



Letter from the President

Markets are Globalizing: Now, How About Regulations and Tax Laws?

by Ian C.W. Russell

Global financial markets have become a reality. It is time for regulatory and tax regimes to catch up with that fact.

The acceleration of cross-border trade in financial products and services over the past decade – driven by the removal of trade and capital barriers, diversification opportunities into global financial assets, and expansion of non-financial trade in global markets – quickly resumed after coming to a jarring halt in the wake of the 2008 crisis. This reflects a simple fact: global trade and financial services are integral to global prosperity. But one thing is different in the post-2008 world: trade in the developing countries is the subject of increased focus, reflecting faster recovery and buoyant prospects for an emerging middle class that will increasingly demand financial services.

Canadian Firms Take Advantage of New Opportunities

These cross-border financial flows have opened up opportunities for large and mid-sized Canadian securities dealers. Firms that are members of the Investment Industry Association of Canada (IIAC) have provided foreign clients with research and trade execution, and clearing and settlement for the purchase and sale of Canadian stocks and bonds. This is feeding a foreign appetite for Canadian securities stemming from the performance of the Canadian financial sector and economy through the financial crisis and its aftermath, and the sustained strength of commodities markets.

Last year, foreigners purchased a record \$116 billion in Canadian securities. IIAC member firms also advised and executed transactions in foreign securities on behalf of domestic retail and institutional clients, and advised corporate clients on offshore acquisitions and the sale of domestic assets. Foreign direct investment in the fourth quarter last year reached its highest level in three years, with significant merger and acquisition activities of Australian firms. The failed BHP bid for Potash has triggered debate on the outlook for Canadian acquisitions. But foreign interest is unlikely to wane given the attractiveness of Canadian energy and mining firms with strong assets in Canada and substantial assets abroad.

Driving Growth in Foreign Markets – in the U.S. and Beyond

Strategic focus is the key to building international business. In the past decade, Canadian securities firms have mostly been focused on U.S. investors familiar with the Canadian economy and investment opportunities, especially in energy and mining plays.

Because the safe harbour for foreign broker-dealers (SEC Rule 15a-6) in its current format is too restrictive, large integrated Canadian firms and mid-sized boutiques have projected trading and sales with institutional clients through registered U.S. affiliates. While affiliates offer the flexibility to structure a relatively cost-effective platform, they are still more expensive and complex than dealing directly through the domestic firm. Several integrated dealers have gone one step further, establishing U.S. subsidiary operations offering wealth management services as a complement to their institutional business, despite compliance costs and stiff competition in the U.S. retail wealth management business.

Canadian firms have also moved beyond U.S. markets, to London and, more recently, Hong Kong. The business focus in London is the global institutional market, with large firms dealing in fixed income and OTC derivatives (mainly interest rate swaps), and large and mid-sized firms trading, sales and distribution of Canadian mining and energy equities. Smaller Canadian firms also have established relationships with individual registered firms in London and New York, to exchange products and services, and jitney equity transactions listed on foreign exchanges. These relationships – though sometimes costly and with the risk of exposing client business – may be an effective first step to building a beach-head in foreign markets.

In the Hong Kong market, large integrated Canadian dealers have recently established a foothold in the high net-worth wealth management business. Some large firms have built prime brokerage businesses, including trade execution and custodial services, with institutional clients, in various markets around the world.



Building on Strengths – and Seeking a Fair Playing Field

The international successes so far have been based largely on the efficiencies of firms' domestic institutional platforms, built on substantial investments, expertise, technology, and domestic trading and dealing infrastructure. The offshore focus is as much about capabilities and competitiveness in the domestic market as about business vision and opportunities abroad. The Canadian securities industry, both large integrated firms and institutional boutiques, have a global reputation for research, trading and underwriting securities in the energy and mining sector, and for cost-effective trade and clearing systems to execute transactions.

Building a sustainable and competitive international business to serve domestic and international clients also requires a cost-efficient regulatory framework and effective domestic tax arrangements. IIAC is pursuing several initiatives to improve cost-effective access to foreign institutional markets.

First, while there appears to be no regulatory appetite in the United States for mutual recognition (even for institutional trading and dealing), IIAC has encouraged the SEC to re-submit an amended and less restrictive safe harbour for foreign broker-dealers dealing in U.S. institutional markets, where regulatory requirements are the toughest in the world. On the retail front, IIAC is also seeking modification to the SEC safe harbour for RRSPs to recognize fee-based accounts.

Second, in this era of stock market consolidation, mutual recognition of listing standards would facilitate increased market cross-listing, exploiting the key benefits of enhanced liquidity and financing scope for listed companies on merged stock exchanges.

Finally, IIAC supports a Double Tax Agreement with Hong Kong that gives individuals and companies in Hong Kong an exemption from Canadian withholding taxes. Such a tax protocol would not only encourage investment in Canadian dividend-paying stocks, but would also stimulate direct investment into Canada through Canadian-based affiliates of Hong Kong companies.

In globalizing markets, Canadian securities firms are bringing a lot to the table. A liberalized regulatory and tax regime would enhance that process – to the benefit of both investors and companies.

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Yours sincerely,



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