



**Submission to the Expert Panel
on Securities Regulation
“Creating an Advantage in Global Capital Markets”**

Submission of Royal Bank of Canada

July 15, 2008

Introduction

Guiding Principle

The financial services industry is driven by and thrives on *innovation*, increasingly applied on a *global* scale. More than at any time in our history, the Canadian financial services industry, and its customers and shareholders, need a straight-forward and efficient regulatory structure capable of keeping pace with innovation and global developments to achieve the following objectives:

- Fair treatment of investors
- Promote fair and efficient capital markets
- Enhance the competitiveness of Canada’s securities industry
- Enable innovation by reducing the cost and time-to-resolution of new product and regulatory change initiatives
- Proactive response to systemic risk issues
- Reduce the costs of regulation and of access to the Canadian capital markets
- Ability to speak for Canada on the international stage
- Coordinated, timely and effective enforcement

➤ ***RBC’s Perspectives.*** RBC is uniquely placed to comment on proposals to improve Canada’s securities regulation as it is continuously subject to multiple layers of regulation within Canada and internationally and includes thousands of employees who are registered under Canadian securities laws:

- ***Public Company.*** As North America’s fifth largest financial institution by market capitalization, RBC complies with extensive continuous disclosure requirements in an international context and regularly accesses capital markets globally, including Canada, the U.S., Europe and Japan utilizing securities offering mechanisms from traditional prospectuses to short form prospectuses, to shelf prospectuses in various jurisdictions.
- ***Capital Markets.*** The trading, investment banking, corporate lending and debt and equity capital markets operations of RBC Capital Markets, primarily in Canada, the U.S. and the U.K., but increasingly globally, are closely regulated,

both at the securities regulator and SRO level. RBC Capital Markets has daily trading turnover of approximately U.S. \$42 billion. In 2007, RBC Capital Markets had U.S. \$1.1 trillion in equity trading turnover, U.S. \$6.4 trillion in fixed income trading turnover, U.S. \$197 billion in lead managed debt transactions, U.S. \$38 billion in book run equity transactions and U.S. \$2.8 trillion in foreign exchange trading turnover, as well as U.S. \$120 billion in daily Canadian payments for global FIs. RBC Capital Markets consists of over 3,300 professionals and employees operating in 75 offices in 15 countries.

- ***Wealth Management.*** RBC's brokerage, retail mutual fund, institutional and private client asset management businesses in Canada and the U.S. and its international wealth management businesses carried out by 36 offices in 22 countries globally are subject to a complex web of regulation by numerous entities. RBC Wealth Management has approximately \$500 billion in assets under administration, more than \$240 billion of assets under management, and more than 4,000 financial consultants, advisors, private bankers and trust officers.

- ***It is Time for Significant Change.*** RBC and its clients have benefited from the safety, soundness and fair market practices motivated by Canada's securities regulatory authorities to date, but we believe that the time is right to make significant improvements to the efficiency and effectiveness of our securities regulatory system. It is clear to us that there are unnecessary costs, inefficiencies and duplication built into our current system that must be eliminated to permit the Canadian securities industry to keep up with the pace of innovation locally and globally. That the regulatory structure has worked as well as it has thus far is a credit to the extensive efforts and cooperative spirit of the many regulatory authorities involved - but now we can and must do better.

- ***Global Perspective.*** The title of the Panel's Consultation Paper, "*Creating an Advantage in Global Capital Markets*", is apt: technological developments and international expansion have accelerated the global reach of all financial industry participants and their clients. We believe this trend will continue to accelerate and intensify. At the same time, it is clear from recent credit market challenges that risk itself also must be managed on a global basis, both by financial system regulators and the financial industry participants themselves. The developments and emerging risks that in our view should be the focus of financial industry regulation today transcend the provincial: they are at least national, but often truly global, in scope. As such, Canada needs a regulatory system for its financial services industry that is able to respond in an integrated fashion to global risks and opportunities, has the capability to be the first choice of other jurisdictions opening their markets through international mutual reliance arrangements and to coordinate effectively and proactively with other financial system regulators and the industry.

Submissions

Consultation Item 1: Objectives, Outcomes and Performance Measures

The Panel has posed the following questions relating to the objectives, outcomes and performance measures for securities regulation in Canada:

Should Canada have a common set of objectives? What should be the objectives of securities regulation in Canada? Given the current context in global financial markets, should the reduction of systemic risk be an explicit objective of securities regulation? If so, how broadly should it be defined? Are there objectives for Canada that go beyond those defined by IOSCO? For example, should an objective be to enhance the competitiveness of Canada's capital markets?

- ***Common Objectives.*** Traditionally, Canada's securities regulators have been served well by objectives which are generally centred around investor protection, promotion of fair and efficient capital markets and market integrity. Going forward, however, we believe that the Canadian securities regulatory system also should have a common set of high-level, statutory objectives that explicitly relate to:
- the efficiency and effectiveness of the securities regulatory authorities;
 - enhancing the competitiveness of Canada's securities industry; and
 - proactive responses to systemic risk issues.

It should be emphasized however, that common objectives will not be meaningful unless they are translated into a set of specific, strategic outcomes that are associated with each objective which are in turn applied consistently in all jurisdictions across the country. As discussed further below, our view is that a single national securities regulator is now the model that can best deliver this result.

- ***Efficiency and Effectiveness.*** We believe that it is important that Canadian securities regulatory authorities have an explicit objective relating to efficiency and effectiveness. We will have further comments below under "Consultation Item 5, Securities Regulatory Structure", but the current structure contains the following inherent inefficiencies that persist, despite sincere attempts at cooperation among securities regulatory authorities and the good will and best efforts of the regulatory staff involved:

- There is too much duplication of functions across the various commissions (that is, too many people doing the same thing), slowing down decision making and regulatory initiatives.
- Rule making initiatives (both securities commission and SRO) often take too long to be finalized and approved as securities commission staff attempt to achieve consensus across Canada.

- Except for simple matters, regulatory relief applications can take too long to resolve. As is the case with rule making initiatives, much of the timing delays may be attributed to the need for staff in the various commissions to achieve consensus as well as inconsistent rules. For example, a recent exemptive relief application involving few novel issues preceding the closing of an acquisition required eleven different orders or rulings due to differing rules and took a significant time due to the need to achieve consensus among multiple regulators.
- The time and expense of coordinating regulatory issues associated with new and innovative products greatly add to the expense and time-to-market of new products. For example, we are able to issue equity linked notes using our shelf prospectuses in the U.S. at a cost that is about 10% of the cost in Canada (filing fees and external counsel costs) due to securities regulatory product approval processes. Also, mutual fund product development initiatives can be slow and expensive due to overly prescriptive and complicated rules and the need for exemptive relief in many cases.
- Securities industry participants at SRO registered firms are required to deal with the commissions and/or SROs in different jurisdictions resulting in a fragmented administrative framework due to incomplete delegation by securities commissions to the SROs on registration and related issues.
- Rules continue to be inconsistent in certain areas and regional variations in the rules continue without sufficient policy justification. This leads to increased complexity and confusion that may actually undermine market participants' understanding and compliance with the applicable requirements in each jurisdiction. Even the recently announced national registration reform initiatives continue to have provincial idiosyncrasies that undercut the effectiveness of the initiative.

The implementation of the passport system will not in our view adequately address the inefficiencies noted above. These inefficiencies, if not addressed, will continue to compromise the efficiency and effectiveness objective of our securities regulatory authorities. These inefficiencies add significantly to the costs of compliance in our businesses, which ultimately impacts our customers. The passport system and preceding mutual reliance initiatives were a useful first step, but inherently are not able to address the broader policy issues we discuss in this submission. The passport system only addresses a limited range of issues due to the fact that it is, at best, a “workaround”. We believe these inefficiencies will continue as long as we have a fragmented securities regulatory structure. Our securities regulators have been attempting through the passport system to act in certain areas *as if* they were a single regulator. We believe they need to *be* a single regulator.

- ***Enhanced Competitiveness.*** We also believe that it should be an explicit objective of Canada's securities regulatory authorities to enhance the competitiveness of Canada's securities industry and to facilitate innovation in connection with regulated activities.

Enshrining this objective in the legislation, we believe, would lead to increased focus by securities regulators on initiatives to facilitate new product offerings and new offering structures and to respond promptly to international developments. The international character of financial services must be acknowledged along with the importance of maintaining the competitive position of Canada's capital markets internationally. Canada competes with international markets for securities business that could easily flow elsewhere if our markets or our market participants are perceived to be unsafe, inefficient or uncompetitive.

- **Systemic Risk.** We also believe that Canadian securities regulators should be in a position to respond proactively to systemic risk issues. The Panel's Consultation Paper asks whether an objective of "reduction of systemic risk" should be explicitly mentioned. We would phrase it differently: systemic risk, like any risk, should be understood, monitored and mitigated. An objective only to reduce systemic risk, will only do part of the job. In addition, we question whether our currently fragmented securities regulatory system could respond in a sufficiently coordinated and swift manner (this is discussed further with our comments on structure below). Of course, it is not possible for securities regulators to attempt to address systemic risk issues on their own: they can only do part of the job and would need to coordinate systemic risk issues with OSFI and the Bank of Canada and to co-operate with international regulators both with respect to setting international standards and participating in monitoring of global firms and markets.

Thus far, securities regulators in Canada have focused their attention and resources for the most part on their traditional areas of expertise: mostly, primary distribution of securities, public company regulation, equity trading markets and associated regulatory and enforcement issues, yet much of the financial markets activity and emerging risks are happening elsewhere. The blurring of asset classes and the proliferation of new tradeable financial instruments that reallocate risks in ways unforeseen when our securities laws were developed mean that securities regulators that are provincially focused and operating mostly in their historical comfort zones will be limited in their ability to understand and assess how and if these new risks will impact investors in Canada or to participate in the cross-regulator cooperation and collaboration that will facilitate this understanding.

It is difficult to imagine how Canada's fragmented securities regulatory system could effectively play any meaningful part of the "systematic cross-border supervisory cooperation" recommended by the "*Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*", April 2008, or contribute effectively to a Canadian analogue of the President's Working Group on Financial Markets (in the U.S., consisting of the Secretary of the Treasury and the Chairmen of the Federal Reserve, the SEC and the CFTC).

What criteria should be used to evaluate securities regulation in Canada?

- **Performance Measurement.** We believe that the efficiency of securities regulators would be enhanced by linking each of the objectives of the securities regulatory system to specific outcomes, as is the case with the FSA. These outcomes would be capable of measurement in such a way as to provide governments, securities market participants and the Canadian public with clear measures of success. However, two cautions would be appropriate in this regard. First, we would recommend avoidance of creation of a performance measurement “bureaucracy” which would divert resources from substantive regulatory work. Second, the performance measurement criteria would need to be carefully developed so that they encourage efficiency and effectiveness, but do not otherwise encourage behaviour that might detract from the substantive regulatory work of the staff involved (for example, managing a file in a manner so as to meet a performance objective but does not assist in achieving the substantive result). Ultimately, any performance measurement system will only be effective if it is readily understandable and informative, and it is applied consistently to the securities regulatory regime across the country.

Consultation Item 2: Principles-Based Securities Regulation

Could a more principles-based approach improve securities regulation in Canada? Are there areas of securities law or regulation that are overly prescriptive and could benefit from a more principles-based approach? What core regulatory principles should constitute the foundation of securities law? What are the risks and challenges of a more principles-based approach to regulation?

- **Principles-Based Regulation.** RBC supports a move to increasingly explicit principles-based regulation. We express our support this way because Canada already has a mix of principles and rules, albeit heavily weighted in favour of rules at this point in time. The Allen Committee Report, “Canada Steps Up”, made the following observation:

“We emerge from our discussions regarding the “rules versus principles” debate with the view that this distinction is unnecessarily arbitrary. Rules must be based on underlying principles. And principles must find their expression, in the interest of a basic modicum of clarity, in rules.” (s.3.19)

- **Integrated Approach to Principles-Based Regulation.** We believe that if an increasingly principles based approach is to be effective, it is essential that the same principles apply to all financial products that are, to the end purchasers, functional substitutes and their manufacture, distribution and sale should be regulated the same

way by the same regulator so as to promote investor choice and minimize the possibility of confusion by investors.

- ***Continued Need for Rules.*** Even with a more principles-based approach, rules will continue to be important, as they provide a clear indication of minimum standards of conduct required by regulators and, accordingly, provide clarity to market participants on key behaviours. In addition, detailed rules are often important to establish the “rules of the road” for transactions between market participants so as to foster clear and efficient dealings between market participants (e.g., UMIR trading rules). In a principles-based regime, there may be a motivation for regulators to communicate detailed and prescriptive “expectations” for market conduct in relation to the principles. Where this occurs, we would encourage a practice of adoption of rules and policies, after public comment, to enshrine such expectations, so as to avoid a situation in which market participants find their behaviour judged by detailed pronouncements on market conduct released informally in speeches, on web sites or otherwise.
- ***Principles Applied in an Enforcement Context.*** Experience has shown that Canada has applied a principles-based approach in any number of cases, beginning with the *Canadian Tire* and *George Albino* cases through to the recent *Sears Canada* decision. It is clear that in the face of conduct which regulators believe is abusive, securities regulators will take action, even in the absence of a violation of a specific rule (and even, in the *George Albino* decision, in the absence of a clear finding that a “security” was involved). Knowing this, responsible market participants judge their own actions and behaviours based upon an analysis of the purpose of a specific rule, and not just the technical wording of the rule.
- ***Principles Applied in Other Contexts.*** Even outside of the enforcement realm, there is ample evidence of principles-based regulation in our current structure. For example, prospectuses are required to include “full, true and plain disclosure of all material facts”. This is clearly principles-based and outcome oriented. Theoretically, this could be sufficient as the rule governing the content of prospectuses; however, for the sake of consistency in disclosure standards and to set minimum standards for disclosure, regulators have specified in greater detail what their expectations are through detailed form items requiring specific disclosures. At some point, however, the details in the form may go beyond that required for consistency and minimum standards into the realm of “micro managing” to a degree that is unproductive and imposes additional costs as lawyers and securities regulators ensure that every form item is addressed, whether or not an investor in the circumstances of the particular issuer would find it remotely useful to have that additional piece of disclosure. As a result, rules must be subjected to a rigorous cost-benefit analysis prior to their adoption, after public consultation, with the objective of striking the appropriate balance between rules and principles.
- ***Content of Principles.*** As to the content of the principles, no one could argue with the “Eleven Regulatory Principles for Business” quoted on page five of the

Consultation Paper, as adopted by the FSA. In fact, we believe that these principles outline in broad terms the objectives of every responsibly run financial services enterprise. It is clear, however, that the FSA principles alone would not be sufficient to regulate the market, as market participants and their customers would not have sufficient guidance as to the expectation of regulators and, accordingly, further principles need to be developed under each of the broader categories of principle to provide more guidance as to market conduct. And, finally, those principles need to have a set of clear rules promulgated to the extent necessary only to provide clarity to market participants and to establish minimum standards of behaviour. It is necessary, therefore, to strike a balance between principles and rules that is more principles based than is currently the case.

- ***Mutual Fund Rules.*** One specific example of a scheme of regulation that appears to have gone too far in the direction of detailed and prescriptive rules is the regulation of mutual funds, where an increasingly principles-based and outcome-oriented rules regime would greatly benefit the industry, and permit greater innovation without compromising integrity of the markets or lessening the responsibility of fund managers. One does not have to spend very much time with the rules governing mutual funds to discover that they are inordinately detailed, prescriptive and restrictive, which in our view significantly undermines innovation. At the same time, the mutual fund disclosure regime suffers from a legacy that is based upon a disclosure system crafted for public companies carrying on an active business. Many of the requirements are also out-of-date and have failed to keep pace with the significant changes and innovations that have occurred in the global capital markets over the past number of years. This is evidenced by the significant number of exemption applications that have been submitted with respect to investment funds. We believe that the disclosure regime for mutual funds should be overhauled and simplified and the disclosure delivery mechanisms adjusted to fit the realities of how these products are sold, what investors want and need to know and how the disclosure can be best delivered in an increasingly electronic world.

Consultation Item 3: Proportionate Securities Regulation

To what extent is there need for proportionate regulation in Canada? What areas of securities regulation impose undue burden and could benefit from proportionate regulation? Should the economic characteristics of a company determine how it is regulated? If so, what should be the economic characteristics? What role could risk analysis play in the regulation of businesses?

- ***Public Companies.*** We support the principle of proportionate securities regulation as applied to public companies so that smaller public companies are not hampered by the costs of compliance with onerous regulatory requirements, but it is important that a baseline level of investor protection is provided: to an investor, \$100 invested in a

smaller company or a larger company is still \$100. Here, investor protection issues must be balanced against the high costs of compliance for smaller public companies which are driving many companies to AIM or to consider other capital raising alternatives. At the same time, while smaller companies could benefit from somewhat less extensive regulation, large, well capitalized companies with good compliance records, that are followed by the analyst community, should receive the benefits of greater ease of capital raising with continued simplification of public offering processes and less stringent review of continuous disclosure documents by securities regulatory authorities.

- **Market Participants.** We believe that levels of regulatory scrutiny should mirror the regulators' assessment of the company's financial strength, management and compliance records and enforcement history, such that regulatory resources are focused on firms with the greatest need of close supervision. It is however, important that, in the case of market participants, the baseline levels of regulation should be set at a level that protects all clients of firms operating in an industry on a consistent basis.

Consultation Item 4: Enforcement

What would be the opportunities and risks to enforcement under a more principles-based approach in Canada? Should enforcement action be taken solely on the basis of a breach of principle? Would the current system be sufficiently well-positioned to enforce a more principles-based approach?

- **Timely, Fair and Proportionate Enforcement.** We submit that Canada's investors and market participants desire an enforcement system that is timely, fair and proportionate. Canada's reputation for effective enforcement matters in a global financial system: it is easy for trading and capital raising to migrate elsewhere if our enforcement is believed to be lacking. Due to insufficient resources and the difficulty in coordinating investigations among multiple agencies, enforcement in Canada's securities industry has been perceived to be slow and has generally been most successful when the market participants already self-reported the infraction. The case for better enforcement has already been made by a number of well regarded commentators, so we will confine our comments to enforcement in a principles-based environment.
- **Enforcement Under a Principles-Based Regulatory Structure.** We have no issue with the behaviour of market participants being judged on the basis of principles in addition to rules. As we observed above, that is already the case at present. We believe it must be possible for a firm to predict, at the time of the action it is undertaking, whether that action would be a breach of a principle, in order to reduce the likelihood that the regulator will apply hindsight in an enforcement context. If a

more principles-based structure is adopted, where enforcement is being considered for breach of a principle, in the absence of a violation of a specific rule, we believe that because the action is being judged in hindsight in the absence of a clear rule governing the behaviour, it would be fair to require a higher threshold (for example, “abusive of capital markets” or “manifestly unfair to the market participant’s clients”) in order to sustain a successful enforcement case. In addition, we believe that a broader range of possible regulatory responses should be considered prior to taking any enforcement action, which would depend upon factors including the nature and severity of the breach, whether it is a newly arisen issue or a first offence, whether the market participant had and applied reasonable compliance policies in respect of the subject matter of the infraction, the enforcement record of the institution and similar mitigating circumstances. Depending on the circumstances, under a principles-based regime, it should be open to a regulator to take no action in respect of a breach of a principle other than an informal warning, which would form part of the overall assessment of the market participant’s compliance record, potentially leading to a greater degree of regulatory scrutiny of the market participant until the situation that led to the infraction was corrected. In other words, this is a risk-based approach where regulators would increasingly focus their ongoing attention and examinations on those with the poorest compliance records.

- ***Better Enforcement Benefits Everyone.*** In closing, we believe that timely, fair and proportionate enforcement benefits everyone: clients benefit from fair and honest market conduct and swift resolution of claims; market participants benefit from increased confidence in their advice and products as well as a level of regulatory scrutiny that is proportionate to their compliance record; and Canada’s capital markets benefit from the improved pricing, liquidity and trading and underwriting volumes that go with a reputation for fairness.

Consultation Item 5: Securities Regulatory Structure

Which structural model (passport or single securities regulator) would be best for Canada? Which model would best support the adoption of new regulatory approaches, including proportionate regulation and a more principles-based approach? Which would fulfill the need for the effective governance of Canada’s capital markets?

What are the opportunities and risks of moving to a single securities regulator? How could a single securities regulator be implemented without being unduly disruptive to the marketplace? In particular, what can be done to effect a smooth transition?

What is the best way forward for the federal and provincial governments? In the absence of an agreement, what do you suggest as an alternative model?

- ***It is Time for Significant Change.*** RBC and its clients have benefited from the safety, soundness and fair market practices motivated by Canada's securities regulatory authorities to date, but we believe that the time is right to make significant improvements to the efficiency and effectiveness of our securities regulatory system. It is clear to us that there are unnecessary costs, inefficiencies and duplication built into our current system that must be eliminated to permit the Canadian securities industry to keep up with the pace of innovation locally and globally. That the regulatory structure has worked as well as it has thus far is a credit to the extensive efforts and cooperative spirit of the many regulatory authorities involved - but now we can and must do better.

- ***Global Perspective.*** The title of the Panel's Consultation Paper, "*Creating an Advantage in Global Capital Markets*", is apt: technological developments and international expansion have accelerated the global reach of all financial industry participants and their clients. We believe this trend will continue to accelerate and intensify. At the same time, it is clear from recent credit market challenges that risk itself also must be managed on a global basis, both by financial system regulators and the financial industry participants themselves. The developments and emerging risks that in our view should be the focus of financial industry regulation today transcend the provincial: they are at least national, but often truly global, in scope. As such, Canada needs a regulatory system for its financial services industry that is able to respond in an integrated fashion to global risks and opportunities, has the capability to be the first choice of other jurisdictions opening their markets through international mutual reliance arrangements and to coordinate effectively and proactively with other financial system regulators and the industry.

- ***The Case for a Common Securities Regulator.*** We believe that the case has already been made very effectively for a single securities regulator for Canada, most notably by the Crawford Panel and the Wise Person's Committee. Our securities regulators have been attempting, with varying degrees of success, to deliver the benefits of a single regulator without actually consolidating – we believe that it is now time for them to actually become a single regulator. We believe that the model proposed by the Crawford Panel represents a workable model that accommodates regional issues, yet would lead to greater regulatory effectiveness and efficiency. We strongly encourage the governments involved to cooperate to move forward with implementation to develop a national framework, in cooperation with the federal government, for a single securities regulator that pools the regulatory resources and expertise that has been developed by our provincial securities commissions. This single securities regulator is a natural evolution of the Passport system and the other mutual reliance initiatives that have been underway for years. This is not an issue that requires further study.

- ***Benefits of a Single Regulator.*** From RBC's perspective as a public company and as a market participant, there are numerous benefits to a single regulator:
 - Speed up decision-making and regulatory initiatives caused by duplication of effort

- One Securities Act and set of rules and policy statements reduces cost of compliance
 - Enable innovation by reducing the cost and time-to-resolution of new product and regulatory change initiatives
 - Proactive response to systemic risk issues
 - Ability to coordinate effectively with other financial regulators, both within Canada and internationally
 - Reduce the costs of regulation and of access to the Canadian capital markets
 - Ability to speak for Canada on the international stage
 - Coordinated, timely and effective enforcement
 - Facilitate greater coordination of policy issues with SROs and other financial service regulators, particularly with respect to novel financial instruments
- ***Strong Regional Representation.*** With the creation of a single regulator, we believe that strong regional representation, such as that proposed by the Crawford Panel, is necessary to retain the specific areas of expertise that have been developed in the provincial securities commissions and to respond to issues unique to each provincial economy and its issuers and investors.
- ***Continued SRO Role.*** Self regulatory organizations, such as IIROC and the MFDA, already are national in scope and provide the benefit of industry self regulation and expertise. Certain inefficiencies and duplication today result from incomplete delegation to SROs, with the result that securities commissions are regulating matters also being covered by SROs. To avoid duplication and to streamline the current administrative regime, however, we would recommend that, for example, IIROC be given authority over all aspects of the registration and trading conduct of market participants.
- ***Integrated Regulatory System.*** It should be clear from our preceding submissions that a single national securities regulator operating with one rule book will only solve part of the problem. This new regulator also should be part of a coordinated financial regulatory matrix (modeled on the regulatory structures in place in Australia or Quebec, or the FSA in the U.K.) which is able to manage proactively and collaboratively issues that include systemic risk, safety and soundness, market conduct and other issues relating to all stages of a financial product's manufacture, distribution and sale to institutional through to individual consumers. This integration and collaboration should not only arise when a crisis arises; it should be an ongoing part of the regulatory operating system. If implemented effectively, this would create an advantage for consumers and for our financial services industry.