

Oliver hints at Volcker rule legal challenge

By JEFF BUCKSTEIN

Federal Finance Minister Joe Oliver has called out the United States government on a key element of its *Dodd-Frank Wall Street Reform and Consumer Protection Act*, charging that it will hurt investors.

"There is one avenue where American investors cannot enjoy the Canadian advantage, and that is the ban on proprietary trading of non-U.S. government securities by U.S. banks, a policy known as the 'Volcker rule,'" Oliver said, speaking at the 2015 Canada-U.S. Securities Summit in New York. "I hope that the U.S. administration sees that changing the Volcker rule is in its own best interest and that of its biggest trading partner."

Oliver also raised the spectre of a possible legal challenge.

"I also believe with a strong legal basis that this rule violates the terms of the North American Free Trade Agreement (NAFTA)," he said.

Cyndee Todgham Cherniak, founder of LexSage Professional Corporation, a Toronto-based international law and sales tax firm, agreed that the Volcker rule, named after former U.S. Federal Reserve chairman Paul Volcker, could be challenged under NAFTA.

It could also set an interesting legal precedent depending on how such a challenge proceeded, particularly if it is based on Chapter 14 of NAFTA covering financial services disputes, she said.

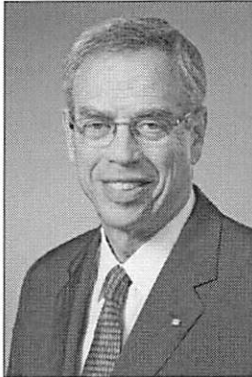


Photo by Couvrette Ottawa

OLIVER

"Article 1404(1) of NAFTA says 'no party may adopt any measure restricting any type of cross-border trade in financial services by cross border financial service providers of another party ... except to the extent set out in Annex VII,'" said Todgham Cherniak, noting there has never been a prior challenge launched under NAFTA's Chapter 14 (Article 1414 — which guides dispute settlements).

This is a complex area that references the NAFTA Chapter 20 dispute resolution mechanisms, she explained.

"With respect to Canada, the United States reserves the right to adopt any measure relating to cross-border trade in securities services that derogates from Article 1404(1) or 1406 [dealing

with most-favoured nation treatment].

"This is either a broadly worded reservation or a very narrow reservation. The question for the NAFTA Chapter 20 panel would be whether the Volcker rule is a 'measure relating to cross-border trade in securities.' The focus will be on the definition of securities. The word 'securities' is not defined in NAFTA Chapter 14 — for example Article 1416 — nor is it defined in Annex VII. A debt instrument may be a financial instrument, but not a security," said Todgham Cherniak.

If the matter went to a NAFTA panel, Canada might argue NAFTA Article 1405 [national treatment] and/or 1406 [most-favoured nation]. The U.S. might argue Article 1409, which links to reservations in Annex VII, she added.

Another factor making a potential challenge under NAFTA so compelling from a trade lawyer's perspective is that previous challenges have more typically occurred under Chapter 11 of NAFTA, rather than Chapter 20. Any NAFTA challenge under Chapter 20 would be government-to-government, said Todgham Cherniak.

Chapter 11 is designed to establish a framework of rules and disciplines that provide investors from NAFTA countries — Canada, the United States and Mexico — with a predictable, rules-based investment climate. NAFTA Chapter 11 also aims to provide dispute settlement procedures for investors to pursue claims and timely access to an impartial arbitral tribunal.

However, no Chapter 11 challenge brought by a Mexican or Canadian investor against the U.S. government has succeeded, so the batting average is not good, added Todgham Cherniak. Experts also believe the Volcker rule could result in significant economic consequences for Canada and the U.S.

Laurence Booth, a professor of finance at the University of Toronto's Rotman School of Management, said investors could become reluctant to buy securities they believe are going to be difficult to sell or trade without taking a financial hit.

"Anything that reduces trading, and reduces the ability

of the banks to make a market in those securities does reduce the liquidity of the bonds and increase their borrowing costs," he said.

The United States has an international reputation for being the safest and most reliable country in the world for investments. That means corporations and governments such as in Canada, the United Kingdom, Germany and France want to trade their bonds in the U.S. capital markets, said Ian Lee, an assistant professor of strategic management and international business at the Sprott School of Business at Carleton University in Ottawa.

"You want to have Canadian bonds, or any Canadian financial instrument being able to access the U.S. markets simply because it is the biggest, the broadest, the deepest. And of course that gets into the whole efficient markets

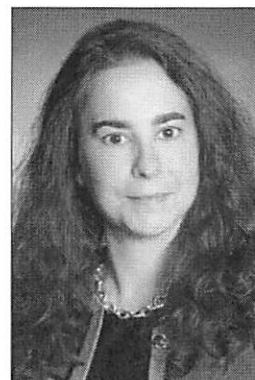
does curtail or put restrictions on the Canadian government that are unnecessary," he added, noting that Canada will feel the impact more than any other country because of how tightly knit the Canadian and U.S. economies are, along with the geographically shared border that creates other similarities.

Booth emphasized that the Volcker rule is aimed at all non-U.S. government debt, and is not specifically targeted towards Canada. He said it is basically a blanket rule to stop U.S. banks from trading in non-U.S. government securities in what is known as proprietary trading.

Lee agrees with that premise. "I believe Canada has a safer banking system, and a stronger regulatory framework for financial services ... but their argument, I'm sure, is going to be 'We're not picking on Canada. We're just passing generic rules

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TODGHAM CHERNIAK

hypothesis: the bigger the market, the deeper the market, the more liquid it is, the more efficient that capital market is," Lee said.

"Will [the Volcker rule] cause real serious harm? No. But it

that affect all countries.' And there are countries out there that, of course, are nowhere near as strong as Canada," he added.

Oliver also raised the spectre of safe Canadian banks with the securities executives in New York.

"The World Economic Forum has called Canada's banking sector the soundest in the world and that for seven years in a row. Our nation's financial institutions continue to meet global regulatory reform thresholds on time and often ahead of schedule," he said.

Booth said he doesn't believe the U.S. would want to start ascertaining which foreign securities to hold simply because they are considered lower risk. And were the U.S. to make an exemption for Canada that would open up a new can of worms about why they weren't doing so

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for other safe countries such as the United Kingdom and Germany, he added.

Moreover, while it might seem ironic that a major credit rating agency like Standard and Poor's (S&P) ranks Canada's sovereign debt at AAA, which is slightly better than the AA+ rating afforded the U.S., many experts don't place a lot of stock in the

U.S. having experienced a small credit downgrade.

"The idea that the U.S. is ever going to default is ludicrous," Lee stressed.

Credit risk isn't the only key consideration. There is also, for example, currency risk, with the Canadian dollar having slid precipitously in value over the past several months.

One might want to argue that the Volcker rule discriminates by

allowing American banks to only buy their own securities, but the U.S. would likely argue that they are a sovereign country with the right to regulate their banks as they see fit, said Lee.

"Of course, that's the whole argument behind sovereignty. Each country has the full authority to regulate as it sees fit. Having said that, trade agreements in the past 10-20-30 years, as the critics of trade agreements

have argued, have tried to curtail the degrees of freedom of sovereign governments. I actually agree with the statement. But I conclude that's a good thing, not a bad thing as the critics argue, because it curtails capricious behaviour. It curtails self-interested of MPs or Congressmen or whatever, in a particular country," said Lee.

Booth surmised there could also be a silver lining emanating

from the Volcker rule.

"It could be good for Canada," said Booth.

"U.S. investment banks are restricted from making a market and trading Canadian government securities in New York from their U.S. desks. That's not true if the Canadian banks make a market in those same securities in Toronto. So it may push some of that business back to Canada."