

IIROC NOTICE

Administrative Notice Request for Comments

Please distribute internally to:
Senior Management
Finance

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Removal of the risk component of the annual fees paid by Dealer Members

Executive Summary

IIROC sets annual membership and other fees it charges pursuant to section 3.4 of IIROC General Bylaw No. 1. Most of the fees we collect relate to four fee models: The Dealer Member Fee Model, the Equity Market Regulation Fee Model, the Debt Market Regulation Fee Model and the Debt Information Processor Fee Model.

Under the existing Dealer Member Fee Model, a Dealer Member is assessed annually to determine its risk profile by each of IIROC's Financial & Operations Compliance (FINOPS) and Business Conduct Compliance (BCC) departments. If a Dealer Member is assigned a "high risk" profile by one or both of FINOPS and BCC, the Dealer Member's annual fee is increased by the applicable risk premium. A credit equal to the aggregate risk premium payable is then applied towards the annual fee payable by those Dealer Members that are not required to pay a risk premium.

Historically, the objective of this risk component was to allocate, to high-risk firms, some portion of the costs associated with the additional time spent by the FINOPS and BCC groups to oversee such firms, and to act as an incentive to change their high-risk behaviour.

However, since the high risk approach was originally implemented in 2012, IIROC has substantially revised the approach towards assigning compliance resources to firms, which is now based not only on their risk but also on the impact to their clients and to the financial system.



Further, the method used to calculate such risk premiums does not result in a material reallocation of fees. Aggregate risk premiums averaged about \$70K from FY2018 to FY2020, and this amount taken as a percentage of average Dealer Member fees of around \$51M for the same period, represents only about 0.1% of fees.

Finally, the administrative effort to calculate, assess, and ultimately reallocate the high risk premiums is significant relative to the amounts involved.

As an interim step and as part of the pandemic response program, IIROC set the risk component to zero for FY2021. IIROC now proposes to make that change permanent by removing the risk component from its Dealer Member Fee Model.

Guiding Principles

IIROC uses the following guiding principles as an objective frame of reference to evaluate potential fee model changes:

- **Fairness** – A Dealer Member’s share of fees should be based on its usage or consumption of IIROC’s regulatory services.
- **Transparency** – Dealer Members should understand how their fees reflect the application of the guiding principles.
- **Consistency** – Fees and principles that determine such fees should be consistently applied and understood by all Dealer Members.
- **Industry Competitiveness** – In the public interest and to the greatest extent possible, fees should not inhibit new entrants to or prevent smaller Dealer Members from remaining in the industry. The setting of fees should be designed to not favor one Dealer Member over another.
- **Cost Recovery of Regulatory Services Provided** – IIROC will operate on a cost recovery basis.

Removal of the risk component of the Dealer Member Fee Model

The Annual Fee for each Dealer Member is determined with reference to the following components:

- Revenue Component;
- Approved Person Fees Component;
- Minimum Dealer Regulation Fee Component; and
- **Risk Component**



For this risk component, a Dealer Member is assessed annually to determine its risk profile by each of IIROC's FINOPS and BCC departments. If a Dealer Member is assigned a "high risk" profile by one or both of FINOPS and BCC, the Dealer Member's annual fee is increased by the applicable risk premium. A credit equal to the aggregate risk premium payable is then applied towards the annual fee payable by those Dealer Members that are not required to pay a risk premium.

Between FY 2018 and FY 2020, the FINOPS risk premium ranged between \$2,400 and \$3,200 per high-risk firm, while the BCC premium ranged between \$3,800 and \$4,000. The credit to non-high-risk firms represented approximately 0.1% of fees in each of those years. As a reference point, IIROC's minimum fee is \$22,500.

For FY 2021, the risk component was set to zero in addition to deferred payment relief of fees payable by small and medium-sized Dealer Members in light of the impact of the COVID-19 pandemic.

We have determined that there are a number of issues with the risk component:

- High-risk firms may have terms and conditions imposed by IIROC which can often require the firm to incur additional costs, such as hiring compliance consultants that shift the incremental burden from IIROC to the firm.
- FINOPS already has another mechanism to recover reasonable costs and expenses incurred in connection with the oversight of Dealer Members that are in Early Warning Level 2¹.
- A firm's risk level is not the only driver of IIROC's costs to oversee the firm. The compliance groups now assign an "impact factor" to each Dealer Member that is taken into consideration in reassigning compliance examination resources towards those firms that are assessed as having a "high impact" to investors, the industry and/or marketplaces in Canada. A high-risk firm may not necessarily be a "high-impact" firm.
- The additional amount charged to high-risk Dealer Members does not act as a strong incentive to change their behavior as it could simply be regarded as a modest additional cost of doing business. Rather, we believe that high risk behaviour is more effectively addressed via the measures (examples, Early Warning restrictions as noted above or Terms and Conditions).
- The amount of the credit received by non-high-risk firms is de minimis.
- The effort required by IIROC to administer the risk component is significant, relative to the amounts involved.

The proposed change is not expected to have any impact on industry competitiveness. In addition, eliminating the risk component has no material impact on the relative fairness of the Dealer Member Fee Model given the low absolute level of the high-risk premiums.

¹ Dealer Member Rules subsection 30.5(i).



Effective Date

The proposed changes would be effective as of April 1, 2021. Invoices reflecting our approved fees for fiscal 2022 and the proposed changes in this notice (for the first and second quarters of the fiscal year) will be sent out in the first week of July.

Request for Comments

The amendments were approved for publication for comment in November 2020 by the IIROC Board of Directors.

IIROC seeks written comments on the proposed amendments. Comment letters should be delivered by February 1, 2021 (45 days from the publication date of this notice) and addressed to the attention of:

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Commenters should be aware that a copy of their comment letter will be made publicly available on the IIROC website at www.iiroc.ca