

Keeping the G20 Reform Process Focused:

Let's Not Allow Costly Regulatory Interference To Undermine Needed G20 Reforms

In the aftermath of the 2008 financial crisis, regulators and politicians in developed and developing countries have rallied under the aegis of the G20 to implement sweeping global securities reforms. For the most part, the reforms strengthen investor protection and mitigate system risks in capital markets. But some initiatives with little bearing on the crisis or its causes have piggy-backed on the G20 agenda, undermining the reform process.

The reform agenda, with the direction set by the Financial Stability Board and implemented by national and pan-national regulators, is an ambitious but necessary and largely successful renovation of the global regulatory framework.

What impact has the reform process had on the regulatory agenda in Canada?

First, for many initiatives Canada is moving in lockstep with offshore counterparts. We are building a framework to better safeguard the OTC derivatives markets, focusing on structural solutions for greater transparency and standardization of derivative securities, trade repositories to monitor transactions, and central counterparties for clearing, as well as detailed rules for disclosure and trading. Canadian regulators are developing rules related to short-selling securities, for high-frequency trading and for "dark pools". Banking and securities regulators are focused on capital and liquidity rules for banking and securities firms, notably led by the Basel III Accords.

Second, while Canada is actively involved in the formulation of the Basel III capital and liquidity rules, efforts have also focused on the prudential agenda for markets as well as institutions. After all, we escaped the institutional collapses common to other developed countries. Unlike the U.S. and Europe, our strict adherence to the Basel II Accords and

the corresponding lower leverage of Canadian banks, coupled with good management, ensured our ability to manage systemic risks.

A Canadian priority has been to strengthen the financial stability of our capital markets, notably the “intra-financial system” markets (repo and securities lending markets) that provide funding for institutions. The building of a simultaneous netting system for debt repo transactions should improve the efficiency and workings of domestic repo markets. Canada is also moving forward with the single regulator project to improve coordination with federal regulators.

Third, Canada is ahead of the curve with reforms related to investor protection and transparency. Draft proposals that strengthen product disclosure, disclosure of the investment process, due diligence for new investment products and more stringent Know-Your-Client and suitability rules, initiatives well in the works before the financial crisis, are near completion. Rules governing the transparency of transactions in the OTC government and corporate bond markets have been effective for some time.

Finally, there are initiatives that have come forward in the U.S. and some European jurisdictions that are unrelated to the financial crisis – offering little or no investor protection, interfering with market stability, adding costs to market participants and distracting from the reform process.

They are examples of activist legislators and regulators “not wanting the crisis to go to waste”.

While the proposed global bank tax – an example of regulatory over-reach – was beaten back by Canada and many emerging countries, other unrelated regulations are sneaking through.

One initiative with a negative and unnecessary impact on Canadian financial institutions is the oppressive tax-reporting rules for U.S. investors holding assets with Canadian institutions. It is driven by the leverage of applying full withholding tax at source, despite protocol agreements and the fact Canada is not a tax haven.

Foreign dealer access to U.S. institutional markets has always been more difficult than elsewhere. U.S. regulators, in a move entirely unrelated to the crisis, slammed shut the door and dropped proposals to improve access through a more liberal safe harbor (SEC Rule 15a-6) and mutual recognition of regulatory standards. Further, while U.S. registered affiliates of Canadian dealers now clear and settle securities through their Canadian-registered parent firms, the U.S. regulator FINRA will henceforth require U.S. registration for staff engaged in these activities, at significant compliance costs.

As well, the Canadian investment industry has argued for some alleviation in the heavy compliance burden stemming from anti-money laundering legislation. Canadian dealers should not be required to undertake detailed scrutiny of offshore institutional clients already registered with a recognized foreign jurisdiction.

Moreover, the G20 did not *just* call for financial reforms. Recognizing the destabilizing impact of large fiscal deficits, it also called for the restoration of fiscal balances. But large deficits are forecast well into the future in the U.S. and many EU countries, reflecting political gridlock and indecision. These deficits will contribute to the very market instability reforms are attempting to alleviate, and represent a genuine priority.

The global reform agenda is sweeping and complex. It is challenging enough for regulators to implement rule-making in harmony with their counterparts. Rather than muddy the waters and complicate their task (and add unnecessary compliance cost burdens to market participants) regulators should focus on initiatives tied to the G20 agenda and quickly remedy problems from peripheral measures. The goal was to avoid another 2008-style meltdown. That should continue to be the objective, and regulators should not allow peripheral issues to get in the way.