

INVESTMENT DEALERS ASSOCIATION OF CANADA - BY-LAW NO. 17.19 - BUSINESS CONTINUITY PLAN REQUIREMENT

I OVERVIEW

A CURRENT RULES

The Association's rules require that all Member firms have the appropriate financial and operational safeguards in place to protect customer assets. These safeguards include the requirement:

- to maintain adequate risk adjusted capital at all times (By-law No. 17.1 and Form 1);
- to keep and maintain adequate books and records (By-law No. 17.2 and Regulation 200);
- to establish maintain adequate internal control systems (By-law No. 17.2A and Policy No. 3);
- to segregate fully paid and excess margin securities held for a customer (By-law Nos. 17.3, 17.3A and 17.3B); and
- to maintain adequate insurance coverage at all times (By-law Nos. 17.6 through 17.9, Regulation 400 and Form 1);

There is no current requirement for a Member firm to establish and maintain a business continuity plan.

B THE ISSUE

The customer asset safeguard requirements are only effective when the Member firm service (both staff and systems based) is relatively uninterrupted. Any disruption in service can quickly impair the ability of the firm to honour its obligations, both to its customers and other capital markets intermediaries.

C OBJECTIVE

The adoption of proposed By-law No. 17.19 (enclosed in Attachment #1) would make it a requirement for all Member firms to have a business continuity plan. The requirement to have and the existence of a plan will not in itself guarantee that a Member firm will not suffer service interruptions. Rather, the objective of requiring a Member firm to have a business continuity plan (including the regular testing of such plan) would be to ensure that it has made adequate preparations to deal with significant business interruption scenarios and is able to resume service within an acceptable period of time.

D EFFECT OF PROPOSED RULES

Since proposed By-law No. 17.19 seeks to require that each Member firm have a business continuity plan, there will costs borne by those Member firms that do not currently have a business continuity plan. The proposed amendment will not impact market structure or competition between Member firms and non Member firms or others.

II DETAILED ANALYSIS

A PRESENT RULES, RELEVANT HISTORY AND PROPOSED POLICY

There is no current requirement for a Member firm to establish and maintain a business continuity plan.

The development of the proposal was undertaken by the FAS Business Contingency Subcommittee (the Subcommittee). In addition to the development of proposed By-law No. 17.19 the Subcommittee has also developed guidance on how to develop a business continuity plan.

Given the complex interdependencies of the markets, there is a potential for a sudden business disruption to cascade into a significant market-wide crisis. This issue has become a major concern for the securities industry and the subject of much discussion, both nationally and internationally, particularly in response to the serious new risks posed in the post-September 11th environment. The resilience of the securities industry and the financial sector as a whole in the event of a market-wide disruption is contingent upon the rapid recovery and resumption of many critical activities that support financial markets.

The proposed rule amendment would make it a requirement for all Member firms to have a business continuity plan. The requirement for and the existence of a plan will not in itself guarantee that a Member firm will not suffer service interruptions. Rather, the objective of requiring a Member firm to have a business continuity plan (including the regular testing of such plan) would be to ensure that it has made adequate preparations to deal with significant business interruption scenarios and is able to resume service within an acceptable period of time.

B ISSUES AND ALTERNATIVES CONSIDERED

The Subcommittee considered the passage of more prescriptive business contingency plan requirements than those being proposed. The Subcommittee decided against a more prescriptive approach due to concerns that procedures/processes that might be critical to the resumption of service for a large Member firm (i.e., permanent disaster recovery backup location) would be both inordinately costly and inappropriate for a small Member firm. A more principles based rule was therefore developed to give Member firms of varying sizes and business focus the flexibility to establish a business continuity plan that addresses the key business resumption risks and is cost effective.

C COMPARISON WITH SIMILAR PROVISIONS

United Kingdom

The Financial Services Authority (FSA) requires financial institutions to have a business contingency plan, but it has not set out any prescriptive guidance/requirements. In July 2002, the FSA issued a paper dealing with the management of operational risk. This paper contained high-level guidance on some of the main operation risks areas that a firm should consider, including business continuity risk management. The paper was followed in March 2003 by a policy statement that confirmed respondents (to the paper) had broadly approved the FSA's high-level approach to business continuity risk management. The policy statement reassured firms that the FSA had no intention of being prescriptive in its guidance on business continuity. Instead the policy was designed to be flexible and to be interpreted in accordance with the nature, scale and complexity of a firm's activities.

United States

Proposed NASD Rule 3510, Business Continuity Plans, deals with business continuity planning. Proposed NASD Rule 3510 would require NASD member firms to create and

maintain written business continuity plans. As with proposed IDA By-law No. 17.19, the proposed NASD Rule 3510 recognizes that business continuity plans should reflect the particular operations and activities of a dealer. Therefore, the proposed rule would allow members to tailor or customize plans to suit their size, business and structure. However, there are minimum standards that this plan must meet including data back-up and recovery of mission critical systems, financial and operational assessments, alternate communications, counter-party impact, regulatory reporting and communications with regulators. Plans must be reviewed annually to determine if modifications are necessary. In addition, plans must be made available to NASD staff for inspection during routine examinations and promptly on request by NASD staff. NASD will limit its review of a member firm's business continuity plan to the categories listed above to ensure that NASD is not micromanaging business operations.

D SYSTEMS IMPACT OF RULE

The systems impact of this rule may be significant. The level of impact on an individual Member firm will be highly dependent on the extent of current preparedness for business interruptions, something that can only be determined once a firm specific business impact assessment has been performed. It is believed that while system impacts may be felt in varying degrees at individual Member firms, the industry benefits of requiring a business contingency plan, in terms of improved securities industry preparedness for business interruptions, are far greater.

The Bourse de Montreal is also in the process of passing this amendment. Implementation of this amendment will therefore take place once both the IDA and the Bourse de Montreal have received approval to do so from their respective recognizing regulators.

E BEST INTERESTS OF THE CAPITAL MARKETS

The Board has determined that the public interest rule is not detrimental to the best interests of the capital markets.

F PUBLIC INTEREST OBJECTIVE

According to subparagraph 14(c) of the IDA's Order of Recognition as a self-regulatory organization, the IDA shall, where requested, provide in respect of a proposed rule change, "a concise statement of its nature, purposes (having regard to paragraph 13 above) and effects, including possible effects on market structure and competition". Statements have been made elsewhere as to the nature and effect of the proposal with respect to the proposed amendment.

The specific purpose of proposed By-law No. 17.19 is to make it a requirement for all Member firms to have a business continuity plan. As a result, the related general purpose of this proposal is:

- To standardize industry practices where necessary or desirable for investor protection

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

III COMMENTARY

A FILING IN OTHER JURISDICTIONS

These proposed amendments will be filed for approval in Alberta, British Columbia and Ontario and will be filed for information in Nova Scotia and Saskatchewan.

B EFFECTIVENESS

It is believed that the proposed amendments will be effective in improving securities industry preparedness for business interruptions.

C PROCESS

The proposed by-law was developed and recommended for approval by the FAS Business Contingency Planning Subcommittee and recommended for approval by the Financial Administrators Section.

IV SOURCES

References

- FSA Consultation Paper 142, Operation Risk Systems and Controls
- FSA Policy Statement, Feedback on FSA Consultation Paper 142, Operation Risk Systems and Controls
- Draft ICSA Business Continuity Planning Guidelines for Securities Firms
- Proposed NASD Rule 3510, Business Continuity Plans.

V OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying proposed by-law so that the issue referred to above may be considered by OSC staff. The Association has determined that the entry into force of the proposed by-law would be in the public interest. Comments are sought on the proposed by-law. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Richard J. Corner, Vice President, Regulatory Policy, Investment Dealers Association of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5T 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

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INVESTMENT DEALERS ASSOCIATION OF CANADA
BY-LAW NO. 17.19 - BUSINESS CONTINUITY PLAN REQUIREMENT
BOARD RESOLUTION

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

1. By-law No. 17 is amended by adding the following:

“**17.19.** Every Member shall establish and maintain a business continuity plan identifying the necessary procedures to be undertaken during an emergency or significant business disruption. Such procedures shall be reasonably designed to enable the Member to stay in business in the event of a future significant business disruption in order to meet obligations to its customers and capital markets counterparts and shall be derived from the Member’s assessment of its critical business functions and required levels of operation during and following a disruption.

Every Member shall update its plan in the event of any material change to its operations, structure, business or location. Every Member must also conduct an annual review and test of its business continuity plan to determine whether any modifications are necessary in light of changes to the member's operations, structure, business, or location. The Association, in its discretion, may require this annual review to be performed by a qualified third party.”

PASSED AND ENACTED BY THE Board of Directors this 13th day of June 2004, to be effective on a date to be determined by Association staff.