Letter from the President

IIAC on Regulatory Reform: Bolstering Canadian Weaknesses – and Protecting Canada's Strengths

It would be easy for Canadians to look at the impact of the 2008 financial crisis and feel a sense of security. But it would also be a mistake. No doubt, we came out of the financial crisis far better than the U.S. and Europe, mainly because Canadian regulators held to sound rules and principles, particularly in terms of responsible capital and leverage standards. Canadian financial institutions effectively navigated the shocks from the global financial system.

Nonetheless, the Canadian financial sector exhibited several weaknesses: inadequate disclosure requirements, especially for securitized products; the need for strengthened infrastructure in the repo and securities lending markets, vital to interbank funding; and the importance of a single national securities regulator to oversee complex national markets more effectively, and manage systemic risks in the marketplace.

Moreover, in the wake of the meltdown, the Canadian financial services industry faces threats in the form of U.S. over-reaction and over-regulation.

Many of the regulatory initiatives taken on by IIAC in the past year or so have been tied either directly or indirectly to the principles set out in the G20 reform agenda for global markets in November 2008. The G20 set the direction for reform in the immediate aftermath of the 2008 financial crisis, embracing broad themes of transparency, investor trust and confidence, and the efficiency and soundness of capital markets, designed to address their perceived weaknesses.

But for specific regulatory initiatives, the G20 has turned to national and pan-national (EU) regulators for implementation. IIAC has been active in the process of providing recommendations for reforming Canadian regulation, and in representing the interests of Canadians participating in other markets.

Focusing on Priority Areas

In the past two years or so, the IIAC committees and working groups have given strong focus to the following policy areas:

Transparency

i. Transition CanPX – Canada's designated transparency provider for corporate debt markets — to a new technology provider, CanDeal, to improve efficiencies of the transparency system and broaden distribution channels for real-time bond data.

ii. Comment on Canadian Securities Administrators (CSA) proposals for the disclosure of securitized products and revised exemptions for short-term paper.

iii. Participate in regulatory roundtable discussions and comment on CSA proposals for better and more flexible disclosure and access to issuer communication with shareholders.

Investor Confidence

i. Comment on the final element of the Client Relationship Model related to reporting obligations for client portfolio performance. The Association has already commented extensively on rules to improve disclosure of the investment process, and tougher standards for Know-Your-Client and suitability.

ii. Comment on Ombudsman for Banking Services and Investments (OBSI) proposals related to loss assessments in suitability claims, as well as providing suggestions for needed improvements to the effectiveness and fairness of the client restitution process.

iii. Best practices for syndication of debt offerings.

Better Functioning and Sound Capital Markets

i. Respond to CSA proposals for electronic trading and direct market access in secondary equity markets. The Association has been active in responding to regulatory proposals for best trade execution for clients in multiple markets to achieve integrated, non-fragmented equity markets.

ii. Respond to Bourse de Montréal required reporting requirements for positions in listed equity options.

iii. Comment on the upcoming CSA proposals for over-the-counter (OTC) derivative securities.

iv. Support for federal efforts to implement a single securities regulator in Canadian capital markets.

v. Provide liaison between industry working groups and consultants, and the needed infrastructure, to support efforts in building a central counterparty and netting system for debt repurchase transactions.

vi. Contribute to multinational efforts to build a global "legal entity identifier" (LEI) system to report and monitor transactions in global markets.

The Need to Minimize U.S. Compliance Burdens

The above initiatives are at the core of strengthening the efficiency, soundness and fairness of our capital markets. The securities industry has committed substantial resources to the consultation process on proposed rules. Once the rule framework is completed, we will, on a firm-by-firm basis, devote the necessary resources to comply with new regulations.

However, the reform agenda has been complicated by the financial crisis in the United States (provoking a fiscal crisis and a need to clamp down on tax evasion), as well as the necessity to address other threats to the financial system. These issues, peripheral to the G20 agenda, have drawn focus and resources from the ongoing G20 priorities. While the ancillary agenda must be addressed, governments and regulators have an obligation to respond to practitioner concerns and remedial suggestions expeditiously, and implement revised proposals to minimize the compliance burden on market participants and the likelihood of unintended consequences.

Addressing New U.S. Reporting Burdens

The most serious initiative in this peripheral agenda is the tax-reporting obligations of the U.S. Treasury and Internal Revenue Service (IRS) under the new Foreign Account Tax Compliance Act (FATCA) legislation. The proposed reporting of investment positions in the accounts of U.S. persons with Canadian dealers, and other foreign institutions, exceed the existing reporting burden of "Qualified Intermediary" designated dealers and will place a new and onerous burden on introducer dealers. Treasury's lever is the threat to apply a 30% withholding tax (double the protocol percentage) on investment income and redemptions. IIAC has a two-track approach to ease the reporting and witholding burden for member firms: i) work with the U.S. Treasury and IRS to mitigate the reporting obligation as much as possible, and ii) encourage Canadian federal Finance officials to consult with their American counterparts to make maximum use of the information sharing facility between the Canada Revenue Agency (CRA) and IRS for the required information to alleviate the burden on individual Canadian firms.

Working Against Increased U.S. Registration Burdens

Second, the U.S. self-regulatory body Financial Industry Regulatory Authority (FINRA) has extended registration requirements to employees of the parent Canadian firm of the U.S. affiliate engaged in back-office functions related to the clearing and settlement of Canadian securities. The employees of the Canadian parent firm will be required to register and qualify for FINRA registration even if these professionals act only as settlement agents and service providers for the U.S. affiliate firm. It is unclear how far registration would extend to the parent firm engaged in the clearing and settlement functions for the affiliate.

We object to the FINRA action on several grounds: i) extended registration is unnecessary as the activities of the Canadian employees providing ancillary services to the U.S. affiliate are subject to compliance and oversight of the Canadian self-regulator, the Investment Industry Regulatory Organization of Canada (IIROC), ii) this unprecedented action was initiated after 20 years of existing practice without evidence of regulatory problems at the U.S. affiliates of Canadian firms, iii) FINRA's conduct in asserting jurisdiction in Canada violates the provisions of the North American Free Trade Agreement (NAFTA), and iv) the FINRA actions will cause significant costs for Canadian firms to meet the U.S. registration requirements, either through extended U.S. registration of Canadian personnel or engaging U.S. clearing firms for these U.S. affiliates.

The Association is following a two-track course of action. We have explained our concerns to CSA regulators and requested they take action with their U.S. regulatory counterparts at the SEC and FINRA. We have also had discussions with the federal Department of Finance to explain the interference in cross-border trade caused by the FINRA action and its contraventions of the NAFTA agreement. We have recommended the Department of Finance raise the trade matter in bilateral discussions with the U.S. Treasury.

Maintaining Reasonable Money-Laundering Requirements

Third, the federal anti-money laundering legislation imposes extensive and onerous requirements to confirm offshore client identity, procedures that exceed the due diligence requirements in other jurisdictions. IIAC initially sought an exemption under the anti-money laundering legislation for institutions already registered with a recognized regulatory jurisdiction. After much consultation with government officials, the Association is working with the Department of Finance to achieve a more streamlined disclosure regime rather than press for a formal exemption.

Ensuring Oversight – Preventing Overkill

It is not surprising that the 2008 market disruption would spawn regulatory attempts to prevent future crises. However, it is important not to exceed appropriate oversight and enter into the territory of regulatory overkill. The IIAC agenda is aimed at promoting well-regulated markets, while ensuring the Canadian financial services industry is not obstructed from serving either Canadian or U.S. clients.

Yours sincerely,

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