

Market Integrity Notice |

Guidance

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Suggested Routing

- Trading
- Legal and Compliance
- Management

JOINT REGULATORY NOTICE - THE ROLE OF COMPLIANCE AND SUPERVISION

Key Topics

- Supervisory Obligations
- Compliance Obligations

Summary

This Joint Regulatory Notice is issued by Market Regulation Services Inc., The Investment Dealers Association of Canada, the Mutual Fund Dealers Association of Canada and the Bourse de Montréal in order to provide their expectations respecting the role, responsibility and accountability for compliance at a Participant or Member.

UMIR Provisions Referenced

- Rule 7.1 – Trading Supervision Obligations
- Rule 10.16 – Gatekeeper Obligations of Directors, Officers and Employees of Participants and Access Persons

Questions / Further Information

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Market Integrity Notices Referenced

- Market Integrity Notice 2003-025 – *Guidance – Guidelines on Trading Supervision Obligations* (April 1, 2005)
- Market Integrity Notice 2005-011 – *Notice of Amendment Approval – Provisions Respecting Manipulative and Deceptive Activities* (November 28, 2003)

JOINT REGULATORY NOTICE - THE ROLE OF COMPLIANCE AND SUPERVISION

Summary

This Joint Regulatory Notice (“Notice”) is issued by Market Regulation Services Inc. (“RS”), The Investment Dealers Association of Canada (“IDA”), the Mutual Fund Dealers Association of Canada (“MFDA”) and the Bourse de Montréal (“Bourse”) in order to provide their expectations respecting the role, responsibility and accountability for compliance at a Participant or Member.

Background

RS has previously issued Market Integrity Notices respecting the supervisory and compliance responsibilities of Participants. Reference should be made to Market Integrity Notice 2005-011 – *Notice of Amendment Approval – Provisions Respecting Manipulative and Deceptive Activities* (April 1, 2005) and Market Integrity Notice 2003-025 – *Guidance – Guidelines on Trading Supervision Obligations* (November 28, 2003). This Notice should be read in conjunction with those Market Integrity Notices as well as Rule 7.1 and Rule 10.16 of UMIR.

Joint Regulatory Notice The Role of Compliance and Supervision

Introduction

Industry compliance professionals play an important role in the system of securities regulation. Self regulatory organizations (“SRO”) and industry compliance professionals have a common objective to promote compliance at firms and set industry standards. In order to achieve this objective, SROs need to be absolutely clear in their expectations of the chief compliance officer (“Chief Compliance Officer”), the compliance department (“Compliance Department”) and the member firm, including its management.

The purpose of this Notice is to provide Members and Participants (collectively, “Member” or “Members”) with SRO expectations of the compliance function at Members and the role, responsibility and accountability of the Member, the board of directors, management, Compliance Departments and compliance officers (“Compliance Officer”).

The SROs have issued notices and bulletins in the past that address many of the matters outlined below.¹ In addition, there are specific SRO rules that deal with supervisory and compliance responsibilities. This Notice should be read in conjunction with those regulatory instruments.

¹ IDA Compliance Interpretation Bulletin C-130, July 12, 1999 *Accountability of Compliance Officers in Disciplinary Actions*
Bourse’s Circular No. 017-2003, February 18, 2003 *Surveillance and Compliance*
MFDA Member Regulation Notice MR –0037, March 16, 2005 *Compliance Responsibilities*
RS Market Integrity Notice No. 2003-025, November 28, 2003 *Guidelines on Trading Supervision Obligations*
RS Market Integrity Notice No. 2005-011, April 1, 2005 *Provisions Respecting Manipulative and Deceptive Activities*

Responsibility for Compliance

The responsibility for compliance belongs to the Member generally: the board of directors, management, supervisors and those fulfilling the compliance function. Compliance should not be viewed as an isolated activity of the Compliance Department but as an integral part of a Member's general business activities. Within that general framework, it is the responsibility of the board of directors, management and supervisors to consider and implement the advice from those performing a compliance function.

The role of the Compliance Department is to identify, assess, advise on, communicate, monitor and report on the Member's compliance with regulatory requirements.

Distinction between Supervisory and Compliance Roles

Compliance Departments and Compliance Officers, while they carry out similar functions across firms, have responsibilities tailored to the size, resources and business needs of the particular Member. In some cases their sole responsibility will be fulfilling the compliance function; in others they may also have supervisory roles.

In contrast to the compliance role described above, a person in the role of "supervisor" has authority for the day-to-day management of a business function or area which includes the supervision of individuals and the authority to implement changes to how the business function or area is run. The difference between supervisory and compliance roles is defined by who has the authority to resolve issues once they are identified.

For example, if an issue is identified by a Compliance Officer and referred to a branch manager for resolution, the Compliance Officer is executing a compliance function only. In doing so, the Compliance Officer may also, while still conducting a compliance function, be checking on the efficacy of the branch manager's reviews. As long as the authority to effect change resides with the branch manager, he or she is in the supervisory role. In those circumstances where Compliance Officers have the express authority to effect change they are also exercising a supervisory role.

In determining whether an individual is acting in a supervisory role, the SROs will look at the individual's responsibilities, authority and the functions he or she performs for the Member, not simply at his or her title. While the SROs will consider documentation setting out an individual's responsibilities and authority, they will also look to confirm whether these are reflected in the day-to-day operations of the firm. In other words, it is a two-fold test: documentation and practice.

The activities of those exercising compliance functions should not be viewed by supervisors as a substitute for their responsibility to supervise the business of the firm. Supervisors still retain ultimate authority over, and are ultimately accountable for, business activities and the people they supervise when issues arise, and supervisors must remain vigilant in carrying out their responsibilities.

In some instances, the Compliance Officer may also have supervisory responsibility, for example, as a branch manager. The risks of such consolidation should be carefully considered when outlining the responsibilities of each position.

Role of the Member, Board of Directors, Management and the Compliance Officer

The Member

The Member is responsible for establishing, implementing, communicating and maintaining effective compliance programs to ensure compliance with applicable laws and regulations. This responsibility extends to all directors of the Member with respect to their corporate governance responsibilities and all officers of the Member with regard to areas of their management responsibility.

The Board of Directors

The board of directors must ensure that the Member maintains a compliance program that identifies and addresses material risks of non-compliance and that appropriate supervision and compliance procedures to manage those risks have been implemented. The board has responsibility to act on reports from the Compliance Department as outlined below.

Management

Senior management has responsibility to establish and maintain a Member's overall compliance system. All management has the responsibility to supervise and to direct the activities of the Member and the individuals within the Member firm to achieve compliance with applicable laws and regulation with respect to areas of their management responsibility.

The Chief Compliance Officer²

The Chief Compliance Officer must report the results from its monitoring to management and the board of directors at least annually, but should have direct access to senior management as needed to report significant issues as they arise. The mandate of the Chief Compliance Officer is to provide the board of directors with *reasonable* assurance that all standards and requirements of applicable laws and regulations are met.

The Compliance Officer

A Compliance Officer's responsibility is to monitor compliance and take appropriate steps to assist in ensuring that corrective measures are being taken by supervisors or managers to remedy any issues that are identified. It is not enough to simply identify issues. Compliance Officers in their advisory capacity should communicate their findings to the appropriate manager

² The term "Chief Compliance Officer" is not used by the MFDA or RS. Unless otherwise indicated, references to "compliance officer" in this Notice include individuals designated as the Chief Compliance Officer.

and recommend appropriate corrective measures. If performing solely a compliance function, the steps will involve advising supervisors or managers who have the authority to direct what must be done.

Compliance Officers must also monitor the corrective measures taken. If supervisors do not adequately address problems, the Compliance Officer must escalate the problem as appropriate. Escalation procedures should be detailed in the firm's procedures. In some cases the Compliance Officer may raise the issue with a higher level supervisor, in others, to the Chief Compliance Officer, who must ensure that the problem is escalated within the Member to a higher management level or, where appropriate, the board of directors.

The steps taken by Compliance Officers and corrective actions taken by supervisors must be documented, maintained and auditable.

Other Individuals

Other individuals in the Member firm must also comply with the Member's compliance program.

When Individuals will be Subject to Enforcement Action by SROs

The standard against which the conduct of board members, management, Compliance Officers and other individuals will be measured in a discipline hearing is that of a reasonably proficient and diligent individual in that position. The standard is an objective one; it is not what the respondent actually knew or did but rather what he or she ought to have known or done. It is always open to the individual to demonstrate that they exercised due diligence to prevent the harm that occurred.

A Compliance Officer may be subject to enforcement action if she or he violates securities laws or aids and abets another in such violations. A Compliance Officer may be subject to enforcement action for failing to supervise if she or he has been specifically delegated, or has assumed, supervisory authority for particular business activities or situations, and therefore has the requisite degree of responsibility, ability or authority to affect the conduct of the individual in the Member firm whose behaviour is at issue. A Compliance Officer may be subject to enforcement action if she or he fails to identify rule violations according to the standard of a reasonably proficient and diligent Compliance Officer, or, if after identifying the violation, he or she fails to sufficiently escalate and follow up the issue with management, in accordance to the standard of a reasonably proficient and diligent Compliance Officer. What is sufficient escalation and follow-up will often be fact specific. If the SRO is satisfied that the Compliance Officer has met these regulatory expectations he or she will not be subject to an enforcement action.

Creating an Effective Compliance Program

In order to be effective, compliance programs must be reasonably designed to identify and control the risk of compliance failure that could result in investor and/or market harm and financial losses and reputational damage to the Member.

Members have an obligation to develop and implement effective compliance programs, which includes: allocating sufficient resources; creating measures and systems that encourage and reward compliant behaviour and discourage non-compliant behaviour; and ensuring that Compliance Officers have appropriate access to senior management. There are many steps that a Member can take to promote the importance of compliance, including the following:

- (i) Promote a culture of compliance by clearly identifying, prioritizing and communicating compliance goals.
- (ii) Insist on compliance and high ethical standards throughout the Member with senior management leading by example.
- (iii) Ensure that effective execution of compliance and supervisory roles is an explicit element of compensation and promotion decisions.
- (iv) Ensure that others in the firm have a clear understanding of the role of Compliance Officers and the Compliance Department.
- (v) Communicate compliance and regulatory information to individuals within the Member. Emphasize compliance and regulatory subjects in training. Training should include educating individuals about their compliance responsibilities on an ongoing basis.
- (vi) Make available to all individuals an effective means of communicating (confidential or anonymous, if appropriate) compliance, regulatory or ethical concerns to Compliance Officers, senior management or the board of directors if necessary without fear of retaliation.
- (vii) Encourage the development, training, professionalism and retention of the Member's Compliance Officers with compensation, benefits and recognition in keeping with their contributions; and implement sanctions or other corrective actions for non-compliant behaviour. Further, staff the Compliance Department with sufficient, qualified, experienced and knowledgeable professionals.
- (viii) Ensure sufficient access to information for Compliance Officers to enable them to carry out their responsibilities.
- (ix) Develop a cooperative relationship between regulators and Members.

Tips for Compliance Officers

There are many steps that Compliance Officers can take to ensure that they have discharged their responsibilities in connection with the expectations of SROs including the following:

- (i) Ensure that they have a clear understanding of the nature of their responsibilities. This includes having a detailed job description with clearly established reporting lines and a clear understanding of whether they are expected to act in a supervisory capacity.
- (ii) Maintain written records that detail all steps that were taken to either correct, report or escalate issues that were identified along with any supporting documentation which demonstrates actions taken.

- (iii) Lawyers who perform compliance functions in addition to legal functions should make it clear to other individuals when they are acting as legal counsel and providing legal advice.
- (iv) Compliance Officers should be active in promoting compliance related initiatives both inside and outside the Member and be available to individuals within the Member for consultation on compliance issues.
- (v) Ensure steps in the compliance process are appropriately tailored to the size and nature of the Member's business and that they are tested to ensure that they adequately address any compliance gaps.
- (vi) Ensure that SRO rule changes, bulletins and notices are reviewed and incorporated into the Member's compliance policies and procedures in a timely and effective manner which addresses the nature and size of the Member's business.
- (vii) Compliance policies and procedures should be constantly reviewed, tested and updated to ensure that existing procedures continue to effectively reflect the business practices of the Member and are in compliance with new rules and regulations.
- (viii) Periodically review the websites of provincial regulators and the SROs and where possible attend SRO meetings or seminars devoted to regulatory issues. Doing so will give Compliance Officers advance notice of proposed and imminent rule changes that may affect the Compliance Officer and the Member firm.
- (ix) Develop a cooperative relationship between regulators and Members.

Questions / Further Information

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