

## REGULATION

# Gaining relief from U.S. registration rules

*Canadian securities industry is preparing to see if the U.S. will adopt a more open approach*

■ BY JAMES LANGTON

**F**OR DECADES, U.S. SECURITIES regulators have been confident that they ran the tightest ship in the global financial industry. If the world wanted to play in their market, it would have to follow their rules.

However, in recent months, that attitude has seemingly softened, and U.S. regulators are hinting at a more open approach. The Canadian securities industry is getting ready to test whether or not it's all just talk.

The Toronto-based **Investment Industry Association of Canada** is working on a proposal, which it hoped to have finalized by the end of June, that seeks an exemption from U.S. registration requirements for Canadian brokers dealing with U.S. institutional investors in Canadian securities. The IIAC has formed an eight-member committee of dealers to work on the issue, and will be seeking the exemption on behalf of all members of the IIAC and the **Investment Dealers Association of Canada**.

IIAC president and CEO Ian Russell thinks the IIAC has a better than even chance of winning this exemption because of a recent attitude adjustment at the U.S. **Securities and Exchange Commission**.

The SEC has long prided itself on being the world's toughest, most rigorous regulator. That reputation is well earned — from the billions of dollars in restitution it has

exacted for wronged investors to the lengthy prison terms it has won against miscreants. Given that the SEC is seen as the gold standard in securities regulation, the regulator has seen little reason to accept anything other than full compliance with its rules as the price of

admission to the U.S. markets. And, as the U.S. markets are the deepest, most liquid markets in the world, many firms — including many Canadian firms — have willingly paid that price.

But, there's been a bit of a shift in the past couple of years. The uncontested primacy of the U.S. capital markets has suddenly come into question.

Several panels have been struck to examine a perceived loss of competitiveness in the U.S. marketplace. Regulators in other jurisdictions, most notably Britain's **Financial Services Authority**, have been recognized for more progressive approaches, for example, in embracing principles-based regulation.

At the same time, the globalization of capital markets has taken another step forward with the creation of NYSE Euronext and Nasdaq's failed attempt to buy the London Stock Exchange — developments that have pushed na-

tional regulators to accept that they now face the challenge of overseeing truly global markets.

All of this seemingly has the SEC willing to entertain the idea of a more open, collaborative approach to regulation.

The first real sign of this shifting attitude came with the publication of an article in the *Harvard International Law Journal* this past winter, co-written by Ethiopis Tafara, director of the SEC's office of international affairs, and Robert Peterson, senior counsel at the SEC. It proposed that rather than requiring foreign firms to register with the SEC, it could move to a system of "substituted

compliance" — that is, rather than submitting to direct SEC supervision, foreign firms and stock exchanges could seek an exemption based on their compliance with "substantively comparable" rules, oversight and enforcement in their home jurisdiction.

"Our markets are now interconnected, and viewing them in isolation — as we have for so long — is no longer the best approach to protecting our investors, promoting an efficient and transparent U.S. market or facilitating capital formation for U.S. issuers," the

paper says. It suggests that this sort of mutual recognition model could enhance the SEC's ability to protect U.S. investors, promote strict regulatory standards around the world and facilitate competition.

A paper by a couple of employees doesn't constitute an official policy change at the SEC, but their idea does seem to be gaining acceptance. In mid-June, the SEC held a round-table discussion on the concept of mutual recognition. The idea has also been mentioned in speeches by various SEC officials and commissioners, including chairman Christopher Cox.

Whether this is all just talk or something more substantive will soon be tested by the Canadian securities industry's proposal. "We're taking advantage of the overture the SEC has made," explains the IIAC's Russell. Without the SEC making the first move, he doubts that its initiative would have much chance of success.

Bringing this sort of proposal to the SEC now gives it an opportunity to signal that it is serious when it talks about embracing mutual recognition. The fact that it comes from Canada, and is focused on the institutional market, may also be attractive, because it's an opportunity to test-drive the concept in a limited way to see how it works.

The big question is whether the SEC sees the Canadian regulatory regime as good enough to merit recognition. The Tafara/Peterson

paper proposed that the standard for granting such an exemption should be comparability between the U.S. regime and the foreign applicant's regime. But determining what constitutes "comparability" is the hard part.

Russell points out that the SEC has already endorsed the comparability of the Canadian regulatory system in the area of corporate disclosure by allowing the existence of the multi-jurisdictional disclosure system. Recognizing the comparability of broker-dealer rules and oversight would simply be another step down the same road, he says.

Also, as this effort is focused on the institutional market, the SEC shouldn't have the same investor protection concerns that it might have were the IIAC seeking an exemption for firms to do retail business in the U.S.

The argument in favour of granting an exemption to Canadian firms is essentially that it would lead to lower transaction costs for U.S. institutional investors dealing in Canadian securities. As it stands, Canadian firms that want to deal with U.S. investors face huge operating costs because they have to establish U.S. affiliates, register with the SEC and comply with all of its rules in order to do business in the U.S. If the exemption is granted, those costs could be slashed, and the savings passed on to U.S. investors. The exemption could also

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mean that U.S. firms would get reciprocity from Canadian regulators.

Indeed, while the IIAC would like to see the SEC simply grant its exemption request, Russell acknowledges that its approval may well carry certain conditions, including reciprocal treatment for U.S. firms.

Granting similar access to U.S. broker-dealers would be no big deal, Russell says, because those firms can already come north and deal with Canadian investors simply by acquiring an international dealer registration, which

is little more than an exercise in paperwork and fee collection. So, Canadian regulators wouldn't be giving up much to grant a similar exemption for U.S. firms, although this would probably involve dealing with the provincial securities regulators individually, which inevitably complicates things.

While U.S. dealers don't appear to have much to gain from this exercise, Russell says, the IIAC proposal already has the support of the **Securities Industry and Financial Markets Association**, the U.S. trade association. SIFMA is seeking

freer trade for securities among the U.S. and the rest of the world generally. It is keen to see mutual recognition in action, too. Its support could go some way toward convincing the SEC that an institutional exemption isn't going to harm the U.S. industry or investors.

This notion of free trade in securities has been championed by **TSX Group Inc.** for some time now.

The idea has also been embraced by the federal Finance Department. The most recent budget included a call for free trade in securities via mutual recognition.

The topic has had some discussion at the G-7 and the World Trade Organization, too, although any overreaching trade deal seems a long way off.

In the meantime, facilitating access at the regulatory level seems to be the first — and the most achievable — step.

A Canadian Finance official says that any negotiation of mutual recognition will be led by the securities regulators, adding, "The federal government's role is to encourage other countries to consider engaging in these discussions

among regulators and to ensure that Canada is positioned to take advantage of any opportunities that might arise."

The IIAC committee has already had one constructive meeting with the SEC, and Russell expects those discussions to expand once the IIAC is ready to bring forward its proposal, sometime around this coming autumn.

The IIAC is on the verge of taking the first step toward cross-border mutual recognition. Hopefully, all the SEC's talk hasn't simply been a tease. **IE**

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