INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Ian C.W. Russell FCSI
President & Chief Executive Officer

February 8, 2007

Mr. Aleksander Popovic
Vice-President, Enforcement
Investment Dealers Association of Canada
121 King Street West
Suite 1600
Toronto, Ontario
M5H 3T9

- And -

Ms. Nancy Mehrad
Legal and Policy Counsel, Regulatory Policy
Investment Dealers Association of Canada
121 King Street West
Suite 1600
Toronto, Ontario
M5H 3T9

Dear Mr. Popovic and Ms. Mehrad:

RE: By-laws 19 and 20 Reform Project – Consultation Paper

We are writing on behalf of our membership to express some concerns regarding the process by which the Consultation Paper on the By-laws 19 and 20 Reform Project was prepared by the Investment Dealers Association of Canada (IDA), and the need for further input and consultation from member firms. Industry consultations have not been sufficient with respect to scope and the amount of time provided to firms to preview the Consultation Paper.

The Investment Industry Association of Canada (IIAC) recommends the delay of amendments to By-laws 19 and 20 until the IDA can consider and respond to our comments and work with industry professionals to develop fair, transparent and workable alternatives.

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The IIAC members support the need to revise some provisions contained in By-laws 19 and 20 and appreciate the time and effort that IDA staff has dedicated to the process. However, a broad segment of industry professionals, including some members of the IDA Subcommittee that was struck to deal with these By-laws, question some of the end proposals. In particular, it is our understanding that questions and concerns raised by the Subcommittee at its initial meeting on November 22, 2006 with IDA Staff do not appear to have been considered. There have been no further meetings with the Subcommittee since the initial meeting, although the IDA has now scheduled one hour on February 9th and 12th. This, however, gives very little time to ask questions and formulate a response prior to the February 15th comment deadline.

While the IDA stated that there have been broad consultations, the consultations that have taken place so far have been largely briefing sessions rather than constructive give-and-take on the structure and content of the proposed By-laws. We believe it is in the best interest of investors and the industry if the IDA demonstrates flexibility and responsiveness to member concerns, particularly once members have had sufficient time to consult with their internal legal counsel and other relevant individuals within their respective firms on the Consultation Paper. We have not heard anything about the comments made by other participants in the process – there will have to be a broad process where all points of view are reasonably placed in front of all parties to the process.

The members want to emphasize that they support the IDA's effort to create an efficient, transparent and clear enforcement process. Promoting the integrity of the capital markets and protection of investors are in the best interest of all market participants. Member firms are also supportive of an enforcement regime that is fair and balanced. We also recognize that a transparent execution of examinations, enforcement activities and hearing processes will not only protect investors but in turn result in stronger relationships with clients and enhance the reputation of all firms.

The starting point for the discussion should focus on whether to continue toward a more formalized adversarial model of investigation and enforcement or to consider a more cooperative approach. For example, some members believe that there are some serious flaws in the current proposal and believe that a model that partners with their internal compliance departments would provide a more effective, efficient and fair alternative. A member's compliance department is already responsible for reviewing any allegations of misconduct or non-compliance on the part of the member's employees, for taking appropriate action as a result of such reviews and where appropriate, for reporting the results to ComSet. Upon review of ComSet, IDA investigators could call upon the member's compliance department where there are remaining concerns that a complete and thorough investigation was not done or appropriate corrective measures were not taken.

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The Consultation Paper as currently drafted is contrary to principles-based regulation and the risk-based analysis to which the IDA contends that it subscribes. The current Paper also undermines the gatekeeper function that a member's compliance department is supposed to undertake. The Paper proposes a more adversarial model for enforcement activities rather than emphasizing partnership and co-operation between the IDA investigator and the firm's compliance department. Instead, the proposed model does not utilize the experience of a firm's compliance department and the resources available to a firm. IDA resources are limited and it might make more sense to allow firms to investigate client complaints and other matters with some general oversight by the IDA. An alternative to consider would be drafting regulations to create a structure that allows firms to deal with enforcement issues internally and create a partnership between the IDA and a firm's compliance department. In doing so, a firm's compliance department would be strengthened and more effective in dealing with enforcement issues quickly and decisively.

Before a decision is made on which approach is most appropriate, it would appear valuable to at least have such a discussion of options and get a sense of what approach the membership would prefer.

By the IDA not recognizing a firm's role and responsibilities in the enforcement regime, and moving to the type of regime contemplated by the Consultation Paper, they are moving away from the "self" in self-regulatory organization and into simply a true regulatory model which brings with it a series of other considerations relative to balancing the rights of members.

To address these issues, the members recommend the IDA commence a discussion with the Subcommittee that it struck to consider alternative enforcement models and how the investigation/enforcement process is intended to work once the merger with RS is complete. The Subcommittee is willing to work closely with the IDA to use this opportunity to create an effective enforcement model for the entire industry.

In any event, if the approach reflected in the Consultation Paper is to proceed, there are at a minimum, some procedural enhancements to the examination, enforcement and hearing process that should be considered to ensure balance and fairness in the process. There include:

- adopting the Ontario *Statutory Powers Procedures Act* or the other provincial equivalents as a minimum set of procedural fairness requirements,
- publishing all decisions, including interim motions on the IDA website,
- client complaint letters that result in investigations should be shared with the member/registrant along with a copy of the IDA's response to the client,
- providing a registrant with an opportunity to respond to warning letters,

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- including costs provisions so that the IDA can be ordered to pay the costs of proceedings, including costs associated with complying with investigative orders,[1]
- the ability to object to notice of hearings before they are published,
- specifically outlining procedures for motions at the investigative and hearing stage to ensure that there is a formal process for issues such as challenges to investigative orders.

We ask that the IDA Subcommittee that was constituted to comment on IDA By-laws 19 and 20 be consulted to provide additional practical and fair alternatives.

General Need for Amendments

In the Wednesday, January 5th, 2007 Financial Post, Paul Bourque wrote a piece entitled "The marketplace onus". In it, he stated that it is the regulators, not the players who need to justify their securities industry actions. Mr. Bourque queried: "Who has the onus of proof? Will the regulator be required to demonstrate the need for change or will the industry be required to 'show cause' why more rules are not needed?"

Further, while the Consultation Paper argued that a primary concern with By-law 19 was the lack of transparency, the article in the Post stated:

"It is difficult to argue against more transparency in the abstract. More of a good thing is always better. However, policy choices involve trade-offs and in the absence of careful analysis, the trade-offs will be missed and unintended consequences will result."

With respect to the onus of proof and demonstrating the need for more rules, the members state that in some areas of By-laws 19 and 20, more rules are not needed. For example, members have concerns about the proposal regarding the time lines of investigations. The members point out that the usual practice is for IDA investigators to work out time lines with the relevant individuals in the investigation. This co-operative approach to time lines has proven effective. In addition, the consequences for non-compliance currently exist as members can be charged with "failure to cooperate". Consequently, the proposal in the Consultation Paper simply leads to more unnecessary rules and will likely result in an increase in the length of time to conduct an investigation, due to the imposition of a system that substitutes prescription for co-operation.

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[1] In fact, the final report of the Task Force to Modernize Securities Legislation in Canada, "Canada Steps Up", October 2006, recommended that regulators should be authorized to order costs in favour of the respondent and that policies and guidelines be developed regarding the circumstances in which costs may be ordered and to look at providing for the recovery of costs on usual principles, rather than requiring the payment of costs on the basis of full cost recovery to fund the investigation, prosecution and adjudication of securities matters. See recommendation 55 of the report.

With respect to the argument for greater transparency, the members are of the belief that some of the proposals set out in the Consultation Paper do result in unintended consequences rather than greater transparency. These issues are further outlined below.

Timing for Amendments

The members question the timeframe for making amendments to By-laws 19 and 20 given the impending merger of Market Regulation Services Inc. and the IDA. If there is going to be a consolidation of these activities and rules is now the right to proceed with these reforms?

Specific Amendments

Our concerns with specific provisions of the Consultation Paper are outlined as follows:

BY-LAW 19

Introduction

The introductory paragraph of the Consultation Paper states: "While the By-law has undergone certain changes over time, these changes have not kept pace with changes in administrative law principles and the changing landscape of the security industry."
It would be useful if members were provided with examples of the "changes in administrative law principles" to which the Consultation Paper refers.

Segregation of Examinations and Investigations

The members recommend that there should be clear and timely notification of when an examination has been converted to an investigation. Transparency and fairness should always be a priority.

In addition, the language of the By-law should be amended to include a directive that would require the IDA to classify as an investigation any examination that does not follow an unbiased sampling method. In other words, if before or during the course of an examination, the examiner requests information based on materials, advice or recommendations received from IDA Enforcement Staff, the member must be given notice of the information obtained and how it will be used as regards to the examination.

The members also want to emphasize that it is important to ensure that the principles outlined in *R. v. Jarvis* are met.

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Notice Requirement for Investigations

The Consultation Paper states that the notice requirement be revised to align it with "similar provisions of other regulatory notice requirements." We request that members be provided with these provisions to compare them to what the IDA is proposing. Further, while there is mention of the provincial securities commissions' powers to carry out investigations without disclosing the nature or content of an Investigation Order, it would be useful for the IDA to determine the content of the securities commission provision, in particular, how often it is used and in what circumstances.

The members are concerned about the potential ability of the IDA to delay the issuing of notice. Clear and timely written notice is a fundamental aspect of due process and fairness. It is also contrary to the members' gatekeeper responsibilities. We believe that a member's compliance department and the Ultimate Designated Person (UDP) should always be promptly notified of the commencement, subject matter and initial scope of an investigation. The SRO Joint Regulatory Notice MR0435 "The Role of Compliance and Supervision" requires among other things, that the compliance officer promptly advise the Board of any investigations. This reporting function, which is integral to good corporate governance, would be frustrated. A member's compliance department and UDP (or their designate) would certainly want to know and participate in the investigation of any of its employees or clients. If the OSC or provincial regulator is issuing an investigative order such that the IDA should not be disclosing the investigation, it is certainly within the power of the provincial regulator to issue a similar non-disclosure order against the member's compliance department and/or UDP.

In the alternative, if this delay provision is adopted, the IIAC questions if the reasons for the decision to delay issuing notice will be documented and whether the decision will be reviewable at a hearing. What is the exact meaning of "reasonable right to delay notice"? Will any protections be afforded to the member/registrant when the IDA uses such a power? At a minimum, there should be a formal investigation opening memo or order to confirm the commencement of an investigation, even if notice is not provided so that the commencement of the investigation is documented.

Timing of Compliance with Information Requests

As mentioned above, members have experienced a great deal of co-operation with investigators with respect to time lines for the production of information. As a result, there is question whether such a provision is necessary.

While the Consultation Paper states that specific time lines ought to be considered and references similar provisions in the U.K., the U.K. provisions simply states that the Authority may require production before the end of such reasonable period "as may be

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specified." There is concern that if the IDA is considering "specific time lines" instead, they may not be appropriate in certain types of cases, and may be dependent on the facts and circumstances of a particular case. For example, there have been numerous problems experienced with rigid deadlines regarding IMET/RCMP Production Orders, including the inability or unwillingness of the investigator to exercise discretion for reasonable extensions.

Further, in light of the *Re Credifinance Securities Limited* decision, there is the obvious concern that IDA Enforcement Staff may not act reasonably with respect to powers relating to the timing of information requests; in fact, as the decision demonstrates, timing requirements could be *misused* by IDA Staff. In any event, the *Credifinance* decision succinctly states how the By-law is supposed to operate in relation to information requests: "It is there to oblige Members to make reasonable responses, in reasonable time, to reasonable requests."

As stated above, it does not appear as though the timing of compliance with information requests is a pressing matter and any change to the By-law in order to implement this proposal may in fact create an unnecessary layer of regulation that places too much discretion in the hands of investigators.

In addition, this is an example where RS's provisions should be considered in advance of a merger with the IDA.

In any event, there should be continued consultation between the member and investigators to develop appropriate time lines based on the circumstances of the information request.

Mandatory and Voluntary Submissions

It is not clear that this issue has been raised in the investigatory process. Perhaps the IDA could provide examples of how the present language has led to confusion in the past because currently the language does not appear confusing or unclear.

Videotaping Interviews

Reference is made in the Consultation Paper to amending By-law 19 to "compel such interviews," but it is unclear whether it is meant that videotaping could be compelled. The members are concerned about the ability to *compel* witnesses to be videotaped, especially when the case cited as justification for videotaping is a criminal case involving child witnesses and is not necessarily relevant to the IDA situation. It would be beneficial if the IDA could provide us with the provisions of other self-regulatory bodies that compel videotaping.

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The IDA states in the Paper that the videotaping of interviews "ensures the protection of all parties involved in the interview." We request clarification of what is meant by the word "protection" in this context. In other words, who is being protected and from what? Where is the evidence that a videotaped interview will provide any better result than taping and transcribing? Many of our members feel that videotaping is an unwarranted and intimidating process which simply is not required for our industry. A witness must have the ability to accede or not to any request for this process.

There are also some due process concerns with videotaping as it leads to questions regarding the right to cross examine a witness. Will the tape be substituted for testimony? Will the IDA want to submit videotaped complainant interviews to hearing panels without providing the respondent with the ability to cross-examine the witness? Further, it is unclear what powers the IDA would have with respect to the future use of these videotapes in other investigations or in other jurisdictions. Will the information be shared with law enforcement or regulators in other jurisdictions? These issues require clarification.

The IDA must consider amending the provision to give individuals the choice as to whether a video or tape recorder is used.

Finally, the Consultation Paper refer to the criminal law case of *R.* v. *B. (K.G.)*, but perhaps the more recent case of R. v. *Khelawon* should be reviewed as well. Again, we are concerned about the import of criminal law type decision into the self-regulatory world. Will this also mean that we will need to import Charter protections?

Confidentiality of Investigations

The members question the end result of this provision, as the scope and effectiveness of the confidentially clause would be seriously diminished based on the exceptions listed and the need to communicate to a wide range of persons within the firm.

Further, the proposed provision may result in a situation whereby members are put in the position of having to demonstrate that disclosure falls within the exceptions. The IDA should make clear what type of investigation requires this level of confidentiality.

Again, it would be useful to see what other regulators require.

Access to Documents

The members acknowledge that the IDA has the right to enter onto a member's premises for examinations and investigations; however, access should be granted with reasonable prior notice so that the member's business is only minimally disrupted and the firm can provide appropriate assistance. The exercise of this provision should only occur once the members have had an opportunity to provide information voluntarily.

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Removal of Documents

The ability to demand and remove original documents and computer hard drives is somewhat of a draconian measure which causes significant concern to members. Consequently, the provision should be used in only very narrow circumstances and as a last resort for corrupt, fraudulent or non-co-operative firms. In the alternative, rather than a new requirement, members should have the opportunity to provide information via an information request. Reasonable time frames could be provided to members to enable them to respond to information/document requests in a comprehensive manner. If members do not cooperate in these time frames, the IDA has the ability to sanction the member through a "failure to cooperate" hearing.

Further, the removal of original documents conflicts with regulatory obligations dealing with recordkeeping (such as IDA Regulation 200). In addition, it would be useful if the IDA could further discuss why original documents need to be removed as opposed to being copied. A member's ability to conduct business could be seriously jeopardized in cases where original documents or computer hard drives are seized.

If the proposal is adopted, we ask that some definition or examples be provided with respect to the language "demonstrated need". In addition, it should not be a decision of investigators without senior level review and/or an Order for a panel member. We recommend that the Anton Pillar Order test be applied given that this is the same type of measure. In addition, we request that certain safeguards be also implemented such as:

1. Undertaking/security by the IDA to pay for damages if the Order is unwarranted or wrongfully executed.
2. Process for contestation of the Order.
3. Limited use of the items seized for the purposes of the pending hearing.
4. Return of materials seized as soon as practicable.
5. Privileged/confidential mechanism to enable subject to advance claims of privilege or confidentiality over documents.

Information Sharing with Other Regulators and Regulatory Organizations

While there is protection under the OSC provision in that an order is required before they can assist, this is not the case in the IDA proposal. In addition, the IDA proposal goes beyond the OSC provision in that while the OSC allows the commission to *assist*, the IDA proposal would also provide the authority to *seek* the assistance of other securities regulators. As a consequence, this could lead to enforcement information being shared with the NASD and the SEC and those bodies sitting in on IDA interviews.

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When this proposal is applied in conjunction with the power to videotape, the delay of notice and confidentiality provisions, there appears to be a total lack of balance, fairness and protection for the member/registrant. We suggest that there be a deemed undertaking that information obtained via an investigation is not disclosed or used for another purpose.

We suggest that the IDA consider Justice Campbell's decision in *A.* v. *OSC* [2006] O.J. No. 2646, where the court was comforted that section 11 of the *Securities Act* (Ontario) did not infringe the Charter because of a process in place via section 17 providing the opportunity to contest the provision of information obtained through section 11 prior to the disclosure to another person or body. It is also important to draw the IDA's attention to the absolute prohibition in subsection 17(3) and section 18 of the *Act* on the use of compelled testimony.

We request that the content of the IDA information sharing arrangement be provided and the scope of the proposal be narrowed only insofar as it would allow the IDA to fulfill its obligations. Without adequate information with respect to the current information sharing arrangements or examples of the types of information being shared, there is not enough background to provide meaningful input on this proposal. Perhaps the IDA could consider making public its current information-sharing agreements so that all interested parties could inform themselves with which organizations the IDA shares information, the types of information shared and under what circumstances.

In the alternative, when information may be potentially shared with another securities regulator, the members should have the right to know in advance. Consequently, the member should be given notice whenever the IDA provides a foreign organization information pursuant to an information sharing agreement. It is suggested that this notice include the name of the organization, the information being provided and a statement that in the opinion of the IDA the information being provided does not violate Canadian privacy legislation. The IDA should also consider that there may be issues related to privileged documents and issues regarding the provision and use of certain information (e.g. compelled testimony) by authorities in other jurisdictions outside of Canada.

Request for Information from Other SROs and Regulators

We suggest that the provision not include reference to law enforcement agencies (i.e. agencies that are unable to obtain search warrants should not be able to use the IDA to compel such access or information). Any requirement that compels a registrant to provide information to law enforcement agencies is a serious and complex matter that could have Charter implications.

We also reiterate the comments above regarding the current protection in the *Securities Act* (Ontario) regarding information sharing with law enforcement agencies.

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Obstruction of Justice and Failure to Cooperate

We query the need for a specific sanction for a failure to cooperate. By virtue of the proficiency examinations taken by all approved persons, it is clear that it is wrong to lie, misrepresent, etc. It is not necessary to specify a penalty since it is clearly professional misconduct not to cooperate with the governing body of one's profession. Members also note that sanctions currently exist for the failure to cooperate, including the lack of credit for co-operation and the ability of the IDA to prosecute for a failure to cooperate. Further, through the proposed provision regarding the removal of documents, the IDA has an alternative means of acquiring what it needs. Consequently, this provision appears to be an unnecessary layer of regulation.

If this proposed provision is adopted, we request that the wording be carefully considered. For example, the title given in the Consultation Paper refers to "obstruction of justice", which is a criminal term that should not be carried into the self-regulatory realm. In addition, a carve-out for privilege should also be created.

BY-LAW 20

Alternate Resolution Methods - Minor Settlement Agreements

The Consultation Paper does not set out the powers of the Minor Violation Settlement hearing panel. How does it differ from a regular Settlement Agreement hearing? We also request that clear guidelines be provided on what constitutes "minor" violations that would be subject to the alternate resolution methods. How will "minor" be defined?

While the members recognize the benefits with respect to resources when a hearing panel consists of one adjudicator, there is some concern of having a single-person panel.

The IIAC is also concerned that as a Settlement Agreement is made public, the result will be more cases that are made public but the general public will not be able to distinguish Minor Settlement Agreements from other Settlement Agreements, thereby increasing stigma to registrants.

Fees

With respect to the proposal on fees, we recommend that the imposition of fees be limited to those with respect to filing fees.

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The Test for Appointing a Monitor

We welcome the opportunity to provide suggestions on a term that can replace "imminent harm". We agree that a threshold is necessary for this serious action and that it should indeed be a high threshold. Some alternatives include: "reasonable foreseeable harm" and building in a materiality test with language such as "imminent material harm".

Whatever term the IDA adopts, there should be an opportunity for careful review and consideration by the industry.

Expedited Hearings

Members are of the view that the elimination of industry representatives from the expedited hearing panels would result in losing the "self" in self-regulation.

Further, members contend that expedited hearings should be with notice and that the member has the right to be heard.

Non-Compliance with Hearing Panel Decision

The ability to immediately suspend a member, summarily, without further notice, is a very serious matter and while this makes sense for fines, it may not for other imposed conditions. For example, if a condition is imposed to develop appropriate internal controls, the member may be using its best efforts to comply but have valid reasons for a delay.

Rather than an immediate suspension without notice, there should be a provision to follow-up with the firm, and for the firm to have an opportunity to be heard. In addition, consideration should be given to the materiality of the breach and the circumstances surrounding non-compliance.

We question whether other regulators have such a power. If no such power exists, we strongly urge the Association to not make such a drastic revision to the current process.

Eliminating the IDA Appeal Panel

The costs and complexity for members to appeal to the securities commission should be weighed against the difficulty of the IDA to hold an appeal panel hearing. The importance of members having the ability to appeal to a panel that includes other IDA members, who may have a better understanding of the industry issues facing the member in question, should not be discounted.

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We also question whether the IDA is considering eliminating the appeal mechanism for non-disciplinary matters and decisions by the IDA.

The Consultation Paper, while perhaps intended to clarify some existing rules and add a few others to improve the overall process, in fact introduces some very far reaching implications to the process which must be very carefully scrutinized as to their appropriateness and whether there is a corresponding need to add significant procedures to balance all stakeholders' rights. We would be pleased to discuss these comments in further detail if it would be helpful.

Yours sincerely,

11 King Street West, Suite 1600, Toronto, ON M5H 4C7
Tel: 416-865-3036 Fax: 416-364-4861 irussell@iiac.ca / www.iiac.ca