

# IIROC NOTICE

## **Rules Notice Notice of Approval/Implementation**

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*Contact:*

Rossana Di Lieto  
Vice President, Registrations and Complaints  
416-943-6911  
[rdilieto@iiroc.ca](mailto:rdilieto@iiroc.ca)

Richard J. Corner  
Vice President, Member Regulation Policy  
416-943-6908  
[rcorner@iiroc.ca](mailto:rcorner@iiroc.ca)

**09-0268**  
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## **IIROC Dealer Member Rule Amendments to Implement the CSA's Registration Reform Project**

### **I. Introduction**

The IIROC Board has approved various amendments to IIROC's Dealer Member Rules that are related to the implementation of the Registration Reform Project of the Canadian Securities Administrators (CSA) (collectively the "IIROC Registration Reform Rule Amendments"). Except as described in Part VII below the IIROC Registration Reform Rule Amendments will be effective on the date that the CSA's National Instrument 31-103 *Registration Requirements* comes into force, which is September 28, 2009.

The IIROC Registration Reform Rule Amendments were also published on July 17, 2009 to provide market participants advance notice of the rule changes.<sup>1</sup> At that time the rules were

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<sup>1</sup> IIROC Rules Notice – Notice of Approval by IIROC Board – 09-0213



still subject to approval by the applicable securities regulatory authorities (the “Recognizing Regulators”). The Recognizing Regulators have now approved these rule changes.

We have made a few drafting changes to the rules published on July 17, 2009 in response to comments received from the Recognizing Regulators and to clarify some definitions. We have also deleted from the rules the proposed amendment to the definition of “Institutional Client” which sought to increase the threshold applicable to “high net worth non-individuals” from \$10 million to \$25 million to align, in part, with the CSA’s definition of “permitted client” in NI 31-103. NI 31-103 establishes the concept of “permitted clients” – large institutions and wealthy individuals – who are either sophisticated investors or can afford to hire outside experts to assist them. We will publish this proposed change to the threshold for comment subsequent to the implementation of Registration Reform.

## **II. Background and Objectives of the IIROC Registration Reform Rule Amendments**

The CSA, IIROC and the Mutual Fund Dealers Association of Canada have worked jointly on a project – the Registration Reform Project – to modernize, streamline and harmonize registration and approval requirements for dealers and their registered individuals. The project has resulted in a proposal to harmonize securities legislation across the CSA jurisdictions and the development of a National Instrument 31-103 – *Registration Requirements* (NI 31-103) that has been adopted by all CSA jurisdictions. IIROC and its predecessor, the Investment Dealers Association of Canada have been involved in this project to provide policy recommendations and ensure that there is no inconsistency between CSA and IIROC regulations regarding registration requirements.

The objectives of the IIROC Registration Reform Rule Amendments are for the most part those of the CSA’s Registration Reform Project:

1. Simplify the categories of approval and eliminate rote, follow-on approvals, such as approvals to trade specific products that are based almost entirely on meeting specific proficiency requirements, in favour of notice processes.
2. Derive approval requirements from functions rather than titles. In this regard, the rule changes propose ceasing to approve all those with specific officer titles, instead approving those exercising executive management functions at a Dealer Member – the “mind and management” of the Dealer Member.
3. Modernize registration-related requirements on Dealer Members, moving to the extent reasonable to a principles-based approach. In this regard they remove as far as possible prescriptive structural requirements that are not appropriate to all of the different types of Dealer Members’ businesses and business models, such as requirements to place



supervisory responsibilities on resident branch managers of all business locations about a certain size. They will therefore give Dealer Members greater flexibility to develop compliance and supervision structures and processes appropriate for their size, type(s) of business, business structures, systems and resources.

4. Harmonize as far as possible the IIROC Rules with those of the CSA and MFDA. Where harmonization is not possible, ensure that there is no conflict between CSA and IIROC rules. Where NI 31-103 sets a standard applicable to IIROC Dealer Members that would be in conflict, such as eligibility for registration/approval as Ultimate Designated Person, the amendments harmonize IIROC Dealer Member Rules with proposed NI 31-103.

Some of the rule changes are housekeeping or are directed at improving the clarity of the rules. There have also been a few deletions of transitional provisions that are no longer required, such as the transition provisions in Rule 40 required to get Approved Person data into the NRD System.

### **III. Publication for comment and summary of written comments**

We published the rule changes for a 30 day comment period on September 26, 2008.<sup>2</sup> The comment period was extended to December 29, 2008.<sup>3</sup> We received 7 comment letters. We have considered the comments received and thank all of the commenters. A summary of the comment letters received and our responses is included in Appendix B to this Notice. After considering the comments, we have made some changes to the version of the rule amendments that were published for comment in September 2008. We do not believe these changes are material and are not republishing the rule changes for a further comment period. The notable changes made since first publication for comment are summarized in Part V of this notice.

### **IV. Summary of the Amendments**

The following describes the main overall affect of the IIROC Registration Reform Rule Amendments. Some of the changes necessary to achieve the results described are spread through more than one Rule. A more detailed discussion of the IIROC Registration Reform Rule Amendments can be found in the notice that accompanied the initial publication for comment.

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<sup>2</sup> A copy of the September 2008 publication is publicly available on IIROC's website ([www.iiroc.ca](http://www.iiroc.ca)) under the heading "Policy" and sub-heading "Dealer Proposals/Comments". Alternatively please see (2008) 31 OSCB 9274.

<sup>3</sup> IIROC Rules Notice – Request for Comments – 08-0156



## **1. Simplification of approval categories**

IIROC currently has 46 approval categories for individuals; the amendments reduce the number to 11.

Each category now represents a different conjunction of five elements:

- (1) the type of trading activity – trading, order-taking only, advisory or portfolio management;
- (2) the type(s) of product(s): securities, mutual funds only, options or commodities;
- (3) type of client: retail or non-retail
- (4) the individual's position with the Dealer Member: representative, partner, officer or director; and
- (5) supervisory responsibilities: Ultimate Designated Person, Chief Financial Officer, Chief Compliance Officer, Alternate Designated Person or Branch Manager.

Each element of an approved persons function includes a specific proficiency requirement. As any of these items changes, the Dealer Member has to file an application for a category change and, if necessary, notification of completion of the applicable proficiency requirements.

The amendments simplify the categories by focusing solely on functions. These are:

- (1) Investment Representative: approved to take unsolicited orders
- (2) Registered Representative: approved to give investment advice
- (3) Trader: approved to enter orders into the trading systems of specific exchanges
- (4) Supervisor: approved to supervise the business activities of other approved persons
- (5) Executive: approved to participate in the executive management of a Dealer Member
- (6) Director: approved to sit on the Board of Directors of a Dealer Member or occupy a similar position in a Dealer Member not organized as a corporation
- (7) Ultimate Designated Person: the Chief Executive Officer of a Dealer Member or person in a similar position, approved to have overall responsibility for the Dealer Member's compliance with laws and regulations, including the Rules, governing its securities-related activities;



- (8) Chief Financial Officer, approved to be responsible for ensuring that the Dealer Member complies with the financial adequacy requirements of the Rules;
- (9) Chief Compliance Officer, approved to be responsible for ensuring that the Dealer Member has systems and controls reasonably designed to ensure its compliance with laws and regulations, including the Rules, governing its business conduct.

Under the amendments, specifics as to the types of products, clients and services will be information items, but will remain subject to proficiency requirements. They will be reported in initial applications, but subsequent changes will require only notification that the Approved Person has completed the necessary proficiencies and will be undertaking the applicable business activity. There will be no approval by IIROC staff, only a check, which may come after the fact, that the Dealer Member has disclosed the completion of the necessary proficiency requirements.

## **2. Merging of supervisory categories and implementation of a principles-based approach to supervision**

The Rules currently require that each location of a Dealer Member have a Branch Manager who is approved as such by IIROC. A location having less than 3 or 4 RRs (depending on the rules of individual CSA members) may be designated as a sub-branch supervised by the resident Branch Manager of a full branch. Dealer Member Rule 2500 sets out specific account supervision requirements for Branch Managers of retail branches.

While establishing one effective method of supervising branch retail activity, the current requirements have restricted Dealer Members from adopting any other supervisory structure and therefore from being innovative in the way they supervise business conduct. They are inappropriate for Dealer Members conducting non-retail or non-advisory other businesses, for example institutional sales and trading, proprietary trading and suitability-exempt discount brokerage.

The current requirements do not fit many business models of Dealer Members. For example, under the current regulations a Branch Manager is responsible for all activity in the branch. However, a large branch may also do institutional business, research and corporate finance that a Branch Manager does not have the necessary expertise to supervise. Those doing those types of business may in fact report directly to a department supervisor in the Dealer Member's head office.

The amendments remove the forced structural element of the Branch Manager requirements, merging all supervisory categories into one: Supervisor. Current Branch Managers will become approved in that category, as will other specific supervisory categories including product-specific supervisors such as options and futures contracts principals. As with trading



categories, the proficiency requirements to supervise specific types of activity will remain. Changes in proficiency and types of business being supervised will be matters of notice.

In place of the prescribed positions and functions, Dealer Members will be required to maintain detailed historical records of their supervisory structures and the persons responsible for fulfilling specific supervisory functions.

The amendments continue to require that specific persons be designated to perform specific functions, such as overall supervision of options or futures trading, portfolio supervision and retail account supervision. However, under the proposed rules those fulfilling those functions will no longer have a separate category and approval requirement; they will be approved as Supervisors<sup>4</sup>. Dealer Members will be required to maintain historical records as to who fulfills those designated roles, and their alternates.

The amendments are not intended to eliminate the branch manager structure as a viable way of supervising business activity. Dealer Members will still be able to designate branch managers and assign them the same responsibilities currently contained in the Rules. However, they will be approved as Supervisors. The rules contain no restrictions on the use of most currently used titles such as Branch Manager.

Changes to Dealer Member Rule 2500 make it more of a guidance document, but establish the two-tier method of retail account supervision prescribed in the current Rule as an acceptable option rather than a specific requirement. This change will permit Dealer Members to develop alternative approaches to supervision.

The amendments to Dealer Member Rule 2500 also include new guidance designed to give effect to the more principles-based approach, and additions designed to more fully delineate some requirements, including:

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<sup>4</sup> A change to Dealer Member Rule 1 defines “Designated Supervisor” as a person fulfilling one of these roles. However, “Designated Supervisor” is not proposed as an approval category. The term is defined because of frequent references to specific “Designated Supervisors” in the proposed amendments. Each reference to a Designated Supervisor in the proposed amendments contains a reference to which Designated Supervisor where the reference is not apparent from the context.



- Guidelines for a risk-based approach to selecting accounts for supervisory review;
- A general requirement that Dealer Member's account opening procedures take into account gatekeeper obligations;
- A restriction preventing ongoing trading in an account when a fully completed new account form has not been approved;
- A requirement that Dealer Members restrict the ability to update customer information on their electronic systems and have means independent of the RR handling an account for verifying significant changes to client information;
- Expanded descriptions of requirements regarding placing restrictions on the types of strategies to be used in options and futures accounts;
- An expanded description of the available means of monitoring losses and loss limits in futures accounts.

### **3. Limiting partner / officer / director registration to the mind and management of the Dealer Member**

The current rules require approval of all partners, directors and senior officers of Dealer Members. "Senior officers" include any persons having titles listed in Dealer Member Rule 1: Chairman, Vice-Chairman, President, Vice-President, Treasurer, Secretary and General Manager. Anyone using any of those titles is required to have the Approval of the Corporation in the position and to complete the Partners, Directors and Senior Officers Qualifying Examination (PDO).

Many Dealer Members appoint individuals to positions like Vice-President in recognition of seniority and accomplishment, even though they have no involvement in the actual management of the Dealer Member. They are first required to complete the PDO, which focuses on corporate governance issues in the securities industry that are irrelevant to their actual functions.

Changes to partnership structures have also made the current rules outdated. Partnership interests set up for compensation purposes but that do not include the ability to bind the partnership continue to be treated as full partnerships, requiring approval by IIROC and completion of the PDO.

The amended rules deal with these problems by focusing on the function of managing a Dealer Member rather than on specific titles. Those filling executive management functions,





the “mind and management” of the Dealer Member, will have to apply and be approved in the Executive category, whatever their title, and will continue to have to complete the PDO.

#### **4. Bringing the Ultimate Designated Person and Chief Compliance Officer categories into the approval system and making them consistent with NI 31-103**

Dealer Member Rule 38.1 requires the appointment of one of a Dealer Member’s senior management to the role of Ultimate Designated Person (UDP) to “be responsible to [IIROC] for the conduct of the firm and the supervision of its employees.” Those eligible to take the position are “its Chief Executive Officer, its President, its Chief Operating Officer or its Chief Financial Officer (or such other officer designated with the equivalent supervisory and decision-making responsibility).”

Dealer Member Rule 38.1 ensures that at least one person in a senior management position has direct, individual responsibility for compliance and supervision matters.

NI 31-103 adopts the UDP requirement, but requires that it be generally occupied by the Chief Executive Officer. The amendments include an amendment to Dealer Member Rule 38 to make it consistent with NI 31-103 in that regard. Dealer Members will be subject to the NI 31-103 provision therefore it would be impractical and confusing to retain the current Rule provision and risk having different people in the same role, one under NI 31-103 and the other under Dealer Member Rule 38.

NI 31-103 includes UDP and CCO as registration categories. At present Dealer Member Rule 38 requires a Dealer Member to appoint senior officers to those positions, but does not contain any requirement for them to be approved by IIROC to occupy those roles. The amendments require approval by IIROC of UDPs and CCOs, giving IIROC authority to refuse approval or grant it subject to conditions.

#### **5. Eliminating transfer of Approval delays**

The current process for an IR or RR to transfer from one Dealer Member to another involves an application for transfer filed through NRD and approved by IIROC. National Instrument 33-109 *Registration Information* (NI 33-109) establishes a new process under which individuals can have their registration automatically transferred from one registered firm to another within three months of leaving a sponsoring firm without having to re-apply for registration. Individuals can automatically transfer their registration if they do not change their registration category and the new sponsoring firm is registered in the same category and province and territory as the former sponsoring firm. The new process will generally eliminate any waiting time for the review and approval of a transfer application. The automatic transfer process





cannot be used, however, if (i) an individual has new information to disclose regarding regulatory, criminal, civil or financial matters; or (ii) an individual was dismissed, or was asked by his/her firm to resign, following an allegation of criminal activity or a breach of securities legislation or SRO rules.

The amendments will implement the same process for the transfer of Approved Persons between Dealer Members. As with the NI 33-109, automatic transfers will be made only when there is no change of category involved and the triggering events noted previously have not occurred.

Because there is generally no waiting for transfer of an approval, it is essential that IIROC have the power to act if it later receives information that calls into question the fitness or propriety of the transferring person. In most cases, such as when an investigation has been launched, information received may not be sufficient to deny or revoke approval, but raises enough questions to warrant putting conditions on the individual's approval until the matter is resolved. The most frequent conditions are close or strict supervision.

It is therefore important to ensure that IIROC has the authority to impose conditions on an existing approval. The amendments include changes to Dealer Member Rule 20.18 to make that authority clear.

## **6. Repeal or amendment of Outmoded or Redundant Provisions**

The amendments include deletion or amendment of the following outmoded provisions:

- Dealer Member Rule 7.4(c) requiring a Dealer Member to have two officers, at least one of whom must be full-time;
- Dealer Member Rule 7.7 regarding multiple employment of officers
- Dealer Member Rule 18.13 requiring notice of approvals by the Corporation to be sent to CSA members and SROs.
- Dealer Member Rule 18.14(b) requiring an undertaking by Dealer Members to supervise employees with outside business activities
- Dealer Member Rules 40.1(17) and (18), 40.10 and 40.13 governing requirements for the transition to NRD
- Dealer Member Rule 1300.3 regarding a reference to an IIROC approval category that no longer exists



- Dealer Member Rules 1300.5(e) and 1300.8(d) regarding use of a specific delivery method for a notice
- Dealer Member Rules 1800.2(e)(i) and (f)(i) requiring an office trading futures contracts or futures contracts options to have two people approved to do so
- Dealer Member Rule 1800.6 regarding dealings in futures with institutions and registered firms
- Dealer Member Rule 1900.4 and 1900.7 regarding opening and supervision of options accounts
- Dealer Member Rule 2500, Part VII.E regarding managed accounts

## **7. Miscellaneous changes**

The amendments include miscellaneous amendments designed to promote consistency and reflect current practice:

- References in Dealer Member Rules 7 and 18 to remuneration in relation to the placement or sale of securities are changed to refer to “securities related activities” to reflect the application of the Rules to ancillary activities that may fall outside of a strict definition of “placed or sale of securities.”
- A new Dealer Member Rule 1.3 has been added clarify that the onus for compliance with the Rules falls on both Dealer Members and their Approved Persons where the Rules refer only to Dealer Members. Similarly, Dealer Member Rule 18.2 has been amended to clarify the onus on both Dealer Members and individuals.
- In places such as Dealer Member Rule 18.2 where rules relating to securities also cover futures contracts, references to futures contract have been added.
- New Dealer Member Rule 18.6 limits the period during which an IR or RR can be restricted to mutual funds business.
- A replacement for Dealer Member Rules 18.16 and 18.17 regarding use of titles contains a general prohibition against the use of misleading titles or designations.
- Amendments to Dealer Member Rule 1300.4 regarding discretionary accounts makes controls on such accounts consistent with those on managed accounts
- An amendment to Dealer Member Rule 2700 amendments makes it consistent with NI 31-103 by incorporating into the definition of “Institutional Customer” the applicable



elements of “permitted clients” from NI 31-103. The provision is limited because it does not apply to the individuals that can be “permitted clients” under the proposed NI 31-103 definition.

- An amendment to Dealer Member Rule 2900, Part I A.6 adds options for the supervision of those managing discretionary portfolios during the first two years of their portfolio management, a period during which they would be in the category Associate Portfolio Manager under the current categories. The amendment permits the supervision to be done by a qualified person at another Dealer Member or a registered adviser under Canadian securities legislation.

## **V. Summary of changes since publication for comment in September 2008**

As a result of public comments, changes made to NI 31-103 and NI 33-109, and further internal review we have made a number of changes to IIROC’s Registration Reform Rule Amendments. The most notable changes being made include:

- The definition of “Executive” has been amended to clarify that it includes any senior officer in a senior managerial position who has significant authority over daily operations of a Dealer Member.
- The authority of District Council in Dealer Member Rule 20.18 has been amended to include the authority to revoke or suspend an approval at any time if it appears to the District Council that (i) the individual is not suitable for approval by reason of integrity, solvency, training or experience or has failed to comply with the Rules or Rulings of the Corporation; or (ii) the approval is otherwise not in the public interest. Rule 20.18 has also been amended to make clear that District Council cannot refuse an application for approval, impose terms and condition, or revoke or suspend an approval without giving the affected individual an opportunity to be heard.
- Dealer Member Rule 20.18 has been amended to expressly authorize District Council to delegate to IIROC Staff the authority to impose terms and conditions on an individual’s approval (either at the time of application or any time thereafter) or to refuse an application for approval. The change will permit IIROC Staff to deal with more routine approval issues that typically trigger the imposition of some form of heightened supervision.
- Dealer Member Rule 38.5 has been amended to clarify who can be designated as the Ultimate Designated Person (UDP) for a Dealer Member and the responsibilities of the UDP. Generally, the chief executive officer of a Dealer Member must be the firm’s UDP.



The changes made are intended to more closely align IIROC Dealer Member Rules with the requirements of NI 31-103.

- The roles and responsibilities of a Chief Compliance Officer set out in Dealer Member Rule 38.7 have been amended to align IIROC Dealer Member Rules more closely with the requirements of NI 31-103.
- Dealer Member Rule 40.7 has been amended to clarify that an individual's approval is automatically suspended when an individual ceases to have an employment, partnership or agency relationship with a Dealer Member. Dealer Member Rule 40.7 has also been amended to permit automatic reinstatement of an approval provided:
  - the individual transfers to another firm in the same approval category within 3 months of having left his previous firm;
  - there have been no changes to the information previously submitted in respect of items 13, 14, 15, or 16 of the individual's Form 33-109F4 since the individual's approval was suspended; and
  - the individual's employment, partnership or agency relationship with their former sponsoring firm did not end because the individual was dismissed for cause, or was asked by the firm to resign, following an allegation against the individual of: (i) criminal activity; (ii) a breach of securities legislation; or (iii) a breach of the rules of an SRO.

The changes made to Dealer Member Rule 40.7 are intended to align with the requirements and restrictions of NI 31-103 and NI 33-109.

- Dealer Member Rule 1300.2 has been amended to more precisely reflect the current industry practice as it relates to the collection of know your client information. Specifically, the wording now recognizes that because there are different suitability assessment requirements for Retail Customers, Institutional Customers, and suitability exempt accounts, the know your client information collection requirements are also different.
- Dealer Member Rule 2900 Part I has been amended to (i) require Supervisors of Registered Representatives and Investment Representatives to have successfully completed the Canadian Securities Course and the Conduct and Practices Handbook Course; and (ii) require Supervisors of Approved Person dealing with retail customers in options to have successfully completed the underlying proficiencies required to trade in options (i.e., The Derivatives Fundamentals Course and The Options Licensing



Course). The proposed changes respond to public comments received as well as feedback from the Education and Proficiency Committee.

- Schedule 1 to Dealer Member Rule 2900 Part III has been amended to align the existing continuing education requirements with the new IIROC approval categories. Part III of Dealer Member Rule 2900 was inadvertently not published for comment with the IIROC Registration Reform Proposals in September 2008 and the changes being made now are simply consequential in nature.

## **VI. Summary of the impact of the Amendments**

The amendments will make IIROC's Dealer Member Rules consistent with the goals of the CSA Registration Reform Project.

The amendments will give Dealer Members greater flexibility in designing their compliance systems. In doing so they may result in savings to Dealer Members by permitting them to take more efficient approaches. However, cost savings are not the objective of the amendments and IIROC will review changes to Dealer Member systems as part of its normal business conduct reviews to ensure that changes result in systems that are at least as effective as those prescribed by the current Dealer Member Rules.

The amendments will require Dealer Members to maintain extensive records of both Approved Persons and assignment of responsibilities. In the case of Approved Persons, some Dealer Members currently rely on the NRD System for their own record keeping in ways that they will not be able to after implementation of the proposed amendments. In that case the amendments may increase registration record keeping costs of some Dealer Members.

## **VII. Implementation Plan**

The amendments are to be implemented on September 28, 2009 with the exception of the change to the definition of "Registered Representative" and "Investment Representative" which will be implemented at the same time that IIROC's proposed changes to the definition of "securities related business" are implemented.

## **VIII. Appendices**

- [Appendix "A" sets out the text of the amendments to the applicable Dealer Member Rules.](#)
- [Appendix "B" sets out a summary of the comment letters received in response to the September 2008 Request for Comments. Appendix "B" also sets out the response of IIROC to the comments received.](#)



- [Appendix “C” includes a black-lined copy of the rule amendments against current rules.](#)