SENATE OF CANADA

CANADA 1992

Toward a National Market in Financial Services

Eighth Report

Standing Senate Committee on Banking, Trade and Commerce

Honourable Sidney L. Buckwold
Chairman

Honourable Jean-Marie Poitras
Deputy Chairman

Honourable Michael Kirby
Member, "Steering Committee"

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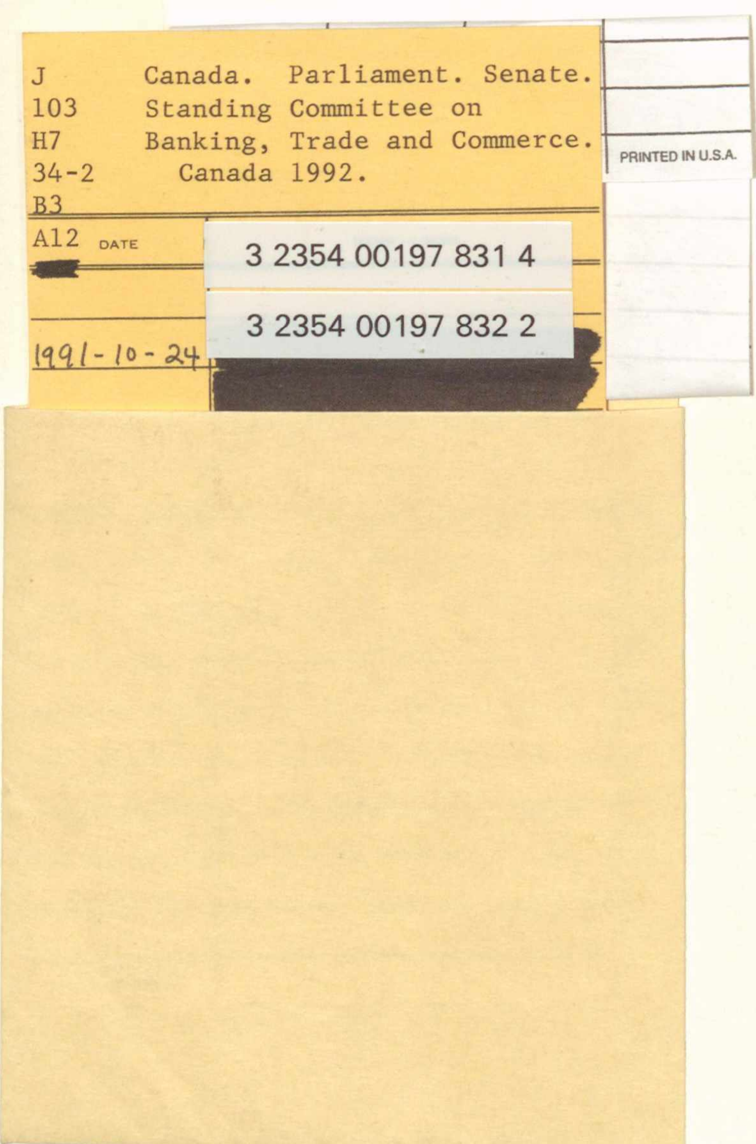
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Second Session
Thirty-fourth Parliament, 1989-90

Deuxième session de la
trente-quatrième législature, 1989-1990

SENATE OF CANADA

SÉNAT DU CANADA

Proceedings of the Standing Senate Committee on

Banking, Trade and Commerce

Délibérations du Comité sénatorial permanent des

Banques et du commerce

Chairman:
The Honourable SIDNEY L. BUCKWOLD

Président:
L'honorable SIDNEY L. BUCKWOLD

Wednesday, May 9, 1990

Le mercredi 9 mai 1990

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Study of Canadian Financial Institutions

Quinzième fascicule concernant:

Étude des institutions financières canadiennes

EIGHTH REPORT

HUITIÈME RAPPORT

MEMBERSHIP OF THE COMMITTEE

(as of May 8, 1990)

° The Honourable Sidney L. Buckwold, *Chairman*
° The Honourable Jean-Marie Poitras, *Deputy Chairman*

and

The Honourable Senators:

Anderson, Margaret
Austin, Jack, P.C.
David, Paul
Gigantes, Philippe Deane
Kelly, William M
° Kirby, Michael J.L..
* MacEachen, Allan J., P.C. (or Frith, Royce)
Marsden, Lorna
* Murray, Lowell, P.C. (or Doody, C. William)
Nurgitz, Nathan
Perrault, Raymond J., P.C.
Simard, Jean-Maurice

* *ex officio* Members

° Members, Subcommittee on Agenda and Procedure

Note: The Honourable Senators Bonnell, Bosa, Cools, Grafstein, Graham, Kolber, Leblanc *(Saurel)*, Lewis, Olson, P.C., Ottenheimer, Roblin, P.C. and Stanbury also served on the Committee at various stages during the course of this study.

Advisors:

Professor Thomas J. Courchene, School of Policy Studies, Queen's University;
Mr. Gérald A. Lacoste, Counsel, Martineau Walker, Montreal.

Research Staff:

Mr. Marion Wrobel, Senior Analyst, Research Branch, Library of Parliament;
Mr. Anthony Chapman, Research Officer, Economics Division, Research Branch, Library of Parliament.

Timothy Ross Wilson
Clerk of the Committee

ORDERS OF REFERENCE

Extract from the *Minutes of the Proceedings of the Senate*, Wednesday, October 4, 1989:

"The Honourable Senator Buckwold moved, seconded by the Honourable Senator Anderson:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to study the future of Canadian financial institutions in a globally-competitive and evolving environment and, in particular, the ownership of such institutions; and

That the Committee present its final report no later than March 31, 1990.

After debate, and -
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the *Minutes of the Proceedings of the Senate*, Wednesday, March 14, 1990:

"The Honourable Senator Buckwold moved, seconded by the Honourable Senator McElman:

That, notwithstanding the Order of the Senate adopted on Wednesday, 4th October 1989, the Standing Senate Committee on Banking, Trade and Commerce, which was authorized to study Canadian financial institutions, be empowered to present its final report no later than Monday, 30th April 1990.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the *Minutes of the Proceedings of the Senate*, Wednesday, April 11, 1990:

"The Honourable Senator Buckwold moved, seconded by the Honourable Senator Anderson:

That, notwithstanding the Order of the Senate adopted on 14th March 1990, the Standing Senate Committee on Banking, Trade and Commerce, which was authorized to study Canadian financial institutions, be empowered to present its final report no later than 10th May 1990.

The question being put on the motion, it was—
Resolved in the affirmative."

Gordon L. Barnhart

Clerk of the Senate

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The Honourable Senator Buckwold moved, seconded by the Honourable Senator Anderson:

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Resolved in the affirmative.

Gordon L. Barnhart

Clerk of the Senate

WEDNESDAY, May 9, 1990

REPORT OF THE COMMITTEE

The Standing Senate Committee on Banking, Trade and Commerce has the honour to present its

EIGHTH REPORT

In obedience to the Order of Reference of October 4, 1989 and the Orders of March 14, 1990 and April 11, 1990, your Committee has proceeded to study the future of Canadian financial institutions in a globally-competitive and evolving environment and, in particular, the ownership of such institutions; it now presents its final report.

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ACKNOWLEDGEMENTS

In October, 1989, this Committee was instructed by the Senate to study and report on the future of Canadian financial institutions in a globally competitive and evolving environment and, in particular, on the ownership of such institutions.

Over the period from late October to the end of January, the Committee heard from 26 groups of witnesses. In addition to the formal background papers associated with the hearings, the Committee received more than 40 further reports, speeches, technical papers and the like from concerned players. The Committee wishes to express its sincerest thanks for this participation and cooperation.

What follows is our Report on the future of Canadian financial institutions.

In addressing these issues and in the preparation of the Report, the Committee has been very fortunate to have the advice and assistance of Mr. Thomas J. Courchene, Professor of Economics at the School of Policy Studies, Queen's University, and former Chairman of the Ontario Economic Council; of Mr. Gérald A. Lacoste, former Chairman of the *Commission des valeurs mobilières du Québec* and presently a partner in the law firm of Martineau Walker of Montreal; of Mr. Marion Wrobel, Senior Analyst, Research Branch, Library of Parliament; and of Mr. Anthony Chapman, Research Officer, Economics Division, Library of Parliament. The foregoing were all instrumental in conducting research and drafting the Report on instructions from the Committee.

The work schedule has demanded extraordinary effort on the part of our Senate staff. The Committee gratefully acknowledges their usual cooperation and assistance. In particular, the Clerk of the Committee, Mr. Timothy Ross Wilson, must be commended for successfully coordinating the work of the support team and for his timely procedural advice.

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RECOMMENDATIONS AND OBSERVATIONS

PART I

BACKGROUND TO THE REPORT

CHAPTER 1

Highlights of the 1986 Report

A. The Underlying Principles

B. Consumer Protection and Financial Institution Stability

C. Enhancing Competition

D. Federal-Provincial Harmonization

E. Summary

1. **The Committee endorses the nine principles that underpinned the "Green Paper", our 1986 Report and, indeed, most other official reports relating to reform of the Canadian financial system: improving consumer protection; ensuring the soundness of financial institutions and the stability of the financial system; controlling self-dealing; guarding against abuses of conflict of interest; promoting competition, innovation and efficiency; enhancing the convenience and options available to consumers in the marketplace; broadening sources of credit available to individuals and businesses; promoting international competitiveness and domestic economic growth; and promoting the harmonization of federal and provincial regulatory policies.**

2. **Given the incredible pace at which financial systems, globally and domestically, are transforming, the Committee's view is that regulatory policy should place a premium on flexibility and adaptability in terms of how the Canadian financial system can respond to these challenges.**

3. **Relatedly, the overall policy framework for the financial system must encourage rather than inhibit innovation. In practical terms this means that the underlying presumption ought to be that innovations are acceptable unless they can be demonstrated to run counter to the public interest. Unfortunately, it is too often the case that the innovators themselves are called upon, at considerable cost in terms of time and money, to demonstrate that their products/processes are in the public interest. This latter**

approach assigns a degree of optimality to the *status quo* that is clearly inappropriate in a fast-changing domestic and international financial environment.

4. Finally, in spite of the fact that financial reform at the federal level is long overdue, Canadians can take pride in the achievements of our financial sector. This being the case, the Committee's approach is that, wherever possible, proposals for reform ought to work from and build upon these existing policy and institutional strengths.

CHAPTER 2

New Challenges

A. Introduction

B. International Developments

The FTA and Financial Services

- *The 10/25 Rule*

- *The Schedule II Bank Provision and the AMEX Charter*

5. The Canada-United States Free Trade Agreement (FTA) complicates financial institution reform. It may be perceived as increasing the vulnerability to U.S. takeover of non-bank, federally chartered financial institutions. Moreover, when the FTA provision relating to Schedule II banks is viewed in tandem with the AMEX charter decision (as several of our witnesses tended to view them), the resulting perception is one of more-than-equal treatment of American residents vis-à-vis our domestic banks and trusts. This introduces yet another complication in finding common domestic policy ground between the trusts and the Schedule I banks.

Europe 1992

- *Reciprocity*

- *Home Country Control/Mutual Recognition*

6. As part of Europe 1992, the Europeans are committed to creating a single market in financial services. The Committee observes that if the European Community can provide for the free flow of financial services across national boundaries, then the time has surely come for Canadian regulatory authorities to ensure that financial services can flow free and freely across provincial boundaries.

C. Domestic Developments

Recent Provincial Policy Initiatives

- *Opening Up the Securities Sector*

The Quebec Model

- *Prudent Portfolio Approach*

- *Networking Insurance*

- *Downstream Commercial Links*

The Equals Approach

7. **Several provinces including Ontario, Quebec, British Columbia and New Brunswick have updated their legislation as it pertains to trust, loan and insurance companies. This has already resulted in some switching of charters from federal jurisdiction to provincial jurisdiction. Recently, some large trusts indicated that they were considering following suit. The window of opportunity for federal legislation is rapidly closing. Any significant further delay will imply that there will likely be little left to regulate at the federal level, particularly in the trust sector.**

New Initiatives in Insurance

- *Consumer Protection*

- *Minimum capital standards*

8. **The Committee congratulates the Canadian Life and Health Insurance Association (CLHIA) for instituting its consumer protection plan and for developing its Minimum Continuing Capital and Surplus Standard for membership in the plan. The Committee notes further that this initiative represents a major step toward creating a national market for insurance products.**

Policy Harmonization Initiatives

9. **The Committee welcomes the provincial initiative to establish a Conference of Provincial Ministers Responsible for Financial Institutions. To be fully effective, the Conference should include the federal minister as a full member.**

PART II

ANALYSIS AND RECOMMENDATIONS

CHAPTER 3

The Ownership Dimension

A. **Introduction**

B. **Ownership Regimes for Deposit-Taking Institutions**

The Case for Widely Held Institutions

The Case for Narrowly Held Institutions

The Committee's Approach

- *The "Core" Recommendations*

10. **The Committee's approach is to entrench both ownership regimes for deposit-taking institutions. Both have served Canada and Canadians well, and both have more than earned the right to continued existence.**

11. **Current ownership provision for Schedule I banks should remain in place, subject to recommendations 15 through 17 below.**

12. **Stand-alone or unaffiliated trusts can be wholly owned. Trust Companies that are part of a conglomerate (commercial or financial) must, within a reasonable time of the implementation of new legislation, have at least 35 per cent of their voting shares publicly traded. The control block will be able to maintain its share of any new equity issues. If there is a financial holding company above the trust, then the 35 per cent public float can be satisfied at either the financial holding level or the trust company level.**

13. **If the upstream owner of a trust is a commercial enterprise (even if the enterprise is widely held), the provision for a 35 per cent public float will apply, as in the above recommendation.**

14. **In order to encourage new entry, the Committee recommends that newly incorporated trusts within a conglomerate will have ten years to work down to a 35 per cent public float. This provision parallels the existing provision whereby a domestic Schedule II bank has ten years to become widely held.**

- *The Bank Holding Company Route*

15. **Schedule I banks shall be allowed to reorganize their ownership structure by creating widely held Schedule I Bank Holding Companies. These holding companies must be upstream and the provisions for share ownership and the composition of boards of directors shall be those applied to Schedule I banks (e.g., the ten per cent rule for individual holdings and the 25 per cent cumulative ownership limits for non-U.S. foreigners).**

16. **The chartering of a Bank Holding Company would allow the existing shareholders of the bank to become shareholders of the Bank Holding Company. The *Bank Act* (or the Bank Holding Company Act) would deem a bank conforming to this structure to be widely held. Over the longer term, the Committee can foresee situations where the Bank Holding Company might want to own less than 100 per cent of the Schedule I bank. This should be allowed provided that shares held by persons or companies other than the Bank Holding Company meet the requirements of the *Bank Act* with respect to Schedule I banks.**

17. **The Bank Holding Company can then establish downstream commercial companies or holdings which can be wholly owned, joint ventured, etc. The commercial arm could then engage in any activity. As noted in Recommendations 44 and 45 below, there would be no asset transactions allowed (unless specifically sanctioned) between the financial and the commercial arms but networking and fee-based transactions will be permitted.**

- *Schedule III Banks*

18. **The Committee proposes the creation of a new category of bank, namely a Schedule III bank. The defining characteristic of these Schedule III banks is that they will be**

subsidiaries of financial institutions that are deemed to be widely held. Accordingly, mutual insurance companies and credit unions/caisses populaires (or their "centrals") should be allowed to convert their trust company subsidiaries into Schedule III banks or to charter new Schedule III banks. Here again, as is the case for Bank Holding Companies, the mutual or credit-union ownership of Schedule III banks may be less than 100 per cent provided that the remaining shares are held in accordance with the ten per cent rule.

19. The Committee offers the following as an observation, not as a recommendation. We have considered the possibility of utilizing a Schedule III charter as a transition category toward a Schedule I bank. Narrowly held trusts and domestic Schedule II banks would qualify for Schedule III bank status provided that on a change in ownership they sell down on a widely held basis, or else sell to an institution deemed to be widely held (mutuals, banks and credit unions). Whether this option will attract existing trusts and Schedule II domestic banks depends in large measure on the definition of what will constitute a change in ownership. The upside potential for this approach is essentially three-fold. First, if a lenient approach is taken to what will trigger the selling down of shares, then most trusts will opt for a federal charter. Second, if there is a concern about Canadian ownership of trusts this transitional Schedule III charter is an obvious solution since the only way to exit is via a widely held shareholding. Third, if the Committee's later proposals for unifying the Canadian financial market run into problems from intransigent provinces, a Schedule III bank charter will end-run any provincial barriers. As noted, however, the Committee is not sufficiently confident to make this a formal recommendation.

C. Ownership of Insurance Companies

20. Financial institutions or financial holding companies can acquire insurance companies as part of their diversification across the pillars. Either the financial institution (or the financial holding company) or the acquired insurance subsidiary must have a 35 per cent public float.

D. Ownership Diversification Across the Pillars

E. Canadian Ownership

21. The Committee endorses the principle that Canadian financial institutions should remain in Canadian hands. The procedures for ensuring that this is the case are numerous and they involve, among other items, recourse to ministerial discretion as well as recourse to the relevant provisions of of the *Canadian Ownership and Control Determination Act*. Moreover, the application of Canada's financial policy should ensure that powers granted to foreign institutions operating in Canada do not place Canadian institutions at a competitive disadvantage. With these provisions in place the Committee is confident that our major financial institutions will remain in Canadian hands.

22. The pending federal financial-institution legislation should incorporate Canadian ownership as one of the principal goals of financial sector policy and the exercise of ministerial discretion under the Acts governing financial institutions should reflect this goal.

CHAPTER 4

Powers and Networking

A. Introduction

23. The Committee embraces in principle all four approaches to financial diversification:

- **within-institution expansion of powers;**
- **subsidiaries;**
- **upstream and downstream holding companies; and**
- **networking.**

B. Expanding In-House Powers

- *Commercial Lending*

24. The Committee recommends that the present qualitative approach to the asset portfolio of trust companies be replaced by a prudent portfolio concept. It also recommends that the Bank for International Settlements (BIS) capital-adequacy rules or some appropriately modified version thereof be applied to trusts. The net effect of this will be that, for equivalent liability structures, the asset-side powers of trusts will be roughly identical to those of banks.

25. The Committee also recommends that the prudent portfolio approach be applicable to the insurance industry. We particularly welcome an updating of the insurance legislation since the term-to-maturity profile of insurance liabilities implies that this sector has a very significant role to play in the financing of longer term investment projects.

- *In-House Trust Powers*

26. The Committee proposes to expand the range of eligible fiduciary powers by permitting the direct exercise of trust powers by banks and insurance companies, with the following exceptions:

- **carrying out trusts conferred by order of a court;**
- **carrying out *inter vivos* trusts;**
- **acting as an executor or administrator under wills and bequests;**
- **acting as official guardian or tutor for, or curator of, assets.**

27. Banks and insurance companies will be able to engage in the full range of fiduciary activities through a trust company subsidiary.

28. If and when the in-house powers in Recommendation 26 cross into provincial jurisdiction, the relevant provincial registration, regulation and monitoring will apply.

29. While the Committee believes that the three previous recommendations respect provincial jurisdiction in the trust area, it notes that the Conference of Provincial Ministers Responsible for Financial Institutions agreed in principle at their August 30, 1989 meeting in Moncton that financial institutions other than trusts be prohibited from engaging in trust business except through trust subsidiaries. The Committee prefers recommendations 26-28. However, should some concessions to the provinces be deemed necessary in the context of achieving the Committee's later-enunciated goal

of a single national market for financial services, acquiescence to the provinces' demands with respect to in-house trust powers represents an acceptable trade-off.

- *Ancillary Activities for Banks*

30. The Committee recognizes that banks in particular have long lobbied to have ancillary activities such as factoring and computer services come under the definition of banking. If the federal policy and regulatory authorities feel comfortable having these financed directly or indirectly by CDIC-insured deposits, then the Committee will defer to these authorities. However, now that the Committee has recommended alternative structures, e.g. bank holding companies, for engaging in these activities, our distinct preference is for financial institutions to use these new alternatives for undertaking ancillary activities.

C. Networking

31. Networking of financial services has become a reality in Canada. The Committee fully supports this development, with two provisos. Tied selling must be prohibited and networking fees should be above board and subject to monitoring by the relevant regulator.

32. Recent federal proposals prohibited licensed sales of insurance services on bank or trust premises. The Committee suggests that this is not the most appropriate way to approach this issue. The decision to allow or disallow licensed insurance agents to operate on the premises of deposit-taking institutions rests with each of the provinces. Thus the Committee recommends that, in each of the provinces, federally and provincially chartered institutions be under the same regime in terms of on-premises sale of insurance.

33. The Committee notes that the end result of the above recommendation may well be different treatment from province to province. This recognizes the provincial prerogative in this area. What our recommendation does accomplish, however, is the levelling of the playing field, by province, for provincially and federally incorporated institutions. Thus, if Quebec allows, as it does, the caisses populaires to network insurance on their premises, this right must also be extended to federally chartered institutions such as the National Bank and Trust Général.

34. Employees of deposit-taking institutions should not be allowed to be licensed to sell insurance. There is an inherent conflict of interest here since a customer indebted to a bank, trust, or credit union can be put in a position where she/he might find it difficult to refuse an offer for insurance coverage. Therefore, the Committee recommends that federal and provincial insurance regulators come to an agreement to the effect that if a province wishes to license on-premises sales this be done via networking arrangements and not by licensing employees of deposit-taking institutions. In any event, federal legislation should prevent such licensing of employees of deposit-taking institutions.

35. All of the above recommendations relating to networking insurance are premised on the assumption that confidential customer information will not pass between the deposit-taking institution and the insurance salespersons operating in the branches of deposit-taking institutions.

36. Persons licensed to sell insurance should be allowed to place clients' funds on a networking basis with deposit-taking institutions.

D. Other Issues

37. **The Committee recognizes that the entry of BCE Inc. into the financial sector may confer a unique competitive advantage on BCE Inc. because it can combine banking and telecommunications. However, we also note that major computational and telecommunications companies in other countries are entering the financial sector. In general, the Committee's position is that if there is a concern here it is a competition policy issue, not a financial policy issue.**

CHAPTER 5

Regulatory Oversight, Self-Dealing and Corporate Governance

A. Introduction

38. **The Committee will not frame any recommendations relating to deposit insurance. This does not reflect a view on our part that all is well with deposit insurance. On the contrary, this is an area that deserves further attention, particularly since novel approaches are beginning to surface. If appropriate agencies do not take up this challenge, the Committee may well revisit the general area of deposit insurance in the near future.**

B. Corporate Governance

- *The Composition of Boards of Directors*

39. **The number of board members that may be drawn from among the officers and executives of the financial institution or its affiliates (inside directors) will be limited to 15 per cent, subject to regulatory exemption for small boards for which this constraint would be burdensome.**

40. **At least one-half of the directors will be required to meet stringent criteria establishing their independence of the corporation. These criteria include:**

- **that they are not officers, employees or significant shareholders of the financial institution or companies related to it;**
- **that they do not have significant business links with the institution or companies related to it, directly or indirectly (which includes being an officer of a significant borrower);**
- **that they do not belong to firms acting as major legal advisers to the institution; and**
- **that they are not immediately related by birth or marriage to any person in the above categories.**

41. **The above recommendation is not meant to create two classes of directors. All directors shall be required to act in good faith with a view to the best interests of shareholders, depositors and, as the case may be, beneficiaries, and they shall exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances.**

42. In view of the greater responsibilities that will be placed on directors and particularly on independent directors, comprehensive indemnification provisions will be permitted, as in the *Bank Act*, to ensure that qualified people are willing to serve in this important capacity.

43. Boards of directors of commercial companies coming under the umbrella of a Bank Holding Company can include directors or appointees of the Bank Holding Company, subject to the general provisions of established corporate practice.

- *Self-Dealing*

44. As an operating principle in terms of related-party transactions, the Committee favours an outright ban except for networking relationships and fee-based services.

45. To the extent that this ban on related-party transactions counters standard or accepted business practice, the Committee recommends that a panel composed of representatives of primary regulators, of the CDIC, of professional associations and of financial institutions be involved in drawing up a list of exceptions to this ban, including an outline of the conditions and procedures under which such transactions can proceed.

46. The role of the Business Conduct Review Committee (BCRC) is to review in advance allowable exceptions to the ban on related-party transactions, networking arrangements and fee-based services contracts. The BCRC will be charged to ensure both that these transactions do not expose minority shareholders and consumers to abuse and that they are carried out at prices that fairly reflect those which would occur in arm's length transactions.

47. The structure and operation of the BCRC will follow the guidelines incorporated in the recommendations of our 1986 Report (see Appendix A).

48. For newly chartered trusts and domestic Schedule II banks, there will be no exceptions to the ban on related-party transactions. This absolute ban will remain in place until the trusts have a 35 per cent public float and the Canadian-owned Schedule II banks become widely held and then only when the primary regulators are satisfied that appropriate corporate governance procedures are in place.

CHAPTER 6

Policy Harmonization

A. **Introduction**

B. **International Harmonization**

Foreign Bank Entry into Canada

- *The U.S. In-House Banks*
- *What is a Foreign Bank?*
- *Criteria for a Foreign Bank Subsidiary*
- *Foreign Bank Exemptions*
- *The AMEX Charter*

49. **The granting of a Schedule II charter to AMEX is perceived by some as a policy anomaly. The concern and uncertainty generated by this decision require that the Government further develop and announce its policy on foreign entry.**

50. **Toward this end, the Committee offers a few observations:**

- **We endorse the recent federal moratorium on the granting of Schedule II foreign bank charters to U.S. "corporate banks" such as Sears, GM, GE and Ford, etc.**
- **If the Committee's bank holding company approach were adopted and if, over time, the BHCs' commercial activities exceeded some significant threshold, then the federal government should be willing to re-evaluate its moratorium.**

Enhanced Canadian Access

51. **The Committee believes that far too much attention has centered on potential access to the Canadian financial market by foreign, particularlyU.S., financial institutions. The other side of the equation also merits attention, namely how to secure enhanced manoeuverability for Canadian financial institutions in foreign financial markets, and in the U.S. market in particular.**

Europe 1992

52. **Canadian policy must ensure that reciprocal arrangements with Europe are approached in a manner such that Canadian institutions are not disadvantaged relative to European institutions in the Canadian market. Relatedly, since many Canadian financial institutions have long-standing activities in the U.K., Canada must ensure that the continental European approach to financial regulation does not erect barriers to Canadian entry via the U.K.**

C Domestic Harmonization

Toward a National Financial Market

- *The Europe 1992 Model*

53. If Europeans can harmonize across national boundaries, then Canadians can surely harmonize across provincial boundaries.

- *The Royal Trust Model*
- *The Committee's Proposal*

54. The Committee's proposal for a single national financial market is built around four tenets:

- **a new consensus on key standards and principles;**
- **a federal-provincial accord on regulation;**
- **acceptance of the designated jurisdiction concept;**
- **acceptance of host-province conduct-of-business rules and consumer protection laws (the concept of "provincial treatment").**

55. Now that the BIS capital adequacy rules apply to banks in roughly a dozen countries and, within Canada, several jurisdictions are already moving in this direction, the time has surely come for all primary regulators to reach consensus on some minimum acceptable standards and principles. The Committee recommends that jurisdictions in which the policy or regulatory authorities insist on enacting more lenient rules with respect to capital or regulatory oversight shall not be eligible for CDIC coverage for their chartered institutions.

56. Responsibility for regulating prudential aspects (capital, self-dealing, etc.) and for framing basic business and investment powers will rest with the chartering jurisdiction. This is the "designated jurisdiction" concept. Provinces will designate the chartering jurisdiction to have this responsibility. The general approach to this regulatory oversight will be governed by the federal-provincial accord on regulation.

57. Provinces will be able to implement their own conduct-of-business rules and consumer protection laws. However, "provincial treatment" must prevail in the application of these conduct of business rules: institutions chartered federally or in other provinces must be accorded the same privileges as host-chartered institutions. For example, it is likely that some provinces will prevent insurance networking on the premises of deposit-taking institutions. But for provinces that do allow such networking, this privilege must be extented to all institutions, irrespective of where they are chartered.

Challenges on the Horizon

- *The Equals Approach*

58. Host-province conduct-of-business rules shall not have extra-territorial effect, that is, they shall not be applied in a way that affects operations outside the province. Ontario's "equals approach" runs counter to this principle. The Committee is optimistic that its earlier recommendations relating to self-dealing along with the

minimum acceptable capital adequacy standards and the federal-provincial accord on regulation will meet Ontario's concerns.

- *QDIC*

Encouraging Developments

59. The Committee wishes to emphasize that New Brunswick and British Columbia legislation already incorporate the designated jurisdiction concept. In terms of New Brunswick, for example, the provincial government is allowed to classify any Canadian jurisdiction (on the basis of the adequacy of its regulatory and supervisory standards) as a "designated jurisdiction". Financial institutions chartered in such designated jurisdictions will be subject primarily to regulation by their home authorities. Moreover, companies from designated jurisdictions will be exempted from the investment and business provisions of the New Brunswick legislation. This is exactly the model that needs to spread across the country.

PART III

CONCLUSION

CHAPTER 7

Toward a National Market in Financial Services

60. The Committee urges all interested parties—consumers of financial services, financial institutions, provincial governments, regulators, and the federal government—to commit themselves publicly to the eminently reasonable and critically important goal of achieving a single national financial market by 1992.

PREFACE AND OVERVIEW

The Standing Senate Committee on Banking, Trade and Commerce (henceforth referred to as the Committee) received the following Order of Reference from the Senate on October 4, 1989: "That the Standing Senate Committee on Banking, Trade and Commerce be authorized to study the future of Canadian financial institutions in a globally competitive and evolving environment and, in particular, the ownership of such institutions". In addressing these issues and in weighing the evidence and testimony brought before us, the Committee was not starting from square one. In 1985, as part of an earlier Order of Reference relating to the regulation of Canadian financial institutions, we tabled *Deposit Insurance*, an interim report containing our conclusions and recommendations on the general subject of deposit insurance. And in 1986 we tabled *Towards A More Competitive Financial Environment* (henceforth referred to as the 1986 Report), our final report on the restructuring of the Canadian financial system. We are, of course, not bound in any way to abide by our previous conclusions and recommendations, particularly since so much has transpired in the interim. On the other hand, there is also no point in abandoning them unless they were either seriously flawed initially or are no longer relevant in the context of the more globally integrated environment characterized, among other ways, by the FTA and Europe 1992. In any event, it is important to focus briefly on aspects of the philosophy and recommendations of the 1986 Report. This is especially the case given that this 1986 Report still remains one of the viable options for restructuring the financial system.

Accordingly, the first chapter will be devoted to reviewing aspects of the 1986 report, *Towards a More Competitive Financial Environment.* Only highlights will be included in the text. The specific recommendations from the 1986 Report appear as Appendix A. This will be followed by a chapter focussing on how domestic and global financial markets have evolved since the 1986 Report and in some cases how they are likely to evolve in the near future. Included here will be the impact of Canada-US free trade on the financial environment, the likely implications for our regulatory framework arising from the move to a single European Market in 1992, the recent developments in terms of provincial legislation in the trust and insurance pillars and, finally, the federal-provincial and interprovincial policy and regulatory overlaps and particularly the challenges to ensuring internal free trade in financial services now that the Europeans have shown us the way to generate free trade across national boundaries. Together, these two chapters comprise Part I, Background to the Report.

With these two chapters as backdrop and with the evidence and testimony arising from our hearings, Part II of the Report presents the Committee's analysis, views and recommendations on the evolution of the Canadian financial system. In Chapter 3 of Part II, the Committee tackles the ownership issue in all its dimensions—the ownership regime for deposit-taking institutions and for insurance companies, the ownership structures for conglomerates and, finally, approaches to enhancing Canadian ownership of financial institutions.

Chapter 4 focusses on powers and networking, where the major issues relate to the asset-side powers of the various institutions and to the potential for networking insurance services on the premises of deposit-taking institutions. Supervisory concerns, such as regulatory oversight, self-dealing and corporate governance are dealt with in Chapter 5.

The final substantive chapter deals with the evolving issues relating to policy harmonization. On the international side, the major concern is one of developing consistent policy for foreign bank entry. On the domestic side, the challenge is to create a national market for financial services.

Part III presents the Committee's concluding comments and reflections.

As will become evident, the title of the Report, "Canada 1992: Toward a National Market in Financial Services" carries with it a two-fold message. The first is, of course, a reference to Europe 1992 in terms not only of the integration of financial services in the Community but even more importantly of the Community's goal of creating a single market for financial services. Much of the thrust of the Report is to ensure that the Canadian market for financial services becomes truly national. The second, and related, aspect is reflected in our last recommendation, namely a call to all players—governments, regulators, institutions and the public—to commit themselves to a 1992 deadline for achieving the goal of a unified Canadian financial services market.

We now turn to some highlights of our 1986 Report.

PART I

BACKGROUND TO THE REPORT

CHAPTER 1

Highlights of the 1986 Report

A. The Underlying Principles

Our point of departure was to endorse the nine principles underlying the Federal Government's 1985 "Green Paper" (*The Regulation of Canadian Financial Institutions: Proposals for Discussion)*. We re-arranged these principle into three broad categories:

1. Consumer Protection and Financial Institution Stability
   - improving consumer protection;
   - ensuring the soundness of financial institutions and the stability of the financial system;
   - controlling self-dealing;
   - guarding against abuses of conflicts of interest.

2. Enhancing competition:
   - promoting competition, innovation and efficiency;
   - enhancing the convenience and options available to to customers in the market place;
   - broadening the source of credit available to individuals and businesses;
   - promoting international competitiveness and domestic economic growth.

3. Federal-Provincial Considerations
   - promoting the harmonization of federal and provincial regulatory policies;

To this list the Committee added another precept: "in a fast moving world, regulatory policy should avoid as much as possible the imposition of a preconceived structure on the financial system." At that time the Committee felt that this degree of flexibility was essential if Canadian institutions were to achieve and maintain world class status in today's competitive financial environment.

Anticipating the later analysis somewhat, the Committee still adheres to these principles or precepts but would probably add a few more, based on the evidence received. One of these would be that in any future reciprocal agreements our policy-makers ensure that powers granted to foreign institutions operating in Canada do not place Canadian institutions at a disadvantage.

A second one would be that, given the existence of the FTA and the single European market in 1992, Canada must ensure that federal-provincial and interprovincial harmonization embraces the concept that our domestic financial markets become truly national. A fragmented domestic market not only imposes costs on consumers but as well handicaps our institutions as they attempt to play in the global financial marketplace. As the title of this Report indicates, the Committee has made this principle one of the centrepieces of our analysis.

A third principle would be that our major financial institutions remain in Canadian hands. This takes on more importance today than in 1986 since, as later analysis demonstrates, the FTA has restricted our range of options in this area.

The review of the 1986 Report will follow the three general categories referred to earlier.

B. Consumer Protection and Financial Institution Stability

In the fall of 1985 and early 1986, it was probably fair to say that consumer protection and financial institution solvency and stability were uppermost in the minds of individual Canadians and policymakers alike. Indeed, the Committee was holding hearings for the 1986 Report in parallel with hearings dealing with the failures of the CCB and the Northland Bank. The challenge before the Committee was how to address these significant regulatory and solvency concerns in a manner that then allowed it to focus on the "enhancing competition" objective. In an important sense, the Committee's approach to these regulatory areas was absolutely critical to later recommendations relating to powers, networking and cross-pillar expansion.

We focused on the five key players in this area—the primary regulators, the CDIC, the auditors, the institutions themselves in terms of corporate governance (including ownership restrictions), and, finally, the consumer of financial services. The Committee's approach was that the most effective regime would be one where the roles of all five players were enhanced. In turn, it was this balanced approach that led us to reject approaches that focused on only one problem area, such as limiting ownership of all deposit taking institutions to ten per cent tranches.

Our conclusions with respect to the role of primary regulators appear in general terms in recommendations 1 through 6 in Appendix A and in more specific terms in recommendations 16 through 19. In terms of the role of auditors we simply refer readers to recommendations 20 to 24 in Appendix A.

The roles of the CDIC and corporate governance need more elaboration. In terms of the former, recommendations 7 through 15 in Appendix A summarize our conclusions. The more detailed analyses and recommendations appear in our 1985 report *Deposit Insurance*. One aspect deserves highlighting since it will play a role in the later analysis, namely the potential free-rider problem where provinces can charter and regulate deposit-taking institutions but the ultimate guarantor is the federal government, via CDIC. In our recent hearings this issue was directly addressed by the representatives of the National Bank of Canada. They argued that one of the likely reasons why there were no failures in Quebec, despite this province's greater flexibility in terms of ownership and powers for financial institutions, was that the costs of any failure would accrue to the QDIC, not the CDIC. In other words, there exists a tremendous incentive for the QDIC to ensure that provincially chartered institutions are monitored effectively and on a timely basis.

Our approach to this free-rider problem was to assert in recommendation 15 in Appendix A that access to CDIC was a privilege, not a right, so that the CDIC could refuse insurance for those provincially chartered institutions whose regulators did not meet or follow CDIC guidelines. Beyond this we recommended in recommendations 11 and 12 in Appendix A that if the CDIC deemed a provincially chartered institution to be no longer insurable, the CDIC would send in a group of

investigators/auditors to assess the likely CDIC exposure. The relevant provincial minister could, in the face of this evidence and the estimate of CDIC liability, maintain the institution as a going concern, provided that any further liabilities would be the sole responsibility of the relevant provincial government.

Now to the fourth and most controversial area—corporate governance. The Senate's 1986 report advocated a three-tiered approach to issues relating to self-dealing and, in particular, abuses thereof. The first tier was a selective ban on certain non-arms-length transactions (NALTs). This ban would vary by institution. For example, the *Trust Companies Act* already incorporates prohibitions against lending to any major shareholder.

The second tier incorporated the recommendation for a Business Conduct Review Committee (BCRC). The BCRC would be composed of "outside", "disinterested" or "independent" directors with guidelines to ensure that such directors are genuinely outside, disinterested or independent. The role of the BCRC would be to assess all NALTs and to approve only those which are consistent with market transactions in terms of price and conditions. Related-party transactions that are not approved by the BCRC could not proceed. The BCRC could have the right to retain independent counsel, auditors, evaluators and other professionals if and when the need arose.

The third tier was pre-clearance with the regulator for certain sorts of self-dealing transactions that in the normal course of events, might be approved but because of certain features or characteristics must receive regulatory pre-clearance. This is recommendation 38 in Appendix A and the recommendations relating to the first two tiers run from 25 to 37 and 39 to 42 respectively in the same Appendix.

Underlying this approach to corporate governance is the general requirement that at least 35 per cent of the voting shares of financial institutions must be publicly traded. The Committee was of the view that a public share ownership of 35 per cent was sufficient to ensure that professional financial analysts would monitor the operations of the firm and that this public scrutiny and awareness would provide an important further incentive for institutions to ensure that their BCRCs would function effectively and, indeed, would represent the interests of the public shareholders. The specific recommendations here appear as numbers 43 through 47 in Appendix A.

Observation, 48 in Appendix A notes that the Committee is satisfied that these procedures will ensure an effective supervisory and monitoring system with respect to consumer protection, institution soundness and system stability. It is this confidence that allowed the Committee to propose a rather aggressive system with respect to enhancing competition, to which we now turn.

C. Enhancing Competition

In approaching the issue of enhancing competition, the Committee embraced yet another principle. Specifically, when the regulatory or policy authorities are presented with innovative approaches to institutions or products, the presumption ought to be that these innovations are acceptable unless they can be demonstrated to run contrary to the public interest. Unfortunately, it is all too often the case that the innovators themselves are called upon, at considerable cost in terms of time and money, to demonstrate that their products or processes are in the public interest. This assigns a degree of optimality to the status quo that is clearly inappropriate in a fast-changing domestic and international financial environment. In other words, the overall policy framework for the financial system must encourage rather than inhibit innovation. Within this framework, namely that the financial system must encourage innovation, the Committee adopted a corollary principle: financial sector reform should work from, and where possible build upon, existing policy and institutional strengths.

Our overriding recommendation (number 50) in Appendix A was that subject to certain criteria and priorities, we welcomed all four general approaches to financial diversification:

- within-institution expansion of powers;
- subsidiaries;
- upstream and downstream holding companies; and
- networking.

Detailing the many recommendations in this area (51 through 74 in Appendix A) is clearly not in order. Some general comments must suffice. Basically, the Committee was in favour of full networking, as well as full ownership integration across the pillars. For institutions that were deemed to be widely held, namely Schedule I banks, mutual life companies and credit unions, they would have the freedom to wholly own subsidiaries in other pillars. For narrowly held trusts, for example, the requirement was that ownership integration across the pillar required either that the financial holding company have 35 per cent of its voting shares publicly traded or that each financial institution falling under the holding company have 35 per cent of its shares publicly traded.

In terms of narrowly held trusts, the implications were as follows. As long as the financial holding company or the trust or insurance company itself had a 35 per cent public float it could wholly own subsidiaries in other pillars, except banking. As noted earlier, if this provision was not met then each subsidiary must have a 35 per cent public float. In terms of the asset side of trust and insurance companies, we recommended the move toward the prudential portfolio approach with the restriction that a maximum of 20 per cent of assets for trust and insurance companies could be in the area of commercial lending/leasing. Further activities on the commercial/leasing side would have to be run through a Schedule II bank, which would be limited in terms of its overall size and branching.

Although not specifically formulated in terms of a recommendation, the Committee argued that for newly established financial institutions or for a change in control of an existing financial institution, all NALTs would have to be pre-cleared with primary regulators for a specified time period or until the regulators were satisfied that appropriate corporate governance procedures were put in place.

In terms of ownership of institutions within the securities pillar, the Committee recognized that since the provinces regulate this sector, the ability of federally incorporated financial institutions to buy securities firms would rest on provincial approval (recommendation 68 in Appendix A). This sort of recommendation—allowance by Ottawa if the provinces are willing—will feature prominently in the later section relating to networking of insurance.

The Committee respected the status quo in terms of banks—they should remain widely held. Because they are widely held they have the freedom to diversify fully, via wholly owned subsidiaries, across the pillars.

Finally, while ownership would be integrated, each of the core functions would be regulated by the primary regulator for that function.

D. Federal-Provincial Harmonization

From the 1986 Report:

> We believe that one of the distinguishing features of our report . . . is that our recommendations complement fully the existing federal-provincial allocation of powers and responsibilities in the Canadian financial sector. While we were cognizant at all times of the federal-provincial implications arising from these recommendations, the principal reason for working within the

existing structure, rather than in engaging in a process of constitutional or jurisdictional re-design, is our belief that the existing structure has served Canadians well.

While the Committee recognized the problem that multiple jurisdictions (vertical and horizontal) posed, it also noted in Observation 78 in Appendix A that there can also be benefits in terms of flexibility, innovative experimentation and healthy competition.

Nevertheless, the challenge was clear: the ultimate goal would be to have a structure where regulations are sufficiently compatible that markets can become national. However, regulatory coordination can only do so much in terms of ensuring this compatibility. Regulators are subject to the overall policies of their respective jurisdictions. In the final analysis it is at the policy level where the system must strive for harmonization. In the Committee's words, "for regulators to coordinate, legislators must harmonize".

Accordingly, the Committee recommended (number 80 in Appendix A) that the federal government take the initiative to establish, with the provincial governments, a Permanent Committee of Ministers Responsible for Financial Institutions. This body would be responsible for adopting a national perspective with respect to the markets in which Canadian institutions now operate. Such a global overview, as it were, is essential since the Canadian financial market is much more encompassing than the domain of any one regulator or jurisdiction.

Later in this report we shall make reference to some notable achievements in this area, but more needs to be done particularly in light of what the European Community is hoping to achieve.

E. Summary

This, then, reflects the Committee's thinking as of early 1986. However, the march of events pushes relentlessly onward, so that the perspective of 1990 is markedly different from that of 1986. Moreover, at the federal level the ownership dimension, further complicated by the FTA, has led to legislative paralysis. For these reasons, among others, the Committee is revisiting the general area of financial sector policy and structure. The following chapter outlines some elements of the altered environment.

We conclude this chapter by framing a few principles, drawn largely from our 1986 Report, that will serve as guideposts not only in terms of how we will integrate the new developments outlined in the following chapter but as well how we shall approach the evidence and testimony presented to us.

RECOMMENDATIONS AND OBSERVATIONS

1. **The Committee endorses the nine principles that underpinned the "Green Paper", our 1986 Report and, indeed, most other official reports relating to reform of the Canadian financial system: improving consumer protection; ensuring the soundness of financial institutions and the stability of the financial system; controlling self-dealing; guarding against abuses of conflict of interest; promoting competition, innovation and efficiency; enhancing the convenience and options available to consumers in the marketplace; broadening sources of credit available to individuals and businesses; promoting international competitiveness and domestic economic growth; and promoting the harmonization of federal and provincial regulatory policies.**

2. **Given the incredible pace at which financial systems, globally and domestically, are transforming, the Committee's view is that regulatory policy should place a premium on flexibility and adaptability in terms of how the Canadian financial system can respond to these challenges.**

3. **Relatedly, the overall policy framework for the financial system must encourage rather than inhibit innovation. In practical terms this means that the underlying presumption ought to be that innovations are acceptable unless they can be demonstrated to run counter to the public interest. Unfortunately, it is too often the case that the innovators themselves are called upon, at considerable cost in terms of time and money, to demonstrate that their products/processes are in the public interest. This latter approach assigns a degree of optimality to the *status quo* that is clearly inappropriate in a fast-changing domestic and international financial environment.**

4. **Finally, in spite of the fact that financial reform at the federal level is long overdue, Canadians can take pride in the achievements of our financial sector. This being the case, the Committee's approach is that, wherever possible, proposals for reform ought to work from and build upon these existing policy and institutional strengths.**

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

Trade Agreement (henceforth referred to as the FTA) are far and away the most significant, although the ramifications of the single European market will gain importance as 1992 approaches. Domestically, the challenges are probably best reflected in recent declarations by the two largest trust companies, Canada Trust and Royal Trust, that they are considering abandoning their federal charters if new legislation at the federal level is not soon forthcoming. The purpose of this chapter is to focus on various of these financial sector milestones, beginning with the FTA.

B. International Developments

The FTA and Financial Services

Financial services in the insurance area are an integral part of the FTA and, as such, are subject to the full range of provisions including, for example, the dispute-settlement mechanism. The remainder of financial services are covered in Chapter 17 of the FTA which, except for a few specified provisions, is effectively a separate agreement. In Chapter 17, there is no specific obligation on either party to accord "national treatment".

The Committee's purpose in focussing on the FTA (or more correctly, on Chapter 17) is not so much the larger issue of whether Canada gave up more than it received. On this score, it is probably fair to say that the financial community is prepared to live with the FTA and in their brief to the Committee the Consumers Association of Canada, after assessing the advantages and disadvantages, concludes that in the longer run the FTA "will most likely be beneficial to consumers". These generalizations aside, the Committee's concern here is to sort out the implications of some specific provisions.

- *The 10/25 Rule*

Among the most important provisions of Chapter 17 of the FTA is Article 1703, which exempts U.S. residents from limits on foreign ownership of Canadian federally regulated financial institutions. As applied to federally regulated non-bank financial institutions, the so-called "10/25" rule prevents any single non-resident from acquiring more than ten per cent of an institution's shares and non-residents from acquiring in aggregate more than 25 per cent of those shares. With respect to Schedule I banks, no single investor may own more than ten per cent of the shares of these institutions. This restriction, which applies to both residents and non-residents, remains intact, but U.S. residents are exempted from the 25 per cent limit on aggregate foreign ownership of the shares of any Schedule I bank. In other words, for federally regulated financial institutions, U.S. residents now have the same ownership rights as Canadians. Presumably what this means is that Americans can buy any of the large federally-chartered trusts, loan companies and insurance companies subject only to the same ministerial review that would apply to Canadians and to any legislative constraints such as those found in the *Bank Act*.

One interpretation given to all of this by many who appeared before the Committee is that the large trusts are now open to American takeover. To keep the trusts in Canadian hands, one obvious solution would be to subject them, like the banks, to the ten per cent rule.

While the Committee agrees that the FTA may have exposed the trusts to takeover, in terms of technicalities the previous paragraph is incorrect. Indeed, the Schedule I banks are the only Canadian financial institutions that could become wholly U.S. owned in the time it takes to read this report. Specifically, ten non-associated Americans could each make a bid for ten per cent of, say, the Toronto Dominion Bank. Alternatively, 100,000 Americans could also buy up the shares. No ministerial approval is required. What is true, however, is that these ten Americans (as with ten Canadians) could not vote their ownership as a block, because this would be in violation of the ten per cent rule. What ultimately keeps the Schedule I banks Canadian-controlled (which is not the same as Canadian owned) is: a) that shareholders cannot act in concert if more than ten per cent of voting shares are

involved; and b) the *Bank Act* provisions which require that three quarters of a Schedule I bank's board of directors must be Canadian citizens, ordinarily resident in Canada. Thus, what guarantees Canadian control is that Schedule I banks are management- and director-controlled.

Two further points are relevant here. The first is that the 10/25 rule still applies to residents of countries other than the U.S. The second is that Chapter 17 does not apply to provincially chartered financial institutions. Thus, Americans could not buy the Quebec-chartered arm of Royal Trustco because Quebec legislation still incorporates the 10/25 rule. This leads in a rather anomalous direction: if Canadians want to allow trusts to be narrowly held and also want to ensure that they remain in Canadian hands, the "solution" would be to have them charter provincially!

- *The Schedule II Bank Provision and the AMEX Charter*

A second significant provision is that which exempts U.S. Schedule II banks from the asset ceiling on the size of the foreign bank sector and improves the ease with which they can establish branches. This, combined with the adoption of the BIS (Bank for International Settlements) capital-adequacy standards for both Schedule I and II banks, effectively means that there are no differences in terms of powers between Schedule I banks and U.S. Schedule II banks. However, there are differences in terms of ownership structure.

U.S. Schedule II banks, like all other foreign banks, are subsidiaries of their parent banks. As stated in the foreign bank guidelines (Appendix D), foreign bank applicants are generally expected to be widely held and involved primarily in financial services, although this has not always been the case. Use of guidelines rather than legislative requirements recognizes that the situation of foreign banks is not uniform around the world. The Committee understands that roughly ten per cent of the foreign banks with subsidiaries in Canada are either commercially linked and/or narrowly held outside Canada (such as state-owned banks). Most of these are non-U.S. foreign banks. However, with the decision to allow American Express to charter a Schedule II bank, some witnesses expressed concern that Canada had fundamentally altered its policy toward foreign bank entry. Specifically, if AMEX serves as a guide, the playing field would be altered since U.S. Schedule II banks could be commercially linked whereas Canadian Schedule I banks could not. What is true is that, over the years, the application of the policy toward foreign entry has resulted in several cases where the ownership structures for the parents of Schedule II banks are less restrictive than the ten per cent rule applicable to Canadian banks. Since most of these pre-date the FTA (and most are non-U.S. foreign banks), it is inappropriate to link this to the Free Trade Agreement.

The trust companies also feel aggrieved by the AMEX decision. They argue that if a U.S. resident (American Express) can now own a bank in Canada, then similar Canadian providers of financial services should also be permitted to own a bank in Canada. The comparison that comes easily to mind is between BCE Inc. and American Express (U.S.). Both are widely held and both are commercially linked (although, to be fair, BCE Inc. is essentially involved in commerce whereas American Express is basically engaged in financial-related activities). Yet AMEX has a Schedule II bank charter which it can wholly own in perpetuity whereas BCE Inc. can only obtain a domestic Schedule II bank charter, which requires BCE Inc. to sell down to ten per cent within ten years.

There are no obvious solutions to these issues. To allow Royal Trustco, for example, to charter a bank would compound the playing field problems for the banks: both U.S. Schedule II banks and wholly owned domestic banks (if such a category were to exist) would have an ownership freedom not allowed to Schedule I banks. The obvious solution might appear to be to have only one class of Canadian bank where the only provision would be to have at least 35 per cent of voting shares publicly traded. The problem then would be that the existing Schedule I banks would be vulnerable to American takeover because of the access provided to U.S. residents under the FTA.

The Committee recognizes that as long as financial policy and financial structures differ across national boundaries, a process of bilateral or multilateral arrangements to enhance trade in financial services will inevitably lead to some situations where similarly situated Canadian firms are treated differently than foreigners. The concern with the combination of the FTA and the AMEX charter is that this unlevelling of the playing field is perceived as being one-sided. In the view of some witnesses who appeared before us, U.S. Schedule II banks have acquired more than national treatment *vis-à-vis* both the banks and the trusts.

RECOMMENDATIONS AND OBSERVATIONS

5. The Canada-United States Free Trade Agreement (FTA) complicates financial institution reform. It may be perceived as increasing the vulnerability to U.S. takeover of non-bank, federally chartered financial institutions. Moreover, when the FTA provision relating to Schedule II banks is viewed in tandem with the AMEX charter decision (as several of our witnesses tended to view them), the resulting perception is one of more-than-equal treatment of American residents vis-à-vis our domestic banks and trusts. This introduces yet another complication in finding common domestic policy ground between the trusts and the Schedule I banks.

These issues may well be further complicated in the context of Europe 1992, to which we now turn.

Europe 1992

As with the FTA, there are some larger issues associated with European financial integration that, while important to the prospects of Canadian financial institutions in Europe, are beyond our mandate. More to the point, the witnesses who appeared before us generally restricted their comments to the potential implications for the domestic financial structure. However, there were two specific issues that did arise and that merit highlight.

- *Reciprocity*

The first is related to the earlier FTA discussion and is, in fact, driven by the FTA. Specifically, in order to gain access to Europe 1992, Canada will be under substantial pressure to grant to the Europeans the same privileges granted to the Americans under the FTA, especially exemption from the asset ceiling for European Schedule II banks. It is probably fair to say that when witnesses addressed this issue they felt that this was inevitable and, in the current context anyway, not much of a concession since European Schedule II banks are well below the 12 per cent cap on domestic assets held by foreign bank subsidiaries. However, there was genuine concern on the part of witnesses that, as a result of concessions here and there, financial sector policy in Canada could end up with a substantial cumulative preference for foreign institutions. If, as a result, Canadian institutions were to lose a substantial part of their relative ability to access the domestic market, their future as international players would be bleak indeed.

Intriguingly, an issue which arose as part of this general discussion was whether Canadian regulations were, if anything, too transparent. If Canadians impose any restrictions (on ownership, for example, or on the size of Schedule II banks), these are typically up front for everyone to see. British banks are widely held, not because there are any restrictions but because the Bank of England will not give permission to any individual to hold more than 15 per cent of the shares of any bank. And on the continent, discretion plays an even larger role. It is probable that all nations will attempt to ensure that their major financial institutions remain in the hands of nationals. But few nations follow the Canadian policy of writing this down in black and white in statutes or regulations. The Committee wishes simply to register this observation.

- *Home Country Control/Mutual Recognition*

The second issue arising from Europe 1992 was by far the more important one in terms of the Committee's deliberations, namely the fact that the European Community nation states are designing a system where financial services can flow freely across national boundaries whereas Canada has trouble ensuring free trade in financial services across provincial boundaries. Several witnesses recommended that Canada adopt this emerging European model. The essential features are the concept of "Home Country Control" (the chartering nation) coupled with minimum harmonization of prudential standards and the provision for "mutual recognition" of the chartering jurisdiction by other nations. Host countries can dictate certain operating procedures but they must provide full access to foreign-chartered institutions. The Committee is emboldened by this development to press for a similar option within Canada. This will be elaborated in the later section dealing with the federal-provincial and interprovincial financial interface.

RECOMMENDATIONS AND OBSERVATIONS

6. As part of Europe 1992, the Europeans are committed to creating a single market in financial services. The Committee observes that if the European Community can provide for the free flow of financial services across national boundaries, then the time has surely come for Canadian regulatory authorities to ensure that financial services can flow free and freely across provincial boundaries.

C. Domestic Developments

Recent Provincial Policy Initiatives

A third area where the financial environment has been altered significantly since 1986 relates to the legislative programs of the various provincial governments. Several provinces, including Ontario, Quebec, British Columbia, and New Brunswick, (see Appendix B) have updated their legislation as it pertains to trust and loan companies. This has generally meant that the provinces are in the lead in terms of providing new directions for financial sector evolution. It has also meant that there has been some charter flight from federal to provincial jurisdiction in order to take advantage of updated legislation and, as noted earlier, some large trusts are now threatening to follow suit. Reform of the federal trust, loan and insurance legislation was urgent in 1986. The delay has already severely compromised federal government flexibility in this general area and it is now becoming evermore apparent that it is compromising the viability of the Canadian financial sector generally.

- *Opening Up the Securities Sector*

In November of 1986, Scotiabank signalled its intention to enter the securities industry by establishing in Quebec a full service securities firm, Scotia Securities Inc., a wholly owned subsidiary of the bank. This had rather dramatic implications. Ontario's tentative moves in the direction of deregulating its securities industry were abandoned in favour of comprehensive deregulation. In December of 1986 Ontario announced that effective July 1, 1987, restrictions on investment in securities dealers by other Canadian financial institutions would be completely removed; for foreigners, the elimination of the investment restrictions would be staged to occur with a delay of one year. One result of this Canadian "big bang" is that the Schedure I banks now own the majority of assets in the Canadian securites sector.

Intriguingly, this move of the chartered banks into the securities sector received almost no attention from the witnesses who appeared before the Committee. The only major reference came from the insurance industry. Their point was that if banks were allowed to buy insurance companies

the insurance industry would suffer the same fate at the hands of the banks as did the securities sector.

The Quebec Model

The Committee now focuses on some of the more significant developments at the provincial level. The most far-reaching of these was the Quebec blueprint for financial-sector reform introduced in 1987. Among the guiding principles were: a) the ability to integrate across the system via subsidiaries; b) the acceptance of commercial links and narrowly held positions; c) the encouragement of self-regulation; and d) the introduction of "financial links" (the ability of the financial sector to buy the commercial sector). Mr. Pierre Fortier, who was the Minister responsible for the 1987 financial-institution regulatory blueprint in Quebec, noted in his appearance before us that the model for much of this reform was the 1986 Report. Madame Louise Robic, the current Quebec Minister Responsible for Financial Institutions, recently signalled her intention to complete the reform of the Quebec financial services sector.

- *Prudent Portfolio Approach*

Quebec, and presumably other provinces as well, have introduced the prudent portfolio approach for the asset-side powers of financial institutions. This replaces the former quantitative approach for various asset categories and the "legal for life insurance" approach for the asset portfolios of insurance companies. There is no neat and tidy definition of a prudent portfolio. The Quebec legislation on trust and savings companies (1987) utilizes the following wording: "Every company shall, in exercising its loan and investment powers, act as a prudent and reasonable person would act in similar circumstances, honestly and faithfully and in the best interests of the shareholders, the depositors and, as the case may be. the beneficiaries." Among other things, what is prudent will obviously depend upon the term structure of the institution's liabilities. In any event, the Committee not only welcomes these initiatives but will later recommend that the prudent portfolio approach be applied to all financial institutions.

- *Networking Insurance*

More intriguing is Quebec's decision to allow the Caisses populaires Desjardins to network insurance in their branches. The insurance salespersons must be regulated by the insurance pillar and, in the case of the Caisses populaires, must be employees of the insurance subsidiary, not of the caisses. This provides an interesting and valuable experiment, particularly since the federal Blue Paper and, later, the 1987 federal draft legislation for loan and trust companies opted to ban the networking of insurance through bank and trust branches.

However, it "unlevels" the playing field along provincial lines. For example, whereas all banks that appeared before us want to network insurance, the concern is most urgent for the National Bank which competes head-on with the Mouvement Desjardins. The Committee will tackle this issue later in the report.

- *Downstream Commercial Links*

The final area where Quebec is innovating is in terms of embracing an integration of finance and commerce. In particular, Quebec has taken steps to permit the financial sector to establish links with the commercial sector. At the federal level, the major policy debate has been centred around upstream links—who can own financial institutions and in particular deposit-taking institutions. The Quebec legislation already accepts that financial institutions can be both narrowly held and commercially linked and it is now proposing that, downstream, the financial sector ought to be able to own the commercial sector. This issue will also be addressed later in the report.

The Equals Approach

All is not commendable in terms of provincial initiatives. In April 1988, Ontario introduced the "equals approach" as part of the legislation to revise the *Loan and Trust Corporations Act*. Under this approach, a trust company which operates in Ontario is, for certain activities, subject to Ontario regulation and supervision in all its operations (including those in other provinces) even if it is incorporated under federal law or the law of another province. While the Committee sympathizes with Ontario's ultimate goal, namely the province's desire to protect its citizens from the potential costs of financial-institution failure arising from more leniant rules in the chartering jurisdiction, it opposes the extraterritorial reach of the equals approach.

Canadians have a long tradition of vigorously opposing U.S. legislation that applies extra-territorially in Canada. Surely we cannot countenance this sort of legislation within our boundaries. One of the Committee's challenges will be to accommodate concerns like Ontario's without fragmenting the national market for financial services.

This completes our selective survey of provincial initiatives. Detail relating to other initiatives appears as Appendix B ("A Chronology of Selected Financial Policy Initiatives since May 1986").

RECOMMENDATIONS AND OBSERVATIONS

7. Several provinces including Ontario, Quebec, British Columbia and New Brunswick have updated their legislation as it pertains to trust, loan and insurance companies. This has already resulted in some switching of charters from federal jurisdiction to provincial jurisdiction. Recently, some large trusts indicated that they were considering following suit. The window of opportunity for federal legislation is rapidly closing. Any significant further delay will imply that there will likely be little left to regulate at the federal level, particularly in the trust sector.

New Initiatives in Insurance

- *Consumer Protection*

From the Committee's 1985 Report, *Deposit Insurance*:

Recommendation 25

. . . the Committee encourages the Canadian Life and Health Insurance Association to develop its own consumer protection plan. However, should [the industry] wish at some point in the future to become associated with the CDIC [it] should have the opportunity. In such a case [the industry] would enter with a separate pool and would be allowed to appoint a representative to the CDIC's Board of Directors.

The Committee is pleased to observe that the CLHIA has carried forward its intentions in the consumer protection area. In 1988, a federally incorporated private company—the Canadian Life and Health Insurance Compensation Corporation (CompCorp)—was established to administer its pending consumer protection plan.

While the option of associating with the CDIC is probably no longer relevant, the CompCorp coverage limits appear to be set with CDIC limits in mind. Under CompCorp there are three separate classes of insurable policies, each with its own limits:

Class A: In this class are policies providing life insurance protection and policies providing for the accumulation of money. These include accumulation annuities, registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs). The limits for this class are:

- $200,000 life insurance protection
- $60,000 in cash withdrawal for policies registered under the *Income Tax Act* such as RRSPs, RRIFs and pension policies
- $60,000 in cash withdrawal for non-registered policies (including life insurance cash values).

Class B: In this class are life annuity and disability income policies with no option of a lump sum, cash withdrawal. The limit for this class is:

- $2,000 income per month

Class C: In this class are health benefits, other than disability income annuities. The limit for this class is:

- $60,000 in total payments.

- *Minimum capital standards*

Before CompCorp can come into operation, governments must have in place solvency standards that companies would have to meet and that could be used to monitor their solvency status. Toward this end, the CLHIA developed a Test Formula for a Minimum Continuing Capital and Surplus Standard (MCCSS). If an insurance company's total capital and surplus were to compromise this MCCSS requirement, it would become subject to various restraints and controls on its operation. And if it fell below the MCCSS, it would become ineligible for future coverage under CompCorp.

Over 95 per cent of the industry has now "signed on" to these standards for minimum continuing capital and surplus requirements and the Committee has been led to believe that most if not all of the regulators, federal and provincial, are also on side.

This is a significant development since it represents a critical step in integrating insurance services into a single national market. But the system is not quite there yet. The MCCSS represents minimum standards for participating in the industry's insurance protection plan. Several regulators, the federal government included, do not view these Minimum Continuing Capital and Surplus Standards as fully adequate, of and by themselves, for prudential regulatory purposes. However, the process of converting the MCCSS into an insurance equivalent of the BIS standards involves the same general focus and the same methodology so that there is room for considerable optimism that the minimum regulatory and supervisory standards needed to underpin a single national insurance market can be developed.

RECOMMENDATIONS AND OBSERVATIONS

8. The Committee congratulates the Canadian Life and Health Insurance Association (CLHIA) for instituting its consumer protection plan and for developing its Minimum Continuing Capital and Surplus Standard for membership in the plan. The Committee notes further that this initiative represents a major step toward creating a national market for insurance products.

Policy Harmonization Initiatives

While one of the principal messages of this Report will be the need to ensure a free flow of financial services across provincial boundaries, the Committee notes that some important recent steps have already been taken in this direction. We highlight only two. The first is related to the potential regulatory problem arising from the purchase of securities firms by federally regulated institutions. Regulatory overlap was minimized via accords between the federal Office of the Superintendent of Financial Institutions (OSFI) and the provincial regulatory authorities in Ontario, British Columbia and Quebec. Some problems remain, but the view expressed by the Conference Board of Canada in its brief is that appropriate mechanisms to deal with them are in place and that no major structural change, such as the establishment of a National Securities Commission, is likely.

The second initiative is the establishment of the Conference of Provincial Ministers Responsible for Financial Institutions. This Conference grew out of the Information Sharing Agreement signed by the four western provinces in October, 1988. In December of 1988, the first full provincial Conference was held in Quebec City, the second meeting of the Conference was held in Vancouver in April of 1989 and the third in August of 1989 in Moncton. The Committee agrees with the view incorporated in the Information Sharing Agreement, namely that the exchange of draft policies and legislation facilitated under the Agreement is a significant development in promoting cooperation in the formulation of policy and legislation for the financial sector and will contribute substantially to the process of intergovernmental policy coordination.

In our 1986 Report we called for the establishment of a Permanent Committee of Ministers Responsible for Financial Institutions (see Recommendation 80, Appendix A). While the on-going provincial initiative is obviously a welcome one, it has one glaring defect, namely that the federal government is not a full member. The Committee is pleased by the recent announcement that the provincial ministers have invited the federal minister to join their group.

RECOMMENDATIONS AND OBSERVATIONS

9. **The Committee welcomes the provincial initiative to establish a Conference of Provincial Ministers Responsible for Financial Institutions. To be fully effective, the Conference should include the federal minister as a full member.**

At the international level, there have also been several important developments that will foster increased coordination and harmonization. The most obvious are the Bank for International Settlements' (BIS) capital-adequacy rules, which establish international norms for banks in Canada and eleven other signatory countries. The BIS rules, or variants thereof, will likely become more widespread. For example, trust companies competing in the global marketplace will be under increasing pressure to adopt such rules.

The International Organization of Securities Commissions (IOSCO) has been expanded in recent years to include securities regulators from around the world. The organization has set up working groups to study a number of important questions including the international coordination of prudential supervision of the securities industry. One of these groups has agreed on a common approach to assessing the capital adequacy of firms engaged in securities activities.

Progress has also been achieved in terms of bilateral securities agreements involving Canada. The U.S. Securities and Exchange Commission has entered into agreements with its counterparts in Ontario, Quebec and British Columbia to share information and to take evidence with respect to alleged wrongdoing in the other state. The U.S. Commission has also reached a reciprocal prospectus agreement with Canadian securities commissions.

Finally, as alluded to earlier in this chapter, the movement toward the creation of a single European market involves very substantial policy and regulatory coordination among the various European nations.

PART II

ANALYSIS AND RECOMMENDATIONS

CHAPTER 3

The Ownership Dimension

A. Introduction

With this chapter, the Committee embarks on the challenging process of addressing the various issues, weighing the relevant trade-offs and, most importantly, coming to decisions in the form of recommendations for the evolution of the Canadian financial sector. In addition to background material in Part I, the primary inputs into the Committee's deliberations are the evidence, testimony and background papers of the many witnesses who appeared before us. However, the Committee, through its Chairman, has also received a substantial number of position papers, technical documents and speeches on issues relating to our mandate and deliberations. These too form part of the input into the process. A complete list of these background documents appears as Appendix F to the Report.

In the normal course of events, the ideal way to proceed would be to follow the format of our earlier report—focussing first on consumer protection and solvency issues followed by an elaboration of powers and competitive concerns and, finally, addressing the harmonization issues. However, because of the overwhelming role that ownership considerations played in our deliberations and because the ownership issue was prominent in our mandate, the first priority of the Committee has to be that of sorting out the many facets of ownership. This is the purpose of the present chapter. The following chapter will focus on the powers of financial institutions, including networking opportunities. Chapter 5 then turns to supervisory issues where corporate governance and self-dealing concerns will loom large. The final chapter of Part II will address policy harmonization issues—international, federal-provincial and interprovincial.

In terms of the present chapter, the first issue to be addressed is the appropriate ownership regime or regimes for deposit-taking institutions (essentially trusts and banks). The Committee's analysis and recommendations in this area will constitute most of the chapter. Since our 1986 Report, a new issue has assumed policy centre-stage—whether deposit taking institutions should be allowed to own insurance companies. Addressing this question constitutes the second part of the chapter. The third section effectively generalizes the earlier ownership recommendations in terms of how each of banks, trusts, insurance companies and conglomerates are able to diversify across the pillars. The concluding section will focus on aspects of Canadian ownership of the financial sector.

B. Ownership Regimes for Deposit-Taking Institutions

Prior to presenting recommendations with respect to the ownership regime for deposit-taking institutions, the Committee attempts to summarize the cases for both widely held and narrowly held ownership structures. (The existing ownership structure across all pillars is summarized in Table 1). We recognize that this is a delicate endeavour and that our attempts at summary positions will inevitably be viewed as biased or lacking nuance. Nonetheless, the effort needs to be made, particularly since the opposing cases have been presented much more cogently than was the case for our last report. We begin with aspects of the argument as presented to us for the ten per cent rule.

The Case for Widely Held Institutions

While the case for the ten per cent rule was articulated in five separate appearances by representatives of the banking establishment (the Canadian Bankers' Association and four bank chairmen) and also by other witnesses including the Governor of the Bank of Canada, the most convenient reference point is a letter to the Prime Minister dated September 20, 1989, signed by the chairmen of the six large Schedule I banks and tabled before the Committee by the National Bank Chairman, André Bérard on January 29, 1990. The letter was triggered by the bankers' "deep concern with what appears to be emerging government policy on the ownership of deposit-taking institutions", specifically the "government's apparent intent to back away from the previously announced policy that would require major deposit-taking institutions in the trust industry to be widely held". In very summary fashion, but frequently in the bankers' own words, the elements of the overall case are as follows.

First, the requirements for broad ownership of banks were originally introduced in 1967 because of fears about foreign domination of banks. With the FTA and the removal of the 10/25 rule, any American resident would be free to become the owner of an existing federally incorporated trust company. If the ten per cent rule as applied to banks were to be applied to trusts as well, this would ensure that control of the trusts remained in the hands of Canadians.

Second, if the government backs away from its previously announced ownership policy, Canada will be the only major jurisdiction in the industrialized world to explicitly sanction concentrated ownership for a major component of its nation-wide deposit-taking industry.

Third, broad ownership has come to be recognized as the most effective safeguard available against self-dealing or the misuse of depositors' funds. The recent spectacle of the savings and loan industry failures in the U.S. is a convincing demonstration that a permissive policy on ownership can bring grave fiscal consequences. This is the traditional argument in favour of the ten per cent rule: the incentives for abusive self-dealing, particularly if the narrowly held ownership is commercially linked, are ever present and even the most sophisticated system of supervision and corporate governance may not be able to prevent misuse of depositor's funds. Once the abuse takes place, it is typically impossible to undo the damage. Wide ownership is an effective way to guard against owner self-dealing.

The banker's fourth point relates to the possibility of credit denial to customers that are in competition with the range of activities of the narrowly held owners of deposit-taking institutions.

The fifth concern relates to the role of deposit insurance in encouraging more risky asset portfolios. In part, this interacts with the earlier potential for ownership self-dealing. In part, however, it is an issue on its own merits, one that will be addressed briefly in Chapter 3 below.

The sixth aspect is the most novel. The reference point is a table (reproduced here as Table 2) presenting asset values for selected years and growth rates over 1983-88 for the five largest trusts and

the six big banks. From this, the bankers draw two conclusions. The first is that the trust companies are very large institutions, especially if ETA (Estate, Trust and Agency) assets are included. This relates to the earlier comment that Canada is unique in the industrialized world in terms of allowing institutions with concentrated ownership to access deposits since all five trusts are narrowly held, although in the case of Montreal Trust the holding company (BCE Inc.) is widely held.

The second general conclusion the bankers draw from Table 2 is that the narrowly held trusts have been growing very rapidly, due in part to acquisitions, and that in the future the trusts will likely continue to grow much faster than the banks if the former remain narrowly held. This last point apparently has to do with the perceived benefits of narrow ownership in terms of access to capital and shareholder interest. Under such a dual ownership regime some banks would eventually be forced to "look beyond the *Bank Act* for avenues to widen their ownership freedom and avoid the loss of investor interest". The bankers conclude by posing the following questions:

> Do you believe that unrestricted shareholding is important to ensure the international competitiveness of Canadian financial companies? If this is so, then fairness and competitive equity requires that the same advantages be available to commercial banks. On the other hand, if you do not believe that less restrictive ownership rules proposed for trust companies convey a long-term competitive advantage, then, in the absence of any public policy advantages, these companies should not be permitted to be narrowly held since there are clear disadvantages to narrow ownership.

In terms of how the policy authorities ought to introduce wide ownership for trusts, the bankers focus on the potential role for the CDIC. Essentially the CDIC would enforce a ten per cent rule for non-banks (or else no insurance coverage), coupled with generous "transitional" provisions for those institutions that currently exceed the ten per cent ownership limit. It is not fully clear what "generous" means. The bankers recognize that in the case of the major trust companies, where management is professional and the owners are well known, the risk of abusive self-dealing seems slight. Concern seems to attach to future generations of owners, in which case one interpretation of a generous transition period might involve a required selling down to ten per cent upon any change in ownership. Finally, the bankers add that small trust companies could be closely held up to some threshold size in order to facilitate new entry, particularly new entry of regional institutions.

Thus the ten per cent or bank-model approach to deposit-taking institutions would impose widely held ownership on all CDIC-insured institutions, with some special provisions for small institutions. A polar version of this model would have the closely held trusts sell down to ten per cent over a specified period, e.g. five years. A variant more respectful of the status quo, and one hinted at by the bankers, would provide for the transition "through means other than outright divestiture" which could imply, for example, that any new share issues would be on a widely held basis.

Leaving comments until later, the Committee now reviews the arguments for a less restrictive ownership structure.

TABLE 1

EXISTING OWNERSHIP RULES FOR FINANCIAL INSTITUTIONS

	Canadians	Foreigners	Americans* after FTA
Banks			
1. Schedule I banks	10% max. shareholding for individuals	10% max. shareholding by individuals aggregate limit of 25%	same as for Canadians
2. Schedule II banks			
foreign	N/A	wholly owned	same as for foreigners
domestic	can initially be wholly owned but must be widely held in ten years	N/A	N/A
Trusts			
new trusts	no restrictions**	no restrictions in principle (but legislative moratorium)	same as for foreigners
existing trusts			
federal	no restrictions***	10/25	no restrictions***
provincial	no restrictions	10/25****	10/25****
Insurance			
(same as trusts) +			
Securities	no restrictions	no restrictions + +	no restrictions + +

* Americans were treated as foreigners prior to the FTA.

** Can be subject to ministerial approval.

*** May incorporate "big cannot buy big" provision.

**** Provinces need not put controls on, but they are allowed to do so. Some provinces do.

\+ Except that, for new foreign and American entry, there is greater flexibility (e.g. a foreigner can enter via a branch or subsidiary).

\+ + Could be subject to foreign bank rules.

TABLE 2

Growth of Major Financial Institutions

Total Assets, including Assets[1] under Administration (Billions of Dollars)

	1983	1987	1988	Average Annual Growth Rate
ROYAL TRUSTCO LIMITED				
Corporate Assets	10.6	24.5	28.5	
Estate, Trust, and Administration	32.8	59.2	68.2	
Total Assets	43.4	83.8	96.7	17.5%
CT FINANCIAL SERVICES INC.				
Corporate Assets	10.2	25.5	29.2	
Estate, Trust, and Administration	36.5	60.6	67.4	
Total Assets	46.7	86.1	96.6	15.7%
MONTREAL TRUSTCO INC.				
Corporate Assets	2.0	7.7	10.2	
Estate, Trust, and Administration	17.3	28.0	33.6	
Total Assets	19.3	35.7	43.8	17.9%
NATIONAL VICTORIA & GREY TRUSTCO LIMITED				
Corporate Assets	3.3	10.9	12.2	
Estate, Trust, and Administration	11.6	26.9	27.4	
Total Assets	14.9	37.8	39.6	21.5%
GENERAL GUARANTY TRUST CO.				
Corporate Assets	*	9.9	13.6	
Estate, Trust, and Administration	*	8.6	9.7	
Total Assets	*	18.5	23.3	*
ROYAL BANK OF CANADA	84.7	102.2	110.1	5.5%
CIBC	68.1	88.4	94.7	6.9%
BANK OF MONTREAL	63.2	84.2	78.9	4.7%
BANK OF NOVA SCOTIA	54.8	71.4	74.7	6.5%
TORONTO-DOMINION BANK	42.5	54.5	59.3	6.9%
NATIONAL BANK OF CANADA	17.8	30.0	30.9	11.5%

*Comparative figures not available

Source: Company Annual Reports

(1) For both trust companies and banks, includes assets of mortgage loan subsidiaries

[Copied from the Canadian Bankers Association submission]

The Case for Narrowly Held Institutions

The case for narrowly held institutions, or more precisely the case for a flexible ownership regime, was presented by four representatives of the trust industry (the Trust Companies' Association and officers of the owners of three of the big trusts) and by several other witnesses, such as insurance representatives. The Committee will focus on the points emphasized by the trust companies.

The trust companies generally begin their case by noting that an ownership rule (such as ten per cent) can indeed play a role in minimizing concerns such as self-dealing and foreign takeovers, but that the competitive costs of using this instrument for these ends would simply be too high. Far better to attack the problem directly, via self-dealing bans, more effective corporate governance, enhanced supervision and disclosure and the like. Alternatives presented to the Committee ranged from Royal Trust's Business Conduct Review Committee, to the undertakings assumed by Imasco and Canada Trust, and to the recent BCE Inc. by-law under which Montreal Trust will not have any dealings with any of the BCE Inc. subsidiaries or affiliates except for the provision of what is called fee-based services.

In addition, BCE Inc. Chairman, Raymond Cyr provided another perspective:

> ... for any financial institution, access to capital is the single most important factor in ensuring solvency, growth and competitiveness. I think that is one of the things we bring to the table—access to capital. We have seen in the past a number of circumstances in financial institutions where access to capital has been the one criterion that has determined whether the institution survived or not. The ownership structure of those Canadian institutions that have failed was never the real criterion—access to capital in time of crisis is the most important factor in ensuring the solvency of financial institutions.

The trust companies also argued that the formal ten per cent rule is not critical in terms of ensuring Canadian ownership. While most countries want to retain control by nationals over their deposit-taking institutions, hardly any of them go about it by means of a ten per cent rule. Rather, virtually every western nation has in place a provision whereby no one can buy more than ten or 15 per cent of a federal (or national) financial institution without the express approval of the Minister. Since Canada also has this provision in place there is no need for a legislated ten per cent limit to control foreign ownership.

These points are defensive in that they argue against the imposition of a widely held ownership regime applicable to all deposit-taking institutions. There is also a positive side to the trust companies' case which is probably captured best by a quotation from the brief of the Trust Companies Association:

> If our financial institutions are to be able to survive and compete in a global market, they will need access to enormous amounts of capital. A restrictive ownership regime will make it more difficult for institutions to raise this capital. Prohibiting significant, controlling commercial investment in the financial sector will impede both new entry into the industry and the growth of our domestic financial institutions. The prohibition would also have the effect of forcing Canadian commercial capital offshore to more hospitable investment climates. Yet at the same time, the domestic financial services market will be increasingly penetrated by foreign institutions, and by large non-financial commercial enterprises [that are] foreign owned.
>
> ... We will see foreign institutions and large commercial non-financial enterprises tapping into retail financial markets, offering attractive new financing vehicles for the aging "baby boomers", who will tend to focus their activity on the savings end of the market for their retirement years. The Ford Credits, the General Motors Acceptance Corporations, the GEs of

this world, will be major players in the future in retail financial markets. Our traditional financial institutions could become largely irrelevant in this environment, if their access to capital and their growth are constrained by restrictive ownership rules.

A final point made by the trusts is to note that, over the last decade, the big narrowly held trusts have not been a drain on either the CDIC or the federal treasury. Small trusts in Ontario and elsewhere have failed and saddled the CDIC with substantial losses. So have some small widely held banks, including some that merged. While the large banks have not drawn upon CDIC funds, the reserves that they have built up against the poor performance of their third-world loan portfolio have cost the federal treasury many times the value of the small trusts' CDIC losses. In his appearance before us, Mr. Ronald McKinley, Chairman of the CDIC, estimated that there were about $650 million in losses to the corporation that can be attributed to widely held institutions as a result of either failure or re-organization of four banks. Failures of narrowly held institutions resulted in CDIC losses of just under $1.1 billion.

This is in contrast to the $15 billion of third-world debt that was gradually written off ("reserved against" is the technical term since the debt need not be written down). Since these reserves are treated as losses for tax purposes, the cost to tax payers is substantial. While these figures are not strictly comparable, they do indicate that widely held institutions can also impose significant revenue losses on the federal government.

On the basis of this evidence, the Trust Companies Association concludes that the typical policy proposals for trusts—wholly owned up to a certain size threshold and then moving toward wide ownership—run in a perverse direction: it is the small trusts, normally linked to real estate, that pose the major solvency problem, not the large trusts.

The model preferred by the trusts would be a Schedule III "trust-bank", which would, from their perspective, remove them from the myriad of barriers arising from the lack of federal/provincial and interprovincial harmonization. In addition, if AMEX is a bellweather then a Schedule III bank would put the trusts on an equal footing with the U.S. Schedule II banks that can be commercially linked. These trust banks could be held by a controlling shareholder in perpetuity as long as 35 per cent of voting shares are publicly traded. Under this model, corporate governance and supervisory rules would be much more strict than for widely held banks. The position of the trusts, as reflected in their testimony, is that the Schedule I banks would be granted in-house trust powers and they could remain widely held if they wished or could opt for a Schedule III charter or, presumably, anything in-between. Under this proposal, most trust companies would remain under, or seek to come under, federal control. This trust-bank (or bank-trust) status would not be an incursion into the provincial domain since ETA (estate, trust and agency) activities would still have to be provincially licensed and monitored, in much the same way that federally chartered Trust Général must comply with Quebec regulations for its ETA activities. Again, these are the views of the trust companies, not of the Committee.

The Committee's Approach

● *The "Core" Recommendations*

The Committee rejects both polar models. We are not in favour of narrowly held domestic institutions attaining bank (or trust-bank) status, although we recognize the potential unlevelling of the playing field with respect to the foreign Schedule II banks. Likewise, following our earlier recommendation/observation that no single structure should be imposed on the evolution of the Canadian financial system, we do not accept the bankers' approach that all deposit-taking institutions be widely held.

While it is not our intention to compare and evaluate the two positions, a few comments are warranted. We are not very taken by the bankers' fourth point relating to credit denial. The

Canadian financial system is simply too competitive and extensive for this to be an important factor, apart from the obvious point that this would represent poor business practice on the part of any institution. Second, while the Committee recognizes that self-dealing played a role in the U.S. Savings and Loan debacle, there were also other factors such as fraud and the mismatching of portfolios caused by deregulation of interest rates. Third, the Committee questions the wisdom of utilizing the CDIC as the vehicle for enforcing a particular ownership regime. In practice, the presence of the QDIC (Quebec Deposit Insurance Corporation) will mean that Quebec would likely go its own way on ownership whereas none of the other provinces could, unless provinces like Ontario dust off their earlier proposals for embarking on their own deposit-insurance schemes. Finally, in terms of the bankers' points, the Committee has already recognized that the FTA complicates the Canadian ownership dimension of federally chartered trust and non-mutual insurance companies.

The Committee is somewhat skeptical of the trust companies' view of the likely evolution of retail banking, but does not wish to engage in any forecasting exercise. We recognize the role that access to capital in times of crisis can play in terms of solvency, but we question whether differential capital access for large trusts and banks is a major source of competitive inequality in the current environment.

In general, then, the Committee has concluded that both types of institutions (and ownership structures) have served Canada and Canadians well. Both have more than earned the right to continued existence. This said, the Committee does recognize that there are important aspects of the playing field with respect to trusts and banks that are not level. However, the Committee's firm view is that this relates far more to powers than to ownership. We shall address this later in the chapter. For the present, our message on ownership is that the time has come for one and all to accept both structures and to get on with the process of financial system reform.

Thus, the Committee's approach is to entrench both ownership regimes. The implications for corporate governance and controlling self-dealing for these alternatives regimes are dealt with in Chapter 5 below. Accordingly:

RECOMMENDATIONS AND OBSERVATIONS

10. The Committee's approach is to entrench both ownership regimes for deposit-taking institutions. Both have served Canada and Canadians well, and both have more than earned the right to continued existence.

11. Current ownership provision for Schedule I banks should remain in place, subject to recommendations 15 through 17 below.

12. Stand-alone or unaffiliated trusts can be wholly owned. Trust Companies that are part of a conglomerate (commercial or financial) must, within a reasonable time of the implementation of new legislation, have at least 35 per cent of their voting shares publicly traded. The control block will be able to maintain its share of any new equity issues. If there is a financial holding company above the trust, then the 35 per cent public float can be satisfied at either the financial holding level or the trust company level.

13. If the upstream owner of a trust is a commercial enterprise (even if the enterprise is widely held), the provision for a 35 per cent public float will apply, as in the above recommendation.

14. In order to encourage new entry, the Committee recommends that newly incorporated trusts within a conglomerate will have ten years to work down to a 35 per cent public

float. This provision parallels the existing provision whereby a domestic Schedule II bank has ten years to become widely held.

These recommendations are close to those contained in our 1986 Report, with the exception that we are no longer recommending that trusts have the option of chartering a narrowly held Schedule II bank, limited in terms of both size and branches. In large measure, this is because the Committee will, in Chapter 4, recommend expanded commercial lending powers for trusts. The option still remains for trusts to charter a domestic Schedule II that must become widely held in ten years.

- *The Bank Holding Company Route*

The Committee recognizes that this set of "core" recommendations does not level the playing field as it relates to the ownership of deposit-taking institutions. It is not possible to level this playing field without eliminating one or the other of the existing sets of institutions. More to the point, the Committee has come to the view that the critical level-playing-field concern relates to powers, not to ownership. While the banks did argue that allowing narrowly held trusts might place them at a disadvantage in capital markets, nowhere in their testimony did they point to problems in terms of access to capital. However, time and time again reference was made to the fact that other financial institutions, domestic and foreign, were able to engage in activities not permitted to them under their bank charters. Some of these concerns will be highlighted in Chapter 6 below.

One way to address this legitimate concern is to enhance bank powers in terms, say, of expanded in-house powers or of the range of downstream subsidiaries that they are allowed to acquire. For some activities, this is the obvious route to follow. For others, however, it may result in the extension of the definition of banking (and financing them directly or indirectly via insured deposits) well beyond what is appropriate. Moreover, levelling the playing field for every new activity will likely require something akin to a continuous revision process for the *Bank Act*. This is simply not practical.

An alternative approach is needed. The Committee's view is that this alternative is the Bank Holding Company (BHC). Since the BHC proposal is among the most significant recommendations of this Report, the concept merits elaboration. After presenting some underlying objectives of the Bank Holding Company structure and the specific BHC recommendations, the Committee then engages in a discussion of some of the implications that flow from such a structure.

The objectives of a Bank Holding Company structure include the following:

- to enhance the competitive position of banks by designing a structure to allow them to engage in certain activities, such as travel insurance, factoring, acquisition of computer servicing companies, etc., that their competitors can now do;
- to accomplish this in a manner that does not compromise the ability of regulators to isolate the core "banking function" and thus to protect depositors. Phrased differently, those ancillary activities that are deemed to be beyond the limits of banking will not be able to be financed by insured deposits; and
- to retain wide ownership so as to reduce the risk of self-dealing and to ensure that control remains in Canadian hands.

The Committee therefore recommends:

RECOMMENDATIONS AND OBSERVATIONS

15. Schedule I banks shall be allowed to reorganize their ownership structure by creating widely held Schedule I Bank Holding Companies. These holding companies must be

upstream and the provisions for share ownership and the composition of boards of directors shall be those applied to Schedule I banks (e.g., the ten per cent rule for individual holdings and the 25 per cent cumulative ownership limits for non-U.S. foreigners).

16. The chartering of a Bank Holding Company would allow the existing shareholders of the bank to become shareholders of the Bank Holding Company. The *Bank Act* (or the Bank Holding Company Act) would deem a bank conforming to this structure to be widely held. Over the longer term, the Committee can foresee situations where the Bank Holding Company might want to own less than 100 per cent of the Schedule I bank. This should be allowed provided that shares held by persons or companies other than the Bank Holding Company meet the requirements of the *Bank Act* with respect to Schedule I banks.

17. The Bank Holding Company can then establish downstream commercial companies or holdings which can be wholly owned, joint ventured, etc. The commercial arm could then engage in any activity. As noted in Recommendations 44 and 45 below, there would be no asset transactions allowed (unless specifically sanctioned) between the financial and the commercial arms but networking and fee-based transactions will be permitted.

Panels A and B of Chart 1 illustrate what the Committee has in mind. In the Panel A structure, all the financial subsidiaries flow directly from the Bank Holding Company. Under the Panel B structure, the Schedule I bank serves as a financial holding company and the remaining financial institutions are subsidiaries of the bank. The Committee has some concerns about the Panel B structure if everything beneath the bank holding company is wholly owned. Given that the Schedule I bank is narrowly held (by the widely held Bank Holding Company), our earlier rule that either parent or subsidiary must have a 35 per cent public float would imply that either the Schedule I bank have a 35 per cent public float or that each of the subsidiaries should be so structured. Consistent with Recommendation/Observation 2, both approaches should be allowed (except for securities firms which can now be wholly owned and should remain so).

Because of the structure of the BHC model and because the financial arm will not be able to commit assets to the commercial arm, this implies that a) insured deposits cannot be utilized to finance commercial operations and that b) problems arising on the commercial side cannot impact directly on the capital of the Schedule I bank although, as detailed below, indirect impacts cannot be ruled out. Thus, this is not the German universal bank model where commercial activities are directly downstream from the bank. In such a case, a problem with a downstream company can have a direct impact on the solvency of the bank. This is less so for the Bank Holding Company structure that the Committee is proposing.

The Committee now turns to some likely implications of a BHC structure. The underlying assumption in what follows is that banks need greater powers in terms of engaging in the range of activities that is open to their principal competitors, domestic and foreign. The question, then, is how to deliver these enhanced powers. One obvious alternative is an ancillary powers clause in the *Bank Act* allowing banks to undertake any bank-related activity for a trial period of, say, ten years. It is not difficult to foresee that this will lead to intense lobbying in terms of what is "ancillary". The BHC concept allows the banks themselves to define what activities are ancillary to banking. Moreover, as noted above, any such activities would not be undertaken downstream from the banks.

Yet another alternative is to extend the definition of banking on a more or less continuous basis. This is what has happened in connection with the AMEX charter. The federal government has now proposed to allow banks the power to promote goods and services, including insurance, to their credit card holders. Presumably, this approach could be used to redefine banking to include factoring, travel

insurance, leasing and so forth. One likely consequence is that pressures will build for these activities to fall under the purview of the bank (or financial) regulators. It is far from obvious that this would be warranted. Nonetheless, the Committee recognizes that there are viable alternatives to aspects of the BHC approach.

The second point of elaboration is that the Bank for International Settlements (BIS) capital adequacy rules already anticipate that some countries will have bank holding companies. What this means in practice is that the BIS rules would require that the BHC be subject to some regulatory oversight.

Thirdly, the Committee recognizes that the BHC structure may not be foolproof when it comes to "contagion effects". Problems on the commercial side may spill over to the financial side in terms of depositor confidence. If the alternative model is that banks not be allowed to engage in these ancillary activities, then the BHC model does introduce a new risk of potential contagion effects. If, however, the alternative model is to allow these activities downstream from the bank, then the Committee prefers the BHC model.

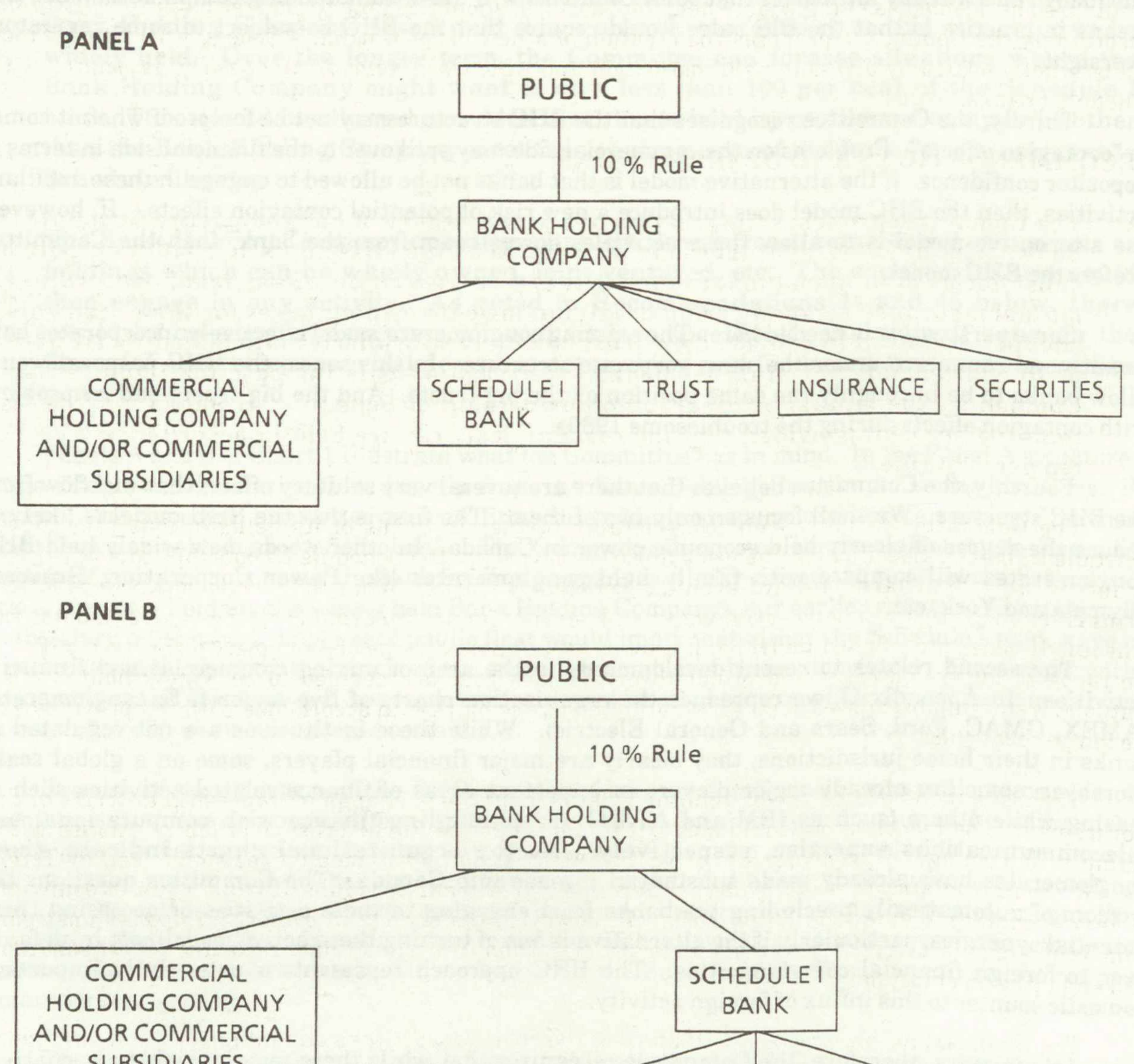
Some perspective is needed here. The existing conglomerate model effectively incorporates both finance and commerce under the same corporate structure. In this sense, the BHC proposal would allow banks to be in roughly the same position as the big trusts. And the big trusts had no problem with contagion effects during the troublesome 1980s.

Fourthly, the Committee believes that there are several very salutary effects that will flow from the BHC structure. We shall focus on only two of them. The first is that the BHC model is likely to reduce the degree of closely held economic power in Canada. In other words, new widely held BHC conglomerates will compete with family held conglomerates like Power Corporation, Brascan, Olympia and York, etc.

The second relates to recent developments in the area of mixing commercial and financial activities. In Appendix C, we reproduce the organization charts of five major U.S. conglomerates (AMEX, GMAC, Ford, Sears and General Electric). While these institutions are not regulated as banks in their home jurisdictions, they clearly are major financial players, some on a global scale. Moreover, some are already major players in important areas of finance-related activities such as leasing while others (such as IBM and AT&T) are comingling finance with computational and telecommunications expertise, respectively. As the organizational charts indicate, these conglomerates have already made substantial inroads into Canada. The Committee questions the wisdom of automatically precluding the banks from engaging in these activities or accessing these potential synergies, particularly if the alternative is one of turning these activities, almost by default, over to foreign financial comglomerates. The BHC approach represents a potentially important domestic counter to this influx of foreign activity.

In summary, therefore, the Committee recognizes that while there may be viable alternatives for some of the objectives associated with our recommendation for bank holding companies, none has the full potential of the BHC. As a final point, the Committee wishes to emphasize that the Bank Holding Company approach is an option, not a requirement. Some Schedule I banks may wish to retain their current status. Others may choose the BHC route.

CHART I
The Bank Holding Company Model: Alternative Structures



- *Schedule III Banks*

The Committee has already noted its intention, for domestic financial institutions, to restrict the label "bank" to those institutions that are required by law to be widely held. Only Schedule I banks now qualify. This definition is too narrow. Mutual insurance companies and credit unions should also be deemed as being widely held and, as such, should be able to charter banks downstream. Accordingly the Committee proposes the creation of a new class of bank, a Schedule III bank, which can be wholly owned by a widely held institution and which will have all the powers associated with Schedule I banks. Thus:

RECOMMENDATIONS AND OBSERVATIONS

18. The Committee proposes the creation of a new category of bank, namely a Schedule III bank. The defining characteristic of these Schedule III banks is that they will be subsidiaries of financial institutions that are deemed to be widely held. Accordingly, mutual insurance companies and credit unions/caisses populaires (or their "centrals") should be allowed to convert their trust company subsidiaries into Schedule III banks or to charter new Schedule III banks. Here again, as is the case for Bank Holding Companies, the mutual or credit-union ownership of Schedule III banks may be less than 100 per cent provided that the remaining shares are held in accordance with the ten per cent rule.

The Committee actually went considerably further in terms of its deliberations relating to Schedule III banks. Specifically, the issue arose as to whether the Schedule III category could also be a "transitional" bank charter toward eventual Schedule I status. What this would mean in practical terms is that any trust company satisfying the 35 per cent public float could roll the trust or a domestic Schedule II bank into a Schedule III bank provided that upon the sale of a majority ownership position the range of buyers be restricted either to institutions that are deemed to be widely held (banks, mutuals, credit unions/caisses populaires) or to the public market in accordance with the provisions of the ten per cent rule.

The issue then became one of defining what is meant by a change of ownership in terms of the requirement to sell down on a widely held basis. Consider the Royal Trustco-Trilon relationship, for example. If a change in the ownership of Royal Trustco is defined to mean a decision to sell by Trilon (i.e., by the immediate upstream owners), then this transitional Schedule III bank would presumably be very appealing to all of the large trusts. If, however, the change in ownership applies upstream from Trilon (e.g. if it applies to the ultimate owners), then this transitional Schedule III concept may well end up as an empty set.

The downside to this proposal is that all of the trusts might take advantage of the transitional bank charter and then begin a massive lobbying effort for eventual grandfathering provisions. If the end result is one where these Schedule III banks end up being narrowly held in perpetuity, this may really unlevel the playing field between banks and trusts and it would be inconsistent with our earlier recommendation that the designation of "bank" be limited to institutions that are widely held.

The upside potential is threefold. First, if the definition of what triggers selling down is a "Trilon" decision rather than an upstream sale, then virtually all trusts will come under federal regulation as "transitional" Schedule III banks. Second, if Canadian ownership of trusts becomes a problem because of the FTA, then this transitional Schedule III charter (where trusts enter as narrowly held but can only exit as widely held Schedule I banks) represents a full-proof approach to ensuring continuing Canadian ownership.

The third rationale is quite different. Later in this report, the Committee will outline a series of proposals to ensure that the market for financial services becomes national. Since most of the existing provincial barriers apply to trust companies, if the Committee's approach to a free internal market is derailed by actions of one or more of the provinces, the transitional Schedule III bank route provides a vehicle for cutting through any protectionist or extra-territorial behaviour on the part of the provinces.

RECOMMENDATIONS AND OBSERVATIONS

19. The Committee offers the following as an observation, not as a recommendation. We have considered the possibility of utilizing a Schedule III charter as a transition category toward a Schedule I bank. Narrowly held trusts and domestic Schedule II banks would qualify for Schedule III bank status provided that on a change in ownership they sell down on a widely held basis, or else sell to an institution deemed to be widely held (mutuals, banks and credit unions). Whether this option will attract existing trusts and Schedule II domestic banks depends in large measure on the definition of what will constitute a change in ownership. The upside potential for this approach is essentially three-fold. First, if a lenient approach is taken to what will trigger the selling down of shares, then most trusts will opt for a federal charter. Second, if there is a concern about Canadian ownership of trusts this transitional Schedule III charter is an obvious solution since the only way to exit is via a widely held shareholding. Third, if the Committee's later proposals for unifying the Canadian financial market run into problems from intransigent provinces, a Schedule III bank charter will end-run any provincial barriers. As noted, however, the Committee is not sufficiently confident to make this a formal recommendation.

The Committee now turns to the ownership of insurance companies.

C. Ownership of Insurance Companies

Virtually every previous official report on the reregulation or deregulation of financial institutions recommended that deposit-taking institutions (or their financial holding companies) could own insurance companies. However, the insurance representatives that appeared before the Committee mounted a strong case for preventing deposit-taking institutions from owning insurance companies. Part of the concern was that the recent move by banks into the securities sector would be repeated for the insurance sector.

In assessing this argument, the Committee could not ignore several other factors. First of all, most of the large stock insurance companies are already part of financial conglomerates. Would prohibition of any linkage between deposit-taking institutions and insurance companies imply that Trilon, for example, be required to sell one or the other of London Life and Royal Trust? Second, mutuals cannot by definition be acquired. Third, there are nearly twenty insurance companies that now have trust company subsidiaries, including two of the largest mutuals that acquired trust companies during the Committee's deliberations. Presumably the ban would be a two-way street: if deposit-taking institutions cannot own insurance companies, then the reverse should hold as well. Fourth, under the earlier recommendations, mutuals will be able to roll their trust companies into Schedule III banks. Finally, the Committee is aware of foreign practice in this regard. In the March 1990 issue of *Life Insurance International*, twelve of the seventeen European countries surveyed allowed life companies to own banks and twelve countries as well (but a slightly different twelve) permitted banks to own life companies. As the Committee's views were not influenced by what other nations do, this last point is primarily for information.

Overall, the Committee's conclusion is that its 1986 recommendation remains appropriate:

RECOMMENDATIONS AND OBSERVATIONS

20. Financial institutions or financial holding companies can acquire insurance companies as part of their diversification across the pillars. Either the financial institution (or the financial holding company) or the acquired insurance subsidiary must have a 35 per cent public float.

D. Ownership Diversification Across the Pillars

The two previous sections outlined the provisions pertaining to the ownership of deposit-taking institutions and insurance companies. In this section, the Committee presents some stylized examples of how cross-pillar ownership diversification can proceed under different structures.

Chart 1 has already focussed on possible ownership integration options for BHCs. Chart 2 presents alternative structures for a commercial/financial conglomerate. Panel A has a financial holding/operating company inserted between the financial subsidiaries and the overall holding company. In this case, the financial holding company must have a 35 per cent public float or else all the financial subsidiaries must have 35 per cent of their shares publicly held. There are two exceptions to this. The first is the domestic Schedule II bank which may be wholly owned initially but must become widely held over a ten year period. The second relates to subsidiaries in the securities pillar. Securities subsidiaries can now be wholly owned. This should continue. Indeed, strictly speaking, securities firms are not financial intermediaries but rather "market intermediaries" to fall back on the distinction utilized by the Economic Council of Canada.

Panel B of Chart 2 has the financial institutions as direct subsidiaries of the conglomerate holding/operating company. The Power Corporation/Power Financial/Great West Life structure is similar to the panel A model whereas the BCE Inc./Montreal Trust structure resembles panel B, i.e., no financial holding company.

Chart 3 focusses on diversification alternatives for mutual insurance companies. Panel A presents the mutual insurance equivalent to a bank holding company: since the mutual is deemed to be widely held, all financial subsidiaries can be 100 per cent owned (and the Schedule III bank must be as well or else it must have all its public share issue subject to the ten per cent rule). The Panel B structure allows for a financial holding company between the mutual and the financial subsidiaries.

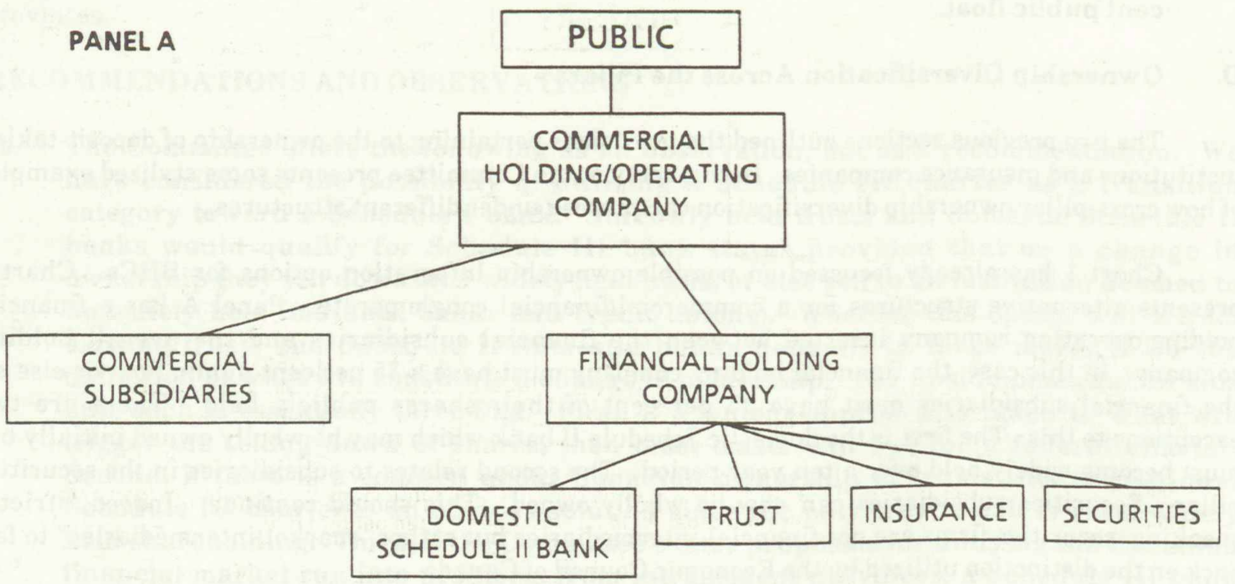
Chart 4 presents one option for diversification across the pillars from a trust company perspective. However, for most if not all of the existing narrowly held trusts the structure in Chart 2 is more relevant.

Finally, Chart 5 presents the actual organizational chart of the Desjardins System. Missing from the chart are the many commercial interests (running the gamut from bakery and confectionery, to machinery and steel, to transportation, to communications, etc.) that fall under La Société d'investissement Desjardins Inc. The Committee presents this chart largely for information purposes since most of the Desjardins activities fall under Quebec regulation. However, it is the Credit-Union equivalent to the BHC model proposed earlier in this chapter.

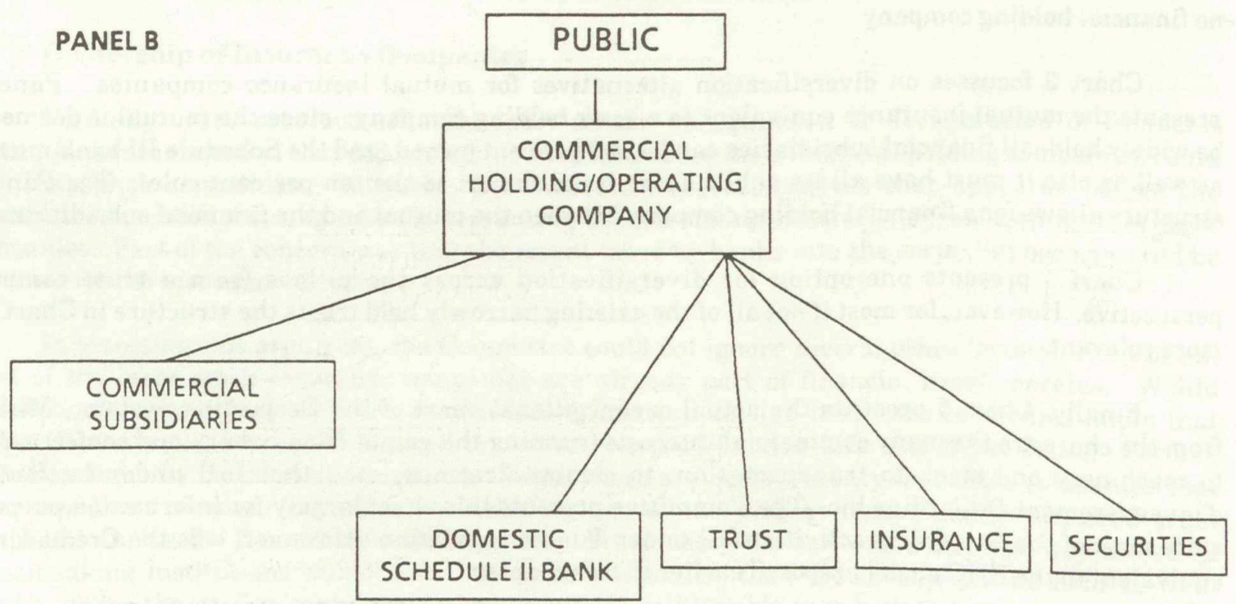
The Committee recognizes that, on the surface, these structures may appear to complicate the ownership relationships among existing conglomerates. However, in our 1986 Report, we included the actual organization/ownership chart of Power Corporation (when it still had Montreal Trust under its corporate umbrella). Our impression at that time was that for the 20 to 30 financial subsidiaries coming under the Power Financial holding company, compliance with our ownership provisions would require some modest selling down of shares at only two or three places in the structure.

CHART 2

Diversification by a Conglomerate



If all of the financial subsidiaries are not 35 per cent publicly owned, then the financial holding company must have a 35 per cent public float. A domestic schedule II bank must become widely held within ten years

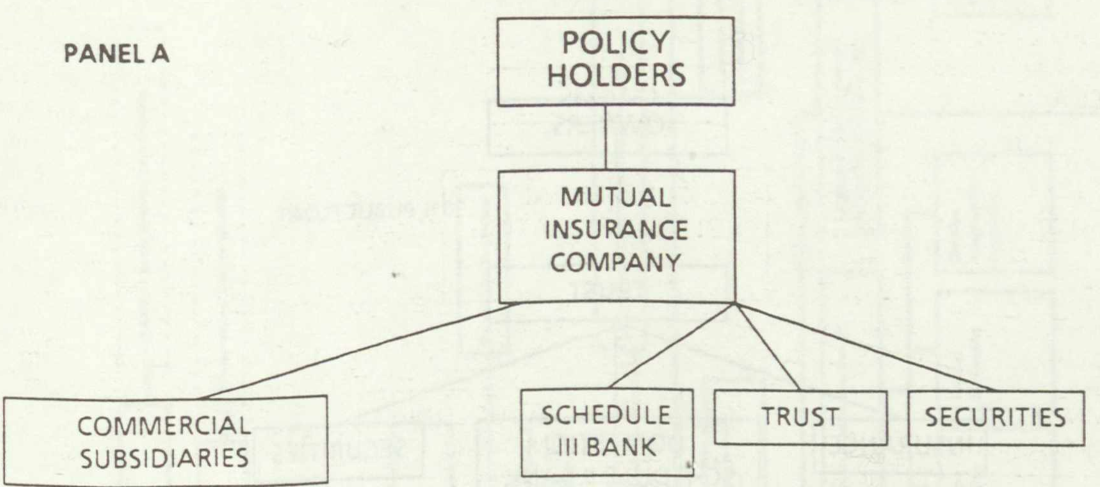


Trust and insurance subsidiaries must have a 35 per cent public float.

CHART 3

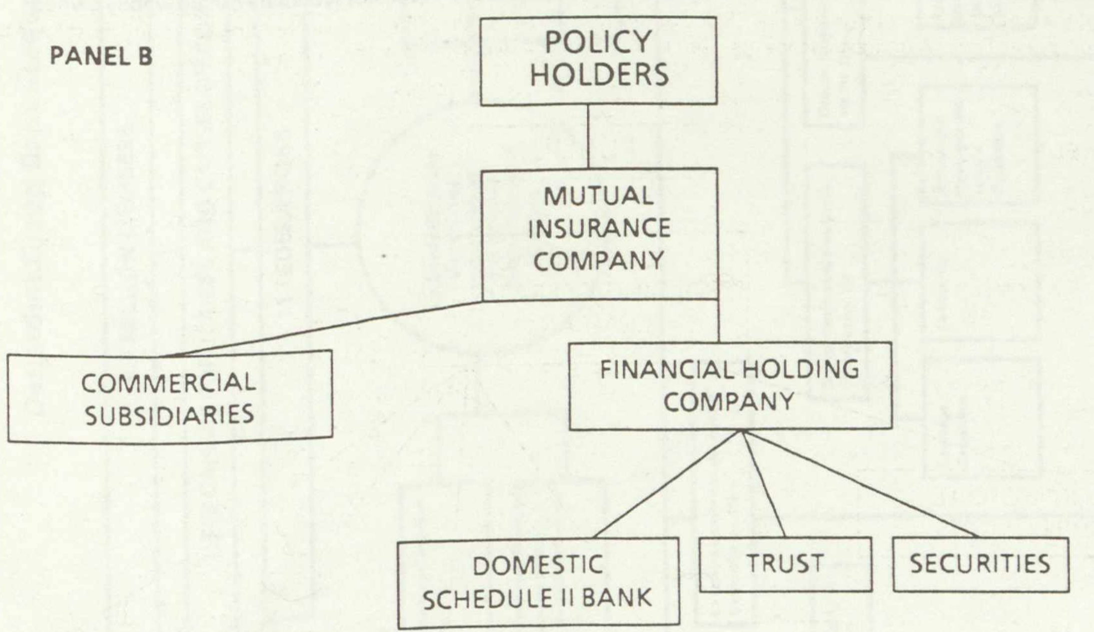
Diversification by a Mutual Insurance Company

PANEL A



Since a mutual insurance company is deemed to be widely held, all financial subsidiaries can be wholly owned. If the Schedule III bank is not wholly owned, any public shareholding must obey the ten per cent rule.

PANEL B



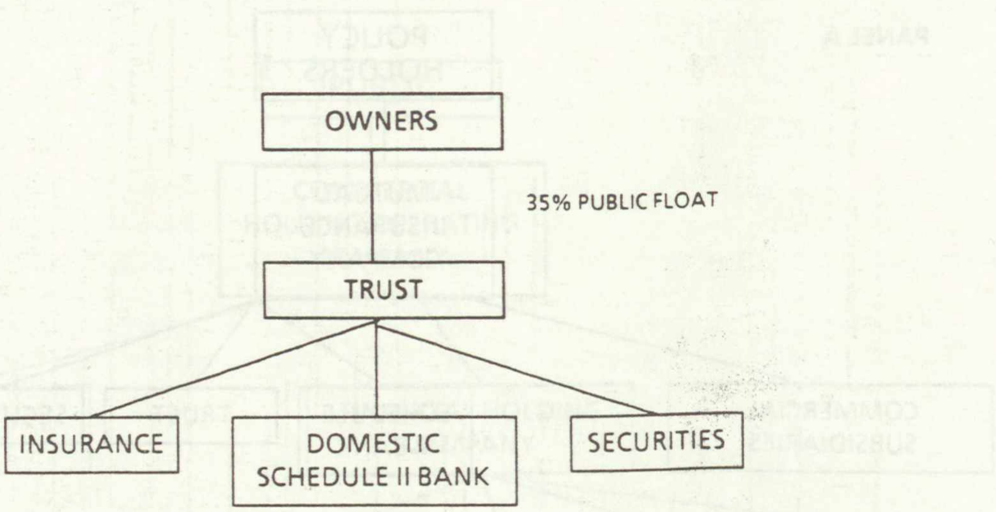
Either the financial holding company or all financial subsidiaries must have a 35 per cent public float.

If the financial holding company has a significant (i.e. more than 10 per cent) shareholder other than the mutual insurance company, it cannot own a Schedule III bank. Panel B shows the holding company owning a Schedule II bank.

A domestic schedule II bank must become widely held within ten years. A securities subsidiary can be wholly owned.

Chart 4

Diversification by a Trust

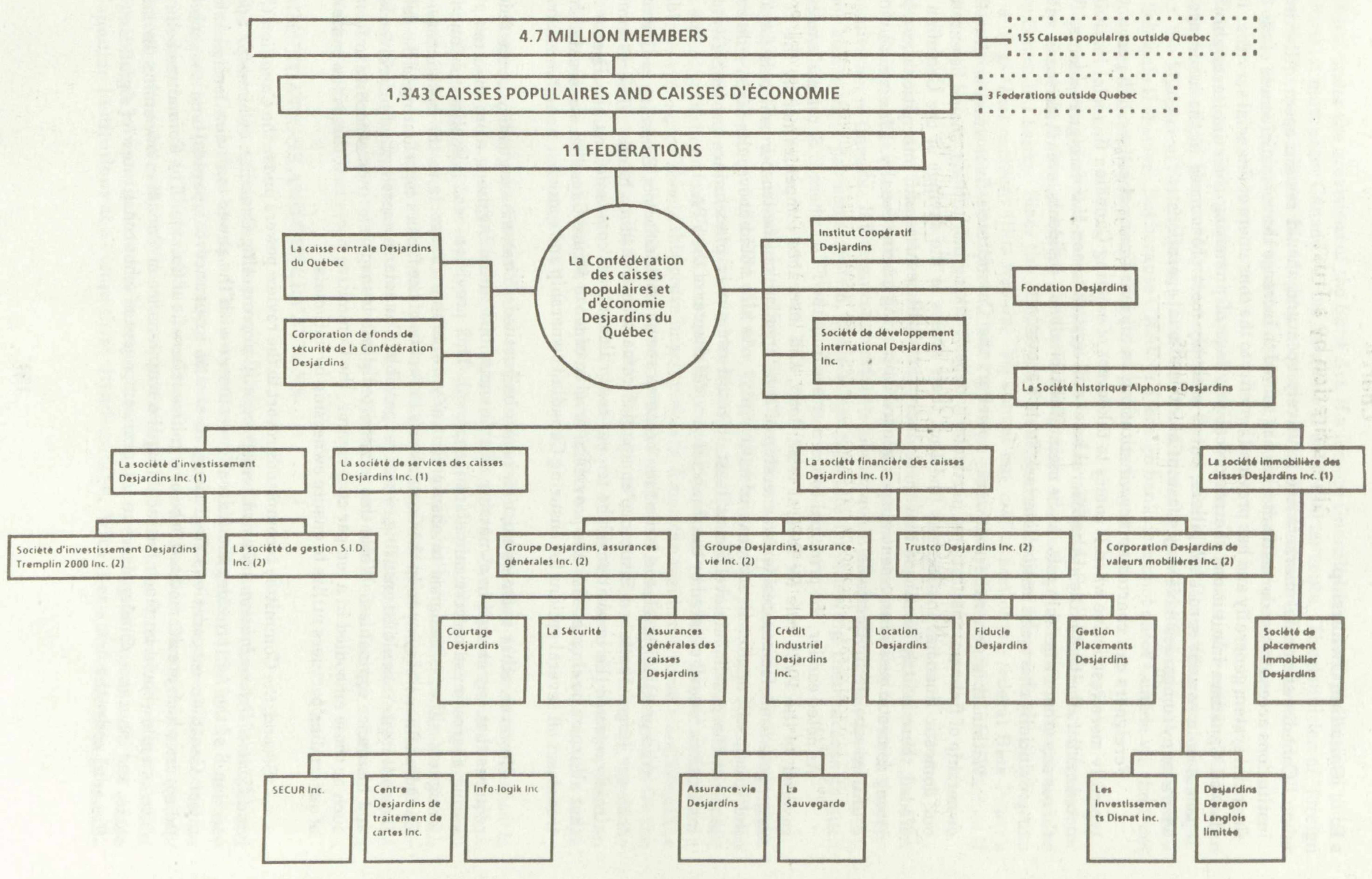


The subsidiaries of the trust company may be wholly owned because the trust itself is required to have a 35 per cent public float.

A domestic schedule II bank must become widely held within ten years. A securities subsidiary can be wholly owned.

CHART 5

Desjardins Group Organization Chart



January 1990 1: Holding companies 2: Intermediary holding companies ---- Auxiliary members The organization chart may be revised during the year.

Source: Submission by the *Mouvement des caisses populaires et d'économie Desjardins*, January 29, 1990

E. Canadian Ownership

Canadian financial markets are relatively open and should remain open. Allowing foreign institutions access to our domestic market has served to increase the competitiveness of the Canadian financial system generally and has provided benefits to the consumers of financial services. It has also allowed Canadian institutions the reciprocal privilege of promoting their interests abroad. This openess is important across all pillars, but is probably most pronounced in the insurance industry where many companies have very substantial international operations.

Foreigners can charter *de novo* institutions in all four financial pillars. The regulations are typically more restrictive when it comes to takeovers of existing Canadian financial institutions. As noted earlier, the 10/25 rule at the federal level still applies to non-U.S. foreign residents. Moreover, this or any other ownership rule can be maintained for all non-residents, even Americans, with respect to provincially chartered institutions (see Table 1 above).

Within this general framework, however, the Committee's firm view is that Canadian ownership of financial institutions, particularly deposit-taking institutions, should be encouraged. If our domestic financial institutions find that their access to the savings of the Canadian public is eroded, there is little likelihood that these institutions will be successful international competitors: a strong domestic base is an essential springboard for moving internationally. This is not unique. Most countries espouse similar goals.

As noted earlier, the principal concern arises from the FTA, where U.S. residents are no longer covered by the 10/25 rule for federal trust, loan, and insurance companies nor by the 25 per cent aggregate limit for non-resident ownership of chartered banks (the ten per cent rule for any single individual still applies irrespective of nationality). As also noted above, the 10/25 rule remains in place at the provincial level (or at least it could remain in place) since provincially chartered institutions are not covered by the financial services chapter of the FTA.

At a practical level, the issue then becomes one of whether or not Canadian policy can ensure that our large trusts and insurance companies remain in Canadian hands. The Committee has already rejected the imposition of the ten per cent rule on trust companies. It also rejects the notion that all trusts be chartered at the provincial level in order to secure Canadian ownership. In a sense, this closes off several options for ensuring Canadian ownership and control.

However, other avenues exist and must be pursued. First, existing policy at the federal level requires that any change in ownership of a financial institution involving more than ten per cent of voting shares must receive ministerial approval. This provision, which applies to Canadians and foreigners alike, is designed to ensure that any ownership change is in the best interests of the Canadian financial system. In the Committee's view, one of the factors contributing to the definition of "best interests" should be ensuring, wherever possible, Canadian ownership and control for large trust and insurance companies. While this is admittedly less transparent than resorting to formal rules, such as those embodied in a ten per cent regime, the Committee notes that this is the route that most of our trading partners utilize to ensure ownership by nationals.

Second, the Committee recommends resort to the review powers under the *Canadian Ownership and Control Determination Act* as an important ally in promoting Canadian ownership. Specifically, section 6 of the Act provides the federal government with the power to review foreign takeovers of major Canadian corporations (including trust and insurance companies) and to prohibit those takeovers which are deemed not to be of significant benefit of Canada. The Committee believes that a case can and should be made for including the maintenance of Canadian ownership for large trust, loan, and insurance companies as an integral component of what constitutes "of significant benefit to Canada" under the Act.

Third, under the provisions of the *Bank Act*, if a foreign financial institution is deemed to be a foreign bank, it must enter Canada via the Schedule II bank charter route. The definition of "foreign bank" for this purpose is quite far-ranging, so that most U.S. financial institutions would fall under this provision, even if they are not regulated as banks, *per se*, in their home country.

This provision can provide substantial policy freedom in terms of ensuring Canadian ownership. For example, General Motors Acceptance Corporation (GMAC) qualifies as a foreign bank. However, the Minister of State (Finance) has announced recently that GMAC would not qualify for a foreign Schedule II charter. But because GMAC is a foreign bank, it cannot enter Canada via the trust company route. This provides substantial protection for our large trusts.

There is a related aspect to this foreign bank issue. When U.S. financial institutions enter Canada as Schedule II foreign banks, they essentially have the same privileges and constraints as domestic Schedule I banks. Since the Minister of Finance is not likely to allow a Schedule I bank to acquire a large trust company (this was the "big cannot buy big" aspect of the federal Blue Paper's proposals, which the Committee supports), it is relatively easy to also refuse this for a U.S. Schedule II as well.

More pointedly, the Committee does not believe that Canada has an obligation under the FTA to allow U.S. firms that are not principally engaged in financial-service activities to own a deposit-taking institution in Canada. If foreign conglomerates cannot qualify as banks in their home country or cannot access their payments system, there is no rationale for allowing them access to such privileges in Canada.

This general point can be taken further. The Committee notes that the view of some witnesses was that the combination of the FTA and the AMEX decision implied that Americans have been granted privileged access or more-than-equal treatment in the Canadian financial sector. Within this context, ensuring that our large trust and stock-insurance companies remain in Canadian hands is a reasonable *quid pro quo*. Should this prove unacceptable to American residents, some members of the Committee have suggested that the federal government could define Americans as Canadians for the purposes of establishing Schedule II banks. As "Canadians", their Schedule II banks would be equivalent to Canadian Schedule II banks and, therefore, be required to be widely held within ten years. Alternatively, Observation 19 provides a substitute route to ensuring that Canada's large trusts remain in Canadian hands.

In summary, then, the Committee is confident that the combination of these approaches is adequate to ensure that our major deposit-taking institutions remain Canadian-owned and controlled. Moreover, some perspective is needed here. The only deposit-taking institution in recent years to fall into the hands of foreigners was not a trust company but rather a Schedule I bank, the Bank of British Columbia. And it would have likely remained in Canadian hands if federal policy had allowed Power Financial, or Trilon, or Laurentian to enter the takeover bidding. Thus, this was a case where the adherence to the ten per cent rule domestically essentially pre-ordained a foreign takeover for a deposit-taking institution!

RECOMMENDATIONS AND OBSERVATIONS

21. **The Committee endorses the principle that Canadian financial institutions should remain in Canadian hands. The procedures for ensuring that this is the case are numerous and they involve, among other items, recourse to ministerial discretion as well as recourse to the relevant provisions of of the *Canadian Ownership and Control Determination Act*. Moreover, the application of Canada's financial policy should ensure that powers granted to foreign institutions operating in Canada do not place Canadian institutions at a competitive disadvantage. With these provisions in place the**

Committee is confident that our major financial institutions will remain in Canadian hands.

22. The pending federal financial-institution legislation should incorporate Canadian ownership as one of the principal goals of financial sector policy and the exercise of ministerial discretion under the Acts governing financial institutions should reflect this goal.

CHAPTER 4

Powers and Networking

A. Introduction

In focussing on the powers of financial institutions the Committee wishes to reiterate those aspects of Recommendation/Observation 1 that relate to competition and efficiency. These are:

- promoting competition, innovation and efficiency;
- enhancing the convenience and options available in the market place;
- broadening the sources of credit available to individuals and business; and
- promoting international competitiveness and domestic economic growth.

The challenge, therefore, is to develop an approach to financial policy that encourages, rather than inhibits, innovation and efficiency in our financial system while at the same time protects the public. (Consumer protection and solvency concerns are dealt with in the following chapter).

As was the case in the earlier discussion of ownership, the Committee's view in terms of powers and networking is that the policy authorities should avoid the imposition of a preconceived structure on the system. Technology is evolving too quickly and innovation is proceeding too rapidly for the policy authorities to attempt to straightjacket the system in any one direction.

RECOMMENDATIONS AND OBSERVATIONS

23. The Committee embraces in principle all four approaches to financial diversification:

- **within-institution expansion of powers;**
- **subsidiaries;**
- **upstream and downstream holding companies; and**
- **networking.**

The Committee's very open approach to upstream and downstream holding companies as well as to subsidiaries was adequately dealt with in the chapter on ownership. Thus, attention in the present chapter centres largely on in-house powers and networking.

B. Expanding In-House Powers

- *Commercial Lending*

The Committee recommends that the present qualitative approach to investment for trust companies be replaced by a prudent portfolio approach, monitored by the investment committee of the board of directors. What is prudent will presumably depend in part on the nature of the institution's

liability structure. Combined with the application of BIS rules to banks and eventually a variant thereof to trusts, the Committee's underlying assumption is that, for equivalent liability structures, the asset-side investment powers for trusts and banks would essentially be identical.

The approach to asset-side powers in the insurance sector should also be driven by the prudent portfolio approach. Indeed, much has already been accomplished here. In some provinces, the old "legal for life" restrictions have already been replaced by the prudent portfolio concept. Given the generally longer term of insurance liabilities, what is "prudent" for insurance companies, in comparison with banks and trusts, will typically involve much greater flexibility to invest in projects with longer time horizons.

RECOMMENDATIONS AND OBSERVATIONS

24. The Committee recommends that the present qualitative approach to the asset portfolio of trust companies be replaced by a prudent portfolio concept. It also recommends that the Bank for International Settlements (BIS) capital-adequacy rules or some appropriately modified version thereof be applied to trusts. The net effect of this will be that, for equivalent liability structures, the asset-side powers of trusts will be roughly identical to those of banks.

25. The Committee also recommends that the prudent portfolio approach be applicable to the insurance industry. We particularly welcome an updating of the insurance legislation since the term-to-maturity profile of insurance liabilities implies that this sector has a very significant role to play in the financing of longer term investment projects.

- *In-House Trust Powers*

At present the banks and insurance companies face more or less blanket prohibitions on the exercise of trustee powers, including management and agency powers. The Committee believes that these restrictions are too severe. In expanding in-house trust powers the Committee is following closely the federal Blue Paper's recommendations.

RECOMMENDATIONS AND OBSERVATIONS

26. The Committee proposes to expand the range of eligible fiduciary powers by permitting the direct exercise of trust powers by banks and insurance companies, with the following exceptions:
- **carrying out trusts conferred by order of a court;**
- **carrying out *inter vivos* trusts;**
- **acting as an executor or administrator under wills and bequests;**
- **acting as official guardian or tutor for, or curator of, assets.**

27. Banks and insurance companies will be able to engage in the full range of fiduciary activities through a trust company subsidiary.

28. If and when the in-house powers in Recommendation 26 cross into provincial jurisdiction, the relevant provincial registration, regulation and monitoring will apply.

29. While the Committee believes that the three previous recommendations respect provincial jurisdiction in the trust area, it notes that the Conference of Provincial Ministers Responsible for Financial Institutions agreed in principle at their August 30, 1989 meeting in Moncton that financial institutions other than trusts be prohibited from engaging in trust business except through trust subsidiaries. The Committee

prefers recommendations 26-28. However, should some concessions to the provinces be deemed necessary in the context of achieving the Committee's later-enunciated goal of a single national market for financial services, acquiescence to the provinces' demands with respect to in-house trust powers represents an acceptable trade-off.

- *Ancillary Activities for Banks*

The banks have long desired to acquire or establish subsidiaries in finance-related areas such as factoring and leasing or in ancillary activities such as computer service companies. Given that the Committee has aleady endorsed the BHC concept, it is obvious that banks and other financial institutions should be able to engage in these activities. The only question is "how". If these ancillary activities fall naturally into the domain of the financial sector, then the appropriate route would be to regulate these activities and to allow financial institutions to engage in them through downstream holdings. Alternatively, if these are essentially viewed as commercial activities, then it is questionable whether they should be financed directly downstream from financial institutions. In this case, the preferable route would be the bank holding company structure and, more generally, commercial subsidiaries along the lines depicted in Charts 1 to 5 above.

RECOMMENDATIONS AND OBSERVATIONS

30. **The Committee recognizes that banks in particular have long lobbied to have ancillary activities such as factoring and computer services come under the definition of banking. If the federal policy and regulatory authorities feel comfortable having these financed directly or indirectly by CDIC-insured deposits, then the Committee will defer to these authorities. However, now that the Committee has recommended alternative structures, e.g. bank holding companies, for engaging in these activities, our distinct preference is for financial institutions to use these new alternatives for undertaking ancillary activities.**

C. Networking

Networking is a term used to describe arrangements between financial institutions under which one of the institutions provides the public with access to products or services issued by the other. This type of arrangement can exist between affiliated or independent institutions. It provides an opportunity for independent and small institutions to offer a broader range of financial services than they could otherwise offer on their own account.

The Committee adopts a very positive approach to networking. We believe that it is in the interests of consumers since it enhances product differentiation. This may be of particular importance for communities that have only one financial institution. Moreover, networking allows an alternative form of diversification for financial institutions that desire to restrict their own operations to specialized areas.

Networking has now become a reality. Focussing only on the networking of home insurance, the T.D. Bank offers consumers in Quebec, Ontario and Saskatchewan insurance services (or rather information, brochures and phone lines to access insurance) from Simcoe and Erie Investors Ltd. The Bank of Nova Scotia markets Canada Life Casualty insurance through brochures and phone lines at its Ontario branches. Mortgage holders with Canada Trustco Mortgage Co. will now be offered home insurance with Prudential of America Federal Insurance Co. (Canada). And on and on.

RECOMMENDATIONS AND OBSERVATIONS

31. **Networking of financial services has become a reality in Canada. The Committee fully supports this development, with two provisos. Tied selling must be prohibited and**

networking fees should be above board and subject to monitoring by the relevant regulator.

However, the issue that has arisen is not networking per se, but rather networking of insurance services directly on the premises of deposit-taking institutions. And if licensed insurance agents can sell insurance services on the premises of deposit-taking institutions, who can be so licensed? The Committee now addresses these issues.

In the federal government's Blue Paper and in its draft legislation, licensed insurance agents were to be prohibited from selling insurance services on the premises of deposit-taking institutions. Witnesses from the insurance industry supported this ban while the chartered banks argued for on-premise distribution. Representatives from the National Bank were the most concerned since Quebec legislation allows on-premise distribution of insurance products for caisses populaires.

The Committee's view is that whether insurance agents are licensed to sell their products on the premises of (non-insurance) financial institutions is a provincial, not a federal, decision. However, if a province allows this privilege for its provincially chartered institutions (credit unions, caisses populaires, provincial trusts) then the Committee believes that this same privilege must also extend to federally chartered financial institutions. Thus, the appropriate sort of recommendation here is not one that says yes or no to on-premise selling of insurance. Rather, it is that federally regulated financial institutions will be able to network insurance products in their branches in any province where provincially chartered institutions have this right.

An alternative model is the one that the federal government appears to be proposing. In this model, banks and trust companies are allowed to network insurance products through some distribution channels (e.g. to credit card holders) and some insurance activities can be networked in bank branches (e.g. credit-related life insurance and travel insurance). Other forms of these products cannot be networked through branches, regardless of who employs the insurance agent.

This option has some advantages. It does not ban completely insurance networking but it does circumscribe cases where conflicts may arise. However, it still can leave a federal institution at a competitive disadvantage compared to a provincial institution which is allowed complete networking.

Returning to our own proposal, the Committee recognizes fully that the end result of this may be different treatment from province to province. This is a provincial prerogative. However, what is does mean is that if the caisses populaires can network insurance in Quebec, so can the National Bank. It may be that neither credit unions nor other financial institutions will be able to network insurance in Ontario. What is important, however, is that they playing field is levelled, province by province, and that federally chartered institutions are not disadvantaged vis-à-vis provincially chartered institutions.

Whether or not the end result of this will be full on-premises networking across all provinces will obviously depend on the experience of those provinces which have opted for on-premise networking. Part of the evaluation of this experience will involve an assessment of the adequacy of provisions to ensure that confidential consumer information does not pass between the deposit-taking institution and the insurance agents. If on-premises networking insurance proves beneficial to consumers, the Committee believes that it will become national. Otherwise, it will not. Surely, this is the appropriate way for federal policy makers to address this issue.

Thus,

RECOMMENDATIONS AND OBSERVATIONS

32. Recent federal proposals prohibited licensed sales of insurance services on bank or trust premises. The Committee suggests that this is not the most appropriate way to approach this issue. The decision to allow or disallow licensed insurance agents to operate on the premises of deposit-taking institutions rests with each of the provinces. Thus the Committee recommends that, in each of the provinces, federally and provincially chartered institutions be under the same regime in terms of on-premises sale of insurance.

33. The Committee notes that the end result of the above recommendation may well be different treatment from province to province. This recognizes the provincial prerogative in this area. What our recommendation does accomplish, however, is the levelling of the playing field, by province, for provincially and federally incorporated institutions. Thus, if Quebec allows, as it does, the caisses populaires to network insurance on their premises, this right must also be extended to federally chartered institutions such as the National Bank and Trust Général.

In terms of who should be licensed for on-premises sale, the Quebec model as it applies to the Mouvement Desjardins requires that the licensed persons be representatives of the insurance subsidiary, not of the caisses populaires. This general model would allow financial institutions to enter into contractual (networking) agreements with affiliated or non-affiliated insurance companies to share distribution facilities. The financial arrangements could be flexible—straight rental of space or a percentage of premium income—but the key operating principle that would distance the two pillars would be that bank/trust employees and insurance employees would be subject to different primary regulators.

An alternative approach is the so-called "two hat" model where bank/trust employees can also be licensed to sell insurance products. In effect, this model represents an in-house expansion of banking powers into the insurance pillar. The problem is that this represents an inherent conflict of interest. Customers who are indebted to the deposit-taking institutions (via loans or mortgages) may feel that they are in no position to refuse an offer for insurance coverage.

An even more potentially abusive conflict would arise if insurance agents had full access to clients' overall financial positions *vis-à-vis* the deposit-taking institution, as they would have if they wore the two hats of bank employee and registered insurance agent. Thus, the Committee has no trouble at all in rejecting this two-hat model.

RECOMMENDATIONS AND OBSERVATIONS

34. Employees of deposit-taking institutions should not be allowed to be licensed to sell insurance. There is an inherent conflict of interest here since a customer indebted to a bank, trust, or credit union can be put in a position where she/he might find it difficult to refuse an offer for insurance coverage. Therefore, the Committee recommends that federal and provincial insurance regulators come to an agreement to the effect that if a province wishes to license on-premises sales this be done via networking arrangements and not by licensing employees of deposit-taking institutions. In any event, federal legislation should prevent such licensing of employees of deposit-taking institutions.

35. All of the above recommendations relating to networking insurance are premised on the assumption that confidential customer information will not pass between the

deposit-taking institution and the insurance salespersons operating in the branches of deposit-taking institutions.

As a final comment on insurance networking, the Committee notes that the inherent conflict of interest does not run in the other direction.

RECOMMENDATIONS AND OBSERVATIONS

36. Persons licensed to sell insurance should be allowed to place clients' funds on a networking basis with deposit-taking institutions.

D. Other Issues

One other issue relating to powers merits attention. Some witnesses suggested that the entry of BCE Inc. into the financial sector might create a unique competitive advantage because BCE Inc. can now combine expertise in both banking and telecommunications. The Committee notes that such a linkage would not be unique. AT&T has recently inaugurated Visa and Master Card operations in the U.S. and IBM is chartering a European bank. To be sure, this latter example represents a computational link, not a telecommunications one, but the principle is similar. The Committee's view is that if there is a problem here, it is not a financial policy issue but rather a competition policy issue. Thus,

RECOMMENDATIONS AND OBSERVATIONS

37. The Committee recognizes that the entry of BCE Inc. into the financial sector may confer a unique competitive advantage on BCE Inc. because it can combine banking and telecommunications. However, we also note that major computational and telecommunications companies in other countries are entering the financial sector. In general, the Committee's position is that if there is a concern here it is a competition policy issue, not a financial policy issue.

CHAPTER 5

Regulatory Oversight, Self-Dealing and Corporate Governance

A. Introduction

Perhaps because of the wording of our mandate and in particular its focus on ownership and on the impact of globalization or perhaps because the financial-sector problems of the early and mid 1980s are now viewed as being behind us, the general area of regulatory oversight received scant attention from most of the witnesses that appeared before the Committee. Obviously, the testimony of the various regulators was an important exception to this statement. So, too, were the contributions by Professors Chant and McFetridge which focussed on new approaches to deposit insurance. Nonetheless, there is precious little in the way of testimony and new evidence for the Committee to embark on a comprehensive rethinking of our 1986 recommendations with respect to the powers of, and interaction between, primary regulators, auditors, the CDIC and corporate governance. Accordingly, we refer readers to our 1986 recommendations in Appendix A in this general area, even though we recognize that the march of events may have overtaken the relevance of some of these recommendations. However, their thrust still rings true.

In glossing over these areas, the message from the Committee is not that all is well here. No doubt the system of regulatory oversight is functioning far better than it was earlier in the 1980s. However, some important concerns remain. This is particularly the case with respect to deposit insurance. Novel approaches to deposit insurance have surfaced recently and these approaches (some of which were presented to the Committee) merit further consideration and assessment. The Committee takes this opportunity to register the following observation:

RECOMMENDATIONS AND OBSERVATIONS

38. **The Committee will not frame any recommendations relating to deposit insurance. This does not reflect a view on our part that all is well with deposit insurance. On the contrary, this is an area that deserves further attention, particularly since novel approaches are beginning to surface. If appropriate agencies do not take up this challenge, the Committee may well revisit the general area of deposit insurance in the near future.**

Two areas that did attract considerable attention, from members of the Committee and witnesses alike, were those relating to corporate governance and self dealing. These are important in their own right, but they acquire greater significance in light of the fact that the Committee has already opted for a flexible ownership structure as well as expanded powers for financial institutions. Indeed, as will be detailed below, the Committee adopts a much tougher stance with respect to self-dealing and non-arms-length transactions (NALTs) than it did in 1986. Prior to focussing on our approach to NALTs, however, we direct attention to the composition and role of boards of directors.

B. Corporate Governance

- *The Composition of Boards of Directors*

In the Committee's view, one key to enhancing corporate governance lies in strengthening the role and composition of the board of directors of regulated financial institutions. The existing regulations relating to directors differ widely across institutions. Attention has typically focussed on the standards for directors for narrowly held and commercially linked institutions, since potential self dealing between owners and their financial institution is a concern. This attention is warranted.

However, the Committee is also concerned about the structure of the boards of Schedule I banks, since the possibility exists for potential self-dealing between officers and directors and other entities they control or are affiliated with. In particular, the situation where officers of companies that are major bank borrowers sit on the boards of these same banks is increasingly at odds with ongoing societal efforts to minimize potential conflicts of interest. While the Committee received little if any evidence that suggested that the boards of directors of banks were anything but effective (although the massive third world write-offs suggest otherwise), the fact remains that the conception of banks as widely held institutions, and the public perception underlying this conception, would appear to require a standard of governance not consistent with a board dominated by directors whose companies are major borrowers of the bank.

Accordingly, the Committee proposes some measures to strengthen the role of directors of regulated financial institutions. Essentially, we are modelling the recommendations that follow after those that appeared in the federal government's Blue Paper (*New Directions for the Financial Sector*). The thrust of the recommendations is that the make-up of the board of directors will be to ensure that the board has adequate access to the views and judgment of individuals who neither are officers or employees of the corporation, nor have other significant associations with the corporation.

RECOMMENDATIONS AND OBSERVATIONS

39. **The number of board members that may be drawn from among the officers and executives of the financial institution or its affiliates (inside directors) will be limited to 15 per cent, subject to regulatory exemption for small boards for which this constraint would be burdensome.**

40. **At least one-half of the directors will be required to meet stringent criteria establishing their independence of the corporation. These criteria include:**
    - **that they are not officers, employees or significant shareholders of the financial institution or companies related to it;**
    - **that they do not have significant business links with the institution or companies related to it, directly or indirectly (which includes being an officer of a significant borrower);**
    - **that they do not belong to firms acting as major legal advisers to the institution; and**
    - **that they are not immediately related by birth or marriage to any person in the above categories.**

41. **The above recommendation is not meant to create two classes of directors. All directors shall be required to act in good faith with a view to the best interests of shareholders, depositors and, as the case may be, beneficiaries, and they shall exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances.**

42. In view of the greater responsibilities that will be placed on directors and particularly on independent directors, comprehensive indemnification provisions will be permitted, as in the *Bank Act*, to ensure that qualified people are willing to serve in this important capacity.

There is one further alteration in the composition of boards of directors that follows from the recommendations in previous chapters. If Schedule I banks opt for the Bank Holding Company route and establish commercial enterprises downstream, it follows rather naturally that officers of the Bank Holding Company should be able to become directors of downstream commercial holdings. Accordingly,

RECOMMENDATIONS AND OBSERVATIONS

43. Boards of directors of commercial companies coming under the umbrella of a Bank Holding Company can include directors or appointees of the Bank Holding Company, subject to the general provisions of established corporate practice.

- *Self-Dealing*

As noted in the introductory chapter, the Committee's 1986 approach to non-arm's-length transactions (NALTs) was three-fold: an outright ban for selected related-party transactions; a so-called Business Conduct Review Committee (BCRC) composed of independent directors to review all allowable NALTs in order to ensure that they do not expose minority shareholders and consumers to abuse or materially increase the risk of insolvency; and a provision for pre-clearance with the regulator for certain types of NALTs. Implicit in this overall approach was the designation of a list of prohibited transactions, with all other related-party transactions falling under the scrutiny of the BCRC.

The Committee wishes to *reverse* the burden of proof in terms of related-party transactions. This is a major shift from our 1986 position. In altering our views, we were persuaded by what has come to be known (within the Committee) as the "BCE Inc. bylaw". Specifically, from the testimony of Mr. Raymond Cyr, Chairman and CEO of BCE Inc:

> I would just like to state here that Montreal Trust . . . will not have any dealings with any of the BCE subsidiaries or affiliates except for the provision of what is called fee-based services. In other words, in terms of loans or other financial transactions, we decided by board resolution last month that all of these companies would be excluded from any financial transactions with Montreal Trust.

Thus,

RECOMMENDATIONS AND OBSERVATIONS

44. As an operating principle in terms of related-party transactions, the Committee favours an outright ban except for networking relationships and fee-based services.

The Committee recognizes that this operating principle is overly restrictive, particularly for transactions within a financial conglomerate but probably for some potential transactions between the financial and commercial arms of a conglomerate as well. In terms of the former, for example, the line-of-credit relationship between a bank and its investment-dealer subsidiary in terms of underwriting a bought deal for a third party comes easily to mind. In our 1986 Report, we recommended that representatives from the primary regulators, the CDIC, the professional associations and the financial institutions be instructed to draw up a list of prohibited transactions. In 1990, our view is that these

same groups be instructed to draw up a list of allowable exceptions to our ban on related-party transactions.

RECOMMENDATIONS AND OBSERVATIONS

45. To the extent that this ban on related-party transactions counters standard or accepted business practice, the Committee recommends that a panel composed of representatives of primary regulators, of the CDIC, of professional associations and of financial institutions be involved in drawing up a list of exceptions to this ban, including an outline of the conditions and procedures under which such transactions can proceed.

Within this framework, we can now address the corporate governance role of the Business Conduct Review Committee.

46. The role of the Business Conduct Review Committee (BCRC) is to review in advance allowable exceptions to the ban on related-party transactions, networking arrangements and fee-based services contracts. The BCRC will be charged to ensure both that these transactions do not expose minority shareholders and consumers to abuse and that they are carried out at prices that fairly reflect those which would occur in arm's length transactions.

47. The structure and operation of the BCRC will follow the guidelines incorporated in the recommendations of our 1986 Report (see Appendix A).

One final recommendation is in order, namely the provisions that should apply to *de novo* trusts and banks and to takeovers of financial institutions.

48. For newly chartered trusts and domestic Schedule II banks, there will be no exceptions to the ban on related-party transactions. This absolute ban will remain in place until the trusts have a 35 per cent public float and the Canadian-owned Schedule II banks become widely held and then only when the primary regulators are satisfied that appropriate corporate governance procedures are in place.

CHAPTER 6

Policy Harmonization

A. Introduction

This final substantive chapter of our report deals with the enduring concerns relating to policy coordination and harmonization. In our 1986 Report, the emphasis on harmonization related almost exclusively to internal harmonization—federal-provincial and interprovincial. These domestic harmonization concerns remain of utmost importance. Indeed, the Committee views its later proposals for ensuring that markets become truly national to be among the most important recommendations of the report.

However, the advent of Canada/U.S. free trade and the prospects in 1992 of a single European market require that harmonization concerns embrace international aspects as well. Thus, the chapter begins with a focus on the most pressing of these international harmonization concerns, namely the potential inroads into the Canadian financial sector by the so-called American "in-house" or corporate banks. This is followed by a more detailed assessment of the AMEX issue. The section on international harmonization concerns concludes with some potential implications arising from Europe 1992.

B. International Harmonization

Foreign Bank Entry into Canada

- *The U.S. In-House Banks*

The Canadian Bankers' Association forwarded a copy of its recent report, *The Right to Compete*, to the Committee. The report documents the financial services activities of four U.S. firms (GE, Ford, GM and Sears) in addition to American Express. Like AMEX, these firms are major players in retail financial markets in the USA and, in many instances, are already active within certain segments of the Canadian financial services market.

Charts C.1 through C.5 in Appendix C, reproduced from the CBA document, depict the corporate structure of these U.S. corporations, including the extent of their Canadian activities (denoted by Canadian flags in the charts). General Electric (Chart C.1) probably has the most extensive Canadian presence and is one of the leaders in the leasing area. Ford Motor Company (Chart C.2), with its First Nationwide Financial Corporation is now the second largest U.S. thrift company with U.S. $35 billion in assets and 330 branches in 15 states. It too has a substantial Canadian presence with operations in the areas of leasing, insurance and consumer loans.

Chart C.3 details the holdings of General Motors and, of more interest, GMAC, including its leasing and financial operations in Canada. GMAC is the largest automotive financier in Canada with nearly 500,000 vehicles with loans and over 200,000 vehicles on lease. Chart C.4 presents the Sears structure. Sears' Canadian activities are substantial, ranging from retail operations to

insurance to the securities firm Dean Witter Reynolds Canada. One of the likely attractions to Sears of the Canadian financial market would be to integrate its "plastic money" (the Discover Card) with the Canadian Payments System. The final chart is that for American Express—a world leader in payments services, one of the world's largest mutual fund groups, a significant capital markets player with Shearson Lehman Hutton under its wing, a major force in insurance and, in Canada, among the largest auto leasers. Despite its broad range of banking services through several U.S. non-bank banks, AMEX is not regulated as a bank holding company in the U.S. Nor are the four others.

This list could be easily extended: AT&T is into the financial sector, IBM is making a big splash with its new European bank, and so on.

The CBA appears resigned to the fact that the granting of Schedule II bank status to AMEX is irreversible. From their vantage point, the relevant issue then becomes: if these other firms apply for a bank license, should their requests be granted? If they were, this would raise the same unresolved issues as the AMEX charter—whether foreign firms should be granted competitive opportunities within Canada that are denied to similarly situated Canadian firms.

The CBA argues that it would not be in the public interest to permit any further incursions into domestic retail financial markets by these or similar foreign multinationals until such time as financial reform legislation has been implemented. Presumably this is only a stop-gap measure: the CBA will formulate a longer-term position once the federal government introduces its legislation.

As noted earlier, federal minister Gilles Loiselle has publicly endorsed the CBA request for a moratorium. This position was clearly stated in the House of Commons on March 22, 1990.

> Mr. Jim Peterson (Willowdale): Mr Speaker . . . There are other companies doing business in Canada that are in the same position as American Express, major financial institutions such as GMAC, General Electric, Sears-Roebuck and Ford Credit.
>
> What is the minister going to say when these companies come knocking on his door and ask for the same treatment that American Express got?
>
> . . .
>
> Hon. Gilles Loiselle (Minister of State (Finance)): Mr. Speaker, since they have not asked us anything I do not know what I would say.
>
> I would be tempted to tell them that they are not primarily a financial institution, but a commercial organization that has grown into some financial activity. I would be tempted to tell them that they are not widely owned like American Express, that they are not publicly traded in some instances and therefore that in my view at this time they would not be acceptable.

In the Committee's view, this issue is not going to go away. What Canada needs, as part of its overall financial sector reform, is a policy clarification with respect to the chartering of foreign banks, particularly U.S. banks. While the Committee will not attempt to formulate such a policy, we will express a few pertinent observations. As backdrop, however, more information is needed on how U.S. firms can enter the Canadian financial sector.

- *What is a Foreign Bank?*

A foreign bank can apply to establish a foreign bank subsidiary (Schedule II bank) in Canada. Indeed, unless specifically exempted, the *only* way in which a foreign bank can engage in banking activities in Canada is via a schedule II bank. For example, it could not enter via the trust sector, federally or provincially. The question then becomes: what is a foreign bank? From the *Bank Act*, a foreign bank:

. . . means a corporation, association, partnership or other institution incorporated or established by, pursuant to or in accordance with the laws of a country other than Canada, or a department or agency of the government of a country other than Canada or a political subdivision of such a country that,

(a) is a bank according to the laws of any country other than Canada where it carries on business,

(b) carries on a business in a country other than Canada that, if carried on in Canada, would be wholly or to significant extent the business of banking,

(c) acquires, adopts or retains a name that, in any language, includes the word "bank", "banks" or "banking", either alone or in combination with other words, or any word or words of import equivalent thereto to indicate or describe its business,

(d) engages in the business of lending money and accepting deposit liabilities transferable by cheque or other instrument,

(e) is an affiliate of a corporation that is a foreign bank within the meaning of this definition, or

(f) controls a corporation that is a foreign bank within the meaning of this definition.

Since AMEX does not operate as a federally regulated bank in the U.S. it obviously does not qualify under category a) above. Perhaps travellers' cheques qualify under d) as an instrument for transferring deposit liabilities or perhaps b) above is the relevant section. In any event, if AMEX is any guide, it would appear that the definition of foreign bank can be quite broad, presumably broad enough to cover GMAC, GE, Ford and Sears among others.

- *Criteria for a Foreign Bank Subsidiary*

If a foreign financial institution is designated as a foreign bank, it may then apply for a charter to establish a foreign bank subsidiary. Whether the application is accepted depends in part on how the application squares with guidelines for establishing foreign bank subsidiaries in Canada. Selected aspects of these guidelines, issued by the Office of the Superintendent of Financial Institutions, appear as Appendix D to this Report. While these provisions include a preference for foreign banks that have widely held parents, there are no specific provisions relating to commercial links. What the guidelines emphasize is that the applicant be in the general business of lending and borrowing money.

Although not included in the provisions listed in Appendix D, elsewhere the document describes the guidelines as "generally desirable" but then states that "the Minister of Finance along with the Governor in Council have ultimate authority for approving applications". The Committee recognizes that some discretion to overrule the guidelines is essential, given the differing structures of financial systems across countries. However, discretion can, as in the AMEX charter, generate concern and confusion among the financial community.

- *Foreign Bank Exemptions*

The federal government can, in effect, exempt a foreign bank from being a foreign bank. In the *Foreign Bank Exemption Order* of May 27, 1981, 101 foreign banks were, in the language of the Order, "exempted from being a foreign bank". Exemption numbers 62 through 88 inclusive all refer to the Ford conglomerate—Ford Credit, Ford Leasing, Ford Consumer Credit, etc.—both in the U.S. and worldwide. What this seems to imply is that Ford could start up a trust company in Canada. If it chartered provincially, say in Quebec which intends to allow the links between the commercial and financial sectors, presumably it would have the latitude of continuing to operate a full range of financial and commercial services in Canada. Were the federal government to revoke this exemption,

then the financial arm of Ford would have to enter Canada as a Schedule II bank. As such, the parent and its affiliated companies are restricted in their ownership of Canadian companies. Under the current *Bank Act*, they (parent or Schedule II) cannot own more than ten per cent of companies in Canada unless those companies:

- do what a bank is permitted to do;
- engage in securities dealing or fiduciary services;
- are engaged in the business of insurance.

The Government can grandfather the existing range of non-financial activities and it can also include restrictions of various sorts in the Schedule II license or by other means. Deutsche Bank Canada is a Schedule II bank. Yet Deutsche Bank (Germany) effectively controls Daimler-Benz. Section 305(3)(c) of the *Bank Act* enables interests which were in existence at the time of the application for a Schedule II bank license to be grandfathered by the Minister. In the case of Deutsche Bank these interests were grandfathered in 1981, but the license stipulates that Deutsche Bank Canada cannot provide any banking services to a non-bank affiliate of the parent. In the case of AMEX, its existing credit card and travel insurance activities will be grandfathered. As a condition of licensing, however, AMEX has agreed to cease its car-leasing activites in Canada, to restrain from engaging in new non-travel-related business and to abide by the data processing rules under the *Bank Act*.

What all of this signifies to the Committee is that there is need for the Government to clarify its policy toward foreign bank entry. Minister Loiselle's moratorium on the approval of new U.S. Schedule II banks is welcome both in its own right and because it will provide a timely window in which a foreign bank policy can be articulated. The Committee's view is that the moratorium should not be lifted until such a policy is in place.

- *The AMEX Charter*

The Committee finds it difficult to sort out fact from perception when it comes to assessing the potential implications of the AMEX Schedule II bank charter. Accordingly, the appropriate way to begin is to present the Government's view of the AMEX case. The selective passages that follow are extracted from a January 24, 1989 public letter from Finance Minister Michael Wilson to Warren Moysey, Chairman of the Executive Committee of the Canadian Bankers Association.

> . . . For purposes of the *Bank Act*, American Express is a foreign bank and as such is eligible to apply to establish a foreign bank subsidiary in Canada. American Express Company has extensive financial services operations, is a long established financial services company in Canada and some of their services are banking type activities.
>
> American Express does have a longstanding travel services business in Canada. The *Bank Act* allows applicants to continue non-banking activities that they have been engaged in. . . . the principle of grandfathering such non-bank activities has been followed in a number of cases. American Express has agreed to restrictions that ensure that it will be constrained from engaging in new non-travel-related businesses. Accordingly, I do not believe that this application compromises our policies on not mixing financial and commercial interests in bank ownership.
>
> You have raised the point that American Express is not a regulated full service bank in its home jurisdiction and you have suggested that it should, therefore, be ineligible to have a bank subsidiary in Canada. You have pointed out that regulation of the foreign bank parent is one criterion set out in the 1980 guidelines on bank ownership issued by the Inspector General of Banks.
>
> I would point out that the Inspector General's document describes the guidelines as "generally desirable" but says that "the Minister of Finance along with the Governor in Council

have ultimate authority for approving applications". . . . Moreover, I do not agree that approving this application would imply that any or all future applicants, regardless of the nature of their business, would be approved without taking into account Canadian policies and instituting terms and conditions appropriate to the case.

. . . I plan to bring before Parliament amendments to the *Bank Act* to ensure that all banks have the power to promote goods and services, including insurance, to their credit cardholders. This means that in practice banks already established in Canada will have the same opportunities as American Express in this regard.

. . .

American Express has also agreed that it will cease car leasing activities in Canada when it becomes a bank, and has agreed to limitations on the financial activities that can be performed in travel offices. As well, American Express' Schedule B bank (which will be offering the credit card activities in Canada) will be subject to the data processing rules under the *Bank Act*, like any other bank.

The recent policy position with respect to the four U.S. financial conglomerates (Ford, GE, GM and Sears) reinforces one aspect of Finance Minister Wilson's position, namely that the granting of a charter to AMEX does not imply that "any and all future applicants, regardless of the nature of their business, would be approved . . ." Elaborating somewhat, the Committee understands that AMEX was essentially viewed by the Department of Finance as a financial institution: its commercial activities were viewed as minor, or *de minimis*. This is not the case for the four companies whose organization charts appear in Appendix C: they are first and foremost commercial companies.

The Committee has no desire to assess or evaluate this position on a point-by-point basis. However, focussing on some aspects of the AMEX case is essential both to understanding the depths of concern from some quarters of the financial sector and to making progress toward designing an acceptable policy for foreign financial institution entry into Canada. In what follows, the Committee is reflecting the concerns of witnesses who appeared before us and, on occasion, we shall resort to direct quotations.

The first point to make is that, on the basis of our evidence, it appears that AMEX does not intend to become a deposit-taking institution in the traditional sense of the term. Rather, its principal goal is to access the payments system and the automatic teller network. The issue put before the Committee is not easily answered: given that Canadian financial institutions have through time, effort and money developed one of the world's most efficient payments systems, why are we allowing AMEX to access our payments system when it does not have access to the payments system in its home country?

The second general point relates to that aspect of the foreign bank guidelines (number 8 in Appendix D) that requires that "the applicant must be able to demonstrate a potential to make a contribution to competitive banking in Canada". The Committee's view is that the presence of AMEX will surely increase competition in the money card market. Hopefully, it will also innovate in this area so that consumers of all money cards will benefit. The standard American Express card is essentially a debit card (with a one-month payment deadline) rather than a credit card. As such, AMEX has, over the years, cultivated an upscale market. Toronto Dominion's CEO Richard Thomson phrased the underlying concern this way: "There is a saying in the banking business that you make all your money from the top ten per cent of your customers, and American Express is creaming Canada in high income people. You will not find workers at the General Motors plant carrying American Express cards: they carry our cards."

The fear is that AMEX will intensify money card competition only in the upscale market, the impact of which will be that the Canadian financial institutions may be forced to follow suit in terms of

catering to high-income Canadians to the detriment of consumers at large. This merits close monitoring.

The third concern brought to the Committee's attention relates to the level playing field issue. It is true that the Government has promised to bring down legislation to allow the banks and trusts additional powers that the AMEX Schedule II will have. However, this is, at the very least, a most peculiar way to re-define or redesign ancillary in-house powers for banks and trusts. In the view of some of our witnesses, this process is essentially one of allowing exceptions to become the rule and in this way to determine the evolution of what constitutes banking in Canada. The general point is straightforward. Extending the boundaries of banking should be a conscious Canadian policy decision, not a process driven by a series of exceptions to accommodate new foreign entrants.

The granting of the AMEX charter has complicated the Committee's efforts to devise an acceptable domestic trade-off between banks and trusts. It is difficult to recommend that Montreal Trust, a subsidiary of one of the most widely held of Canadian institutions, must have a 35 per cent public float when commercially linked (according to long-standing Canadian practice) U.S. and foreign firms can wholly own a schedule II bank in Canada.

From this review, the Committee offers a few observations.

RECOMMENDATIONS AND OBSERVATIONS

49. The granting of a Schedule II charter to AMEX is perceived by some as a policy anomaly. The concern and uncertainty generated by this decision require that the Government further develop and announce its policy on foreign entry.

50. Toward this end, the Committee offers a few observations:

- **We endorse the recent federal moratorium on the granting of Schedule II foreign bank charters to U.S. "corporate banks" such as Sears, GM, GE and Ford, etc.**
- **If the Committee's bank holding company approach were adopted and if, over time, the BHCs' commercial activities exceeded some significant threshold, then the federal government should be willing to re-evaluate its moratorium.**

Enhanced Canadian Access

To this point, the focus has been on potential U.S. access to the Canadian financial market. There is the important other side to this general issue, namely enhancing Canadian access to the U.S. market. Although most attention in our hearings was focussed on financial institution access in terms of Europe 1992, the U.S. market is far and away the most important international market for most of our financial institutions. This is particularly true for insurance companies which are the most international of Canada's financial institutions.

In general, the witnesses representing the insurance industry were very satisfied with the FTA and the manner in which it dealt with insurance services on both sides of the border. The deposit-taking institutions, particularly the banks, were less satisfied. In particular their inability to branch interstate, in the U.S. deprives the banks of one of their areas of expertise. Now that the banks have entered into the securities business, the Glass-Steagall provisions in the U.S. are also viewed as very restrictive. The Committee notes, however, that the FTA did incorporate a change in the *Glass-Steagall Act* which allowed Canadian bank-linked securities companies to continue underwriting and dealing in a wide range of Canadian government securities. The recent decision by the Federal

Reserve Board to grant new securities activities to four U.S. banks has, we believe, also been made available to Canadian banks under the provisions of the FTA.

Nonetheless, the implicit, if not explicit, message delivered to the Committee was that if the federal government is intent on allowing other U.S. AMEXes into Canadian banking, then this should be conditional on obtaining enhanced manoeuverability of Canadian deposit-taking institutions in the U.S. financial sector. The Committee concurs.

RECOMMENDATIONS AND OBSERVATIONS

51. The Committee believes that far too much attention has centered on potential access to the Canadian financial market by foreign, particularly U.S., financial institutions. The other side of the equation also merits attention, namely how to secure enhanced manoeuverability for Canadian financial institutions in foreign financial markets, and in the U.S. market in particular.

Europe 1992

The aspects of Europe 1992 that most impressed the witnesses were the provisions designed to create a single financial market. Virtually all witnesses pleaded for some version of this to be implemented in Canada in order to escape from our domestic financial balkanization. The Committee will present its proposals along these lines in the later section on domestic harmonization.

More generally, witnesses observed that the likely price of full access to the single European market would be that the Europeans would demand the same treatment in Canada as the Americans obtained under the FTA. This means removing the asset ceiling on European Schedule II banks, removing the 10/25 rule for non-banks and removing the 25 per cent ceiling for European ownership of banks (albeit limited individually to ten per cent slices). Already the Europeans have indicated that they view these provisions as discriminatory. The Committee views the removal of these provisions in the context of Europe 1992 as inevitable.

The *quid pro quo* must be two-fold. First, Canadians must have access to the single European market, one aspect of which is to ensure that the continental European approach to regulation does not erect barriers to Canadian institutions entering Europe via the United Kingdom. Some witnesses expressed concerns on this point. Second, Canadian policy must ensure that reciprocal arrangements are pursued in a manner such that Canadian institutions are not disadvantaged in the Canadian market relative to European institutions. This is but another way of restating the earlier point that the most important market is the domestic market: Canadian financial institutions can be competitive internationally only to the extent that they remain strong at home.

RECOMMENDATIONS AND OBSERVATIONS

52. Canadian policy must ensure that reciprocal arrangements with Europe are approached in a manner such that Canadian institutions are not disadvantaged relative to European institutions in the Canadian market. Relatedly, since many Canadian financial institutions have long-standing activities in the U.K., Canada must ensure that the continental European approach to financial regulation does not erect barriers to Canadian entry via the U.K.

C Domestic Harmonization

Toward a National Financial Market

- *The Europe 1992 Model*

In Chapter 2 of Part I, we welcomed the initiatives of the provincial ministers of finance in the direction of harmonizing the regulation of financial institutions and we also welcomed the invitation they extended to the federal government to join them in future meetings. Likewise, the Committee is pleased to recognize the accomplishments of the CLHIA in designing a system of capital adequacy rules to underpin their consumer protection plan. This is a significant step toward the creation of a national market for insurance services.

Nonetheless much more is needed, particularly for deposit-taking institutions. Because the concerns, indeed frustrations, relating to provincial impediments were expressed by virtually everyone who appeared before us, the Committee is emboldened to make some rather dramatic recommendations in this area. The motivation underlying the Committee's desire to enhance the national aspects of Canada's domestic financial markets derives from the commitment, as part of Europe 1992, to a single European market for financial services.

RECOMMENDATIONS AND OBSERVATIONS

53. If Europeans can harmonize across national boundaries, then Canadians can surely harmonize across provincial boundaries.

It is instructive to outline the main features of the Europe 1992 model. In testimony before the Committee, Nicholas Le Pan, Assistant Deputy Minister with the federal Department of Finance, focussed on three basic principles underlying the European model of financial integration. The first is "mutual recognition" by member states of the authorization for a financial institution chartered in one state to do business in another member state. The second, and closely related, principle is that mutual recognition is subject to the harmonization of minimum standards, including minimum capital standards. Underlying this harmonization is, of course, substantial coordination, information sharing and the like among national regulators. These two principles pave the way for "home country rule" in which the regulator in the chartering nation is responsible for the supervisory oversight of the institution in its operations throughout the Community. The final principle is that the conduct-of-business rules or operating rules would be those of the host country, that is the country where the services are provided. In effect, then, the thrust of the Europe 1992 approach is that financial institutions will have a right to trade in financial services on the basis of a single "passport" from their home jurisdiction, subject only to host-country operating codes.

- *The Royal Trust Model*

The blueprint for the Committee's proposal comes from the Royal Trust brief, in particular the three-part "Royal Trust Model". The three components of the Royal Trust approach are:

1. a new consensus on key standards and principles;
2. a federal-provincial accord on regulation;
3. acceptance of the designated jurisdiction concept.

In terms of what might be included in this "new consensus", Royal Trust suggests:

- fitness and competence standards for owning and operating a financial institution;
- common capital adequacy standards to safeguard institutional solvency;
- corporate governance methods for prudent management;

° division of responsibility for regulation by "home" and "host" jurisdiction, including a more prominent use of the deposit insurance system with an enhanced role for the insurer;
° coordination of supervision and administration among regulators.

The brief notes that an obvious vehicle for achieving such a consensus would be the Senate's 1986 recommendation for a Permanent Committee of Ministers Responsible for Financial Institutions, steps toward which have already been taken by the provincial premiers. The brief also supports a suggestion made by the Conference Board of Canada before the Committee, namely that industry people should be involved in this process as well.

In terms of the second point, the federal-provincial accord on regulation, the Royal Trust brief offers as possible models the series of agreements between OSFI and provincial securities regulators in terms of the division of responsibilities for the regulation of the securities sector.

Finally, the "designated jurisdiction" concept is a variant of the mutual recognition/host county operating rules of Europe 1992. Essentially, the chartering or "designated jurisdiction" embodies: a) primary regulation by the chartering jurisdiction; b) mutual recognition by other jurisdictions of this designated jurisdiction; and c) acceptance of some conduct-of-business rules and consumer protection laws of the host province. One difference from the Europe 1992 model, which effectively involves a single banking license for the Community, is that the Royal Trust model contemplates registration and licensing in the host province.

- *The Committee's Proposal*

The Committee formally endorses the substance of the Royal Trust Model, including harmonization of minimum regulatory standards, the designated jurisdiction concept and host county operating rules.

RECOMMENDATIONS AND OBSERVATIONS

54. The Committee's proposal for a single national financial market is built around four tenets:

- **a new consensus on key standards and principles;**
- **a federal-provincial accord on regulation;**
- **acceptance of the designated jurisdiction concept;**
- **acceptance of host-province conduct-of-business rules and consumer protection laws (the concept of "provincial treatment").**

55. Now that the BIS capital adequacy rules apply to banks in roughly a dozen countries and, within Canada, several jurisdictions are already moving in this direction, the time has surely come for all primary regulators to reach consensus on some minimum acceptable standards and principles. The Committee recommends that jurisdictions in which the policy or regulatory authorities insist on enacting more lenient rules with respect to capital or regulatory oversight shall not be eligible for CDIC coverage for their chartered institutions.

56. Responsibility for regulating prudential aspects (capital, self-dealing, etc.) and for framing basic business and investment powers will rest with the chartering jurisdiction. This is the "designated jurisdiction" concept. Provinces will designate the chartering jurisdiction to have this responsibility. The general approach to this regulatory oversight will be governed by the federal-provincial accord on regulation.

57. Provinces will be able to implement their own conduct-of-business rules and consumer protection laws. However, "provincial treatment" must prevail in the application of these conduct of business rules: institutions chartered federally or in other provinces must be accorded the same privileges as host-chartered institutions. For example, it is likely that some provinces will prevent insurance networking on the premises of deposit-taking institutions. But for provinces that do allow such networking, this privilege must be extented to all institutions, irrespective of where they are chartered.

Some elaboration is in order. In establishing the basic precepts of the system there is bound to be a natural tension between the designated jurisdiction and the host-province conduct-of-business rules. As the recommendations indicate, the Committee believes that authority over prudential rules, corporate governance monitoring, allowable investments and basic business powers must reside with the designated jurisdiction (chartering province). Host provinces can regulate business conduct conditions such as disclosure and consumer protection provisions, as long as these do not impact extra-territorially. The model does not necessarily imply that a Quebec-chartered financial institution can do in Ontario everything it can do in Quebec, and vice versa. Thus, differing host-province business conduct rules convert the model into a "provincial-treatment" model, that is, a Quebec-chartered firm can do in Ontario everything that an Ontario firm can do. Note that the Quebec-chartered firm operating in Ontario would have the same operating rights as an Ontario firm irrespective of the Quebec firm's business powers or how it is structured. CDIC coverage for the Quebec firm in its Ontario operations is the only relevant criterion for the Ontario regulators: if the institution has CDIC coverage, it has all the operating rights and privileges of an Ontario firm.

An example may be in order. Suppose that federal policy allows trusts to buy insurance firms, but Ontario policy does not. If a federally chartered trust were to own an insurance firm (chartered federally or, say, in Manitoba) that operated in Ontario, the firm would have all the operating rights of an Ontario chartered insurance firm even though an Ontario-chartered insurance firm could not be owned by a trust. As noted earlier, Ontario can prevent all deposit-taking institutions from networking insurance on their premises, even if some of these have this right in their home provinces. In other words, insurance networking on the premises of deposit-taking institutions falls under conduct-of-business rules, to be regulated by host provinces.

Challenges on the Horizon

The Committee recognizes that there may be some concerns in the application of this recommendation, among them that Quebec has its own deposit insurance system and that Ontario may wish to retain its so-called "equals approach". We shall deal with each of these, beginning with the equals approach.

- *The Equals Approach*

As noted earlier, under Ontario's equal approach, a trust company operating in Ontario is subject to Ontario regulatory and operational oversight not only in Ontario but in other provinces as well. In other words, all trust companies even those chartered federally, must in effect manage their business inside and outside Ontario according to Ontario law. Because the Ontario market is so critical, Ontario regulation and supervision effectively dominates the trust industry, at least for those institutions that wish to access the Ontario market.

The Committee's view is that this is unacceptable and must come to an end.

While decrying the equals approach, the Committee sympathizes with the aspects of the underlying rationale. Basically the rationale is two-fold. First, Ontario has been influenced by the spate of recent failures both in Ontario and elsewhere. Hence, it attaches very high importance to

effective regulatory oversight, one result of which is very tough provisions with respect to matters such as self-dealing. Second, as noted by the Conference Board in their submission to the Committee, the equals approach protects Ontario against the potential flight of financial institutions and financial activity to provinces with easier rules.

In the Committee's opinion, neither of these rationales is, in any fundamental way, inconsistent with the above proposal. Indeed, the opposite is true. Effectively, what Ontario is signalling by way of the equals approach is the need for some minimum acceptable standards with respect to issues such as capital adequacy and corporate governance. This need also underlies our proposal. Issues may arise in terms of the degree of vigilance desired. However, the BCE Inc. approach to self dealing (Recommendation 44) is surely as stringent as the Ontario rules. Therefore, the Committee is optimistic that Ontario can be brought on side in terms of these proposals to enhance the national dimension of Canada's financial markets.

RECOMMENDATIONS AND OBSERVATIONS

58. Host-province conduct-of-business rules shall not have extra-territorial effect, that is, they shall not be applied in a way that affects operations outside the province. Ontario's "equals approach" runs counter to this principle. The Committee is optimistic that its earlier recommendations relating to self-dealing along with the minimum acceptable capital adequacy standards and the federal-provincial accord on regulation will meet Ontario's concerns.

- *QDIC*

The concern relating to Quebec is quite different in nature because this province has its own system of deposit insurance. In principle, Quebec could march to its own drummer in terms of regulatory oversight. In practice, however, the opposite appears to be the case. Quebec is an active participant in the interprovincial consultative and harmonization process (the Conference of Provincial Ministers Responsible for Financial Institutions). Second, harmonization and collaboration between the CDIC and the QDIC are a *fait accompli*. From the testimony of Mr. Ronald McKinley, Chairman of the Board of the CDIC: "The plans are essentially the same and we work well with that organization. It has been helpful to us and vice versa." Thus, capital adequacy standards are probably not at issue. Third, the Committee assumes that if our recommendation for networking of insurance is accepted, Quebec will allow institutions chartered elsewhere (e.g. the National Bank) to have the same privileges as the Caisses populaires. This would represent tangible evidence that Quebec has bought into the notion of a national market. Fourth, when Quebec-chartered institutions operate in other provinces they are covered by CDIC. Finally, the fact that Quebec has its own deposit insurance system also implies that the province is the ultimate guarantor so that it must bear the costs of regulatory or institutional failure. This alone will ensure regulatory vigilance. Even though Quebec does have legislation in place that incorporates different powers than those currently in place in other jurisdictions (including the federal jurisdiction), the Committee sees nothing in Quebec's overall approach to the financial sector that would point in the direction of anything but full cooperation with the goal of enhancing national markets.

Encouraging Developments

In advancing this proposal—designated jurisdiction/mutual recognition/provincial treatment—the Committee is aware that aspects of this concept has already caught on in some provinces. For example, in the New Brunswick *Loan and Trust Companies Act*, passed in 1987, the provincial government is allowed to classify any Canadian province or territory as a "designated jurisdiction". Financial institutions chartered in designated jurisdictions and federally incorporated companies will

be primarily subject to regulation by their home authorities. The administrative and enforcement provisions of the Act continue to apply but companies from designated jurisdictions will be exempted from the investment and business provisions of the New Brunswick legislation. The designation of jurisdictions is made on the basis of the adequacy of the home province's legislation and supervisory procedures. This is exactly what the Committee believes must be extended across the country.

A second development is worthy of note. British Columbia's *Financial Administration Act* of 1989, which is to be proclaimed in 1990, also contains a form of the designated jurisdiction rule. However, in designating a jurisdiction the government may take into account whether the other province provides B.C. incorporated firms with reciprocal treatment. The Committee's interpretation of the B.C. reciprocity provision is that firms chartered in Ontario, where the equals approach is in effect, are unlikely to benefit from the designated jurisdiction provision. This sort of retaliation is bound to intensify unless effective alternative measures are put in place. In turn, this implies that time is of the essence in terms of moving toward a truly national financial market.

RECOMMENDATIONS AND OBSERVATIONS

59. The Committee wishes to emphasize that New Brunswick and British Columbia legislation already incorporate the designated jurisdiction concept. In terms of New Brunswick, for example, the provincial government is allowed to classify any Canadian jurisdiction (on the basis of the adequacy of its regulatory and supervisory standards) as a "designated jurisdiction". Financial institutions chartered in such designated jurisdictions will be subject primarily to regulation by their home authorities. Moreover, companies from designated jurisdictions will be exempted from the investment and business provisions of the New Brunswick legislation. This is exactly the model that needs to spread across the country.

PART III

CONCLUSION

CHAPTER 7

Toward a National Market in Financial Services

The preceding chapters present the Committee's assessment of the challenges facing Canada's financial system and our recommendations in terms of how the system ought to respond. Underpinning these recommendations is a recognition that the financial sector is undergoing such rapid transformation that it would be foolhardy to constrain the system to evolve in a pre-conceived or pre-determined direction. Money is so mobile, instruments so creative and ideas so fungible that adaptability has to be a key characteristic of a financial system. On the other hand, the Committee also recognizes the substantial social and institutional capital embodied in Canada's existing financial institutions and environment. Thus, wherever possible, our distinct preference was to build upon these existing strengths.

With these precepts as backdrop, entrenching both competing ownership structures for deposit-taking institutions followed rather naturally. Moreover, the Committee came to the decision that to the extent that the playing field between banks and trusts was unlevel, the tilt related to powers, not to ownership structures. Accordingly, we took the bold initiative of recommending the Bank Holding Company structure. However, this initiative is bold only if the comparison is to what the banks have traditionally done. If the frame of reference is what the big trusts and their corporate owners can do or to what the Mouvement Desjardins can and does do, than the initiative falls in the more modest category of an appropriate levelling of the playing field. In a world where competitive advantage is difficult to come by, the Committee believes that Canada has to lever off its strengths. And one of our strengths is the financial sector.

Thus, the BHC concept unleashes the latent power of the banks and transfers to their management, their directors and shareholders the decision as of whether and how to make use of these new powers and opportunities. Finally, the requirement that these Bank Holding Companies be widely held was considered by the Committee as a further plus since BHCs have the potential to serve as a bulwark against the concentration of economic power in Canada in the hands either of a few influential families and/or of foreign interests.

While many of the recommendations are similar to those of our 1986 Report, one area where the Committee reversed itself was in terms of the burden of proof for self-dealing, whether owner or management/director related. Our earlier approach was essentially that self-dealing was allowed, apart from certain prohibited transactions. Our present approach is essentially that no self-dealing is allowed unless explicitly sanctioned. The Committee's view is that we have finally got it right. If

individuals or corporations wish to enter the finance sector, this has to be because they want to be financial players over the longer term. Phrased differently, the above proposals effectively close off the possibility of entering the financial sector in order to promote related commercial activities. This is the appropriate approach in its own right and it is also appropriate given the very flexible structure that the Committee is recommending.

In framing the recommendations with respect to the design of the Canadian financial system, the Committee did not operate from a position of ensuring that appropriate trade-off were carved out across the pillars in terms of what each wanted and what the Committee recommended. Upon reflection, however, a balance of sorts did emerge. The banks wanted the trusts to be widely held. The Committee said no. The trusts wanted to be able to be called banks. The Committee said no. The insurance companies wanted to be immune from takeover by deposit-taking institutions. The Committee said no.

On the positive side of the ledger, we have affirmed the existing ownership regime for trusts and effectively made them banks in everything but name. In terms of the banks, we have responded to their perennial concerns about extending the definition of banking to include various ancillary activities by creating a BHC structure which gives them a veritable *carte blanche* with respect to commercial activities, ancillary or otherwise. Mutual insurance companies can not only create downstream holding companies, but they can now roll their trust companies into new Schedule III banks.

The Committee has no illusions that our recommendations will constitute a permanent solution to financial sector reform. This was not our goal. Indeed, it would have been inconsistent with our underlying premise relating to the incredible pace of financial sector evolution Rather, our approach was driven by a desire to provide, over the medium term, ample flexibility for each sector to expand and to innovate, building on its existing strengths. We believe we have accomplished this objective.

Two other concerns loomed large in our analysis and/or recommendations. The first relates to the issue of foreign entry into the financial sector. Without taking sides on the issue, there is no question that the FTA and the AMEX charter have generated concern in terms of both present and future policy. We are the first to recognize that our observations and recommendations in this area are but initial steps. What is clear, and what we wish to convey, is that there is an urgent need for federal policy to clarify the basic ground rules.

The final issue of the Committee's focus may well be the most important, namely our determination to create a truly national market in financial services. The Committee, in its recommendations, is quite tolerant of provincial initiatives and experimentation. So was our 1986 Report. However, the time has now come for the federal government to take the lead in terms of the evolution of the financial system. We believe that the above recommendations will not only restore this leadership role to the federal government but as well will set in place a process whereby institutions operating nationally will opt increasingly for federal rather than provincial charters. In any event, creating a single national market for financial services has to be an integral part of the federal government's regaining the leadership role in terms of Canadian financial sector policy.

The Committee wishes to conclude with one last recommendation relating to the goal of achieving a single national market for financial services. It is our impression, based on the evidence presented to us, that all the players believe that this is an idea whose time has come. So do Canadians. So does the Committee.

Therefore, the impediment to a single market must reside somewhere in the policy arena—either in the lack of political will on the part of the federal and provincial governments or in the admittedly complex federal/provincial and interprovincial jurisdictional overlaps. The Committee does not have much time for these negative-sum jurisdictional niceties. Consumers and institutions

are suffering from this lack of direction. So is the ability of our major financial players to make inroads internationally. The Committee believes that the time is ripe for all interested parties to bring the regulators and policymakers into line. Hence, as a concluding comment, fully consistent with the title of this Report, the Committee recommends:

RECOMMENDATIONS AND OBSERVATIONS

60. The Committee urges all interested parties—consumers of financial services, financial institutions, provincial governments, regulators, and the federal government—to commit themselves publicly to the eminently reasonable and critically important goal of achieving a single national financial market by 1992.

APPENDIX A

1986 REPORT RECOMMENDATIONS

PREFACE AND OVERVIEW: TOWARDS A MORE COMPETITIVE FINANCIAL ENVIRONMENT

PART I
CONSUMER PROTECTION AND FINANCIAL INSTITUTION STABILITY

A. A PERSPECTIVE ON THE REGULATORY PROCESS

Introducing Discipline Throughout the System

The Four Pillars

Regulation by Function

FHCs and the Four-Pillar Approach

Centralizing Regulatory Functions

1. **The Standing Senate Committee on Banking, Trade and Commerce views the historical evolution of federal and provincial roles in the regulation of the Canadian financial sector as an important ingredient of Canada's social capital. Hence, the reform of the Canadian financial sector should, as much as possible, respect the existing institutional and federal-provincial division of powers and responsibilities.**

2. **Accordingly, the Committee opposes the consolidation of regulatory/supervisory powers in a single, all-powerful regulatory agency.**

3. **Ensuring consumer protection and institution stability is best achieved by the introduction of greater discipline with respect to all four regulatory components — the Canada Deposit Insurance Corporation (CDIC), the primary regulators, the auditors and corporate governance — rather than placing excessive reliance on any one component.**

4. **If concerns such as solvency and self-dealing are to be addressed effectively, there must exist primary regulators with authority over the entire operations of the institution. Thus, the Committee favours the present system which aligns regulators and institutions according to the institution's core function. This practice of assigning separate primary regulators to each core function has come to be known as the "four-pillar" approach.**

5. The forces of competition and technology are inducing financial institutions to undertake cross-pillar activities — activities that fall outside the competence and jurisdiction of the primary regulator. Given that the line of demarcation between various types of financial instruments is progressively more blurred, it is neither possible nor desirable to restrict an institution's activities to its core function. However, any such cross-pillar activities must be subject to monitoring by one of the primary regulators.

6. Thus, the challenge is to ensure that each dollar deposited with an institution is regulated somewhere while at the same time ensuring that this does not lead either to regulatory overlap or to the "un-levelling of the playing field".

B. DEPOSIT INSURANCE

7. The CDIC should be constituted as a separate institution with its own board of directors drawn from both levels of government, the private sector and member institutions.

8. The CDIC will function as an insurer. Its role shall be one of administering the deposit insurance funds. Since these funds are financed through premiums from insured institutions, the CDIC shall have the responsibility of acting as agent for these member institutions in managing and protecting the assets of these funds, for the ultimate benefit of insured depositors.

9. In the normal course of events the CDIC will delegate its regulatory powers to the primary regulators. In return, the primary regulators will be required to establish a set of arrangements that would operate as an "early warning system" to signal those institutions that may be experiencing problems.

10. The CDIC would become directly involved in the supervision and regulation of the institutions identified as potential problem institutions by the early-warning system. The range of powers that the CDIC would have in order to restore these institutions to financial health would include the authority to alter leverage ratios, the authority to issue cease and desist orders with respect to selected activities and/or practices and the authority to assemble its own qualified team of examiners.

11. If the CDIC determines that an institution is no longer insurable, this information will be communicated immediately to the relevant primary regulator and to the responsible minister. Normally, this would trigger the process of winding down that institution.

12. The possibility exists, however, that the government responsible for the institution will want to keep it in operation in spite of the fact that the CDIC deems it to be no longer insurable. The Committee believes that this is the government's prerogative. However, we also believe that, in all such cases, the CDIC's exposure with respect to such an institution must be limited as of the date of the notice to the relevant minister that the CDIC has determined that the institution is no longer insurable. Thus any further liabilities or exposure must be the responsibility of the relevant government.

13. The level of deposit insurance should remain at $60,000 until the reconstituted CDIC is in place and operating for at least one full year. Beyond this period, a majority of the Committee is in favour of full insurance up to $25,000 and 80 per cent insurance for the next $50,000.

14. The CDIC should operate on the basis of separate "pools" — one for banks, one for trust companies and one for credit unions. Losses by a member institution would be made up by a series of surcharges levied on other members of the same pool. The rationale for these segregated funds is that they will encourage a desirable degree of industry self-regulation. The CDIC would welcome the Canadian Life and Health Insurance Association (CLHIA) and the securities industry as members, but the Committee recognizes that these sectors prefer, at present, to operate their own consumer protection plans or funds.

15. Finally, the Committee views deposit insurance as a privilege, not a right. Thus, the CDIC must have the authority to set standards for insurability and, indeed, to refuse insurance to those institutions which do not meet these standards or whose primary regulators do not follow CDIC guidelines.

C. INCREASING THE EFFECTIVENESS OF PRIMARY REGULATORS

Exercising Existing Powers

16. To a considerable degree, the recent problems in the financial sector appear to reflect not so much an inadequate range of regulatory powers as an inadequate exercise of existing powers. To the extent that this is the case, it is important that legislators do not react to recent events by endowing regulators with unnecessary and unwarranted powers.

Increasing Existing Powers

17. Increases in regulatory powers should be restricted to those areas where existing powers limit the ability to monitor the soundness and solvency of an institution or to restore problem institutions to financial health. They should not be utilized to supplant management's prerogative to manage and direct an institution.

18. The most serious weakness of the existing regulatory framework is the lack of procedures or mechanisms to identify problem institutions on a timely basis.

An Early-Warning System

19. Primary regulators must be required to develop a computerized data base to serve as the building block for an early-warning system. Other components of the system would include the monitoring of brokered deposits and the establishment of an institutional rating system modelled, for example, after the U.S. CAMEL system. (CAMEL is an acronym for Capital adequacy, Asset quality, Management ability, Earnings quality and Liquidity.) The CDIC would become directly involved in the supervision and regulation of institutions that fall below some minimum threshold level in terms of the rating system or, more generally, in terms of the indicators relating to the early-warning system.

D. AUDITORS

Upgrading Standards

Enhancing Reporting Requirements

Appointment of Auditors

Auditors and Audit Committees

20. **The Committee recommends that the CDIC, the primary regulators, industry representatives and the CICA work together in developing reporting and assessment standards that will reflect more accurately an institution's exposure to risk. In particular, it is important that financial statements strive to reflect the current or market values of assets. This requires more uniform reporting across institutions for non-performing loans and provisions for losses.**

21. **All financial institutions should be required to submit to annual audits by two firms. One of these firms should be appointed by the primary regulator. The rationale for this recommendation is two-fold: first, to enhance the independence of auditors and, second, to encourage an audit perspective that takes into account the interests of depositors as well as shareholders. Unlike a somewhat similar recommendation by the House of Commons report, which would have the second auditor follow separate audit standards and report to the primary regulator rather than to management, we would prefer to have the audit and reporting standards and regulations remain as they currently are.**

22. **The Committee recommends that the auditors be required to attend the meetings of the institution's audit committee.**

23. **The present procedures whereby auditors report on inappropriate practices or procedures to the extent that they affect the institution in a "material" way place an inappropriate degree of judgemental responsibility on the auditors. The Committee recommends that the auditors be required to report to the audit committee all instances of self-dealing, malfeasance and transactions outside the apparent powers of the financial institutions, in accordance with the guidelines established by the audit committee.**

24. **Copies of the post-audit reports to management and the audit committee of the board of directors must be provided simultaneously to the primary regulator.**

E. CORPORATE GOVERNANCE

Standards of Care and Diligence for Directors

25. **The Committee recommends that directors exhibit, in exercising their powers and discharging their duties, a degree of skill that may reasonably be expected from persons of their knowledge and experience.**

26. **The Committee recommends comprehensive indemnification provisions for a director of a regulated financial institution against costs and expenses incurred in respect of a civil, criminal or administrative action to which the director was a party if the director acted honestly and in good faith with a view to the best interests of the institution and if the director had reasonable grounds for believing that his or her actions were lawful.**

Self-Dealing

The Green Paper Position

The Essence of the Self-Dealing Concern

27. The Committee rejects the Green Paper proposal for a general ban on all non-arm's-length transactions (NALTs). Rather, the objective of an approach to

self-dealing ought to be to prevent potentially "abusive" NALTs while allowing constructive ones to proceed. Toward this end the Committee proposes a three-pronged procedure that would incorporate a system of NALTs review. We also provide for appropriate regulatory oversight, safeguards, public redress and sanctions.

A Three-Tiered Approach to Self-Dealing

Tier One: A Selective Ban

28. The first tier is an outright ban on a selective set of self-dealing transactions that by their very nature would jeopardize consumer protection and the stability of the institution. Here, the Committee follows the recommendation of the House of Commons report that representatives from the primary regulators, the professional associations (including lawyers, accountants, appraisers and actuaries) and the financial institutions be involved in drawing up the selective list of prohibited transactions.

Tier Two: Business Conduct Review Committee

29. Every financial institution would be required to establish a Business Conduct Review Committee (BCRC) of the board of directors to review in advance all non-arm's-length transactions to ensure that they do not either expose minority shareholders and consumers to abuse, or materially increase the risk of insolvency to the institution.

30. The BCRC will be comprised of not less than three "outside", "disinterested" or "independent" members of the board of directors. A director is deemed not to be qualified to serve on the BCRC if:

- he or she is an officer, employee, solicitor, auditor or has any professional association with the financial institution or an affiliate of the financial institution, or is a relative of any of the foregoing individuals;

- he or she is a significant shareholder in the financial institution, i.e. holds more than ten per cent of the outstanding voting shares individually or in combination with associates; and

- he or she has significant financial interests in or with the institution, e.g. a significant borrower.

31. As a safeguard to assure the independence of BCRC members, the Committee proposes that provision be made for interested parties to be allowed to apply to the courts to determine whether members are truly independent and thereby qualified to act. This right could be exercised by the regulators, minority shareholders or the public.

32. The role of the BCRC is to ensure that all NALTs are consistent with the prices, terms and conditions that would prevail in arm's-length transactions.

33. The BCRC should have the right to retain independent professional counsel.

34. The BCRC would be responsible for establishing procedures and guidelines to ensure that all related-party transactions are brought to its attention for pre-clearance and either approved or disallowed.

35. If the BCRC disallows any NALT, the transaction cannot proceed.

36. The Committee recommends that there be statutory requirements for all directors, senior management, auditors, solicitors and associated professionals to report all related-party transactions to the BCRC.

37. All decisions of the BCRC will be reported immediately to the auditors, to the audit committee of the financial institution and to the members of the board of directors.

Tier Three: Pre-Clearance with the Primary Regulator

38. The third tier is a provision for pre-clearance with the primary regulator for certain sorts of self-dealing transactions. Such transactions would include:

- NALTs involving particularly sensitive assets such as real estate, or closely-held corporations or other generally illiquid assets for which there is no reliable independent basis of evaluation;

- individual transactions over a certain size or cumulative NALTs over a certain percentage of assets; and

- all NALTs for a specified period of time after the establishment of a new financial institution or upon a change in control of an existing financial institution.

Redress and Safeguards

39. The Committee proposes that, upon the application of a member of the public or the regulatory authorities, the legislation confer on the courts the power to set aside improper related-party transactions and to direct that the related party account to the institution for any profit or gain realized in such transaction. This type of remedy is already available under the *Canadian Business Corporation Act* (CBCA), but it should apply to all regulated financial institutions.

Recapitulation

40. The Committee believes that with these provisions in place, all third parties and regulators will have a high degree of assurance that any and all self-dealing transactions are in the best interests of the institution, its shareholders, and its customers and are being carried out at prices that would fairly reflect those which would occur in arm's-length or market transactions.

41. Beyond some learning period, the Committee is of the view that financial institutions will be able to cope rather well with these provisions. Undoubtedly, it will be the case that these institutions will henceforth have to conduct their affairs with considerably more concern for their customers and minority shareholders. However, this is entirely appropriate since, as will be detailed later, the *quid pro quo* is greater flexibility and maneuverability in the market-place.

F. SELF-DEALING WITHIN A CONGLOMERATE

Should Holding Companies be Regulated?

42. The regulation of financial holding companies would add yet another substantial layer to the regulatory process. To the extent that the rationale for this is to control self-dealing, we believe that the concern is unwarranted given

the previous recommendations addressing self-dealing. Since there are two sides to every transaction, each episode of self-dealing will be subjected to scrutiny in at least one institution and if the NALT is designed to be between two affiliated companies it will come under the scrutiny of both BCRCs. Accordingly, the Committee rejects the Green Paper proposal for federally regulated financial holding companies.

Cross-Pillar Activity and Self-Dealing

43. Where one financial institution has a controlling interest in another financial institution operating in a different pillar, either the institution itself or its affiliate must have 35 per cent of its shares traded publicly. For financial conglomerates, if the holding company does not have 35 per cent of its shares traded publicly, all of its subsidiaries must be publicly traded to the extent of 35 per cent. Since schedule A banks, mutual companies and credit unions are, or are deemed to be, widely held they could, under these provisions, hold wholly-owned subsidiaries. The rationale for this provision is to enhance the role of corporate governance in monitoring self-dealing. A public share ownership of 35 per cent is probably sufficient to ensure that professional financial analysts will monitor the operations of the firm. This added scrutiny and increased public awareness will provide yet another incentive for institutions to ensure that their business conduct review committees function properly.

44. Where there is a difference between the percentage of shares publicly traded and the percentages of voting rights publicly traded, it is the latter that is the focus of our recommendation.

Financial and Non-Financial Activities

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

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.

H. SUMMARY

48. The Committee is satisfied that the preceding recommendations will ensure an effective supervisory and monitoring system with respect to consumer protection, institution soundness and system stability.

PART II
ENHANCING COMPETITION

A. INTRODUCTION

49. The Committee endorses the principles relating to competition and efficiency enunciated in the Green Paper. However, in conducting the analysis the Committee was also influenced by the following concerns:

- **the ultimate role of the financial system is to transfer funds efficiently from lender to borrower;**
- **government policy in the financial arena should avoid the imposition of a preconceived structure on the financial system;**
- **the policy framework for the financial sector must encourage rather than inhibit innovation;**
- **any set of reforms must ensure that our successful institutions remain world class and that other institutions have the flexibility to achieve this status; and**
- **where possible, the reform process ought to work from, and build upon, our existing strengths.**

B. BROADENING SOURCES OF CREDIT AND CUSTOMERS' OPTIONS

The Process of Financial Integration

An Approach to Institution Flexibility

50. Subject to certain criteria and priorities to be detailed later, the Committee welcomes all four general approaches to financial diversification:

- **within-institution expansion of powers;**
- **subsidiaries;**
- **upstream and downstream holding companies; and**
- **networking.**

C. EXPANDING IN-HOUSE POWERS

Commercial Lending

- Trust Companies
- Insurance Companies
- Credit Unions
- Summary

51. The present qualitative approach to investment should be replaced by a quantitative or prudent portfolio approach that would be monitored by the

investment committee of the board of directors. The essential features of this portfolio approach would be that quantitative limits would be established with respect to the proportion of the portfolio that can be invested in each type of security.

52. As far as the investment limits relating to commercial lending/leasing, the Committee is in favour of establishing an all-inclusive maximum of 20 per cent of assets for trust companies and insurance companies. It may be appropriate to have these limits escalate to the maximum levels in terms of a series of thresholds based, say, on the amount of capital.

53. Provided that the regulation of credit unions and caisses populaires outside Quebec satisfies the prudential standards established by the CDIC, the Committee is also in favour of expanding the commercial lending powers of credit unions, in phases again based on capital, up to a maximum of 20 per cent of assets. Since the regulations relating to credit unions are essentially in the domain of the provinces, this recommendation is directed principally to the CDIC in terms of the conditions on which it should be willing to accept credit unions for deposit insurance, other prudential considerations assumed to be in order.

Other Cross-Pillar Activities

54. There is probably scope for allowing greater in-house expansion of powers into other cross-pillar activities, provided that they are regulated or monitored by the responsible primary regulator. The Committee's approach is to be flexible unless a case can be made that such an expansion of in-house powers would run counter to the public interest.

55. The Committee concurs with the House of Commons report that life-insurance companies be allowed to act as trustee of funds payable on insurance contracts, registered pension plans and registered retirement savings plans. However, as a general rule, the Committee would prefer that institutions wishing to engage in the estate, trust and agency business do so through affiliated institutions rather than through an expansion of in-house powers.

D. DIVERSIFICATION THROUGH SUBSIDIARIES

56. Financial intermediaries should be allowed to diversify their financial activities through subsidiaries. However, subsidiaries of financial institutions should not be in the non-financial area, except to the limited extent referred to in the recommendations of the previous chapter. Moreover, the 35 per cent rule relating to publicly traded stocks will also apply: either the institution or the subsidiary must have 35 per cent of its stock publicly traded.

57. Equity investment in subsidiaries must be deducted from base capital in order to avoid double leveraging. A 20 per cent ownership stake in a subsidiary should be the threshold level for triggering this provision against double leveraging. This should ensure that only institutions with a strong financial base could take advantage of diversifying through subsidiaries.

E. HOLDING COMPANIES

58. Diversification across the pillars by either upstream or downstream holding companies should be permitted.

59. **Double counting of capital would not be permitted, even for mutual life companies and credit unions. However, these institutions should be allowed to issue preferred stocks and subordinated debentures.**

60. **For institutions desiring even greater commercial lending ability, a schedule B bank should be permitted as part of a holding company. Such banks would be restricted in terms of size. To exceed these limits would be possible only if they adopted the widely-held, schedule A route. The rationale for this approach is to encourage the development of regional banks as well as to allow regional institutions to use the schedule-B bank route to diversify their assets across regions.**

F. NETWORKING

61. **The Committee takes a very favourable view of networking, with two provisos. Tied selling must be prohibited and networking fees should be above board and subject to monitoring by the relevant regulator.**

G. INTERNATIONAL ASPECTS

62. **The Committee endorses the existing approach toward foreign ownership of Canadian trust and life companies; transfer of ownership or control of existing Canadian financial institutions to foreign interests should be restricted, or at least subject to ministerial approval, but new entry should be freely allowed.**

63. **Given the growing internationalization of the markets for credit and capital, Canadian regulatory policy should avoid initiatives which could result in our institutions being denied access to foreign markets.**

64. **Mutual life companies incorporated in Canada should be deemed Canadian institutions.**

H. CAPITAL REQUIREMENTS

65. **The Committee endorses the generally accepted view that higher initial capital requirements are required for financial institutions, but cautions against setting these requirements so high as to unduly restrict entry.**

I. SECURITIES INDUSTRY

The Structure of the Securities Industry

The Increasing Foreign Penetration

The Approach of the Official Reports

The Committee's View

66. **The Committee recognizes that policy with respect to the securities industry falls under the legislative domain of the provinces. Nonetheless, the securities industry plays such a pivotal role in Canadian capital markets that no overview of the regulation of the Canadian financial system can be complete without some reference to the operations of securities markets.**

67. The Committee also recognizes that the Green Paper and the House of Commons report appear in principle to be willing to include the securities industry as an integral part of their overall designs for reform. In particular, should the provinces be willing, these reports would allow securities firms to come under the umbrella of a financial holding company (the Green Paper and the House of Commons report) or become a subsidiary of a financial institution operating in a different pillar (the House of Commons report).

68. Consistent with the general approach we have taken to the opening up of the financial system, the Committee recommends, for consideration by the provinces:

- that securities firms be treated like any other financial institution in terms of being able to be part of an upstream or downstream holding company or subsidiaries of a financial institution operating in another pillar; and
- that securities firms themselves be given powers similar to those of other financial institutions in terms of being able to acquire subsidiaries and to form downstream holding companies.

69. The Committee welcomes the call by the Ontario Task Force that the province of Ontario review its policy with respect to foreign ownership of securities firms.

J. CHARTERED BANKS

Reserve Requirements and the Level Playing Field

70. The fact that the chartered banks are required to hold part of their reserves in the form of non-interest-bearing deposits with the Bank of Canada serves, in effect, to levy a tax on banks relative to other financial institutions. The preferred solution is for the Bank of Canada to pay interest on these reserves. Since trust companies, for example, typically hold some of their reserves with chartered banks, the Bank of Canada might look to the interest rate paid on these deposits when determining the appropriate interest rate to pay on chartered-bank deposits with the Bank of Canada.

71. Interest should not be paid on any chartered-bank excess reserves (i.e. reserves beyond those required) held on deposit with the Bank of Canada. Together, these two provisions — interest on required reserves and no interest on excess reserves — will ensure that the Bank of Canada's ability to exercise its monetary control function will not be impaired.

Extending Bank Powers

72. In principle, there is no reason why the flexible approach which the Committee has outlined for the financial system should not apply to the chartered banks. Those who would wish to constrain the chartered banks in their sphere of operations should be required to demonstrate that an extension of bank powers would be contrary to the public interest.

73. This is particularly the case for the securities industry. If the provinces move to allow foreign securities firms and merchant bankers to establish domestic operations, then the Committee believes it is essential that the chartered banks,

or at least their offshore merchant-banking subsidiaries, be allowed equivalent privileges.

74. The Committee recommends that the ownership restrictions applicable to schedule A banks remain in place.

The Legislative Timetable

75. The Committee recommends that the updating of the trust company and life insurance company legislation take priority over the 1990 Bank Act revisions.

K. CONCENTRATION

76. The Committee is concerned about the degree of concentration in the financial sector. We take this opportunity to signal our intention to undertake a thorough review of the concentration issue as it relates to both the financial and non-financial sectors, including the issues raised by the commingling of financial and non-financial activities.

PART III
FEDERAL-PROVINCIAL CONSIDERATIONS

A. FEDERAL-PROVINCIAL RELATIONS AND FINANCIAL SECTOR REFORM

77. The Committee believes that the federal government can act now upon the foregoing recommendations, confident that they respect the historical and judicial evolution of powers and responsibilities in the Canadian financial system.

B. JURISDICTIONAL HARMONIZATION

The Jurisdictional Mosaic

Jurisdictional Harmonization and the Legislative Process

Jurisdictional Havens and Competitive Deregulation

CDIC, CPA, and Financial-Institution Jurisdiction

78. The Committee recognizes that the existence of multiple jurisdictions can and does complicate the operations of the Canadian financial sector. However, there may also be substantial benefits in terms of flexibility, innovation, experimentation and healthy competition. Moreover, the two most recent substantive alterations of the financial system, namely the advent of deposit insurance and the Canadian Payments Association, have been introduced in such a manner that they have served to endorse and even entrench the existing institutional and federal-provincial operating environment.

C. REGULATORY COORDINATION

Exclusive Jurisdiction

Multiple Horizontal Jurisdictions

79. The ultimate objective of regulatory coordination should be to create a structure where regulations are sufficiently compatible across jurisdictions that the markets can in effect become national markets. Some pillars are more advanced in achieving this goal than others. Frequently, however, the stumbling block is not that coordinating mechanisms are not in place, but rather that there is a lack of policy harmonization across jurisdictions.

D. POLICY HARMONIZATION

80. The Committee perceives that the institutional infrastructure designed to harmonize the financial environment at the policy level is, at present, inadequate. Accordingly, the Committee recommends that the federal government take the initiative to establish, with the provincial governments, a Permanent Committee of Ministers Responsible for Financial Institutions. This body would be responsible for achieving policy harmonization. In particular, it would be responsible for adopting a national perspective with respect to the markets in which financial institutions now operate. This global overview is essential since the Canadian financial market is much more encompassing than the domain of any one regulator or jurisdiction.

E. CONCLUSION

81. The Committee concludes by reiterating its view that what is required on the federal-provincial front is not a re-design of the underlying structures or responsibilities in the financial sector, but rather a re-orientation of existing structures in order to address the challenges of the 1980s and beyond. In this sense, the federal-provincial implications arising from the preceding recommendations call primarily for renewed and creative efforts in addressing the perennial problems of harmonization and coordination.

E. REGULATORY COORDINATION

Exclusive Jurisdiction

Multiple Horizontal Jurisdictions

79. The ultimate objective of regulatory coordination should be to create a structure where regulations are sufficiently compatible across jurisdictions that the markets can in effect become national markets. Some progress has been achieved in achieving this goal more informally. Frequently, however, the stumbling block is not that coordinating mechanisms are not in place, but rather that there is a lack of policy harmonization across jurisdictions.

F. POLICY HARMONIZATION

80. The Committee perceives that the institutional framework designed to harmonize the financial environment of the policy-makers is at present, inadequate. Accordingly, the Committee recommends that the federal government take the initiative to establish, with the provincial governments, a Permanent Committee of Ministers Responsible for Financial Institutions. This body would be responsible for achieving policy harmonization. In particular, it would be responsible for adopting a national perspective with respect to the markets in which financial institutions now operate. This global overview is essential since these marketplaces are increasingly more national in scope than the domain of any one regulator or jurisdiction.

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81. The Committee concludes by reiterating its view that what is required on the federal-provincial front is not a re-design of the underlying structures or responsibilities in the financial sector but rather a re-orientation of existing structures in order to address the challenges of the 1990s and beyond. In this sense, the federal-provincial implications arising from our foregoing recommendations call primarily for renewed and creative efforts in addressing the perennial problems of harmonization and coordination.

APPENDIX B

A CHRONOLOGY OF SELECTED FINANCIAL SECTOR INITIATIVES SINCE MAY 1986

May 1986 - The Standing Senate Committee on Banking, Trade and Commerce presented its report "Towards a More Competitive Financial Environment".

November 1986 - Scotiabank announced its intention to enter the securities business in Quebec through Scotia Securities Inc., a wholly owned subsidiary of the Bank.

December 1986 - The Ontario Government announced that effective 30 June 1987 restrictions on investment in securities dealers by other Canadian financial institutions would be removed completely and eliminated in two stages for non-residents.

December 1986 - The Blue Paper, "New Directions for the Financial Sector", was tabled in the House of Commons.

January 1987 - The federal Government introduced a Notice of Ways and Means Motion to amend the *Income Tax Act* to provide for the establishment of International Banking Centres in Montreal and Vancouver.

February 1987 - The British Columbia Securities Commission issued a policy statement suggesting that the B.C. securities industry be opened up to ownership by non-residents, Canadian financial institutions and other Canadian entities. B.C. securities dealers would be permitted to own financial or non-financial entities and could carry on banking, trust and insurance business through subsidiaries.

June 1987 - New Brunswick passed the *Loan and Trust Companies Act* permitting the province to classify any Canadian province or territory as a "designated jurisdiction".

June 1987 - The Ontario Government lifted to 50 per cent the limitation on foreign ownership of an investment firm.

June 1987 - Bills C-42 and C-56 were enacted. Bill C-42 consolidated the Office of the Inspector General of Banks and the Department of Insurance into the Office of the Superintendent of Financial Institutions (OSFI) and increased the powers of CDIC. Bill C-56 permitted federally regulated financial institutions to own securities dealers, granted OSFI the power to halt unsound business practices and raised the financial standards of federally incorporated insurance companies.

October 1987 - The preliminary text of the Canada-U.S. Free Trade Agreement (FTA) was initialled. In terms of the provisions relating to the financial sector, each country agreed to offer what amounts to national treatment to the other country's financial institutions operating within its borders.

October 1987 - The Quebec Government released the document entitled "Reform of Financial Institutions in Quebec: Objectives, Guiding Principles and Action Plan." The paper suggested: 1) a firm could offer a complete line of financial services through subsidiaries; 2) no restrictions on financial/commercial links; 3) encouragement of self-regulation; 4) facilitation of financial networking.

November 1987 - The Quebec Government introduced Bill 74. *An Act respecting trust companies and savings companies*. The Bill would permit trust and savings companies to: 1) offer investment counselling and portfolio management services and to sell securities; 2) network other financial services; 3) engage in leasing; 4) sell lottery tickets; 5) engage in other activities authorized by the Minister.

December 1987 - The federal government introduced a discussion draft of the *Trust and Loan Companies Act* based on the December 1986 Blue Paper.

March 1988 - The federal government reached agreement with the Ontario and Quebec governments on the regulation of investment dealers owned by federally incorporated financial institutions.

April 1988 - Ontario's Bill 116, *An Act to Revise the Loan and Trust Corporations Act*, came into force. The legislation introduced the "prudent investment standard", expanded the investment powers of trust and loan companies, increased consumer and commercial lending powers of trust companies and permitted leasing. It also introduced the "Equals Approach", which has extraterritorial effects on any trust company operating in Ontario.

June 1988 - The Ontario Government removed the remaining restrictions on foreign ownership of investment dealers.

July 1988 - The Bank for International Settlements (BIS) Agreement on capital requirements was signed by representatives from ten member countries including Canada. One of the objectives of the Agreement is to reduce "a source of competitive inequality among international banks." Under the Agreement banks from the signatory countries are expected to achieve a capital to risk-adjusted assets ratio of 8 per cent by the end of 1992 and an interim target ratio of 7.25 per cent by 1990.

October 1988 - Ministers responsible for financial institutions from the four western provinces of British Columbia, Alberta, Saskatchewan and Manitoba signed the Information Sharing Agreement. The agreement provided for the exchange of information, cooperation and consultation among regulators and notification of special examinations of financial institutions.

November 1988 - The Government issued an Order-in-Council approving in principle a license for American Express to operate a Schedule II bank in Canada. However, the Minister of Finance announced in February 1989 that issue of the letters patent permitting American Express to commence banking operations would be delayed for up to one year to allow the Government time to introduce and pass new financial institutions legislation.

December 1988 - The provincial ministers responsible for financial institutions met in Quebec City and agreed to develop an accord governing the supervision of financial institutions based on the agreement reached by the four western provinces in October 1988.

April 1989 - The provincial governments signed an agreement on sharing of information necessary for supervision of financial institutions. The information sharing agreement is based on the principles established in the accord signed by the four western ministers in October 1988. It was also agreed that the federal government should be invited to join an information sharing agreement with the provinces.

May 1989 - The Quebec Government introduced Bill 134 permitting market intermediaries, such as insurance agents and brokers, claims adjusters, financial planners, securities dealers and advisers, to hold multiple licenses to carry on activities in more than one financial field.

June 1989 - The British Columbia Government introduced two bills governing the regulation of financial institutions. The *Financial Institutions Act* applies to all provincially regulated financial institutions but corporate law issues for credit unions are provided in the *Credit Union Incorporation Act*.

June 1989 - The Chairman of the House of Commons Standing Committee on Finance and the Insurance Brokers of Ontario claimed that the practice by banks of referring clients to insurance companies was illegal. The Superintendent of Financial Institutions, Mr, Mackenzie, stated that the practice did not contravene the *Bank Act*.

August 1989 - A group representing European Community bankers identified Canada as one of the countries which impose restrictions on the volume of foreign banking. The EC's Second Banking Directive requires that negotiations be entered into with countries which discriminate against EC banks.

August 1989 - At the third meeting of the Conference of Ministers Responsible for Financial Institutions in Moncton it was agreed: to set up a life insurance compensation scheme, if necessary; to work toward uniform reporting, auditing and accounting standards; to develop a uniform capital adequacy test and common set of quantitative investment rules; and to limit trust activities to trust companies. The importance of meeting with the Federal Minister of State for Finance was emphasized.

December 1989 - The European Community adopted the Second Banking Directive, which will establish a single European banking market on 1 January 1993. Third countries are expected to provide EC banks with national treatment and market access comparable to that accorded the outside country's institutions in the EC.

June 1989 - The British Columbia Government introduced two bills governing the regulation of financial institutions. The *Financial Institutions Act* applies to all provincially regulated financial institutions but separate provisions for credit unions are provided in the *Credit Union Incorporation Act*.

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APPENDIX C

ORGANIZATION CHARTS: U.S. IN-HOUSE BANKS

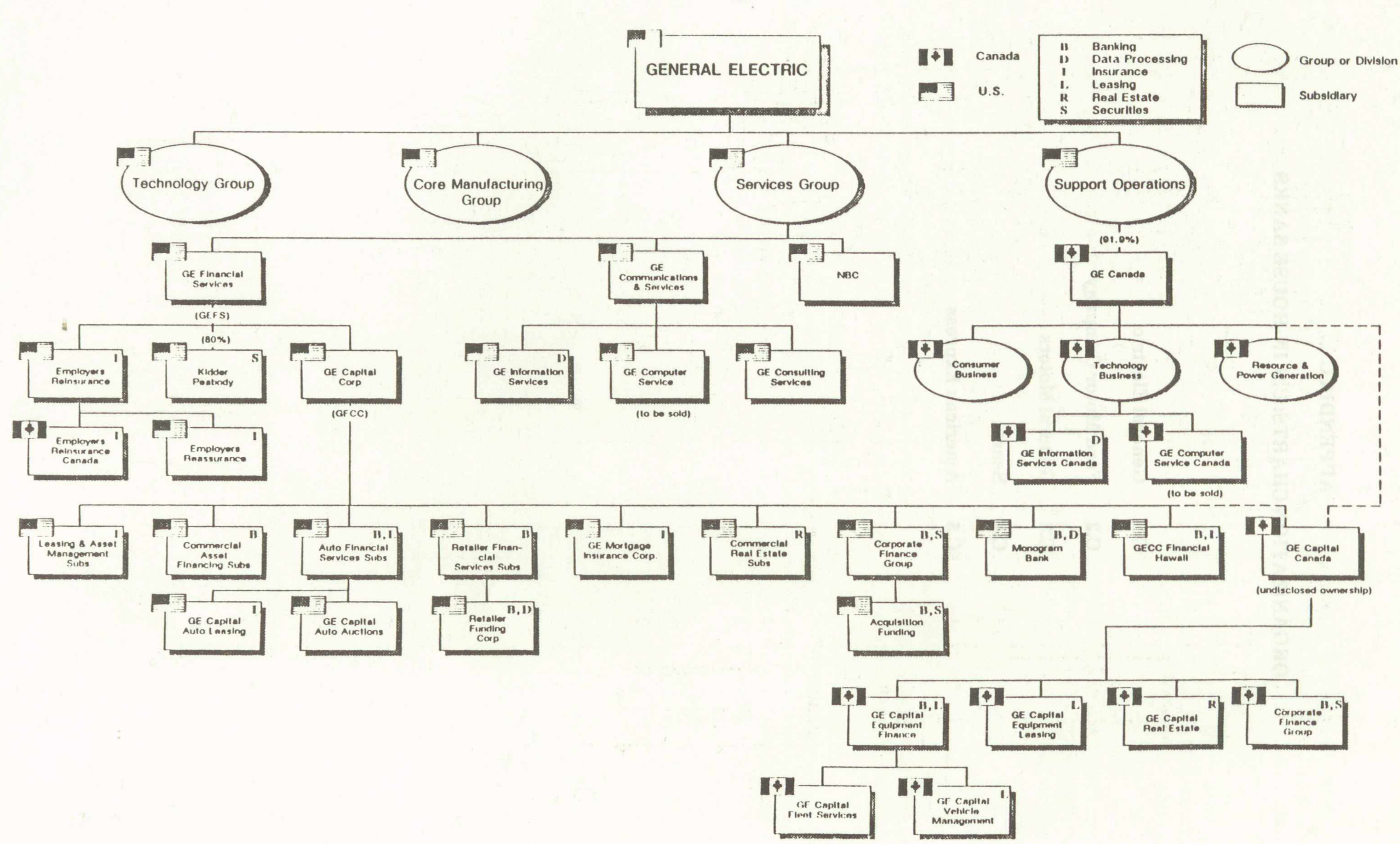
C.1 General Electric

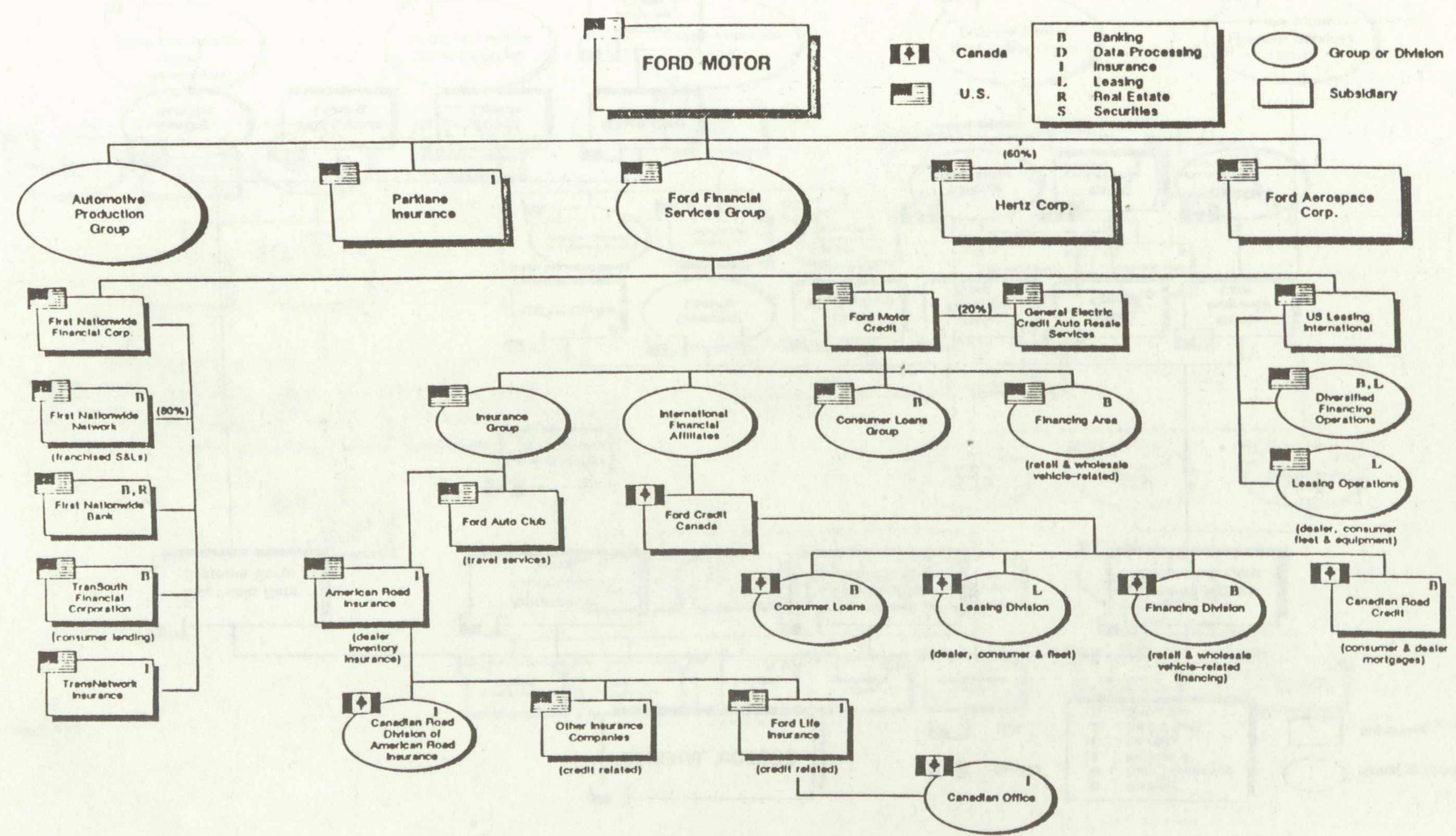
C.2 Ford Motor Company

C.3 General Motors

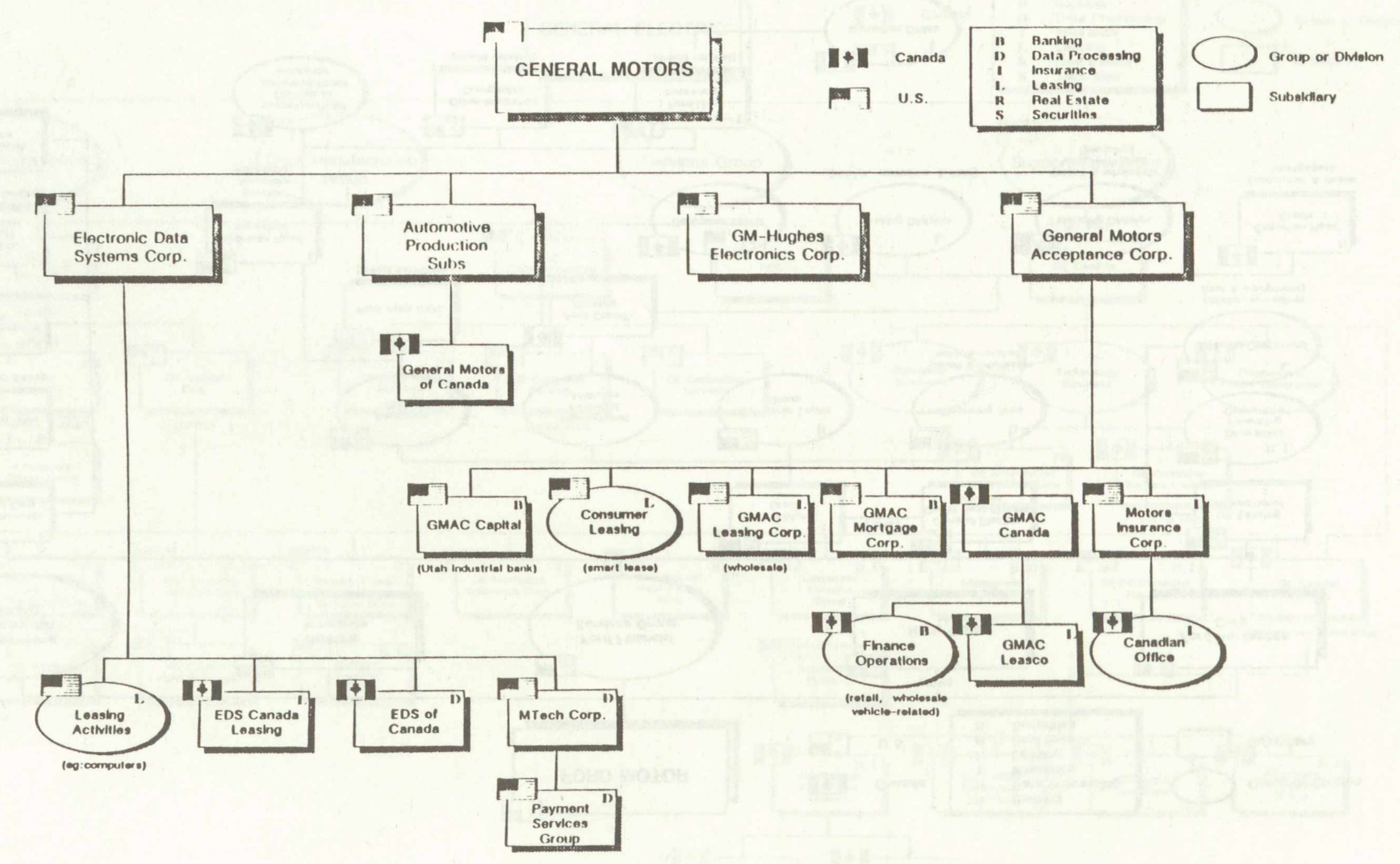
C.4 Sears

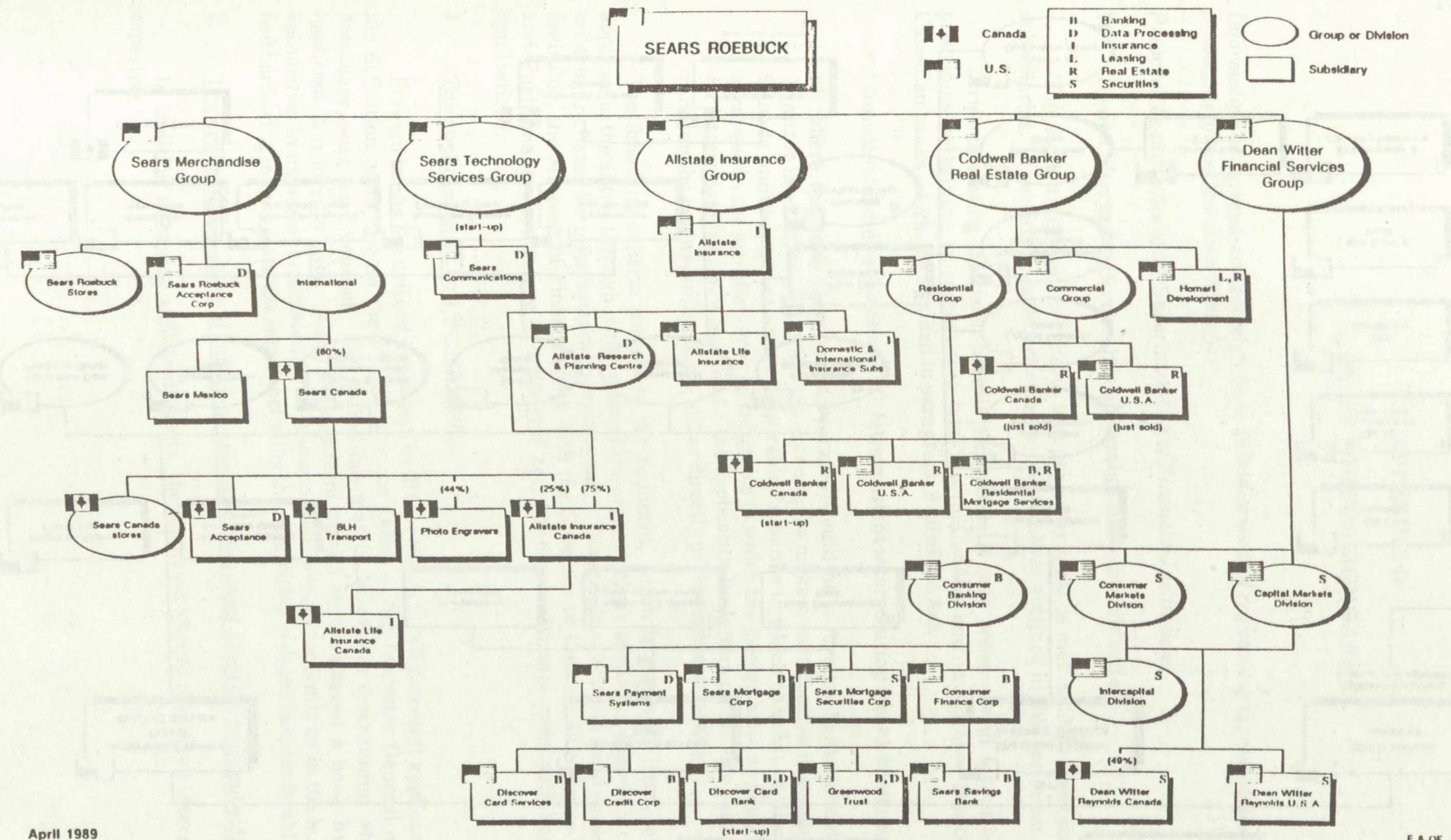
C.5 American Express


GENERAL ELECTRIC
Canada
U.S.
B Banking
D Data Processing
I Insurance
L Leasing
R Real Estate
S Securities
Group or Division
Subsidiary
Technology Group
Core Manufacturing Group
Services Group
Support Operations
GE Financial Services
(GEFS)
(80%)
GE Communications & Services
NBC
(91.9%)
GE Canada
Employers Reinsurance I
Kidder Peabody S
GE Capital Corp
(GFCC)
GE Information Services D
GE Computer Service
(to be sold)
GE Consulting Services
Consumer Business
Technology Business
Resource & Power Generation
Employers Reinsurance Canada I
Employers Reassurance I
GE Information Services Canada D
GE Computer Service Canada
(to be sold)
Leasing & Asset Management Subs I
Commercial Asset Financing Subs B
Auto Financial Services Subs B,I
Retailer Financial Services Subs B
GE Mortgage Insurance Corp. I
Commercial Real Estate Subs R
Corporate Finance Group B,S
Monogram Bank B,D
GECC Financial Hawaii B,L
GE Capital Canada
(undisclosed ownership)
GE Capital Auto Leasing I
GE Capital Auto Auctions
Retailer Funding Corp B,D
Acquisition Funding B,S
GE Capital Equipment Finance B,L
GE Capital Equipment Leasing L
GE Capital Real Estate R
Corporate Finance Group B,S
GE Capital Fleet Services
GE Capital Vehicle Management L

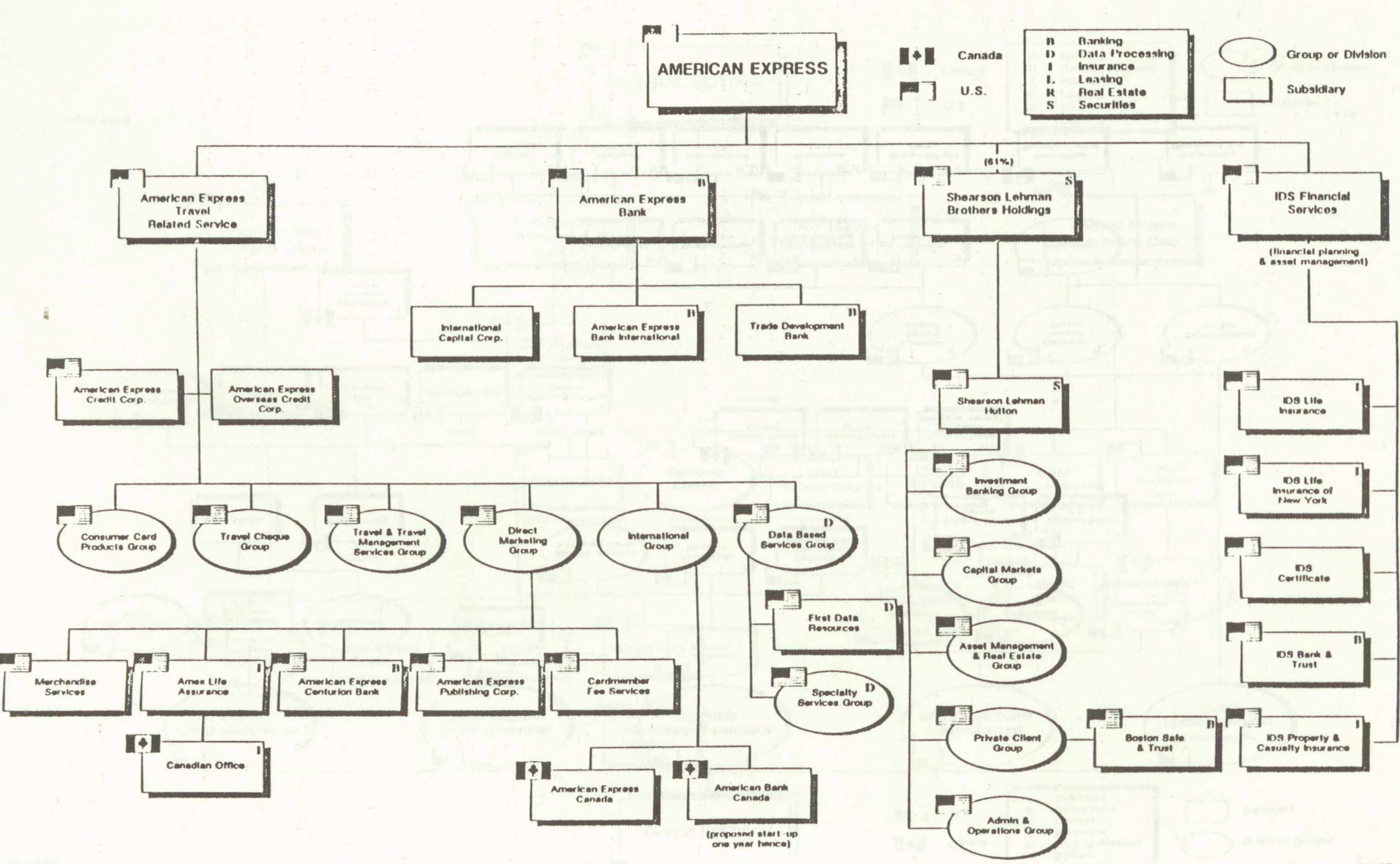


April 1989


GENERAL MOTORS
Canada
U.S.
B Banking
D Data Processing
I Insurance
L Leasing
R Real Estate
S Securities
Group or Division
Subsidiary
Electronic Data Systems Corp.
Automotive Production Subs
GM-Hughes Electronics Corp.
General Motors Acceptance Corp.
General Motors of Canada
GMAC Capital
(Utah Industrial bank)
Consumer Leasing
(smart lease)
GMAC Leasing Corp.
(wholesale)
GMAC Mortgage Corp.
GMAC Canada
Motors Insurance Corp.
Finance Operations
(retail, wholesale vehicle-related)
GMAC Leasco
Canadian Office
Leasing Activities
(eg:computers)
EDS Canada Leasing
EDS of Canada
MTech Corp.
Payment Services Group



SEARS ROEBUCK
Canada
U.S.
B Banking
D Data Processing
I Insurance
L Leasing
R Real Estate
S Securities
Group or Division
Subsidiary
Sears Merchandise Group
Sears Technology Services Group
Allstate Insurance Group
Coldwell Banker Real Estate Group
Dean Witter Financial Services Group
Sears Roebuck Stores
Sears Roebuck Acceptance Corp D
International
(start-up)
Sears Communications D
Allstate Insurance I
Residential Group
Commercial Group
Homart Development L, R
(60%)
Sears Mexico
Sears Canada
Allstate Research & Planning Centre D
Allstate Life Insurance I
Domestic & International Insurance Subs I
Coldwell Banker Canada R
(just sold)
Coldwell Banker U.S.A. R
(just sold)
Coldwell Banker Canada R
(start-up)
Coldwell Banker U.S.A. R
Coldwell Banker Residential Mortgage Services B, R
(44%)
(25%) (75%)
Sears Canada stores
Sears Acceptance D
SLH Transport
Photo Engravers
Allstate Insurance Canada I
Consumer Banking Division B
Consumer Markets Divison S
Capital Markets Division S
Allstate Life Insurance Canada I
Sears Payment Systems D
Sears Mortgage Corp B
Sears Mortgage Securities Corp S
Consumer Finance Corp B
Intercapital Division S
(40%)
Discover Card Services B
Discover Credit Corp B
Discover Card Bank B, D
(start-up)
Greenwood Trust B, D
Sears Savings Bank B
Dean Witter Reynolds Canada S
Dean Witter Reynolds U.S.A. S
April 1989
E & OE



AMERICAN EXPRESS
Canada
U.S.
B Banking
D Data Processing
I Insurance
L Leasing
R Real Estate
S Securities
Group or Division
Subsidiary
American Express Travel Related Service
American Express Bank
(61%)
Shearson Lehman Brothers Holdings
IDS Financial Services
(financial planning & asset management)
International Capital Corp.
American Express Bank International
Trade Development Bank
American Express Credit Corp.
American Express Overseas Credit Corp.
Shearson Lehman Hutton
IDS Life Insurance
IDS Life Insurance of New York
Investment Banking Group
Consumer Card Products Group
Travel Cheque Group
Travel & Travel Management Services Group
Direct Marketing Group
International Group
Data Based Services Group
Capital Markets Group
IDS Certificate
First Data Resources
Asset Management & Real Estate Group
IDS Bank & Trust
Merchandise Services
Amex Life Assurance
American Express Centurion Bank
American Express Publishing Corp.
Cardmember Fee Services
Specialty Services Group
Private Client Group
Boston Safe & Trust
IDS Property & Casualty Insurance
Canadian Office
American Express Canada
American Bank Canada
(proposed start-up one year hence)
Admin & Operations Group

APPENDIX D

A GUIDE FOR FOREIGN BANKS

Information on incorporating foreign bank subsidiaries and registering representative offices under the provisions of the Canadian Bank Act

Prepared by the Office of the Superintendent of Financial Institutions

II. Basic Criteria for Ownership of Foreign Bank Subsidiaries

This section outlines the criteria that generally must be met in order to establish foreign bank subsidiaries. In particular cases, criteria, beyond what are outlined in this document, may also apply.

Prior to stating the basic criteria applicable, it may prove useful to outline the statutory provisions pertaining to competitive banking in Canada and favourable treatment abroad for Canadian banks which are outlined in paragraph 8 (d) of the Act.

"Notwithstanding subsection 7(2), letters patent incorporating a bank shall not be issued ...

(d) where the bank thereby incorporated would be a foreign bank subsidiary, unless the Minister is satisfied that it has the potential to make a contribution to competitive banking in Canada and that treatment as favourable for banks to which this Act applies exists or will be arranged in the jurisdiction or jurisdictions in which the foreign bank or foreign banks applying for letters patent or on whose behalf the application for letters patent has been made principally carry on the business of banking, either directly or through a subsidiary."

The following criteria pertain to the applicant, which is generally the foreign bank and, if applicable, the entity through which most of the organization's banking business is conducted. These criteria are listed for informational purposes only. Though these criteria are deemed to be generally desirable, the Minister of Finance along with the Governor-in-Council, in the case of letters patent, and Parliament, in the case of a special act, have the ultimate responsibility for approving applications.

1. The applicant must be a foreign bank.

Foreign banks are defined in subsection 2(1) of the Act. All potential applicants should review the definition, then discuss the matter with the Office of the Inspector General of Banks, and, if necessary, seek legal counsel. Two guidelines may be helpful in determining whether or not an applicant is a foreign bank. One, the applicant should be considered a bank by the regulatory authorities in its home jurisdiction. Two, the applicant should generally be in the business of lending and borrowing money, with the latter including the acceptance of deposits transferable by order.

2. The applicant should be of sufficient asset size to support a foreign bank subsidiary in Canada.

In addition to having sufficient assets, the applicant should also have international banking expertise.

3. The applicant should have had a favourable earnings record over the last 5 years.

In this regard, there will be no attempt to employ as a floor a specific return on capital or on assets. Instead, the applicant should be able to demonstrate that, on the basis of an international comparison, its earnings record has been relatively good.

4. Ownership of the applicant should be widely held.

This criterion follows from the government's basic banking policy which imposes a particular limit, namely ten per cent, on individual shareholdings in Schedule A banks. As a guide, there is a stated preference for widely held ownership of the applicant where no one shareholder (and those associated with him) effectively controls the bank. Nonetheless, there may be exceptions, for example, if the applicant is owned or controlled by a foreign government.

5. The home jurisdiction should report favourably on the applicant.

There are two requirements that might apply in this regard. If the applicant is required to have regulatory approval from its home jurisdiction in order to win a foreign bank subsidiary in Canada, evidence of such approval must be included with the application. If the applicant is not required to have such regulatory approval, the application should contain a statement to this effect from the appropriate regulatory authority in the home jurisdiction. In all cases, the applicant should submit a certificate of good standing from its home jurisdiction. The basic form of such a certificate is outlined in Appendix 1. The supervisory authority may be asked to provide comments beyond those contained in the certificate.

6. The applicant should be well supervised in its home jurisdiction.

The applicant should provide information on the type and scope of supervision that applies in its home jurisdiction and thereby demonstrate that it is well supervised.

7. The applicant must demonstrate that Canadian banks receive or will receive similar competitive opportunity to that afforded indigenous banks operating in the home jurisdiction.

The applicant should provide a written statement from the appropriate regulatory authority in the home jurisdiction stating the nature of the reciprocal banking provision. The form of this statement is outlined in Appendix 2. In this regard, the home jurisdiction is that in which the bank principally carries on the business of banking. (Refer to paragraph 8(d) of the Act.) Information, beyond that contained in the statement, may be required.

8. The applicant must be able to demonstrate a potential to make a contribution to competitive banking in Canada.

The informational requirements, which basically pertain to a business plan for the Canadian operation, are outlined in section VI of this document. (Refer to paragraph 8(d) of the Act.)

9. The applicant is expected to provide a letter of comfort with regard to the foreign bank subsidiary.

The form of the letter of comfort is outlined in Appendix 3. Should there be any doubt as to the meaning or intent of these requirements, the applicant should consult with the Office of the Inspector General of Banks. For example, there may be cases where the jurisdiction of incorporation is not the jurisdiction in which the bank principally carries on the business of banking. As a result, there may

be different home jurisdictions depending on the criterion in question. Further, there may be a need to consider the form of a given requirement as a result of particular circumstances.

Another area of note pertains to joint ownership of a foreign bank subsidiary by a number of foreign banks. Such joint ownership is permissible under the Act. In such cases, however, it would generally be expected that there would be a lead investor or principal owner. Consultation should be undertaken with the Office of the Inspector General of Banks to determine the means of meeting the requirements in cases where there is more than one foreign bank applicant.

In concluding this section, it should be noted that the basic criteria for ownership of a foreign bank subsidiary are designed to be sufficiently flexible so as to facilitate the implementation of the government's banking policy in a fair and reasonable manner.

in different home jurisdictions depending on the criterion in question. Further, there may be a need to consider the form of such regulatory approval for particular circumstances.

Another area where questions of joint ownership may arise is foreign bank subsidiaries owned by a number of foreign banks. Such joint ownership is permissible under the Act. In such cases, however, it would generally be expected that there would be a leading or principal owner. Consultations should be undertaken with the Office of the Inspector General of Banks to determine the means of meeting the requirements in cases where there is more than one foreign bank applicant.

In concluding this section, it should be noted that the basic criteria for determining a foreign bank subsidiary are designed to be sufficiently flexible so as to facilitate the implementation of the government's banking policy in a fair and reasonable manner.

APPENDIX E

GLOSSARY OF TERMS AND ABBREVIATIONS

AFFILIATE COMPANY
An operating corporation, related to other operating companies through common upstream ownership is considered to be affiliated. The activities of affiliated companies may be totally unrelated.

BCRC Business Conduct Review Committee
This is the name given to a committee of independent directors empowered to review a firm's activities. It constitutes a form of corporate governance.

BIS CAPITAL ADEQUACY STANDARDS
This risk-based system of standards agreed to by the major banking countries is designed to judge the adequacy of bank capital in relation to the assets that it supports. By the end of 1992, banks from signatory nations must hold capital equal to 8 per cent of their risk adjusted assets. The standards require that at least 50 per cent of capital be comprised of common shares, preferred shares and disclosed reserves. Assets are weighted according to their riskiness; for instance cash or government bonds of certain OECD countries have a zero risk weighting while real estate or other claims on the private sector are weighted at 100 per cent.

BANK FOR INTERNATIONAL SETTLEMENTS (BIS)
This is an international organization of central banks, established in 1930 to handle war reparation payments. It now acts as a provider of short-term liquidity to central banks in need, operates the private ECU clearing and settlements system, and acts as agent for several organizations of the European Community. It is a major forum for promoting cooperation among central banks and other international organizations.

BLUE PAPER
New Directions for the Financial Sectors, tabled in the House of Commons by the Honorable Thomas Hockin, Minister of State for Finance, on December 18, 1986.

CBA Canadian Bankers' Association

CCB Canadian Commercial Bank

CDIC Canada Deposit Insurance Corporation

CLHIA Canadian Life and Health Insurance Association

CAPITAL
The sum of shareholders' funds invested in a company that represents their proprietary interest in that company.

CLOSELY HELD OWNERSHIP
The ownership of a company is closely held when a single shareholder or a limited number of shareholders can exert control over its activities. As we have used the term in this report, it generally refers to holdings greater than ten per cent.

CO-INSURANCE
This is a deposit insurance system in which only a proportion—say, 80 or 90 per cent—of an eligible deposit is insured thus requiring depositors to bear a degree of risk. Under some proposals, co-insurance would apply only to deposits above a certain minimum.

COMMERCIAL LINKS
Such a link exists when a financial institution is associated through ownership with a commercial enterprise. A financial enterprise has an upstream commercial link if a commercial enterprise owns more than ten per cent of the shares of the financial institution.

COMP CORP The Canadian Life and Health Insurance Compensation Corporation
The administrator of the life insurance protection plan.

CONFLICT OF INTEREST
Situations which arise in a financial institution in the performance of its intermediary role, in which it must choose between its own interests and those of clients, or between the interests of different clients. Conflicts of interest do not generally threaten the solvency of a financial institution, but they do threaten the interests of clients.

CORPORATE GOVERNANCE
This represents a form of regulation internal to the institution. The management and directorate of a financial institution are structured, and internal rules and regulations are formulated, to monitor and direct corporate behaviour. An example is the institution of, and powers given to, committees of boards of directors to supervise various aspects of the business of financial institutions. Examples include: audit committees and committees to oversee non-arm's-length transactions.

CROSS-OWNERSHIP
The ownership of two or more types of financial institutions by the same ownership interests, possibly through a holding company structure, constitutes cross ownership. An example is bank ownership of investment dealers.

DOUBLE LEVERAGE
Capital is subjected to double leveraging when the common stock or subordinated debt eligible to be counted as part of the capital base of a financial institution is owned by another financial institution but not deducted from the capital base of the owning institution for purposes of determining its leverage ratio for lending. In effect, both the parent and the subsidiary are able to use the same capital to leverage their assets.

DOWNSTREAM HOLDING COMPANY
This is a corporate structure in which an operating corporation owns one or more operating subsidiaries through the intermediate link of a holding company.

EC European Community

ESTATE, TRUST AND AGENCY FUNDS
These are assets of trust companies managed for clients but over which the institution does not have ownership. A trust deed defines the powers that the trust manager has in administering his client's assets and the client's rights to the income generated by the assets being so administered. Similarly, the institution, subject to specific agreements, may act as agent or registrar for various types of assets.

EUROPE 1992
This refers to the program of the European Community to integrate its internal market by the end of 1992.

FTA The Canada-United States Free Trade Agreement.

FACTORING
The process of buying notes or accounts receivable at a discount from the holder to whom the debt is owed; from the holder's point of view, the selling of such notes or accounts. When a single note is involved, the process is called "discounting a note".

FEE-BASED SERVICES
Financial institutions earn most of their income by investing in financial assets which earn some rate of return. They may also earn income by providing services, for a fee, to clients. Providing special accounts, offering facilities to pay bills, etc. constitute services which are provided for a fee.

GLASS-STEAGALL ACT
This U.S. Banking Act, adopted in 1933, established, among other things, the principle of separation of banking from securities activities.

GRANDFATHER CLAUSE
Such a clause exempts an institution from abiding by newly introduced legislation, on the grounds that it was legally engaged in the now-prohibited activity before the law changed.

GREEN PAPER
The Regulation of Canadian Financial Institutions: Proposals for Discussion, Department of Finance, Canada, April 1985.

HOME COUNTRY
The chartering jurisdiction for a financial institution represents the home country.

HOST COUNTRY
This is the jurisdiction in which an institution, chartered elsewhere, operates.

IOSCO International Organization of Securities Commissions

IN-HOUSE POWERS
Lending and investment business activities which may be undertaken within the corporate structure of a single financial institution constitute its in-house powers.

INDEPENDENT DIRECTOR
Broadly speaking, a director of a corporation who has no other links to that firm. For example, a director is independent if he or she is not an officer of the firm or a significant owner or major client of the firm.

INTERMEDIATION
There are several forms of financial intermediation: "denomination intermediation," whereby institutions obtain funds through deposits or other instruments in denominations that are different from those of the loans they make; "default-risk intermediation," whereby institutions offer to savers claims on themselves that are somewhat more insulated from losses than the individual claims that they have acquired; "term intermediation," whereby an institution supplies funds with a term to maturity different from that of the money entrusted to it; "interest-rate intermediation," whereby an institution fixes the interest rate over a given term for either the lender or the borrower without a similar arrangement being made on the other side of the ledger; and "capital-value intermediation," whereby the institution holds securities with a capital value that fluctuates while offering liabilities that can be redeemed at a fixed money value.

LEVEL PLAYING FIELD
This is a term that has increasingly been used to compare the state of competitive equity between various institutions. For example, if foreign financial institutions operating in Canada have more powers than domestic financial institutions, one can say that the playing field is unlevel as between foreign and domestic financial institutions. Likewise, if an owner of a trust company can have a share position of, say, 65 per cent whereas banks have to be owned in ten per cent tranches, one may say that the playing field in terms of ownership is not level for deposit-taking institutions. And so on.

LEVERAGE
This is broadly defined as the debt to equity ratio. It is an indicator of safety and stability of an institution.

MARKET INTERMEDIARIES
Intermediaries who arrange for the direct purchase by investors of financial instruments. These intermediaries usually work on a commission basis.

NALT Non-arm's-length transaction
A transaction between two related parties; for example, a financial transaction between two institutions associated through ownership links or between an institution and its owners, directors, or managers. Abusive NALTs could threaten the solvency of a financial institution.

NARROWLY HELD OWNERSHIP
For the purposes of this Report, see Closely Held Ownership.

NATIONAL TREATMENT
As applied to financial services, national treatment requires that foreign institutions are treated no less favourably by the host country than are domestic institutions.

NETWORKING
An arrangement whereby one institution provides facilities to sell the products of another institution. This may be accomplished by the one institution leasing physical space to the other institution or by cross-selling. Networking can take place between affiliated corporations or independent firms.

OSFI The Office of the Superintendent of Financial Institutions.
The federal regulator of financial institutions.

PILLAR
A group of institutions performing a major financial function constitutes a pillar. The Canadian financial system is often described as consisting of four "pillars": banks, trust companies, insurance companies, and securities dealers.

PRUDENTIAL STANDARDS
These are standards of corporate behaviour imposed by regulators to assure the stability and soundness of financial institutions and to protect the consumer of financial services against loss through fraud or mismanagement.

PUBLIC FLOAT
See Publicly Traded.

PUBLICLY TRADED
When voting shares are in the hands of the public and not in the hands of the control block, they are considered to be publicly traded.

QDIC The Quebec Deposit Insurance Corporation

RECIPROCITY
Reciprocity can be defined in a number of different ways. In trade negotiations, "overall reciprocity" implies an exchange of concessions to the mutual, equal advantage of each party. In contrast, "mirror-image reciprocity" means that access to host country A's market by outside country B's firms is limited by the access provided to country A's firms operating in country B. In other words, "Your firms can do in my market only what my firms can do in your market." This should be distinguished from national treatment, where foreign-owned institutions are treated by the host country the same as domestic institutions.

SCHEDULE A BANK
See Schedule I Bank

SCHEDULE B BANK
See Schedule II Bank

SCHEDULE I BANK
This class of bank includes the large retail banks that dominate domestic banking asets in Canada. The defining characteristic of these banks is the ownership restrictions they face. No individual or related group may own more than ten per cent of the shares of a Schedule I bank. In addition, non-American foreigners may not own collectively more than 25 per cent of a Schedule I bank.

SCHEDULE II BANK
There are two types of Schedule II banks. Domestic Schedule II banks constitute a transitory type of institution—they may be closely held initially but must meet the ownership requirements of a Schedule I bank within ten years.

The other type of Schedule II bank is a foreign bank subsidiary. This bank is a closely held subsidiary of a foreign bank and may be wholly owned in perpetuity. Non-American foreign bank subsidiaries must obtain ministerial approval to open additional branches and are subject to an aggregate asset limit equal to 12 per cent of domestic banking assets.

These banks are currently subject to more stringent leveraging rules than are Schedule I banks. The move to implement the BIS capital adequacy standards will impose similar capital requirements on all classes of banks.

SELF-REGULATION
This is an approach to regulation in which an association of financial institutions sets out rules and regulations by common agreement and assumes the enforcement power. The rules and regulations applying to members of the various stock exchanges are an example of self-regulation.

THRIFTS
Regional banking institutions in the United States consist of savings and loan associations, mutual saving banks, and credit unions. These institutions, commonly referred to as thrifts, are the major group of institutions originating mortgages in the United States.

TIED-SELLING
A transaction in which a customer is required to purchase a second service as a condition of purchasing the first constitutes a tied sale.

UNDERWRITING
The purchase for resale, of a security issue by one or more investment dealers or *underwriters*. The formal agreements pertaining to such a transaction are called *underwriting agreements*.

WIDELY HELD OWNERSHIP

A firm is widely held by a large number of investors when no single shareholder has a controlling interest. The concept of wide ownership of ten includes the proviso that investors cannot act in concert. As used in this report, wide ownership means no single investor holds more than ten per cent of a firm's shares.

Sources: Economic Council of Canada, *A Framework for Financial Regulation*, Ottawa, 1987

Economic Council of Canada, *Globalization and Canada's Financial Markets*, Ottawa, 1990;

Canadian Financial Institutions, Report of the Standing Committee on Finance, Trade and Economic Affairs, House of Commons, Ottawa, November 1985.

APPENDIX F

WITNESSES

Issue No.	Date	Organization and Witnesses
3	October 17, 1989	**From the Department of Finance:** Mr. Nicholas Le Pan, Assistant Deputy Minister, Financial Sector Policy Branch; Mr. John Raymond LaBrosse, Acting Director, Financial Institutions and Markets Division; Ms. Louise Pelly, Legal Advisor, Financial Institutions and Markets Division. **From Jalynn Bennett Associates Limited:** Ms. Jalynn Bennett, President.
4	October 24, 1989	*11:00 a.m.* Mr. Pierre Fortier, President and Chief Operating Officer, *Société financière des caisses Desjardins inc.*, *Confédération des caisses Desjardins du Québec*; Mr. Alex Radmanovich, Vice-Chairman, *Cabinet des relations publiques NATIONAL Inc.* *11:45 a.m.* Mr. Stanley Beck, Vice-Chairman, Central Capital Corporation.
5	November 7, 1989	**From the Canadian Bankers' Association:** Mr. Warren Moysey, Chairman of the Executive Council; President, Individual Bank, CIBC; Ms. Helen K. Sinclair, President; Mr. Léon Courville, Member, Executive Council; Executive Vice-President, National Bank of Canada.
6	November 8, 1989	**From the Economic Council of Canada:** Mr. Harvey Lazar, Deputy Chairman; Mr. Keith Patterson, Economist; Ms. Andrée Mayrand, Economist.
7	November 21, 1989	**From the Office of the Superintendent of Financial Institutions:** Mr. Michael A. Mackenzie, Superintendent; Mr. André Brossard, Director, Rulings Division; Mrs. Nancy Murphy, Director, Communications and Public Affairs.

Issue No.	Date	Organization and Witnesses
9	November 28, 1989	**From The Canadian Co-operative Credit Society Limited:** Mr. Tod T. Manrell, Chairman; Mr. William G. Knight, Director, Government Affairs.
		From the Canada Deposit Insurance Corporation: Mr. Ronald A. McKinlay, Chairman of the Board; Mr. Chas. C. de Léry, President and Chief Executive Officer; Mr. Lewis Lederman, Corporate Secretary and General Counsel; Mr. Jean-Pierre Sabourin, Vice-President and Chief Operating Officer.
11	December 5, 1989	**From the Canadian Life and Health Insurance Association:** Mr. P.D. Burns, Chairman; Mr. K. Kavanaugh, Director; Mr. Mark Daniels, President; Mr. J.P. Bernier, Vice-President and Counsellor.
		From the Trust Companies Association of Canada: Mr. John Evans, President.
12	December 6, 1989	**From the Conference Board of Canada:** Dr. Charles Barrett, Vice-President, Business Research; Mr. Stephen Wandfield-Jones, Senior Advisor, Financial Services Research Program; Mr. Guy Glorieux, Director, Financial Services Research Program;
		From the Insurance Brokers Association of Canada: Mr. Jack E. Lee, Vice-President; Mr. George E. Creek, Associate of the Insurance Institute of Canada; Mr. John Morin, courtier d'assurances agréé. Mr. Basil N. Steggles, General Manager.
13	December 12, 1989	**From BCE Inc.:** Mr. J.V. Raymond Cyr, Chairman, President and Chief Executive Officer; Mr. Josef J. Fridman, Vice-President and General Counsel.
		From Carleton University: Professor Donald G. McFetridge.
14	December 13, 1989	**From Royal Trust:** Mr. Hartland M. MacDougall, Chairman; Mr. William J. Inwood, Managing Partner and General Counsel; Mr. Joseph P. Chertkow, Associate General Counsel.

Issue No.	Date	Organization and Witnesses
		From Imasco Limited: Mr. Purdy Crawford, Chairman, President and Chief Executive Officer; Mr. Torrance J. Wylie, Executive Vice-President; Mr. John Bennett, Senior Vice-President; Mr. Brian Levitt, Partner of Osler, Hoskin and Harcourt and Director of Imasco Limited.
		From Simon Fraser University: Professor John Chant.
15	December 19, 1989	**From Power Financial Corporation:** Mr. James W. Burns, Chairman and Chief Executive Officer; Mr. Edward Johnson, Vice-President, Secretary and General Counsel.
		From the Canadian Federation of Independent Business: Ms. Catherine Swift, Vice-President Research, Chief Economist; Mr. Ted Mallet, Research Analyst.
16	January 23, 1990	**From the Canadian Institute of Actuaries:** Mr. Peter C. Hirst, President; Mr. James A. Brierly, Vice-President; Mr. Horace W. McCubbin, Chairman of the Committee to Develop the Role of the Valuation Actuary; Mr. Brian Wooding, Executive Director.
18	January 29, 1990	**From the Bank of Canada:** Mr. John W. Crow, Governor.
		From the National Bank of Canada: Mr. André Bérard, Chief Executive Officer; Mr. Richard Carter, Vice-President and Chief Economist.
		From *Le Mouvement Desjardins*: Mr. Claude Béland, President; Mr. Yves Morency, Vice-President of Planning, *Confédération des caisses populaires Desjardins*.
20	January 31, 1990	**From the Toronto-Dominion Bank:** Mr. Richard Thomson, Chairman and Chief Executive Officer; Dr. D.D. Peters, Senior Vice-President and Chief Economist.
		From the Royal Bank of Canada: Mr. Allan R. Taylor, Chairman and Chief Executive Officer.

Issue No.	Date	Organization and Witnesses
9	November 28, 1989	From The [illegible] Credit Society Limited
		Mr. [illegible], Government [illegible]
		From the Canada Deposit Insurance Corporation:
		Mr. [illegible], Chairman of the Board
		Mr. Chas C. de Léry, President and Chief Executive Officer;
		Mr. [illegible], Corporate Secretary and General Counsel;
11	December 5, 1989	From the [illegible] Insurance Association:
		Mr. D. [illegible], Chairman;
		Mr. K. Kavanaugh, Director;
		Mr. [illegible], Vice-President and Counsel
		From the Trust Companies Association of Canada:
12	December 5, 1989	[illegible] of Canada:
		[illegible] Vice-President, Business Research
		[illegible], Senior Adviser, Financial [illegible]
		Mr. Guy [illegible], Director, Financial Services
		From the Insurance Brokers Association of Canada:
		[illegible] of the Insurance [illegible]
13	December [illegible], 1989	[illegible]
		[illegible], Chairman, President and Chief Executive Officer
14	December 13, 1989	From [illegible]
		Mr. [illegible] General Counsel

APPENDIX G

LIST OF BRIEFS AND DOCUMENTS RECEIVED

Appraisal Institute of Canada: Submission to the Standing Senate Committee on Banking, Trade and Commerce; January 1990

Appraisal Institute of Canada: Letter from Robert Mason, President, to the Honourable Sidney L. Buckwold, Chairman, Standing Senate Committee on Banking, Trade and Commerce re: Regulation of Real Estate Appraisers; February 14, 1990

Bank of Canada: "Introductory Statement by John W. Crow, Governor"; January 29, 1990

Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank of Canada, The Bank of Nova Scotia, The Royal Bank of Canada and The Toronto-Dominion Bank: Letter to the Prime Minister of Canada re: Ownership of Deposit-Taking Institutions, and Memorandum re: Ownership of Deposit-Taking Institutions; September 20, 1989

Bank of Nova Scotia: Letter from J.A.G. Bell, Deputy Chairman of the Board, President and COO, to Chairman, Standing Senate Committee on Banking, Trade and Commerce, re: "Competitive pricing of bank insurance products"; February 20, 1990

Bank of Nova Scotia: see also "Bank of Montreal..." above

BCE Inc.: Statement by J.V. Raymond Cyr, Chairman, President and CEO, to the Standing Senate Committee on Banking, Trade and Commerce (EXHIBIT A-11); December 12, 1989

Canada Trust Company: see Imasco Limited

Canada Trustco Mortagage Company: see Imasco Limited

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Respectfully submitted,

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