3. EUROPE 1992: EFFECTS ON CANADA'S FINANCIAL SECTOR

The advent of a truly unified market among the EC countries will be felt around the world. Already the growing interpenetration of economies, the globalization of markets and the development of multinational strategies are penetrating into even well-defended sanctuaries. The financial sector offers the best means for facilitating these exchanges, capital and investment flows. In fact, the unification process would have occurred even without the Single European Act, but at a much slower pace and certainly not to the same extent.

3.1 Direct Effects

Canadian banks have reduced their presence in the EC. They were once very active in Eurodollar syndicated loans and Eurodollar underwriting. In a race to accumulate revenues while paying too little attention to costs, market makers have experienced losses on deals that were too thinly priced. In 1989, Canadian banks and securities firms managed only 2 per cent of Canadian bonds issued in European markets, compared to 6 per cent in the 1970s. The network of local offices has been critically re-examined to determine its raison d'être. The Royal Bank has sold its retail facilities in France, for example, after determining it was serving a purely domestic clientele with no potential synergies with other products or cross-border services. The Toronto Dominion Bank is pulling out of continental Europe where it once held substantial assets. These assets have decreased from 50 per cent to 10 per cent of the bank's total, and in time might totally disappear. The bank has decided that profits from traditional banking activities in some countries of Europe are insufficient to cover the higher cost of capital in Canada. Only countries with high interest rates — i.e, the U.K., Australia, New Zealand and to a lesser degree the U.S. — offer returns that compare with Canada; hence the bank concentrates its European assets in the U.K. domestic market. The new capital adequacy rules dictate reallocating capital to the most profitable areas and focusing on less capital-intensive products.

Profitability is no longer being considered globally, but rather product by product to determine which activities should be developed or abandoned. Securities firms as well as banks are now selecting the niches where they are most competitive and the corresponding products that best fit their expertise.

One of the most important niches is mergers and acquisitions (M & A), for which the single market will create unlimited opportunities. The number of M & A deals is almost doubling from year to year as barriers are lifted and companies restructure in anticipation of 1992. Many small- and medium-sized companies are facing transfer problems; aging owners must organize their succession. Scores of others that lack the resources to keep up with the competition and are unable to raise additional capital must either merge or face a slow death.

North American financial institutions have a recognized expertise in M & A, particularly in very large deals. M & A deals present many advantages. They are conducted by small teams of highly skilled individuals, advising and arranging complex operations for large fees. They do not freeze any capital, and can lead downstream to very profitable financings. This is an area of natural synergy between Canadian banks and their recently acquired investment dealer subsidiaries.

Private banking is receiving renewed attention because of the constant rise in living standards, the growing number of wealthy individuals and the fast growth of savings and insurance products in Europe. The Royal Bank employs a large percentage of its staff in Europe in private banking. Royal Trust is developing