

## **Response of Market Regulation Services Inc. to ASC/BCSC Audit of Market Regulation Services Inc. – Western Region**

We acknowledge receipt of the report of the ASC/BCSC audit of Market Regulation Services Inc. – Western Region, covering the period from March 1, 2002 to August 31, 2004. We appreciate the opportunity to provide you with our response.

In general, we have no substantive areas of disagreement with the report's findings. We also agree with and accept most of the recommendations made in the report. We have already implemented some of these recommendations and are in the process of implementing others. We have organized our response in accordance with the order of the recommendations as presented in the audit report.

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### **Summary of Key RS Audit Findings**

### **Summary of Recommendations & Expected Outcomes**

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#### **1. More substantial enforcement results are anticipated over the next fiscal year.**

##### **Response:**

As noted in the report, since the beginning of this year the Western Region has completed four significant and related settlements involving one firm and three employees. A hearing is scheduled in another related matter. Several additional investigations have been or shortly will be completed. We anticipate that a number of additional matters will be recommended for disciplinary action over the next several months.

#### **2. RS will expeditiously complete investigation reports for all current investigations.**

##### **Response:**

The current target turnaround time for investigation reports is within 6-9 months of the commencement of the investigation. We are committed to meeting this target on each of our investigations.

#### **3. Chief Counsel duties need to be clearly defined with specific performance objectives. These duties and functions should be included in the Investigations and Enforcement Policies and Procedures Manual.**

**Response:**

The Investigation Procedures Manual referred to in the recommendation has the purpose of documenting common standards in investigative procedures and reporting methods and would not appear to be the appropriate place to include specific duties and performance objectives for the Chief Counsel position. RS has not created an enforcement policies and procedures manual as UMIR Policy 10.8 in effect provides the policy and procedural information that would otherwise be included in such a manual. The duties and specific performance objectives for the Chief Counsel position are detailed in the job description and in the Performance Plan for the position. The Performance Plan is an annual plan that is prepared at the beginning of each fiscal year. The performance of the Chief Counsel is evaluated annually based on the Chief Counsel's success in meeting the performance objectives detailed in the Performance Plan.

- 4. A separate Manager of Investigations should be reconsidered to manage the files and allow the Chief Counsel to focus only on Prosecution files (see "Staffing, Turnover and Training" for further discussion).**

**Response:**

Please refer to our response to recommendation 2 under "Staffing, Turnover and Training" below.

**Staffing, Turnover and Training**  
**Summary of Recommendations & Expected Outcomes**

- 1. Report in writing to the BCSC any management position that remains vacant for more than 60 days.**

**Response:**

We will make the report as requested. There are currently no vacant management positions.

- 2. Revisit the decision to eliminate the Manager of Investigations to allow Prosecutions to focus exclusively on their files.**

**Response:**

The combined position of Manager of Investigations and Chief Counsel has worked well in our Eastern Region. It has not resulted in productivity issues in that region or in material delays in the initiation and conduct of disciplinary actions. We agree that it can be difficult to hire qualified staff for such a position. Indeed, the Western

Region vacancy persisted beyond 60 days largely due to such recruiting challenges. We are confident, however, that we have been very successful in filling the Western Region position with a qualified individual and that our investigation and enforcement results will evidence this. At some point, investigation and enforcement workload may require additional legal resources. RS is committed to minimizing delays in the enforcement process and will ensure that these resources are made available if necessary either by contracting with outside counsel or by hiring counsel to assist the Chief Counsel.

- 3. Provide a report to the BCSC by September 30, 2005, addressing staff turnover and RS's assessment and plans to manage the issue going forward.**

**Response:**

RS is currently in the process of developing a formal retention strategy and implementation plan. The intent is to build a compensation and career development framework at RS that will provide a strong incentive for regulatory staff to remain with RS for at least 3-5 years and preferably longer term. We will provide the BCSC with either the completed retention strategy and implementation plan or an update on its progress by the recommended deadline.

**File Prioritization, Performance Measures and File Aging  
Summary of Recommendations & Expected Outcomes**

- 1. RS should follow its policies and procedures or consider choosing a different prioritization method for TRA files. A simpler process may be more effective.**

**Response:**

RS is in the process of implementing, during the second and third quarters of this fiscal year, regulatory program changes to ensure that RS's regulatory operations focus on and address the high risks to market integrity while dealing with lower-ranked risk activities through the use of alternative methods of detection and resolution. The implementation plan builds on the risk profile for UMIR violations that was established based on the results of the strategic review of UMIR conducted in 2004. Besides the determination of high risk versus lower risk violations, the implementation plan includes the following elements:

- development and use of enhanced analytical tools for speedier identification of violations;
- categorization of identified potential violations, whether through market surveillance or complaints, as urgent, high, medium or low priority;

- fast-tracking procedures for urgent and high priority files and alternative procedures for lower-priority risks and files; and
- redefinition of performance measurements to reflect the focus on high risks to market integrity.

A component of the implementation plan is to revise the process by which priorities are set for TRA files. Each referral from market supervision or as the result of a complaint will be assigned a priority of urgent, high, medium or low. The priority categorization criteria include factors such as the nature of the alleged violation, the apparent and potential market impact, whether the conduct is ongoing or concluded, outstanding or resolved, initial or recurring. The priority categorization is intended to provide an early assessment of the potential harm the conduct represents to market integrity. Based on the priority ranking, the approach in the TRA group to assessing the referral of a matter will differ, including required turnaround time for assessment and subsequent referral, as well as assessment procedures to be applied.

The objectives of the categorization process are to address ongoing risks to market integrity real-time, to refer only urgent and high priority matters to the Investigation & Enforcement department, and to assist in enabling these referred matters to be brought to the stage of a Notice of Hearing or settlement offer within 4-12 months of the violation. The following procedures are being developed with these objectives in mind:

- upon the identification of an apparent trading violation, immediate contact by surveillance staff or manager with the Participant firm to have the firm address and rectify as necessary the apparent violation;
- initial assessment by market supervision staff and TRA manager of priority ranking;
- fast-tracking referrals of urgent priority matters, e.g. insider trading violations currently are being fast-tracked to the OSC, AMF and ASC;
- preliminary analysis and referral by TRA staff of non-urgent priority matters within the turnaround times applicable to the priority of the matter;
- low priority matters normally resolved through alternatives to enforcement action.

2. **The current performance measures for the TRA group are not being followed. We expect RS to expedite their development of benchmarks in this area and have appropriate performance measures in place (and followed) by August 31, 2005.**

**Response:**

As referred to in the previous response, a significant component of the implementation plan described is to redefine the performance measurements of each operational department to ensure that they reflect and encourage a focus on high risk market issues. Performance measures for the TRA group are being developed to reflect the file categorization process described in the previous response. These performance measures will be implemented by August 31, 2005.

**3. Improvements need to be made to clearly define and track when a file is closed in Investigations and subsequently opened in Prosecutions.**

**Response:**

These procedures have been added to the Investigation Procedures Manual, specifying that any investigation file that is forwarded for possible disciplinary action is closed for operational and statistical purposes as an investigation file and opened as an enforcement file. Operating statistics currently provided for oversight purposes to the British Columbia and Alberta Securities Commissions reflect this practice.

**Policies and Procedures**

**Summary of Recommendations & Expected Outcomes**

**Recommended changes to the policies and procedures manuals:**

- **Revise procedures for the assignment of files to the TRA group**

**Response:**

Please refer to our response to recommendation 1 under “File Prioritization, Performance Measures and File Aging” above. These revised procedures will be included in the TRA policies and procedures manual.

- **Define procedures for files closed out of Investigations and opened in Prosecutions**

**Response:**

Please refer to our response to recommendation 3 under “File Prioritization, Performance Measures and File Aging” above. These procedures have been added to the Investigation Procedures Manual.

- **Add follow up requirements for recipients of red flag letters**

**Response:**

The Investigation Procedures Manual has been revised to provide that a red flag letter should include a request for the Participant to provide a written response describing the steps taken to address the matters raised in the letter.

- **Detail the Chief Counsel's responsibilities**

**Response:**

Please refer to our response to recommendation 3 under "Summary of Key RS Audit Findings" above.

- **Include the requirement in the Investigation Procedures Manual to document all management input on significant decisions about file direction, including decision rationale**

**Response:**

Documentation of management's rationale for closing all or part of an investigation, for engaging in an alternative to disciplinary action or for proceeding to enforcement is part of the normal record-keeping practices followed by RS staff. The specific procedural requirement to document the rationale for management decisions has been added to the Investigation Procedures Manual under the applicable sections relating to procedures for closing an investigation and for determining to take enforcement action.