

Ministry of Finance
BRIEFING DOCUMENT

To: Honourable Michael de Jong, Q.C. **Date Requested:**
Minister of Finance **Date Required:**

Initiated by: Heather Wood **Date Prepared:** July 20, 2016
Assistant Deputy Minister
Policy and Legislation Division

Ministry Contact: Chris Dawkins **Phone Number:** 250 387-7567
Executive Director **Email:** Christina.Dawkins@gov.bc.ca
Financial and Corporate Sector
Policy Branch
Cliff #: 351322

TITLE: Request from the Investment Industry Association of Canada (IIAC) for an exemption for investment dealers from the trust business authorization requirements under the *Financial Institutions Act* (FIA)

PURPOSE:

(X) DECISION REQUIRED

COMMENTS:

- IIAC wrote to you on April 21, 2016 requesting an exemption for investment dealers who appear to be off-side the trust business authorization requirement in FIA when they place their clients' money in GICs and other deposit accounts held in the name of the firm.
 - IIAC advises that the investment dealer practice of holding clients' money in trust accounts is an efficient process, beneficial to investors and financial institutions, including credit unions, and is authorized by and regulated under the securities law regulatory framework.
 - Ontario trust company legislation adopts a broader exemption covering any corporation (including an investment dealer) that is acting as a trustee as required by legislation, ^{s.13}
-

Executive Director approval: _____

ADM approval: _____

DM approval: _____

DATE PREPARED: July 20, 2016

TITLE: Request from the Investment Industry Association of Canada (IIAC) for an exemption from the *Financial Institutions Act* (FIA)

ISSUE: Should the government proceed with the exemption request from IIAC?

BACKGROUND:

- The FIA generally requires any corporation undertaking trust business to hold a business authorization under the legislation, with some exemptions authorized in legislation or by regulation.
- Obtaining a business authorization is costly for corporations because of regulatory fees. It also involves complying with a large amount of regulation in areas such as minimum capital, governance, filings and oversight.
- Investment dealers promote a variety of investments for their clients, including brokered deposits which are low-risk, low-return investments, used primarily by institutional investors and wealthy individuals where the deposits are held in the name of the dealer as nominee. The adoption in 2008 of unlimited deposit insurance increased the attractiveness of brokered deposits in BC credit unions.
- With this increase, investment dealers approached the Financial Institutions Commission (FICOM) to confirm that there were no issues in deposit insurance coverage for their brokered deposits. FICOM undertook a review and issued an information bulletin "Use of Deposit Agents," highlighting that deposit agents such as investment dealers can only hold deposit accounts for the benefit of another person if they are a trustee authorized to do trust business. This applies to brokered deposits in credit unions, banks or trust companies.

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DISCUSSION:

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OPTIONS:

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RECOMMENDATION: OPTION 3 (Adopt broader exemption)

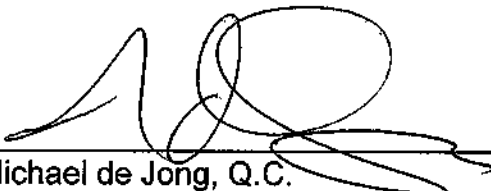
We recommend that you approve proceeding with the proposed broader regulatory exemption, namely exempting any corporation that is acting as a trustee as required by legislation. If you agree, Ministry staff will prepare drafting instructions for Legislative

Counsel Office. When completed, the proposed Order in Council and regulations will be sent to you for your review and approval.

A proposed reply to IIAC is attached for your signature, advising that you have asked Ministry staff to review their concerns.

Attachment

APPROVED / NOT APPROVED



Michael de Jong, Q.C.
Minister

Aug 12, 2016
Date

Wong, Gina G FIN:EX

From: Minister, FIN FIN:EX
Sent: Monday, August 15, 2016 2:18 PM
To: 'nsolomon@iiac.ca'
Subject: RE: Exemption Request for Investment Dealers from Application of BC Trust Legislation

350812

Naomi Solomon, Managing Director
Investment Industry Association of Canada
nsolomon@iiac.ca

Dear Ms. Solomon:

Thank you for your email of April 21, 2016, regarding a request for an exemption for investment dealers from the application of trust business authorization requirements under the *Financial Institutions Act* (FIA). Please accept my apology for the delay in responding.

I am advised that investment dealers hold GIC and other deposits in trust accounts in credit unions, banks and other deposit taking institutions, a practice which has raised questions with respect to the FIA. Your members believe that this industry practice is beneficial to consumers and financial institutions and results in no legitimate public protection concerns.

I have asked Ministry staff to review your request and provide me with an analysis of the issues. Although your letter asks that the Ministry of Finance resolve these issues by granting investment dealers an exemption from trust company regulation under section 70 of the FIA, please understand that only the Lieutenant Governor in Council has the authority, by regulation, to authorize an exemption from the FIA's trust business authorization requirements.

Ministry staff will follow up with you as their work progresses. I would like to thank you again for taking the time to write.

Sincerely,

Michael de Jong, Q.C.
Minister of Finance

From: Naomi Solomon [<mailto:nsolomon@iiac.ca>]
Sent: Thursday, April 21, 2016 1:13 PM
To: Minister, FIN FIN:EX
Cc: Cole, Elizabeth FIN:EX
Subject: Exemption Request for Investment Dealers from Application of BC Trust Legislation

Please find attached the IIAC's exemption request letter in respect to the application of BC trust legislation to investment dealers operating nominee accounts when holding GIC issuer deposits. I would be pleased to be in contact with your office to address any questions or concerns, including meeting in person. I appreciate your consideration and further advice on the request for exemption from the application of BC trust legislation to investment dealers.

Regards,

Naomi Solomon
Managing Director
Investment Industry Association of Canada (IIAC)
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Naomi Solomon
Managing Director
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Via Email: Fin.Minister@gov.bc.ca

April 21, 2016

The Honourable Michael de Jong
Minister of Finance
PO Box 9048 Stn Prov Govt
Victoria BC V8W9E2

Dear Minister de Jong:

Re: Request for Exemption for Investment Dealers from Application of Section 70 of the Financial Institutions Act (FIA)

In regard to the impact of the application of section 70 of the FIA¹ to investment dealers in B.C., the Investment Industry Association of Canada (the "IIAC") has taken the opportunity to address its concerns through participation in the FIA & CUIA Review Initial Public Consultation Paper (the "Initial Consultation")² by written submission and a meeting with the Director, Financial Institutions (Ministry of Finance Policy and Legislation Division) and other Ministry staff, as well as through ongoing consultation with the Deputy Superintendent, Regulation, and other staff at the Financial Institution Commission (FICOM).

The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 144 investment dealer member firms ("IIAC Members") that are regulated by the Investment Industry Regulatory Organization of Canada ("IIROC"). These dealer firms are the key intermediaries in Canadian capital markets, accounting for the vast

¹ Under section 70 of the FIA, a corporation is prohibited from carrying on trust business unless it is a trust company or a corporation carrying on a prescribed trust business or class of trust business.

² Please see FIA/CUIA Consultations. In particular, a question was posed as to whether further exemptions are needed in respect of trust business undertaken by corporate entities (e.g., broker dealers).

majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations that is fundamental to economic growth.

The IIAC raised concerns in its consultations that an unintended consequence of the broad restrictions on “trust business” under section 70 of the FIA, is the potential for IIROC Dealer Member intermediaries in B.C. to be caught under the legislation as carrying on “unauthorized” trust business. The concern arose further to FICOM’s credit union review related to the use of deposit agents, in particular the longstanding practice wherein dealers act as deposit agent holding BC credit union guaranteed investment certificates (BCCU GICs) in nominee accounts on behalf of clients. FICOM also recently alerted the IIAC that it is broadly concerned that whenever dealers hold the GIC deposits in nominee accounts, regardless of the issuer (whether BCCU, bank or trust company), this may constitute unauthorized trust business under section 70 of the FIA.

Regulating investment dealers as “trusts”, which is not apparently done in any other Canadian jurisdiction, would negatively impact B.C. investment dealers and investors. For clarity and to avoid the creation of an artificial barrier to legitimate deposit-taking business under which IIROC Dealer Members have traditionally held the deposits in nominee accounts on behalf of clients, the Minister of Finance is requested to exempt investment dealers from trust regulation under section 70 of the FIA on an expedited basis.

Background

The B.C. provincial deposit business increased its competitiveness as a result of the lifting of limitations on deposit insurance coverage in 2008, in response to the global financial crisis. British Columbia developed a robust credit union financial services sector, with B.C. credit unions taking around one quarter of deposits as a fraction of total financial institution deposits in British Columbia³. Investment dealers located in B.C. have participated as intermediaries holding BCCU GICs in nominee accounts for their clients both in the current environment of increased investment in BCCU GICs and prior to the lifting of limitations on deposit insurance coverage. Investment dealers have thus been able to facilitate their clients’ investment objectives and needs until recently, without regulatory impediment.

Notably, the nominee account deposit structure has worked whether the insurance coverage regime was limited or unlimited. Regulation under the FIA⁴ exists to address limited insurance coverage for these deposits by deeming what constitutes a separate deposit for the purpose of applying an insurance coverage limit in the case of a “pooled trust account” maintained by a trustee for the deposit of trust funds on behalf of beneficiaries generally, whether or not the identity of each beneficiary is disclosed in

³ Credit Union Supervision in British Columbia, Auditor General of British Columbia, March 2014 (the “AG Report”).

⁴ See section 2, Credit Union Deposit Guarantee Regulation, B.C. Reg. 317/90. This regulation became ineffective, however, since the lifting of the limitation on deposit insurance coverage in 2008.

the records of the credit union. As such, regardless of whether the deposit insurance regime may be changed to limit coverage again, the nominee account structure that has always been used by dealers can remain in place.⁵

Investment dealers in B.C. were however alerted to the recent review by FICOM of credit union compliance with the FIA in regard to BCCU GIC deposits held by investment dealers in nominee accounts on behalf of clients. FICOM also previously issued an information bulletin⁶ (the "information bulletin") in which it was indicated that deposit agents cannot act as nominee, and when acting as trustee must be authorized. As such, FICOM indicated that investment dealers may be considered to be engaging in "unauthorized" trust business under section 70 of the FIA if the FIA is applied to regulate investment dealers as trusts.

The Initial Consultation is considering the regulation of trust business undertaken by corporate entities and the need for investment dealer exemptions, however the IIAC was advised by Ministry staff that the consultation will take over three years. In the circumstances, an expedited exemption from trust regulation under section 70 of the FIA would be required in order to provide clarity for investment dealers and to avert any unreasonable barrier to dealers' deposit taking business by operation of the subject legislation. With an exemption from trust regulation, participation by investment dealer intermediaries in the B.C. deposit-taking business may appropriately continue.

Request for Expedited Exemption from Trust Regulation for Investment Dealers

The IIAC's Members that act as deposit agent in respect of BCCU GICs are concerned with the information bulletin issued by FICOM indicating that under the FIA, deposit agents cannot act as nominee and when acting as trustee must be authorized. While holding nominee accounts is not necessarily equivalent to engaging in trust business, we understand that FICOM staff interpret section 70 of the FIA as generally applying to investment dealers holding BCCU GICs in nominee accounts on behalf of clients and that the nominee account structure if employed by dealers for bank or trust company GICs would also be governed under section 70 of the FIA. The unintended consequence is regulation of these investment dealers as trusts. This also creates a conflict with the requirements under securities legislation which govern investment dealers, producing an ineffective regulatory framework that will unreasonably restrict dealers in B.C. from engaging in legitimate provincial deposit-taking business.

⁵ By comparison, the Canada Deposit Insurance Corporation (CDIC) does provide recourse to coverage for each beneficiary of "in trust for" accounts, including such accounts held by dealers subject to SRO rules. See CDIC website: How does the CDIC coverage work for ITF Accounts? Investors in BCCU GICs should also have coverage eligibility in the same manner when holding the investment in a nominee account. Each beneficiary holding BCCU GICs in dealer nominee accounts should remain eligible for deposit insurance coverage, so that clients of investment dealers will not shift away from holding BCCU GIC investments and to allow provincial deposit-taking business to effectively continue. This would also be aligned with the principle that deposit insurance should adequately cover a large majority of depositors.

⁶ See Bulletin Number CU-2014-02.

Dealers acting as deposit agent for credit unions register their clients' BCCU GIC deposits in nominee name (as well as bank GIC deposits) rather than in client name with the credit union (or bank). Nominee name is more efficient than requiring each client to become a credit union member and/or for each client's deposit to be held in a separate account requiring new account documentation, it facilitates tax reporting that is handled by dealers and generally it is required that dealers hold client assets in nominee name under securities legislation⁷. Dealers cannot maintain a material number or amount of off-book client named positions and to the extent possible, off-book client name positions are required to be converted into on-book nominee name positions⁸. Otherwise, dealers must produce a report on client positions held outside the dealer, which is onerous and costly for dealers that would have to build this capability not generally now existing, merely for the purpose of holding these BCCU GICs in client name despite lacking feasibility. Further, client relationships are with the investment dealer and it would be unreasonable to require the client to attend at the credit union directly (or bank) only to invest in BCCU GICs (or bank GICs) when other investments are also held with the investment dealer so the client's entire portfolio can be reviewed more appropriately.

The IIAC submits that the nominee account structure has a strong legacy of effectiveness, as evidenced by the lack of market conduct or other issues over the many years this structure has been in place for holding BCCU GICs (or other issuer deposits). Indeed, the CDIC recognizes the existing nominee account structure for bank GICs through its coverage policy and there has been no issue raised that the practice offends provincial trust legislation. The IIAC's Members are thus concerned that they now could be restricted from continuing to hold deposits registered in nominee name when acting as deposit agent for B.C. credit unions or other issuers although no legitimate public protection rationale is advanced by such prohibition. In particular, dealers are already subject to self-regulatory organization (SRO) segregation rules supported by written custodial agreements that contain prescribed terms and conditions that serve to meet the protection of customer property entrusted to a member firm, and dealers are subject to additional capital requirements if proper custodial documentation is not obtained.⁹

Dealers will have no practical recourse if the BCCU GICs (or other issuer GICs) are not permitted to be held in nominee name. Some dealers have become members of credit unions while holding BCCU GIC deposits in nominee accounts, however this does not address the application of the FIA to prohibit dealers from holding the BCCU GICs in nominee accounts on the basis that this constitutes "unauthorized" trust business.

⁷ See s. 14.6 of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and s. 14.6 of the Companion Policy to NI 31-103 (31-103CP).

⁸ See s. 14.14.1 of NI 31-103 and IIROC Notice 15-0013 – *Client Relationship Model - Phase 2* (January 19, 2015), at pp. 6, 9.

⁹ See IIROC Notice MR-0080 – *"Evidence of Deposits" and Custody Agreements* (July 1, 2001).

FICOM staff have advised us recently that in regard to their review of credit union compliance with the FIA, credit unions that take deposits from dealers holding BCCU GICs in nominee accounts for clients are considered compliant with the FIA¹⁰ and that these deposits are covered by the Credit Union Deposit Insurance Corporation¹¹, however they are concerned that “trust business” is being conducted by dealers without being “authorized” as required under the FIA. Nonetheless, FICOM staff advised that they consider the nominee account structure for holding BCCU GICs to be proven effective as governed under IIROC rules and that they would support an exemption from trust regulation under the FIA sought by the IIAC on behalf of its Members.

As a result, without an exemption from trust regulation under section 70 of the FIA, dealer intermediaries will find it impracticable to conduct this deposit-taking business in B.C. which has historically been structured in this manner. The artificial barrier created by such application of the regulatory framework would arguably be detrimental to investors, credit unions and the dealer intermediaries who wish to service clients. An expedited exemption from trust business regulation is needed for investment dealers. It is necessary to clarify that investment dealers may hold BCCU GIC deposits in nominee name without legislative prohibition.

Notably, other regulatory exemptions have been granted from s.70 of the FIA¹² and the goal in providing exemptive relief to investment dealers from trust regulation would be to ensure an effective and balanced regulatory framework, which will help investors in B.C. continue to benefit fully from the financial services sector and maintain their confidence in it. A prescriptive prohibition with a foundation that is not clearly substantiated should not be imposed on legitimate provincial deposit-taking business undertaken by investment dealers that are subject to SRO rules. Preventing dealers from continuing to act as intermediaries in respect of B.C.’s deposit-taking business that is well-established with the public would be unproductive.

In conclusion, the IIAC urges the Ministry of Finance to expedite the resolution of these issues by granting investment dealers an exemption from trust regulation under section 70 of the FIA in order to eliminate unnecessary regulation and promote financial stability and certainty so that the financial services sector, including its B.C. intermediary dealer entities, can continue to service clients’ investment needs as appropriate with BCCU GICs and other issuer deposits.

¹⁰ Pursuant to section 82 of the FIA, a credit union can accept deposits from members, a member acting as trustee or a person acting as trustee or agent.

¹¹ The Credit Union Deposit Insurance Corporation (CUDIC), is a statutory corporation that guarantees all deposits of B.C. credit unions as set out in the FIA.

¹² See examples of exemptions from s. 70 of the FIA: B.C. Reg. 173/2008 *Trust and Deposit Business Exemption Regulation*, and BC Reg 142/2000 *Mutual Fund Trustee Exemption Regulation*.

Thank you for considering our request for an exemption. We would be pleased to discuss this application further and welcome the opportunity for ongoing dialogue in this process, including, if agreeable, by meeting in person together with FICOM and IIROC staff.

Yours sincerely,

"Naomi Solomon"

cc. Elizabeth Cole, Executive Director, Strategic Projects and Policy
Policy and Legislation Division, Ministry of Finance (via email)