

*OSC Examination of the Corporate Governance and
Organizational Structure of the Investment Dealers
Association of Canada and Review of the 1999 Member
Regulation Self-Assessment
July 2000*

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I. Objectives and Scope of IDA Examination

Objectives

During 1999 and early 2000, staff of the Ontario Securities Commission (the “staff”) conducted its oversight review of the Investment Dealers Association of Canada (“IDA”). Specifically, staffs mandate was to

- ensure that the IDA’s core regulatory functions are being performed in a manner that results in appropriate and consistent enforcement of securities laws and IDA rules;
- ensure that the IDA has appropriate procedures and resources to perform its member regulation functions adequately;
- identify any weaknesses in the above and to report on them to the Commission, including a plan for action and follow up; and
- determine compliance with the terms and conditions of the Recognition of the IDA, and the undertakings signed in connection thereto.

A summary of staff’s work plan is included as Appendix I.

The review of the IDA was conducted in three phases. The first two phases included a review of all key member regulation functions as follows: Sales Compliance, Financial Compliance, Enforcement, Regulatory Policy and Registration. A summary of previously reported results is included for your information as Appendix II.

Scope of this Review

The scope of this final segment of the examination was to perform an assessment of:

- the corporate governance and organizational structure of the IDA;
- the IDA’s compliance with the terms and conditions of its Recognition; and
- the 1999 Member Regulation Self-Assessment.

Staff performed the following procedures as part of this review.

1. Conducted interviews with selected personnel from each member regulation department and additionally Human Resources, Information Systems and Corporate Secretary, in order to obtain an understanding of mandates, procedures and processes and an understanding of how the departments interact with each other. A detailed listing of personnel interviewed has been included in Appendix III.
2. Conducted external interviews with a sample of IDA members, with the President of the Canadian Investor Protection Fund, and staff of the British

Columbia and Alberta Securities Commissions to obtain their views on the effectiveness of the IDA as a self-regulatory organization (“SRO”). A detailed listing of persons interviewed has been included in Appendix IV.

3. Performed a review of the IDA’s corporate governance and organizational structure including a review of organization charts, business plans, mandates and minutes of selected committees, budgets, performance measurement process, and compensation structure.
4. Reviewed the IDA’s 1999 Member Regulation Self-Assessment report.
5. Reviewed the terms and conditions of the Recognition of the IDA for the purposes of assessing compliance.

II. Overall Assessment and Summary of Observations and Recommendations

Overall Assessment

It is staff’s view that there is a need for significant improvement in the IDA’s corporate governance and organizational structure and in the Enforcement department. The recommendations set out herein are offered with the intent of improving the current structure, processes and operating methods of the IDA with the objective of ensuring the IDA meets its mandate of self-regulation. Staff would like to assist the IDA in addressing these matters.

Summary of Observations and Recommendations

Corporate Governance and Organizational Structure

- The IDA has a dual role as a SRO and a trade association. As a result, there is a need to manage the conflict of interest between the dual roles. Staff makes the following recommendations in this regard:
 - The IDA must take steps to clarify the District Councils’ role and to make amendments to keep separate trade association functions from member regulation functions as they relate to the District Councils.
 - The Regulatory Policy Department must be responsible and accountable for the prioritization of policy initiatives. Staff recommends that a plan be formalized that gives the Regulatory Policy Department the primary responsibility for assessing and prioritizing policy initiatives and the authority to direct staff and committees in the timely completion of policy initiatives.
 - The Regional Director, who performs a trade association function, must not be part of the charge laying and penalty process. This will help separate the trade

association and member regulation functions and help eliminate any perceived or real conflict of interest in the decision-making process.

- The IDA does not have a formalized strategic planning and business planning process. For example, staff identified that key project initiatives in the Enforcement Department have not been undertaken in a timely fashion. Staff recommends that the IDA formalize and improve its strategic planning and business planning process to ensure commitment to and accountability for the plan and strict monitoring of adherence to the plan.
- The mandates of various committees are vague and do not clearly establish the role, responsibility, authority or the composition of each committee. Staff recommends that the Board of Directors (the “Board”) review the mandates to ensure that these issues are addressed. In the case of the Audit Committee, the IDA should consider appointing more public directors to the committee.
- There are no formal policies and procedures in place for evaluating the effectiveness of the existing committees on a regular basis. Staff recommends that the Board develop and implement such policies and procedures.
- There is no formal process in place to evaluate the effectiveness of the Board. The Board should establish a process for assessing its effectiveness as a whole and the contribution of individual directors.
- Management decisions and issues are not reported to the Executive Committee and the Board in a formalized, consistent, and regular manner. Staff recommends that the IDA formalize its management reporting process from senior management to the Executive Committee and to the Board. Criteria should be defined as to the issues that should be escalated, the information that should be provided including any decisions made, and the frequency of the reporting. The Executive Committee and thus the Board will then be able to effectively fulfill their roles.
- The IDA does not have a formalized performance measurement process for its key member regulation operations. Staff recommends that a formalized performance measurement process be developed immediately. The annual self-assessment should measure the member regulation performance against the performance benchmarks developed. These benchmarks should be reviewed on an ongoing basis to ensure that they are relevant and appropriate.
- The IDA does not have a clear IT strategy. Staff recommends that the IDA formalize its IT plan and develop a time frame for implementation as soon as possible. Development of certain technology tools would increase the efficiency and effectiveness of the IDA.
- The IDA has difficulty attracting and retaining professional staff below the senior management level. As a result resources seem to be stretched in all departments. It

also appears that low morale is an issue. Staff recommends that the IDA revisit its compensation structure and recruiting process and take steps to develop a plan to address these concerns. For example, a compensation review could be performed in order to address employee turnover, and an anonymous staff survey could be undertaken in order to identify the reasons for low morale and possible ways to rectify the situation.

- The IDA does not have sufficient resources allocated to its member regulation function to ensure that it meets its obligations as a SRO. This was evidenced in the areas of technology and personnel. Staff recommends that the Member Regulation Oversight Committee develop guidelines to ensure that the budget allocation process results in the allocation of adequate resources to the member regulation function. Furthermore, a process should be developed to communicate any relevant member regulation issues from the Member Regulation Oversight Committee to the Audit Committee on a timely basis as part of the Audit Committee's budget review process.
- Several departments do not have formalized policies and procedures. As the IDA continues to expand and evolve, formal policies and procedures are necessary to clarify processes and encourage consistency. Staff recommends that formalized policies and procedures be developed for the Human Resources, Information Systems and Enforcement departments. Staff has made this recommendation in our previous reports for the Registration and Regulatory Policy departments.

Enforcement

- A significant issue facing member regulation is the continued and growing backlog of files in both the Investigation (including Complaints/Inquiries) and Enforcement Counsel groups despite an increase in resources. The IDA currently does not have a plan in place to address this pervasive issue facing the Enforcement Division. Staff recommends that the IDA implement a plan for clearing the backlog of files immediately which includes an allocation of additional resources to the Enforcement Division on an emergency basis.
- Contributing to the backlog in Enforcement is the fact that there is no screening process for complaints before they are forwarded for investigation and the fact that each investigation file, once completed, goes through five levels of review. Staff recommends that the IDA undertake a review of the Enforcement process with a view of adding a screening process prior to commencing an investigation and streamlining the review process for completed files.
- A significant number of changes appear to be made by the Senior Vice-President of Member Regulation ("S.V.P.") to the penalty recommendations put forward by Enforcement Counsel. This brings into question the adequacy of the due diligence process followed by Enforcement Counsel in formulating the recommendations. The due diligence process undertaken by Enforcement Counsel should be reviewed

and a plan developed to rectify any weaknesses identified. In addition, all changes made by the S.V.P. to the recommendations put forward by Enforcement Counsel and the reasons for these changes should be documented to ensure that the process is transparent.

Compliance with Terms and Conditions of IDA Recognition

- Staff noted that a cumulative summary of all open investigations is not provided to the OSC on an annual basis. This report should be submitted to the OSC Manager, Compliance.
- Staff noted that the IDA is not annually reviewing all material settlements involving its members and their clients with a view of determining whether any action is warranted. This process should be implemented immediately.
- Staff noted that there is currently no one at the IDA who is responsible to ensure that all the terms and conditions of the IDA Recognition are being met. It is staff's view that the S.V.P. should be responsible for ensuring compliance with the terms and conditions of the IDA Recognition.

III. Corporate Governance and Organizational Structure

The following are staff's findings and recommendations resulting from its review of the corporate governance and organizational structure of the IDA.

III.A SRO vs. Trade Association Function

The IDA's role as a SRO has been expanding such that, except for the Montreal Exchange, the IDA will soon be the sole SRO for all full service dealers in Canada. The IDA, however, is also the trade association of the investment dealer community. As a trade association, the IDA's objective is to protect the interests of its members. Its mission statement as a SRO is to foster fair, competitive and efficient capital markets by encouraging participation in the savings and investment process and the integrity of the marketplace. There is an inherent conflict of interest in the performance of these two roles. This was identified in the IDA recognition criteria published by the OSC. The IDA recognition criteria required that IDA operational arrangements and resources should at a minimum include, "16. (c)(v) procedures and structures that minimize or eliminate conflicts of interest at the IDA."¹ In addition the terms and conditions of the IDA's Recognition state that,

¹ "Recognition of the IDA as an SRO. Staff Proposal for Initial Recognition Criteria and Ongoing Monitoring and Request for Comments", (1995) 18 OSCB 2675.

“18. From and after the date hereof, activities which are identified by the IDA as being primarily of a trade association or lobbying character shall be appropriately structurally separated from the self-regulatory operations of the IDA and involve separate persons within the IDA.”²

It is imperative that the IDA proactively manage this conflict and any perceived conflicts of interest such that the IDA will be seen as performing its member regulation function in an independent, objective and appropriate fashion.

Staff’s oversight review identified the following areas where there are perceived conflicts of interest that the IDA needs to eliminate or manage better.

III.A.1 Role of District Councils

During staff’s interviews with senior management, it was noted that the District Councils’ role is unclear as to its involvement in trade association versus member regulation matters. It is staff’s understanding that the District Councils form a part of the IDA’s trade association. One example where there appears to be a lack of segregation between the member regulation and member advocacy functions is in the area of Registration. District Councils advocate on behalf of members by making recommendations regarding registration exemptions from proficiency requirements. Staff believes that the registration function should be independent of members in order to avoid a conflict of interest.

Another area of confusion is that some District Council members view their roles to be more than member advocacy. For instance, some District Councils perceive that they are the decision-makers in the rule-making process rather than members’ advocates who provide the industry’s views on proposed and existing regulations. Staff has been informed that the IDA is currently in the process of formalizing its rule-making process, including clarifying the roles of the District Councils.

Staff recommends that the IDA take steps to clarify the District Councils’ role and to make amendments to keep separate trade association functions from member regulation functions.

III.A.2 Policy Development

During discussions with senior management and a review of the self-assessment, it was identified that the IDA does not have a clear process to initiate and direct the work on policy managed by the Regulatory Policy Department.

It is staff’s understanding that policy is generated not only by the Regulatory Policy Department, but also by Member committees including the Financial Administrators Section (FAS) and the Joint Industry Compliance Group, as well as Corporate Finance, Capital Markets and special ad hoc committees. The Regulatory Policy Department is

² “Recognition (Section 21.1)”, (1995) 18 OSCB 5293.

charged with the responsibility of managing the rule development process. Although the department has a “Policy Projects & Priorities List”, this list is now provided only to the FAS and is not currently reviewed and approved by the Board. Furthermore, a process is not in place whereby the priorities set by the Regulatory Policy Department are communicated to all committees, and whereby the Regulatory Policy Department is given the authority to direct the committees’ work to ensure timely completion of policy initiatives. As a result, the committees are not necessarily working on priorities of Member Regulation resulting in inefficiencies in the rule development process. Senior Management has indicated to staff that it is currently working on a plan to formalize the roles of the committees (including the District Councils -see discussion in #1 above) however the timeline for implementation, including formalizing the prioritization process, has not yet been defined.

Staff recommends that the IDA formalize its policy development process. The process should aim to strengthen the role of the Regulatory Policy Department by giving it the responsibility for assessing and prioritizing policy initiatives and the authority to direct the committees working on those priorities. The process should also include a requirement for the Board to review and approve the priority list.

III.A.3 Authorization of Charges and Penalties in Settlement Agreement

Through discussions with IDA senior management and IDA staff, it was identified that the final level of authority for all charges and penalties to be presented in a settlement agreement, as recommended by Enforcement Counsel, rests with the S.V.P. In interviewing staff, it was noted that the Regional Director (“R.D.”) attends the final penalty meeting with staff and the S.V.P. Staff acknowledges that the R.D. input in these meetings is minimal and that the R.D. is present for information purposes. However, this situation creates a perceived conflict of interest in the decision-making process, primarily due to the fact that the R.D. represents the trade association of the IDA, not member regulation.

Staff recommends that the Regional Director not be part of the charge laying and penalty process. This will help separate the trade association and member regulation functions, and help eliminate any perceived or real conflict of interest in the decision-making process.

III.B Strategic Planning and Business Planning

During the review, staff identified that the IDA does not have a formalized strategic planning and business planning process. There also seems to be a lack of commitment to any plan put forward. The following are examples of these weaknesses.

III.B.1 Enforcement Department

It was identified through discussions with senior management and staff’s review of the self-assessment, that significant Enforcement project initiatives have not yet been

initiated. For example, the development of a case management and a time reporting system for Enforcement has not yet been initiated even though this was recommended by the OSC in October 1999. Furthermore, the IDA has been unsuccessful in addressing the backlog of files in the Investigation (including Complaints/Inquiries) and Enforcement Counsel groups (see discussion at item IV.A). The IDA does not yet have a plan in place to rectify the backlog even though the problem was noted in each of 1997, 1998 and 1999 self-assessments and was communicated by the OSC to the IDA in October 1998 as an issue to be addressed.

III.B.2 Impact of CDNX and Ontario Securities Dealers

A review of the 1999 Member Regulation Self-Assessment included a strategic plan for fiscal 2000. This plan did not include a plan to address the significant expansion of the IDA's membership which is expected as a result of the newly formed CDNX and the requirement by the OSC for all securities dealers to be members of a SRO. A discussion with senior staff indicated that the IDA had not yet developed a plan to address these issues but is monitoring the situation to learn how to deal with these issues.

III.B.3 Issues Not Addressed in 1999

The self-assessment indicated significant initiatives from the 1999 strategic plan that had been carried forward to 2000 in the areas of systems development, development of policies and procedures and performance measurements. Not only were these initiatives not met in the previous year, but no explanation was given as to why they had been postponed or if there is a plan to monitor these "overdue" issues.

III.B.4 Boston Consulting Group

In the summer of 1998 the Board engaged the Boston Consulting Group ("BCG") "...to review the performance of the Association in the context of the significant growth of the organization and the rapidly evolving financial services industry."³ A review of the minutes of the Board dated January 13, 1999 and a letter to the Chair of the OSC dated January 14, 1999 indicated that the recommendations of the BCG were accepted and approved in principle and the initiative would be carried out.

The IDA has not developed an implementation plan to carry out the recommendations relating to member regulation, including a time-line for implementation and the allocation of responsibility to ensure that the plan is carried out in a timely, efficient and effective manner.

BCG's recommendations for enhancement of the IDA's self-regulation functions included the creation of a new Member Regulation Oversight Committee and an enhancement of member regulation via a comprehensive set of initiatives. Staff is aware

³ "Preparing The IDA For The Future, Summary of Situation Assessment and Recommendations", The Boston Consulting Group, January 6, 1999.

that the Member Regulation Committee was created in 2000 however the status of the member regulation enhancement initiatives is not clear.

Staff believes that it is important for the IDA to have a well-defined strategic planning and business planning process. This will ensure that the organization's objectives are prioritized, adequate resources are allocated to initiatives, responsibilities and accountability are allocated to appropriate staff, and time frames are defined to accomplish its objectives. The plan must be monitored on an ongoing basis and changes to or variances from the plan should be adequately explained and agreed to by the Board.

Staff recommends that the IDA formalize and improve its strategic planning and business planning process to ensure commitment to and accountability for the plan and strict monitoring of adherence to the plan.

III.C Committees

III.C.1 Mandates of Committees

Staff reviewed the mandates of all committees of the IDA including its Board, Executive Committee, Audit Committee and Member Regulation Oversight Committee. Staff noted that in several cases, the mandates were vague and did not clearly establish the role, responsibilities, authority, composition of each committee, or how each committee's mandate is consistent with the IDA's mission and goals. Furthermore, it was not clear which committees were considered to serve a member regulation role and the extent of this role. For example, the mandate for the Corporate Finance Committee was stated as follows: "Deals with issues related to provincial securities legislation and industry regulations for corporate underwriting and corporate advisory activities. It assists securities commissions in developing and amending securities legislation, particularly disclosure requirements for underwriting and corporate asset transactions." In this case, the mandate does not establish the authority of the committee, its reporting responsibilities to the Board, the composition of the committee, and its role as related to member regulation.

Furthermore, it was noted that the membership of the Audit Committee consisted of only one independent member who is a public director. Of the four members of the committee, the three remaining members consisted of the IDA Chair, IDA Vice-Chair and FAS Chair. Results of a CICA research study on audit committees indicated that "[all] members of the audit committee should be outside directors."⁴ An outside director "...should be interpreted to mean a director who is independent of management and free from any relationship that, in the opinion of the board of directors, would interfere with the exercise of independent judgement as a committee member."⁵

Staff recommends that the Board review the mandate of each committee to ensure that it is consistent with the IDA's mission and goals; it clearly describes the responsibilities of

⁴ "Audit Committees - a research study." CICA. p.7, March 1981

⁵ Ibid.

the committee; it addresses the authority of each committee to ensure that it is clearly established, including the committee's authority to take action on behalf of the Board; it clearly indicates the member regulation responsibilities of the committee (if any); and that the composition of each committee is clearly define. In the case of the Audit Committee, the IDA should consider appointing more public directors to the committee.

III.C.2 Evaluating Committees and the Board

During the review of the Board minutes, staff noted that there is no formal process in place for evaluating the effectiveness of the existing committees. Due to the fact that the IDA has numerous committees and sub-committees and some committees have a large number of members, this may result in ineffective decision-making. Furthermore, staff noted that there is no formal process in place to evaluate the effectiveness of the Board itself.

Staff believes that the Board should be responsible for monitoring the overall effectiveness of the Board and its committees. This would include the review of "... the structure and responsibilities of the Board and its committees; the knowledge, understanding and diversity of directors; the culture and chemistry in the boardroom: and the effectiveness of the Chair."⁶

Staff recommends that the Board develop and implement policies and procedures for assessing the effectiveness of the committees on a regular basis. In addition, the Board should establish a process for assessing its effectiveness as a whole and the contribution of individual directors and the Chair.

III.C.3 Management Reporting to the Executive Committee and Board of Directors

Staff noted that management decisions and issues are not reported to the Executive Committee and Board in a formalized, consistent and regular manner. Staff understands that the Board has delegated the majority of its powers to the Executive Committee in accordance with the provisions of By-law 10.16 during the intervals between meetings of the Board. In general, the Board retains its decision-making power over rule making and other specified matters while the Executive Committee must assess and report to the Board on the IDA's performance of its self-regulatory committees.

Staff's review of the minutes of the Executive Committee revealed that the Executive Committee deals with a significant number of issues; however there does not appear to be a clear manner by which these issues are escalated to the committee by senior management and/or other committees. Moreover, a review of the Board minutes indicated that some of the issues discussed by the Executive Committee are referred to the Board; however there appears to be no defined criteria as to how the Executive Committee determines which issues should be escalated and how frequently.

⁶ "Guidance For Directors - Governance Processes For Control". CICA, p.16, December 1995

Staff believes that an appropriate reporting structure that ensures adequate, timely and regular reporting is necessary to ensure that the Board can fulfill its role to effectively manage the IDA's affairs, supervise senior management appropriately, provide guidance, and develop policy.

Staff recommends that the IDA formalize its management reporting process from senior management to the Executive Committee and finally to the Board. Criteria should be defined as to the issues that should be escalated, the information that should be provided, including decisions made, and the frequency of the reporting. The Executive Committee and thus the Board will then be able to effectively fulfill their roles.

III.D Performance Measurement

Staff noted that the IDA does not have a performance measurement process for its key member regulation operations. In accordance with the terms and conditions of its Recognition, senior management of the IDA is required to at least annually prepare a self-assessment of its self-regulatory responsibilities and report to the Executive Committee, together with any recommendations for improvements. However, the self-assessment does not include an assessment of performance against specific performance benchmarks. Staff is aware through discussions with senior management and review of the minutes of the Member Regulation Oversight Committee, that senior management is in the process of developing performance benchmarks. It is staff's understanding that the Member Regulation Oversight Committee has as part of its mandate the responsibility to oversee the Member Regulation operations in order to ensure that the IDA is fulfilling its obligations in a fair, effective and efficient manner. This committee can review and recommend for Board approval standards for departmental performance in specific areas, monitor performance in relation to those standards and make recommendations for improvement.

Staff consider it key that a process for performance measurement be developed so that the performance of the IDA's member regulation function can be effectively monitored by the Board on an ongoing basis. The OSC had previously recommended that performance criteria be developed for departments such as Sales Compliance and Enforcement as a result of its review of the 1997 member regulation self-assessment. Furthermore, the IDA 1999 and 2000 strategic plans include the development of measurements but the IDA has yet to meet its plans. Performance benchmarks, adequately developed and consistently applied to an organization's performance, are good indicators of areas which need immediate attention and enable the organization to make the appropriate changes in a timely manner.

Staff recommends that a formalized performance measurement process be developed immediately. The annual self-assessment that is prepared by senior management should measure the member regulation performance against the performance benchmarks developed. These benchmarks should be reviewed on an ongoing basis to ensure that they are relevant and appropriately measure the member regulation function of the IDA.

III.E Adequacy of Resources

III.E.1 Technology

During the review it was identified that the IDA does not have a clear vision of their IT Strategy. Although a consultant (Stratix) was hired in the fall of 1998 to develop an IT Strategic Plan which was presented to the Board and senior management in January 2000, the majority of the plan was not implemented. Since then, the IDA has hired a Director, Information Systems. It is staff's understanding that the Director is currently revising the IT Strategic plan for presentation to the IT Steering Committee by mid-2000. His mandate is to develop short-term implementation plans for the IDA taking into account the priorities identified.

The need for an IT strategy is consistent with the background paper to the IDA recognition criteria which stated that operational arrangements and resources should at a minimum consist of, "16. (c)(iii) adequate management information systems."⁷ Adequate information systems enable an organization to adequately manage information in an efficient and effective manner, access this information on a timely basis, and communicate this information both internally and externally, as required. In the previous two reports presented to the IDA, it was identified that key areas of member regulation are in need of systems development, and especially in the Enforcement Department where there is no case management system or time management system.

Staff recommends that the IDA formalize its IT plan immediately and develop a time frame for implementation as soon as possible. The IDA should submit this plan to the OSC as soon as it is approved.

III.E.2 Personnel

During discussions with senior management and review of the Board minutes, it was noted that the IDA has difficulty attracting and retaining professional staff, such as Enforcement Counsel and Chartered Accountants. As a result, personnel resources seem to be stretched in all departments, most notably in the Enforcement, Financial Compliance and Sales Compliance areas. Staff's discussions with IDA staff indicated that base salaries and incentives are an issue. The current bonus program is for managers and above only. Based on interviews with IDA staff it appears that low morale is also an issue. For example, lack of resources and inadequate compensation has led to a heavy caseload for each of the Enforcement Counsel, resulting in high turnover and low morale.

As a result of not having sufficient resources the IDA has experienced a growing backlog of files in the Investigation (including Complaints/Inquiries) and Enforcement Counsel groups. Similarly, Sales Compliance has been unable to complete the number of head office reviews required.

⁷ "Recognition of the IDA as an SRO, Staff Proposal for Initial Recognition Criteria and Ongoing Monitoring and Request for Comments", (1995) 18 OSCCB 2675.

Ensuring adequate staffing is key to the effective operation of the IDA's member regulation functions. It is important for the compensation structure to be competitive so that the organization can attract and retain individuals with special skills and knowledge. This is consistent with the background paper that was published with the IDA recognition criteria, which refers to a minimum of operational arrangements and resources including, "16. (c)(i) sufficient full-time paid and qualified staff, including professional and other appropriately trained staff, and with appropriate compensation structures."⁸

Staff recommends that the IDA revisit its compensation structure and recruiting process and take steps to develop a plan to address these concerns. For example, a compensation review could be performed in order to address employee turnover, and an anonymous staff survey could be undertaken in order to identify the reasons for low morale and possible ways to rectify the situation.

III.E.3 Budget Review Process

The IDA does not have sufficient resources allocated to its member regulation function to ensure that it meets its obligations as a SRO. Evidence of lack of resources was discussed in III.E.1 and III.E.2 above. The Audit Committee plays a key role in the budget process and is responsible for understanding the process of developing the budget, reviewing the budget, and providing feedback to senior management prior to the Board's approval.

Staff is aware that a separate budget is prepared for member regulation. Furthermore, it is staff's understanding that until recently, the Audit Committee's review of the budget included ensuring that the budget for member regulation was adequate. This responsibility has now passed over to the newly formed Member Regulation Oversight Committee, the mandate of which is to ensure the efficiency and effectiveness of the member regulation function at the IDA. Staff believes that this shift in responsibility is a positive one. However, it is not clear what process has been put in place by the Member Regulation Oversight Committee to ensure that the member regulation budget is adequate and that any concerns are brought to the attention of the Audit Committee on a timely basis.

Staff recommends that the Member Regulation Oversight Committee develop guidelines to ensure that the budget allocation process results in an adequate allocation of resources to the member regulation function. Furthermore, a process should be developed to communicate resource issues from the Member Regulation Oversight Committee to the Audit Committee on a timely basis. Finally, it is staff's view that the resources currently allocated to the Member Regulation function are inadequate and this should be communicated to both committees immediately.

⁸ "Recognition of the IDA as a SRO, Staff Proposal for Initial Recognition Criteria and Ongoing Monitoring and Request for Comments", (1995) 18 OSCB 2675.

III.F Policies and Procedures

During staff's discussion with senior management it was identified that several departments do not have formalized policies and procedures. These include the departments of Human Resources, Information Systems and Enforcement. Staff has made this recommendation in our previous reports with respect to the Registration and Regulatory Policy departments. The IDA has seen tremendous growth since its recognition by the OSC in 1995. With such an expansion, informal policies have been developed on an ad hoc basis to deal with issues. However, as the IDA continues to expand and evolve, formal policies and procedures are necessary to clarify processes and encourage consistency.

Staff recommends that formalized policies and procedures be developed for the Human Resources, Information Systems, and Enforcement departments. Please submit a copy of these policies and procedures to the OSC once completed.

IV. Enforcement Division

The following section discusses issues related to the Enforcement Division identified as a result of staff's review of the 1999 Member Regulation Self-Assessment and interviews with IDA staff.

IV.A Backlog of Enforcement Cases

It was identified through discussions with senior management, staff's review of the self-assessment, and staff's review of the minutes of the Board that a significant issue facing the Enforcement Division is the continued and growing backlog of files in both the Investigation (including Complaints/Inquiries) and Enforcement Counsel groups despite an increase in resources. For example, the backlog of files has increased from 1997 to 1999 as follows: Complaints- from 141 to 225; Investigation - from 212 to 337; Prosecution - from 61 to 144. In staff's view this has become a serious issue. Contributing to this problem is the Enforcement Division's inability to maintain adequate levels of staffing and the fact that there is no process to screen matters before they are forwarded for investigation. The latter results in many relatively minor cases awaiting investigation which might be dealt with more expeditiously in another fashion.

Another contributing factor is the lengthy review process each investigation goes through. For example, recommendation reports on each and every case file in the Enforcement Division are subject to five levels of review. The files are each reviewed by the Enforcement Manager, the Director, Investigations, the Vice-President, Enforcement Division, Enforcement Counsel and ultimately the S.V.P. (see discussion at III.A 3.). It

is staff's view that this level of review is excessive and adds unnecessary delay to the litigation process.

The IDA currently does not have a formalized plan to address the growing backlog in Enforcement. Staff is aware that the Director of Enforcement has developed and presented a proposed plan to the President and S.V.P. for their consideration, but staff has not yet been given access to this plan.

Staff recommends that the IDA implement a plan for clearing the backlog of files immediately. The plan should include the allocation of additional resources to the Enforcement Division on an emergency basis to clear the backlog. A review of the Enforcement process should also be undertaken. Such a review should result in implementation of a screening process for all files prior to commencing an investigation and the streamlining of the review process for completed Enforcement files. Staff requests that the IDA submit a plan to the OSC by November 30, 2000.

IV.B Due Diligence Process

As a result of staff's review of the IDA's 1999 Member Regulation Self-Assessment and through discussions with IPA staff, staff identified that the due diligence process for determining penalties may not be effective. Enforcement Counsel are required to perform a thorough review of the file prepared by the investigator and are required to perform research regarding appropriate penalties. This research includes a review of precedent cases and TSE penalty guidelines. Enforcement Counsel then propose penalties which are reviewed and approved by the Enforcement Manager, the Director of Investigations, and the Vice-President of Enforcement. The final level of approval rests with the S.V.P. who may change the recommendations brought forward by Enforcement Counsel. These changes may result in less severe or more severe penalties.

Through our discussions with IDA Enforcement staff, the penalty recommendations put forward by Enforcement Counsel appear to be altered by the S.V.P. on a very frequent basis. Staff has not been able to quantify how often this occurs on a percentage basis. However, in one instance it appears that out of the 17 cases forwarded to the S.V.P., 12 recommendations were changed. Staff was informed that reasons for the changes are not provided and are not documented.

Staff is concerned with the large number of changes made to Enforcement Counsel's recommendations especially following a lengthy review and approval process. Staff believes that this may indicate a significant flaw in the due diligence process followed in formulating the recommendations.

Staff recommends that the due diligence process to determine the penalty recommended by Enforcement Counsel should be reviewed and a plan developed to rectify any weaknesses. In addition, all changes made by the S.V.P. to the recommendations put forward by Enforcement Counsel and the reasons for these changes should be documented to ensure that the process is transparent.

V. Compliance with Terms and Conditions of Recognition

In October 1995, the OSC recognized the IDA as a SRO pursuant to section 21.1 of the Act subject to terms and conditions attached to the recognition order.

The CSA has agreed to harmonize IDA reporting requirements and is currently undertaking a review of these requirements. This review may result in a change to the IDA's current reporting requirements as stated in the terms and conditions.

This examination reviewed the IDA's adherence to its terms and conditions as currently stated. In this regard, staff has identified the following issues that require attention.

V.A Terms and Conditions Item 5

Item 5(c) of the terms and conditions states “[t]he IDA shall provide to the Commission annually or more frequently upon request a summary of all open investigations, and such notice shall indicate the date the investigation started, identify the member and relevant Approved Persons involved and summarize the misconduct alleged.” Staff noted that a cumulative summary of all open investigations is not provided to the OSC on an annual basis.

Item 5(f) of the terms and conditions states “...[t]he IDA shall at least annually review all material settlements involving its members and their clients with a view of determining whether any action is warranted, ...” Staff noted that the IDA is not annually reviewing all material settlements involving its members and their clients with a view of determining whether any action is warranted.

Staff requires that the IDA take steps to ensure that the requirements of Item 5 (c) and 5 (f) are met in the future. The report in 5(c) should be submitted to the OSC Manager, Compliance.

V.B Terms and Conditions Item 13

Item 13 of the terms and conditions states that “...[t]he IDA shall...give the Commission notice of new directors, officers and committee chairpersons including a 5 year employment history and information as to prior involvement in criminal (other than highway traffic), administrative or insolvency proceedings and civil proceedings involving business conduct or alleging fraudulent conduct or deceit in respect to each such person.” Staff noted that the notice given to the OSC of new IDA directors, officers and committee chairpersons does not include a 5 year employment history and information as to prior involvement in criminal (other than traffic), administrative or

insolvency proceedings and civil proceedings involving business conduct or alleging fraudulent conduct or deceit in respect to each such person.

Staff requires that the IDA take steps to ensure that the requirements of Item 13 of the terms and conditions be met in the future. Such reports should be submitted to the OSC Manager, Compliance.

V.C Terms and Conditions Item 19

Item 19 of the terms and conditions states “[t]he IDA shall ensure that it is accessible to the public and shall designate and make public the names and telephone numbers of persons to be contacted for various purposes, including complaints and enquiries.” Staff noted that the IDA does not make public a list of contact persons that are to handle public enquiries. All enquires are received by reception and are then forwarded to the appropriate department which in turn deals with the issue.

Staff requires that the IDA take steps to ensure that the requirements of Item 19 are satisfied. Please provide a copy of this list with your response.

V.D Monitoring of Terms and Conditions

Staff noted that there is currently no one at the IDA who is responsible to ensure that all the terms and conditions of the IDA recognition criteria are being met.

Staff recommends that the IDA develop and implement a process to monitor the terms and conditions of its Recognition to ensure they are met in the future. The S.V.P. should be responsible for this process. The IDA’s compliance with its terms and conditions of Recognition should be reported in the annual member regulation self-assessment. Please submit a description of this process with your response.

Appendix I: Work Plan

General

1. Organizational assessment - review and evaluate governance and structure, staffing, budgets and business plans to ensure that the IDA can meet its member regulation responsibility as a SRO.
2. Terms and Conditions - review and assess compliance with the terms and conditions of recognition and the undertakings signed by the IDA when they were formally recognized as a SRO.

Financial Compliance

1. Review the procedures for determining compliance with minimum standards as imposed by CIPF and ensure the procedures are adequate and that they are being followed effectively.
2. Review procedures for monitoring capital adequacy, insurance and segregation requirements (i.e. review of monthly, quarterly and annual financial questionnaires). Ensure that any reportable conditions are being dealt with in accordance with the minimum standards.
3. Review examination programs to ensure that they cover all relevant IDA and OSC rules.
4. Review sample of examination files to ensure that examinations are carried out completely and effectively, that all deficiencies are identified and documented, and that deficiencies are adequately and consistently dealt with, including taking disciplinary actions when appropriate.
5. Review oversight procedures performed by CIPF to ensure that they are consistent with its agreement with the CSA.
6. Perform financial compliance examinations on a sample of member firms and compare results to those of the IDA and CIPF.

Sales Compliance

1. Review procedures and criteria for selecting members for head office and branch sales compliance reviews. Determine adequacy of procedures and criteria and adherence to them.
2. Review examination programs to ensure that they adequately address IDA and OSC rules.
3. Review sample of examination files to ensure that examinations are carried out completely and effectively, that all deficiencies are identified and documented, and that deficiencies are adequately and consistently dealt with, including taking disciplinary actions when appropriate.
4. Perform sales compliance examinations on a sample of member firms and compare results to those of the IDA.

Enforcement

1. Review process for dealing with complaints and conducting investigations to ensure they are appropriate and result in consistent and timely enforcement of IDA rules and securities legislation and in compliance with the terms and conditions of recognition.
2. Review a sample of complaint files to determine adequacy, timeliness and consistency of dealing with complaints.
3. Review a sample of investigation files to determine adequacy, timeliness and consistency of dealing with investigations. Ensure that appropriate disciplinary action is taken against individuals and member firms.
4. Ensure that all disciplinary matters are dealt with appropriately and in accordance with the terms and conditions of recognition.

Registration

1. Review procedures for determining suitability for registration to ensure that the objectives of the relevant sections of the Act are met.

2. Review process for new applications for registration to ensure that they are carried out completely and effectively, that all deficiencies are identified and documented, and that deficiencies are adequately and consistently dealt with.
3. Examine a sample of new applications, applications for exemptions and applications for amendments to ensure that they were dealt with appropriately and, where applicable, that the discretion used was appropriate and consistent.
4. Review the membership approval process to ensure that the decision to accept or reject membership is fair.

Regulatory Policy

1. Review overall IDA rule-making process to ensure that the IDA is in compliance with Paragraph 12 of Schedule A to the OSC's Terms and Conditions of Recognition.
2. Review a sample of IDA by-laws finalized in order to verify the rule-making process.

Appendix II: Previously Reported Results

Sales Compliance

- Overall, documentation was weak in the Sales Compliance working paper files. Without clear documentation in the file, the manager's review of the working papers and report is not effective in identifying deficiencies and ensuring appropriate conclusions reached. It was recommended that file documentation standards be implemented.
- The Sales Compliance department has not implemented its risk-based approach to member branch reviews. In 1995 the IDA signed an undertaking in which it stated that it would implement a risk-based approach to member branch reviews. It was recommended that the Sales Compliance department implement its risk-based approach to the scheduling of reviews immediately.
- The IDA Sales Compliance department does not have a formal training program for its examiners. As a result, and as noted through the review of the working papers, the quality of the work performed by the examiners varies dramatically. It was recommended that a training program be developed and implemented promptly.

Financial Compliance

- The IDA's Financial Compliance reviews of member firms are mainly substantive examinations. Management should consider the cost-effectiveness of performing substantive versus system-based procedures in obtaining assurance as to the accuracy of members' Risk Adjusted Capital.
- Financial Compliance maintains an extensive database of its members. Access is limited to this department nor do other departments have such a database. The IDA should consider developing a global database as part of its IT Strategic Plan.

Enforcement

- The Enforcement Department uses 3 separate Q&A databases to track complaints, investigations and prosecutions. The IDA Enforcement Department's case tracking

system could be improved significantly by allowing all IDA Enforcement Department staff to have access to a single networked case information system. This will improve the communication process and enhance the overall effectiveness of the case tracking system through continuous monitoring of complaints, investigations and prosecution cases.

- The Enforcement Department has no objective method for determining the costs of an investigation. The acquisition and implementation of an appropriate time management system in the IDA Enforcement department would be an effective management tool. This system would not only assist management in monitoring the progress of the case to completion but also assist management in assessing staff's performance.

Regulatory Policy

- The IDA does not have procedures with regard to the development and implementation of IDA by-laws. It was recommended that the IDA develop a policies and procedures manual which at a minimum includes guidelines for file documentation, review process, time frame for submission to the Board, filing procedures and how members are informed of new or amended by-laws.
- Review of the IDA by-laws indicated that different individuals in the Regulatory Policy Department have different standards for file documentation. A completed IDA by-law file should contain sufficient information to substantiate the decision reached by the IDA on the proposed by-law. It was recommended that the IDA establish standards on file documentation for by-laws.

Registration

- The IDA Registration department does not have a policies and procedures manual. Staff recognized that this manual was in development at the time of review but recommended that such a manual be implemented promptly to ensure consistency of work performed. Staff noted numerous procedural deficiencies that could be rectified through development of standard policies and procedures for the Registration department.
- The Registration department's current filing system is not adequate. Without an accurate and efficient system for the storage and tracking of files, files can be misplaced and time spent searching for those missing files is an inefficient use of the Registration staff's time. It was recommended that the IDA Registration

department update and reorganize their current filing system to ensure all files can be located on a timely basis.

There is no procedure in place for the communication of all company changes between the IDA Corporate Secretary's department and the IDA Registration department and between the IDA Registration department and the OSC Registration department. It was recommended that procedures to communicate this information should be implemented promptly.

Appendix III: Listing of IDA Interviews

G.M. Clarke	Senior Vice-President, Member Regulation
D.W. Grant	Senior Vice-President, Finance and Administration
S. Barrett	Association Secretary
K. Rose	Vice-President, Regulatory Policy
F. Maefs	Vice-President, Enforcement
L. Piergeti	Vice-President, Financial Compliance
M. Al-Samadi	Vice-President, Financial Compliance
L. Boyce	Vice-President, Sales Compliance and Registrations
M. Weigelin	Director, Information Systems
J. Siddall	Manager, Human Resources

Appendix IV: Listing of External Interviews

Members

TD Securities Inc.	Donald Wright, Chairman and Chief Executive
Newcrest Capital Inc.	Robert Dorrance, President and Chief Executive Officer
Investors Group Securities Inc.	Mike Miller, Chairman
Charles Schwab Canada	Paul Bates, President and Chief Executive Officer Sean Church, Executive Director and Chief Operating Officer
Dundee Securities Corporation	Donald Charter, Chairman, Chief Executive Officer John E. Panneton, President
CIBC World Markets Inc.	Richard Venn, Chairman and Chief Executive Officer

Canadian Investor Protection Fund

Rozanne Reszel, President and Chief Executive Officer

CSA Steering Committee

Christina Forster (ON)
Felicia Tedesco (ON)
Jennifer Elliott (ON)
Carolyn Davis (ON)
Dina Dizon (for Gina Sugden) (ON)
Noreen Bent (BC)
Ross McLennan (BC)
John Porges (BC)
Gerry Halischuk (BC)
Ken Parker (AB)
Wayne Alford (AB)
Barbara Shourounis (SASK)
Jacinthe Bouffard (PQ)