INVESTMENT COMPANY INSTITUTE

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December 8, 2014

Cooperative Capital Markets Regulatory System
c/o: The Government of Canada
The Government of British Columbia
The Government of New Brunswick
The Government of Ontario
The Government of Prince Edward Island
The Government of Saskatchewan

Re: Capital Markets Stability Act—Draft for Consultation

Dear Sirs and Mesdames:

The Investment Company Institute, on behalf of its entire fund membership,[1] appreciates the opportunity to comment on the *Capital Markets Stability Act* (CMSA), which has been proposed as part of the governance and legislative framework for a cooperative capital markets regulatory system (Cooperative System) in Canada.[2] ICI and its members around the globe long have favored sound regulation to address risks to investors and the capital markets. We actively have supported efforts to address abuses and excessive risk taking highlighted by the global financial crisis and to bolster areas of insufficient regulation. As both investors in the capital markets and issuers of securities, ICI members understand the importance of ensuring a vibrant and resilient global financial system.

We are concerned, however, that regulators—in the United States, through the Financial Stability Oversight Council (FSOC), and globally through the Financial Stability Board (FSB)—thus far have appeared to pursue their post-crisis systemic risk mandates based principally on their familiarity with risks in the banking system and with prudential regulatory responses to those risks. This banking orientation lends itself, in our view, to a misunderstanding of capital markets participants and an insufficient appreciation for the diversity that exists in the global financial system: the different types of

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[1] The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. ICI's US fund members manage total assets of $17.4 trillion and serve more than 90 million US shareholders. Non-US fund members manage total assets of US$1.5 trillion.

[2] Capital Markets Stability Act – Draft for Consultation (Aug. 2014), available at http://ccmr-ocrmc.ca/wp-content/uploads/CMSA-English-revised.pdf.

financial institutions, the different purposes and models for their activities, the different ways in which they are currently regulated, and, consequently, the vastly different risk profiles that they present. ICI believes that recognition of these differences is critical to appropriate tailoring of the regulatory requirements to which financial institutions are subject, particularly as regards regulatory measures to address potential risks to financial stability.

The systemic risk authorities proposed in the CMSA duplicate in large measure corresponding authorities in the Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted by the US Congress in July 2010.[3] ICI and its members have expressed serious concerns with the way in which some of these authorities have been, or could in the future be, exercised by FSOC, particularly with regard to the asset management industry. We have raised similar concerns with regard to the FSB's proposed methodology for identifying nonbank, non-insurer financial institutions, including investment funds, as global systemically important financial institutions (SIFIs). Several ICI comment letters provide in-depth discussion of these concerns, with supporting data and economic analysis.[4]

In this letter, we seek to highlight our most fundamental concerns, in the hope that our observations may assist the governments participating in the Cooperative System ("the governments") in ensuring that any systemic risk authorities ultimately adopted as part of the Cooperative System are appropriately delineated. We note that our comments are limited to the CMSA as currently proposed, and we echo the call by the Investment Funds Institute of Canada that stakeholders be given meaningful opportunities to comment on revisions to the legislation and on the companion regulations before the Cooperative System is finalized.

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[3] In December 2013, the European Parliament asked the European Commission to assess whether asset managers should be designated as systemically significant taking into account the scope of their activity and using a comprehensive set of indicators such as size, business model, geographical scope, risk profile, creditworthiness, whether they trade for their own account and whether they are subject to requirements relating to the segregation of client assets. *See* Resolution of the European Parliament on Recovery and Resolution Framework for Non-Bank Institutions, December 10, 2013, available at http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2013-0533. With the intervening May 2014 Parliamentary elections and a newly confirmed European Commission in October, the status and priority of this effort are uncertain. We are unaware of any SIFI initiatives related to asset managers or funds by other national authorities.

[4] A list of these letters, with Internet links, is provided in the Appendix.

I. Summary of Comments

Asset Management and Systemic Risk Regulation

- For the reasons highlighted in this letter, neither individual regulated investment funds nor their managers, which would be included within the definition of "capital markets intermediary" in Section 2 of the CMSA, pose risks to financial system stability that would warrant their designation as systemically important capital markets intermediaries.[5] Accordingly, we urge that the governments consider providing a specific exclusion in the CMSA for regulated funds and their managers from systemic or "SIFI" designation. By "regulated funds," we mean Canadian investment funds subject to National Instrument 81-102, US investment companies registered under the Investment Company Act of 1940, and funds organized or formed in other jurisdictions and substantively regulated to make them eligible for sale to retail investors (*e.g.*, funds qualified under the UCITS Directive).[6]

- In ICI's view, any potential risks to the capital markets or the broader financial system seen in the asset management sector are best addressed through regulation tailored to the specific activities or practices giving rise to concern on the part of the Capital Markets Regulatory Authority ("Authority"). This is the approach being taken, for example, with respect to money market fund reforms in the US and the European Union.

Proposed SIFI Designation Powers

- More generally, ICI strongly believes that SIFI designation authority should be used judiciously, and reserved for circumstances in which the Authority has determined that a specific capital markets intermediary clearly poses significant, demonstrable risks to the financial system that cannot otherwise be adequately addressed through other regulatory measures.

[5] Our focus in this letter is on regulated stock and bond funds. While we believe that systemic designation would be neither appropriate nor effective for money market funds, significant reforms have been made in the U.S. since 2008 and are under consideration by the European Union. The approach being taken in these jurisdictions is an example of an activity-based approach to risk mitigation which, as we discuss below, is a more promising approach in the asset management sector generally.

[6] We discuss the question of whether the legislation applies to non-Canadian entities later in this letter.

- The governments should consider providing greater specificity, either in the CMSA or through implementing regulations adopted by the Authority, regarding how a capital markets intermediary would be evaluated for possible SIFI designation. We suggest that this greater specificity extend to the factors in Section 27(2) that the Authority is required to consider and the definition of "systemic risk related to capital markets" set forth in Section 3. Similarly, we recommend that the Authority be specific about how it may identify individual capital markets intermediaries for evaluation.
- The governments should consider including in the CMSA certain due process protections applicable to any capital markets intermediary that is under evaluation for possible systemic designation. ICI likewise believes it is important that the Authority provide adequate transparency as to its actions relating to systemic risk identification and regulation.
- The governments should consider requiring the Authority to delineate the regulatory consequences of a SIFI designation through rulemaking under Section 28 before it makes any such designations. Under this approach, the Authority would be in a better position to determine whether those regulatory consequences would indeed mitigate the potential risks to financial stability posed by a capital markets intermediary.

Other Aspects of the CMSA

- **Designation of Benchmarks, Classes of Securities/Derivatives as Systemically Important.** The governments should consider removing Sections 25-26 (concerning the systemic designation of a benchmark) and Sections 30-31 (concerning the systemic designation of a class of securities or derivatives) from the CMSA. These provisions have no counterpart in the Dodd-Frank Act or, to our knowledge, any other existing law. Instead, we believe that any concerns relating to the use of a benchmark or certain securities or derivatives are best addressed through the capital markets regulatory framework, which addresses matters such as how securities and derivatives are offered, sold, traded, and used by market participants.
- **Application to Non-Canadian Entities.** The CMSA is silent on whether the legislation applies to non-Canadian entities. The broad definition of "systemic risk related to capital markets" in Section 3, however, suggests that such application is possible. We recommend that the governments provide greater clarity as to the intended scope of the CMSA.
- **Information Collection and Confidentiality.** Sections 9-10 of the CMSA would provide the Authority with broad discretionary power to request records or information from any person for purposes of monitoring capital markets activity and identifying or mitigating systemic risk. Although information obtained by the

Authority that is not publicly available must be treated as confidential information, two very broad exceptions (set forth in Sections 14-15 of the CMSA) would give the Authority considerable discretion to disclose nonpublic information. We recommend that the governments consider eliminating, or at least paring back, the exceptions in Sections 14-15. ICI believes it is critically important for the governments to give the highest priority to protecting the confidentiality of the information it receives, including a company's business information.

II. Asset Management and Systemic Risk Regulation

Exclusion from SIFI Designation for Regulated Funds and Their Managers

- Section 27 of the CMSA authorizes the Authority to make an order designating a capital markets intermediary as systemically important if, "in the Authority's opinion, the activities or material financial distress of the capital markets intermediary could pose a systemic risk related to capital markets." This standard is strikingly similar to that contained in Section 113 of the Dodd-Frank Act. That Dodd-Frank Act language is rooted in the actual experience of the global financial crisis, when the distress or disorderly failure of certain large, interconnected and highly leveraged financial institutions—banks, insurance companies and investment banks—required direct intervention by the US government, and taxpayer bailouts, to repair the damage.

It is difficult to conceive of a situation in which a regulated fund manager's financial distress or activities could give rise to similar systemic concerns. In providing investment management and other services to funds, the manager acts in an agency capacity. The manager manages the fund's portfolio in accord with the fund's investment objectives and policies as described in the fund's disclosure documents. A regulated fund manager does not take on the risks inherent in the securities or other assets it manages for regulated funds, or in other activities or strategies it may pursue on behalf of one or more funds, such as securities lending. Those are investment risks that appropriately are borne by the fund's investors. The manager may not use the assets of any fund to benefit itself or any other fund. The economic exposures, the impact of any use of leverage, and the interconnections with counterparties are those of each individual fund—not of the fund manager. As a result, the agency nature of the asset management business stands in stark contrast to the principal capacity in which banks operate.

The concept of SIFI designation of individual regulated funds is similarly inapt. There are several compelling reasons why even the world's largest regulated funds do not raise systemic concerns. They include the following:

- Regulated funds typically have little to no leverage. By way of illustration, and as described more fully in our April 2014 comment letter to the FSB, the average leverage ratio for the very

largest US regulated funds (those with assets greater than $100 billion) is 1.04—stated differently, these funds average 4 cents in debt for every dollar of equity.[7] This point is significant, because history amply demonstrates that highly leveraged companies pose greater risk to the financial system. In times of market stress, leverage can act as a multiplier, turning small losses into larger ones and creating risks that can shake the system overall. Former US Federal Reserve Board Chairman Alan Greenspan is one of many authorities to have emphasized the role of leverage in the global financial crisis. He noted that subprime mortgages were toxic assets, but said that if those assets had been held by mutual funds, there would not have been the same level of "serial contagion" precisely because of the funds' lack of leverage.[8]

- The concept of "financial distress" has little relevance to regulated funds. All investment results belong to a fund's investors on a pro rata basis. If a fund doubles in value, it is the investors who reap this reward. And if the fund plunges in value, it is the investors who absorb the impact of those losses. This is the expectation shared by all investors in regulated funds and by the broader marketplace. And it is one that contrasts sharply with the expectation of bank customers, who have deposited their money in anticipation of principal repayment plus interest, as well as the expectation of the broader marketplace, which anticipates government action and intervention to preserve the safety and soundness of individual banks and the banking system generally.
- Certain structural features of funds have the effect of limiting risk and the transmission of risks. Most notably, the assets of each regulated fund are separate and distinct from, and not available to claims by creditors of, other funds or the fund manager. Each regulated fund has its own investment objectives, strategies, and policies. One regulated fund's economic exposures will be different from another's and belong to it alone. Fund losses are not absorbed by other funds or the manager.
- Regulated funds must adhere to comprehensive regulatory requirements that protect investors *and* serve to mitigate risk to the financial system. These requirements include, among others, provisions relating to disclosure (particularly with regard to investment risk), custody of assets, valuation of assets, and investment restrictions (*e.g.*, leverage, types of investments or "eligible assets," concentration limits and/or diversification standards).
- Regulated funds are the *bearers* of counterparty exposure. They are, first and foremost, holders of long positions in debt and equity instruments through paid-in capital (equity) from investors. Regulated funds thus generally act as providers of capital (to financial and operating

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[7] *See* Letter from Paul Schott Stevens, President & CEO, ICI, to FSB, dated Apr. 7, 2014, at Appendix B, available at http://www.ici.org/pdf/14_ici_fsb_gsifi_ltr.pdf.

[8] Alan Greenspan, "How to Avoid Another Global Financial Crisis," *The American*, March 6, 2014, available at, http://american.com/archive/2014/march/how-to-avoid-another-global-financial-crisis.

companies, various governments and government agencies, and central banks), rather than as borrowers of capital. In other words, it is far more common that a regulated fund—and, by extension, its investors—are the bearers of counterparty exposure (*e.g.*, by reason of the fund's purchase of debt issued by a bank), rather than transmitters of risk to those counterparties.

For these and other reasons, and as detailed more fully in recent ICI comment letters, we strongly believe that SIFI designation of individual regulated funds or their managers is unwarranted. In addition, these funds and their managers are highly substitutable, so designation likely would cause investors simply to move their assets to another fund or manager. As such, SIFI designation would be an ineffective way to mitigate any identified risks in this context. We accordingly urge the governments to consider amending the CMSA to expressly exclude regulated funds and their managers from the provisions of Section 27.

In making this recommendation, we note that we are not aware of any publicly available description of the policy basis underlying Section 27 of the proposed legislation—and in particular any explanation of why regulated funds and their managers have been expressly included within that provision. To the extent there is any thought by drafters of the CMSA that the experience of a US money market fund (the Reserve Primary Fund) during the financial crisis provides such a basis, we respectfully submit that it would be inappropriate to view all regulated funds, including other money market funds, through that narrow lens. Even during the worst days of the financial crisis, regulated stock and bond funds and nearly all other money market funds did not encounter the problems experienced by the Reserve Primary Fund in September 2008. And as noted earlier, there have been significant reforms to the rules governing money market funds in the US since the financial crisis, which are designed to make these funds more resilient to stress in the financial markets while preserving their utility and value for investors. This activity-based approach to risk mitigation is, in our view, a more promising approach for the asset management sector generally.

Activity-Based Regulation

As discussed above, regulated funds and their managers simply do not pose the concerns that would warrant SIFI designation. Moreover, the possible regulatory consequences of SIFI designation—as contemplated by Section 28—are largely prudential in nature, and their application to a regulated fund would be both wholly inappropriate and harmful to the fund and its investors. Such a designation, quite simply, would make a regulated fund economically and commercially unviable.

We are encouraged that key US regulatory officials have acknowledged the limitations of prudential regulation[9] and that policymakers appear to be tailoring their systemic risk analysis in the asset management sector, with a greater focus on market activities. In the US, for example, FSOC announced this summer that it had asked its staff to "undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry."

In our view, an activity-based approach offers several advantages. First, it starts with identified activities and practices that pose demonstrable risks. Second, it would follow regular rulemaking procedures, including public notice and opportunity for comment. Third, regulation intended to mitigate the specific risks posed by an activity or practice can be applied broadly to entities engaged in that activity or practice (in contrast to regulation applicable only to entities designated as systemically important).

Since the global financial crisis, regulators have taken and are continuing to take "activity-based" actions to mitigate risk in the financial system or to make markets and market participants more resilient to future shocks. Areas of focus have included, among others, securities lending and repurchase agreement transactions, comprehensive OTC derivatives markets reforms, improving transparency and regulatory oversight of hedge funds (or "alternative funds") and closing data gaps. Another emerging area of focus, and one that lends itself particularly to an activity-based approach, is cybersecurity.

Accordingly, if the Authority believes specific activities or practices pose risks to the capital markets or to the broader financial system, we recommend that it use the rulemaking authority set forth in Section 32 of the CMSA to address those risks through activity-based regulation.

III. Proposed SIFI Designation Authority

Use of SIFI Designation Generally

Our recommendation that regulated funds and their managers be excluded from consideration under Section 27 of the CMSA is consistent with the view that SIFI designation should be reserved for

[9] *See, e.g., Regulating Systemic Risk*, Remarks by Daniel K. Tarullo, Member, Board of Governors of the Federal Reserve System, at the 2011 Credit Markets Symposium, Charlotte, N.C. (March 31, 2011), available at http://www.federalreserve.gov/newsevents/speech/tarullo20110331a.pdf (observing that "prudential standards designed for regulation of bank-affiliated firms may not be as useful in mitigating risks posed by different forms of financial institutions"); *Remarks to the 2014 SEC Speaks Conference*, Mary Jo White, Chair, SEC (Feb. 21, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370540822127 ("We also will continue to engage with other domestic and international regulators to ensure that the systemic risks to our interconnected financial systems are identified and addressed – but addressed in a way that takes into account the differences between prudential risks and those that are not. We want to avoid a rigidly uniform regulatory approach solely defined by the safety and soundness standard that may be more appropriate for banking institutions.")

rare and compelling cases—*i.e.*, where regulators have determined, on the basis of a thorough and reasoned analysis, that (1) a specific financial institution poses significant, demonstrable risks to financial system stability that cannot otherwise be adequately addressed through enhancements to existing regulation or by other regulatory authorities and (2) SIFI designation would appropriately reduce those risks.

As noted above, the language proposed in Section 27 appears to parallel the SIFI authority in the Dodd-Frank Act. Accordingly, the legislative intent underlying that provision in the Dodd-Frank Act may be instructive. In a 2010 Senate colloquy during the final floor debate on the legislation, former Senate Banking Committee Chairman Christopher S. Dodd stated: "The Banking Committee intends that only a limited number of high-risk, nonbank financial companies would join large bank holding companies" in being designated as systemically important and thus subject to regulation and supervision by the US Federal Reserve Board.[10] A year earlier, during a Congressional hearing on financial regulatory reform proposals from which many parts of the Dodd-Frank Act were developed, Federal Reserve Board Chairman Ben Bernanke expressed similar views. When asked about the number of firms that might be considered to be "systemically significant, too big to fail, too interconnected to fail," Chairman Bernanke responded:

> A very rough guess would be about 25. But I would like to point out that virtually all of those firms are organized as bank holding companies or financial holding companies, which means the Federal Reserve already has umbrella supervision. So, I would not envision the Fed's oversight extending to any significant number of additional firms.[11]

Subsequent comments by the other primary sponsor of the US legislation—former House Financial Services Committee Chairman Barney Frank—likewise provide helpful context regarding the types of firms that the US Congress may have had in mind in designing the SIFI designation authority. In a December 2013 interview, Chairman Frank explained: "When we were writing the law, I certainly felt that it was entities that were engaged on their own in large bets facing serious risks for their money that were the likeliest to get into trouble." Commenting further, he stated that he was "frankly

[10] 156 Cong. Rec. S5903 (daily ed. July 15, 2010).

[11] *See* Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals, Part II: Hearing before the House Committee on Financial Services (Serial No. 111-68), 111th Congress (2009), p. 47 (question by Rep. Campbell).

surprised to see suggestions that the asset managers that are diversified and fairly stolid in their approach would be considered" for possible SIFI designation.[12]

Specificity Regarding the Evaluation of a Capital Markets Intermediary for Possible SIFI Designation

Similar to the SIFI designation provisions in the Dodd-Frank Act, the provisions in the CMSA relating to the consideration of various factors in assessing a capital markets intermediary (Section 27(2)) and determining whether it could pose a "systemic risk related to capital markets" (Section 3) are extremely broad, leaving much discretion to the Authority. While we can understand the desire to ensure that the Authority has sufficient flexibility to respond to financial system risks as circumstances dictate, this unconstrained authority would likely cause great uncertainty among financial market participants, both within and outside Canada, as to the "rules of the road." A company deciding whether to restructure or enter a new line of business, for example, should be able to consider whether its proposed move would have implications under Section 27. Likewise, ICI members and other institutional investors typically consider how a company is regulated as part of their investment analysis. Being able to surmise whether a particular company could become designated under Section 27 and subject to additional requirements under Section 28 is relevant to the decision about whether and how to commit capital to that company.

It is our strongly held view that the CMSA, or at the very least implementing regulations adopted by the Authority, should provide more specificity regarding how a capital markets intermediary may be assessed for possible SIFI designation. This specificity can be provided in a way that would not unduly limit the Authority's discretion. For example, the analytical framework set forth by FSOC as interpretive guidance, while far from perfect, provides financial market participants with some insight into FSOC's views on the Dodd-Frank Act factors and standards relating to SIFI designation.[13]

In our comment letters to FSOC and the FSB, ICI has outlined in detail its views on many of the factors set forth in CMSA Section 27(2). In particular, we have emphasized the following:

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[12] *See* Joe Morris, "Fidelity Not a 'Systemic Risk' in Barney Frank's Book," Financial Times/FTfm (Dec. 8, 2013). For further ICI analysis of why judicious use of SIFI designation is appropriate, *see* Letter from Paul Schott Stevens, President & CEO, ICI, to FSOC, dated Nov. 5, 2010, at pp. 2-5, available at http://www.ici.org/pdf/24696.pdf.

[13] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21637, 21657-60 ("FSOC SIFI Designation Rule and Guidance") (Apr. 11, 2012), available at http://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies.pdf.

- *Size*—A company's size alone reveals very little about its potential to pose risk to the financial system and, consequently, would be highly misleading if considered alone, even as an initial threshold. Any assessment of a company's size should focus on the size of the company's potential on- and off-balance sheet risks, and its degree of leverage (discussed below). In the case of a company that manages assets owned by others, there are several clear reasons why the managed assets should not be attributed to the company. With regard to a regulated fund manager, these reasons include: (1) investor recourse for losses is solely with respect to the fund, absent wrongdoing on the part of the manager; (2) the manager cannot pledge the fund's assets to advance its own interests; (3) the manager does not take on leverage to manage the fund's portfolio; and (4) the manager must manage the fund's assets as a fiduciary and in accord with the fund's own investment objectives and restrictions.
- *Leverage*—As noted earlier in this letter, history amply demonstrates that companies that are highly leveraged pose greater potential risk to the financial system. For example, when one highly leveraged company holds the debt of another highly leveraged company, losses can mount exponentially and spread quickly. Regulated funds must adhere to regulatory limits on leverage and typically have little to no leverage. This has the effect of tightly constraining the risks a fund might pose to the financial markets.
- *Interconnectedness*—The key issue appears to be whether a company's failure could force a disorderly unwinding of its on- and off-balance sheet positions and spark a cascade of failures among the company's counterparties that then spread beyond these counterparties. Interconnectedness poses the greatest risk when it is coupled with leverage, either of the company itself or its counterparties. Regulated funds "interact" with large numbers of investors and market participants. But because regulated funds generally act as providers of capital and typically have little to no leverage, their participation as counterparties in financial transactions poses very modest risks.
- *Availability of Substitutes*—The lack of ready substitutes for a company that provides a critical function or service on which other market participants rely can be an important factor in assessing whether that company may pose a risk to financial stability. As acknowledged by the FSB, "the investment fund industry is highly competitive with numerous substitutes existing for most investment fund strategies (funds are highly substitutable)."[14]

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[14] FSB, *Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions: Proposed High-Level Framework and Specific Methodologies* (8 January 2014) at 30, available at http://www.financialstabilityboard.org/publications/r_140108.pdf. In the US, for example, the five US regulated funds with assets greater than $100 billion that Morningstar categorizes as Large Blend must compete in a market with more than 500 other US regulated funds with similar investment objectives. *See* Letter from Paul Schott Stevens, President & CEO, ICI, to FSB, dated Apr. 7, 2014, at 16 and Appendix F, available at http://www.ici.org/pdf/14_ici_fsb_gsifi_ltr.pdf.

Not on the list of factors that the Authority must consider—but which we recommend be added to that list in Section 27(2)—is the extent and nature of the existing regulatory scrutiny to which a company is subject. A company that already is highly regulated is more likely to have robust internal controls and compliance procedures. Further, we suggest that the Authority look specifically at the degree to which the regulatory requirements already applicable to that company serve to limit or control risk. As a general matter, a company that must adhere to risk-limiting requirements is less likely to warrant a SIFI designation. As discussed above, regulated funds are subject to comprehensive and risk-limiting regulation, including with respect to leverage, custody of assets, transparency, and mark-to-market valuation of fund assets. Regulated fund managers also are highly regulated, including in Canada with, among other things, the registration requirements that apply to investment fund managers operating in Canada.

We also recommend that the Authority be specific regarding how it intends to identify individual capital markets intermediaries for evaluation. FSOC's interpretive guidance, for example, sets forth several quantitative thresholds against which nonbank financial companies will be measured. These metrics provide companies and the broader public with some insight into which companies may be selected for evaluation, although they are not dispositive.[15]

Due Process Protections and Transparency

In this area as well, aspects of the US experience may be instructive. In the US, FSOC has come under widespread criticism for lacking sufficient transparency in its operations.[16] In addition, many stakeholders, including members of Congress, have identified serious deficiencies in FSOC's process for designating nonbank SIFIs and some have proposed legislative changes to address these concerns. For example, in July, Congressmen Dennis Ross (R-FL) and John Delaney (D-MD) introduced bipartisan legislation (H.R. 5180) that would enhance FSOC transparency and add meaningful substantive steps to the process FSOC must follow before designating a nonbank financial company as a SIFI.

The CMSA already contemplates giving capital markets intermediaries "an opportunity to make representations" in certain circumstances.[17] Such an opportunity is essential as a matter of basic fairness to the capital markets intermediary in question. It also means that the Authority will have a more complete record upon which to base its decisions regarding potential actions under the CMSA.

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[15] *See* FSOC SIFI Designation Rule and Guidance, *supra* note 12, at 21660-61.

[16] FSOC has taken some steps to increase transparency, such as publishing "readouts" of closed-door meetings that identify the topics discussed by FSOC members. Those readouts, however, offer no insight into FSOC's thinking on those topics.

[17] *See, e.g.,* Section 27(3) (the Authority must give a capital markets intermediary an opportunity to make representations before making an order designating the capital markets intermediary as systemically important) and Section 29(2) (the Authority must give a systemically important capital markets intermediary an opportunity to make representations before requesting the Minister of Finance's approval of an order imposing obligations on the capital markets intermediary).

While the opportunity to make representations is important, we recommend that the CMSA or implementing rules provide greater specificity on mechanics such as how a capital markets intermediary can exercise this right (*e.g.,* at an oral hearing, upon request) and timing (*e.g.,* for submitting written materials), as well as to whom the intermediary would make its submissions (*e.g.*, in what jurisdiction, to which level of the Authority).

In addition, based on experience in the US, there are a number of other key protections that the governments should consider incorporating into the legal/regulatory framework for considering designation of a particular capital markets intermediary, including the following:

- Notification to a capital markets intermediary when the Authority has identified the capital markets intermediary for detailed review, and the opportunity at that point for the capital markets intermediary to submit information to be considered in the Authority's analysis.
- Provision to the capital markets intermediary of sufficiently detailed information about the potential risks of concern to the Authority, so that it may provide the Authority with an informed and appropriately targeted response.
- Consideration by the Authority of whether potential risks posed by the capital markets intermediary are better addressed through regulation targeted to the relevant activity, rather than through systemic designation of the individual capital markets intermediary.
- Opportunity for the capital markets intermediary to propose changes to its business, structure or operations to address the risks identified by the Authority, and a response from the Authority to those proposed changes.

We believe that incorporating similar measures into the CMSA, the implementing rules, or both would help to inspire public and industry confidence in the integrity of the systemic designation process and the Authority's exercise of its related powers.

Regulatory Consequences of a SIFI Designation

As proposed, Section 28 of the CMSA would provide the Authority with considerable discretion in fashioning regulations to prescribe requirements, prohibitions and restrictions for systemically important capital markets intermediaries. We recommend that the governments consider requiring the Authority to adopt regulations that delineate the regulatory consequences of SIFI designation, in at least some level of detail, before making any determinations that one or more capital markets intermediaries should be designated as a SIFI. This approach should lead to more informed decision making by the Authority, because the Authority would be in a better position to determine whether those regulatory consequences would indeed mitigate the potential risks to financial stability

presented by a particular capital markets intermediary. It would also help to avoid some of the controversy seen in the US, where FSOC has designated three nonbank financial companies as SIFIs (and proposed the designation of a fourth) without knowing how the required prudential standards outlined in the Dodd-Frank Act will be applied to those companies. We further recommend that Section 28 be amended to clarify that the Authority should tailor its regulations as needed to accommodate the structure, existing regulation and other attributes of any capital markets intermediary that is designated as systemically important.

IV. Other Aspects of the CMSA

Designation of Benchmarks, Classes of Securities/Derivatives as Systemically Important

In addition to systemic risk authorities closely resembling those in the Dodd-Frank Act, the CMSA includes some provisions that have no counterpart in the Dodd-Frank Act or, to our knowledge, any other existing law. In particular, the CMSA would empower the Authority to designate a benchmark, or prescribe a class of securities or derivatives, as systemically important. The Authority then could prescribe requirements, prohibitions, or restrictions applicable to such benchmark or class of securities or derivatives.[18]

These unprecedented types of systemic designations strike us as an impractical approach to mitigating systemic risk and, more importantly, one that could interfere with legitimate activity within the capital markets. Section 30 of the CMSA, for example, is concerned with systemic risk to capital markets stemming from "the trading in, the holding of positions in or the direct or indirect dealing with [a class of] securities or derivatives." In our view, these concerns are best addressed through the capital markets regulatory framework, which addresses matters such as how securities and derivatives are offered, sold, traded, and used by market participants, and not from labeling particular classes of securities or derivatives themselves as inherently systemically risky. Because the Authority, under separate legislation, will have the necessary "regulatory toolkit" to address any such concerns, we recommend that the governments consider removing Sections 25-26 and 30-31 from the CMSA.

Application to Non-Canadian Entities

The CMSA is silent on whether the legislation is intended to apply to non-Canadian entities. The broad definition of "systemic risk related to capital markets" in Section 3, however, suggests that such application is possible.

We recommend that the governments provide greater clarity as to the intended scope of the CMSA. This is particularly important given the widespread availability of foreign securities in Canada

[18] *See* Sections 25-26 (benchmarks) and Sections 30-31 (class of securities or derivatives).

and the participation of foreign capital markets intermediaries in Canada's capital markets. In the event that the CMSA does apply to non-Canadian entities, we suggest that some consideration of home jurisdiction regulation should be factored into any evaluation of the systemic risk that a non-Canadian entity may have on the Canadian marketplace.[19]

Information Collection and Confidentiality

Sections 9-10 of the CMSA would provide the Authority with broad discretionary power to request records or information from any person for purposes of monitoring capital markets activity and identifying or mitigating systemic risk. Under Section 13 of the CMSA, information that is obtained by the Authority under this Act that is not publicly available must be treated as confidential information. Regrettably, this protection is subject to two very broad exceptions (set forth in Sections 14-15) that give the Authority considerable discretion to disclose nonpublic information including, for example, "if the Authority considers that the public interest in disclosure outweighs any private interest in keeping the information confidential."

We recommend that the governments consider eliminating, or at least paring back, the exceptions in Sections 14-15. ICI believes it is critically important for the governments to give the highest priority to protecting the confidentiality of the information it receives, regardless of type, form, or source. This, in our view, should include protecting the confidentiality of a company's business information to the greatest extent possible under law.

We note that Section 112(d)(5) of the Dodd-Frank Act imposes confidentiality obligations on both FSOC and its member agencies. It does not contain provisions that would allow FSOC or its member agencies to disclose nonpublic information, as contemplated by Sections 14-15 of the CMSA.

[19] *See, e.g.*, Section 113(b)(2)(H) of the Dodd-Frank Act, which requires FSOC to consider "the extent to which [a foreign nonbank financial] company is subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority" in evaluating whether such company should be designated as systemically important in the US.

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We appreciate the opportunity to comment on this consultation. If you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5901 or paul.stevens@ici.org, Dan Waters, Managing Director, ICI Global, at (011) 44- 203- 009- 3101 or dan.waters@iciglobal.org, or Susan Olson, Chief Counsel, ICI Global, at (202) 326-5813.

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
President & CEO
Investment Company Institute

Appendix

Appendix: Relevant ICI Comment Letters

U.S. Financial Stability Oversight Council: Development of SIFI Designation Framework

1. Letter from Paul Schott Stevens, President & CEO, ICI, to FSOC, dated Nov. 5, 2010 (commenting on advance notice of proposed rulemaking), available at http://www.ici.org/pdf/24696.pdf
2. Letter from Paul Schott Stevens, President & CEO, ICI, to FSOC, dated Feb. 25, 2011 (commenting on initial rule proposal), available at http://www.ici.org/pdf/24994.pdf
3. Letter from Paul Schott Stevens, President & CEO, ICI, to FSOC, dated Dec. 19, 2011 (commenting on revised rule proposal), available at http://www.ici.org/pdf/25729.pdf

U.S. Office of Financial Research: Report on Asset Management and Financial Stability

4. Letter from Paul Schott Stevens, President & CEO, ICI, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated Nov. 1, 2013 (responding to SEC request for public feedback on OFR Report), available at http://www.ici.org/pdf/13_ici_ofr_asset_mgmt.pdf

Financial Stability Board: Consultation on Assessment Methodology for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions

5. Letter from Paul Schott Stevens, President & CEO, ICI, to FSB, dated Apr. 7, 2014, available at http://www.ici.org/pdf/14_ici_fsb_gsifi_ltr.pdf