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Contact:

Madeleine A. Cooper
Policy Counsel, Member Regulation Policy
Telephone: 416.646.7203
e-mail: mcooper@iiroc.ca

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Account Supervision Guidance

Executive Summary

In this Guidance Note, we set out IIROC's expectations for Dealer Member (**Dealer**) supervision of client account activity.

Registered Individuals¹ are primarily responsible for compliance with business conduct requirements. However, Rule 3900 requires Dealer supervision of account activity to ensure compliance with IIROC requirements, securities laws and other applicable laws. The standards in Rule 3900 provide Supervisors with guidelines to monitor the handling of these responsibilities by Registered Individuals.

Dealers' supervisory structures should include policies and procedures that address screening of trading activity to detect issues for further enquiry or investigation. A Dealer is not required to enquire into or investigate every trade that meets the criteria in Rule 3900 or this Guidance, but should exercise reasonable judgment in selecting items for further investigation.

¹ In this guidance, "Registered Individual" refers to Registered Representatives, Investment Representatives, Portfolio Managers and Associate Portfolio Managers.



This Guidance focuses on the requirements in Rule 3900 of the IIROC Rules² - *Supervision*. Guidance on IIROC's Universal Market Integrity Rules' (**UMIR**) trading supervision requirements can be found in [Notice 17-0190](#).

Related Projects

In IIROC's Three Year Strategic Plan and Priorities for Fiscal 2020³, we discuss modernizing our approach to supervision. Generally, our supervisory requirements are technology neutral and we support Dealers using automation to assist them with supervisory tasks. It is reasonable to think that as Dealers' technological capabilities improve, they will be able to supervise accounts on a more comprehensive basis. However, we have received requests from industry participants for more clarity about how our rules are to be applied to evolving business models and processes (e.g. the use of algorithm logic). Consequently, we are working on a number of separate projects to modernize our approach to supervision and provide the clarity industry is seeking. This work will result in, among other things, new guidance and updates to this Guidance. In the meantime, we encourage you to contact us if you have any questions relating to this topic.

² In this guidance, all rule references are to the IIROC Rules unless otherwise specified.

³ See IIROC Notice [19-0099](#) – *IIROC'S Three Year Strategic Plan and Priorities for Fiscal 2020*



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1. Supervision of client accounts

Part B of Rule 3900 sets out the general requirement for Dealers to establish and maintain written policies and procedures for supervising accounts, which includes its supervision standards and account activity review steps. Parts C through G of Rule 3900 contain more specific supervision requirements for different account types⁴. For example, Part C contains the requirements for supervision of retail client accounts, and Part G contains those for managed and discretionary accounts.

1.1 Supervisory structure

1.1.1 General considerations

- a) An effective supervisory structure considers the Dealer's business model, which includes the following factors:
 - types of products traded and securities offered,
 - type of trading the Dealer and its Registered Individuals engage in,
 - location of the Dealer's Supervisory personnel and its Registered Individuals, and
 - the different functions their Supervisors may be responsible for.
- b) The Dealer's supervisory system should enable Supervisors to properly fulfill their functions.
- c) Supervisors should have access to the information necessary to properly conduct their supervision. To review client accounts, this includes readily accessible client and account activity information, including:
 - receipts,
 - deposits,
 - withdrawals, and
 - journal entries.
- d) Supervisors should have the authority to take effective and timely remedial action when they detect activity that falls or appears to fall outside the bounds of proper conduct, just and equitable principles of trade or good business practice. We consider escalating to a more senior Supervisor or Executive an acceptable action.

1.1.2 Considerations when appointing Supervisors

When appointing Supervisors, Dealers should consider the following:

⁴ Part C – Supervision of retail client accounts, Part D – Supervision of institutional client accounts, Part E – Supervision of order execution only accounts, Part F - Supervision of options, futures contracts and futures contract options trading accounts and Part G - Supervision of discretionary accounts and managed accounts.



- a) Supervisors must be qualified to supervise trading activity in all products traded by those under their supervision.⁵ If a Supervisor is unqualified to supervise trading activity in certain products by those under their supervision, a Dealer may divide the supervision between two or more Supervisors, provided:
- there are appropriate mechanisms for them to communicate with one another,
 - the system ensures the Dealer maintains an overall view of the client's situation and activity, and
 - the assignment of responsibilities is clear and complete.

Dealers can also appointment a primary Supervisor that other Supervisor(s) advise on the activity the primary Supervisor is unqualified to supervise.

- b) Dealers must provide back-up during Supervisors' absences.⁶ For any prolonged Supervisor absences, the back-up Supervisor(s) should be aware of any specific ongoing issues they need to monitor.
- c) Dealers should ensure that where a Supervisors is dually-registered and also advises or trades for their own clients, another Supervisor reviews that Supervisor's advice to and trades for clients.

1.1.3 Considerations specific to retail business outside head office

Dealers conducting retail business outside their head office should consider the following:

- a) Resident Supervisors⁷ are best positioned to know the Registered Individuals in their office, meet clients, understand local conditions and needs, facilitate timely approval of new accounts and respond immediately to issues. However, Dealers can determine the necessity of a resident Supervisor based on:
- the number of Registered Individuals in the location,
 - Registered Individuals' experience in the location,
 - the business conducted in the location,
 - Supervisor availability in nearby locations, and
 - other systems and controls mitigating remote supervision risk.
- b) Business locations without Resident Supervisors should have an assigned outside Supervisor. The outside Supervisor should visit the location periodically to review business

⁵ See subsections 2602(2) and 3905(5).

⁶ See subsection 3925(4).

⁷ "Resident Supervisors" are Supervisors who work in a specific Dealer branch office.



conduct and compliance with applicable laws. Dealers' policies and procedures should specifically address these outside Supervisor visits.

1.2 Retail account activity supervision policies and procedures

The following should be considered when developing policies and procedures addressing the supervision of retail client accounts, as required by Part C of Rule 3900:

- a) Dealers may conduct their reviews on a pre-trade or post-trade basis. A robust pre-trade review process may lessen or remove the need for post-trade reviews.
- b) Review procedures should cover all retail account types. For example, a Dealer who offers commission and fee-based accounts cannot select accounts for review solely based on commission levels, they should also have a procedure for selecting fee-based accounts.
- c) Patterns of activity may not be apparent by reviewing single trades. If a Dealer reviews trades over a longer period, they may detect issues with the overall account activity even if each trade is suitable for the client.
- d) Dealers should review non-trade issues such as late payment, margin problems, trade cancellations or suspicious transfers and flows of funds or securities.
- e) Dealers may use a risk-based approach to select the activity for post-trade review, provided the reviewer has all relevant information they need to assess the risk. They can also use this approach to determine the review period. A Dealer may determine some clients present a higher risk of improper market activity, such as those who have access to material non-public information about issuers, holders of control blocks of public issuers and market professionals.
- f) Dealers should include employee and agent account activity in their review.
- g) Dealers should review accounts on a timely basis. Their timing should be designed to identify matters requiring attention as quickly as possible.
- h) During a review, Supervisors should have access to and consider information about clients that may present a higher risk of improper market activity.
- i) Dealers can use technology to select specific activity for review.

2. Two-tier reviews

Based on their business model, Dealers may choose to use a two-tiered trade review system as described in this Guidance. We traditionally considered a two-tier system of post-trade activity review acceptable for Dealers with multiple business locations conducting retail account activity. However, other supervisory systems can be used based on the Dealer's business model provided they meet our



daily and monthly trade supervision requirements⁸. We invite any Dealer considering a different supervisory system to speak with us.

2.1 First-tier reviews

Resident Supervisors will normally conduct the first-tier review at their respective business location. Dealers can conduct these reviews in a central location (head office or regional office) provided:

- there are resources available to conduct the review at that location, and
- the Dealer has adequate procedures for dealing with any issues identified.

2.1.1 Daily reviews

Dealers should design their first-tier daily review of the previous day's trading to detect the issues in section 3945. They should complete this review one business day after the trading activity occurs, unless precluded by unusual circumstances.

2.1.2 Monthly reviews

A first-tier monthly review should cover the same areas as daily activity reviews. Dealers may not be able to review every retail account statement produced. A first-tier monthly review starts with the selection of retail client accounts. Dealers should design this selection to detect improper account activity. For example, a Dealer could review the activity of all clients charged gross commissions of \$1,500 or more for that month.

A first-tier monthly review should include all non-client accounts with any activity other than dividend and interest payments.

Dealers should complete this review within 21 days of the review period, unless precluded by unusual circumstances.

2.2 Second-tier reviews

While a Dealer's head office will normally conduct the second-tier review, a regional office could also conduct it. Second-tier supervision has a different purpose and is generally not at the same depth as first-tier supervision. Dealers should design their second-tier supervision to:

- ensure no serious account issues were missed by first-tier supervision, and
- ensure first-tier supervision is conducted adequately.

Where the second-tier reviews are conducted by personnel who do not have the authority to resolve the issues they identify, the Dealer should have procedures for referring these issues to a Supervisor who has the appropriate authority.

⁸ See subsection 3945(1).



2.2.1 Daily reviews

Dealers should include criteria for trading activity subject to second-tier daily reviews in their policies and procedures. For example, the following criteria would satisfy Rule 3900:

- stock trades with a value over \$5,000 and a price under \$5.00 per share,
- stock trades with value over \$20,000 and a price at or over \$5.00 per share,
- bond trades over \$100,000 value per trade,
- non-client trading,
- producing branch managers' client accounts,
- all client accounts not reviewed by a branch manager,
- trade cancellations,
- restricted account trading,
- suspense account trading,
- account number changes,
- late payments, and
- outstanding margin calls.

Dealers should complete this review one business day after the activity occurs, unless precluded by unusual circumstances.

2.2.2 Monthly reviews

Dealers should select accounts for second-tier review based on criteria in their policies and procedures. For example, the following review criteria would satisfy Rule 3900:

- accounts of clients charged more than \$3,000 in commission during the month, and
- accounts of all clients and non-clients charged more than \$1,500 in commissions during the month not subject to a first-tier level review, including producing first level Supervisors' client accounts.

Dealers should complete this review within 21 days of the review period, unless precluded by unusual circumstances.

3. Other activity

Dealers must have policies and procedures that address identifying, dealing with and keeping first level Supervisors informed about other client related matters such as:

- client complaints,
- cash account violations,
- transfers of funds and securities between unrelated accounts or between non-client and client accounts or deposits from non-client to client accounts, and



- trading while under-margined.⁹

4. Applicable rules

IIROC Rules this Guidance Note relates to:

- Rule 3900.

5. Related notices

This Guidance relates to:

- [Notice 19-0201](#) – AML Compliance Guidance.

This Guidance Note was published under [Notice 20-0007](#) – Notice of Approval/Implementation – Guidance Review Project – Group 1.

⁹ See subsection 3946(1).