

  
**APR 11 2019**

**IN THE MATTER OF:**

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA**

**AND**

**TD WATERHOUSE CANADA INC.**

**NOTICE OF HEARING**

An initial appearance (“Initial Appearance”) will be held before a hearing panel (“Hearing Panel”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) pursuant to Sections 8203 and 8205 of the Consolidated Enforcement, Examination and Approval Rules of IIROC in this matter. The purpose of the Initial Appearance is to schedule a hearing (“Hearing”).

The Initial Appearance will be held on: Wednesday, June 5, 2019 at 10:00 AM.

The Initial Appearance will be held at: IIROC – Quebec Room  
121 King Street West, Suite 2000  
Toronto, Ontario

The Respondent must serve a Response (“Response”) to this Notice of Hearing and the Statement of Allegations dated April 11, 2019 (“Statement of Allegations”) in accordance with Section 8415 within 30 days from the effective date of service of this Notice of Hearing.

If the Respondent does not file a Response in accordance with Section 8415(1), the Initial Appearance may be immediately converted to a Hearing.

If the Respondent files a Response in accordance with Section 8415(1), the Initial Appearance will be immediately followed by an initial prehearing conference. In preparation for the prehearing conference, the Respondent must serve and file a prehearing conference form in accordance with Section 8416(5).

The purpose of the Hearing will be to determine whether the Respondent has committed the contraventions that are alleged by the staff of IIROC (“Staff”). The alleged contraventions are contained in the Statement of Allegations.

Pursuant to Section 8409, the Hearing will be conducted as a[n]:

- Oral Hearing
- Electronic Hearing
- Written Hearing

The Initial Appearance, the Hearing and all related proceedings will be subject to the Rules of Practice and Procedure as set out in Section 8400.

Pursuant to the Rules of Practice and Procedure, the Respondent is entitled to attend the Hearing and to be heard, to be represented by counsel or by an agent, to call, examine and cross-examine witnesses, and to make submissions to the Hearing Panel at the Hearing.

If the Respondent fails to serve a Response at the Hearing the Hearing Panel may, pursuant to Section 8415(4):

- (a) proceed with the hearing as set out in this Notice of Hearing, without further notice to the Respondent;
- (b) accept as proven the facts and contraventions set out by Staff in the Statement of Allegations; and
- (c) order sanctions and costs against the Respondent pursuant to Sections 8209, 8210 and 8214 and/or IIROC Dealer Member Rules 20.33 and 20.34.

If the Hearing Panel concludes that the Respondent did commit any or all of the contraventions alleged by Staff in the Statement of Allegations, the Hearing Panel may, pursuant to Sections 8209 and 8210 and/or IIROC Dealer Member Rules 20.33 and 20.34, impose any one or more of the following sanctions:

**Where the Respondent is/was a Dealer Member:**

- (a) a reprimand;
- (b) disgorgement of any amount obtained, including any loss avoided, directly or indirectly, as a result of the contravention;
- (c) a fine not exceeding the greater of:
  - (i) \$5,000,000 per contravention; and

- (ii) an amount equal to three times the profit made or loss avoided by the Dealer Member by reason of the contravention;
- (d) suspension of the membership or of the membership rights and privileges of the Regulated Firm, including a prohibition from dealing with clients for any period of time and on any terms and conditions;
- (e) imposition of any terms or conditions on the Dealer Member's continued membership, including on access to a Marketplace;
- (f) expulsion from membership and termination of the rights and privileges of membership, including access to a Marketplace;
- (g) a permanent bar to membership in IIROC;
- (h) appointment of a monitor; and
- (i) any sanction determined to be appropriate under the circumstances.

If the Hearing Panel concludes that the Respondent did commit any or all of the contraventions alleged by the Staff in the Statement of Allegations, the Hearing Panel may assess and order any investigation and prosecution costs determined to be appropriate and reasonable in the circumstances pursuant to Section 8214 and/or IIROC Dealer Member Rule 20.49.

**DATED** this 11 day of April, 2019.

  
\_\_\_\_\_  
NATIONAL HEARING COORDINATOR  
Investment Industry Regulatory Organization of Canada  
Suite 2000, 121 King Street West  
Toronto, Ontario, M5H 3T9

**IN THE MATTER OF:**

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY  
ORGANIZATION OF CANADA**

**AND**

**TD WATERHOUSE CANADA INC.**

**STATEMENT OF ALLEGATIONS**

Further to a Notice of Hearing dated April 11, 2019, staff of the Investment Industry Regulatory Organization of Canada make the following allegations:

**PART I – REQUIREMENTS CONTRAVENED**

Since December 31, 2015, the Respondent has failed to include position cost information within the quarterly client account statements for certain securities positions, contrary to the position cost calculation and disclosure requirements set out in clauses 200.2(d)(ii)(F) of Rule 200.

**PART II – RELEVANT FACTS AND CONCLUSIONS**

**Overview**

1. The Respondent is a Dealer Member and operates as a full service retail brokerage. The Respondent also offers order execution only services to retail customers through TD Direct Investing, a separate division of TD Waterhouse Canada Inc.

2. On February 29, 2008 IIROC (at the time known as the IDA) first provided notice to the industry that significant amendments to regulatory requirements regarding client reporting obligations, including the requirement to provide clients with individual position cost information would be made. These proposed amendments (collectively known as the Client Relationship Model, "CRM") were phased in over time. The requirement to provide clients with individual position cost information was part of the second phase of CRM ("CRM2").
  
3. Specifically, on December 31, 2015, IIROC implemented prospectively requirements to provide Retail Customers with cost information on a quarterly basis for all account positions held at the quarter end (the "Position Cost Requirements"). As of December 31, 2015, Dealer Members were required to disclose for each account position held:
  - (a) The actual amount paid by the client for the position (position cost)
  - (b) For positions added to the account prior to the effective date of the rule, one of:
    - (i) Position cost;
    - (ii) An estimate of position cost using the market value of the position at December 31, 2015 (2015 estimated position cost);
    - (iii) Where neither position cost nor estimated position cost could be determined, a notation within the account statement informing the client of this (not determinable notation).
  
4. The Respondent had the capability of becoming fully compliant with the Position Cost Requirements by December 31, 2015, However, in the spring of 2015 the Respondent identified what it considered to be potential litigation risks and client experience issues that might result from its proposed manner of implementing compliance with the Position Cost Requirements.

5. An alternative solution was proposed and approved in May 2015. The alternative solution included the acceptance of the business risk that a certain percentage (then believed to be approximately 8%) of client positions would be non-compliant with the Position Cost Requirements.
6. In order to mitigate the business risk, the project team responsible for the implementation of CRM2 was to develop, using internal resources, updated information technology that would bring the non-compliant account position information into compliance in mid-2016. The completion date for the proposed project was then delayed until 2017 and presently remains uncompleted.
7. The Respondent did not, at the time of making its decision, advise IIROC Staff or any other securities regulatory authority that a certain percentage of its client positions would be non-compliant with the Position Cost Requirements.
8. IIROC Staff only became aware of the non-compliance in April 2017 when it received a written complaint from a TD Direct Investing retail client alleging that the Respondent was not complying with the requirement to provide position cost information for all positions within his account.
9. IIROC Staff reviewed the complaint and concluded that the Respondent was not complying with the position cost calculation and disclosure requirements for all positions in the complainant client's account and the non-compliance was not limited to the complainant's account.
10. The Respondent advised that, due to the nature of the computer systems and data, its external service provider would take not less than approximately two years, at a cost of approximately \$10 million, to replace the non-compliant position costs with compliant position costs based on market values as at December 31, 2015, where available. The

Respondent has a pending exemption application to the IIROC Board of Directors with respect to the manner in which to address the non-compliant security positions going forward. IIROC Member Regulation Staff advised the Respondent that they expected the Respondent to take steps to mitigate the non-compliance with the Position Cost Requirements by replacing all remaining "N/D" non-compliant position costs in client statements with market values of the security positions as at December 31, 2018, where available, whether or not the exemption application is granted. The Respondent implemented that replacement.

### **Regulatory Background and Framework**

11. The implementation of CRM is an important regulatory initiative that coincided with amendments to National Instrument 31-103. The amendments to NI 31-103 are harmonized with IIROC CRM requirements.
12. Between 2008 and 2015, both IIROC and the CSA published multiple CRM notices and rule proposals. Each publication included the opportunity for stakeholders to provide comments on the proposed rules. The Respondent submitted comments in response to CRM Notices published in February 2008, April 2009 and January 2011.
13. Implementation of the requirement in CRM2 to provide quarterly position cost information reporting on client positions was announced on January 19, 2015 with an intended implementation date of July 15, 2015. On June 11, 2015, the industry was advised that the effective date had been revised to December 31, 2015.
14. The primary purpose of the CRM2 client reporting obligations is to provide clients with full and complete information regarding their portfolio holdings and to better equip the client to assess how their account assets are performing. In turn, clients can make more informed investment decisions.

15. As part of the CRM2 client reporting obligations, the Respondent is required to provide Retail Customers with cost information for each position within their account on a quarterly basis, in accordance with new specific definitions.
16. Specifically, as of December 31, 2015 firms were required to disclose for each account position held:
  - (a) The actual amount paid by the client for the position (“position cost”) calculated in accordance with either the “book cost” or “original cost” definitions set out in IIROC Dealer Member Rule subsections 200.1(a), 200.1(b) and 200.1(e)
  - (b) For positions added to the account prior to the effective date of the rule, one of:
    - (i) position cost;
    - (ii) an estimate of position cost using the market value of the position as at December 31, 2015; (“2015 estimated position cost”); or
    - (iii) where neither position cost nor estimated position cost could be determined, a notation within the account statement informing the client of this (“not determinable notation”).
17. Prior to the new CRM2 requirement coming into effect, the Respondent provided information to clients regarding the cost of securities (book value) on their monthly statements. In many (but not all) instances the book value of a security was the same as book cost, one of the acceptable calculations for position cost as required by CRM2.

#### **Discovery of the Non-Compliance: Client Complaint and FinOps Field Examination**

18. On April 14, 2017, IIROC staff received a complaint from a client of the Respondent that the position cost of certain securities was not provided on his account statements.
19. The issue raised in the client complaint was referred to IIROC Financial Operations staff



who were in the process of performing a routine Financial and Operations Compliance Field Examination (“FinOps Field Examination”).

20. In early June 2017, FinOps Staff members first discussed the book cost issue with Staff members of the Respondent. FinOps Staff was advised that there had been recent turnover in the “book cost” department and the person responsible for the book cost issue during CRM2 implementation was no longer employed by the Respondent. Members of the Respondent’s compliance department agreed to address the issue.
21. The field work for the FinOps Examination was concluded on June 23, 2017. During the Exit Interview conducted at that time, FinOps Staff indicated that the book cost issue would be reported as a finding on the formal Examination Report and also noted that FinOps Staff had not yet been able to speak with anyone from the Respondent regarding the extent of the non-compliance or how it would be resolved.
22. In mid-July 2017 in response to further follow up by FinOps Staff, the Respondent advised that it was continuing to work on resolving the book cost issue but were also at that time resolving other CRM2 reporting issues that were considered to be of greater urgency. The book cost issue had not been thoroughly investigated and the Respondent was not yet able to determine the extent of the non-compliance or provide a timeline as to its resolution.
23. In early August 2017, the Respondent advised FinOps Staff that it continued to work on resolving its CRM2 reporting issues, including the book cost issue.
24. At the end of September 2017, the Respondent advised FinOps Staff that it had a proposed solution to the book cost issue and that it was committed to providing the funding and resources to implement necessary changes to the account statements, but in light of the fact that the necessary changes required the involvement of Staff Members

with intimate knowledge of the Respondent's operating platforms, the estimated timeline for delivery of the resolution was September 30, 2018.

25. On October 11, 2017, FinOps Staff issued its final examination report (the "Examination Report"). The Examination Report noted as a deficiency that certain positions on client statements provided by the Respondent to its clients showed cost as "N/D". The positions were noted to be mainly US dollar listed securities for which market value could be easily determined.
26. On October 16, 2017 FinOps Staff met with representatives of the Respondent to discuss certain CRM2 issues, including the book cost issue. The Respondent indicated that its proposed resolution would involve the creation of a new column on account statements for book cost that fully complied with Rule 200. The existing column on account statements contained values that had been used by clients in the past and the Respondent preferred to leave that column intact.
27. The Respondent further indicated that the proposed solution would take up to a year to implement because its systems were more complicated and they were also in the process of resolving certain other CRM2 reporting issues.
28. On November 16, 2017 the matter was referred by FinOps Staff to IIROC's Enforcement Department. Prior to the referral to Enforcement, the Respondent made no mention of its decision to "accept the business risk" that approximately 8% of client positions might be non-compliant with the Position Cost Requirements.

#### **Staff's Investigation and the Respondent's Compliance Efforts Regarding the Position Cost Requirements**

29. During the course of Staff's investigation documentation was provided by the

Respondent regarding its efforts to comply with the Position Cost Requirements and the reason for its non-compliance.

30. In order to guide the implementation of CRM2 by a project team or teams, the Respondent put in place an Executive Steering Committee (the “CRM2 ESC”). Although there was some overlap in their compositions, the CRM2 ESC reported to the Wealth Risk Committee (“WRC”), which included senior personnel and the Respondent’s Ultimate Designated Person.
31. On December 14, 2014, in anticipation of the pending CRM2 changes, the Respondent requested an estimate from its external IT service provider for requirements for the implementation of CRM2. The requested estimate included preparation for a one-time reset or “overwrite” of the “book value” to “market value” for three types of securities, which the Respondent thought at the time were not compliant with Position Cost Requirements:
  - (a) Adjusted Positions – those for which the book value had been adjusted at the request of the client.
  - (b) Invalid Positions – those for which there was a processing issue that created an “Invalid” flag associated with the book value.
  - (c) Zero Positions – those for which the book value was either zero or invalid, in either case resulting the book value showing as “N/D” on client statements.
32. The Respondent’s external IT service provider gave its estimate on December 22, 2014 and was instructed to proceed with preparation for the “overwrite”.
33. The computer code to effect the conversion was provided in September 2015 and put into production and turned on during the weekend of November 20, 2015. From that date on, the Respondent had the functionality to “overwrite” the book values of the

three types of security positions noted above to market value as at December 31, 2015.

34. Implementing these changes would have resulted in the Respondent having been compliant with the Position Cost Requirements.

### **Relative Magnitude of Positions Requiring Remedy to become CRM2 Compliant**

35. As of January 16, 2015, the Respondent had 10,645,940 security positions on its books.

The Respondent believed that (approximately) the following positions would need to be addressed in order to be compliant with the Position Cost Requirements:

- (a) 343,088 or 3.2% were Adjusted Positions
- (b) 100,415 or 0.9% were Invalid Positions
- (c) 414,578 or 3.9% were Zero Positions

### **Identification and Evaluation of Alternatives**

36. In early 2015, the CRM2 ESC consulted with interested internal departments and considered options available to the Respondent to achieve compliance with the Position Cost Requirements.
37. At its February 10, 2015 meeting the CRM2 ESC noted that the Respondent had been considering a two column solution to deal with CRM2 position costs (the "Two Column Solution"). The first column would retain existing book value information for clients (which could be used for Canada Revenue Agency tax reporting requirements) and the second column would contain CRM2 position cost information. The CRM2 ESC noted that the Two Column Solution could not be implemented within required regulatory

timelines.

38. At its March 10, 2015 CRM2 ESC meeting, specific concerns were identified to the CRM2 ESC that resetting or “overwriting” of book values with market value could lead to litigation risk and/or a client experience issue for clients who rely on Book Value information for tax purposes”. The CRM2 ESC was presented with a table setting out the number of TDW client positions that the Respondent believed at the time may have to be reset to market value to comply with the Position Cost Requirements. These figures are those set out at paragraph 35 above and total approximately 8% of client positions.
39. The Respondent considered strategies to mitigate this perceived risk, including:
  - (a) The contacting of clients ahead of any reset to allow for an opportunity to substantiate adjustments (which had been suggested by the CRM2 ESC); and
  - (b) The capturing of a “snapshot” of values prior to any overwrite and ensuring that this information was retained and accessible for an appropriate period of time (which had been suggested by the Respondents’ Corporate Tax Department).
40. The Respondent did not elect to perform the resetting or “overwriting” of book values with market values in conjunction with either of these mitigation measures.
41. However, the CRM2 ESC decided to solicit requirements from its external IT service provider and the Respondent’s internal IT resources to assess the time and cost for the Two Column Solution.

#### **The External IT Service Provider**

42. On March 24, 2015 the Respondent requested an estimate from its external IT service

provider for the Two Column Solution project. The Respondent received its estimate on April 30, 2015.

43. The Rough Order of Magnitude estimate from the external IT service provider was approximately \$5,500,000 and it was also noted that the project could not be delivered in 2015. Together with other costs, the total expenditure for that external solution was identified as approximately \$11,200,000.
44. At its May 6, 2015 meeting the CRM2 ESC considered the various alternative solutions to the position cost issue.
45. The preferred option by the CRM2 project team was to “repurpose existing book value as book cost”. The CRM2 project team again noted that this proposed solution “will incur some risk as Book Values reported for approximately 8% of positions will be previously adjusted – these are not in line with IIROC Book Cost definition” and would not comply with the Position Cost Requirements.
46. The CRM2 project team also recommended a second phase to the proposed solution. This involved the internal development of the second column to be included on account statements. The second column would include “original cost” information and would result in any remaining non-compliant client account position information becoming CRM2 compliant. The delivery for the internal second column solution was initially expected to be completed by mid-2016, six months after the Position Cost Requirements would come into force.
47. The project team advised that this preferred option could be accomplished through the Respondent’s internal IT resources and would not require the use of the external IT service provider.

48. The proposal recommended by the CRM2 project team was approved by the CRM2 ESC at its May 11, 2015 meeting.
49. The Respondent's WRC was advised of the CRM2 ESC's decision and of the expected implementation by mid-2016 at its meeting of May 21, 2015. The WRC noted that the "business has accepted the risk that approximately 8% of the book values reported will not initially comply with CRM2 position cost requirements" and that to "address the risk going forward, the project team will be building an original cost field in ISM (expected to be completed mid-2016)".
50. At this point, the Respondent did not notify IIROC Staff of its decision or its recognition that the position cost information for some account statement positions would not be compliant with CRM2 requirements, or that its proposed solution was anticipated to be implemented in mid-2016.
51. In August 2015, the target timeline for the presentation of the second column information was extended from mid-2016 to Q4/2016. In November 2015, the expected implementation was described as "2016/2017".
52. On November 20, 2015, the computer code described earlier in paragraph 33 was put into production and activated. From that date on the Respondent had the functionality to comply fully with the Position Cost Requirements. The Respondent did not convert the non-compliant position cost information because it still intended to proceed with the Two Column Solution in 2016/17.
53. Although the Respondent continued to work on other aspects of CRM2 compliance in 2016, its proposed Two Column Solution was never implemented.

## The Extent of Non-Compliance and Current Status

54. At the request of Enforcement Staff, the Respondent has made inquiries as to the extent of non-compliance with the Position Cost Requirements. The Respondent has advised that due to limitations of the computer systems and data, a precise estimate of the extent of non-compliance is not possible.
55. The Respondent has indicated that as of May 25, 2018:
- (a) 309,616 security positions were coded "N/D";
  - (b) These 309,616 positions were held by 179,252 clients in 192,337 unique accounts;
  - (c) The 309,616 securities are comprised of 19,612 unique securities of which 9,135 had a market value as of May 25, 2018;
  - (d) Some of the positions coded "N/D" would be properly categorized as such and are compliant with the Position Cost Requirements, but it is not possible to determine this figure with precision without its external IT service provider undertaking a two year rebuild project at a minimum cost of \$10,000,000.
56. In light of the length of time required to achieve full compliance with the Position Cost Requirements and its apparent computer systems and data limitations, the Respondent has a pending exemption application to the IIROC Board of Directors with respect to the manner in which to address the non-compliant security positions going forward.
57. Effective December 31, 2018, the Respondent replaced all N/D position costs in client statements with market values of the security positions as at December 31, 2018, where available, as directed by IIROC Member Regulation Staff.



## **Conclusion**

58. The Respondent made a deliberate decision to accept a business risk that it believed would result in approximately 8% of client positions being non-compliant with the Position Cost Requirements. Plans to remedy that non-compliance have not been implemented and the Respondent now seeks an exemption from the IIROC Board to permit it to provide clients with market value data as at December 31, 2018 as an estimate of position cost rather than as at December 31, 2015 as required by Rule 200.

**DATED** at Toronto, Ontario this 11th day of April, 2019.