensure that independent dispute resolution services or mediation services are made available, at the firm's expense, to clients in order to resolve complaints about any trading or advising activity of the firm or one of its individual representatives. In addition, clients must be informed about their right to access these dispute resolution or mediation services.

The dispute resolution and mediation services referenced above currently apply to all registered dealers and advisers that became registered on or after September 28, 2009. For those that were registered before this date, they may rely on a temporary transition period until the earlier of September 28, 2014 or the coming into force of amendments to the dispute resolution and mediation services provisions in NI 31-103 (this transition period does not apply in Québec by reason of the existing regime in that jurisdiction).

Securities regulators are proposing amendments to NI 31-103 which, if adopted, would

require all registered dealers and registered advisers outside of Québec to utilize *Ombudsman for Banking Services and Investments* (OBSI) as their complaint handling service provider in respect of their dispute resolution or mediation services. These proposed amendments were published on November 15, 2012 and are expected to come into force in late 2013.

The firms most directly affected by the proposed amendments are dealers and advisers registered outside of Québec that are not members of either IIROC or the MFDA. This is because IIROC and the MFDA have mandated the use of OBSI for many years. IFMs are only subject to the dispute resolution and mediation services requirements in NI 31-103 to the extent they also operate under a dealer or adviser registration.

In Québec, a registered firm is deemed to comply with the dispute resolution and mediation services requirements in NI 31-103 if it complies with specific provisions of the *Securities Act* (Québec). These provisions set out a complaint handling regime whereby the AMF may act as a mediator (the Québec regime). Staff indicated that the Québec regime will remain unchanged following the consultation regarding the proposed amendments.

MFDA and IIROC member firms

In addition to the requirements in NI 31-103, MFDA and IIROC member firms are subject to specific complaint handling processes established by their SRO. The detailed requirements for the MFDA's and IIROC's complaint system are set out in MFDA Policy No. 3 and IIROC Dealer Member Rule 37.

Policy No. 3 stipulates that the dealer must provide its client with the *MFDA Client Complaint Information Form* (CCIF), which describes complaint options, as well as the different avenues available for bringing complaints, i.e. with the dealer and/or the MFDA or OBSI if the mutual fund dealer has not responded to the client's satisfaction or has not responded to the complaint within 90 days of the date of the complaint.

IIROC Dealer Member Rule 37 requires dealer members to participate in arbitration proceedings should a client initiate them. If the investor takes their complaint to the arbitration program, the IIROC dealer member must participate. The program provides dispute resolution for claims of up to \$500,000.

The two parties must appoint an independent arbitrator to listen to the facts and arguments of both sides and decide how the dispute should be resolved. IIROC has designated two independent arbitration organizations: *ADR Chambers* and, for Québec residents, the *Canadian Commercial Arbitration Centre* (CCAC). Arbitration decisions are binding and cannot be revoked by a court or any other resolution service.

OBSI

OBSI is an independent ombudsman and has been resolving complaints for IIROC and MFDA members firms since 2002. As indicated above, OBSI offers a free, independent and impartial resolution service and provides compensation of up to \$350,000. OBSI's recommendations are not binding, but investors may still pursue legal action after using OBSI's services.

Supervision*Securities Regulators*

Risk-based

As stated in Principle 24, the regulatory agencies use a risk-based approach to conduct on-site inspections on registered dealers, other than IIROC and MFDA members who are reviewed by their respective SRO, and registered advisers. Each of the agencies has developed its own risk framework to classify firms, including the use of risk assessment questionnaires that provide information on internal controls and risk management that the firms have to complete and submit on a periodic basis.

The frequency of inspections among them varies; some of them are able to include all the registrants for whom they act as principal regulator on a schedule, while for others only the higher risk firms are put on a fixed schedule. In those cases a limited number of firms rated medium or low risk would also be inspected more on a random basis.

Since 2009, the CSA has harmonized a full inspection program for each main registration category. For example, in the case of a PM the program would include modules on: compliance and supervision, including assessing the adequacy of the policies and procedures and the overall compliance structure administration; conflicts of interest; financial condition; marketing and sales practices; referral arrangements; trading; use of service providers; offering documents; custody; and portfolio management.

Registration Category and Inspection Type	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012	5 years
Portfolio manager: regular reviews	23	36	12	32	29	132
Portfolio manager: for cause	2	1	4	8	2	17
Portfolio manager: sweep	25	60	37	51	36	209

IFM: regular reviews	13	11	1	7	17	49
IFM: for cause	3	7	1	-	-	11
IFM: sweep	26	43	32	1	24	126
EMD: regular reviews	15	24	5	21	37	102
EMD: for cause	4	-	1	-	1	6
EMD: sweep	-	32	2	-	11	45
Multiple categories - regular reviews	9	5	25	21	42	102
Multiple categories - for cause	1	-	1	-	1	3
Multiple categories – sweep	4	3	-	-	6	13
Scholarship plan dealer - regular reviews	6	2	-	1	6	15
Scholarship plan dealer - for cause	-	-	-	-	-	-
Scholarship plan dealer – sweep	2	4	-	-	-	6
Mutual fund dealer - regular reviews	16	15	13	6	24	74
Mutual fund dealer - for cause	2	-	1	2	-	5
Mutual fund dealer – sweep	-	30	-	-	-	30
Other - for cause	3	-	1	-	-	4
Total	154	273	136	150	236	949

	<p>Overall stakeholders considered the inspections conducted by the securities regulators to be sound, although many of them expressed the need for the regulators to bring into the teams more specialized expertise.</p> <p>Annual desk reviews of registrant financial statements and capital calculations are done by the agencies to assess compliance with the working capital requirements.</p> <p>Sweeps</p> <p>The agencies also conduct sweeps, when there is a concern about compliance with a particular topic, or triggered by specific market events. The following is a list of targeted inspections conducted in the last five years:</p> <ul style="list-style-type: none"> • the relationship disclosure information sweep by several CSA members. • the Ontario sweep of EMDs and PMs to assess their compliance with their KYC, KYP and suitability obligations under NI 31-103; • the British Columbia sweep of persons and companies relying on the North West exemption; • the Eurozone survey in Ontario to assess the impact of recent developments relating to the euro and the Eurozone on registrants. • the Alberta and Ontario sweep of new EMDs to raise general awareness among registrants of their ongoing registrant obligations and to better understand how EMDs are operating in the marketplaces. • the CSA marketing sweep performed on over 50 portfolio managers. The objective of the sweep was to better understand the marketing practices of portfolio managers and to harmonize compliance oversight across Canada. A staff notice was published in 2011 that described the findings of the sweep and provided suggested best practices to help registrants ensure their marketing practices are in accordance with securities law, are fair and not misleading. • an asset backed commercial paper (ABCP) sweep of a sample of large portfolio managers was conducted in some jurisdictions. The purpose of the sweep was to determine investors' exposure to ABCP investments that were purchased by their portfolio manager on a discretionary basis, and to assess the adequacy of their investment process, research, ongoing monitoring, and valuation for ABCP investments and other money market instruments. The reviews found that none of the portfolio managers' clients had any significant exposure to non-bank sponsored ABCP.
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Category	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
PM: New registrant sweep	20	30	31	-	-
PM: High risk sweep	-	29	-	-	8
PM: Impact sweep	-	-	6	-	-
PM: Foreign bank representative office sweep	-	-	-	22	17
PM: Asset backed commercial paper sweep	5	-	-	-	-
PM: Marketing sweep	-	-	-	46	6
Limited Market Dealer/EMD: New registrant sweep	B	32	-	-	17
Limited market dealer/EMD: High risk sweep	-	-	-	-	6
PM/EMD/Multiple categories: Relationship disclosure sweep	-	-	-	-	34
Multiple categories: New registrant reviews	-	-	-	-	20
Total	25	91	37	68	108

IIROC

IIROC has three separate teams that conduct respectively compliance reviews on conduct obligations, financial, and trading conduct. Each Department has developed a separate risk assessment model, which allows scoring firms relative to peers.

Overall inspections are done separately, but staff informed that they take an integrated approach for firms classified as high risk, as well as when there are efficiency gains.

- For business conduct: The objective of Business Conduct Compliance's Risk Assessment Model is to identify dealer members having a higher than average or lower than average indication of risk in their business models. Dealer member firms rated low and moderate risk are subject to an examination within the regular examination cycle, currently set at four years.

Exam Year	Time Period	Number of Examinations
F12	April 1, 2011 to March 31, 2012	114
F11	April 1, 2010 to March 31, 2011	90
F09/F10	January 1, 2009 to March 31, 2010	112
F08	January 1, 2008 to December 31, 2008	108
F07	January 1, 2007 to December 31, 2007	119

- For financial: The objective of the FinOps Risk Assessment Model is to identify regulated firms having a higher than average probability of incurring a capital deficiency. All dealer member firms are subject to an annual full-scope field examination, except for dealer member firms that have a low residual risk score, which are subject to bi-annual reviews. For the examination period for April 2013 to March 2014, IROC has adjusted its examination cycle criteria to allow low risk firms to qualify for triennial examination and low to moderate risk firms for biennial examination. Integrated self-clearing firms, including carrying brokers, remain subject to annual risk-based examination. All field examinations are based on a risk-based approach in which the focus of review is an assessment of the control infrastructure of the firm's business activities and operations before determining the extent of substantive testing to perform.

Exam Year	Time Period	Number of Examinations
F12	April 1, 2011 to March 31, 2012	159
F11	April 1, 2010 to March 31, 2011	165
F09/F10	January 1, 2009 to March 31, 2010	169
F08	January 1, 2008 to December 31, 2008	169
F07	January 1, 2007 to December 31, 2007	159

- **For trading:** The objective of the Trading Conduct Risk Assessment Model is to identify Dealer Members having a higher than average, or lower than average, probability of failing to maintain or uphold market integrity and/or

comply with the requirements set out in UMIR. Dealer members rated as high risk are generally visited each year. Dealer members rated as moderate risk are generally visited every two years, and those rated as low risk are generally visited every three years. Over the past number of years, based on a varying total of 130 applicable firms' assigned scores, the TCC risk rating of applicable firms has averaged 40 percent low risk, 50 percent moderate risk and 10 percent high risk.

Exam Year	Time Period	Number of Examinations
F12	April 1, 2011 to March 31, 2012	55
F11	April 1, 2010 to March 31, 2011	61
F10	April 1, 2009 to March 31, 2010	66
F09	March 1, 2008 to March 31, 2009	61
F08	March 1, 2007 to February 28, 2008	68

Overall stakeholders considered that the staff involved in the on-site reviews was knowledgeable and that inspections were sound. Some anecdotal evidence suggested that in some cases deeper analysis would be beneficial.

Thematic inspections (sweeps)

Thematic inspections are more frequently used on business conduct issues. Thematic inspections are generally determined in the beginning of the fiscal year, but may be modified over the course of the year, if conditions warrant. When determining the selection of thematic inspections, BCC considers a number of criteria, including recent market events, new products or services, trends, compliance issues, new rules, IIROC areas of regulatory emphasis, exam findings and client complaints. These client complaints include suitability complaints (e.g. from seniors) and complaints regarding borrowing money to make investments.

BCC has conducted thematic inspections in the areas identified below over the past five years:

- F13: *Non-Arm's Length Investment Product Review.*
- F12: *Client Complaint Handling Review.*
- F12: *Use of Titles and Designations.*

- F11: *Product Due Diligence Regulatory Review—Common Deficiencies and Requirements for Written Policies, Procedures and Controls.*
- F09/F10: *Principal Protected Notes (PPNs) Compliance Review: New Product Due Diligence Regulatory Review—Common Deficiencies and Requirements for Written Policies, Procedures and Controls.*
- F08: *Review of Dealer Member Branch Office Supervision Processes.*
- F07: *Review of Dealer Members' Debt Market Trading.*

FinOps does not generally conduct thematic inspections. IIROC's risk-based examination approach takes into consideration new regulatory risks that are identified and incorporated in the examination planning as new modules or examination procedures. This includes a new module on identifying all outsourcing arrangements of firms and assessing how firms risk manage these arrangements. Added examination procedures include focus on how self-clearing firms risk manage liquidity, and balance sheet leverage.

The TCC also does not generally conduct thematic inspections. However, in 2010, TCC did conduct a targeted review of primary debt offerings. In late 2012 and early 2013, TCC conducted a survey of best execution practices that involved all dealer members of IIROC.

The *Primary Debt Offering* targeted review was selected because it was a new area not previously reviewed and IIROC found consistently poor compliance in each firm visited as part of the regular TCC review cycle. It was decided that all firms should be reviewed and brought into compliance at the same time, rather than wait for the regular review cycle which could take as long as three years to visit all firms.

The *Best Execution* survey has been planned by IIROC to assess the common practices in place at its dealer members. While it does include Best Execution in the TCC review program, an overall view that included non-participant dealer members would be valuable to potentially lead to guidance regarding best practices.

Category	Exam Year	Time Period	Number of Examinations
Non-arm's length investment product review	F13	April 1, 2012 to March 31, 2013	7
Client complaint handling review	F12	April 1, 2011 to March 31, 2012	47
Use of titles and designations	F12	April 1, 2011 to March 31, 2012	129
Product due diligence regulatory review	F11	April 1, 2010 to March 31, 2011	14
Principal protected notes (PPNs) compliance review	F09/10	March 1, 2008 to March 31, 2010	15
Review of dealer member branch office supervision processes	F08	March 1, 2007 to February 28, 2008	10
Review of dealer members' debt market trading	F07	March 1, 2006 to February 28, 2007	6
ABCP review	F07	March 1, 2006 to February 28, 2007	26
Total			254

MFDA

As in the case of IROC the MDFA has two separate teams for on-site review, one focused on financial Compliance and the other on Sales Practices examinations. For the larger firms (level 4) the financial review is done separately and on an annual basis; while for Level 2 and 3 firms the MFD usually does "combined" inspections, on a two- or four-year cycle, based on an assessment of risk factors.

Inspection Type	2007	2008	2009	2010	2011
Financial Compliance: Regular inspections	42	39	37	37	36
Financial Compliance: Targeted inspections/sweeps	-	1	1	1	1
Sales Compliance: Regular inspections	60	42	74	43	28
Sales Compliance: Targeted inspections/sweeps	-	2	1	5	23
Sales & financial compliance: Regular inspections	48	60	68	97	65
Total	150	144	181	183	153

Historically, the MFDA has not conducted any themed inspections. However, in 2012, the MFDA conducted a *Client Disclosure Sweep* across all 119 MFDA members, in which members were asked to submit information with respect to:

- Relationship Disclosure Document,
- Complaint Handling Summary, and
- Client Complaint Information Form.

Staff's review of Member Relationship Disclosure documents has been completed. MFDA Bulletin 0562-P (Client Disclosure Sweep—Review of Member Relationship Disclosure Documents) was issued and sets out the results of the review and provides additional guidance and information to members.

Assessment	Broadly Implemented
Comments	<p>The main issue considered for the grade is the intensity of the on-site program for securities intermediaries directly under the supervision of the securities regulators, in connection with question 17 of the methodology.</p> <p>The assessor notes that the on-site programs of both the securities regulatory agencies and the SROs follow a risk-based approach. However, as discussed in Principle 12, the risk-based approach developed by the regulatory agencies has resulted in a more</p>

	<p>focused use of on-site inspections in particular in the agencies with the largest populations. . The assessor notes that the intermediaries under the direct supervision of IIROC and MFDA are those that cater to retail investors, and thus arguably are those with the most impact for the investors' protection mandate of the regulatory agencies. Thus taking the supervisory program as a whole, the current system can be considered adequate. Nonetheless having a robust program of on-site inspections for PMs and EMDs remains important, not only vis-à-vis accredited investors, but more generally vis-à-vis risk identification, as well as to determine whether the regulatory perimeter is being complied with (for example, whether EMDs are conducting only the type of activities that are permitted to them and catering only to accredited investors). Therefore the broadly implemented grade.</p> <p>In the case of the SROs, the main challenge identified is in connection with appropriate follow up of inspections with enforcement actions. This issue has been discussed in Principle 12. Some anecdotal evidence suggests also the need for the SROs to include more interviews with key staff during inspections, as a way to get a more in-depth view of the state of internal controls and risk management oversight and contrast such views against the findings arisen from the review of files and trading systems.</p> <p>The assessor encourages the authorities to extend the requirement to use of OBSI to all securities intermediaries. As explained to the assessor, the Canadian system works under the rule that the loser pays the fees of both parties, which makes use of the courts more challenging for retail investors. In that context it is critical that they all have access to this service. As use of OBSI is extended to more firms, consideration should be given to make its decisions mandatory (as for smaller firms reputation per se might not have the same effect). Finally, it is important that a strong framework of oversight be developed for OBSI.</p> <p>Finally the assessor encourages the authorities to give priority to initiatives aimed at ensuring that clients are advised and sold products that are suitable for them. In this regard, in addition to the initiatives aimed at providing better/more clear information to investors, the assessor considers important that work on the "product" manufacturing side be a priority. Research conducted by other regulatory agencies showed that although important, efforts on transparency and suitability have not been sufficient to eradicate poor advising and distribution practices, and that more emphasis should be given to ensuring compliance with obligations on the manufacturing side, and that in specific circumstances regulators use "intervention" powers to ensure that certain products are not targeted to retail investors.</p>
Principle 32.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.

Description	<p>Monitoring solvency—regulators</p> <p><i>Detection of financial difficulties as a means of preventing firm failures</i></p> <p>Currently the main mechanism for early warning system of registrants under the direct oversight of the securities regulators is the filing of financial statements and working capital forms together with the notification of capital deficiencies by the firms themselves. In particular the notification allows the regulators to intervene quickly with the registered firm, since a deficit in excess working capital may signal either significant financial difficulties or an occurrence which can be rapidly resolved.</p> <p>Staff of the agencies informed that in cases where the working capital has fallen below zero the regulators have imposed terms and conditions on registrants requiring them to submit a Form 31-103F1 on a more frequent basis, such as monthly, for dealers, and quarterly, for advisers. This has allowed them to closely monitor registrants with working capital issues.</p> <p><i>Powers of the Regulators</i></p> <p>The regulators use the following powers to deal with a deterioration of a firm:</p> <ul style="list-style-type: none"> • Terms and conditions: under Securities legislation the regulators may impose terms and conditions after providing the firm an opportunity to be heard: <ul style="list-style-type: none"> ○ restrict the ongoing activities of a firm; ○ require the appointment of a consultant to provide expert assistance in addressing compliance issues; ○ require the appointment of a monitor to review the conduct of a firm and make reports to the CSA as necessary; ○ require monthly financial reporting requirements if a firm does not comply with financial and capital requirements; ○ require ongoing management reporting; and ○ require close supervision of a registered individual by the firm if the individual engages in improper conduct that does not warrant a termination. • Orders: the regulators may issue orders under securities legislation to allow staff to attend at a firm's premises and require the firm to disclose pertinent information for review. The information obtained from the firms is used to assess whether the registered firm is posing a risk to the marketplace that is
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	<p>significant enough to warrant further action by the regulators.</p> <ul style="list-style-type: none"> • Suspensions: the regulators may restrict the operations of a firm by suspending their registration, which prohibits any further securities-related activities while the suspension remains in effect. • Surrenders: the regulators may accept the voluntary surrender of registration of a firm if the regulators are satisfied that the firm has satisfied all of its obligations to its clients. The regulators request the following documents before it will allow a voluntary surrender of registration: <ul style="list-style-type: none"> ○ evidence that the firm has resolved all outstanding client complaints, settled all litigation, satisfied all judgments or made reasonable arrangements to deal with and fund any payments relating to them, and any subsequent client complaints, settlements or liabilities; ○ confirmation that all money or securities owed to clients has been returned or transferred to another registrant, where possible, according to the client instructions; ○ up-to-date audited financial statements with an auditor's comfort letter; ○ evidence that the firm has satisfied any SRO requirements for withdrawing membership; and ○ an officer's or partner's certificate supporting these documents. <p>Monitoring solvency—SROs</p> <p>As indicated under Principle 30, the MFDA and IIROC have early warning systems in place to help in the early detection of a breach of capital requirements. In addition to filing unaudited monthly financial statements in a prescribed format, MFDA and IIROC members must also submit additional statements and schedules, which include calculations for the early warning system. This allows the MFDA and IIROC to determine if the capital calculations have triggered the system and placed the member in an early warning position.</p> <p>Under MFDA Rule No. 3.4.2 and IIROC Rule 30, there are a number of factors with different thresholds that can trigger a member into early warning. The table below explains these factors and the triggers for each. For IIROC members, there are two levels of early warning, which are defined by the severity of the breach in the capital requirements.</p>
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Factor	Threshold triggered by MFDA member	When the threshold is triggered by an IROC member	
		Level 1	Level 2
Capital	<ul style="list-style-type: none"> risk-adjusted capital is less than zero 	<ul style="list-style-type: none"> risk-adjusted capital is less than 5% of the total margin required 	<ul style="list-style-type: none"> risk-adjusted capital is less than 2% of the total margin required
Liquidity	<ul style="list-style-type: none"> liquidity (as defined by early warning excess) is less than zero 	<ul style="list-style-type: none"> early warning reserve is less than zero 	<ul style="list-style-type: none"> early warning excess is less than zero
Profitability	<ul style="list-style-type: none"> risk-adjusted capital at the time of calculation is less than the net loss for the most recent quarter 	<ul style="list-style-type: none"> profitability level must meet the requirements in the formula under IROC Rule 30.2 	<ul style="list-style-type: none"> profitability level must meet the requirements in the formula under IROC Rule No. 30.4
Frequency	<ul style="list-style-type: none"> placed in early warning more than twice in the last 12 months 		<ul style="list-style-type: none"> placed in early warning: <ul style="list-style-type: none"> more than three times in the last six months or in Level 1 under the profitability criteria and the liquidity or capital criteria
Discretion	<p>At the MFDA's discretion, if the condition of the member is not satisfactory for any reason, including, without limitation:</p> <ul style="list-style-type: none"> financial or operating difficulties 	At the IROC's discretion	At the IROC's discretion

		<ul style="list-style-type: none"> • concerns arising from recordkeeping • failure to submit financial reports • significant concerns over a recent business combination or reorganization. 			
<p>If a member triggers any of these early warning thresholds, the MFDA or IROC will immediately notify the member to address the breach in capital. The member must take immediate action to rectify the breach and limit any possible issues that could affect its financial viability.</p> <p>The member must:</p> <ul style="list-style-type: none"> • provide an explanation in writing of how it intends to deal with the capital deficiency; • file its next set of monthly financial statements within 15 business days of month-end; and • under MFDA Rule No. 3.4.2 and IROC Rule 30, not engage in any activity, without prior written approval, that would: <ul style="list-style-type: none"> ○ reduce its capital; ○ reduce or repay any debt that has been subordinated; ○ directly or indirectly make any payments by way of loan, advance, bonus, dividend, repayment of capital or other distribution of assets to any director, officer, partner, shareholder, related company, affiliate or associate; or ○ increase its non-allowable assets unless a prior binding commitment to do so exists or enter into any new commitments which would have the effect of materially increasing the non-allowable assets of the member. <p>The MFDA and IROC may prohibit a member which is designated as being in early warning from:</p> <ul style="list-style-type: none"> • opening any new branches; • hiring additional employee; 					

- opening any new accounts; or
- changing in any material respect the investment positions of the member.

Under the MFDA's *Amended and Restated Recognition Order*, Schedule A, section 7 (Compliance by Members with MFDA Rules) and Schedule 2 of the IIROC RO, the MFDA and IIROC must report to the regulators if any member:

- does not file any required financial, operational or other reports on a timely basis; or
- triggers an early warning threshold that would reasonably be expected to raise concerns about a member's liquidity, risk-adjusted capital or profitability; and
- any condition exists with respect to the member which, in the opinion of the MFDA/IIROC, could give rise to payments being made out of the compensation funds (MFDA Investor Protection Plan/CIPF respectively)

IIROC staff indicated that in the current economic environment, many of the small firms are experiencing a decline in profits, and more firms are now triggering the early warning. As a result they are being put in a watchlist. Staff also indicated that they have put terms and conditions in some of these firms, including for example an obligation to deleverage.

Coverage provided by the Investor Protection Funds

There three investor protection funds in Canada:

- CIPF, in which IIROC members must participate;
- IPC, in which MFDA members must participate; and
- the Fonds d'indemnisation des services financiers (FISF), established pursuant to the DFPSA, in which mutual fund dealers and scholarship plan dealers registered in Québec must participate.

Whereas CIPF and IPC are insolvency funds, the FISF provides compensation to clients that are victims of fraud, fraudulent tactics (dishonest practices) and embezzlement.

CIPF (IIROC)

IIROC member firms must participate in CIPF. The maximum coverage is \$1,000,000. According to CIPF, there have been 18 CIPF member insolvencies since CIPF's inception in 1969. CIPF has made payments of \$36,000,000, net of recoveries, and no eligible customers have suffered a loss of property.

CIPF receives the monthly financial data from all the members. With such information it has built a financial model that allows them to assess member firms, so that those that could be of higher risk to the fund are charged more. CIPF subjects the fund to periodic stress tests.

IPC (MFDA)

MFDA member firms must participate in IPC. Coverage of customer accounts commenced on July 1, 2005. As is the case with CIPF, the maximum IPC coverage is \$1,000,000.

Clients with accounts in Québec at MFDA member firms, and whose assets are held by MFDA member firms in Québec are not entitled to protection by IPC. Generally, an account is considered to be in Québec for these purposes if the office serving the client is located in Québec.

FISF (Québec)

Mutual fund dealers registered in Québec and their representatives must make mandatory annual contributions to the Fonds d'indemnisation des services financiers (FISF), established pursuant to the DFPSA in order to compensate victims of fraud, fraudulent tactics (dishonest practices) and embezzlement. The AMF assesses claims, renders a decision on their eligibility to receive an indemnity through the FISF and determines the amount of the indemnity to be paid to the victim.

Dealing with the Failure of a Registered Firm

Part XII of the *Bankruptcy and Insolvency Act* of Canada (BIAC) establishes a special regime for administering bankruptcies of securities firms. The regulators or CIPF can apply in court for a bankruptcy order against a registered firm under the BIAC. The suspension of a registered firm by a regulator constitutes an act of bankruptcy, according to section 256(2) of the BIAC, if the suspension is due to the failure of the firm to meet capital adequacy requirements.

In an insolvency of an IIROC ID, because all customers' positions are clearly identified on the books and record of the IIROC dealer, securities go into a customer pool, along with the securities and cash held by the firm for its own account.

This customer pool is shielded from other creditors of the insolvent firm and are readily identified and transferred to, or to the order of, the customer. If CIPF sees that there is any risk that there will be a shortfall in the customer pool, then all of the assets in the pool are frozen. CIPF will distribute these assets among customers on a pro rata basis and will top any shortfall up to CAD\$ 1,000,000 per customer account. Once the distribution and top up have been calculated, CIPF will distribute the customer assets to

a solvent dealer on behalf of or to the customer (it is possible that if the customer account was greater than CAD\$1,000,000 after the prorata distribution, the customer will suffer a loss.

In the case of derivatives, the free credit balances that are calculated from a customers' derivatives positions and margin deposits will become part of the customer pool, similar to other customer assets, and are handled in a similar manner. Any losses suffered by customers in a dealer insolvency could be covered by CPIF within the defined limits (i.e. up to CAD\$ 1,000,000 per customer) Staff of the authorities commented that issues related to the impact of the PFMI on segregation practices for the derivatives markets are currently being assessed.

The liquidation and winding-up of the firm are effected under corporate legislation.

Failures of IIROC Member Firms since 2002

Failures of IIROC members firms are a relatively rare occurrence in Canada. When an IIROC member firm does fail or becomes insolvent, customer assets are protected and typically there is an orderly transfer of accounts to another IIROC member firm. The following are the three IIROC member firm failures since 2002. In those cases, IIROC suspended the member firms as events at these firms' US-based parent dealers significantly impacted their Canadian subsidiary operations:

- MF Global: in November 2011, IIROC announced the suspension of MF Global Canada Co. when it became capital deficient as a result of the bankruptcy of the U.S. parent. MF Global Canada Co.'s bankruptcy was the first of an IIROC member firm since 2002. IIROC took steps, together with CIPF, to protect the assets of MF Global Canada Co. clients by obtaining a bankruptcy order appointing a trustee in bankruptcy to administer the Canadian accounts and manage their orderly transfer to another IIROC member firm.
- Peregrine: in July 2012, when Peregrine Financial Group, Inc., a US-based firm, filed for bankruptcy, IIROC took steps to protect the clients of the Canadian subsidiary, Peregrine Financial Group Canada, Inc., and to ensure that the events and actions taken in the U.S. did not adversely impact these Canadian clients. Within a week, all customer futures accounts of the Canadian firm were accounted for and successfully transferred to another IIROC member firm.
- Penson: in January 11, 2013, when Penson Financial Services Canada Inc. (Penson), an indirect subsidiary of Penson Worldwide, Inc., filed for bankruptcy, IIROC also took steps to protect the assets of the Canadian clients and suspended Penson together with other measures to ensure the transfer of the accounts to other IIROC member firms.

	<p>Staff indicated after the insolvency of MF Global Canada a working group list with the names of the main parties that need to be contact in the event of an insolvency was put together and a crisis management group was constituted, integrated by the regulatory agencies, IIROC, CDIC, CIPF, and Finance Canada. The goal is for this group to meet periodically (one meeting already took place). One of the initial objectives of the group is to identify the financial groups under this group and determine scenarios for the conduction of simulation exercises.</p> <p>Some participants indicated the benefits of reviewing the bankruptcy framework so that the special regime could be triggered for suspensions for reasons different from failure to meet capital requirements.</p> <p><i>IIROC April 24, 2012 Investor Alert</i></p> <p>On April 24, 2012, IIROC issued an investor alert titled <i>Information for Clients of IIROC-Regulated Firms if an Investment Dealer Stops Doing Business</i>. The objective of that alert was to explain to clients the role of IIROC and CIPF when a firm goes out of business, either voluntarily or as a result of regulatory action, including situations of insolvency. The alert provides information on:</p> <ul style="list-style-type: none"> • how IIROC member firms are required to follow specific rules intended to minimize the possibility of financial failure and to protect clients' assets, should a firm become insolvent; • the fact that IIROC's minimum capital requirements are aimed at ensuring that firms do not assume excessive leverage or engage in business practices which expose them to too much risk; • the fact that IIROC monitors and enforces compliance with the minimum capital and securities segregation regulations; and • the fact that, in the event that a firm does fail or becomes insolvent, clients will be notified by the bankruptcy trustee or other insolvency official handling the firm's affairs. <p><i>Failures of MFDA Member Firms</i></p> <p>In addition to notifying the MFDA of any capital deficiency, a member firm must notify the MFDA immediately of any of the following:</p> <ul style="list-style-type: none"> • the firm being declared bankrupt; • the firm making a voluntary assignment in bankruptcy; • the firm making a proposal under any legislation relating to bankruptcy or
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	<p>insolvency;</p> <ul style="list-style-type: none"> • the firm being subject to, or instituting any proceedings, arrangement or compromise with creditors; or • a receiver and/or manager assuming control of the firms. <p>If an MFDA member firm commences bankruptcy proceedings:</p> <ul style="list-style-type: none"> • the MFDA orders the firm to wind up or appoint a receiver or similar officer; • an MFDA hearing panel may place terms and conditions or suspend a firm's registration; and • if a hearing panel cannot rectify a situation within a time period that it may prescribe, the hearing panel may suspend a member for a further period, immediately terminate the rights and privileges of a member, immediately expel a member or penalize a member. <p>A hearing panel may also impose penalties.</p> <p>MFDA staff indicated that overall insolvency is less of a concern in connection of MFDs than for IDs given the narrower set of activities of the former. The current economic environment has led to the insolvency of a higher number of MFDs than what is customary; but in general there are no major concerns in their handling.</p>
Assessment	Broadly implemented
Comments	<p>The reason for the grade relates to the need for stronger arrangements in connection with the insolvency of large IDs in connection with Question 1 of the Methodology.</p> <p>The assessor notes that in connection with registered firms that are subject to the direct oversight by the securities regulators the current "early warning" mechanisms are more basic; however this appears to be justified by the simpler business models of such firms. However, in connection with the "largest" IDs the recent insolvency of MF Global showed the importance that coordination arrangements are in place. As described above some steps have been taken in such direction, with the constitution of a working group list and a crisis management group. It is important that such arrangements become more institutionalized, that a specific protocol establishing the roles of each party is established and that simulation exercises are included as a regular plan of the crisis management framework. In addition, given that the largest IDs are part of banking groups it is important that coordination arrangements include OSFI.</p> <p>Finally, the assessor notes that the issue of the impact of the portability principle on segregation of assets in the derivatives markets is currently under review.</p>

Principles for the Secondary Markets	
Principle 33.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>Assessed in 2007</p> <p>NI 21-101 Marketplace Operation has harmonized the framework for the recognition of exchanges and ATS.</p> <p>The operation of an exchange or ATS is subject to an authorization regime. In practice, under the “lead regulator” approach for exchanges, the authorization of an exchange is given by one province via a recognition order while the others would grant an exemption. ATS are members of the IDA and subject to its oversight. They are initially regulated as broker dealers; however they must meet certain marketplace requirements and provide filings to the regulators. In addition, the framework allows the regulatory agencies to regulate them as exchanges once they reach a certain threshold.</p> <p>In addition to the general framework set out in the NI 21–101, regulatory agencies have developed more detailed criteria for the recognition of exchanges. Although these criteria are not enshrined in regulations, they are included in other types of documents (such as notices) and therefore are publicly available. The recognition orders for TSX, TSXV and MX include terms and conditions that address all the criteria required by the IOSCO Principles, as explained below.</p> <ul style="list-style-type: none"> • Financial viability: exchanges are required to maintain sufficient financial resources. • Capacity: exchanges are required to (i) at least annually make capacity tests, conduct stress tests and in general develop and implement procedures for reviewing and keeping up-to-date the development and test methodology for the systems; (ii) have an annual independent system review performed; (iii) review the vulnerability of their systems; (iv) establish contingency plans; and (v) take reasonable steps to ensure that directors are fit and proper. • Clearing and settlement: exchanges are required to conduct clearing through clearing agencies recognized by the OSC and the AMF. • Equitable treatment of members: exchanges are required to allocate fees in a fair manner; in addition, rules should not permit unreasonable discrimination among dealers and issuers or impose unnecessary burdens to competition. • Dispute resolution mechanisms: exchanges are required to maintain dispute

	<p>resolution mechanisms under the oversight of the regulator.</p> <ul style="list-style-type: none"> • Record-keeping: exchanges are required to keep records for a period of seven years. For the first two years records must be kept in a readily accessible location. • Mechanisms in place to identify and address disorderly trading and deal with any contravening conduct: exchanges are required to have appropriate mechanisms and resources in place for performing regulation, evaluating compliance with exchange requirements and disciplining members. • Approval of rules: exchanges are required to submit rules for the approval of the regulator. • Transparency: all rules proposed by the exchanges are subject to a consultation process. Final regulations are publicly available.
Assessment	Fully implemented
Comments	
Principle 34.	There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>Responsibilities for monitoring</p> <p>Currently IIROC performs market surveillance for all the equity ATs (which by law must retain an RSP) and all equity exchanges (which outsource surveillance to IIROC). Derivatives exchanges recognized in Canada perform their own market regulation.</p> <p>Derivatives exchanges also perform real-time and post-trade monitoring of the trading activities on their markets. The securities regulators do not perform any real-time monitoring, but can and do collect and analyze market data to examine broader market trends and trading practices.</p> <p>Equity exchanges and ATs</p> <p>IIROC performs day-to-day monitoring of trading on all equity exchanges and ATs, including dark pools. This monitoring is done both in real-time and using post-trade reports, and is designed to ensure compliance with IIROC's UMIR, applicable provincial regulatory requirements and applicable exchange requirements. Thus this monitoring not only seeks to ensure orderly trading but also seeks to detect unfair trading</p>

practices.

IIROC receives all order and trade data from all equity marketplaces in Canada, including dark pools, in real-time. IIROC uses STEP for monitoring trading activity. The STEP platform has cross-market monitoring capabilities and a full suite of alerts. As such, it provides a consolidated view of orders and trades across all equity marketplaces. This helps in the detection of unusual activity and with identifying possible violations of securities laws and UMIR. The STEP system also provides alerts relating to trade-throughs and locked markets, and monitors for patterns of behavior that would violate UMIR or securities law. IIROC staff also monitor newswires and other information sources for news that may explain price movements in particular securities.

Debt ATs

There is currently no real-time market surveillance for debt ATs, either by securities regulatory authorities or SROs. There are limitations on the amount of data on orders and trades publicly available due to the nature of the debt markets in Canada as it is a predominantly OTC market. However, quarterly filings of value and number of trades information for broad categories of fixed income securities, as well as for the most traded securities, are provided to various securities regulators pursuant to NI 21-101 and these are reviewed by staff at the securities regulators for trends.

IIROC is in the process of developing a debt surveillance system that would require its members to report all trades for surveillance by IIROC. Also, IIROC currently monitors debt trading against its rules, including Rule 3300 *Fair Pricing of Over-the-Counter Securities*, at the dealer level as part of its dealer compliance reviews.

ICE futures

ICE market surveillance program includes monitoring the day-to-day, real-time trading activity and post-trade activity in the markets. Day-to-day, real-time trading surveillance is done through the SMARTS market surveillance system. ICE Futures surveillance staff also conduct post-trade analysis on a daily basis and use an in-house system to produce post-trade reports.

ICE Futures is responsible for ensuring the participants on the exchange comply with ICE Futures rules. This is generally accomplished through trading reviews, reviews of financial filings and monitoring of operational standards. The Regulatory Division of ICE Futures is also in the process of implementing an on-site review program to examine the compliance of its registered participants with their rules.

Further, participants registered in the Category of Futures Commission Merchant must be a member in good standing of IIROC. For those participants, ICE Futures relies on IIROC as primary regulator to monitor capital, liquidity and business conduct standards.

ICE Futures has an information sharing MOU with IIROC.

MX

The MX Regulatory Division is responsible for performing the market regulation and surveillance activities for the MX. The MX market surveillance program includes monitoring the day-to-day and real-time trading activity and post-trade activity in the markets. Day-to-day, real-time trading surveillance is done through the SOLA Surveillance system. The SOLA Surveillance system is a module of the trading platform, robust and low-latency trading system for various types of derivative products across all asset classes in cash, commodity and fixed income markets, including standardized options and futures. It was developed by the MX to perform post-trade analysis and reports based on alerts developed specifically for its markets.

The MX has established position limits (which vary by product). Reporting limit is established to monitor the participants' position by the MX and make sure that they do not exceed the limits. Reporting limit is fixed far below the positions limits.

In addition, as MX is still responsible for monitoring the conduct of its members with respect to compliance with its trading rules, it performs inspection of its approved participants, including trade desk reviews, to assess their compliance with all MX trading rules.

NGX

The NGX market surveillance program includes monitoring the day-to-day real-time and post-trade activity of listed contracts and counterparties on its marketplace. Trade surveillance is conducted through NGX internal systems. The NGX trade practice monitoring program recognizes and identifies a number of pre-coded exceptions that may indicate market manipulation, price manipulation or other improper trading conduct such as can be found in the Flagged Trades Reports.

The ASC's market regulation staff periodically monitor the activities of large traders, key price relationships and relevant supply and demand factors for potential market problems. Monitoring activities generally include reviewing public information concerning energy trading, overall supply and demand and pricing and trading and open interest data as well as confidential information from NGX. NGX reports daily positions and transactions data for each clearing member, which are used to identify the firms that clear the largest buy or sell volumes or hold the biggest positions in a particular contract.

The RO for NGX requires that it conducts periodic reviews of contracting parties, which are generally required to have a net worth exceeding \$5,000,000 or total assets exceeding \$25,000,000. Contracting parties are also restricted to using the NGX

	<p>Trading System as principals. NGX conducts periodic reviews of contracting parties to ensure that the sophistication threshold is met, but does not have direct regulatory oversight of these firms.</p> <p>The NGX trade practice monitoring program recognizes and identifies a number of pre-coded exceptions that may indicate market manipulation, price manipulation or other improper trading conduct such as can be found in the Flagged Trades Reports.</p> <p>Foreign exchanges</p> <p>Foreign exchanges that carry on business in Canada must comply with similar criteria as are applied to Canadian exchanges, including criteria relating to the regulation of participants and the monitoring of trading. They must also make periodic filings with the requisite securities regulatory authority. These filings include information such as whether there are any participants in the jurisdiction or if there was a rule violation.</p> <p>Surveillance across the cash and derivatives markets</p> <p>IIROC has an MOU in place for cooperation and sharing of information with the MX.</p> <p>The MOU has provisions to co-operate and co-ordinate investigations, including the following:</p> <ul style="list-style-type: none"> • IIROC will notify the MX of violations of MX rules found while performing its regulatory functions and vice-versa; • The parties will consult on an ongoing basis to avoid duplication of resources; • The parties may perform joint investigations or compliance reviews, where appropriate; • The parties will exchange examination schedules, with a view to better coordination; and • Trade desk review reports from the MX and compliance review and trading conduct review reports from IIROC will be shared for parties of mutual interest. <p>In practice there is a process in place that automatically makes a referral to the MX for all securities which are option eligible. On a monthly basis the MX provides IIROC with a list of matters they have assessed and investigated so IIROC is aware that MX reviews their referrals; IIROC also reviews these monthly reports to detect any issues in the listed securities. Since May 2008 IIROC have made 509 referrals to the MX, 506 concerned insider trading. MX has referred a few matters to IIROC involving potential market manipulation and front running.</p>
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IIROC also has an MOU with ICE with respect to its business conduct regulation of ICE members.

Oversight of exchanges and ATs

The main mechanism used for the oversight of exchanges are:

- formal on-site examinations (also referred to as oversight reviews);
- a review, analysis and approval, where appropriate, of rule filings and filings relating to changes to the marketplace's operations;
- regular consultations; and
- ad hoc inquiries.

As was explained in Principle 1, pursuant to a formal MOU respecting the Oversight of Exchanges and QTRS among the ASC, AMF, BCSC, MSC, OSC and the SFSC (Oversight MOU), a lead regulator (or two joint lead regulators) is responsible for the oversight of each exchange and for conducting the oversight program, with the other securities regulators reliant on the lead regulator's oversight.

Under the Oversight MOU, the AMF is the lead regulator for the MX, the OSC for the CNSX, Alpha and the TSX, the MSC for ICE Futures, the ASC for NGX, and the ASC and BCSC jointly for the TSX-V. Securities regulators that are not the lead regulator for an exchange generally exempt it from recognition, but retain certain oversight rights under the Oversight MOU.

The Oversight MOU outlines the purpose of the oversight programs for exchanges and provides details on the standards expected to be followed by an exchange. Where applicable, those standards (many of which are also reflected in the requirements of NI 21-101 and NI 23-101) include:

- fair representation in corporate governance and rule-making;
- effective management of conflicts of interests;
- adequate ownership/control structure;
- financial viability;
- sufficient resources to carry out market and regulatory functions;
- fair access for market participants and issuers;
- orderly markets through appropriate review of traded products, trading rules

	<p>and financial requirements for market participants;</p> <ul style="list-style-type: none"> • transparency through timely access to accurate information on orders and trades; • market integrity through the adoption of rules that are not contrary to the public interest, prohibit unfair trading practices, prevent market manipulation and customer and market abuses and promote just and equitable principles of trades; • monitoring of the conduct of the market participants and enforcement of the rules and requirements governing such conduct; • proper identification and management of risks; • effective clearing and settlement arrangements and systems; • information sharing and regulatory cooperation; • appropriate listed or quoted company regulation; • adequate financial products and instruments development process; • specific trading and position limits; • appropriate inventory and stock delivery management procedures; and • appropriate coordination regarding the market surveillance of the underlying securities. <p>ATSs are also subject to the oversight program of IIROC and of the securities regulator(s). The purpose of the oversight program of ATSs is similar to that of exchanges, in that it is intended to ensure that the ATS is complying with all IIROC requirements and relevant provisions of securities law, including the requirements set out in NI 21-101 and 23-101.</p> <p>Approval of rules</p> <p><i>Equity Exchanges</i></p> <p>As is the case for SROs all rules must be submitted to the regulators with the application for recognition. Later on, rules amendments are subject to the approval of the regulators.</p> <p>In certain CSA jurisdictions all rule changes require regulatory approval. In other CSA jurisdictions changes proposed in a filing are classified as either a significant change, a</p>
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housekeeping change, or a fee change. The former are subject to a comment period. Housekeeping changes are not subject to a comment period as they have no or minimal impact on entities other than the marketplace. Depending on the CSA jurisdiction, certain housekeeping rules are approved by the securities regulators and other housekeeping changes may be filed after the fact. Securities regulatory staff may challenge an exchange's characterization of a filing as "housekeeping." If this is done, the exchange must immediately repeal the rule or change and submit it as a significant change (and might also be published for comment depending on the nature of the change).

With respect to fees, NI 21-101 gives marketplaces a shorter time frame (at least seven business days before expected implementation) for filings relating to fee changes. Despite this, due to the complexity or potential impact of some fee changes, staff may inform the marketplace that the timeframe for review and approval will be longer. With respect to fee changes, staff primarily consider whether the fee change is reasonable or will negatively affect fair access to the exchange's services. As with other significant changes described above, staff may ask for additional information.

MX

MX rules are subject to a self certification process. As per the protocol applicable to it, MX published for comments its rules along with the rationales for a change. It then has to submit to the AMF an explanation as to how changes are taken into consideration. While the protocol does not require an explicit approval from the AMF, in practice MX would not publish the final rules until the AMF has sent it a letter confirming that it has no objections.

ATS

In Ontario, the legislation contains a broad provision to make decisions with respect to ATSs similar to the one that exists in most jurisdictions for exchanges. Pursuant to this provision, the OSC requires an ATS to file for approval changes to its operation rules. Changes are also categorized as significant, housekeeping or fee changes under the protocols using the same definitions as applicable for exchanges as described above. These changes are also subject to the same review and comment process as for recognized exchanges listed above, and the same criteria for approval. The review protocols also provide that OSC staff may extend the period for review of a filing if necessary for a thorough review.

ICE Futures

ICE Futures rules are filed with the MSC for non-disapproval.

	<p>NGX</p> <p>NGX is required to file new rules and amendments to its Contracting Party's Agreement to the ASC. For critical changes, NGX will conduct meetings and provide detailed information regarding the rule amendment to ASC staff. Filings are subject to review by ASC staff.</p> <p>Foreign exchanges</p> <p>Foreign exchanges are required to promptly notify the applicable securities regulator of any significant changes to the exchange's rules or the laws of its governing regulatory body, but these are generally not subject to any formalized review or approval processes.</p> <p>On-site oversight examinations</p> <p>Exchanges</p> <p>The securities regulators conduct detailed on-site compliance examinations of domestic recognized exchanges. The examination program is developed based on the Oversight MOU. The scope of review may encompass all of the areas identified in the Oversight MOU, which, for the most part, reflect the types of requirements contained in NI 21-101, or may be limited to areas identified as presenting a greater risk.</p> <p>The areas identified in the Oversight MOU as being subject to periodic oversight reviews include policies and procedures around corporate finance/listings, trading halts, suspensions and de-listings, coordination with the markets of the underlying securities, monitoring of trading and position limits, surveillance and enforcement, access requirements, information transparency, corporate governance, risk management, and systems and technology.</p> <p>During on-site reviews, the lead regulator's staff examine books and records (including policies and procedures manuals, agendas and minutes for meetings of the board of directors and key committees and relevant files) and meet with management, key personnel and members of the board and committees. The purpose of the meetings is to discuss the exchange's understanding of its responsibilities, its approach to and processes for compliance and any issues that arise in the course of the review.</p> <p>Certain lead regulators are in the process of changing the on-site review approach from a comprehensive review performed once every three years to an approach based on regulatory risk. Accordingly, rather than review all aspects of an exchange's operations, the inspections will seek to zero in on the core areas of risk, with a view of seeking to address any significant problems. It is believed this approach will be a more efficient and effective way of discharging its regulatory mandate.</p>
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ATS

Because ATS are jointly regulated by the securities regulators and IIROC, it was determined that, to avoid duplication, IIROC would conduct on-site examinations of the ATSS. These oversight examinations review compliance with IIROC rules (including UMIR) and applicable provisions of NI 21-101 and NI 23-101.

Power of the regulators

A violation of an exchange's RO or applicable rules such as NI 21-101 is a violation of securities or derivatives legislation, as applicable, and is subject to the securities regulators' full range of remedies, including imposition of restrictions or conditions, or an order that the exchange review its practices and procedures and make such changes as the securities regulators direct.

In addition, the securities regulators also have broad plenary powers with respect to recognized exchanges. If it is in the public interest, the securities regulators may make any decision with respect to:

- the manner in which the exchange carries on business,
- the trading of securities or derivatives on the exchange,
- which securities or derivatives may be listed on an exchange,
- any issuer listed on an exchange, and
- any by-law, rule, regulation, policy, procedure, interpretation or practice of the exchange.

The standard for making such decisions is whether the order would be in the public interest and is not predicated on a violation of the legislation or a RO.

Through the powers outlined above, the securities regulators can generally prescribe any course of action if considered in the public interest, including the suspension, restriction or termination of registration or recognition/exemption from recognition for ATSS and exchanges respectively, and the imposition of additional terms and conditions on registration or recognition/exemption from recognition.

Despite the powers noted above, minor or technical instances of non-compliance (either with securities law or an exchange's RO) are typically dealt with informally with the exchange to ensure they are corrected. More significant instances of non-compliance will be followed up immediately and formally. Should no resolution be satisfactory to staff of the securities regulators, formal enforcement action would be considered, and the powers noted above could be invoked. To date, there have not been any instances

	<p>of non-compliance significant enough to merit enforcement action against an exchange.</p> <p>In the case of ATS violations of NI 21-101 (or relevant rules governing investment dealers) are breaches of securities law and are subject to the securities regulators' full range of remedies described above.</p> <p>Securities regulators also have additional abilities to re-examine the ATS and impose a range of actions, such as restrictions or conditions, depending on the statutory authority. For example, in Ontario, the broad plenary provision contained in legislation referred to earlier allows the OSC to make decisions with respect to ATSs similar to the one for exchanges, while in Québec, legislation would allow the AMF to take any steps to ensure compliance with an undertaking given to the AMF and with the provisions of the QSA, QDA and any regulations the reunder.</p> <p>Instances of non-compliance are dealt with in the same manner as for exchanges. There have been no instances significant enough to merit enforcement action against an ATS to date. Deficiencies found in the filings, such as late filings or incorrect classification of changes, have been dealt with through discussions with ATS management to ensure they are aware of and understand the requirements and the deficiencies have been resolved to the satisfaction of staff.</p> <p>Revocation of the RO</p> <p>The securities regulators have the ability to revoke an exchange's RO and an ATS's registration as a dealer. Revocation will render the marketplace unable to carry on business in the jurisdiction and there would be an immediate cessation of trading. Consistent with administrative law principles, any such revocation would be subject to due process, including the right of the marketplace to make submissions and be heard before the Commission.</p>
Assessment	Fully implemented
Comments	<p>As stated in the description, IIROC and the exchanges are the front-line supervisors for purposes of conducting surveillance of the markets. As per the description above, each one has put in place robust automated systems for the surveillance of the markets under their jurisdictions. Such system will be further enhanced with the development of an automated system for surveillance across the cash and derivatives markets. The AMF published an RFI on May 15th, 2013 to seek information surrounding technology solutions. The goal is to gain a better understanding of potential solutions and receive estimated costs related to enhancing its technology. The assessor encourages efforts to develop an automated solution.</p> <p>Current mechanisms for surveillance of the corporate bond market are limited. However the assessor acknowledges that these markets are currently mostly OTC. The assessor</p>

	<p>encourages efforts to improve market surveillance of these markets.</p> <p>On the other hand the authorities have developed a robust program for the oversight of the exchanges.</p>
Principle 35. Regulation should promote transparency of trading.	
Description	<p>Exchange traded securities</p> <p>NI 21-101 contains the transparency requirements applicable in Canada. Generally, order and trade information from a marketplace trading exchange-traded securities must be provided to an information processor. Specifically, Sections 7.1 and 7.2 of NI 21-101 require that a marketplace that displays orders of exchange-traded securities to a person must provide accurate and timely information regarding orders and trades for the exchange-traded securities displayed by the marketplace to an information processor. Under Section 7.5 of NI 21-101, the information processor must produce an accurate consolidated feed in real-time showing the information provided to it. Subsection 14.4(2) provides that an information processor must provide timely, accurate, reliable and fair collection, processing, distribution and publication of information for orders for, and trades in, securities.</p> <p>Since June 2009, TSX Inc. has acted as the information processor for exchange-traded securities other than options, for the purpose of these requirements. The requirements apply in the same way to all types of marketplaces that offer trading in exchange-traded securities</p> <p>Dark pools</p> <p>The Canadian framework with respect to dark liquidity for trading in equity securities was revised in 2012 and has been implemented through amendments to NI 21-101 <i>Marketplace Operation</i> (NI 21-101) adopted by the CSA and to the UMIR administered by IROC.</p> <p>Dark pools, as well as dark orders offered by transparent markets (a transparent marketplace can also offer orders that are partially or fully hidden) continue to be allowed in Canada. However, the framework imposes certain obligations that seek to incentive transparency:</p> <ul style="list-style-type: none"> • A marketplace is not required to provide pre-trade transparency of orders if the marketplace only displays orders to its employees or to persons or companies retained by the marketplace to assist in the operation of the marketplace and if the orders posted to the marketplace meet or exceed a minimum size –as of today there is no minimum size; • Rule 6.3 of the UMIR <i>Exposure of Client Orders</i> promotes transparency of small-

sized orders, by requiring that a Participant immediately enter for display on a marketplace that display orders, a client order to purchase or sell 50 standard trading units or less unless, among other exceptions, the Participant provides price improvement to that order.

- Part 6 of National Instrument 23-101 *Trading Rules* (NI 23-101) includes the OPR, which requires marketplaces to have policies and procedures that are reasonably designed to prevent trade-throughs. Specifically, OPR ensures that immediately accessible, visible and better priced limit orders are executed prior to inferior-priced limit orders.

Iceberg orders

Iceberg orders are allowed, as well as a variation of iceberg orders where the hidden part can trade at a different price (price improvement iceberg orders). Price priority is applicable. A visible order always has priority over a hidden order or the hidden part of an iceberg order. So even if a visible order is received after an iceberg order has been entered at the same price, it will have priority over the hidden part of the iceberg order. Once the visible part of an iceberg order is executed, the hidden part of the iceberg order that becomes visible is treated as a new order in terms of time priority.

In the context of the revised framework introduced in 2012, an iceberg order (a portion of which is displayed in a consolidated market display) will not be considered a dark order and, as such, the hidden portion of the order would not have to provide “price improvement” on execution. However if the hidden portion of the order could trade at a price other than the price displayed by the visible portion, then the hidden portion of the order will be a dark order.

Finally in the context of the Order Protection Rule (Part 6 of NI 23-101) the participant can use a bypass marker when they enter an order on a marketplace. A bypass order will not interact with any hidden order (fully hidden or the hidden part of an iceberg order) and can be used by the participant to meet the OPR.

Block trades

“Block trades” is not a defined term in the UMIR. However, on a few occasions, the UMIR introduces differences for orders larger than \$100,000 or 50 standard trading units (5000 shares for securities trading over \$1.00). For example, these thresholds are used within the context of the revised framework for dark liquidity.

As noted earlier, any order which trades with a Dark Order would have to receive price improvement on the execution unless the order, as entered on the marketplace, is for more than 50 standard trading units or has a value of more than \$100,000. If the order meets either of these requirements, the order could trade with the Dark Order at the

market price, provided no displayed orders are available on that marketplace at the market price.

Another example can be found in *Rule 6.3 of the UMIR—Exposure of Client Orders* which states that: “A Participant shall immediately enter for display on a marketplace that displays orders in accordance with Part 7 of the Marketplace Operation Instrument a client order to purchase or sell 50 standard trading units or less of a security unless (...) (f) the order has a value of more than \$100,000”

Furthermore, *Rule 6.4 Trades to be on a Marketplace* require that “A Participant acting as principal or agent may not trade nor participate in a trade in a security by means other than the entry of an order on a marketplace” (some exceptions are provided). Thus, in Canada, a trade is not a trade until it is executed on a marketplace. When entering a cross for example, the orders sent by a participant will be subject to the obligations generally imposed, such as the Order Protection Rule and Best Execution. Therefore the trade will need to be made in the context of the market at that time, at or within the National Best Bid and Offer. If not, the trade is subject to interference from better-priced orders on the books of all marketplaces.

As mentioned before, according to Rule 6.3, a larger order (i.e. 50 standard trading units or \$100 000) received by a participant does not have to be entered immediately on a marketplace but can be held “upstairs” by a dealer. However, it must be executed on a marketplace (either by entering the order on the marketplace or reporting a matched trade as a cross) according to the prevailing market conditions at that time as described above. If a block order is entered on a marketplace, it is subject to the normal pre-trade transparency rules, that is, it will be visible unless the marketplace is a dark market. When the order is executed on a marketplace or reported as a cross to a marketplace, it will be communicated in the same manner as any other trade.

Monitoring of transparency

As part of the recognition requirements, securities regulators obtain information about the market places that would allow them to determine whether exemptions to pre or post-trade information are warranted. In addition, starting with the 4th quarter of 2012, all marketplaces need to file a quarterly report that will inform the CSA about the marketplace’s activities within 30 days after the end of each calendar quarter.

With respect to dark pools and dark liquidity in general, a detailed set of order and trading information will need to be filed, by all marketplaces. All order and trade information is also currently provided on a real-time basis to IIROC, which monitors the trading activity on all Canadian equity marketplaces at this time. Staff also highlighted that in light of the recent amendments to the dark liquidity framework, as discussed above, IIROC and the CSA will be monitoring their impact on Canadian markets, including dark liquidity. This will help to determine whether a minimum size for dark

orders is required or preferable and whether any adjustments may need to be made to the requirements of the recent amendments. In this last regard, the information provided showed that the volume of dark orders has diminished significantly since the adoption of the framework explained above, to less than 2 percent of trading volumes.

In addition, as part of the dark liquidity framework, IIROC also introduced a new requirement in Rule 7.12 on Participant and Access Persons. A Participant or Access Person should not enter an order on a particular marketplace if it knows or ought reasonably to know that the handling of the order by the marketplace and the trading systems of the marketplace may result in the display of the order or the execution of the order not being in compliance with any of the applicable requirements of UMIR. The effect of this requirement is that the marketplaces will ensure, through their trading systems, compliance by Participants and Access Persons with Rule 6.6 of UMIR. Through its surveillance system, IIROC would be able to detect violations of this requirement and could take enforcement action if required.

Information to market participants

NI 21-101 (as amended effective July 2012) requires that market participants be provided with sufficient information so that they are able to understand the manner in which their orders are handled and executed.

Section 10.1 of NI 21-101 provides that a marketplace must publicly disclose on its website information reasonably necessary to enable a person or company to understand the marketplace's operations or services it provides, including, but not limited to, information related to: how orders are entered, interact and execute; all order types; where routing is offered, how routing decisions are made; and when indications of interest are disseminated, the information disseminated and the types of recipients of such indications of interest.

In addition to these requirements, an application to be recognized as an exchange is published by the CSA for comment. In Ontario, an ATS's Notice of Initial Operations is also published for comment. These applications usually contain information about how orders will be handled and executed by the exchange or ATS.

Information regarding changes to a marketplace's operations may also be published for comment. The information to be filed for changes to a marketplace's operations and the criteria and process for publication are set out in the applicable marketplace protocol. Significant changes are published for a 30-day comment period. Before the publication, the CSA staff will review the notice and materials to ensure that they contain an adequate level of detail, analysis and discussion to elicit meaningful public comment. If comments are received, the marketplace needs to forward to the CSA staff copies of the comments, as well as a summary of the public comments and the marketplace's response to those comments promptly after the end of the comment

	<p>period.</p> <p>Unlisted debt securities</p> <p>Part 8 of NI 21-101 outlines the specific requirements applicable to unlisted debt securities. Specifically, under Section 8.1 of NI 21-101, marketplaces and inter-dealer bond brokers must provide accurate and timely information about orders and trades in government debt securities to an information processor. However, there is currently an exemption in place that has the effect of exempting marketplaces and inter-dealer bond brokers from the requirements of Section 8.1 until January 1, 2015.</p> <p>Regarding corporate debt securities, Section 8.2 of NI 21-101 requires marketplaces to provide accurate and timely information about orders and trades to an information processor, as required by the information processor, but only with respect to corporate debt securities designated by the information processor (designated corporate debt securities). Inter-dealer bond brokers and dealers executing trades outside of a marketplace are also subject to the transparency requirements for designated corporate debt securities, but only with respect to trade information (i.e. post-trade transparency with respect to trades).</p> <p>CanPX has been approved to act as the information processor for corporate debt securities since 2003. CanPX, has set, in consultation with the CSA, the standards for transparency for corporate debt securities. Only dealers and marketplaces that have reached 0.5 percent of the total market share of the corporate bond market are required to report information on trades in corporate bonds. No pre-trade reporting is required at this time. At this time, the information to be reported include: issuer; coupon; maturity; price; time of the trade; and subject to the caps set out below, the volume traded. The information must be provided no later than one hour from the time of the trade or such shorter period of time determined by the information processor.</p> <p>Under Section 8.3 of NI 21-101, the information processor shall produce an accurate consolidated feed in real-time showing the information provided to the information processor. CanPX currently displays the trading information for around 150 of the most liquid corporate debt securities (the number in the past was much lower, around 75). Staff informed its expectation that overtime the number of securities subject to post-trade transparency should increase.</p>
Assessment	Fully Implemented
Comments	The Canadian framework is robust in connection with pre-and post trade transparency of the equity markets including the existence of a consolidated tape— which is still a challenge in other jurisdictions where multiple trading platforms coexist. The new framework for dark orders and dark pools appears reasonable; further the assessor notes that the volume of dark orders has diminished since the establishment of such

	<p>framework. Nevertheless the assessor encourages the regulatory authorities to further consider the benefits of establishing a size limit for dark orders.</p> <p>In light of the fact that the corporate bond market is OTC, the level of transparency currently required is appropriate vis-à-vis Principle 35. However, the assessor encourages the authorities to continue expanding the universe of securities subject to post-trade transparency and to lift the exemption applicable to the government bond market.</p>
Principle 36.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>Assessed in 2007</p> <p>National Instrument 23-101 Trading Rules harmonizes the framework for provincial regulators in this area.</p> <p>The UMIR contains provisions that prohibit market manipulation and other unfair practices in the equity markets. As the SRO for those marketplaces, RS has disciplinary powers to impose sanctions for the violation of UMIR rules.</p> <p>Similarly, the MX also has trading rules that cover manipulative or deceptive methods of trading and has disciplinary powers to impose sanctions for the violation of its rules.</p> <p>Serious misconduct that cannot be pursued by RS or MX—for example insider trading—is within the framework of the provincial regulators and therefore they have disciplinary powers and procedures to sanction them. Certain misconduct such as insider trading also constitutes a criminal offence under the Criminal Code of Canada. The criminal code is federal legislation that applies in all the provinces and territories; however its application is carried out via the police and courts.</p>
Assessment	Fully implemented
Comments	Comment carry from the 2007 assessment: “While the framework to detect and deter unfair practices is robust, actual enforcement is in need of improvement as discussed under Principle 10”.
Principle 37.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>Assessed in 2007</p> <p>TSX</p> <p>The Canadian Depository for Securities Limited (CDS) provides two central</p>

counterparty services, one for equity securities and the other for government debt instruments. A trade that is to be settled in a central counterparty (CPP) service must pass a certain number of edits before the CDS settles it to be sure of the collateralization of the payment obligations at all points of time. One of the pre-settlement edits ensures that a settlement does not result in a negative balance in a participant's fund account exceeding the participant's limit (which is calculated as the sum of the used portion of its operating cap and any available credit lines) and that there is sufficient collateral to cover any negative imbalance.

CDS imposes a soft CPP cap (presently set at CAN\$80 million) on participants on a CPP service. Certain obligations and actions are triggered if the participants exceed certain thresholds, including the provision of additional collateral and notification to the regulator and the IDA. CDS Participant Rules authorize CDS to share information on its participants with any exchange or ATS, securities depository, securities clearing agency, payment clearing system or SRO of which the participant is a member or the services of which the participant uses in connection with its participation in CDS, any insurer of the participant including CIPF or the Canada Deposit Insurance Corporation (CDIC) or the participant's primary Canadian regulatory body.

In addition, the IDA requires members to calculate their exposure on a daily basis. A report is sent to the OSC and the AMF on a monthly basis.

MX

The CDCC is the clearing house of the MX. CDCC manages the risk of large exposures through:

- Selection criteria for clearing members, mainly capital.
- Initial margin as well as daily margins.
- Additional margins are prescribed for low capitalized members.

Coordination

There are MoUs between IDA and CDS, and between IDA and CDCC. Under these MoUs, IDA monitors the financial soundness of IDA members. If IDA receives information of material concern about a member through its monitoring, it must immediately notify CDS or CDCC as appropriate. If a CDS participant is on early warning, he is subject to additional collateral charge imposed by CDS.

In addition, under the terms and conditions of its recognition order, IDA must notify the OSC and the AMF if an IDA member is placed on early warning, which includes if members have an overexposure to certain counterparties.

<p>Issues assessed in 2013</p> <p>Failed settlements</p> <p>National Instrument 24-101 <i>Institutional Trade Matching and Settlement</i> (NI 24-101) requires dealers to establish, maintain and enforce policies and procedures to facilitate settlement of trades at the settlement date prescribed by the exchange. All recognized exchanges have established rules requiring investment dealers to settle trades on the regular settlement date (T+3 in most cases), unless otherwise agreed to by the parties to the trade.</p> <p>While there are not any compulsory buy-ins for failed trades, recognized exchanges and CDS, the clearing agency for securities in Canada, have rules that set out procedures for a purchaser, at its option, to buy-in securities to satisfy a failed trade. The buy-in occurs 48 hours after CDS receives notification that the buyer wants to buy-in the seller, at which time marketplace participants are notified of the details of the buy-in (security and number of shares wanted). The trade takes place on a cash next-day delivery basis and with the failing seller liable for any difference if the price of the buy-in exceeds the buy-in price.</p> <p>There are daily reports on settlement failures that IIROC has access to via the CDS. In addition, UMIR requires participants and access persons that have failed settlements outstanding for an extended period (10 days after the standard settlement date, typically T+13) to report the failure, including the reason for the failure, to IIROC, together with such information that may be required by IIROC. Persons who are required to file an extended failed trade report to IIROC need to make arrangements to borrow the security before executing additional short sales.</p> <p>In addition, UMIR allows IIROC to designate a security as (i) subject to a requirement that short sellers locate a borrow before trading and/or (ii) ineligible for short sales. IIROC can designate a security as being subject to a pre-borrow requirement or as short sale ineligible where there is an unusual pattern of settlement failure in relation to that security or otherwise if such designation would be in the interest of obtaining a fair and orderly market. Staff informed that since these designations were introduced, in October 2012 and October 2008 respectively, IIROC has not designated any securities as being subject to pre-borrow requirements or as being ineligible. Restrictions, however, have been imposed in the past in situations where market authorities became aware that the public float of a security had shrunk to such a degree that it was very difficult or impossible to borrow securities to cover short sales. In addition, equity exchanges have relieved market makers from their obligation to continuously post an offer in a security of responsibility where that would require the market maker to sell short and there are not any securities readily available to borrow.</p>

Short sales

IIROC has the ability to monitor the orderly and efficient functioning, and stability of, equity markets in real-time. UMIR requires all orders that would result in a short sale to include a “short sale” designation that allows IIROC to identify short sale orders in real-time. IIROC has an alert that uses the short sale markers to look for declines in the price of a security associated with changes in the rate of short selling, based on a comparison to historical short selling patterns for the particular security. This allows issues that could affect the orderly and efficient functioning of markets to be addressed immediately.

In addition, UMIR requires investment dealers that have direct trading access to a marketplace (participants) and other entities with direct trading access to marketplaces (access persons) to provide aggregated short position reports for each individual account twice each month as of the 15th and the last day of the month. The equity exchanges gather this information for their listed securities and make it available to market authorities. The TSX publishes the top 20 short positions by security and the top 20 changes in short positions by listed security on its website, while the CNSX publishes short positions for all listed securities on its website.

Finally, IIROC now publishes information on consolidated cumulative short selling activity on all marketplaces for each security on a semi-monthly basis. These reports are based on the same time periods for the short position reports so that market participants are able to compare data on positions against data on actual trading activity over the relevant period. This new approach began in January 2013.

Exemptions to shortselling

Canadian regulations carve out certain categories of transactions from short sale regulations. Some types of short sale orders are to be marked as “short-marking exempt”. Short-marking exempt orders include orders for:

- an arbitrage account;
- the account with market making obligations in respect of a particular security and only on orders for that security;
- a client, non-client or principal account:
 - for which order generation and entry is fully-automated, and
 - which, in the ordinary course, does not have at the end of each trading day more than a nominal position, whether short or long, in a particular security; and

- a principal account that has acquired, during a trading day, a position in a particular security in a transaction with a client that is unwound during the balance of the trading day such that, in the ordinary course, the account does not have, at the end of each trading day, more than a nominal position, whether short or long, in a particular security.

The “short-marking exempt” marker is designed to identify accounts that do not, in the normal course, take a directional view of a security, and buy and sell on a continuous basis with an expectation of being flat or having a nominal position at the end of a trading day.

By having a different marker for these accounts, the “short sale” marker identifies those accounts that are taking a directional position and could be considered true short sellers. This makes the IIROC alerts described in the response to the previous question more meaningful by more accurately identifying genuine problem situations.

As purchases by these accounts must also be marked “short-marking exempt,” IIROC will have data that will indicate if the marker is not being used correctly or is being used to hide directional short selling (e.g. if there is a large imbalance of sales compared to purchases of a security).

Transactions deemed not to be short sales

In addition, the definition of “short sale” in UMIR makes it clear that, in certain cases, a person is deemed to own a security and not considered to be selling short. This includes sales where the person:

- has purchased or has entered into an unconditional contract to purchase the security, but has not yet received delivery of the security;
- owns another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;
- has an option to purchase the security and has exercised the option;
- has a right or warrant to subscribe for the security and has exercised the right or warrant; or
- has entered into a contract to purchase a security that trades on a-when-issued basis and such contract is binding on both parties and subject only to the condition of issuance or distribution of the security.

Like the “short-marking exempt” marker, these exceptions permit the data on short

	<p>sales to better reflect the activities of persons that have adopted a directional short trading strategy.</p> <p>Practice</p> <p>In 2011, IIROC released the results of a study on short sales and failed trades. The study did not show any significant problems with failed trades in Canada, but rather showed that they are relatively few in number. The study also found that a large majority of failures relate to technical, administrative problems with long sales, as opposed to short sales. Technical and administrative problems include a variety of matters including administrative issues at the custodian level, errors in registration, and delays in removing legends from certificates.</p>
Assessment	Fully Implemented
Comments	While there is no mandatory buy in, the assessor considers that the current framework provides sufficient incentives for compliance. In particular, persons who are required to file an extended failed trade report to IIROC need to make arrangements to borrow the security before executing additional short sales. Further, the analysis conducted by IIROC also shows that failed settlement is not an issue of major concern in Canada.
Principles Relating to Clearing and Settlement	
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	
Description	
Assessment	Not assessed.
Comments	