

13.1.4 Amendments to IDA By-Law 38 and Policy 6, Part 1 - CCO Qualifying Examination

INVESTMENT DEALERS ASSOCIATION OF CANADA – AMENDMENTS TO BY-LAW 38 AND POLICY 6, PART I – CCO QUALIFYING EXAMINATION

I OVERVIEW

A -- Current Rules

By-law 38.3 of the Investment Dealers Association of Canada (“The Association”) requires each Member to appoint an Alternate Designated Person as the Chief Compliance Officer (“CCO”). By-law 38.4 permits the appointment of the Ultimate Designated Person under By-law 38.1, as the CCO. By-law 38.5 permits a Member organized in two or more separate units to appoint a CCO for each unit.

By-law 38.11 describes the CCO’s role as being to: “monitor adherence to the Member’s policies and procedures as necessary to ensure that the management of the compliance function is effective and to provide reasonable assurance that standards of the applicable self-regulatory organization are met. The CCO is also required to report at least annually to the Board of Directors of the Member (or its functional equivalent) on the status of compliance at the Member.

B -- The Issue

Corporate governance is an important element in the operation of any corporation. In respect to the securities industry, this includes having qualified management to run the business entity to ensure compliance with a myriad of securities regulations. In respect to non-financial regulations, it is the role and responsibility of the CCO to monitor the firm’s compliance with such rules and bring any compliance issues or problems to the attention of the firm’s management to be dealt with. CCOs generally act as advisors to Members’ management on compliance and supervision issues and systems. At some Member firms the CCO may have direct authority to take action to rectify compliance problems, but such authority is outside of the CCO role.

As the securities industry and the regulations under which Members operate have become increasingly complex, and as principles-based regulation have required firms to develop their own policies and procedures tailored to their business, the advisory and monitoring roles of CCOs have required a broader knowledge of regulations, interpretations and best practices, as well as a broader range of skills in assessing compliance risk and helping develop and operate systems and controls to control it.

However, at present there is no objective standard to evaluate applicants for registration as CCOs. The current Partner Director Officer Qualifying Examination (“PDO Exam”), which is a prerequisite for any officer position, is currently insufficient in terms of testing knowledge of compliance requirements to the competency level expected of a CCO. To increase the coverage of the PDO Exam to include the knowledge required by a CCO would not be appropriate because the PDO addresses more general corporate governance issues and most prospective PDOs do not require the specialist knowledge needed by CCOs.

The Chief Compliance Officers Course (CCO Course) has been developed by the Canadian Securities Institute under the guidance of a sub-committee of the Compliance and Legal Section to cover the knowledge and skills necessary for a CCO. Successful completion of the course will be tested by a CCO Qualifying Examination (CCO Exam) covering the material dealt with in the course.

The desired outcome of this bylaw change is to establish standards for the qualification of CCOs and registration approval of such persons at member firms.

C -- Objective

The objective of this bylaw amendment is consistent with the overall strategic initiative by the Association to develop and implement risk assessment strategies designed to establish a minimum level of corporate governance amongst all member firms and decrease the risk profile of high-risk member firms.

The development of risk assessment strategies gives Member Regulation staff the capability to identify, prioritize, mitigate and contain high-risk situations. The risk-basis method works to identify trends in improper behavior; assess and task resources to matters of greatest risk; and enhance the timeliness of regulatory intervention.

The Association has experienced increased growth and diversity in the business models and organization of Members over the years. The industry has also experienced growth in the number and complexity of products, types of customers and governing regulations. By-law 38 and the roles of UDP and CCO were created on the advice of a subcommittee of the Compliance and Legal Section in 2001 in order to ensure that compliance became firmly embedded in the governance of Members at the senior management and Board levels.

However, the Association has continued to see significant compliance and supervision failures leading to an increasing number of disciplinary actions against Members and their senior management. In some cases such failures have resulted in the financial failure of the Members involved.

This is a systemic problem that has affected the risk profile of a range of member firms. The implementation of the CCO Exam is in part, designed to address it. The proposed requirement is just one of a number of strategic Member Regulation initiatives, including the Chief Financial Officer Qualifying Examination implemented on January 5, 2004.

The CCO Exam will establish a standard of professional competence for the CCO position. The PDO Exam will continue to be a requirement as for any officer position.

The Association has developed a syllabus (in English and French) from which the examination will be based for testing those individuals applying to be registered as CCO of a member firm. The examination will be administered by the Canadian Securities Institute in English and French and is separate from the PDO Exam.

The Association has some Members that do not carry on a traditional customer-based business, such as those engaging only in proprietary trading and those operating alternative trading systems. The content of the CCO Course and Qualifying Examination is not relevant to such Members. Although they have specific regulations governing their activities and therefore continue to require a CCO, the proposed regulation changes will permit the Association to exempt such firms from the requirement to have a CCO who has passed the CCO Exam.

D -- Effect of Proposed Rules

The CCO Exam is based on self-study material relating to compliance rules and practices.

CCOs Approved as of the implementation of the proposed requirement

The effect of the proposed rule change will be to require those previously approved as CCO registrants to review the self-study material and syllabus and write the CCO Exam. It is intended that the self-study material will be of significant value to industry participants as it will be the only published reference source dealing in depth with the breadth of compliance knowledge, skills, processes and practices with which a CCO should be familiar.

Currently approved CCOs are responsible monitoring compliance at their firm and will therefore be required to write and pass the examination within 18 months of the implementation date of the rule amendment. The examination has been designed so that those failing to pass the examination will be able to re-take it without seeing the same set of questions repeated.

New CCO applicants

Any new applicants for approval as CCO after the implementation date of this new by-law will be required to pass the examination in order to be approved.

Acting CCO's

The Association will allow for a transition period between a CCO that leaves the employment of a member and the approval of his or her replacement. The transition period will be 90 days allowing conditional registration for a person to be appointed "acting" CCO. The condition is subject to the acting CCO completing the qualifying exam or the hire of a fully qualified replacement within this transition period, failing which there will be a late completion fee charged against the Member until such time as it appoints a qualified CCO.

Others

The course and examination will be offered to anyone interested in taking it. The Association may require a CCO to re-write the examination as part of a disciplinary action by the Association regarding compliance matters. However, there will be no requirement for someone who has passed the CCO course to re-write it because he or she has not been approved as a CCO for any particular period.

Continuing Education

CCOs are already subject to requirements under the Association's Continuing Education Program. Completion of the CCO Examination will be eligible to meet an individual's compliance requirement for a full Continuing Education cycle.

II -- DETAILED ANALYSIS

A -- Comparison with Similar Provisions

UNITED STATES

In the United States applicants for General Securities Principal must pass the Series 24 Examination. General Securities Principals are registered to supervise or manage a registered firm's corporate finance and corporate securities business, but not to supervise derivative, municipal securities or operations.

The New York Stock Exchange requires that Compliance Officers complete the Series 14 Examination, intended to insure that individuals designated as having day-to-day compliance responsibilities or who supervise ten or more people engaged in compliance activities have the knowledge necessary to carry out their job responsibilities.

OTHER RULES OF THE ASSOCIATION

IDA Policy 6, Part I sets out specific examination requirements for approval in several senior officer and supervisor capacities, including:

- i) The Chief Financial Officers Qualifying Examination
- ii) The Partners, Directors and Senior Officers Qualifying Examination;
- ii)iii) The Canadian Commodity Supervisors Examination for Futures Contracts Principals;
- iii)iv) The Options Supervisors Course for Registered Options Principal.

The Association views the responsibilities of CCOs as critical to the firm's maintenance of adequate compliance systems and procedures and believes that an examination to test competency of applicants for CCO is as important as for these other senior positions.

B -- Systems Impact of Rule

The change has no significant impact on the systems of the Association or its Members. The Chief Compliance Officer category is already included in the categories for the National Registration Database (NRD). The examination will have to be added to a table in NRD in due course. In the interim, the requirement for applicants to complete the examination can be administered manually with little difficulty.

C -- Best Interests of the Capital Markets

The Association believes that it is in the best interests of the capital markets to ensure that those responsible for monitoring Member compliance with requirements designed to protect the public and assisting Member management in rectifying any compliance problems are fully qualified to do so. The desired outcome is to establish a minimum level of corporate governance by establishing a qualification standard for compliance management at member firms.

D -- Public Interest Objective

According to the IDA's Order of Recognition as a self-regulatory organization, the IDA shall, where requested, provide in respect of a proposed rule change "a concise statement of its nature, purposes (having regard to paragraph 13 above) and effects, including possible effects on market structure and competition." The purpose of the CCO Exam is to standardize industry knowledge and practices where necessary or desirable for investor protection in accordance with the IDA recognition order of June 1995. As mentioned above, there are other examinations that the Association includes in its educational requirements for registered individuals in the securities business. Statements have been made elsewhere as to the nature and effect of the proposal to require a written examination for approved CCOs.

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, Members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

III -- COMMENTARY

A -- Filing in Other Jurisdictions

These proposed amendments will be filed for approval in Alberta, British Columbia, Ontario and Quebec and will be filed for information in Manitoba, Newfoundland and Labrador, Nova Scotia and Saskatchewan.

B -- Effectiveness

It is believed that the proposed amendments will be effective in screening CCO applicants for competency and reduce the number of systemic compliance deficiencies resulting from lack of regulatory knowledge and failure to develop appropriate procedures to identify compliance risk and systems and procedures appropriate to control it.

C -- Process

Development of a CCO Qualifying Examination was identified as a strategic initiative by the Board of Directors of the Association. A sub-committee of the Compliance and Legal Section has been directly involved in overseeing the development of the Course learning objectives and material, and the Compliance and Legal Section has been kept informed at a general level of the approach taken and learning objectives.

IV -- SOURCES

References:

- Series 27 and 28 exams
- NASD Membership and Registration Rules 1022(b) and 1022(c)
- IDA By-law 38
- IDA Policy 6, Part I

V -- OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying rule amendments.

The Association has determined that the entry into force of the proposed amendments would be in the public interest. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Lawrence Boyce, Vice-President, Sales Compliance and Registration, Investment Dealers Association of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:
Lawrence Boyce, Vice-President,
Sales Compliance and Registration
Investment Dealers Association of Canada
(416) 943-6903
lboyce@ida.ca

INVESTMENT DEALERS ASSOCIATION OF CANADA

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada (“the Association”) hereby amends the By-laws, Regulations and Policies of the Associations, as follows:

By-law 38 – Responsibilities of the Chief Compliance Officer and Ultimate Designated

By-law 38 is amended by the addition of new sections 38.6, 38.7 and 38.8 as follows:

- 38.6 The Chief Compliance Officer shall have the qualification required pursuant to Policy 6, Part IA, Section 2B.
- 38.7 Notwithstanding By-law 38.6, a Member may, with the Association’s approval, appoint an officer as Acting Chief Compliance Officer, if the Chief Compliance Officer suddenly terminates his or her employment with the Member and the Member is unable to immediately appoint another qualified person as Chief Compliance Officer provided that, within 90 days of the termination of the previous Chief Compliance Officer:
- (i) the Acting Chief Compliance Officer successfully completes the Chief Compliance Officers Qualifying Examination and is approved by the Association as Chief Compliance Officer; or
 - (ii) another qualified person is appointed Chief Compliance Officer by the Member and is approved by the Association.
- 38.8 The Association may grant to a Member an exemption from By-law 38.6 where it is satisfied that the nature of the Member’s business is such that the qualification is not relevant to the Member and that to do so would not be prejudicial to the interests of the Member, its clients, the public or the Association. In granting such an exemption, it may impose such terms and conditions as it considers necessary.

The current By-laws 38.6 through 38.12 are re-numbers 38.9 through 38.15.

By-law No. 38

RESPONSIBILITIES OF THE CHIEF COMPLIANCE OFFICER AND ULTIMATE DESIGNATED PERSON

- 38.1. Every Member shall designate its Chief Executive Officer, its President, its Chief Operating Officer or its Chief Financial Officer (or such other officer designated with the equivalent supervisory and decision-making responsibility) to act as the Ultimate Designated Person (the "UDP") who shall be responsible to the applicable self-regulatory organization for the conduct of the firm and the supervision of its employees.
- 38.2 Where a Member is organized into two or more separate business units or divisions, a Member may designate a UDP for each separate business unit or division.
- 38.3 Every Member shall appoint an Alternate Designated Person (an "ADP"), who shall be so approved, to act as Chief Compliance Officer (the "CCO").
- 38.4 Notwithstanding section 38.3, a Member may appoint the UDP to act as the CCO.
- 38.5 Where a Member is organized into two or more separate business units or divisions, a Member may designate a CCO for each separate business unit or division.
- 38.6 The Chief Compliance Officer shall have the qualification required pursuant to Policy 6, Part IA, Section 2B
- 38.7 Notwithstanding By-law 38.6, a Member may, with the Association's approval, appoint an officer as Acting Chief Compliance Officer, if the Chief Compliance Officer suddenly terminates his or her employment with the Member and the Member is unable to immediately appoint another qualified person as Chief Compliance Officer provided that, within 90 days of the termination of the previous Chief Compliance Officer:
- (i) the acting Chief Compliance Officer successfully completes the Chief Compliance Officers Qualifying Examination and is approved by the Association as Chief Compliance Officer; or
 - (ii) another qualified person is appointed Chief Compliance Officer by the Member and is approved by the Association.
- 38.8 The Association may grant to a Member an exemption from By-law 38.6 where it is satisfied that the nature of the Member's business is such that the qualification is not relevant to the Member and that to do so would not be prejudicial to the interests of the Member, its clients, the public or the Association. In granting such an exemption, it may impose such terms and conditions as it considers necessary.
- 38.69 Every Member shall also appoint as many additional ADPs as are necessary, given the scope and complexity of its businesses, who shall be partners, directors or officers of the Member.
- 38.710 The ADPs referred to in By-law 38.6 shall report to the UDP as necessary to ensure that the businesses of the Member are carried out in compliance with applicable self-regulatory by-laws, regulations, policies and forms.
- 38.811 The CCO shall report to the board of directors (or equivalent) of the Member as necessary but at least annually on the status of compliance at the Member.
- 38.912 The board of directors (or equivalent) shall review the report of the CCO and determine what actions are necessary and ensure such actions are carried out in order to address any compliance deficiencies noted in the report.
- 38.1013 The UDP shall ensure that policies and procedures are developed and implemented which adequately reflect the regulatory requirements of the Member.
- 38.1114 The CCO shall monitor adherence to the Member's policies and procedures as necessary to ensure that the management of the compliance function is effective and to provide reasonable assurance that standards of the applicable self-regulatory organization are met.
- 38.1215 Every Member shall file with the applicable self-regulatory organization
- (a) a copy of a governance document setting out the organizational structure and reporting relationships, which support the compliance arrangement set out above; and

- (b) notice of any material changes to the organizational structure and reporting relationships as set out in paragraph (a).

Policy 6, Part I – Course and Examination Requirements

Policy 6, Part IA is amended by the addition of new sections 2B as follows:

2B. Chief Compliance Officers

The proficiency requirements for a chief compliance officer pursuant to by-law 7.5 are:

- (a) Successful completion of the Partners, Directors and Senior Officers Qualifying Examination;
And
- (b) Successful completion of the Chief Compliance Officers Qualifying Examination.
- (c) Notwithstanding subsection (c) above, any person approved as Chief Compliance Officer with a Member as of [the implementation date of this Policy 6, Part 1A(2B)] shall have until [the date 18 months after the implementation date] to successfully complete the Chief Compliance Officers Examination in order to maintain approval as Chief Compliance Officer.
- (d) A person approved as acting Chief Compliance Officer pursuant to By-law 38.7 shall have 90 days from the date of termination of the Chief Compliance Officer to successfully complete of the Chief Compliance Officers Qualifying Examination.
- (e) Any Member that fails to provide to the Association proof of successful completion of the Chief Compliance Officers Qualifying Examination within 10 days of the dates specified for successful completion in paragraphs (c) or (d) above, or such other dates as the Association may specify, shall be liable for and pay to the Association such fees as the Board of Directors may from time to time prescribe.

INVESTMENT DEALERS ASSOCIATION OF CANADA
CHIEF COMPLIANCE OFFICER EXAMINATION
PROOF OF SUCCESSFUL COMPLETION – LATE FILING FEE

ORDER

WHEREAS the By-laws, Regulations and Policies of the Investment Dealers Association of Canada (“the Association”) require a Member to appoint a Chief Compliance Officer;

WHEREAS the By-laws, Regulations and Policies of the Association require the appointed Chief Compliance Officer (“CFO”) approved by the Association as of [implementation date] to complete the Chief Compliance Officer Examination (“CCO Examination”) no later than [date 18 months after the implementation date]

WHEREAS the By-laws, Regulations and Policies of the Association require a Member to appoint an acting CCO to replace a qualified and approved CCO whose employment with the Member is suddenly terminated;

WHEREAS the By-laws, Regulations and Policies of the Association require the acting CCO to complete the CCO Examination within 90 days of the employment termination date of the CCO;

AND WHEREAS the By-laws, Regulations and Policies of the Association require the Member to pay to the Association such fees as the Board of Directors may prescribe for failing to provide to the Association proof of successful completion of the CCO Examination within 10 days of the specified completion date,

THE BOARD OF DIRECTORS of the Association hereby makes the following Order:

The late filing fee under Policy 6, Part IA, Section 2B(e) is:

\$100.00 per business day, to a maximum of \$1,000 in the first month the notice of completion is late,

\$100.00 per business day, to a maximum of \$1,500.00, in the second month the notice of completion is late; and thereafter,

\$100.00 per business day, with no maximum, until receipt of proof of completion.

SO ORDERED by the Board of Directors this day of , 200 , to be effective immediately upon the implementation of Policy 6, Part IA, Section 2A(e).