INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

IIAC 2014 Survey of Canada's Investment Dealer CEOs: Markets are Recovering – Slowly but Steadily

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The current economy might be called the Michael Corleone slowdown – as soon as we think we're out of the slowdown, we are back into it.

But what does the Investment Industry Association of Canada's recent survey of CEOs of Canada's investment dealers indicate? It indicates that the economy is coming back – slowly but steadily.

The industry is optimistic – tepidly optimistic – for 2014. Industry executives are positive about both the state of the markets and the industry. That is crucial because both depend on each other.

Last year, through an IIAC-sponsored survey, we learned that Canadian investors have a high degree of confidence in their investment advisors. That level of trust is important. As market conditions improve and advisors recommend opportune investments, their clients will be likely to heed their advice. That will benefit the markets and the economy.

This year's sense of tepid confidence echoes last year's survey. The survey found executives expressing cautious optimism about 2013. Those expectations were borne out. Last year saw slow but steady growth – giving us reason to be optimistic that this year's results will also confirm our survey results.

The recent survey also underlined the fact that two important challenges face the industry, and the economy.

First, small boutique investment firms face severe challenges. The country can't afford to lose them. They are critical to competition, to the diversity of markets, to access scarce capital, and to the growth of SMEs.

Second, major regulatory changes need to be implemented this year and next. These years could be make-or-break for many small firms.

I'll have more to say about both these points in a couple of minutes.

First, I'd like to look at some of the survey's results – and the reasons for cautious optimism.

The fact that forty-eight percent of the CEOs surveyed see the state of capital markets as being more or less the same as last year signals stability. This is a positive important signal to investors.

Ten percent of respondents predict that their firms' profitability will significantly improve this year – something which not a single CEO anticipated last year. This reflects the effort that some small firms have made to cut costs, add scale, build business and generally put themselves on a sounder footing. If the overall picture improves, they are positioned to benefit.

The majority of CEOs see investors as more likely to participate in the market, and reduce their holdings in cash and equivalents. Sixty percent said investors would be more likely to participate in equities, and reduce their cash holdings.

Interestingly, fewer investment firm CEOs indicate that they have plans to acquire a firm or enter into a joint venture – only one-third as many as last year. That's despite the fact that conditions are actually more encouraging.

Why the reduced inclination to acquire? Quite simply, some of the most valuable small firms have already been acquired. As the attractive candidates disappear, those firms looking to expand believe it makes more sense to do so by buying the assets and hiring away the personnel they need.

Many firms face a tough challenge just to survive. For some, 2014 will determine whether or not they do.

One potential roadblock, as I mentioned, is the regulatory burden. Eighty-four percent of CEOs interviewed for the survey cited regulatory burdens as a barrier to growth.
That's a higher percentage than any other factor.

In view of the tsunami of rules that has been put in place – and the burdens they create – the industry will increasingly be looking for clear justification for any new rules. The industry – and Canadian companies seeking capital – can ill-afford additional, unjustifiable regulatory burdens that discourage small business investment. This will undermine the growth and the competitiveness of the Canadian economy.

A case in point, regulators must exercise discretion and judgment in auditing compliance with the suitability rules as well as other new regulations. Why? Mechanical "box ticking" regulatory scrutiny of suitability decisions could result in excessive compliance costs and discourage investments with highly variable returns, such as speculative equities.

Speculative investments have a rightful place in properly diversified portfolios.

These outcomes would damage the health and vitality of the venture marketplace, thereby reducing entrepreneurial opportunity, and undermining the competitiveness of the economy.

The impact of the regulatory burden is greatest on small firms, in both the institutional and retail sectors. They were hit hard by both the 2008 market collapse and the ensuing structural developments in the marketplace.

Last year was an abysmal one for small dealer firms. Half of the boutique firms in the industry continued to lose money. Thirteen investment dealer registrants resigned from the self-regulator IIROC, or announced their intention to resign. We expect this trend to continue as consolidation takes place.

The next year or so has the potential to be a make-or-break situation for many small investment dealers. The cost burden of the complex performance reporting rules and the tight deadlines for implementation, and the uncertainty of imposing a fiduciary standard, could be the catalyst for significant change. Firms that have scoped their needs – in terms of technology and compliance resources, and have a strategic implementation plan, will do well. Those that have not, will face an uncertain future.

Yet, overall, the survey offers good news for the new year. It's good to see signs of optimism from investment dealer CEOs. And that's good for the industry – and for the companies and investors that depend on robust capital markets.

But we cannot let a sense of tepid optimism disguise the fact that smaller firms face serious challenges in today's capital markets. Their survival is crucial to a competitive industry, to capital-raising opportunities for small and medium-sized Canadian businesses, and to investor choice and opportunity.

Government needs to provide the right investment incentives. Regulators need to provide an effective regulatory framework. The industry needs to provide the right ideas to bring capital together with investment opportunities.

As I stated at the outset, the industry is optimistic.

We all have a stake in the survival of Canada's envied, small and mid-cap venture markets.