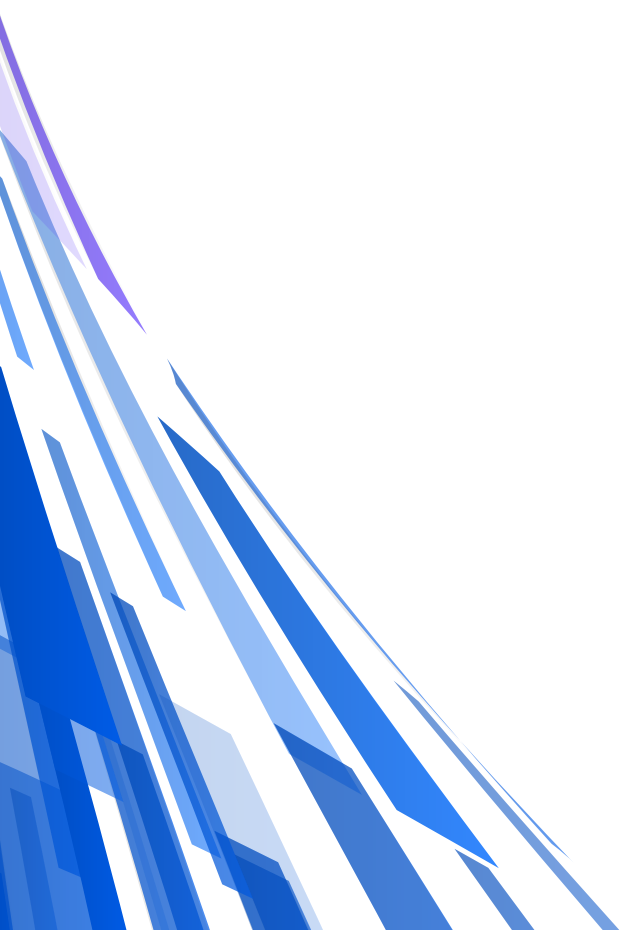




# IMPROVING **SELF-REGULATION** FOR CANADIANS

Consolidating the  
**Investment Industry  
Regulatory Organization  
of Canada (IIROC)**  
and the **Mutual Fund  
Dealers Association  
of Canada (MFDA)**

JUNE 2020





# 1.

## EXECUTIVE SUMMARY

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For the last several years, the investment industry has been rapidly transforming to meet the changing needs of Canadians.

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This technology-driven transformation is not only changing the products, the services and the nature of the advice delivered to Canadians, but also changing behaviours by enabling Canadians to access and consume financial services the way they want. The pace of change will only increase as we all respond to the learnings of the COVID-19 pandemic.

This changing relationship between investors and the investment industry is placing tremendous pressure on the existing regulatory framework—a framework based on assumptions that are no longer true: the concepts of one customer, one account and the idea that financial products are distributed in silos.

To deliver what today’s financial consumers want, the investment industry must divert significant resources away from client service and product innovation—just to comply with duplicative and overlapping regulation. As a result, the current self-regulatory (SRO) model denies many Canadians robust access to the advice, products and services they deserve. This needs to change.



**We propose bringing together IIROC and the MFDA as divisions of a consolidated SRO as an important first step. Over the next decade, this step alone would save hundreds of millions of dollars**

by reducing duplicative red tape and regulatory burden—money that could be reinvested in innovation, customer service and economic growth across Canada.

It could be achieved without disrupting the existing rule framework, business models or regulatory fee structures. It would immediately offer firms flexibility in how to structure their operations, reduce regulatory burden for a broad range of market participants and enhance the regulatory and economic ecosystem. At the same time, consolidation would offer an improved investor experience and enhanced investor protection.

IIROC applauds the Canadian Securities Administrators (CSA) for their leadership in exploring ways to improve the self-regulatory model in Canada through their consultation process, as announced in December 2019. We are supporting the CSA's efforts by recommending this practical, cost-effective solution to enhance investor access to advice, products and services, improve investor protection and enable better and more efficient service by the industry through the reduction of duplication, red tape and regulatory burden.

Our proposal was developed in consultation with investors, investment and mutual fund dealers and advisors, professional bodies and industry associations.

There is remarkable consensus amongst these stakeholders, which informed our proposal.

## **Virtually everyone we spoke to agrees that to be successful, any proposal must:**

- ▶ **Be positive for investors, regardless of where they live or how many assets they have;**
- ▶ **Have a positive impact on dealers' and representatives' ability to serve Canadians, regardless of size or business model<sup>1</sup>;**
- ▶ **Reduce duplicative regulatory burden;**
- ▶ **Be straightforward, simple and inexpensive to execute, with minimal disruption to Canadians, the industry or the CSA oversight regime; and**
- ▶ **Position the SRO model for continued policy streamlining and evolution.**

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1 IIROC currently regulates 175 firms employing over 30,000 representatives. Eighty percent of the firms we regulate employ 100 representatives or fewer and service communities small and large, rural and urban in every province and territory.

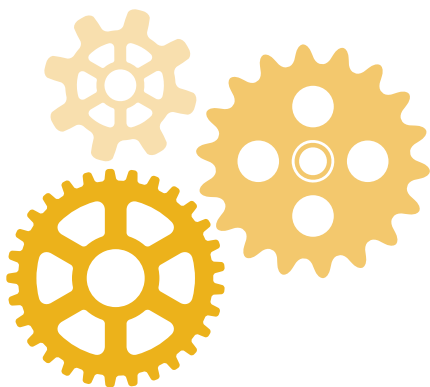
Above all, changes to the SRO model must not limit the practical ability of advisors to deliver financial advice and financial services to Canadians, especially those in under-served communities. We must enhance access to advice and enhance investor protection across Canada.

From a corporate perspective, IIROC and the MFDA should be able to combine within three months from the date that the CSA approves our proposal. Together we could begin delivering real, tangible benefits to Canadians within a year.

From that combined platform, the new SRO would continue to support the CSA in a comprehensive policy review of other registration categories such as Exempt Market Dealers (EMDs), Portfolio Managers (PMs) and Scholarship Plan Dealers (SPDs).

The opportunity—and imperative—to act now is upon us. An existential debate about the merits of going back to the drawing board will only delay progress and enshrine a status quo that is no longer effective or cost-efficient and which has already stifled innovation for too long.

Canadians deserve a better result from their SROs. In partnership with our colleagues at the MFDA and the CSA, IIROC is committed to delivering it.



**The opportunity—and imperative—to act now is upon us.**

# 2.

## AN INDUSTRY IN THE MIDST OF TRANSFORMATION

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Significant demographic shifts and technological innovation have together changed the needs of Canadian investors and the way in which the investment industry serves them.

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Long-established investment dealers are evolving their business models and new entrants, some in partnership with incumbents and others on their own, are innovating rapidly. Their efforts face barriers as a result of the fragmented and duplicative account and product-based self-regulatory framework in Canada. Many stakeholders see these barriers as constraints to innovation and the cost-effective delivery of solutions and services to Canadians and have called for Canada's regulatory ecosystem and for the SRO model to modernize, including the paper "[Modernizing the Regulation of Financial Advice](#)" published by the C.D. Howe Institute.

# 85%

OF CANADIAN INVESTORS TOLD US THEY WANT “ONE-STOP SHOPPING.”

We heard this directly from many market participants in our work with global consulting firm Accenture that culminated in the publication of our joint report in 2019, [“Enabling the Evolution of Advice in Canada”](#). In addition, IIROC’s comprehensive investor research [“Access to Advice”](#) clearly supports the need to update Canada’s self-regulatory framework to improve access to investment advice and services.

Canadians are increasingly asking for more goals-based financial advice that speaks to their entire family situation, advice that is more flexible, transparent and which gives them more control over their investment experience.

**Specifically, over 85%<sup>2</sup> of Canadian investors told us they want “one-stop shopping”. Essentially, they want access to a range of products and services without having to go to multiple providers, or open multiple accounts.**

90% of investors want to be able to access advice on their own terms—when and how they need it, when and how they want it—and investors also reasonably expect that advice to be able to adapt to their changing needs and circumstances throughout their life stages. They want the system to be designed to respond

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2 IIROC, in partnership with The Strategic Counsel, published its latest investor research on [“Access to Advice”](#) in January 2020.

to them, not to have to learn to maneuver through a complex system that is designed for itself. Even worse, they don't want to be captive to a system that limits them to certain categories of investments.

In response, many firms are increasingly focused on delivering a more comprehensive advice and service experience to their clients, across a broader range of products and services, and are forced to spend valuable resources to work around the requirements imposed by the existing fragmented self-regulatory regime.



**This situation is even more difficult for smaller and mid-sized firms, particularly in smaller communities, which often have far fewer resources.**

The challenge is evident from the numbers: as of mid-2019, IIROC-regulated dealer firms managed approximately \$2.9 trillion in client net equity as compared to the approximately \$560 billion in MFDA firms<sup>3</sup>. Mutual funds, an accessible and important financial product for many Canadians, are now distributed broadly through a variety of channels including full-service investment dealers, discount brokers and mutual fund dealers. According to the Investment Funds Institute of Canada, only approximately 1/3 of Canadian mutual funds outstanding by mid-2019 were distributed by MFDA members<sup>4</sup>.

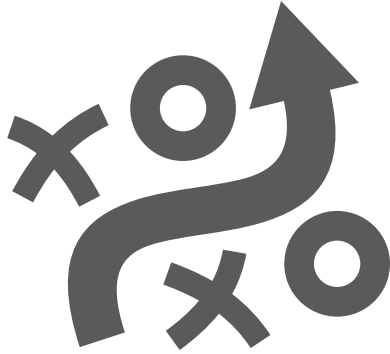
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3 Investment Industry Association of Canada, Mutual Fund Dealers Association, June 2019.

<https://mfda.ca/wp-content/uploads/AR2019.pdf>

4 <https://www.ific.ca/wp-content/uploads/2019/07/News-Release-June-Monthly-Statistics-Mutual-Funds-and-ETFs-July-22-2019.pdf/22805/>; <https://mfda.ca/wp-content/uploads/AR2019.pdf>





**Increasingly popular and often less expensive portfolio alternatives such as Exchange-Traded Funds (ETFs) and Platform-Traded Funds (PTFs)<sup>5</sup> are largely absent from the MFDA channel. Regulatory and operational limitations resulting from the current structure make it hard for mutual fund dealers to distribute these products on a cost-efficient basis.**

In other words, the current SRO model denies many firms the ability to give Canadians the efficient access to the advice, products and services they want, need and deserve.

Consolidation of IIROC with the MFDA would solve this issue by giving mutual fund dealers more efficient distribution options and therefore Canadians more and better access to additional investment alternatives.

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<sup>5</sup> IFIC reports in its January 2020 [Investment Funds Report](#) that ETF net sales have outsold mutual funds in each of the last two years (2018 and 2019).

## 2.1

# LESSONS FROM THE PANDEMIC— ACCELERATING THE TRANSFORMATION

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The 2020 pandemic has not only accelerated the pace of change for the industry and Canadians but is having a significant impact on investor confidence, our capital markets and the economy.

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Now, more than ever, regulators need to be receptive to exploring ways to reduce red tape and the regulatory burden while ensuring that Canadians have the ability to choose from a range of innovative products and services to help them achieve their financial objectives.

We also need to ensure that our markets continue to operate with stability and integrity with the benefit of our strong market surveillance and oversight capabilities.



**IIROC's continuing program of investment in people and technology meant that, even completely working from home, we have been able to monitor nearly 1.4 billion equity transaction messages a day in real time across Canada's equity markets, more than double the previous peak volume and almost five times the average pre-crisis volume.**

It has become clear that we cannot just go back to the way things used to be. For example, Canadians have embraced technology to meet with financial advisors virtually, open new accounts electronically and make investing decisions efficiently and securely from the comfort of their homes. We need to help facilitate these new options as part of a flexible regulatory model that supports Canadians and how they want to consume financial advice and services.

Combined with the already strong desire for one-stop shopping and flexibility in financial services, the acceleration in innovation during the pandemic is reinforcing the need to modernize the regulation of financial advice. As the industry and Canadians adjust to a "new normal" it will be imperative for regulators to rethink how we regulate in this new reality while preserving investor protection and supporting healthy capital markets.

# 3.

## CHALLENGES WITH THE CURRENT MODEL

Canadian investors are severely disadvantaged by the current regulatory structure. It was founded with a focus on specific accounts or products, instead of on the investors themselves.

As a result, too often investors must choose, or the industry imposes upon them, an advisory channel that restricts the investment advice, knowledge and choices they can access.

These limitations flow from the current structure which features two duplicative SROs. This inefficient structure is perpetuated by a single rule<sup>6</sup> that requires a mutual fund representative on the IIROC platform to complete the additional education and proficiency requirements necessary to offer all securities—even if he or she only deals in mutual funds.

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<sup>6</sup> [IIROC Dealer Member Rule Section 18.7](#)

This rule, informally known as the “Upgrade Requirement”, essentially prohibits an investment dealer from employing a limited-license mutual fund representative on the IIROC platform. To do so, an entirely new mutual fund dealer must be created: a separate legal entity with separate and completely duplicative supervisory, compliance and back-office systems and resources. In fact, many dealers have had to go down this expensive road—they are referred to as “Dual-Platform” dealers. They chose to go down this road only because the current system didn’t allow them the flexibility to efficiently match their people and infrastructure to the needs of their clients within a single firm.

The current structure also means that if a client of a limited-license mutual fund dealer is interested in expanding their investments into other securities, they must open a new account with a new investment firm and likely another advisor.



**Having multiple regulators involved in the regulation of similar products causes confusion and additional complexity for investors.**

Fundamentally, it makes it impossible for the industry to deliver effectively on its promise to be responsive to all of the needs of the investors it serves.

A straight-forward solution would be for IIROC to eliminate the Upgrade Requirement, allowing dealers the option of consolidating their representatives in one legal entity, onto one back-office platform, under a single SRO. This would allow investment dealers to introduce a mutual fund-only offering within their existing legal entity without having to establish a separate dealer on the MFDA platform. It is clear from dealer feedback in recent years, as well as our own research and other commentary, that there is material industry interest in pursuing these options.

The issue with this simple solution is the negative impact that it could have on the ability of mutual fund dealers to be regulated in a cost-efficient manner<sup>7</sup>. A significant percentage of Dual-Platform dealers have already indicated that they would actively seek to move their representatives from the MFDA platform to the IIROC platform if the Upgrade Requirement were eliminated. While this would not create a gap in regulatory oversight, as IIROC already oversees mutual fund investments, simply eliminating the Upgrade Requirement would significantly reduce the MFDA's membership and put additional pressure on the regulatory costs for the remaining mutual fund dealers.

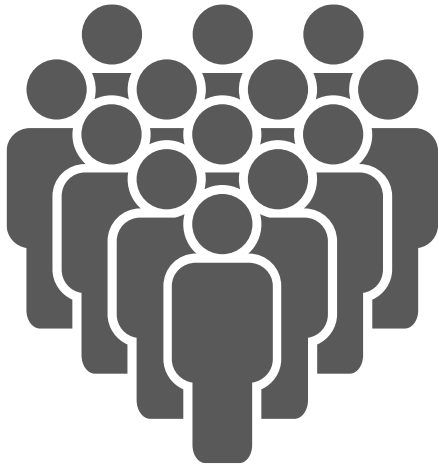
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7 [Summary of Comments Received on a Proposed 2008 Amendment to Ontario Securities Commission Rule 31-502 Proficiency Requirements for Registrants and Response of the Ontario Securities Commission](#) "The consequences of removing the 270 Day Requirement would be to permit a business model that would be inconsistent with the design of the existing regulatory system. Also, if a sufficient number of the MFDA's larger members were to transfer their operations to IDA affiliates, the ongoing viability of the MFDA could be undermined. We therefore believe that it is appropriate to maintain the 270 Day Requirement until such time as the roles of these SROs in our regulatory system is re-evaluated."

**IIROC believes that mutual fund dealers, particularly independent mutual fund dealers who serve Canadians outside of the larger urban centres, play a critical role in the Canadian financial system because they serve Canadians who might otherwise be underserved or even unserved.**

Those firms, and the small business people who are their representatives, must continue to be able to deliver financial advice and services to those communities. We must also enhance their ability to deliver the best and most efficient products to meet their clients' needs, while maintaining and improving investor protection. Therefore, the delivery of regulation to these firms and their clients must continue without interruption.

At the same time, that regulation must be made more efficient, the level of regulatory oversight made more proportionate and duplicative regulatory burden removed.



**With the MFDA and IIROC as part of the same organization, firms would be able to efficiently manage their businesses and the SRO would efficiently allocate compliance and oversight resources on a proportionate and risk-measured basis accordingly.**

Mutual fund dealers are not licensed to trade or settle securities, other than mutual funds. Nor are investment dealers and mutual fund dealers part of the same credit and investor protection regime. As a result of this structural separation, mutual fund dealers are not able to have efficient access, through what is known as an “introducing-carrying relationship”, to the clearing and settlement system via investment dealers.

That restriction sharply limits the practical ability of most mutual fund dealers to distribute many of the most cost-efficient investment products available today—ETFs and PTFs—to their clients, even when the mutual fund representatives are qualified to do so.

The practical solution is to end the structural separation. Bringing IIROC and the MFDA together in the same organization would dramatically improve access to these important product categories for Canadians who are clients of mutual fund dealers.



# 4.

## IMPROVING OUTCOMES THROUGH SRO CONSOLIDATION

IIROC and the MFDA should consolidate as divisions of a new self-regulatory organization (NewCo), one which leverages the strengths of both organizations<sup>8</sup>.

While IIROC and MFDA rules are similar, there are several important differences in policies and procedures. Rather than attempt to create a new, consolidated rule book from scratch—an exercise which experience shows us would take years—a simpler solution exists.

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<sup>8</sup> The Mutual Fund Dealer Division of NewCo and its sibling, the Investment Dealer Division.



**Dealers and representatives could choose to continue to perform the activities they currently perform, under the same level of regulation, post-consolidation if they wish. Alternatively, they could take advantage of the opportunity to consolidate their regulatory oversight in one division of the new SRO.**

For example, mutual fund dealers and representatives could choose to continue to book business in client name<sup>9</sup> and to re-direct commissions<sup>10</sup>; Dual-Platform dealers could choose to consolidate all their representatives in a single legal entity, etc., with each activity regulated in proportion to its risk.

At the same time, removing the arbitrary barrier between the two SROs would greatly improve flexibility, reduce duplication and give to those many Canadians who are served by qualified mutual fund representatives the ability to efficiently access ETFs and PTFs.

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9 An account held in 'client name' is registered in the name of the client and maintained as such on the records of the mutual fund company. When an account is held in 'nominee name' the Dealer is the registered holder of the funds and holds them in trust for the end client.

10 The MFDA allows commissions earned by a representative to be directed to unregistered corporations, where permitted. This requires a written agreement be signed by the mutual fund dealer, the representative and the representative's personal corporation stating that the dealer and the representative must comply with MFDA requirements and the representative and the personal corporation must both provide the mutual fund dealer full access to their books and records. IIROC does not currently allow commission redirection.

All of this would be possible because both IIROC and the MFDA are already recognized by most provincial and territorial securities authorities<sup>11</sup>. Our respective rule books have already been approved by them and therefore, while some differences exist, giving Canadians and the firms which serve them additional flexibility to choose amongst them does not give rise to any public policy concerns.

Of course, the new structure and governance regime would be subject to CSA approval as would be set out in new consolidated Recognition Orders<sup>12</sup>. Over time, the consolidated entity would evolve the division-level rules together, as a family, using the same principles we set out above and would offer a more efficient platform for continued policy streamlining.

The new SRO could also be re-branded to support increased investor awareness. IIROC's research shows that most Canadians have little awareness about regulations, where to seek information about the firms and advisors they work with, and where to turn if they have a complaint.

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11 IIROC is recognized by the securities authorities of all 10 provinces and 3 territories. The MFDA is recognized by 8 provinces, not including Quebec or Newfoundland and Labrador.

12 The current IIROC and MFDA Recognition Orders can be found at: [https://www.iroc.ca/about/governance/Documents/RecognitionOrderOntario\\_en.pdf](https://www.iroc.ca/about/governance/Documents/RecognitionOrderOntario_en.pdf) and [https://www.osc.gov.on.ca/en/SecuritiesLaw\\_ord\\_20180412\\_226\\_mutual-fund.htm?RSS=ORDEN](https://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20180412_226_mutual-fund.htm?RSS=ORDEN), respectively.

# 4.1

## VALUE OF CONSOLIDATION TO INVESTORS

Consolidating IIROC and the MFDA would reduce unnecessary duplication and process and would increase Canadians' understanding of regulation and their ability to navigate through the system. In addition:

- ▶ Investors would be able to have a seamless graduation as their investment needs change over time, from fairly simple products and advice to more complex advisory channels and solutions
- ▶ More products at lower cost, e.g. a full suite of ETFs, would be available to many more Canadians
- ▶ Clients would not have to re-open accounts and/or change firms/advisors as their investing needs change, resulting in:
  - ▶ Less “paperwork burden”
  - ▶ Improved consolidated reporting to investors
- ▶ Elimination of regulatory duplication would offer cost savings that could be reinvested in innovation and client service

## 4.2

# VALUE OF CONSOLIDATION FOR FIRMS

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Mutual fund dealers and investment dealers, of all business sizes and models, and their representatives serving both rural and urban communities across the country, would be able to continue post-consolidation to perform the same activities they currently do today. They would do so, but under one combined regulator rather than two.

### **Mutual Fund-Only Dealers**

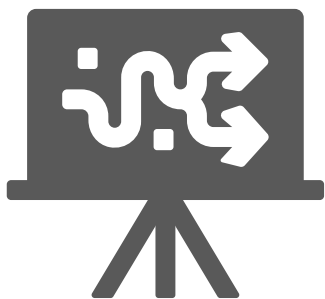
These dealers would benefit from the ability to participate in an introducing-carrying type of arrangement by an IIROC firm and therefore, to gain more efficient access to clearing and settlement systems and to the lower cost products available on them (ETFs and PTFs).

Mutual fund dealers and their representatives would gain that wider system access without having to make any other changes to their current business models or oversight regime. In particular, they would be able to continue with “client name” business and with the practice of “directing commissions”. They could also determine at their own pace when they want to upgrade and having this ability would assist in succession planning.

Finally, mutual fund dealers would benefit from scale (cost) efficiencies available to a larger, consolidated SRO.

### Dual-Platform Dealers

Firms that today operate on more than one regulatory platform would be able to simplify their operations and significantly reduce expenditures related to compliance with the requirements of two different regulators: a single set of systems, integrated compliance and management teams and more risk-based reviews would all follow. This reduction in regulatory burden would lead to cost savings that would be available for investment in innovation and client service.



**The combined SRO could continue IIROC's existing initiative to make its regulation more proportionate. This would permit a material reduction in the regulatory burden for existing or aspiring multiple service model firms. This would in turn reduce barriers to entry and increase competition, helping to fuel the economy.**

### IIROC-Only Dealers

IIROC-only dealers would continue under IIROC rules and would benefit from the removal of barriers to add limited-licensed mutual fund representatives to their platform, if they so desire, at their own pace. Regulation of these limited-licensed representatives would be proportionate to the risk of the business they conduct.

## 4.3

# VALUE OF CONSOLIDATION FOR THE SYSTEM

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The existing Canadian regulatory framework uses both provincial government agency and SRO regulation to protect investors, strengthen market integrity and maintain efficient and competitive capital markets. Legislation in various provinces enables the local securities commissions to recognize and assign important regulatory responsibilities to SROs.

Consolidation of two SROs would remove one regulatory body from the mix and the significant associated duplication.

There would be economies of scale in the administration of a consolidated SRO<sup>13</sup>. Greater visibility across investor holdings would lead to improved regulatory effectiveness and investor protection and confidence.

**Combining and harmonizing the focus of enforcement resources would also contribute to improved consistency, efficiency and better investor outcomes.**

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13 IIROC has approximately 500 FTEs and annual expenditures of \$100 million (see page 37) while the MFDA has approximately 160 FTEs and annual expenditures of \$35 million as at their respective FY2019 year-ends.

## 4.4

### GOVERNANCE

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The governance models of both organizations currently include an equal number of industry and independent directors.

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Incorporating direct financial services experience in the governance model is an important component of the value that SROs bring to the Canadian system. Equally important in such a model, is the need for strong, knowledgeable, independent directors who act as an effective balance to the industry perspective.

As already noted, this proposal was developed through extensive bilateral consultation. Our discussions with investor groups, industry and our regulatory partners identified that the new organization's governance model could be improved over what is in place today by more explicitly including, in the Board of Directors' skills matrix, a need for consumer protection / investor protection experience.

IIROC's Board strongly supported this view and has determined that we should not wait for a new organization to be formed to adopt this measure, and decided to proceed with it immediately<sup>14</sup>.

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14 [IIROC confirms experience with investor issues a critical skill for Board succession.](#)





Our Board also acknowledges that the characteristics of Canadians served by financial services firms which are members of IIROC and the MFDA are not identical. As a result, during our bilateral discussions, a number of groups suggested it would be important for the new organization to adopt an expert investor issues advisory panel. It would be similar to what the Ontario Securities Commission, Québec's l'Autorité des marchés financiers and the United States' Financial Industry Regulatory Authority (FINRA) already have in place.

Here too, IIROC's Board thought it was important to move forward now and supported our recent announcement proposing the creation of a pan-Canadian expert investor issues committee<sup>15</sup>.

The Board of Directors of the consolidated SRO would need, we believe, to continue with these measures. It would also need to ensure that industry directors bring a comprehensive perspective, representing the different sectors and regions that would now be members of the SRO. This would ensure a governance model with at least an equal number of strong, experienced independent directors to provide appropriate challenges and perspectives<sup>16</sup>.

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15 [IIROC to form expert investor issues panel for valuable input on consumer issues](#)

16 The Boards of IIROC and the MFDA are of different sizes but each has an equal numbers of industry and independent Directors, plus their respective CEOs. [IIROC Board of Directors](#); [MFDA Board of Directors](#)



**The CSA would continue to have, via their authority to approve or reject any proposed rules, and through their extensive oversight process, the ability to exercise regulatory supervision of the consolidated SRO<sup>17</sup>.**

Of course, their jurisdiction by jurisdiction role as the reviewing authority for decisions of the SRO's disciplinary panels and the consequential judicial review by Divisional Courts or their equivalents, would also ensure the continuance of due process.

Harmonization of coverage by the Canadian Investor Protection Fund (CIPF, for IIROC members) and the Investor Protection Corporation (IPC, for MFDA members) would also need to be completed. As a first step however, coverage could continue on a division-by-division basis with no disruption to investors or firms. The consolidated SRO would support discussions between CIPF, IPC and the CSA in any way needed to facilitate that process.

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<sup>17</sup> Appendix 3: CSA Oversight of IIROC

# 5.

## **SUPPORTING INVESTOR CONFIDENCE AND SYSTEM STABILITY IS PARAMOUNT**


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The MFDA has argued for the creation of a “clean sheet of paper” SRO.

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The scope of their proposed organization would extend well beyond current IIROC and MFDA mandates to incorporate oversight of Exempt Market Dealers (EMDs), Portfolio Managers (PMs) and Scholarship Plan Dealers (SPDs). These latter three groups are today “direct registrants” of the provincial securities authorities in each of their respective jurisdictions.

We believe that integrating the regulation of these three groups of registrants, who are today regulated province by province, while simultaneously consolidating IIROC and the MFDA would be practically impossible in the medium term because of the complexity of the task and the number of stakeholders involved. This would invariably necessitate extensive consultations and multiple rounds of comment and, if history is any indication,

A decorative graphic in the top right corner consisting of several overlapping, curved teal shapes of varying shades, creating a sense of movement and depth.

extend over multiple years. The practical consequence of such an approach would be to enshrine the status quo and ensure that little gets done for the foreseeable future.

Additionally, a “start from scratch” approach would create even greater uncertainty for investors and market participants, compromising investor confidence and system stability when it is needed most.



**We should build on the strengths of the existing system, while pursuing prioritized improvements in phases, and supporting the implementation of in-progress regulatory improvements such as the Client-Focused Reforms.**

# 5.1

## POST-CONSOLIDATION NEXT STEPS

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Following the consolidation of IIROC and the MFDA, we would seek out synergies and further opportunities to benefit the system.

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We completely agree that there are important questions about the consistency and efficiency of regulation and supervision between and among the “direct registrants” and the SRO members. As a result, we would recommend that, after the consolidation of IIROC and the MFDA is complete, the CSA consider if and which of the three direct registration categories could benefit from being part of a pan-Canadian self-regulatory model and begin consultations if, as and when they feel it is appropriate.

# 6.

## IIROC MOVING AHEAD TO DELIVER VALUE FOR THE SYSTEM

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IIROC is already moving to enhance its governance model and to expand the input it receives on investor and consumer protection issues. We believe these important steps should be carried forward to a consolidated SRO.

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We are also moving forward to increase the flexibility of our existing regulatory framework, in a way which would align with the consolidation model we are proposing.

Investment dealers operate a wide variety of business models. It is true that some large, integrated firms have operations which cover the entire range of activities that an investment dealer is able to conduct<sup>18</sup>. Many more firms though operate in just a few, or only one, part of the market.

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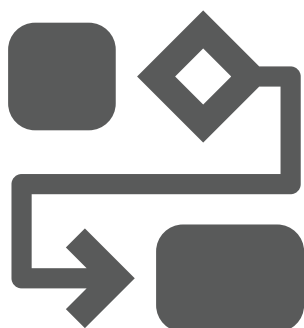
<sup>18</sup> See Appendix 1.

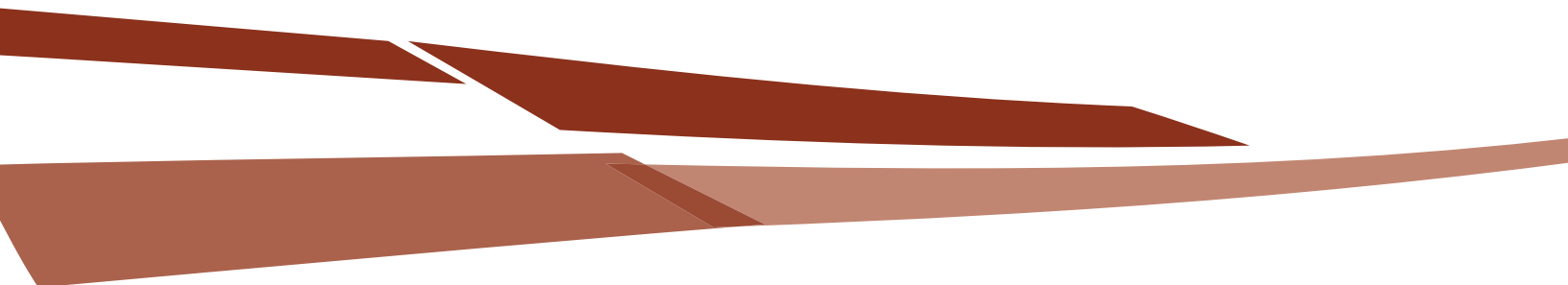
The way in which IIROC's rulebook has evolved has made it difficult to ensure that a particular business attracted only the regulatory oversight applicable to the risks of that business. Put another way, the rulebook is too easily interpreted as applying to firms generally, regardless of their business mix.

Asking firms to show how they comply with rules that are not applicable to their businesses imposes unnecessary regulatory burden—even if it is only the burden of demonstrating periodically to examination teams that the rules in question don't apply.

To this end, IIROC has launched a project to examine how to ensure that businesses attract only the rules—and the regulatory obligations that go with them—that were designed to manage the risks generated by those business activities.

**The goal is to apply proportionate regulation, reduce regulatory burden and build in flexibility in the rulebook for new and innovative business models.**





Some of the activities undertaken by investment dealers are also undertaken by firms registered directly with the various provincial and territorial securities authorities. The best examples are activities conducted by firms registered as EMDs and PMs. In order to ensure consistent application of regulation to like businesses, we will also take this opportunity to coordinate our regulatory expectations with those of our provincial colleagues.

This work is consistent with current efforts at IIROC to review the rules applicable to Alternative Trading Systems (ATs) which represent, in most cases, a discrete subset of the broader IIROC rule book. Consideration of a new membership category for ATs, with only the rules that apply to that business, is consistent with the approach outlined above.

Of course, this work would be as applicable to the mutual fund division of the new SRO as it is to IIROC's model today and we could accelerate our efforts as required to support the chosen timing of the consolidation.





# 7.

## CONCLUSION

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The announcement by the CSA to review the regulatory framework governing IIROC and the MFDA presents an opportunity to immediately evolve the self-regulatory model, thus increasing the value it brings to Canadians for years to come.

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The current fragmentation between the two SROs is inconsistent with the way Canadians are demanding that financial products, services and advice be delivered. Meanwhile, the costs of such fragmentation to investors continues to rise.

Incumbent investment dealers and new entrants alike are working to introduce new business models to meet investor demands, despite concerns with the fragmented, costly and duplicative regulatory framework in Canada. Many in the industry view these constraints as barriers to innovation, investment and the cost-effective delivery of solutions and services to Canadians and are calling for Canada's regulatory ecosystem to modernize its approach to regulation.

Our proposal, which recommends starting with a consolidation of the two existing SROs, would be an important first step for investors and a major relief for many in the industry who seek to innovate and invest to better serve Canadians. The consolidation would free up hundreds of millions of dollars in savings over the next decade, savings from red tape reduction and the elimination of duplication, savings that could be reinvested in innovation and customer service.

With minimal cost and disruption, this would create a streamlined platform on which to continue the evolution of the SRO model in partnership with the CSA. Certainly, everything the financial sector has learned through the experience of the COVID-19 pandemic supports the need to move the system forward in a practical, timely way, step by step.



**Access to advice is an investor protection issue. Canadians, regardless of where they live, how much money they have to invest or whether they are young, middle-aged or seniors, all deserve to have access to appropriate, personalized and fairly-priced financial advice and products without having to seek out multiple service providers and open multiple accounts.**

In our three-year Strategic Plan published in June 2019, we outlined our key organizational strategies and priorities. A significant focus for us is to support the industry's transformation, with one of our stated priorities to "evolve the self-regulatory model to more effectively and efficiently serve Canadians". We recognize that as the industry continues to evolve, IIROC too must continue to change to keep pace and to deliver on our mandate and the needs of Canadians, our members and our regulatory partners.

As we await the CSA's publication of the details of their consultation, we encourage our members, the people and the organizations we regulate, and other industry stakeholders to continue to engage with us about improving effective and efficient self-regulation. It is only by working together and staying current with how the industry and our capital markets are evolving that we can achieve our goal: a structure that is more efficient, more effective and ultimately leads to better outcomes for Canadians.

# APPENDIX 1: ACTIVITY BY REGULATORY PLATFORM SIMPLIFIED

DIRECT OVERSIGHT BY ACTIVITY					
	ACTIVITY	IIROC	CSA	MFDA	OTHER
Sales & Trading	Equity	x			
	Debt	x			x <sup>1</sup>
	Listed Derivatives	x			x <sup>2</sup>
	OTC Derivatives	x	x		
	Mutual Funds	x	x <sup>3</sup>	x	x <sup>4</sup>
	ETFs	x	x <sup>3</sup>	x	x <sup>4</sup>
	Exempt Products	x	x	x <sup>5</sup>	
	Insurance		x	x <sup>6</sup>	x
Advice	Portfolio Management	x	x		
	Advisory Account	x		x	
	Automated Portfolio Management	x	x		
	Order Execution Only	x			
	Research	x			
Corporate Finance	Public	x			
	Private	x	x		

- 1 The Bank of Canada plays a role in its oversight of financial markets infrastructures and also generally with respect to the health of Canada's credit markets.
- 2 The Bourse de Montréal oversees trading of listed derivatives in its capacity as an SRO overseen by the AMF.
- 3 The level of supervisory activity undertaken by a provincial / territorial authority can vary somewhat by jurisdiction.
- 4 The Chambre de la sécurité financière oversees, supervises and disciplines more than 32,000 members in six sectors of activity in Quebec, including mutual fund dealer representatives.
- 5 In some circumstances, exempt products may be distributed through mutual fund dealers.
- 6 In some jurisdictions, mutual fund dealers may also be licensed as insurance firms.

## **APPENDIX 2: ABOUT IIROC**

IIROC is a pan-Canadian self-regulatory organization that is responsible for the oversight of Canada's 175 investment dealers and their trading activities on debt and equity marketplaces.

As a national public interest regulator, IIROC is recognized by each of Canada's 13 securities authorities and delegated authority to protect Canadian investors and the integrity of Canada's capital markets.

With approximately 500 employees and offices in Vancouver, Calgary, Toronto and Montreal, our staff performs a wide variety of functions in every jurisdiction of the country—including the setting and enforcing of high quality regulatory and investment industry standards. We deliver our mandate by developing, testing for compliance and enforcing a broad spectrum of proficiency, conduct, prudential, and market rules.

All investment dealers and Canadian marketplaces overseen by IIROC are subject to a rigorous regulatory approval process. Individuals wanting to work at IIROC-regulated firms in specific roles must apply for approval and must invest in their professional development, including the completion of mandatory continuing education requirements.

We regulate investment dealers of different sizes from all jurisdictions, from the smallest independents to the largest financial institutions in the country. They represent a variety of business models, including a focus on retail or institutional clients, and an integrated approach with both retail clients and investment banking operations. More than a third of our members have 10 or fewer IIROC approved persons and nearly another 50% have 100 approved persons or less.

IIROC is responsible for surveillance of all of Canada's equity and debt market activity. With surveillance rooms in Toronto and Vancouver, we are able to ensure a timely, coordinated approach from coast to coast.

Our surveillance teams in Toronto and Vancouver monitored an average of approximately 500 million messages daily in 2019 and, during the recent COVID-19 crisis, over 1 billion messages each day.

Using a sophisticated state-of-the-art surveillance system, IIROC is able to daily monitor real time feeds from all equity markets, including five stock exchanges and eight alternative trading systems. The system takes data from each market and distills them into a single consolidated view of market activity.

The surveillance system analyzes the data using sophisticated algorithms that look for abnormal trading activity and create alerts, which are investigated by IIROC's Surveillance team.

This system also triggers automated volatility alerts, which halt trading in a security within two seconds. This volatility control is part of a series of controls designed to mitigate risks associated with rapid short-term price movements and ensure fair and orderly markets.

IIROC is also responsible for oversight of Canada's debt markets and tracks all fixed income and money market trades conducted by IIROC dealers. We share this complete data set in partnership with the Bank of Canada in order to help them fulfill their financial system responsibilities.

The Bank of Canada also relies on IIROC to publish transaction-based one- and three-month Bankers' Acceptance Rate to increase market transparency and integrity and will be using IIROC data to calculate and publish the Canadian Overnight Repo Rate Average, a benchmark interest rate.

In 2016, the Canadian Securities Administrators appointed IIROC to act as the Information Processor, responsible for providing market transparency for all trading activity in corporate debt securities by IIROC dealers. The CSA has now proposed that

IIROC's role be expanded to include providing transparency on all debt security trades, including governments, conducted by all IIROC dealers and all Canadian banks.

IIROC also works closely with other national regulators including the Office of the Superintendent of Financial Institutions (OSFI), the Canadian Deposit Insurance Corporation (CDIC) and the Financial Consumer Agency of Canada (FCAC) to ensure Canadians are protected and our markets function fairly and in an orderly manner. IIROC has also over the years entered into a number of Memoranda of Understanding (MOUs) with provincial insurance regulators, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) and others. These MOUs help prevent individuals disciplined from simply moving to a new jurisdiction or switching designations to hide offences.

IIROC is also retained by stock exchanges and alternative trading systems to monitor additional rules for their specific marketplaces.

As a not-profit pan-Canadian regulator, we are committed to prudent fiscal management. Our annual operating budget is approximately \$100 million and is funded primarily from dealer and market regulation fees, with no government funding. Fines collected from wrongdoers as a result of disciplinary sanctions are only allowed to be used for investor protection, education, financial literacy and to support the disciplinary hearings process.

**To learn more about IIROC, visit [www.iiroc.ca](http://www.iiroc.ca)**

## APPENDIX 3: CSA OVERSIGHT OF IIROC

IIROC is recognized as a self-regulatory body recognized by each of the 13 provincial and territorial securities authorities in Canada or “Recognizing Regulators”. IIROC carries out its regulatory responsibilities under Recognition Orders from these 13 jurisdictions.

The Recognition Orders call for extensive reporting from IIROC to the Recognizing Regulators on a quarterly, annual and ad hoc basis (summarized below), as well as an annual self-assessment of how IIROC is meeting its regulatory mandate.

The Recognizing Regulators have entered into a [Memorandum of Understanding](#) (MOU) regarding the oversight of IIROC. The MOU stipulates that the oversight will include the performance of regular reviews of IIROC’s self-regulatory activities and regulation services:

- Quarterly conference calls and an annual in-person meeting of representatives of the Recognizing Regulators (the “Oversight Committee”) and IIROC staff. The purpose is to discuss strategic, policy and operational matters relating to IIROC, to ensure that IIROC is properly executing its mandate. Also included are issues relating to the regulation of IIROC’s Members and other matters that are of interest to the Recognizing Regulators and IIROC.
- Oversight reviews of IIROC offices. Commission staff are actively involved in these reviews. A report on the results of the review is also prepared, published broadly and often the subject of media attention.
- Each Recognizing Regulator also retains the ability to perform a review of IIROC to deal with significant and/or local issues that require immediate attention and that would be best dealt with through a review of an IIROC office.



The objective of the oversight reviews is to evaluate whether the selected regulatory processes were effective, efficient, and applied consistently and fairly, and whether IIROC has complied with the terms and conditions of its Recognition Orders. In 2015, the CSA adopted a risk-based methodology to determine the scope of each oversight review. Since that time, the Recognizing Regulators have conducted these reviews on an annual basis.

The MOU also contains a joint rule review protocol that requires the Recognizing Regulators to approve new or amended IIROC rules following a robust public notice and comment process.

IIROC's Recognition Orders also require that IIROC periodically review its corporate governance structure, including the composition of the Board, 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. IIROC submits the results of these reviews to the CSA and publishes them on its website.

In addition to direct oversight from the CSA, IIROC also maintains a vigorous internal audit program, one that reports directly to the IIROC Board of Directors. To ensure that the internal audit function has the experience and resources required to do an effective job, we have outsourced it to KPMG for the last several years. The CSA Oversight Committee provides input regarding which IIROC departments and/or functions will be targeted for these internal audits and, of course, receives all of the resulting reports. The CSA Oversight Committee also receives quarterly updates on IIROC's progress in addressing all outstanding internal audit findings.

# APPENDIX 4: IIROC REPORTING REQUIREMENTS

## Prior Notification

- changes to technology service arrangements

## Immediate Notification

- membership matters (new, suspended, resigning members)

## Prompt Notification

- situations reasonably expected to raise concerns about IIROC's financial viability
- non-compliance with Recognition Order
- material violations of securities legislation of which IIROC becomes aware
- failure, malfunction, delay or security breach, including material cyber security breaches, of IIROC's systems
- breach of security safeguards involving information under IIROC's control
- actual or apparent misconduct or non-compliance by members, Approved Persons, marketplace participants, or others, where investors, clients, creditors, members, CIPF, or IIROC may reasonably be expected to suffer serious damage
- situations that would reasonably be expected to raise concerns about a member's continued viability
- any action taken by IIROC with respect to a member in financial difficulty
- terms and conditions imposed, varied or removed by IIROC relating to a member
- enforcement agreements and undertakings

## **Quarterly Reporting**

- ongoing initiatives, policy changes, and emerging or key issues
- compliance examinations in progress or completed, including information on repeat or significant deficiencies
- terms and conditions relating to Approved Persons
- discretionary exemptions
- client complaints and complaints received from other sources
- caseload for each of case assessment, trading review and analysis, market surveillance, investigations and prosecutions, including length of time files have been open
- enforcement files referred to Recognizing Regulators
- regulatory staff complement, by function

## **Annual Reporting**

- self-assessment of how IIROC is meeting its regulatory mandate
- certification by IIROC's Chief Executive Officer and General Counsel that IIROC is in compliance with the Recognition Order

## **Financial Reporting**

- unaudited quarterly financial statements
- audited annual financial statements

## Other Reporting

- results of any corporate governance review
- material changes to code of business ethics and conduct and written policy about managing potential conflicts of interests of members of IIROC's Board
- changes in members of IIROC's Board
- financial budget, together with underlying assumptions
- independent review report regarding systems controls
- results of benchmarking of surveillance systems and services, together with summary of process undertaken and conclusions reached
- enterprise risk management reports
- internal audit charter, annual internal audit plan, and internal audit reports
- annual report
- compliance examination plan
- material changes to the compliance or enforcement processes or scope of work
- reasonable prior notice of any document that IIROC intends to publish or issue to public or to any class of members which, in opinion of IIROC, could have a significant impact on:
  - its members and others subject to its jurisdiction; or
  - capital markets generally
- information concerning closed investigations or prosecutions which did not lead to disciplinary or settlement proceedings including final investigation report and recommendation memorandum
- information concerning enforcement matters that resulted in disciplinary or settlement proceedings including final penalty memorandum