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-and-

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January 18, 2013

Dear Mr. Piergeti and Mr. Corner,

Re: Proposed Guidance regarding Outsourcing Arrangement (the "Proposed Guidance")

The Investment Industry Association of Canada ("IIAC" or the "Association") appreciates the opportunity to comment on the Proposed Guidance. We understand that the objective of the Proposed Guidance is to clarify existing regulatory expectations related to outsourcing. We are concerned, however, that the Proposed Guidance changes the current understanding and practice around outsourcing arrangements in a manner that could significantly impact the structure and operations of firms. We believe the objective of IIROC's outsourcing guidance and impending rules should be aimed at ensuring Dealer Members outsource activities in a manner that does not compromise IIROC standards rather than prohibiting Dealer Members from outsourcing activities. Our concerns with the

practical application of the Proposed Guidance and requests for clarification are provided below.

In order to provide meaningful feedback, it would be helpful to understand the specific problem or issue that resulted in the issuance of the Proposed Guidance. We understand that it may have been motivated by recent firm failures, and the difficulty obtaining the books and records from a service provider. If the objectives are more clearly understood, industry feedback could be more targeted to assist in addressing these concerns without creating unintended negative consequences.

As drafted, the scope of the Proposed Guidance is quite broad, and appears to alter current industry practice based on firms' understanding of regulatory expectations. In particular, the breadth of the definition of outsourcing and the general description of core activities may prohibit currently permissible outsourcing arrangements. The specified core activities that may not be outsourced are defined at a high level, without reference to the many sub-tasks that fall under these core activities which, in many cases, are appropriately and necessarily outsourced.

For example, the account opening process is identified as a client-facing core activity that may not be outsourced. However, a number of aspects of the account opening process, including the collection and input of information required to fulfill the know your client (KYC) obligation is not client-facing and does not compromise the firms' ability to meet their regulatory obligations. As part of the KYC process, certain information is frequently collected and inputted from various sources outside of the firm. With respect to institutional firms, the client may be exempt or able to waive suitability requirements and accordingly, the KYC account opening process will be less focused on client-facing activities and relies more heavily on documentation collection. The collection and inputting of client information/documentation is administrative in nature and there is no added value to the client to require a Dealer Member to be directly involved in this process. Bank owned firms, integrated firms and global firms may have a consolidated back office serving all of its divisions that obtains and inputs the information for the ultimate use by the advisor at the dealer firm. The Dealer Member, however, is ultimately accountable and responsible for the account opening process, interacting with the client and performing the KYC analysis. As such, there is no regulatory reason to prohibit this practice. We would also like to clarify that in situations involving Portfolio Management firms using a Dealer Member as custodian to custody client assets, would not be considered outsourcing of the account opening process. While the accounts are held by the Dealer Member, the relationship and suitability requirements would be that of the Portfolio Management firm. These arrangements are currently permissible and any changes to how the account information was collected would be confusing for the client.

In respect of the restriction on outsourcing the handling of client complaints, our members agree that it is necessary to have the Dealer Member supervise and be responsible for the complaint process. However, certain current complaint handling practices that may be deemed to be outsourcing are advantageous to the client, and may be prohibited based on the Proposed Guidance. For instance, Dealer Members may use a mediator, lawyers or OBSI to resolve complaints in appropriate circumstances. Although the ultimate responsibility for the resolution of the complaint rests with the firm, given that these entities are external to the firm, this activity could be considered outsourcing of a prohibited core activity. Similarly, large integrated firms may have a centralized complaint handling system for all related entities. This division would work directly with the Dealer Member to ensure that all complaints from the Dealer Member's business can be addressed simultaneously with those arising from other divisions. The Dealer Member remains responsible for the outcome in respect of their component of the complaint. This provides the client with an easier and more efficient way to seek redress.

A further example is the use of third party technology systems or platforms that Dealer Members may rely on to perform core activities such as the account opening process of the performance of suitability assessments. Many firms do not have the capacity to perform these activities themselves. We would appreciate clarification that the example arrangements described above were not intended to be prohibited, as although they support the core activity, the analysis and decision making related to the core function remains with the firm. The activities listed in the Proposed Guidance should be revised to describe in further detail what elements may or may not be outsourced.

The Proposed Guidance should also clearly distinguish between the use of third-party service providers and the outsourcing of an activity. The use of third-party service providers to assist the dealer member in one of its function should not be considered as outsourcing, for as long as key staff of dealer firms remain accountable for the overall function (e.g. an accounting department hiring additional staff to prepare financial reports as long as the CEO remains responsible to review and confirm the reports with IIROC).

Within the Proposed Guidance, there are some inconsistencies regarding how an activity is categorized, and subsequently whether or not it can be outsourced. For example, under Point 4 on page 8 of the Proposed Guidance, the preparation of non-financial regulatory reports is listed as a core activity which may be outsourced, yet in Appendix B, it states that firms are prohibited from outsourcing this activity. The IIAC requests that such inconsistencies be addressed.

The Proposed Guidance provides firms with considerations related to determining whether a particular activity can be outsourced. Several of the considerations require further clarification. For example, it is not clear how firms can comply with the guidance that

"Dealer Members should *never* enter into an outsourcing arrangement that unduly concentrates its outsourced activities in one or a few outsource service providers. Does the reference to concentration refer to using multiple providers for the same activity, or using different providers for different activities, or ensuring that there is not a market concentration of firms using the same provider? If firms "outsource" to an affiliate or use a common back office, would that result in an overconcentration? Depending on the activity being outsourced, firms may be limited in the choice of provider(s) available. If the concern is related to the market concentration of providers, then this is out of the firms' control and should not form part of the regulation. The restrictions relating to concentration could have significant implications if they are applied to the use of carrying brokers and the providers of back office platforms, as the number of providers are very limited in the Canadian market.

The Proposed Guidance does not provide firms with direction regarding its applicability to current outsourcing arrangements. It would be extremely impractical and onerous to require firms to alter current approved outsourcing arrangements. We recommend that current outsourcing arrangements be grandfathered until the firm has its first opportunity to update or revise the agreement. It should be noted that in their outsourcing guidelines OFSI requires firms to ensure their previous outsource arrangements are compliant at the first opportunity, such as when the outsourcing contract is substantially amended, renewed or extended.

We also request clarification relating to the requirement for firms to "inform" IIROC when entering into an outsourcing arrangement. The Proposed Guidance states that IIROC requires firms to "inform" rather than strictly notifying IIROC when a new outsourcing arrangement involving a core activity is entered into. We question if IIROC is intending to require approval of outsourcing arrangements or additional information than what is required pursuant to a "notification". In addition, we question the use of the term "core" if it refers to the core activities identified in the Proposed Guidance or to a more general notion of what is core to the business of the firm? Furthermore, a materiality threshold should be implemented into the "inform" requirement. Certain activities such as a marketing campaign should not require IIROC notification.

The Proposed Guidance states that "where applicable" a firm should obtain and provide IIROC with an audit report. However, details regarding when it would be applicable for a firm to obtain and provide IIROC with an audit report were not provided. Some smaller service providers (e.g. a marketing firm) may not have the ability to produce the type of audit specified in the Proposed Guidance. Is the applicability based on the activity outsourced, or the capacity of the outsourcing party to produce the audit report? We request clarification regarding the audit report requirement.

We would also like to encourage IIROC to ensure that the Proposed Guidance and impending rules are consistent with OSFI B-10 to prevent any conflict for the bank-owned dealers who are subject to those regulations.

Thank you for considering our input. If you have any questions, please do not hesitate to contact me.

Sincerely,