

## CHAPTER 2

### New Challenges

#### A. Introduction

Far and away the greatest challenge and opportunity facing Canadian financial institutions and their policy regulators is the on-going globalization of financial markets. As the Economic Council of Canada noted in its recent report, *A New Frontier: Globalization and Canada's Financial Markets*, (1989), financial markets have undergone a massive transformation. In the Council's words:

When rapid change occurs on such a dramatic scale in any sphere of activity, those who had grown accustomed to the old conditions are suddenly cast into the situation of pioneers entering unfamiliar territory. They must learn to adapt quickly to the new terrain. . . . those who adjust quickly to the new frontier move forward; those who are slow to learn fall behind.

...

Canadians have entered such a new frontier—a global financial market, where innovative products have shattered the traditional ways of doing business.

...

Thus for borrowers and lenders, and for governments and regulators, there is a need to chart new terrain. For the most part, the systems needed to manage the changes have not been developed, either domestically or internationally. Until they are, Canadians will be unable to avail themselves fully of the benefits of participating in the new financial markets—benefits that will ultimately be reflected in lower costs for the production of goods and services, increased competitiveness in international markets, and higher living standards. (p. 1)

This increasing internationalization of finance is marked by round-the-clock trading, sophisticated instrumentation that can transfer risk across currencies and across time, by an increase in the number of currencies that comprise the international capital market, by the emergence of giant commercial corporations as major financial players, by the shift from commercial banking to investment banking, by the transfer of financial power from Euro-American institutions to Japanese institutions, etc.

These were the underlying forces that motivated the thrust of our 1986 Report. With even more force they are also driving our present Report. Thus while the purpose of this chapter is to focus on various post-1986 international and domestic developments as they relate to or impinge upon Canadian financial sector reform, it is important to recognize that in large measure these developments are derivative from, or subordinate to, the underlying forces of internationalization and globalization.

Nonetheless, some important recent developments on both the international and domestic fronts have combined both to complicate and to increase the urgency of Canadian financial sector reform. In terms of international developments, the implications arising from the Canada-U.S. Free