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**Re: Request for Comments – Consolidation of IIROC Enforcement, Procedural, Examination and Approval Rules**

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FAIR Canada is pleased to offer comments on the Investment Industry Regulatory Organization of Canada's ("IIROC") request for comments regarding the consolidation of IIROC Enforcement, Procedural, Examination and Approval Rules.

FAIR Canada is a national, non-profit organization dedicated to putting investors first. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

**Executive Summary**

1. In general, FAIR Canada supports IIROC for this initiative. We are pleased to offer our comments on the consolidated IIROC rules.
2. FAIR Canada considers it appropriate that, in general, IIROC staff not be required to notify a person who is the subject of an investigation that an investigation has been initiated. From an investor protection perspective, it is of primary importance that investigations be allowed to proceed (particularly in the early stages) with as few impediments as possible.
3. FAIR Canada considers it appropriate that a party not be allowed to delay an investigation because his or her counsel is not available within a reasonable time, particularly since IIROC staff will continue to work with counsel to arrive at mutually agreeable dates.
4. FAIR Canada believes it is a positive step to expressly required Regulated Persons to observe high ethical standards in the conduct of their business, and that they be prohibited from engaging in any conduct that is unbecoming, detrimental to the public interest or inconsistent with just and equitable principles of trade.
5. FAIR Canada encourages IIROC to add guidance to explain that, in order for Regulated Persons to be found to have observed "high ethical standards in the conduct of their business", IIROC will look to whether the "best interests of the client" were considered, and to what extent. We believe that, at a

minimum, adding guidance about a ‘best interest of the client’ standard would help to remedy the imbalance in the client-firm/advisor relationship.

6. FAIR Canada is pleased that IIROC hearing panels will now have the ability to impose a greater number of sanctions on Regulated Persons. FAIR Canada encourages IIROC to make the list of barred persons publicly available so that investors have the ability to review the list when engaging with employees of a Regulated Person. FAIR Canada recommends that Dealer Members be required to notify existing clients of any new IIROC decisions under which terms and conditions have been imposed on a Dealer Member’s membership.
7. However, FAIR Canada also encourages IIROC to improve upon the effectiveness of the sanctions currently available to it, such as the levying of fines. We understand that the rate of fine collections for individuals is particularly low, in the range of between 10 to 15%. We believe that this rate must be improved. We recommend that securities regulators across Canada<sup>1</sup> extend the statutory fine collection power to IIROC (and other SROs) to increase the efficiency and effectiveness of IIROC’s enforcement efforts. In addition, we recommend that Dealer Member firms be made responsible for fines that are levied by IIROC in the case of non-payment by a Dealer Member’s employee.
8. With respect to IIROC’s proposed amendments to the limitation period on enforcement proceedings, FAIR Canada provided comments to IIROC in January 2011. In summary:
  - 8.1. FAIR Canada recommends that no limitation period be applicable in circumstances where the acts of a Dealer Member or Approved Person have negatively impacted a client or member of the public who has made a complaint to IIROC with respect to the Dealer Member or Approved Person’s services. Therefore, limitation periods would only apply in connection with administrative offences or other circumstances where the interests of clients are not directly affected.
  - 8.2. FAIR Canada disagrees with IIROC’s determination that the calculation of a limitation period should be based on event occurrence. 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.
  - 8.3. FAIR Canada recommends that IIROC act to harmonize its recordkeeping rules so that all potentially relevant records are kept to allow enforcement proceedings to be effective.

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<sup>1</sup> In this Executive Summary, we refer to all Canadian securities regulators but, as we explain further below, the *Securities Act* (Alberta) currently provides SROs with the power to enforce their decisions as though they were court judgments.

**A. The Rule Consolidation – General**

In general, FAIR Canada supports IIROC for this initiative, although we are disappointed that input was not sought directly from investor groups in connection with the project in addition to consultations with Dealer Members (as described under “Consultation and Alternatives Considered” at page 21). However, we are pleased to offer our comments on the consolidated IIROC rules in this letter.

**A.1. Enforcement Investigations****A.1.1 Notification**

FAIR Canada considers it appropriate that IIROC staff not be required to notify a person who is the subject of an investigation that an investigation has been initiated. We agree that there may be a need in many situations to conduct the initial stages of an investigation without informing the subject of the investigation, for example, when fraud or manipulation may be involved. We believe that an investigation could be severely compromised if advance notice of an investigation is required to be given in all situations. From an investor protection perspective, it is of primary importance that investigations be allowed to proceed (particularly in the early stages) with as few impediments as possible.

FAIR Canada recognizes that there are circumstances where advance notice may be warranted. For example, there could be an investigation involving a technical breach of the rules with no resulting investor harm. FAIR Canada therefore agrees that it is worthwhile for discretion to be left with IIROC Enforcement department staff, so that such discretion can be exercised if warranted under the circumstances.

**A.1.2 Right to Counsel**

FAIR Canada considers it appropriate that a party not be allowed to delay an investigation because his or her counsel is not available within a reasonable time, particularly since IIROC staff will continue to work with counsel to arrive at mutually agreeable dates. We agree with the clarification in the rule that the right to counsel does not entitle a person to refuse to attend and answer questions at the time specified in an investigation staff request on the basis that his or her counsel is not available to attend with the person on the specified date.

From an investor protection perspective, we believe that the right to counsel should not impede the timeliness of an investigation, and should not be used to the detriment of IIROC’s enforcement process. Therefore, we are pleased that this clarification regarding use of the right to counsel has been added to the rules.

**A.1.3 Limitation**

With respect to the separate proposal to amend IIROC’s limitation periods, FAIR Canada provided public comments to IIROC in January 2011. The substantive content of those comments is described below in Part B of this letter.

**A.2. Disciplinary Hearings - Standards of Conduct**

FAIR Canada considers it appropriate that the standards set out in proposed Consolidated Rule subsection 1402(1), similar to the public interest jurisdiction of securities regulators, comprise a “catch-all” rule that recognizes the impossibility for a regulator to define in advance all circumstances that may require disciplinary action.

It is clear, from an investor protection perspective, that it is not possible to predict in advance all situations in which IIROC may need to bring an action. **We believe it is a positive step to expressly require Regulated Persons to observe high ethical standards in the conduct of their business, and that they be prohibited from engaging in any conduct that is unbecoming, detrimental to the public interest or inconsistent with just and equitable principles of trade.**

We are also pleased with the clear statement in the rule that negligence may be a basis for determining that a general standard of conduct has been violated (with discretion left with hearing panels).

However, we continue to hold the view that the fundamental framework upon which Regulated Persons' activities should be regulated is one where a Regulated Person is required to put the client's best interests first.

Therefore, we encourage IIROC, in reviewing the standards of conduct applicable to Regulated Persons, to consider adding guidance to explain that, in order for Regulated Persons to be found to have observed "high ethical standards in the conduct of their business", IIROC will look to whether the 'best interests of the client' were considered, and to what extent. We believe that, at a minimum, adding guidance about a 'best interest of the client' standard would help to remedy the imbalance in the client-firm/advisor relationship. We have advocated in the past, in the context of the proposed Client Relationship Model, for a "Clients First Model"<sup>2</sup>. We believe that, in the context of IIROC's proposed "Standards of Conduct Rule", it would be appropriate to expressly state that IIROC will look at whether advisors and dealers put their clients' best interests first when determining whether they had observed "high ethical standards in the conduct of their business".

### **A.3. Enforcement - Sanctions**

FAIR Canada considers it appropriate that hearing panels have more sanctions at their disposal, so that they will be expressly authorized to:

- order disgorgement of amounts obtained by a Regulated Person as a result of a rule contravention;
- appoint a monitor over the business and affairs of a Dealer Member (the current rules expressly permit appointment of a monitor only following an expedited hearing);
- prohibit an individual from being employed by a Regulated Person in any capacity, whether or not the position requires registration approval. This authority is complemented by a new provision prohibiting a Regulated Person from employing a person who has been so sanctioned. Regulated Persons will thus be expected, before hiring an individual, to review a list of such persons that IIROC will maintain.

FAIR Canada is pleased that IIROC hearing panels will now have the ability to impose a greater number of sanctions on Regulated Persons. In particular, FAIR Canada considers it appropriate that Regulated Persons will now be expressly prohibited from employing a person who has been barred from employment with a Regulated Person. FAIR Canada understands that IIROC will

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<sup>2</sup> See, for example, FAIR Canada's submission to IIROC dated March 8, 2011 regarding IIROC's proposals to implement the core principles of the Client Relationship Model: [http://faircanada.ca/wp-content/uploads/2011/01/CRM-comment-letter-March-8\\_2011\\_to-IIROC.pdf](http://faircanada.ca/wp-content/uploads/2011/01/CRM-comment-letter-March-8_2011_to-IIROC.pdf).

maintain a list of such barred persons. **FAIR Canada encourages IIROC to make this list publicly available so that investors have the ability to review the list when engaging with employees of a Regulated Person.**

However, FAIR Canada also recommends that IIROC improve upon the effectiveness of the sanctions currently available to it. For example, as we have noted in the past<sup>3</sup>, we understand that the rate of fine collections by IIROC for individuals is particularly low, in the range of between 10 to 15%. We believe that this rate must be improved.

We understand that in Alberta, the *Securities Act* (Alberta) provides SROs with the power to enforce their decisions as though they were court judgments. In December 2006, the CSA SRO Oversight Project Committee “unanimously support[ed] ... the granting of the authority to file disciplinary decisions with the courts” for jurisdictions where these powers were not already in place. Not only would such a power enable IIROC to pursue individuals, but it would also provide IIROC with more leverage in settlement discussions. It appears that, for the moment, CSA members and provincial governments have not implemented the CSA Committee’s recommendations.

FAIR Canada recommends that Canadian securities regulators extend the statutory fine collection power to IIROC (and other SROs) to increase the efficiency and effectiveness of IIROC’s enforcement efforts. We believe that this would increase the likelihood of the payment of penalties and enhance the credibility of self-regulation, which would contribute to improved credibility of the overall securities regulatory system in Canada.

In addition, we recommend that Dealer Member firms be made responsible for fines that are levied by IIROC in the case of non-payment by a Dealer Member’s employee.

#### **A.4. Procedures for Opportunities to be Heard**

With respect to the new ability for IIROC to impose terms and conditions on a Dealer Member’s membership, FAIR Canada encourages IIROC to make such information publicly available, as well as easily accessible by investors. We also recommend that Dealer Members be required to notify existing clients of any new IIROC decisions under which terms and conditions have been imposed on a Dealer Member’s membership.

### **B. Limitation Periods**

#### **B.1. Limitation periods generally**

B.1.1 As noted above, FAIR Canada provided comments to IIROC in January 2011 in the context of IIROC’s request for comment (the “Notice”) about its proposed amendments to the limitation period on enforcement proceedings contained in Dealer Member Rules 19 and 20.

B.1.2 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

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<sup>3</sup> See <http://faircanada.ca/top-news/dishonest-advisors-continue-to-prey-on-investors-in-canada/>.

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.

- B.1.3 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 pointed out in the Notice, the lack of a limitation regime would require indefinite maintenance of records. Nevertheless, there are circumstances where strict adherence to limitation periods may unduly place claimants at procedural or substantive disadvantages.
- B.1.4 For instance, 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.
- B.1.5 Due to the particularly complex and technical nature of many complaints that can arise 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 their representatives and are often reliant on Dealer Members and their representatives precisely because clients lack the specialized understanding and knowledge necessary to evaluate the information they receive. In many circumstances, therefore, many 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.
- B.1.6 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 has passed.
- B.1.7 Traditionally, two defences were available to defeat equitable claims by a principal to whom a fiduciary duty was owed; *laches* and acquiescence. *Laches* involves the principal having delayed the enforcement of his or her rights, where such delay has prejudiced the defendant fiduciary in a proceeding. 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. 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.

- B.1.8 FAIR Canada understands and agrees that the duties of a Dealer Member or Approved Person are not fiduciary in law. However, many of the same principles that have traditionally been considered to make limitation periods unsuitable for breaches of a fiduciary duty can also apply to the relationships between Dealer Members and Approved Persons and their clients. Dealer Members, through their role in today's 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 of many investors. FAIR Canada believes that the fundamental framework on which Dealer Members and Approved Persons' activities should be regulated is one where they are required to put the client's best interest first.
- B.1.9 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 with respect to 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.
- B.1.10 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 B.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.
- B.1.11 FAIR Canada agrees with IIROC that the limitation period should apply uniformly to current and former Dealer Members and Approved Persons.
- B.1.12 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.
- B.1.13 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.
- B.2. *Event occurrence versus discoverability***
- B.2.1 FAIR Canada disagrees with IIROC's determination that the calculation of a limitation period should be based on event occurrence.
- B.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.

- B.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.
- B.2.4 As mentioned in paragraph B.1.5, 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 Approved Persons and their clients in experience, expertise and 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.
- B.2.5 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 and Approved Persons to be an important factor that may delay discovery of inappropriate conduct, despite the lapse of considerable time.
- B.2.6 In the alternative, if IIROC considers it necessary to base the running of the limitation period on event occurrence only, FAIR Canada suggests that IIROC 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 or delay. FAIR Canada notes that the limitations acts of several provinces, including British Columbia, Alberta and Ontario, provide similar protections against wilful concealment.
- B.2.7 In such circumstances, FAIR Canada suggests that the Rules provide for the limitation period to begin from the last time that the material facts had been properly disclosed to IIROC or to any potential complainant who may have been injured or prejudiced by the conduct in question.

### **B.3. *Limitation period and IIROC's public interest mandate***

- B.3.1 If, following consideration of comments from FAIR Canada and other stakeholders, 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.

B.3.2 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.

**B.4. Evidentiary issues and recordkeeping rules**

B.4.1 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.

B.4.2 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 a 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 the cost for retaining such records and information for a longer period of time, even indefinitely.

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. Please do not hesitate to contact Ermanno Pascutto at 416-214-3443 ([ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca)) or Ilana Singer at 416-214-3491 ([ilana.singer@faircanada.ca](mailto:ilana.singer@faircanada.ca)) with any questions.

Sincerely,



Canadian Foundation for Advancement of Investor Rights