



Canadian Foundation *for*
Advancement *of* Investor Rights

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RE: Limitation on IIROC Enforcement Proceedings

FAIR Canada is pleased to offer comments on the Proposed Amendments contained in IIROC's Notice 10-0310 regarding amendments to its limitation period on enforcement proceedings contained in Dealer Member Rules 19 and 20 (henceforth the "Rules").

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As the voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. Limitation periods generally

1.1. FAIR Canada understands IIROC's position that principles of natural justice make it appropriate to impose limitation periods on proceedings against current and former Dealer Members and Approved Persons. (Note that we will henceforth use "Dealer Members and Approved Persons", unless further specified, to mean both current and former Dealer Members and Approved Persons). However, FAIR Canada does not agree that principles of natural justice require a limitation on proceedings against Dealer Members and Approved Persons in all circumstances. FAIR Canada also suggests that principles of natural justice may require unlimited time to initiate proceedings against Dealer Members and Approved Persons in many cases.

- 1.2.** Principles of natural justice require procedural fairness to all parties concerned in a potential dispute, and if a claimant is not encouraged to initiate proceedings within a strictly prescribed limitation period, then recollection of evidence may be a problem. In addition, as IIROC points out in its Notice, the lack of a limitation regime would require indefinite maintenance of records. Nevertheless, there are circumstances where strict adherence to limitation periods may place claimants at procedural or substantive disadvantages.
- 1.3.** A claimant may be unaware of a right to maintain a claim, the claim may be based on an undiscovered or concealed fraud, or the elements of the claim may be concealed from the claimant. In such circumstances, claimants may be unaware that there is a cause of (or right to) action against the defendant. Thus, in cases where the claimant is unaware of his or her right to maintain a claim because the defendant has deliberately concealed these facts from the claimant, strict application of the prescribed limitation period would bar any action against the offending party.
- 1.4.** Due to the particularly complex and technical nature of many complaints that can be made against a Dealer Member, and the wide gap in experience and expertise between a Dealer Member and its clients, it will not be surprising if actions (such as, for example, a Dealer Member offering unsuitable advice to a client) go undetected for many years. Clients place a great deal of trust in Dealer Members and are often reliant on Dealer Members precisely because they lack the specialized understanding and knowledge necessary to evaluate a Dealer Member's conduct. In many circumstances, therefore, long years may pass between an event that could give rise to an enforcement proceeding, and the discovery of such an event (or the discovery that the conduct may have been inappropriate) by a client. Without such a complaint, IIROC will often have no way of knowing that the events have occurred.
- 1.5.** The particular role which risk plays in financial matters may contribute to this factor. Risk can lay dormant within a client's affairs for many years due to decisions made or advice provided by a Dealer Member or Approved Person. However, the proper evaluation of such risks is a crucial aspect of the relationship between clients and advisors. FAIR Canada considers it inappropriate to introduce limitations on IIROC action that enable an advisor to have the effects of inappropriate risk become evident after a fixed limitation period.
- 1.6.** Traditionally, two defences were available to defeat equitable claims by a principal to whom a fiduciary duty was owed; *laches* and acquiescence. Acquiescence involves the acceptance or agreement of a principal to conduct by the fiduciary that was either evident or of which the principal was notified. *Laches* involves the principal having delayed the enforcement of his or her rights, where such delay has prejudiced the defendant fiduciary in a proceeding. Until quite recently, there was generally no other limitation to a cause of action for breach of fiduciary duty in Canada. Recently, some provincial Limitations Acts have changed (Ontario's, for example, in 2002) to place limitation periods on such actions. However, because of the fundamental gap in knowledge and expertise between a fiduciary on the one hand and the principal on the other,

provincial Limitations Acts traditionally provided exemptions for breaches of fiduciary duties.

- 1.7.** FAIR Canada understands and agrees that the duties of a Dealer Member or Approved Person are not fiduciary duties in law. However, many of the same principles that have traditionally been considered to make limitation periods unsuitable for breaches of fiduciary duty can also apply to the relationships between Dealer Members and Approved Persons and their clients. Dealer Members, through their role in modern life and the modern economy, are placed in a position of enormous trust, and are relied upon by their clients to navigate complex concepts that are beyond the comprehension many investors. FAIR Canada believes that the fundamental framework on which Dealer Members' activities should be regulated is one where a Dealer Member is required to put the client's best interests first; a requirement that is already in place in certain aspects of Dealer Members' relationships with their clients. For example, in section 13.4 of the Companion Policy to NI 31-103, there is a directive to Dealer Members to consider whether any of their particular benefits, compensation or remuneration practices are inconsistent with their obligations to clients, and particularly where the firm relies heavily on commission-based remuneration. Similarly, section 13.5 of the Companion Policy provides guidance on referral arrangements that specifically directs Dealer Members to consider whether an unreasonably high fee may create a conflict that would motivate its representatives to act contrary to their duties toward their clients.
- 1.8.** FAIR Canada would therefore submit that a proper alternative limitations regime would allow for no limitation period in circumstances where the acts of the Dealer Member or Approved Person have negatively impacted a client or member of the public who has made a complaint to IIROC in respect of the Dealer Member or Approved Person's services. That is, limitation periods would only apply in connection with administrative offences or other circumstances where the interests of clients are not directly affected.
- 1.9.** FAIR Canada would agree, and would submit, that it would be appropriate to limit such a limitations regime by providing explicitly in the Rules that where such a proceeding takes place six years after discoverability, as outlined in section 2.2 below, the proceeding will not continue if the Dealer Member or Approved Person can show that they are substantially prejudiced by the delay.
- 1.10.** FAIR Canada agrees with IIROC that the limitation period should apply uniformly to current and former Dealer Members and Approved Persons.
- 1.11.** FAIR Canada agrees with IIROC that the proposed Rule should require only that proceedings commence within the limitation period, and should not require that proceedings be completed within the limitation period.
- 1.12.** FAIR Canada also considers it to be appropriate to allow proceedings to "commence" within the limitation period by furnishing a notice to the Dealer Member or Approved Person that IIROC intends to initiate enforcement proceedings against the Dealer Member or Approved Person.

2. Event occurrence versus discoverability

- 2.1.** FAIR Canada disagrees with IIROC's determination that the calculation of a limitation period should be based on event occurrence.
- 2.2.** FAIR Canada considers that instead, the limitation period should be calculated from the *later* of:
- i. the *earlier* of:
 - a) the time at which IIROC obtains information or facts that the event that forms the subject matter of the enforcement proceeding has occurred, and
 - b) the time at which IIROC should reasonably have become aware that a violation is or had occurred; and
 - ii. for non-compliance that is or was continuing, the time of the last occurrence of the conduct in question.
- 2.3.** In other words, if IIROC has no information or facts that do or should put it on notice of the subject matter of the enforcement proceeding, and IIROC can show that it used reasonable diligence in determining the facts behind the wrongful conduct, the limitation period should not begin to run. Furthermore, where non-compliance continues even after IIROC is aware of the conduct, IIROC should remain free to act by bringing enforcement proceedings.
- 2.4.** Given that the sanctions available to an IIROC disciplinary hearing panel are limited to fines, suspensions, and permanent bars, FAIR Canada believes that a limitation period calculated on the basis of discoverability would be consistent with the principles of natural justice. No liberty interest of Dealer Members or Approved Persons is at stake in an IIROC enforcement proceeding.
- 2.5.** Many of the complaints that may be made against a Dealer Member or Approved Person are of a particularly complex and technical nature. There is also a wide gap between Dealer Members and their clients in experience, expertise and the understanding of the Rules. As such, FAIR Canada considers it likely that certain events (such as, for example, a Dealer Member offering unsuitable advice to a client) could go undetected for many years. Clients place a great deal of trust in Dealer Members and are often reliant on Dealer Members precisely because clients lack the specialized understanding and knowledge to evaluate a Dealer Member's conduct. In many circumstances, therefore, long years may pass between an event that could give rise to an enforcement proceeding, and the discovery of such an event (or the discovery that conduct may have been inappropriate) by a client. Without such a complaint, IIROC will often have no way of knowing that the events have occurred.
- 2.6.** FAIR Canada does not consider it a breach of natural justice to allow complaints in such circumstances to proceed. FAIR Canada considers the relative gap in knowledge and understanding between clients and Dealer Members to be an important factor that may delay discovery of inappropriate conduct, despite the lapse of considerable time.

- 2.7.** The particular role which risk plays in financial matters may contribute to this factor. Risk can lay dormant within a client's affairs for many years due to decisions or advice made by a Dealer Member or Approved Person. However, the proper evaluation of such risks is a crucial aspect of the relationship between clients and advisors. FAIR Canada considers it inappropriate to allow for a system of limitations on IIROC enforcement actions that enable an advisor to avoid an enforcement action due to the amount of time that passes before the inappropriate risk taken becomes evident.
- 2.8.** In the alternative, if IIROC considers it necessary to base the running of the limitation period on event occurrence only, FAIR Canada considers that IIROC should nevertheless include an extension of the six year limitation period in any instance where material facts relating to the subject matter of the enforcement proceeding have been wilfully concealed by any party, or where a person has been discouraged from making a complaint. The absence of such a rule would create a perverse incentive for a Dealer Member (or other person who may be implicated in such conduct) to hide material facts from IIROC or a potential complainant, to allow the limitation period to lapse. FAIR Canada considers it a subversion of natural justice to allow a party to unfairly cause a potential action to lapse through obstruction, fraud and delay. FAIR Canada notes that the Limitations Acts of several provinces, including British Columbia, Alberta and Ontario, provide similar protections against wilful concealment.
- 2.9.** In such circumstances, FAIR Canada suggests that the Rules provide for the limitation period to begin from the last time that the material facts have been properly disclosed to IIROC or to any potential complainant who may have been injured or prejudiced by the conduct in question.

3. Limitation period and IIROC's public interest mandate

- 3.1.** In preparing these comments, FAIR Canada requested from IIROC statistics on the length of time between past event occurrence and the initiation of IIROC enforcement proceedings. IIROC responded that it does not maintain and could not access any such statistics. IIROC staff stated to us that its enforcement department is comfortable that six years will be sufficient for them to initiate an enforcement proceeding.
- 3.2.** If, following consideration of these comments, IIROC intends to impose a six-year limitation period, FAIR Canada would recommend that IIROC undertake a review of historical proceedings to ensure that a six-year limitation period is indeed sufficient, prior to enacting any limitation period amendments. FAIR Canada suggests that if IIROC would have been unable to deal with some past investor complaints had the proposed limitations period been in place, it should consider revisiting its proposed amendments to ensure that it is able to properly protect investors. In order to carry out its mandate to protect investors and strengthen market integrity, we recommend that IIROC verify internally that it can fulfil its public interest mandate within the proposed time constraints.

3.3. FAIR Canada would be more comfortable with IIROC's assurance that all enforcement proceedings could be commenced within a six-year period if the effects of the proposed rule on investor protection were considered in the same manner as effects on market structure, dealer members, non-dealer members, competition and costs of compliance (as outlined in the request for comment).

4. Evidentiary issues and recordkeeping rules

4.1. FAIR Canada encourages the harmonizing of the limitation period applicable to enforcement proceedings with the recordkeeping rules that ensure the preservation of evidence that can be used in such proceedings.

4.2. With respect, FAIR Canada considers IIROC's emphasis on harmonizing the limitation period to the recordkeeping rules to be misplaced. Rather, we suggest that the emphasis be on limitation rules and enforcement provisions, including recordkeeping requirements, that best protect Canadian investors within a framework of natural justice. In other words, recordkeeping rules ought to be harmonized to the enforcement regime, and not the other way around. IIROC has identified several instances where Dealer Members are required to keep records for time periods shorter than the proposed limitation periods.

4.3. FAIR Canada considers it imperative that IIROC act to harmonize these recordkeeping rules so that all potentially relevant records are kept to allow enforcement proceedings to be effective. This means, at minimum, that all materials be kept for six full calendar years after the last possible time at which such material may be relevant to an enforcement proceeding. However, FAIR Canada considers some material, such as account records, correspondence, records of internal investigations, and supervisory reviews, to be potentially important on an ongoing basis. Given the low cost and high capacity of digital storage, and the likelihood of continuing improvements in storage cost and capacity in the future, FAIR Canada would encourage IIROC to consider whether such information and records should ever be destroyed. We do not believe that a requirement that such records be retained indefinitely would impose undue or significant hardships on Dealer Members.

5. Further comments

5.1. FAIR Canada would like to provide support for two comments received by IIROC as part of Kenmar Associates' letter dated December 2, 2010, regarding harmonization of limitation periods with the Mutual Fund Dealers Association of Canada (MFDA) and the system of imposing fines on individuals.

5.2. FAIR Canada agrees with the position outlined by Kenmar Associates, that harmonization of IIROC's limitations regime to that of the MFDA would be preferable. We understand that the MFDA have communicated to Kenmar Associates that, in their view, the MFDA's limitation

provisions provide a more desirable level of client protection, and that investors would be ill-served by moving from the MFDA's limitation provisions to those of IIROC. MFDA also made clear that they frequently receive complaints from investors well after the date of occurrence, and that such delays are precisely because, as we discussed above, those clients are unsophisticated. We think that this fact alone constitutes an important argument in favour of significantly strengthening the investor protection elements in IIROC's proposed amendments.

- 5.3.** Finally, FAIR Canada agrees that, as discussed by Kenmar Associates, further changes to the IIROC Dealer Member Rules are desirable to improve enforcement. We support Kenmar's suggestion that IIROC consider an amendment to the Dealer Member Rules to enforce joint and several liability of a Dealer Member for fines imposed by IIROC on a registered representative, investment representative, sales manager, branch manager, assistant or co-branch manager, partner, director, officer, investor or employee of that Dealer Member. Not only would this result in improved success in collecting fines, it would encourage closer supervision of such individuals by their Dealer Member firms, a result that would improve investor protection.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-572-2282/ermanno.pascutto@faircanada.ca or Ilana Singer at 416-572-2215/ilana.singer@faircanada.ca.

Sincerely,



Canadian Foundation for Advancement of Investor Rights