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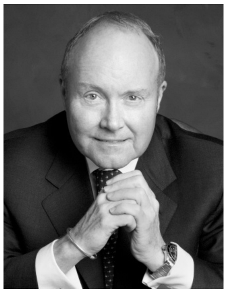

Letter from the President

Taking Stock of Global Reform: The View From Europe

25th ICSA Annual General Meeting, Copenhagen

June 11-12, 2012

What are the principal forces driving the European capital markets? A broad-based panel at the Annual Meeting of the International Council of Securities Associations in Copenhagen last week came to a clear consensus: Uncertainty about the economy and sovereign debt, and the impact of regulatory reforms, are having a profound impact on how these markets are performing.

These were among a number of points raised at the 25th ICSA Annual General Meeting 2012, which discussed progress on the global regulatory reform agenda, with the focus on efforts in Europe and the ongoing financial crisis playing out across the continent. The Investment Industry Association of Canada, and its predecessor the Investment Dealers Association, has been an active member of ICSA since its beginnings 25 years ago. Coming out of this year's conference, I have been appointed Chair of the important ICSA Standing Committee on Regulatory Affairs for the coming two years. I am very pleased to be the first Canadian to serve in this capacity. This will give the IIAC a clear window on the global reform agenda, and on the regulatory positions taken by trade associations in Europe, the U.S. and Asia, as ICSA forges a consensus among its member industry groups.

The Sovereign Debt Crisis and Uncertainty Cloud Economic Prospects

In a panel session of conference speakers and panelists, the common view was that the economic outlook and direction of the sovereign debt crisis in Europe would have an adverse effect on the participation of investors and intermediaries in capital markets, and on capital-raising by corporate and government issuers. As well, broad-based regulatory reform is weighing down banks and dealers in terms of cost and business constraints.

While the OTC cash bond markets have operated well over the past 45 years or so, proposed regulatory structural changes have thrown up uncertainties about the future viability of these markets. The final outcome of the pre-trade and post-trade transparency rules for OTC markets could interfere with market-making activity and damage liquidity. Second, MiFID 2/MiFIR – the scheduled review of the earlier MIFID directives, including those dealing with transparency, market abuse measures, HFTs, and regulations governing the OTC derivatives markets – envision a new trading platform category termed an "organized trading facility". It is unclear whether the operators of these platforms will be able to provide their own capital to make markets or if trades will be forced through this systematic internaliser mechanism – and what will be the ultimate impact on market liquidity? Market participants will have to await the implementation of MiFID 2/MiFIR to see what impact these structural changes will have on OTC cash bond markets.

The rapid growth of the covered bond markets to provide greater security for investors and lower funding costs for issuers, and the continued growth of the repo markets, together with the LTRO operations of the ECB, have sucked up significant collateral in the system, estimated at 500 billion Euro net. The liquidity requirements under Basel III will also have an impact. Finally, the mandated move to central clearing systems (CCPs), and related margin requirements will absorb even more scarce collateral. It is unclear whether technology will enable effective collateral management to offset increasing demand for collateral, or whether the reduction in unencumbered assets on bank balance sheets will constrain trading and borrowing activity. Reduced investor participation in institutional markets and narrowing in commissions has already caused banks in Europe to reduce capital available for institutional equity trading.

The European Reform Process: Squeezing a Decade of Regulation Into Three Years

It was clear from the conference proceedings that European regulators face two challenges:

1) To implement the G20 reforms in a manner that will achieve a more integrated regulatory framework for financial institutions and markets across Europe.

2) To mitigate to the extent possible the financial crisis roiling in European and global markets.

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Jonathan Faull, Director General, Internal Markets and Services at the European Commission, set a tough tone in his remarks. He referred to the regulatory requirements spelled out in MiFID1 and other directives. Many of these regulations in MiFID2/MiFIR have not yet been implemented, reflecting in part complications from the 2008 financial crisis.

The reform process in Europe is extensive. In some aspects, such as the OTC derivative proposals for trade repositories for transparency and CCPs for clearing and settlement, it is moving at breakneck speed. A conference participant noted the scale of reform, pointing out that

> ***Europe is engaged in squeezing a regulatory agenda that would normally take a decade to implement into a three-year window. The impression from Mr. Faull's remarks is that consumer protection has the highest priority, even if it comes at the expense of market efficiencies.***

Some examples of the tilt in balance include the higher exemption thresholds under the Prospectus Directive, the extensive transparency proposals and some aspects of the Market Abuse Directive.

Verena Ross, Executive Director of the newly established European Securities Markets Authority – the supervisory authority for capital markets, complementing similar agencies for banking and insurance – outlined ESMA priorities. The focus is to get rule comparability across the European jurisdictions to achieve a single rulebook for advice, trading and issuance. Second, the Authority aims to achieve supervisory convergence across the jurisdictions. Some of the specific initiatives referred to include regulation of CRAs, short-selling rules, technical standards for OTC derivatives, rules for prospectus offerings and ETFs.

There was clear recognition that common standards across jurisdictions are needed to ensure efficient and well-functioning global markets, notably in areas such as OTC derivatives regulation and CRA oversight.

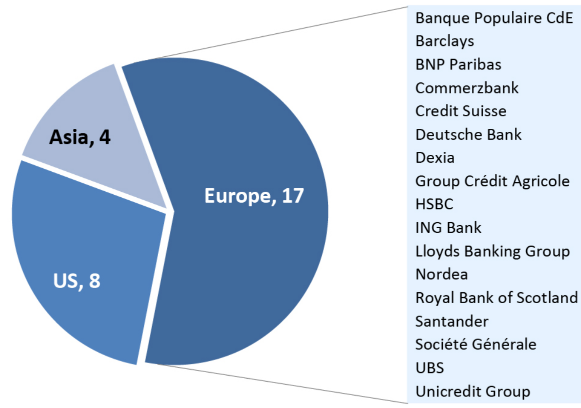
> ***ESMA will seek to achieve international convergence of rules through consultation. The objective was the equivalence of home jurisdiction oversight, enabling mutual recognition.***

IOSCO: Addressing Systemic Risks of 'Too Big To Fail' Banks

The International Organization for Securities Commissions, the umbrella organization of securities commissions around the world, will play a key role in developing uniform standards, and provide guidance for the regulatory community in Europe and elsewhere. David Wright, the new Secretary General, plans a high-level reorganization of IOSCO and will set it on a track to shape the global reform agenda. The Regulatory Affairs Committee of ICSA sees IOSCO as a key interlocutor in discussions on global reform. To this end, the IIAC has invited Mr. Wright to speak to delegates at the IIAC Annual Conference in Toronto on September 20.

Mr. Wright focused his remarks at the ICSA Conference on measures to address systemic risks related to the "too big to fail" banks. This emphasis suggests IOSCO believes the failure of one of these banks would not only require significant taxpayer support, but could have severe negative repercussions in global capital markets, even if a rescue effort were successful.

'Too Big To Fail' Banks by Region



Source: Financial Stability Board

Market and prudential regulators alike must ensure broadly based reforms are in place to ensure the risks of mega-bank failure are minimal. In his remarks, Mr. Wright stressed the importance of resolution authority to stabilize or wind-up troubled institutions through planned structural adjustments – so-called "living wills" – stronger, experienced Boards and tougher management, greater transparency, and higher capital standards. Transparency can be a double-edged sword, important for the investing shareholders, but not always appropriate at times of institutional instability.

Achieving Financial Stability Among Eurozone Countries: Too Different to Succeed?

Two central bankers – Kerstin af Jochnick, First Deputy Governor of Sveriges Riksbank (Swedish Central Bank), and Per Callesen, Governor of Danmarks Nationalbank (Danish Central Bank) – focused their remarks on financial stability and macro-prudential policy-making. Ms. Jochnick was active in European initiatives related to coordinating prudential supervision of the banking system, regulatory reform – notably the Basel III rules for capital, liquidity and leverage ratios – and developing a crisis management framework. Per Callesen highlighted the lessons learned from the conduct of macro-prudential policy-making. He referred to the fact that given the pro-cyclical nature of the financial system and the wide dispersion in economic conditions across eurozone countries, current account deficits matter a great deal and there is a need to get fiscal policies right by focusing on imbalances.

Both bankers noted that the significant differences in structural fiscal policies among countries in the eurozone posed an impediment to implementing a European banking regulator, a uniform deposit insurance scheme and Eurobond financing. The differing capacities among the eurozone countries to absorb the contingent losses from bank failures or sovereign default, reflecting differences in management of public finances, has created resistance to imposing a uniform financial stability package with measures such as bank supervision and a bank rescue fund to bail out and recapitalize European banks. Per Callesen was cautiously optimistic about the prospect of resolving these structural fiscal differences.

Conclusion: Building Our Global Perspective

The 25th ICSA Annual General Meeting 2012 yielded significant insight into the challenges facing regulatory reform, particularly in Europe, and our understanding of these global perspectives will grow as the IIAC chairs the Standing Committee on Regulatory Affairs.

Yours sincerely,

Ian C. W. Russell, FCSI
President & CEO, IIAC
June 2012