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RE: Draft Guidance Regarding Outsourcing Arrangements

FAIR Canada is pleased to offer brief comments on the request for comments on the draft guidance note proposed regarding outsourcing arrangements (the “**Draft Guidance Note**”) by the Investment Industry Regulatory Organization of Canada (“**IIROC**”) contained in Rules Notice 12-0311 dated October 22, 2012 (the “**Notice**”).

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

FAIR Canada Comments

- 1.1. FAIR Canada generally supports the objectives of IIROC’s Draft Guidance Note. FAIR Canada supports operational efficiency at IIROC Dealer Member firms, providing that such efficiency does not come at the cost of consumer protection.
- 1.2. FAIR Canada supports the principles outlined in the Draft Guidance Note that establish IIROC’s expectations of Dealer Members’ due diligence regarding outsourcing. In our view, the fundamental principle relating to outsourcing is that the Dealer Member’s regulatory responsibility may not be subrogated to a service provider. It is essential that a Dealer Member must ultimately be responsible for ensuring that any outsourced activities are performed properly and in compliance with all regulatory requirements.

- 1.3. We agree with IIROC’s approach to identifying which investment dealer activities may be outsourced and which may not. FAIR Canada believes that it is appropriate that the outsourcing of most core, client-facing activities of the Dealer Member be prohibited. These activities, as noted by the IOSCO report, are “critical to... meeting [a firm’s] regulatory obligations to customers”. Such activities, including the account opening process, suitability assessments, and the handling of complaints, are so fundamental to investor protection that the outsourcing of such activities would present a real risk to investor protection. We support the exception of the performance of investment decision making in managed accounts from this prohibition.
- 1.4. Similarly, FAIR Canada supports IIROC’s guidance that Dealer Members are not prohibited from outsourcing other core activities such as trade settlements and the administration of margin loans. However, FAIR Canada stresses that the determination of the suitability of the use of margin or other leverage for investment purposes may not be permitted to be outsourced.
- 1.5. FAIR Canada also questions why items such as “the preparation of regulatory financial reports” and “the preparation of non-financial regulatory reports” are listed as core activities that may be outsourced, while they are prohibited from being outsourced under Dealer Member Rules (as listed in Appendix B of the Draft Guidance Note). We recommend that IIROC clarify in the Draft Guidance Note that these activities are prohibited from being outsourced (even if the prohibition does not arise as a result of them being core activities which may not be outsourced) in order to make the guidance clear and consistent.
- 1.6. FAIR Canada recommends that IIROC add *client harm risk* to its list of risks associated with the outsourcing relationship that need to be managed within its expectations of Dealer Members’ due diligence regarding outsourcing. While some aspects of such a risk may be subsumed within *reputation risk* and *compliance risk*, the risk of harm to the firm’s clients is a separate risk to be considered and managed. In our view, IIROC has a responsibility to ensure that Dealer Members consider the potential for harm to clients in managing the risks of outsourcing.
- 1.7. FAIR Canada also supports IIROC’s intention to introduce outsourcing rules, which IIROC has indicated is it currently working on. We are confident that IIROC will be mindful of IOSCO’s nine guiding principles during the development of the propose rules relating to outsourcing.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-214-3443 (ermanno.pascutto@faircanada.ca).

Sincerely,



Canadian Foundation for Advancement of Investor Rights