GUEST COLUMN

Staying focused on the G20 reforms

Let's not allow costly regulatory interference to undermine needed improvements

BY IAN RUSSELL

IN THE AFTERMATH OF THE 2008 financial crisis, regulators and politicians have rallied under the aegis of the G20 to implement 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 piggybacked on the G20 agenda, undermining the reform process.

The reform agenda, with the direction set by the Basel, Switzerland-based Financial Stability Board, is a necessary and largely successful renovation of the global regulatory framework.

What are the implications for Canada? First, Canada is moving in lockstep with its offshore counterparts on many of the initiatives. We are building a framework to safeguard the over-the-counter derivatives markets better, focusing on greater transparency and standardization of derivative securities, trade repositories to monitor transactions, central counterparties for clearing and 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, notably led by the Basel III accords.

Second, while Canada is actively involved in the formulation of the Basel III capital and liquidity rules, our efforts also have focused on the prudential agenda for markets as well as institutions. After all, we escaped the institutional collapses that had been common in other developed countries.

A Canadian priority has been to strengthen the financial stability of our capital markets, notably the "intra-financial system" (the 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.

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 bond markets have been effective for some time.

Finally, there are initiatives 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. Instead, 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 overreaching — 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 services institutions is the oppressive tax-reporting rules for American investors holding assets through Canadian institutions. This initiative is being driven by the leverage of applying full withholding taxes at source, despite protocol agreements and the fact Canada is not a tax haven.

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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, dropped proposals to improve access through a more liberal safe harbour (SEC Rule 15a-6) and mutual recognition of regulatory standards. Further, while U.S.-based registered affiliates of Canadian dealers now clear and settle securities through their Canada-registered parent firms, the U.S. regulator FINRA will henceforth require U.S. registration for staff engaged in these activities.

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.

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 European Union countries. These deficits will contribute to the very market instability that the G20 reforms are attempting to alleviate, and are a priority.

The global reform agenda is sweeping and complex. It is challenging enough for regulators to implement rule-making in harmony with their global 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 those problems. 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. IE

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