

financial conglomerate or that derive from or are closely related to the principal operations of the financial conglomerate.

RECOMMENDATIONS AND OBSERVATIONS

45. **Financial holding companies should be prohibited from engaging in non-financial activities. This general ban should not preclude allowing financial holding companies from operating subsidiaries, such as data processing units, which are designed to service the needs of the financial conglomerate or that derive from or are closely related to the principal operations of the financial conglomerate.**
46. **Non-financial institutions should be able to engage in financial activities provided they do so through a financial holding company structure. Either the financial holding company must have 35 per cent of its shares publicly traded or else all of its subsidiaries must have 35 per cent of their shares publicly traded.**

G. CONFLICTS OF INTEREST

The very nature of a financial intermediary, interposed as it is between ultimate borrowers and ultimate lenders, involves potential conflicts of interest. Thus, the conflict-of-interest issue relates to preventing abuses of such conflicts since a complete removal of potential conflicts would require the elimination of financial intermediation. In the Canadian context, the concern over conflicts of interest tends to be focussed on the potential conflicts which result when institutions attempt to become involved in cross-pillar activities. We recognize these potential conflicts, but we also believe that the within-pillar conflicts are every bit as troublesome as cross-pillar conflicts. Through regulation and standards of professionalism, Canadians have long accepted that the brokerage and underwriting functions can be co-mingled within the same industry. Until very recently, however, the British have not allowed this combination. Similarly, the Americans appear to have no trouble accepting banking and trust activities in the same institution whereas Canadians have not allowed banks to engage in trust activities.

The Committee is of the view that the combination of enhanced disclosure, effective corporate governance and the establishment and monitoring of Chinese Walls represents an adequate approach to controlling conflicts of interest. This is particularly the case since many of the new cross-pillar activities will, as discussed in the next section, probably be undertaken through separate institutions which will be subject to the supervision of the respective primary regulators.

RECOMMENDATIONS AND OBSERVATIONS

47. **The Committee is of the view that the combination of enhanced disclosure, effective corporate governance, and the establishment and monitoring of Chinese Walls represents an adequate approach to controlling abuses of conflicts of interest. This is particularly the case since many of the new cross-pillar activities will probably be undertaken through separate institutions which, in turn, will be subject to the supervision of the relevant primary regulator.**