Letter from the President

Taking Stock of the Economic Recovery and Regulatory Reform

SIFMA Annual Conference
12 November 2013

Vol. 68

U.S. economic recovery weighed down by policy indecision

The SIFMA Annual Conference in New York City last month provided an opportunity to learn about U.S. trends that will affect our industry. It was a chance to gain insight on the strength of the economic recovery in the United States, and sustainability of the emerging bull market for equities. The conference also provided an update on the U.S. regulatory reform agenda. Finally, it was an opportunity to gauge the effectiveness of the U.S. securities industry in meeting the business challenges from capital markets, characterized by persistently low interest rates and rising equity prices, changing demographics, and from the rising burden of ongoing regulatory reform.

The general consensus from conference participants and delegates was a cautious but pervasive optimism that a steady economic recovery is underway. The progress made on structural improvement in consumer and corporate balance sheets has been the catalyst for a resumption of spending and increased global competitiveness. The pace of recovery, however, has been hesitant, traced to prevailing uncertainty in the consumer and corporate sectors. Household spending has been restrained by concerns about healthcare reform (accounting for 18% of the economy), reflecting the Obamacare debacle, and the inability to build adequate retirement savings, with the average American dependent on social security. Uncertainty in the corporate sector stems from healthcare concerns, particularly the related cost for small business, and the lack of progress in lowering corporate tax rates and simplifying the tax code. Moreover, policy makers have been unable to address needed reform of entitlement programs. While the budget sequestration process has reduced spending and budget deficits, the approach is widely recognized as an inefficient and blunt instrument for dealing with fiscal excesses, and is no substitute for comprehensive fiscal management to spur economic growth.

There was general acknowledgement that monetary stimulus has been a major catalyst for improving economic conditions. Several presentations, however, spoke of deflationary pressures building in Europe from insufficient monetary stimulus and, in the emerging economies, from rising labour costs depressing export growth (notably in China) and the application of technology in manufacturing that depresses labour demand and jobs. Expanding energy production in the United States and the steady move towards energy self-sufficiency has also contributed to deflationary pressures, moving energy prices lower and dampening volatility, with energy prices remaining fairly stable even through the Arab Spring and the Fukushima disaster.

Appealing to Main Street

The U.S. securities industry is concerned that the unrelenting pace of regulatory reform will have a debilitating impact on the capital markets. Reforms have been extensive, and for the most part needed, given the weaknesses in the regulatory framework exposed by the 2008 financial crisis. The wealth management industry has raised particular concern, absorbing a significant regulatory burden even though the causes of the financial crash related mainly to OTC derivatives traded in institutional markets, inadequate capital and liquidity requirements at the large banks, poor mechanisms to avoid systemic failure of financial institutions and inadequate and non-transparent trading and clearing for OTC derivatives.

There is a detectable shift in the strategic approach by SIFMA in its agenda for 2014. In the five years since the financial crisis, the industry association has focused almost exclusively on the regulatory reform agenda in Washington, exerting influence on the rule-making process ranging from systemic issues involving the large financial institutions, to a fiduciary standard affecting broker-dealers, equity market issues, HFTs and market fragmentation concerns from dark pools.

SIFMA will initiate a campaign focused on Main Street to explain the key role the securities industry plays in the savings-investment process, helping Americans to build savings and companies to raise needed capital. It is hoped this publicity

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campaign will strengthen investor trust and confidence in the securities industry and marketplace, encourage more active market participation and increase influence in the rule-making process. It is interesting that the securities industry is still faced with serious investor confidence and trust concerns even six years after the financial crash. This reflects both the sweeping damage done to financial institutions in 2008, and the continued negative publicity of wrongdoing on Wall Street.

SEC and Fed/FDIC regulatory agenda: moving slowly and steadily forward

SEC Chair Mary Jo White outlined her Commission's reform agenda. She described ongoing progress on a range of policy initiatives, such as the SEC survey of the safeguards taken by stock exchanges and other marketplaces to ensure the resilience and effectiveness of their trading systems, reform of money market funds and private placement reforms for small business. Ms. White also noted that the OTC derivative rule-making process was at an early stage at the Commission, compared with completion of these rules at the Commodity Futures Trading Commission (CFTC). Her comment that the SEC is engaged in mapping to the CFTC rules "to the extent possible" seemed to leave open the prospect of possible rule differences between the two agencies.

Ms. White referred to ongoing work on the fiduciary standard. The biggest concern for the industry and the regulators has been agreement on the meaning of the "best interest" standard. The SEC is moving forward in the context of a "know your client" and suitability regime, framing its policy position in a cost-benefit analysis. However, the Department of Labor is also embarked on this agenda and has embraced a "best interest" standard flowing from the ERISA (Employee Retirement Income Security Act) pension legislation. There is not much optimism in the securities industry that the regulators will arrive at a satisfactory resolution of this standard.

Ms. White also commented on efforts to strengthen enforcement by pressing for a greater incidence of admission of guilt in settlements. The past practice of settlement without declaring wrongdoing has come in for considerable criticism, both from the judiciary and the media.

While the SEC Chair indicated there was a good chance of finalizing the Volcker Rule by year-end, it has subsequently come to light that the other SEC Commissioners are not pleased with the current version of the rule. These concerns center on the proposed exceptions for market-making and hedging that are interpreted as giving the banks far too much scope for internal dealing.

On a joint panel that included representatives of the Fed, the FDIC and the E.U., it was made clear they have been working to strengthen the "Too Big to Fail" rule framework through the requirement for resolution mechanisms in the event of institutional failure, and the imposition of higher capital and liquidity requirements, and a leverage ratio. The U.S. regulators will impose, at a minimum, the Basel III capital and liquidity rules, with defined capital surcharges for SIFIs (systemically important financial institutions) and for balance sheet leverage. The authorities view the leverage ratio (at a proposed 3%) as a "complementary measure" to the risk-weighted capital requirements.

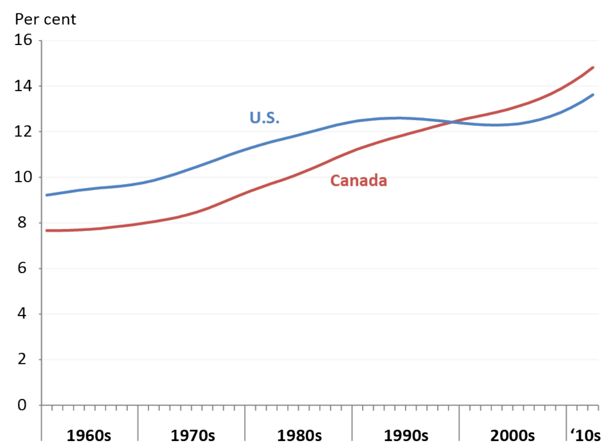
The U.S. regulators have been engaged with their European counterparts on this agenda to achieve congruence in cross-border regulatory treatment to facilitate bank affiliate expansion in respective jurisdictions. These discussions have been made easier with the single E.U. regulatory framework in Europe that replaces "directives" and national rules with E.U. regulations. The supervisory oversight of the European banks, however, is still carried out by the national governments.

Challenges facing the U.S. securities industry

The challenges facing the U.S. securities industry and individual securities firms (broker-dealers and RIAs) were laid out in several panel sessions:

i) **Dealing with demographic change**: The dramatic shift in demographics is altering the techniques in providing wealth management services, and the types of products and services offered.

Population aged 65 and above
% of total



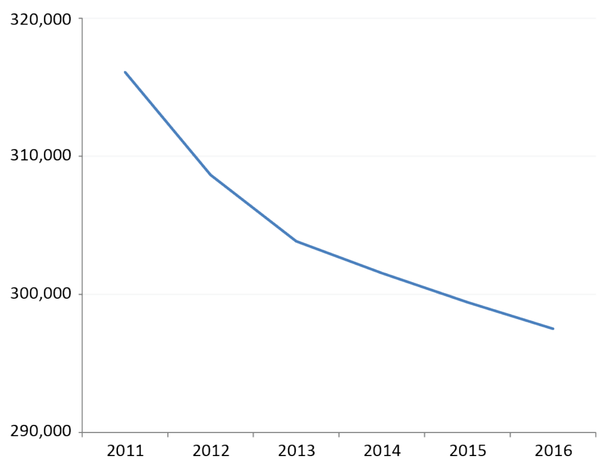
Source: World Bank

Ageing clients require a greater focus on estate and tax planning, and the need to generate income as well as asset growth of the portfolio. The corollary of this ageing demographic is the shift to a higher proportion of women and young clients that will require a different approach to wealth management, different modes of communication and a different mix of financial products and services;

ii) **Absorbing the regulatory burden**: U.S. securities firms will be required to absorb a steadily higher regulatory burden in the coming year as the Dodd-Frank legislation and the accompanying FINRA rules continue to unfold. The rule-making process, while extensive, has moved at a slower pace than in Canada, partly due to the Congressional prerequisite for formal cost-benefit analysis as a requirement for new rules. The large firms (bank financial groups) have the business scale to absorb the encroaching burden of the fiduciary standard and the Volcker rule, two of the significant rules still outstanding. But the regulatory burden will have a proportionately larger impact on small firms, even though they will not be encumbered with systemic issues nor the Volcker rule; and have the benefit of a sophisticated and competitive carrying broker regime and third-party service providers to assist with the compliance burden;

iii) Making up for a wave of retiring advisors: It is estimated that 25,000 advisors will retire in the next four years, and discussions indicate the securities industry has not adequately prepared for this transition.

Projected Estimate of Investment Advisors in the U.S.



Source: Cerulli Associates

The commonly embraced solution is to build advisor teams composed of both experienced and young advisors. This not an easy or straightforward exercise. It requires incentives for older advisors to build teams, and effective recruitment and education programs to attract talented younger advisors;

iv) Rebuilding investor trust and confidence: The industry must continue to make progress restoring investor trust and confidence, damaged by the widespread collapse of the industry in the financial crash. The lack of investor trust and confidence is far more serious than in Canada. The consensus is that trust can be restored most effectively as advisors and firms engage constructively with their clients, build deep financial relationships and work within the construct of a financial plan. Many firms engage in customized education programs for their clients. SIFMA intends to create messaging at the macro level to underline the important role the industry plays in the savings-investment process and capital formation;

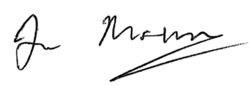
v) Building retirement savings: Prevailing low interest rates and equity prices that have only just returned to previous highs, and an outlook for slow economic growth makes it challenging for advisors to build acceptable retirement savings for their clients. Advisors are faced with a double-edged sword, the need for proper asset allocation to generate adequate portfolio returns, and the need to optimize income in these portfolios;

vi) Strengthening advisors' productivity and effectiveness: The evidence indicates that building deeper relationships with clients by meeting the demand for a holistic approach to financial services builds trust and confidence, and increases client referrals. However, the time required for more customized services for individual clients conflicts with the time required for providing investment advice and managing client portfolios, and dealing with the administrative responsibilities for compliance purposes. The challenge for many advisors will be finding the right balance. Some of the solutions include specialized discretionary managed accounts and the application of technology.

Taking advantage of opportunities, dealing with challenges

Like the Canadian advisor-broker industry, our American counterparts face both opportunities and challenges. We are in the midst of a steady economic recovery. But the growing regulatory burden, changing client demographics, the pressure to meet clients' retirement needs, and other challenges face the industry on both sides of the border. We must keep abreast of developments in our largest trading partner, learn from SIFMA's experience, and incorporate our own solutions to similar problems.

Yours sincerely,



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December 2013