

To Independent Directors of the  
Investment Industry Regulatory Organization of Canada

From Hansell LLP

Date August 31, 2020

Subject **Capital Markets Modernization Taskforce Consultation Report  
Proposals re Self-Regulatory Organizations**

The establishment of the Capital Markets Modernization Taskforce (the "Taskforce") by the Minister of Finance earlier this year was an important step in the modernization of the capital markets in Ontario. The work of the Taskforce is the first of its kind since the report of the Five Year Review Committee<sup>1</sup> in 2003 (the "Five Year Review Report"). The Taskforce issued a consultation report (the "Consultation Report") in July 2020, identifying more than 70 key issues and proposals. You have asked us for our views on the proposals set out in Section 3 of the Consultation Report as they relate to the Investment Industry Regulatory Organization of Canada ("IIROC") (the "Proposals").

Our analysis and resulting views are set out below. Our principal concern is with the impact that the Proposals could have on IIROC's effectiveness as a recognized self-regulatory organization ("SRO"). In order to regulate its members (the "Members"), IIROC must have the authority to carry out its public interest mandate and be seen by its stakeholders to have that authority. The Proposals (if implemented) could compromise the confidence that the capital markets have in IIROC's authority to regulate as well as IIROC's actual authority to discharge its mandate.

### 1. Background

#### (a) IIROC

IIROC is the national SRO that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. The Members are investment dealers and marketplaces. IIROC operates in accordance with the *Securities Act* (Ontario) (the "Act") and other securities laws in place across Canada. The Ontario Securities Commission (the "OSC") serves as IIROC's Principal Regulator.

IIROC is subject to recognition orders made by the OSC and other provincial and territorial securities regulators. Although each provincial and territorial securities regulator retains

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<sup>1</sup> This committee was established pursuant to section 143.12 of the *Securities Act* (Ontario) R.S.O. 1990, c. S-5.

independent authority over IIROC, they coordinate their exercise of that authority through the protocols set out in their Memorandum of Understanding Regarding IIROC Oversight.

Since the Taskforce's final report will be addressed to Ontario's Minister of Finance, we refer in this opinion to the recognition order made by the OSC (the "Recognition Order").<sup>2</sup> We are not aware of any material differences between the Recognition Order and the recognition orders relating to IIROC made by any other securities regulator with respect to the issues discussed in this memorandum. For the same reason, we refer to the Act and to the OSC.

(b) Self-Regulatory Model

In making the Recognition Order, the OSC made the important determination that IIROC's Members should regulate themselves. Ontario uses the self-regulatory model for many professions, including law, accounting, medicine and nursing. The Five Year Review Committee noted in its report:

There is an important role for self-regulation in the securities industry. Self-regulation permits the Commission to assign certain regulatory responsibility for setting and enforcing standards of behaviour of registrants to an organization established by such registrants. Self-regulation permits individuals with the most knowledge about an industry to develop policies and rules for that industry. Enforcement of the rules is likely to be more effective as well, as the regulated entities are more likely to accept rules drawn up by the people with the most experience and expertise in the area.<sup>3</sup>

The concept of self-regulation contemplates that the organization representing industry members will regulate in the ordinary course without first seeking the approval of the regulator (or government) from which it derives its authority. The regulator (or government) must decide how to exercise the control and oversight over the industry organization that it believes is necessary, while allowing the self-regulatory model to operate effectively.

## 2. Current Balance of Oversight and Self-Regulation

In order to provide context for our comments on the Proposals, we have set out below an overview of IIROC's governance structure and certain aspects of IIROC's business operations with particular reference to the role that the OSC plays in these matters. We also provide an overview of IIROC's reporting requirements. A more detailed discussion of each of these matters is set out in the Schedule to this memo.

(a) OSC's Oversight of IIROC's Governance

IIROC's governing statute (the *Canada Not-for-Profit Corporations Act*), IIROC's By-Law No. 1 (the "By-Laws") and the Recognition Order establish requirements for IIROC's governance. We discuss below certain requirements of the Recognition Order as well as how IIROC's governance currently functions within those requirements.

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<sup>2</sup> (2018), 41 OSCB 3009.

<sup>3</sup> Five Year Review Committee Final Report, "*Reviewing the Securities Act (Ontario)*" (March 21, 2003), at p. 109.

(i) Requirements Under the Recognition Order

The Recognition Order requires IIROC to ensure: effective oversight of the entity; fair, meaningful and diverse representation on the Board and its committees; a proper balance among the interests of the different people and companies subject to IIROC's regulation; and that each director or officer is a fit and proper person. The Recognition Order also establishes more specific requirements with respect to IIROC's governance and requires OSC approval prior to key changes to IIROC's governance structure, including to its articles and by-laws.

(ii) IIROC's Governance Under the Recognition Order

The Members elect the members of the board (each, a "Director"). The Board is comprised of the chief executive officer (the "CEO") and fourteen other individuals elected by the Members, including two marketplace Directors, five dealer Directors and seven independent Directors. This provides a balance on the Board between industry experts and independent members. Directors are elected for two-year terms and may serve up to eight consecutive years. The Board is supported by three standing committees: the Corporate Governance Committee ("CGC"); the Finance, Audit and Risk Committee; and the Human Resources and Pension Committee.

The CGC is comprised of only Independent Directors.<sup>4</sup> The CGC recommends to the Board, individuals for election to the Board. In formulating its recommendations, the CGC considers candidates' ability to contribute a range of knowledge, skills and experience, with a regard for the required composition of the Board and representation of IIROC's various stakeholders. The CGC has developed a skills matrix to inform its consideration of Board candidates. That skills matrix includes factors such as, capital markets experience, regulatory experience, and skills and expertise including, governance and investor protection. The CGC Charter also provides that the Committee will consider whether Director candidates have been independent of the industry and IIROC for at least a year before being nominated as an independent Director. We understand that IIROC has adhered to this one-year 'cooling-off' period for independent Directors in all but one instance, where particular circumstances warranted an exception in the best interests of the organization.

IIROC also has ten District Councils that represent all of the provinces and territories. The District Councils provide regional input into the regulatory process, including policy matters, and raise issues of regional interest. The District Councils also have a role in respect of registration and membership matters. The Board has also appointed six Advisory Committees that consult with IIROC on the development of rules and guidance, as well as providing an opportunity for industry to share experiences, information and ideas, and provide input to IIROC.

IIROC's Investor Research Panel is a pool of 10,000 Canadian investors who provide direct input to IIROC through qualitative online surveys conducted by an independent, external research firm. Most recently, IIROC announced plans to establish an Expert Investor Issues Panel, which will enable individuals with a wide variety of experience and expertise related to investors to provide input.

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<sup>4</sup> While the CGC Charter provides that a non-Independent Chair of the Board may be a member of the CGC, IIROC has never had an industry Director on the CGC.

The Board appoints the CEO and oversees the work of the CEO and the management team. It also sets the terms of employment and remuneration of the CEO.

(b) OSC's Oversight of IIROC's Business Operations

Under the Act, the OSC has broad discretion to review IIROC's business operations. Among other things, the OSC "may, if it is satisfied that to do so would be in the public interest, make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized self-regulatory organization." In addition, the OSC's Executive Director or anyone directly affected by a direction, decision, order or ruling made by a recognized SRO may apply to the OSC for a hearing and review of the direction, decision, order or ruling.

The Recognition Order provides that prior OSC approval is required for material changes to, among other things, IIROC's fee model, the functions IIROC performs and its agreements with marketplaces. The Recognition Order also prescribes requirements for IIROC's decision process with respect to membership, registration or enforcement matters and prescribes detailed requirements for how IIROC performs its regulatory obligations and conducts its business.

Beyond the requirements in the Recognition Order, IIROC has instituted its own processes to further engage the Canadian Securities Administrators (the "CSA") by, for instance, inviting the CSA to provide input into IIROC's internal audit planning process and otherwise having regular contact with CSA members, including the OSC, throughout the year.

Accordingly, the oversight authority in the Act, the provisions of the Recognition Order, and IIROC's additional processes for engagement together provide the OSC with extensive means of control over IIROC's business operations.

(c) IIROC Reporting to the OSC

The Recognition Order requires IIROC to provide the OSC with detailed reporting and to provide any additional reports, documents and information requested by the OSC.

The reporting requirements set out in the Recognition Order are extensive and specific. They include prior notice of significant transactions, immediate reporting on disciplinary events or any Member's resignation, and prompt notice of specified events and circumstances concerning IIROC or its Members. IIROC is also required to provide regular reporting on details of its operations and the conduct of its business, as well as self-assessments and proposals for improvements. IIROC must file its annual report with the OSC with a certification by IIROC's CEO and General Counsel that IIROC is in compliance with certain terms and conditions under the Recognition Order.

IIROC must also provide a number of governance documents and reports to the OSC, including: the results of any corporate governance review;<sup>5</sup> any material changes to the code of business

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<sup>5</sup> The Recognition Order requires IIROC to "review the corporate governance structure, including the composition of the Board, at the request of the Commission, to ensure that there is a proper balance between, and effective representation of, the public interest and the interests of marketplaces, dealers and other entities desiring access to the services provided by IIROC". Recognition Order, Appendix A, s. 5(a)(iii). The CGC

ethics and conduct and the Board's conflicts of interest policy; changes to the Board; IIROC's budget; and enterprise risk management reports.

### 3. Taskforce Proposals

We have considered each of the Proposals in the context of the existing relationship between IIROC and the OSC. We have considered the Proposals in particular with regard to the balance between mechanisms for accountability to the OSC and the independence required for effective self-regulation of the investment industry. We have addressed each Proposal in the order in which it appears in the Consultation Report.

#### (a) Submitting Annual Business Plan to OSC for Approval

The Taskforce proposed that IIROC be required to submit to the OSC for approval, an annual business plan covering all activities conducted in Ontario for approval by the OSC be added to the Recognition Order. We note that IIROC is already required to provide key planning documents to the OSC, including its annual budget,<sup>6</sup> annual internal audit plan<sup>7</sup> and compliance examination plan.<sup>8</sup> These documents are provided to the OSC for information, not for approval.

Each year, IIROC publishes a statement of priorities under its strategic plan. Both the strategic plan and the statement of priorities are developed by management and approved by the Board, as appropriate. As is the case with any planning tool, the statement of priorities is the result of an iterative process between management and the Board. It sets out the organization's short-term plan for executing on its strategic plan and for achieving its vision. The Board's approval of the statement of priorities reflects the Board's understanding of management's goals and assessment of risk as well as its own views of management's capabilities and resources in connection with the statement of priorities presented to it by management.

A requirement that the OSC approve the statement of priorities raises a number of issues. The statement of priorities is an integrated whole. Pulling out one piece (or substituting one piece for another) may require a broader rework (which would also be subject to review by the OSC). If the OSC were to require changes to the statement of priorities as a condition of its approval, those changes could require further review by IIROC of other assumptions and priorities reflected in the statement. Alternatively, IIROC may be required to move forward with a statement of priorities that has been approved by the OSC, but which is not fully supported by management or the Board. This may strain or divert resources in a way that compromises some aspects of those priorities. The OSC's review of the statement of priorities would not have the benefit of the discussions that led the Board to approve that document.

The Recognition Order does not currently require IIROC to provide a business plan (or its statement of priorities) to the OSC. In our view, amending the Recognition Order to require IIROC to formally provide the statement of priorities to the OSC is entirely appropriate. However, because the OSC would not have the background or context to approve the statement of priorities, we do

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published governance reviews in 2010 and 2014, and annually considers the need for an updated governance review.

<sup>6</sup> Recognition Order, Schedule 2, s. 7(a)(iv).

<sup>7</sup> Recognition Order, Schedule 2, s. 7(a)(viii).

<sup>8</sup> Recognition Order, Schedule 2, s. 7(a)(x).

not think that the Recognition Order should be amended to require OSC approval of the statement of priorities. In Section 4 below, we discuss the additional complications of all securities regulators (and not just the OSC) having the authority to approve the statement of priorities before IIROC may move forward.

(b) OSC Veto on Significant Publications

The Taskforce proposes adding to the Recognition Order an OSC veto on any significant publication, including guidance or rule interpretations.

We note that the OSC already has significant authority over the materials that IIROC distributes. IIROC is already required to provide the OSC with reasonable notice of any document it intends to publish or issue to the public or to any class of Members which, in the opinion of IIROC, could have a significant impact on: its Members and others subject to its jurisdiction; or the capital markets generally.<sup>9</sup> As noted above, the OSC also has the following authority under the Act:

The Commission may, if it is satisfied that to do so would be in the public interest, make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized self-regulatory organization.<sup>10</sup>

The Consultation Report has not explained why additional OSC authority with respect to significant publications is necessary.

We are concerned that this OSC veto in respect of significant publications could compromise IIROC's standing within the industry. It will be clear to stakeholders reviewing any significant publication issued by IIROC that there is a higher authority than IIROC. In these circumstances, stakeholders would be well advised to not only provide their views to IIROC, but also to circumvent IIROC by advocating to the OSC. An OSC veto could also compromise IIROC's ability to consult with stakeholders by delaying or preventing the publication of discussion papers concerning new policy concepts or issues that may be controversial in the industry.

(c) OSC Veto on Key Appointments

The Taskforce proposes that the Recognition Order be amended to provide the OSC with a veto on key appointments, including the Chair and the CEO.

We note that the Recognition Order already requires that IIROC's governance structure and arrangements ensure that each director and officer is a fit and proper person. The CGC moves past this baseline requirement by engaging in a detailed process to assess the skills that a Director candidate would contribute to the Board, and the likelihood that the candidate would contribute constructively to the work of the Board. Succession planning (assessing and planning for the future needs of the Board) is also an important consideration for the CGC.

An OSC veto on the appointment of the Chair and CEO would take important authority away from the Board. If the Chair and CEO must be acceptable to the OSC, the Board may only appoint individuals to those positions if it is confident that the OSC will not veto the appointment. That

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<sup>9</sup> Recognition Order, Schedule 2, s. 7(b).

<sup>10</sup> *Securities Act* (Ontario) R.S.O. 1990, c. S-5, at s. 21.1(4).

will necessarily constrain the existing process. Moreover, the individuals in those positions will feel an accountability to the OSC that will compromise the authority of the Board.

(d) Term Limits for Key Appointments

The Taskforce has proposed amending the Recognition Order to provide for term limits for key appointments (although it does not specify what it means by "key appointments"). We have addressed below, term limits for Directors and term limits for the CEO.

(i) Term Limits for Directors

Under IIROC's By-Laws, members of the Board are already subject to term limits. They may not serve for more than eight consecutive years.<sup>11</sup> This is on the low end of term limits in the public company context. There is no need for the OSC to provide an additional overlay of requirement on an issue that has already been addressed by the Board.

(ii) Term Limits for the CEO

Terms limits for a CEO are very uncommon. In some Crown corporation contexts, the CEO is appointed to a fixed term. The purpose is to protect the CEO from interference by government during that term. A term limit in the Recognition Order would impose an arbitrary end to the service of a CEO, even in circumstances in which the Board believes that the incumbent CEO is the best person to continue to lead the organization. It could also create the expectation that the CEO will remain in office throughout the term, regardless of performance.

Selecting the CEO is one of the key responsibilities of the IIROC Board. The first CEO served from 2008 to 2014 (under several different contracts), which is not an unusual length of time for a CEO to serve. IIROC's current CEO served from 2014 to 2020 (under an initial contract, which was then renewed). In 2020 the current CEO was appointed by the Board for an additional term of approximately six years. It is always open to the Board to consider whether it has the right CEO in place, particularly when it conducts its annual assessment of the CEO's performance.

(e) Directors with Investor Protection Experience

The Taskforce has proposed that the Recognition Order be amended to require Directors with investor protection experience. There are several issues with this proposal. One issue is that requiring the appointment of a person with specified experience, supposes that a person with that experience who would otherwise be a good fit on the board could be easily identified. The other is what "investor protection experience" means. Establishing this experience as an aspirational concept is very helpful in guiding the selection of board candidates. However, requiring the nomination of a candidate who fits within a generally accepted meaning of this term is more challenging. Finally, investor protection experience is a factor in the skills matrix, which the CGC uses for the purpose of considering candidates for the Board. Repeating in the Recognition Order, what the CGC has already done is at best redundant.

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<sup>11</sup> Subject only to section 5.3(2) of the By-laws.

In identifying Director candidates, the CGC considers investor protection experience and identifies the specific skills and background that could reflect this experience. In a news release dated February 24, 2020, IIROC announced that "the criteria used to identify candidates for upcoming Independent Director positions on its Board has been formally amended to include direct experience with consumer and retail investor issues."

(f) Compensation Linked to Public Interest

The Taskforce has proposed that the Recognition Order be amended to provide that the compensation and incentive structure applicable to IIROC's executives be linked to the delivery of the public interest and policy mandate delegated to IIROC. Fulfilling the public interest mandate of the organization is already recognized as the primary mandate of IIROC's CEO and his performance objectives are linked to achieving that mandate.

Oversight of management is the core function of the Board. To undertake that function effectively, the Board must have the discretion to shape the compensation and incentive structure applicable to management. Otherwise, management is no longer accountable to the Board, but is accountable to the body setting the compensation and incentive structure in place of the Board. The Board's ability to effectively oversee management will be greatly diminished.

(g) Directors Appointed by CSA Members

The Taskforce proposes that up to half of IIROC's Directors be appointed jointly by all CSA members and that a mechanism should be put in place to resolve CSA disagreements on the choice of appointees in a timely manner.

IIROC's CGC engages in a nomination process in accordance with the detailed requirements set out in the By-Laws. This includes a requirement for the CGC to evaluate individual candidates based on their ability to contribute a range of knowledge, skills and experience, having regard for the required composition of the Board, and the fact that the Board, as a whole, should be representative of IIROC's various stakeholders. If some Directors are elected by the Members and some are appointed by the CSA, the ability of the CGC to ensure the appropriate balance of skills and experience may be compromised. Board planning is a challenging and important process in which multiple requirements and criteria need to be considered and balanced. In our view, this Proposal does not reflect the importance and challenges associated with a well-constructed board or with effective succession planning.

There is also a significant risk that Directors will feel that they have joined the Board to represent the appointing regulators. Although Directors are aware that they owe their duty to the corporation, and not to their nominator, in our experience where a significant percentage of Directors are elected or appointed by different constituencies, they often take the perspective of their nominator in board discussions and decisions. This is particularly the case when the nominator is the regulator or government from which the organization derives its authority.

(h) Cooling-Off Period

The Taskforce has proposed that the Recognition Order be amended to include a cooling-off period between working for a Member or IIROC and becoming an independent Director.



As noted above, a one-year cooling-off period is already prescribed in the CGC Charter. We understand that IIROC has consistently adhered to that cooling-off period with only one exception. In that instance, an industry Director made a significant contribution to the Board and had an important role in managing a difficult issue at the time when she left the industry. In those unique circumstances, the Board deemed it to be in IIROC's best interests to retain that Director as an independent director immediately after she left the industry.

The cooling-off period is already formalized as a priority by its inclusion in the CGC Charter and it is respected in practice. With the cooling-off period in the CGC Charter, the Board retains the discretion to vary its application in the event of exceptional circumstances. Including a cooling-off period in the Recognition Order would eliminate that discretion and thus the flexibility to adapt to changing and exceptional circumstances.

(i) Majority of the Board Should be Independent

The Taskforce has recommended that the Recognition Order be amended to provide that the number of independent Directors should be higher than the number of Directors from Member firms. The Taskforce noted that the actual number would have to be determined by function of how many Directors would be appointed by the CSA.

The concept of independence in public company governance means independence from management (and in some contexts, independence from the controlling shareholders). The Taskforce has not defined "independence", but appears to mean independence from the Members. As noted above, the Board is currently comprised of fifteen Directors. Seven are independent, seven are from Member firms and one is the CEO.

The proposal could be accommodated by adding two additional independent Directors to the Board (for a total of seventeen Directors), which would result in nine independent Directors and seven non-independent industry Directors plus the CEO. This would mean that the majority of the Board is independent of both industry and IIROC management. It would continue to be important that the independent Directors have the skills, expertise and experience to contribute effectively to the work of the Board.

(j) Chair Should be Independent

The Taskforce has recommended that the Recognition Order be amended to provide that the IIROC Chair be independent.

The independence of the Chair has been a theme in Canadian governance for many years. In the public company context, the Chair's independence relates to his or her independence from management. There is no requirement in Canada for chairs of public companies to be independent of management (or to meet any independence requirements). It is, however, a recommended practice for non-controlled public companies in Canada. Even so, institutional shareholders are open to exceptions to this recommended practice in circumstances which have been adequately explained.

We assume that by "independent" the Consultation Report means that the Chair is not associated with a Member and has met the cooling-off requirements discussed above. This underscores the importance of the Board's nomination process, which should include Chair succession planning.

Any requirement that the Chair be independent should be accompanied by the public company practice that exceptions may be made in extraordinary circumstances.

Finally, new requirements should not interfere with decisions already made. For example, even if changes were made to the Recognition Order, current terms (including the Chair's term) should run their course.

(k) Ombudsperson

The Taskforce has proposed the creation of an ombudsperson service to address any complaints that SRO member firms may have about services received from their respective SRO.

IIROC Members are already entitled to bring complaints to the OSC pursuant to the Act, as noted above. In particular, the Act permits any person or company directly affected by a direction, decision, order or ruling made under a by-law, rule, regulation, policy, procedure, interpretation or practice of an SRO to apply to the OSC for a hearing and review of the direction, decision, order or ruling.<sup>12</sup> It is not apparent the extent to which the Taskforce intends the ombudsperson service to go beyond what is already provided in this broad review power. It is also not clear whether the proposed ombudsperson is intended to have binding authority, but if it did have such authority it would be duplicative of the OSC's review power and jurisdictional ambiguity would be created.

In any event, in addition to having recourse to the OSC, IIROC Members have recourse through IIROC's governance structure, including to the District Councils, to raise issues in respect of IIROC's conduct and activities. This is consistent with the mandate of self-regulation, which must provide a manner for its regulated members to work through the SRO to ensure effective regulation.

It is not apparent what problem the proposed ombudsperson is intended to address. Layering an ombudsperson on to the existing OSC review power and the available mechanisms within IIROC's governance structure will create unnecessary jurisdictional ambiguity and bureaucracy.

#### 4. Conclusion

Following our review of the Consultation Report, we raise the following issues:

Several of the Proposals contemplate decisions that would be made collectively by all of the securities regulators. For example, the Taskforce is proposing that half of IIROC's Directors be selected by all CSA members. The Taskforce also proposes that the OSC approve an IIROC annual business plan. If these recommendations were adopted, we assume that the other CSA members would adopt those changes too so that the recognition orders would remain harmonized. Notwithstanding the successful efforts on the part of the Canadian securities regulators to work cooperatively and coordinate the exercise of their authority, not every such effort is successful and delays in decisions that affect the operation of IIROC's business could compromise IIROC's ability to meet its public interest mandate.

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<sup>12</sup> *Securities Act* (Ontario) R.S.O. 1990, c. S-5, at s. 21.7.

In addition, several of the proposals would significantly compromise the ability of the Board to oversee management. A board that is fully empowered is able to hire and fire the CEO, set his or her objectives and compensate the CEO based on performance against those objectives. The Proposals would give the OSC a role in these decisions, thereby diminishing the authority of the Board and confusing lines of authority and accountability.

Certain of the Proposals would compromise IIROC's marketplace perception as regulator in the investment industry. Requiring the OSC's approval of IIROC's statement of priorities, and providing the OSC with a veto on the appointment of the Chair and the CEO and on significant publications, would make the OSC the key decision maker, rather than the Board.

Finally, several of the Proposals align with existing IIROC practice and so we question whether anything is gained by including them in the Recognition Order. Term limits for Directors are in place and set terms of employment for the CEO has been the practice at IIROC since it was first established. The Board and the CGC have already included investor protection experience as an important attribute in the board skills matrix and announced earlier this year that it has nominated Director candidates with direct experience in consumer and retail investor issues. The Proposal that a majority of the Board be independent of the Members seems inconsistent with the concept of self-regulation and with the public company concept of the independent directors (where the issue is independence from management, not from shareholders). The importance of the Chair being independent from the Members was not explained in the Consultation Report.

Having reviewed the Proposals in detail, it is not clear what purpose the Taskforce is seeking to advance with those Proposals. It referred to the Consultation Report's overarching theme of supplementing the policing function of Ontario's capital markets regulatory framework with a public policy imperative of growing the capital markets in Ontario. It does not seem to us that the Proposals speak to either of those priorities. In respect of the SROs specifically, the Consultation Report notes that the successful fulfillment of the SROs' public interest mandate requires the SROs to be aligned with Ontario's vision to protect investors and facilitate growth in the capital markets. The Consultation Report does not indicate whether or how it believes that IIROC has not been aligned with Ontario's vision in that regard. IIROC's Members have a vested interest in ensuring that IIROC regulates effectively to preserve and promote the industry's reputation and confidence in IIROC on the part of investors and its other stakeholders.

Finally, the Taskforce has not explained if IIROC's current governance or its current relationship with the OSC is presenting any problems for the OSC or for the capital markets, or whether there is any reason to question IIROC's ability to meet its public interest mandate.

## SCHEDULE

What follows is a detailed discussion of IIROC's governance structure, certain matters relating to the conduct of IIROC's business and IIROC's reporting requirements.

### (a) Governance Structure

The framework for IIROC's governance is set out in its governing statute, the *Canada Not-for-Profit Corporations Act*. Details of IIROC's governance are in its articles and the By-Laws. Governance requirements are also prescribed in the Recognition Order. We have described IIROC's governance below in order to provide context for our comments on the Proposals of the Taskforce.

The OSC retains significant accountability from IIROC in respect of its governance through the Recognition Order. The Recognition Order prescribes a number of requirements with respect to IIROC's governance. It prescribes certain requirements for the composition of the Board. It also requires OSC approval prior to changes to IIROC's governance structure, organizational structure or the activities, responsibilities and authority of the District Councils.<sup>13</sup> It also requires OSC approval of IIROC's by-laws and rules.<sup>14</sup> The Recognition Order requires IIROC to operate on a not-for-profit basis and gives the OSC discretion to impose terms and conditions on any transaction that would fundamentally impact IIROC.<sup>15</sup>

In addition to the foregoing requirements, the Recognition Order requires that IIROC's governance structure and arrangements "ensure: (i) effective oversight of the entity; (ii) fair, meaningful and diverse representation on the [Board] and any committees of the Board, including a reasonable proportion of independent directors; (iii) a proper balance among the interests of the different persons or companies subject to regulation by IIROC; and (iv) each director or officer is a fit and proper person."<sup>16</sup> The Recognition Order prescribes that "IIROC must regulate to serve the public interest in protecting investors and market integrity" and "must articulate and ensure it meets a clear public interest mandate for its regulatory functions."<sup>17</sup> The Recognition Order also requires IIROC to identify and manage conflicts of interest.<sup>18</sup>

IIROC is a not-for-profit corporation.<sup>19</sup> IIROC's governance structure reflects a balance between industry expertise and independent oversight and has built in processes for industry and stakeholder input into material decisions. The governance structure provides for broad participation by the industry and stakeholders, to effect broad-based and effective self-regulation that is responsive to those who the industry serves.

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<sup>13</sup> Recognition Order, Appendix A, s. 2.

<sup>14</sup> Recognition Order, Appendix A, s. 4.

<sup>15</sup> Recognition Order, Appendix A, s. 3.

<sup>16</sup> Recognition Order, Schedule 1, s. 2.

<sup>17</sup> Recognition Order, Schedule 1, s. 2.

<sup>18</sup> Recognition Order, Schedule 1, s. 3.

<sup>19</sup> IIROC is governed by the *Canada Not-for-Profit Corporations Act*, S.C. 2009, c. 23.

IIROC's Members are investment dealers ("Dealer Members") and marketplaces ("Marketplace Members").<sup>20</sup> The Members elect the Board. The Board in turn appoints the CEO and oversees the work of the CEO and the management team.<sup>21</sup> The Board is comprised of the CEO and fourteen other individuals elected by the Members, including two marketplace Directors, five dealer directors and seven independent Directors. Accordingly, there is a balance on the Board between industry experts and independent members.<sup>22</sup> Directors are elected for two-year terms and may serve up to eight consecutive years.<sup>23</sup>

The Board appoints a Chair and one or more Vice-Chairs and specifies the powers and duties of the Chair and Vice-Chairs.<sup>24</sup> The Board also appoints IIROC's President and CEO and specifies his or her powers and duties.<sup>25</sup> The Board or the President may appoint and set the powers and duties of other officers.<sup>26</sup> The Board sets the terms of employment and remuneration of the CEO, and any other officers that the Board may appoint.<sup>27</sup> The Board is entitled to appoint, from among the Directors, committees with such powers as the Board may determine, including acting in the name of the Board except where an action or approval is specifically required from the Board.<sup>28</sup> The Board is supported by three standing committees: the CGC; the Finance, Audit and Risk Committee; and the Human Resources and Pension Committee.<sup>29</sup>

Directors are nominated for election by the Board, on recommendation of the CGC. The CGC considers candidates' ability to contribute a range of knowledge, skills and experience, and with a regard for the required composition of the Board and representation of all of IIROC's various stakeholders.<sup>30</sup> The CGC has developed a skills matrix to inform its consideration of Board candidates. That skills matrix includes factors such as, for instance, capital markets experience, regulatory experience, and skills and expertise including, among others, governance and investor protection. Through its nomination process, the CGC ensures that there is available for election by the Members, at least one Director with experience and expertise in public venture equity markets, one who has been recommended by the Toronto Stock Exchange and one who is a partner, director, officer or employee of a marketplace.<sup>31</sup> The CGC Charter provides that the Committee will consider, in respect of director candidates, whether they have been independent for at least a year before being appointed as an independent Director. We understand that IIROC has adhered to this one-year 'cooling-off' period for independent Directors in all but one instance, where particular circumstances warranted an exception in the best interests of the organization.

IIROC District Councils and Advisory Committees also have roles in IIROC's governance. There are ten District Councils that represent all of the provinces and territories.<sup>32</sup> The District Councils,

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<sup>20</sup> IIROC By-Law No. 1, Amended September 2019 (the "By-Laws").

<sup>21</sup> *Canada Not-for-Profit Corporations Act*, s. 124. The authority of the board set out in this section is subject to the NFPCA, IIROC's articles and any unanimous member agreement.

<sup>22</sup> By-Laws, s. 5.3.

<sup>23</sup> By-Laws, s. 5.3.

<sup>24</sup> By-Laws, s. 8.2.

<sup>25</sup> By-Laws, s. 8.3.

<sup>26</sup> By-Laws, s. 8.6.

<sup>27</sup> By-Laws, s. 8.9.

<sup>28</sup> By-Laws, s. 11.1.

<sup>29</sup> By-Laws, ss. 11.2 - 11.4.

<sup>30</sup> By-Laws, s. 5.4(1)(a).

<sup>31</sup> By-Laws, s. 5.4(1)(b).

<sup>32</sup> By-Laws, s. 10.1.

whose members are elected by Dealer Members of each district along with *ex-officio* members appointed by the Board, provide regional input into the regulatory process, including policy matters, and raise issues of regional interest. The District Councils also have a role in respect of registration and membership matters. The Board may appoint such advisory bodies as it may deem advisable and may delegate such appointment power to any IIROC director, officer, committee or employee.<sup>33</sup> There are six Advisory Committees that consult with IIROC on the development of rules and guidance, as well as providing an opportunity for industry to share experiences, information and ideas and provide input to IIROC. The six Advisory Committees are: (a) National Advisory Committee (consisting of representatives of the District Councils); (b) Conduct, Compliance and Legal Advisory Section; (c) Proficiency Committee; (d) Financial and Operations Advisory Section; (e) Fixed Income Advisory Committee; and (f) Market Rules Advisory Committee.<sup>34</sup>

The Board may make and amend or repeal rules for IIROC's objects as an SRO and those rules are binding on all of IIROC's regulated persons and entities.<sup>35</sup> Rules made by the Board may impose requirements in addition to or higher than those imposed by provincial securities legislation.<sup>36</sup>

(b) Matters Relating to IIROC's Business

In addition to the requirements with respect to IIROC's governance, the Recognition Order prescribes significant requirements with respect to how IIROC conducts business.

The Recognition Order requires prior OSC approval for material changes to, among other things, IIROC's fee model, the functions IIROC performs and the Regulation Services Agreement between IIROC and its Marketplace Members.<sup>37</sup> The Recognition Order requires IIROC to provide any person or company whose rights relating to membership, registration or enforcement matters are affected by an IIROC decision with an opportunity to be heard prior to the decision being made.<sup>38</sup> The Recognition Order prescribes detailed requirements for how IIROC performs its regulatory obligations, such as requiring IIROC to set rules, administer and monitor compliance with those rules, prescribing how it deals with confidential information, requiring it to be accessible to the public, and requiring it to publish all of its documents in both French and English, among other detailed requirements.<sup>39</sup> The Recognition Order also prescribes how IIROC may use its fines and settlements,<sup>40</sup> requires certain steps in respect of its disciplinary matters,<sup>41</sup> and prescribes requirements for the capacity and integrity of IIROC's systems.<sup>42</sup>

The Recognition Order prescribes more detailed requirements with respect to the conduct of its business such as requiring that IIROC maintains sufficient financial resources,<sup>43</sup> that it maintains

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<sup>33</sup> By-Laws, s. 11.6.

<sup>34</sup> IIROC: Advisory Committees (<https://www.iiroc.ca/about/Pages/iiroc-advisory-committees.aspx>).

<sup>35</sup> By-Laws, s. 13.1.

<sup>36</sup> By-Laws, s. 13.1.

<sup>37</sup> Recognition Order, Appendix A, s. 2(b).

<sup>38</sup> Recognition Order, Appendix A, s. 6.

<sup>39</sup> Recognition Order, Appendix A, s. 7.

<sup>40</sup> Recognition Order, Appendix A, s. 8.

<sup>41</sup> Recognition Order, Appendix A, s. 9.

<sup>42</sup> Recognition Order, Appendix A, s. 10.

<sup>43</sup> Recognition Order, Schedule 1, s. 6.

its capacity to effectively and efficiently perform its regulatory functions,<sup>44</sup> that it fulfills certain requirements in each of its offices,<sup>45</sup> and that it maintains controls over its technology systems.<sup>46</sup> The Recognition Order prescribes detailed requirements for IIROC's rules and for information sharing and regulatory cooperation.<sup>47</sup>

In addition to the requirements with respect to the conduct of IIROC's business in the Recognition Order, the OSC is granted broad discretion to review IIROC's business operations in the Act, which provides that the OSC "may, if it is satisfied that to do so would be in the public interest, make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized self-regulatory organization."<sup>48</sup> Further, the Act provides:

The Executive Director or a person or company directly affected by, or by the administration of, a direction, decision, order or ruling made under a by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized exchange, recognized self-regulatory organization, recognized quotation and trade reporting system, recognized clearing agency, designated trade repository or designated information processor may apply to the Commission for a hearing and review of the direction, decision, order or ruling.<sup>49</sup>

Beyond the prescribed requirements in the Recognition Orders, we understand that IIROC has instituted its own processes to further engage the CSA, including the OSC, by for instance inviting the CSA to provide input into IIROC's internal audit planning process and otherwise having regular contact with CSA members, including the OSC, throughout the year.

### (c) Reporting

The Recognition Order requires IIROC to provide the OSC with detailed reporting.<sup>50</sup> Under the Recognition Order, IIROC must both comply with reporting requirements set out in the Recognition Order and with requests for other reports, documents and information as the OSC or its staff request.<sup>51</sup> Through this extensive reporting, there is a significant level of transparency to ensure IIROC's accountability to the OSC.

The reporting requirements set out in the Recognition Order are extensive and specific. This reporting includes prior notification to the OSC twelve months before completing certain transactions and three months prior to terminating or any intended material change to certain agreements relating to critical technology systems.<sup>52</sup> IIROC must immediately report any Member's admission, suspension, resignation or receipt of a Member's intention to resign.<sup>53</sup> IIROC must provide the OSC with prompt notice of certain enumerated events and situations, including the circumstances, IIROC's proposed response and, if appropriate, timely updates.<sup>54</sup> These events and situations include situations that would reasonably be expected to raise concerns about

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<sup>44</sup> Recognition Order, Schedule 1, s. 7(a).  
<sup>45</sup> Recognition Order, Schedule 1, s. 7(b).  
<sup>46</sup> Recognition Order, Schedule 1, s. 8.  
<sup>47</sup> Recognition Order, Schedule 1, s. 11.  
<sup>48</sup> *Securities Act* (Ontario) R.S.O. 1990, c. S-5, s. 21.1(4).  
<sup>49</sup> *Securities Act* (Ontario) R.S.O. 1990, c. S-5, s. 21.7.  
<sup>50</sup> Recognition Order, Schedule 2.  
<sup>51</sup> Recognition Order, Schedule 1, s. 11.  
<sup>52</sup> Recognition Order, Schedule 2, s. 1.  
<sup>53</sup> Recognition Order, Schedule 2, s. 2.  
<sup>54</sup> Recognition Order, Schedule 2, s. 3.

IIROC's financial viability, breaches of securities legislation, security breaches, and actual or apparent misconduct or non-compliance by Members.

IIROC's reporting requirements are not limited to event-triggered *ad hoc* reporting. IIROC is required to report to the OSC regarding financial, enforcement and operational issues on a regular timetable. On a quarterly basis IIROC must file with the OSC a report regarding IIROC's regulatory operations, including ongoing initiatives, policy changes, and emerging or key issues; a summary of all compliance examinations completed, conducted and scheduled; a summary of all discretionary exemptions granted; client complaint and caseload statistics; and a summary of enforcement files referred during the previous quarter.<sup>55</sup> On an annual basis IIROC must file with the OSC a report regarding IIROC's regulatory operations, including a self-assessment of IIROC's performance of its regulatory responsibilities, together with any proposals for improvements.<sup>56</sup> The annual report must also include a certification by IIROC's CEO and General Counsel that IIROC is in compliance with the certain terms and conditions applicable to IIROC under the Recognition Order.<sup>57</sup> IIROC must also file with the OSC unaudited quarterly and audited annual financial statements.<sup>58</sup>

IIROC must provide to the OSC certain governance documents and reports, including the results of any corporate governance review, any material changes to the code of business ethics and conduct and the Board's conflicts of interest policy; changes to the Board; IIROC's budget; IIROC's annual report; and enterprise risk management reports.<sup>59</sup>

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<sup>55</sup> Recognition Order, Schedule 2, s. 4.

<sup>56</sup> Recognition Order, Schedule 2, s. 5(a).

<sup>57</sup> Recognition Order, Schedule 2, s. 5(b).

<sup>58</sup> Recognition Order, Schedule 2, s. 6.

<sup>59</sup> Recognition Order, Schedule 2, s. 7(a).