

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 Proposed IDA Policy No. 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision

INVESTMENT DEALERS ASSOCIATION OF CANADA POLICY NO. 4 – MINIMUM STANDARDS FOR INSTITUTIONAL ACCOUNT OPENING, OPERATION AND SUPERVISION

This Policy No. 4 is blacklined to indicate amendments from the version that was published on February 11, 2005 at (2005) 28 OSCB 1747.

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

1. By adding new Policy No. 4 as follows:

“POLICY NO. 4 MINIMUM STANDARDS FOR INSTITUTIONAL ACCOUNT OPENING, OPERATION AND SUPERVISION

INTRODUCTION

This Policy covers the opening, operation and supervision of institutional accounts, which are accounts for investors that are not individuals who meet the requirements of the definition herein.

This document sets out minimum standards governing the opening, operation and supervision of institutional accounts.

Pursuant to IDA By-laws 29.27 and 38, the Member must provide adequate resources and qualified supervisors to achieve compliance with these standards.

Adherence to the minimum standards requires that a Member have in place procedures to properly open and operate institutional accounts and monitor their activity. Following these minimum standards, however, does not:

- (a) relieve a Member from complying with specific SRO by-laws, rules, regulations and policies and securities or other legislation applicable to particular trades or accounts; (e.g. best execution obligation, restrictions on short selling, order designations and identifiers, exposure of customer orders, trade disclosures);
- (b) relieve a Member from the obligation to impose higher standards where circumstances clearly dictate the necessity to do so to ensure proper supervision; or
- (c) preclude a Member from establishing higher standards.

Any account which is not an institutional account governed by these standards will be governed by the Minimum Standards for Retail Account Supervision (Policy No. 2).

A Member may, with the written approval of the Association, establish policies and procedures that differ from this Policy, provided that, in the opinion of the Association, the Member's policies and procedures are appropriate to supervise trading of its institutional customers.

I. ACCOUNT OPENING

A. **Definition of an Institutional Customer**

For the purposes of this Policy, the following are defined as institutional customers:

1. Acceptable Counterparties (as defined in Form 1);
2. Acceptable Institutions (as defined in Form 1);

3. Regulated entities (as defined in Form 1);
4. Registrants (other than individual registrants) under securities legislation;
5. A non-individual with total securities under administration or management exceeding \$10 million.

B. Customer Suitability

1. When dealing with an institutional customer, a Member must make a determination whether the customer is sufficiently sophisticated and capable of making its own investment decisions in order to determine the level of suitability owed to that institutional customer. Where a Member has reasonable grounds for concluding that the institutional customer is capable of making an independent investment decision and independently evaluating the investment risk, then a Member's suitability obligation is fulfilled for that transaction. If no such reasonable grounds exist, then the Member must take steps to ensure that the institutional customer fully understands the investment product, including the potential risks.
2. In making a determination whether a customer is capable of independently evaluating investment risk and is exercising independent judgment, relevant considerations could include:
 - i(a) any written or oral understanding that exists between a Member and its customer regarding the customer's reliance on the Member;
 - ii(b) the presence or absence of a pattern of acceptance of the Member's recommendations;
 - iii(c) the use by a customer of ideas, suggestions, market views and information obtained from other Members, market professionals or issuers particularly those relating to the same type of securities;
 - iv(d) the use of one or more investment dealers, portfolio managers, investment counsel or other third party advisors;
 - v(e) the general level of experience of the customer in financial markets;
 - vi(f) the specific experience of the customer with the type of instrument(s) under consideration, including the customer's ability to independently evaluate how market developments would affect the security and ancillary risks such as currency rate risk; and
 - vii(g) the complexity of the securities involved.
3. No suitability obligation shall exist pursuant to Section B(1) nor is a determination required under Section B(2) where a Member executes a trade on the instructions of another Member, a portfolio manager, investment counsel, limited market dealer, bank, trust company or insurer.

C. New Account Documentation and Approval

The following documentation is required for each institutional account opening:

1. New customer account form; and
2. All documentation as required by the self-regulatory organization governing the Member.

The Member may establish a 'master' new account documentation file, containing full documentation and, when opening sub-accounts, it should refer to the principal or 'master' account with which it is associated.

Each new account must be approved by the Department Head or his/her designate who is a partner, director or officer, prior to the initial trade or promptly thereafter. Such approval must be documented in writing or auditable electronic form.

The Member must exercise due diligence to ensure that the new customer account form is updated whenever the Member becomes aware that there is a material change in customer information.

II. ESTABLISHING AND MAINTAINING PROCEDURES, DELEGATION AND EDUCATION

Introduction

Effective self-regulation begins with the Member establishing and maintaining a supervisory environment which fosters both the business objectives of the Member and maintains the self-regulatory process. To that end, a Member must establish and maintain procedures which are supervised by qualified individuals.

A. Establishing Procedures

1. Members must appoint a designated supervisor, who is a partner, director or officer and has the necessary knowledge of industry regulations and Member policy to properly establish procedures reasonably designed to ensure adherence to regulatory requirements and to supervise Institutional Accounts.
2. Written policies must be established to document and communicate supervisory requirements.
3. All supervisory alternates must be advised of and adequately trained for their supervisory roles.
4. All policies established or amended should have senior management approval.

B. Maintaining Procedures

1. Evidence of supervisory reviews must be maintained for seven years and on-site for one year.
2. A periodic review of supervisory policies and procedures should be carried out by the Member to ensure they continue to be effective and reflect any material changes to the businesses involved.

C. Delegation of Procedures

1. Tasks and procedures may be delegated but not responsibility.
2. The supervisor delegating the task must take steps designed to ensure that these tasks are being performed adequately and that exceptions are brought to his/her attention.
3. Those to whom tasks are delegated must have the qualifications to perform them and should be advised in writing what is expected.

D. Education

1. The Member's current sales practices and policies must be made available to all sales and supervisory personnel. Members should obtain and record acknowledgements from all sales and supervisory personnel that they have received, read and understood the policies and procedures relevant to their responsibilities.
2. A major aspect of self-regulation is the ongoing education of staff. The Member is responsible for appropriate training of institutional sales and trading staff, as well as ensuring that Continuing Education requirements are being met.

E. Compliance Monitoring Procedures

Members must establish compliance procedures for monitoring and reporting adherence to rules, regulations, requirements, policies and procedures. A compliance monitoring system should be reasonably designed to prevent and detect violations. The compliance monitoring system will ordinarily include a procedure for reporting results of its monitoring efforts to management and, where appropriate, the Board of Directors or its equivalent.

III. SUPERVISION OF ACCOUNTS

A. Policies and Procedures

1. Members must implement policies and procedures for the supervision and review of activity in the accounts of institutional customers. Such procedures may include periodic reviews of account activity, exception reports or other means of analysis.

2. The policies and procedures may vary depending on factors including, but not limited to, the type of product, type of customer, type of activity or level of activity.
3. The policies and procedures should outline the action to be taken to deal with problems or issues identified from supervisory reviews.

B. Account Activity Detection

The supervisory procedures and the compliance monitoring procedures should be reasonably designed to detect account activity that is or may be a violation of applicable securities legislation, requirements of any self-regulatory organization applicable to the account activity and the rules and policies of any marketplace on which the account activity takes place, and would include the following:

1. Manipulative or deceptive methods of trading;
2. ~~Establishing artificial prices;~~
- 3-2. Trading in restricted list securities;
- 4-3. Employee or proprietary account frontrunning;
5. ~~Sales from control blocks;~~
- 6-4. Exceeding position or exercise limits on derivative products; and
5. 7. ~~Transactions raising a suspicion of money laundering or terrorist financing activity”.~~

IV. CLIENT COMPLAINTS

1. Each Member must establish procedures to deal effectively with client complaints.
 - (a) The Member must acknowledge all written client complaints.
 - (b) The Member must convey the results of its investigation of a client complaint to the client in due course.
 - (c) Client complaints involving the sales practices of a Member, its partners, directors, officers or employees must be in writing and signed by the client and then handled by sales supervisors or compliance staff. Copies of all such written submissions must be filed with the compliance department of the Member.
 - (d) Each Member must ensure that registered representatives and their supervisors are made aware of all complaints filed by their clients.
2. All pending legal actions must be made known to head office.
3. Each Member must put procedures in place so that senior management is made aware of complaints of serious misconduct and of all legal actions.
4. Each Member must maintain an orderly record of complaints together with follow-up documentation for regular internal/external compliance reviews. This record must cover the past two years at least.
5. Each Member must establish procedures to ensure that breaches of the by-laws, regulations, rules and policies of the SROs as well as applicable securities legislation are subjected to appropriate internal disciplinary procedures.
6. When a Member finds complaints to be a significant factor, internal procedures and practices should be reviewed, with recommendations for changes to be submitted to the appropriate management level.”

PASSED AND ENACTED BY THE Board of Directors this 19th day of January 2005, to be effective on a date to be determined by Association staff.

**IDA Response to Comment Received on Proposed Policy No. 4 – Minimum Standards
for Institutional Account Opening, Operation and Supervision**

**INVESTMENT DEALERS ASSOCIATION OF CANADA (IDA)
RESPONSE TO COMMENT RECEIVED ON PROPOSED POLICY NO. 4 – MINIMUM STANDARDS
FOR INSTITUTIONAL ACCOUNT OPENING, OPERATION AND SUPERVISION**

On February 11, 2005 the Investment Dealers Association of Canada (IDA) published for comment Policy No. 4 Minimum Standards for Institutional Account Opening, Operation and Supervision.

One comment letter was received from Market Regulation Services Inc. (RS).

SUMMARY OF WRITTEN COMMENTS RECEIVED ON THE PROPOSED POLICY

Part II – Establishing and Maintaining Procedures, Delegation and Education

Comment

RS is concerned that use of language in Section E of Part II entitled *Compliance Monitoring Procedures* that is so similar to that in UMIR may erroneously imply that the IDA has jurisdiction to regulate and monitor compliance with UMIR trading supervision obligations. RS suggests that the IDA explicitly set out that Part II refers specifically to Member firms' obligations to prevent and detect undesirable account activity that is within the IDA's jurisdiction to regulate.

Response

The IDA does not believe that Members are under the impression that the IDA has jurisdiction to regulate and monitor compliance with UMIR. Member firms understand the regulatory functions of RS and the IDA. Furthermore, the IDA is of the view that a reference to a statement regarding Members who are not subject to UMIR will cause confusion as such statements are not included elsewhere in the IDA Rulebook. Members may query why it was necessary to add such a statement in Policy No. 4 but not in Policy No. 2 or other IDA by-laws, regulations or policies.

In addition, the provision is not intended to focus solely on trade desk reviews but also applies to sales compliance and the handling and supervision of client accounts and thus the provision is not duplicative but necessary and appropriate.

Furthermore, similar language does not lead to the assumption that jurisdiction is granted to the IDA. The IDA Rulebook includes language similar to securities legislation, but Members do not assume that the IDA has primary jurisdiction over securities law.

There is nothing in Policy No. 4 that indicates that a Member is relieved from its obligations under UMIR. Policy No. 4 must be read in its entirety. Specifically, RS's concern is currently addressed in the Introduction, found in Part I. The Introduction makes it clear that the standards set out in Policy No. 4 are the minimum standards but also states that:

"Following these minimum standards, however, does not:

- (a) relieve a Member from complying with specific SRO by-laws, rules, regulations and policies and securities or other legislation applicable to particular trades or accounts; (e.g.: best execution obligation, restrictions on short selling, order designations and identifiers, exposure of client orders, trade disclosures);".

However, the IDA is prepared to include a statement in the Bulletin that accompanies the implementation of Policy No. 4 which would outline that Part II applies to Member firms with respect to activities within the IDA's jurisdiction to regulate such as cash account violations and client suitability and for those Members who are not Participants of a marketplace regulated by RS. The Bulletin would go on to explain that Members subject to UMIR would still be required to comply with UMIR Policy 7.1.

Part III – Supervision of Accounts

Comment

RS is concerned that the listed trading activities in Section B of Part III entitled *Account Activity Detection* are activities which are explicitly prohibited or controlled by UMIR and UMIR Policies and are therefore within RS's jurisdiction. RS stated that there is no regulatory gap that requires the IDA to incorporate specific UMIR matters into IDA Policies. RS is of the view that the MOU protocols adequately manage the pre-existing overlap between Policy No. 2 and UMIR. RS suggests that the standards imposed by regulation services providers for particular marketplaces should be given primacy in order to avoid duplication and the possibility of conflicts with the requirements of other self-regulatory entities. RS also suggests that if the IDA wishes to make

a statement in Policy No. 4 as to supervision of accounts for possible manipulative or deceptive methods of trading, establishing artificial prices, trading in restricted list securities and frontrunning, that the IDA must clarify that the statement applies specifically to Member firms in respect of trading that is not subject to UMIR.

Response

Since RS acknowledges that the IDA has primary jurisdiction over trading and conducts trade desk reviews for those Members firms who are not Participants of a marketplace regulated by RS, Section B should remain.

For the same reasons set out above, reference to "Member firms not subject to UMIR" will not be incorporated in Policy No. 4 but an explanation will be provided in the Bulletin.