



# The “Security” in Canada’s Securities Industry

When considering how to invest, retail and institutional investors place their trust in Canada’s securities dealers. Though ranging in size and in the services and products they offer, Canada’s securities dealers are supported by a comprehensive system of legislation, regulation and oversight and by a clearing, settlement and exchange infrastructure considered among the most secure in the world.

*“Canada’s financial system is mature, sophisticated, and well-managed. Financial stability is underpinned by sound macroeconomic policies and strong prudential regulation and supervision. Deposit insurance and arrangements for crisis management and failure resolution are well-designed”*  
– International Monetary Fund,  
Jan. 15, 2008

## **Investment Industry Regulatory Organization of Canada (IIROC)**

IIROC is seen as Canada’s front-line regulator for the securities industry. IIROC was created in 2008 through the merger of the Investment Dealers Association of Canada (IDA) and Market Regulation Services Inc. (RS). IIROC oversees all investment dealers and trading activity on equity marketplaces in Canada.

Firms registered as investment or securities dealers are subject to IIROC regulation, and must meet stringent capital requirements; demonstrate the ability and willingness to conduct business according to IIROC rules, including rules related to the handling of client assets; and are subject to ongoing supervision. IIROC firm employees who deal with the public must be appropriately licensed and investor protection is a top priority. More information about IIROC regulated firms, is available at: <http://www.iiroc.ca/English/About/OurRole/Pages/DealersWeRegulate.aspx>

IIROC also oversees all Canadian equity marketplaces, including the TSX, TSX Venture Exchange (TSXV), Canadian National Stock Exchange (CNSX), Alpha ATS, Bloomberg Tradebook, Chi-X Canada, Liquidnet Canada Inc., MATCH Now, Omega ATS, and Pure Trading. IIROC develops, administers, interprets and enforces a common set of market integrity rules and principles covering all regulated entities, including investment dealers, and also conducts market surveillance for all marketplaces that it regulates and compliance examinations of dealers trading activities. More information about IIROC regulated markets is available at: <http://www.iiroc.ca/English/About/OurRole/Pages/MarketplaceWeRegulate.aspx>.

## **Provincial Securities Commissions**

In addition to IIROC oversight and examination, securities dealers are subject to regulation by the provincial securities commissions that administer and enforce securities legislation in their respective provinces, and have the mandate to protect investors from unfair, improper and fraudulent practices. The commissions’ mandates include setting and enforcing requirements for the maintenance of high standards of business conduct by market participants, including investment dealers.

Multiple securities commissions, including those of Ontario, British Columbia, Alberta and Manitoba, and the Autorité des marchés financiers in Québec, oversee IIROC’s regulation of participant firms and their trading and sales staff. Provincial commissions also oversee infrastructure providers that are critical to the ability of securities dealers to serve their clients.

## **Canada’s Clearing and Settlement Infrastructure Providers**

Canada’s securities industry has a strong foundation based on some of the world’s most developed and secure clearing and settlement organizations and exchanges. CDS Clearing and Depository Services Inc. (CDS) and Canadian Derivatives Clearing Corporation (CDCC) systems and procedures are backed by risk models, collateral, regulatory oversight and other means to ensure the protection of CDS and CDCC participants, as well as these participants’ customers’ securities, and to ensure that payments for securities and derivatives are exchanged in a risk-managed environment.

CDS’s systems, processes and controls receive multiple external reviews to ensure and validate that its operational controls are effective. These reviews include independent financial audits; evaluations by Thomas Murray, a global custody rating agency that assigned an “AA” (stable) rating to CDS, placing it among



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**“CDS, in operating a complex and sophisticated risk model, has put in place very strong controls and procedures in order to minimize risk. The rating reflects the work done over the years to maintain a sound and efficient infrastructure that meets international standards and places CDS among the top tier depositories currently assessed.”**

– Simon Thomas,

CEO and chief ratings officer,  
Thomas Murray,  
2007

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June 2009

the top rated organizations in the world; an annual independent CICA 5970 audit of operational controls (equivalent to the U.S. SAS 70); and, finally, as a depository used for holding investments, CDS is subject to mandatory review by the world's largest custodians under the U.S. Securities and Exchange Commission *Investment Companies Act Rule 17f-7*, an exercise co-coordinated annually by the Association of Global Custodians. There has never been an insolvency of a CDS participant that has caused a loss to CDS or to other participants through their use of CDS services or a call on participants to pay for the default of an insolvent participant.

Securities and fund transfers are settled simultaneously, irrevocably and unconditionally through CDS and the Large Value Transfer System (LVTS) – the wire payment link between the payments and securities systems – on the books of the Bank of Canada, notwithstanding any federal or provincial insolvency laws. The Bank of Canada also has regulatory oversight over CDS's new clearing and settlement platform and LVTS.

For investment dealers that are CDCC participants, CDCC becomes the counterparty to every derivative trade it handles. Also, CDCC participants must segregate their firms' operating assets from those of their customers, with daily reconciliation. In the unlikely event that a participant were to have liquidity problems, CDCC would take control of the positions and any other funds held at either the clearing corporation or in the customer segregated accounts, moving both positions to another clearing member. There has never been the loss of any customer funds in the few instances of insolvency at a CDCC futures commission merchant. External reviews also confirm that the robust systems, procedures and controls applied within CDCC minimize risk for market participants and protect the organization from even abnormal market conditions. CDCC has had an unvarying "AA" rating by Standard & Poor's since CDCC was first assessed – S&P re-rates the organization annually. On top of financial audits, CDCC is subject to an annual independent CICA 5970 audit of operational risk controls. The most recent audit found that CDCC's controls were appropriately designed and effective.

The clearing brokers and banks used by many brokers for, respectively, back-office processing and cash management are also subject to a similar audit guideline. Additionally, banks are subject to Office of the Superintendent of Financial Institutions oversight and examination.

### **Canadian Investor Protection Fund (CIPF)**

What protects investors if their investment dealer becomes bankrupt? Investment dealer bankruptcy is rare, but if bankruptcy does occur, the CIPF steps in. CIPF ensures that investors' cash and securities are safe up to defined limits (coverage can total \$1 million or more). All IIROC-regulated dealers must annually pay insurance premiums to CIPF to have their clients' assets insured. CIPF has paid all eligible claims totalling \$37 million in its close to 40 years of operation. Current fund financial resources are \$377 million. For more information, visit [www.cipf.ca](http://www.cipf.ca). Additional protection funds cover mutual funds ([www.mfda.ca](http://www.mfda.ca)); the Autorité des marchés financiers also provides a fund ([www.chambresf.com/csf/anglais/id\\_3\\_2\\_3.asp](http://www.chambresf.com/csf/anglais/id_3_2_3.asp)).

### **Other Legal Protections**

Over the past two years, Canada's federal bankruptcy and insolvency statutes have been updated to protect investment dealers and their clients. For example, financial collateral arrangements for securities borrowing and lending, repos and reverse repos, derivatives and margin loans (so-called eligible financial contracts or EFCs) are now enforceable without court-ordered or statutory delays. This has brought Canadian protections to the same high standard as in the U.S. and European Union, ensuring that creditors of Canadian counterparties can be certain of being able to realize quickly on pledged financial collateral in the event of a counterparty's bankruptcy or insolvency restructuring. New regulations to each federal statute modernize the definition of an EFC to clearly cover equity and credit derivatives, as well as newer products, such as property index derivatives, inflation derivatives and emissions trading. Uniform securities transfer acts and amendments to personal property security acts made since 2006 provide perfected first-priority security interests in securities, cash and other assets, meeting top U.S. and European standards.