

1996

## Canadian Bank Act and its Implementation under the NAFTA

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### Recommended Citation

Michelle Brown Berziel, *Canadian Bank Act and its Implementation under the NAFTA*, 2 LAW & BUS. REV. AM. 135 (1996)  
<https://scholar.smu.edu/lbra/vol2/iss4/14>

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## Implementation:

# Canadian Bank Act and its Implementation under the NAFTA

*Michelle Brown Berziel<sup>1</sup>*

The North American Free Trade Agreement (NAFTA) significantly impacts the service and manufacturing sectors in all member countries. This Comment focuses on the effect NAFTA has had on Canada's banking industry.

Part I of the Comment explores the history of the Canadian banking system and its evolution to its current status. The Bank Act governs the operations of both domestic and foreign banks in Canada's banking system. The Bank Act's specific statutory provisions governing foreign banks will be discussed. The United States-Canada Free Trade Agreement, which was the precursor to NAFTA, exempting the United States from some of the Bank Act's strict provisions governing foreign banking institutions will also be discussed.

Part II focuses on specific provisions in NAFTA's financial services chapter and how they expand the rights of foreign financial institutions of the member countries. Canada has even amended its Bank Act to accommodate the expansion of financial institutions' privileges under NAFTA.

Part III of the Comment concludes by focusing on the effect that NAFTA is having on Canadian financial institutions. Current and future developments in the Canadian banking industry, in the Bank Act, and in the development of future trade agreements will be discussed.

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## I. INTRODUCTION.

### A. CANADIAN BANKING SYSTEM.

#### 1. *Evolution of the Canadian Banking System.*

In 1792, Montreal businessmen attempted to establish the first Canadian bank.<sup>2</sup> While their attempt was unsuccessful, it stimulated the development of Canada's modern banking system. The Bank of Montreal, founded in 1817 by nine local merchants, still operates today.<sup>3</sup> In fact, the Canadian banking industry continued to rapidly expand throughout Canada's provinces. Each province incorporated and governed the new banks by their own set of laws until the British North America Act of 1867.<sup>4</sup> This act removed the governing power from the provinces and gave the new federal government exclusive jurisdiction over the banking system.<sup>5</sup> The new federal government inherited a banking system that consisted of 35 banks with 164 branches.<sup>6</sup>

Originally, the Canadian banking system consisted of a large number of locally-owned banks.<sup>7</sup> Through the years, the system has evolved and is now comprised of relatively few banks with extensive branches totaling over 7,400.<sup>8</sup> The major commercial banks in Canada at present are the Bank of Montreal, the Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Canadian Western Bank, the National Bank of Canada, the Royal Bank of Canada and the Toronto-Dominion Bank.<sup>9</sup> Six of these seven banks control more than 80% of the financial market in Canada.<sup>10</sup> Canada's extensive branching

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2. *Bank Facts 1992; Industry Overview*, 100 CANADIAN BANKER S1, S1 (1993) [hereinafter *Bank Facts 1992*].

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Canada—Business Guide*, MARKET REPORTS, March 21, 1995.[hereinafter *Canada—Business Guide*].

8. *Id.*

9. Maria Carlino, *Trading with Canada; Recession Over, Growth in Canada Picks Up*, J. COM., May 25, 1995, at 9A.

10. William C. Symonds & Richard A. Melcher, *Making a Break for the Border: Bank of Montreal is on the Expansion Trail in the U.S.*, BUS. WK., June 6, 1994, at 104.

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system allows its banks to serve 1,600 communities in the ten provinces and both territories.<sup>11</sup> As a result, Canada boasts a higher ratio of full service banking branches per person than any other major industrialized nation.<sup>12</sup> Canada has one bank branch for every 3,578 people.<sup>13</sup> This extensive banking system gives Canadians the flexibility of having both neighborhood convenience and nationwide access for their financial needs.<sup>14</sup>

## 2. *The Regulatory Structure in Canada's Banking System.*

Commercial banks are Canada's primary source of monetary deposits which comprise the major component of the nation's official money supply.<sup>15</sup> Consequently, Canadian banks are highly regulated.<sup>16</sup> The Bank Act is the Canadian federal legislative act that governs Canadian chartered banks and foreign banks operating in Canada.<sup>17</sup> The Bank Act is subject to parliamentary review every ten years.<sup>18</sup> This policy of periodic review is due to the fear Canadians have of powerful banks.<sup>19</sup> The review forces bank regulators and parliament to consider both innovative and technological changes in the dynamic banking industry.<sup>20</sup>

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11. *Bank Facts 1992*, *supra* note 1, at S2.

12. *Id.*

13. *Id.* Even though Canada is the world's second largest country in area, it is still a world leader for thoroughness of coverage. *Id.*

14. *Id.* The automatic banking machine system, Interac, gives Canadian bank cardholders access to 13,800 automated banking machines in Canada and to another 100,000 automated banking machines worldwide. *Id.* Japan is the only other nation which provides greater per-capita coverage. *Id.*

15. *Id.* at S1.

16. *Canada—Business Guide*, *supra* note 6.

17. *Id.*

18. 18. Skot Kortje, *Can Watchdogs Find Their Way Through the Maze?*, CAN. BUS., July 1993, at FSG5.

19. J. Michael Robinson & Christine Y. Walter, *Canada: International Banking—A Legal Guide*, EUROMONEY SUPPLEMENT, Sept. 1, 1991, at 17.

20. Kortje, *supra* note 17, at FSG5.

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In addition to the Bank Act, Canada's banks are subject to provincial legislation which affects the operations of banks.<sup>21</sup> This legislation differs depending on the province where the bank is located.<sup>22</sup> The dual regulation of banks through federal and provincial statutes creates overlap and makes Canadian banking highly complex.<sup>23</sup>

To further complicate the banking industry, banks are also regulated by several national departments. For example, the Department of Finance controls the types of financial services that can be offered and the types of investments permitted.<sup>24</sup> The Office of the Superintendent of Financial Institutions (OSFI) administers regulation and supervision of banks, loan and investment companies and cooperative credit associations.<sup>25</sup> The OSFI supervises 10 domestic banks, 55 subsidiaries of foreign banks, and approximately 80 trusts and loans, credit unions and investment companies registered with the federal government.<sup>26</sup> The regulatory scheme is completed with the Bank of Canada which acts as the fiscal agent for the federal government.<sup>27</sup> The Bank of Canada, a separate corporation, acts independently of the government but is responsible for formulating and implementing monetary policies.<sup>28</sup>

The Bank Act creates two types of banks: Schedule I and Schedule II.<sup>29</sup> Schedule I banks are both majority Canadian-owned and widely held by the public.<sup>30</sup> No person may own more than ten percent of any class of shares and non-residents may not own

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21. Robinson, *supra* note 18, at 16.

22. *Id.*

23. *Id.*

24. Canada—*Business Guide*, *supra* note 6.

25. Robinson, *supra* note 18, at 17. The OSFI was established in July 1987 by combining the Department of Insurance and the Office of the Inspector General of Banks. *Id.* See also Kortje, *supra* note 17, at FSG5 for statement that the OSFI is the top federal regulatory watchdog in Canada.

26. Kortje, *supra* note 17, at FSG5. The OSFI also regulates 20 provincially chartered trust and loan companies, life insurance companies, more than half of the property and casualty insurance companies, and approximately 1,000 pension funds. *Id.* See Robinson, *supra* note 18, at 16, discussing the Canadian Bankers' Association which is a voluntary organization consisting of all Canadian and foreign owned banks. This organization acts as a powerful lobby and exerts regulatory influence by objecting to the incorporation of a new foreign bank subsidiary on the grounds of lack of reciprocity for Canadian banks in the home country of the applicant. *Id.*

27. Robinson, *supra* note 18, at 19.

28. *Id.* The Bank of Canada was established in 1935 and has the exclusive authority to issue notes for circulation. *Id.*

29. 29. *Bank Facts 1992*, *supra* note 1, at S1.

30. *Id.* The shares of Schedule I banks are traded on major stock exchanges. *Id.*

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more than 25 percent of the total number issued and outstanding shares.<sup>31</sup> Canada has seven active Schedule I banks.<sup>32</sup>

Schedule II banks are usually closely held with their shares held by only a few parties and generally not offered to the public.<sup>33</sup> Canadian residents or those nations who have been accorded residency status can own up to 100 percent of the bank's shares for the bank's first ten years.<sup>34</sup> However, after the first ten years, this percentage must be reduced to ten percent unless the bank is an approved subsidiary of a foreign bank.<sup>35</sup> If it is an approved subsidiary, a foreign bank may own up to a 100% of a Schedule II bank with no dilution requirement.<sup>36</sup>

### 3. *Liberalization in Canada's financial services sector.*

Traditionally, Canada's financial services industry was divided into "four separate pillars": banks; trust companies; insurance companies; and securities firms.<sup>37</sup> Each sector was required to stay within its own boundaries with cross-ownership forbidden.<sup>38</sup> Through the years, competition and the need for efficiency have relaxed these artificial boundaries.<sup>39</sup> In 1967, banks were allowed to expand into mortgage lending and trust companies expanded into retail accounts.<sup>40</sup> The next big step occurred twenty years later in 1987 when banks, trust and insurance companies were allowed to own securities subsidiaries.<sup>41</sup>

The 1991 revision to the Bank Act further expanded banks' powers within the four "pillars" of the financial services industry by permitting cross ownership between financial sectors.<sup>42</sup> Banks may now own trust, loan, and insurance companies as sub-

31. Robinson, *supra* note 18, at 19.

32. *Bank Facts 1992*, *supra* note 1, at S1.

33. *Id.* Schedule II banks have the same powers as Schedule I banks with the exception of some limitations on branching and asset size. *Id.* There are currently 55 active Schedule II banks operating in Canada. *Id.*

34. Robinson, *supra* note 18, at 19.

35. *Id.*

36. *Id.* Non-bank financial institutions can also directly or indirectly own up to 100 percent of a Schedule II bank with no dilution requirement. *Id.*

37. *Bank Facts 1992*, *supra* note 1, at S11.

38. *Looking Ahead; Forecasts for Canadian Banks*, includes appendices; *Bank Facts 1994*, 101 CANADIAN BANKER S14, S14 (1994) [hereinafter *Looking Ahead*].

39. The Financial Services Competitiveness Act of 1995: Hearings on H.R. 1062 before the Committee on Banking and Financial Services, U.S. House of Representatives, 105th Cong., 1st Sess. (Mar. 21, 1995) (statement of Allan R. Cooper, Senior Vice-President and Treasurer Canadian Bankers Association [hereinafter Congressional Testimony]).

40. Robinson, *supra* note 18, at 16. Interest rate limits were also removed from credit accounts. *Id.*

41. *Id.*

42. *Looking Ahead*, *supra* note 37, at S14. These reforms completed the collapse of the traditional four pillars. *Id.*

sidaries.<sup>43</sup> Banks are also allowed to implement networking agreements with the other "pillars" in the financial services industry to distribute those other sector's financial products.<sup>44</sup> However, a bank is still limited in its power to finance autos or sell insurance at its bank branches.<sup>45</sup>

The 1991 Bank Act also allows banks to move outside the four pillars and offer financial services to other institutions.<sup>46</sup> Banks are moving into the information services arena by offering information processing.<sup>47</sup> Banks can also act in an advisory position for information management systems and in creating computer software and related hardware.<sup>48</sup> In addition, banks are now allowed to engage in real estate services.<sup>49</sup> This permits banks to own, develop, and manage land through real property corporations or by owning real estate firms.<sup>50</sup>

The 1991 Bank Act further expanded bank powers by allowing banks to provide financial planning services through investment counseling and portfolio management.<sup>51</sup> Under the prior Bank Act these services could only be offered by banks through their securities subsidiaries.<sup>52</sup> Furthermore, banks can now own "specialized financing corporations."<sup>53</sup> Through these corporations, banks can participate in broader capital venture and merchant banking activities than allowed under the previous Bank Act.<sup>54</sup> Due to these expansive changes in the old Bank Act and the dynamic nature of the industry, the government will again review and revise the Bank Act in five years, rather than the normal statutory ten year period.<sup>55</sup>

#### B. TREATMENT OF FOREIGN BANKS UNDER CANADA'S BANK ACT.

Foreign banks operating in Canada are also governed by the Bank Act.<sup>56</sup> The 1991 Bank Act defines a foreign bank as a "entity incorporated or formed by or under the laws of a country other than Canada."<sup>57</sup> A bank can qualify as a foreign bank under this defin-

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43. *Bank Facts 1992*, *supra* note 1, at S12.

44. *Congressional Testimony*, *supra* note 38.

45. *Looking Ahead*, *supra* note 37, at S14.

46. *Bank Facts 1992*, *supra* note 1, at S12.

47. *Id.*

48. *Looking Ahead*, *supra* note 37, at S15.

49. *Bank Facts 1992*, *supra* note 1, at S12.

50. *Id.*

51. *Looking Ahead*, *supra* note 37, at S15.

52. *Id.*

53. *Bank Facts 1992*, *supra* note 1, at S12.

54. *Id.*

55. *Congressional Testimony*, *supra* note 38.

56. *Bank Facts 1992*, *supra* note 1, at S2.

57. Bank Act, S.C., ch. 46, § 2 (1991)(Can.).

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ition in seven different ways. The first two ways a bank can qualify are if it is deemed a bank under the laws of any foreign country or if it engages either directly or indirectly in the business of financial services and uses the word "bank" in its name.<sup>58</sup> A third way to qualify is to conduct business in a foreign country that if conducted in Canada would be classified as banking activity.<sup>59</sup> Another way an institution can qualify is to lend money and accept deposit liabilities.<sup>60</sup> Banks that are affiliated with another foreign bank or control another foreign bank that either directly or indirectly provides financial services are also categorized as foreign banks.<sup>61</sup> The last way to qualify is to be a foreign institution other than a foreign bank that controls a Schedule II bank.<sup>62</sup> Subsidiaries of Schedule I banks are specifically exempted from qualifying as foreign banks.<sup>63</sup>

Once a bank qualifies as a foreign bank, it is governed by Part XII sections 507 - 522 of the 1991 Bank Act.<sup>64</sup> Section 508 prohibits foreign banks from: directly or indirectly undertaking any banking business in Canada; maintaining a branch for any purpose in Canada; and operating in Canada through an automated banking machine or remote service unit.<sup>65</sup> Foreign banks cannot guarantee any securities or accept any bills of

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58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.* These first six ways that a bank can qualify as a foreign bank are virtually unchanged from the prior 1980 version of the Bank Act. See Bank Act, S.C., ch. 40, § 2 (1980)(Can.).

62. Bank Act § 2 (1991). Under the prior Bank Act, a foreign institution other than a foreign bank that controlled a Schedule II bank was not classified as a foreign bank. See Bank Act § 2 (1980).

63. Bank Act § 2 (1991). The 1980 Bank Act also excluded corporations, associations, partnerships, other institutions, departments or agencies of a government that used the word "bank" in its title or was affiliated with a corporation that was a foreign bank but did not engage in financial activities. Bank Act § 2 (1980). The prior Bank Act also excluded that same list of institutions that were exempted by the Minister from foreign bank status. *Id.* The 1991 version of the Bank Act does not provide exemptions for any institution other than a subsidiary of a Schedule I bank. See Bank Act § 2 (1991).

64. Bank Act (1991), *supra* note 56, at ch. 46.

65. Robinson, *supra* note 18, at 25. However, foreign banks may enter into agreements with Canadian financial institutions that allow their customers to access their accounts through automated banking machines that are operated by Canadian financial institutions.

66. See Bank Act § 508(3)(1991). Foreign banks can also operate telephone services to quote or to enter into verbal agreements with Canadian customers regarding foreign exchange, deposit or loan rates. *Id.* This provision remained virtually unchanged from the prior Bank Act. See Bank Act § 302(1)(1980).

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exchange issued by Canadian residents for the purpose of being sold or traded in Canada.<sup>67</sup> If any of the above activities are performed by a "nominee or agent of a foreign bank or by an entity that is controlled by a foreign bank, the foreign bank is deemed to have indirectly carried out the activity."<sup>68</sup>

Section 509 creates three express exceptions as to the general prohibitions against foreign banks.<sup>69</sup> Under the first exception, with the Superintendent's approval and in accordance with other applicable regulations, foreign banks may maintain representative offices in Canada.<sup>70</sup> A representative office is defined as an "office established to represent a foreign bank in Canada that is not occupied or controlled by an entity incorporated or formed by or under an Act of Parliament or of the legislature of a province, and the personnel of which are employed directly or indirectly by the foreign bank."<sup>71</sup> The Superintendent allows periodic examinations and inquiries into the operation of the representative office to ensure that it is complying with the applicable regulations.<sup>72</sup> If the Minister, after consulting with the Superintendent, does not believe that the representative office of the foreign bank is operating in accordance with applicable regulations, the registration of the representative office may be canceled.<sup>73</sup>

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67. Bank Act § 513(1)(1991). This prohibition does not apply to securities or bills of exchange that are issued by a foreign bank subsidiary or non-bank affiliate of a foreign bank. *Id.* It also does not apply to securities or bills of exchange issued by another resident in Canada and guaranteed or accepted by a foreign bank subsidiary of the foreign bank. Bank Act § 513(2)(1991).
68. Bank Act § 508(2)(1991).
69. *Id.* § 509.
70. Robinson, *supra* note 18, at 25. See also Bank Act § 509(a)(1991); Bank Act § 302(2)(1980).
71. Bank Act § 507(1)(1991). See Robinson, *supra* note 18, at 26 for proposition that representative offices play only a limited role since they are only allowed to promote the services of a foreign bank or act as a liaison between clients of the foreign bank and other offices of the foreign bank.
72. Bank Act § 510(1)(1991). Section 510(2) allows the Superintendent or anyone acting under his direction to conduct the inspection. *Id.* § 510(2).
73. *Id.* § 510(3). This provision remained virtually unchanged from the prior Bank Act. See Bank Act § 302(5)(1980).
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The second exception allows foreign banks to own shares in a foreign bank subsidiary.<sup>74</sup> A foreign bank subsidiary is a Schedule II bank that is the subsidiary of a foreign bank.<sup>75</sup> A limitation is imposed upon foreign banks or entities associated with foreign banks that own shares in a foreign bank subsidiary by prohibiting them from acquiring or holding a substantial investment in any bank or any other Canadian entity other than the foreign bank subsidiary.<sup>76</sup> Canadian financial services entities are even prohibited from issuing or registering "in their securities register a transfer of any of its shares or ownership interests to a foreign bank or an entity associated with a foreign bank, if the foreign bank would thereby acquire or increase a substantial investment in the Canadian entity."<sup>77</sup> If the Minister determines that the foreign bank or the entity associated with it is not complying with this exception, she may in the name of public interest order the foreign bank to divest itself of the foreign bank subsidiary.<sup>78</sup>

This limitation that prohibits a foreign bank from acquiring or holding a substantial investment in any Canadian entity if it owns shares in a foreign bank subsidiary does not apply in five special circumstances. The first circumstance is when the only substantial investment a foreign bank has in an entity is due to its relationship to the foreign bank subsidiary.<sup>79</sup> The limitation also does not apply to shares or ownership interests in Canadian entities whose principal purpose of business is not one of the four pillars of the financial services industry.<sup>80</sup> The third circumstance in which the limitation does not

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74. Robinson, *supra* note 18, at 25. The Cabinet of Canada and the Minister have the discretion to decide whether to issue a foreign bank subsidiary. *Id.* They consider the following criteria: if the bank will make a contribution to the financial system of Canada; if the home of the foreign company provides just as favorable treatment for Canadian banks; if the total domestic assets for all foreign bank subsidiaries have exceeded 12% of the total domestic assets of all banks; the presence and nature of non-bank activities; the nature and sufficiency of the financial resources; soundness and feasibility of the future business plan, the experience of the applicant; management capability; and the best interests of the financial system in Canada. *Id.* See also Bank Act § 509b(1991).

75. Bank Act § 2 (1991).

76. *Id.* § 518(1).

77. *Id.* § 517(1). Canadian entities can issue or register a transfer of any of its shares or ownership interests to a foreign bank subsidiary if permitted to by the Bank Act's Corporate Structure section (IX) even if it would result in the foreign bank acquiring or increasing a substantial investment. *Id.* § 517(2). See also Bank Act § 303(6) (1980).

78. Bank Act § 520 (1991).

79. *Id.* § 518(2).

80. *Id.* § 518(3).

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apply is when either before or after application for incorporation or acquisition of a foreign bank subsidiary, the Minister granted special permission to hold the shares or ownership interests.<sup>81</sup> If the foreign bank becomes the owner of shares of more than one foreign bank subsidiary through acquisition or amalgamation of two or more banks, the shares may continue to be held by the foreign bank for up to two years.<sup>82</sup> The last circumstance exempt from the limitation is where the foreign bank acquires shares or interests in a Canadian entity through realization of security for a loan or debt.<sup>83</sup> These shares will not be considered to be owned or acquired by the foreign bank for two years and for any additional period as the Minister may allow.<sup>84</sup>

The third exception as to the general prohibition against foreign banks allows a foreign bank, with the approval of the Governor in Council, to locate its head office in Canada and conduct business outside Canada, as long as it does not conduct business inside Canada.<sup>85</sup> The only business the foreign bank may conduct with Canadian residents involves obtaining premises, supplies, services and staff for the office.<sup>86</sup> Two exceptions apply to the rule prohibiting business with Canadian residents from the head office of a foreign bank located in Canada. Both concern foreign banks that were operating in Canada before the establishment of the head office in Canada.<sup>87</sup> The first exception allows the head office to repay any deposits held and collect any outstanding loans existing before the establishment of the head office.<sup>88</sup> The second exception allows a bank to conduct activities at its head office that relate to shares in a foreign bank subsidiary.<sup>89</sup>

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81. *Id.* § 518(3b). The provision containing these first three circumstances was virtually unchanged from the prior act. *See also* Bank Act § 305(3) (1980).

81. Bank Act § 519(1) (1991).

82. *Id.* § 519(2).

83. *Id.* The provision containing these last two circumstances was virtually unchanged from the prior act. *See also* Bank Act § 305 (5 & 7) (1980).

84. Ian F.G. Baxter, *LAW OF BANKING* 176 (3d ed. 1981). *See also* Bank Act § 512 (1991).

85. Bank Act § 512(1) (1991).

86. *Id.* § 512. Both exceptions existed under the prior Bank Act. *See* Bank Act § 302(6a & b) (1980).

87. Bank Act § 512(2) (1991).

88. *Id.* § 512(3).

89. Baxter, *supra* note 83, at 177. *See also* Bank Act § 514 (1991).

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The Bank Act also governs non-bank affiliates of foreign banks.<sup>90</sup> An entity qualifies as a non-bank affiliate of a foreign bank in two ways. It may be a Canadian entity other than a bank that is associated with a foreign bank or an entity in which a foreign bank has a substantial investment.<sup>91</sup> It may also be a non-bank affiliate of a foreign bank if it is controlled by another entity that is associated with a foreign bank or in which a foreign bank has a substantial investment.<sup>92</sup>

Non-bank affiliates of foreign banks are prohibited from lending money and accepting deposit liabilities.<sup>93</sup> Furthermore, non-bank affiliates of foreign banks that carry on "any aspect of the business of banking" cannot borrow loan proceeds or issue debentures, bonds or other securities if it is represented that the repayment of the loan proceeds or interest payments is guaranteed directly or indirectly by the foreign bank or any entity associated with the foreign bank.<sup>94</sup> This limitation does not apply if the foreign bank has obtained written consent from the Minister to engage in such activities.<sup>95</sup> However, the Minister's consent may be conditioned on certain necessary terms and conditions and can be revoked with thirty days advance notice.<sup>96</sup> Non-bank affiliates of foreign banks are required, within six months of the end of the financial year, to provide the Superintendent with a copy of financial statements from the preceding year.<sup>97</sup>

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90. Bank Act § 507(1) (1991).

91. *Id.* § 507(1). The definition of a non-bank affiliate changed from the prior Bank Act. *Id.* The 1991 Bank Act defines non-bank affiliates in terms of substantial investment while the 1980 act defined non-banks affiliates in terms of voting shares. See Bank Act § 303 (1980).

92. Baxter, *supra* note 83, at 177. See also Bank Act § 515 (1991).

93. Bank Act § 514(2) (1991). If represented that the payments are guaranteed directly or indirectly by a foreign bank, a court may on behalf of the Minister enjoin the non-bank affiliate and persons acting on its behalf from making such representations. *Id.* § 515(a). The court also has the option of rendering an agreement based on such a representation inoperative after such a period of time, so as to avoid undue hardship on the innocent party who entered into such an agreement. *Id.* at § 515(b).

94. *Id.* § 514(4). Where the Minister grants consent, notice of that consent shall be published in the Canada Gazette. *Id.* § 514(6).

95. *Id.* § 514(5). Where the Minister revokes consent, notice of that consent shall be published in the Canada Gazette. *Id.* § 514(6).

96. *Id.* § 516. This provision existed in the prior code virtually unchanged. See Bank Act § 307 (1980).

97. Bank Act § 521 (1991).

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Finally, section 521 of the 1991 Bank Act contains the remaining prohibitions on foreign banks conducting business in Canada.<sup>98</sup> Unless the foreign bank obtains the consent of the Governor in Council it cannot directly or indirectly establish a new Canadian business or acquire substantially all the assets of an Canadian entity whose principal purpose of business involves a traditional pillar in the financial services industry.<sup>99</sup> Foreign banks are also prohibited from acquiring shares of ownership in a Canadian entity involved in the financial services sector if it would cause the Canadian entity to become a non-bank affiliate of a foreign bank.<sup>100</sup> If the entity is already a non-bank affiliate of a foreign bank, foreign banks may not acquire shares of ownership that would increase the percentage of outstanding shares or ownership interests to be greater than before acquisition.<sup>101</sup>

### C. UNITED STATES-CANADA FREE TRADE AGREEMENT.

The United States-Canada Free Trade Agreement (FTA) went into effect on January 1, 1989.<sup>102</sup> The FTA was the first general trade agreement to deal with financial services.<sup>103</sup> Canadian banks receive their largest share of foreign income from banking activities with the United States.<sup>104</sup> Thus, a free trade agreement with the United States regarding financial services appeared at the onset to be the next step in the natural progression of increasing growth for Canada's service sector.<sup>105</sup> The FTA attempted to merge and intertwine the financial sectors of two different but culturally similar countries.<sup>106</sup>

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98. *Id.* § 521(a & c).

99. *Id.* § 521(b).

100. *Id.*

102. The North American Free Trade Agreement Implementation Act: Statement as to How the NAFTA Serves the Interests of United States Commerce, 1993 WL 561219 (NAFTA), at 1 (1993) [Interests of United States Commerce]. Since the FTA's implementation, United States service exports to Canada expanded by 98% from 1987 to 1991. *Id.*

103. Minister of Supply and Services Canada, Department of External Affairs, *North American Free Trade Agreement: Canada Statement on Implementation* 172 (Jan. 1, 1994) [hereinafter *Canadian Implementation*].

104. *Id.* at 171. See Congressional Testimony, *supra* note 38 for statement that Canadian banks are the second largest foreign bank provider of loans in the United States (an estimated \$20.3 billion for the second quarter in 1994). Thus, Canada and the United States receive mutual economic benefits from each other's banking activities. *Id.*

105. Leonard Bierman & Donald R. Fraser, *The Canada-United States Free Trade Agreement and U.S. Banking: Implications for Policy Reform*, 29 VA. J. INT'L L. 1, 1 (1988). Canada is the United States' largest trading partner. *Id.*

106. Valerie McNevin, *Policy Implications of the NAFTA for the Financial Services Industry*, 5 COLO. J. INT'L ENVTL. L. & POL'Y 369, 376 (1994).

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1. *Differences Underlying the FTA.*

Although the FTA works with both countries' banking systems, each country has a substantially different approach to the banking industry.<sup>107</sup> The United States' banking system is characterized by local regulation and ownership of financial institutions.<sup>108</sup> The United States Constitutional premise of federalism allows each state to regulate banking within its borders; thus, different regulatory schemes have developed in every state.<sup>109</sup>

In contrast, regulation of banks in Canada is determined at the federal level by the Parliament of Canada.<sup>110</sup> As discussed earlier, the Bank Act governs all banking activity in Canada both domestic and foreign.<sup>111</sup> Canada has a smaller and more widely dispersed population than the United States.<sup>112</sup> This led to the development of national commercial banks with extensive branches that can engage in a wide-range of financial services.<sup>113</sup> Canada has traditionally been protective of its small domestic banking market.<sup>114</sup> In fact, foreign banks were prohibited from transacting business in Canada until the 1980 Bank Act.<sup>115</sup>

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107. Carlos M. Nalda, Note, *NAFTA, Foreign Investment, and the Mexican Banking System*, 26 GEO. WASH. J. INT'L. L. & ECON. 379, 393 (1992).

108. *Id.*

109. *Id.*

110. Cally Jordan, *Financial Services Under NAFTA: The View from Canada*, 9 REV. BANKING & FIN. SERV. 4, 5 (1993).

111. *Id.*

112. Nalda, *supra* note 105, at 394. See also *Canada—Business Guide*, *supra* note 6. The population of Canada is approximately 27 million people, one-tenth the size of the United States. *Id.* Furthermore, Canada is the second largest country in the world in terms of area (9,976,139 square kilometers). *Id.* Due to Canada's vast area, the population is widely dispersed, but Canada's harsh geography also contributes to the population being concentrated in relatively few urban centers along the border with the United States. *Id.* Some have even estimated that the Canadian market is in effect 4000 miles long and 100 miles wide. *Id.* This market consists of a 750 mile-long megalopolis and densely populated metropolitan areas separated by large sparsely populated areas. *Id.*

113. Nalda, *supra* note 105, at 394.

114. *Id.*

115. Robinson, *supra* note 18, at 25.

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Not only did cultural differences lead to problems in negotiations, but complex and diverse regulations on both the national and provincial or state level in each country further complicated discussions.<sup>116</sup> The discussions concerning the financial services section of the FTA became so technically difficult that negotiations were conducted separately from the rest of the FTA.<sup>117</sup> Banking services received their own chapter in the FTA and were exempted from the investment provisions of the FTA.<sup>118</sup> In the end, the two countries agreed to disagree.<sup>119</sup> The parties even stated in the financial services section of the FTA that "this part shall not be construed as representing the mutual satisfaction of the parties concerning the treatment of their respective financial institutions."<sup>120</sup> While both countries had hoped for greater progress in the financial services area, Canada was the most disappointed.<sup>121</sup> The United States was able to benefit by the limited national treatment of U.S. banks in Canada, but Canadian banks did not receive the same treatment in the United States due to the grandfathering of more restrictive banking laws and regulations.<sup>122</sup>

## 2. Provisions of the FTA.

Despite the disagreements, the FTA did lay the initial groundwork for future international financial service agreements.<sup>123</sup> The core concept underlying the FTA is that of national treatment which allows foreign banks to be treated the same as domestic banks.<sup>124</sup> This provision allows Canadian or United States banks doing business in the other country to enjoy the rights and privileges of domestic banks in that country.<sup>125</sup>

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116. Jordan, *supra* note 108, at 4.

117. *Id.* The negotiations over the financial services provisions were difficult due to the fact that international agreements on services, in particular financial services, were a new development, with the FTA being the first general international agreement to deal with financial services. *Id.*

118. Nalda, *supra* note 105, at 394.

119. Jordan, *supra* note 108, at 4.

120. U.S. Canada Free Trade Agreement, Jan. 2, 1988, U.S.-Can., arts. 1702.4 & 1703.4.

121. Jordan, *supra* note 108, at 2.

122. *Canada Banks Want Full Access to Mexican Markets*, 2 N. AM. REP. ON FREE TRADE (1992).

123. Nalda, *supra* note 105, at 395.

124. Bierman, *supra* note 103, at 3.

125. *Id.* Thus, the principal of national treatment benefited the United States more than Canada because the United States was able to take advantage of Canada's banking policies which were more liberal than the current policies at home in the United States. See Jordan, *supra* note 108, at 3. Alternatively, while Canada did receive national treatment in the United States, its banks were subject to the more restrictive banking laws that existed in the United States. *Id.*

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Under the FTA, United States bank subsidiaries are exempted from the 12% aggregate asset ceiling imposed on the size of the foreign banking sector.<sup>126</sup> The United States can also open unlimited additional branches in Canada without prior Minister approval.<sup>127</sup> Moreover, the FTA permits U.S. banking subsidiaries to transfer loans to their parent companies.<sup>128</sup>

Perhaps the biggest concession Canada granted to the United States was exemption from the "10/25" rules in the financial services sector governing foreign banks.<sup>129</sup> The "10/25" rule prohibits any individual, Canadian or foreign, from owning more than 10% of the shares of a Schedule I bank.<sup>130</sup> Furthermore, non-residents cannot collectively own 25% of the shares of a Schedule I bank.<sup>131</sup> The FTA exempts United States residents from the foreign provisions of the "10/25" rules.<sup>132</sup> United States residents are still subject to the 10% limitation that applies to all Canadians but are in essence treated as "honorary Canadians."<sup>133</sup> Both aspects of the "10/25" rule on ownership restrictions were repealed for United States residents in the non-bank financial sector.<sup>134</sup> Under this rule, only foreign individuals were prohibited from owning more than 10% of the shares of a non-bank and from owning more than 25% in the aggregate.<sup>135</sup> The FTA eliminates both requirements for United States residents raising the possibility of a United States controlled Canadian federal trust, loan, investment or insurance company.<sup>136</sup>

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126. *Canadian Implementation*, *supra* note 101, at 172. Due to the exemption, Canada cannot refuse to incorporate a United States-controlled foreign subsidiary or refuse to increase its authorized capital just because it would increase the size of the foreign banking sector over the 12 percent cap. See Robinson, *supra* note 18, at 27. The 12 percent cap continues to apply to other foreign-controlled banks. See also Jordan, *supra* note 108, at 10.
127. Robinson, *supra* note 18, at 27.
128. *Id.* The transfer of loans between a Canadian bank subsidiary and its United States parent is subject to prudential requirements of general application. See also Jordan, *supra* note 108, at 11. This is actually a limited concession by Canada because Canadian withholding tax regulations create a disincentive for transfers of this type. *Id.*
129. *Key Areas of Trade Agreement*, FIN. POST, Aug. 13, 1992, at 12 [hereinafter *Key Areas*].
130. Jordan, *supra* note 108, at 6.
131. *Key Areas*, *supra* note 127, at 12.
132. *Canada-Economic and Trade Policy*, MARKET REP., Mar. 1992, at 11 [hereinafter *Canada-Economic and Trade*].
- 133.. Jordan, *supra* note 108, at 6.
134. *Canada-Economic and Trade*, *supra* note 130, at 11.
135. Jordan, *supra* note 108, at 7.
136. *Id.*
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In turn, the United States granted a major concession to Canada in the FTA by giving permission for domestic and foreign banks operating in the United States to underwrite and trade Canadian government-backed securities.<sup>137</sup> This concession was of major importance to Canadian governments which float most of their debt issues in the U.S. market.<sup>138</sup>

The United States also agreed to grandfather the right of Canadian banks to operate in more than one state even though the International Banking Act of 1978 ended interstate banking privileges.<sup>139</sup> The only problem with this concession was that the grandfathering privilege was only extended at the federal level and the main roadblocks to interstate banking for Canadian financial institutions are at the state level.<sup>140</sup>

The FTA also provides that any future liberalization in the financial services sector of each country will be extended to the other country.<sup>141</sup> This specifically applies to the Glass-Steagall Act which prohibits commercial banks in the United States from engaging in investment banking.<sup>142</sup> The FTA specifically provides that if any changes are made to this act they will be extended to Canadian financial institutions.<sup>143</sup>

Thus, although the FTA did not accomplish as much as both nations would have liked, it did provide the backdrop for the North American Free Trade Agreement and the liberalization of regulations governing financial institutions in both countries.<sup>144</sup>

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137. *Canadian Implementation*, *supra* note 101, at 172. These debt instruments include Canadian federal, provincial, municipal bonds, and other quasi-governmental agency debt as long as the debt instruments are guaranteed by the Canadian government. Bierman, *supra* note 103, at 6. For this provision to become effective, the Glass-Steagall Act, which prohibits United States commercial banks from underwriting or dealing in securities, must be amended. *Id.*

138. *Canadian Implementation*, *supra* note 101, at 172.

139. Jordan, *supra* note 108, at 15. Before the International Banking Act of 1978, foreign banks operating in the United States were permitted to open subsidiary banks in various states, even though United States banks were not allowed to participate in such interstate banking activity. See Bierman, *supra* note 103, at 7. But the 1978 act forced foreign banks to choose one of the states in which it had operations in as its "home" state. *Id.* From that time on, foreign banks could only open new operations in their "home" state while interstate operations that were established before 1978 were allowed to continue under grandfather clauses. *Id.* In essence, the FTA just guaranteed that subsequent legislation could not change the grandfather clauses. *Id.*

140. Jordan, *supra* note 108, at 15.

141. *Canada—Business Guide*, *supra* note 6.

142. *Canadian Implementation*, *supra* note 101, at 172.

143. Jordan, *supra* note 108, at 16.

144. Nalda, *supra* note 105, at 395.

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## II. THE NORTH AMERICAN FREE TRADE AGREEMENT.

### A. CREATION OF THE NAFTA.

The North American Free Trade Agreement (NAFTA) expands on the economic success of the FTA.<sup>145</sup> Both countries rely heavily on each others exports. Canada is the United States' largest export market.<sup>146</sup> Likewise, Canadian exports to the United States continue to expand with 77.5% of all Canadian exports going to the United States in 1993.<sup>147</sup>

Due to their experience in negotiating the FTA, the Canadian Parliament pressured its trade officials to take a firm stance in the NAFTA negotiations.<sup>148</sup> Canada had two main objectives in the NAFTA negotiations.<sup>149</sup> First, Parliament wanted to gain access to Mexico.<sup>150</sup> Second, Parliament aspired to move beyond the FTA's "a la carte approach" and instead base market access on the general principles of national treatment, most-favored nation treatment, cross-border purchases of financial services and the right to market access through the establishment of a commercial presence.<sup>151</sup>

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145. Interest of United States Commerce, *supra* note 100, at 1.

146. Linda Powers, *The Problems and Prospects of a North American Free Trade Agreement: NAFTA and the Regulation of Financial and Other Services*, 1 U.S.-MEX. L. J. 65, 65 (1993). Since the FTA was enacted in 1988, United States exports to Canada have risen from \$72 billion in 1988 to 90.6 billion in 1992. See also Interest of United States Commerce, *supra* note 100, at 1. In addition, United States service exports to Canada have increased by 98%. *Id.*

147. Kelly McParland, *Canada, U.S. get tighter*, FIN. POST, Feb. 26, 1994, at 12. Canada's merchandise trade surplus with the United States was 21.8 billion in 1993. *Id.* This was a \$5 billion increase over 1992. *Id.* The size of the surplus with the United States offsets deficits incurred with other countries, such as Japan and the European nations. *Id.* The end result is a worldwide surplus of 11.7 billion in 1993. *Id.*

148. Nalda, *supra* note 105, at 400-401. There were several factors which contributed to Parliament's push for a tough stance on NAFTA negotiations. *Id.* One factor was that Canadian banks had become more competitive by increasing their market share in the United States and by earning record profits. *Id.* Another factor was the current uncertain economic outlook. *Id.* The last major factor influencing the firm stance was the perception that Canada had acquiesced too easily in prior trade negotiations. *Id.*

149. *Canadian Implementation*, *supra* note 101, at 172.

150. *Id.*

151. *Id.* at 172-173. Defining principles were emphasized so as to build on the progress made in the Uruguay Round in drafting a General Agreement on Trade in Services (GATS). *Id.*

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On August 12, 1992, Canada, the United States, and Mexico finalized negotiations on NAFTA.<sup>152</sup> The agreement affirms their "commitment to promoting employment and economic growth in each country through the expansion of trade and investment opportunities in the free trade area and by enhancing the competitiveness of Canadian, Mexican, and U.S. firms in global markets, in a manner that protects the environment."<sup>153</sup> NAFTA creates an extensive open market of over 360 million people and \$6 trillion in annual output.<sup>154</sup>

#### B. DIFFERENCES BETWEEN THE FTA AND THE NAFTA.

As a result of experience, there are several differences between the FTA and NAFTA.<sup>155</sup> The first major difference between the two agreements is the degree of integration.<sup>156</sup> The financial services provisions in the FTA were "negotiated separately, drafted separately, and share no parentage" with the other FTA provisions.<sup>157</sup> NAFTA has attempted to integrate the financial services chapter into the rest of the agreement by using the language of the General Agreement on Trade in Services ("GATS").<sup>158</sup> Unlike the FTA, NAFTA's financial services chapter also covers insurance and certain investment provisions.<sup>159</sup>

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152. THE GOVERNMENTS OF CANADA, THE UNITED MEXICAN STATES AND THE UNITED STATES OF AMERICA, DESCRIPTION OF THE PROPOSED NORTH AMERICAN FREE TRADE AGREEMENT, Aug. 12, 1995, *available in* Westlaw, NAFTA file [hereinafter THE GOVERNMENTS]. The Canadian Minister of Industry, Science and Technology and Minister for International Trade Michael Wilson, Mexican Secretary of Trade and Industrial Development Jaime Serra and United States Trade Representative Carla Hills are the officials of the three governments responsible for completing the final text of NAFTA. *Id.*

153. *Id.*

154. Office of the Press Secretary, The White House, The North American Free Trade Agreement for Immediate Release: Aug. 12, 1992 (1992).

155. *Canadian Implementation*, *supra* note 101, at 173.

156. Jordan, *supra* note 108, at 20.

157. *Id.*

158. *Id.* In the attempt to intergrate the financial provisions with the rest of NAFTA, the drafters sacrificed some precision and clarity. *Id.* Familiarity with GATT and GATS helps provide the foundation necessary for understanding NAFTA. *Id.*

159. *Id.* at 21.

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NAFTA also creates new restrictions and dispute settlement mechanisms for the financial community.<sup>160</sup> NAFTA establishes disciplines on the regulations of self-regulatory institutions, such as stock and future exchanges.<sup>161</sup> It also creates dispute settlement procedures that are similar to other NAFTA settlement provisions, but allows the procedures to be tailored to serve the unique needs of the financial community.<sup>162</sup>

Finally, NAFTA expands the scope of the FTA.<sup>163</sup> The FTA was a bilateral agreement between the United States and Canada.<sup>164</sup> In contrast, NAFTA not only includes Mexico as a party to the agreement, but also permits the addition of other parties to the agreement in the future.<sup>165</sup> NAFTA's structure encourages the addition of new countries by separating its core provisions in the body of the agreement with the country-specific parts of the agreement located in the Annexes.<sup>166</sup>

While there are several differences between the two agreements, two provisions of the FTA have been incorporated into NAFTA.<sup>167</sup> First, the national treatment accorded by the United States to Canada's government-backed securities for the purpose of excluding such securities from the Glass-Steagall Act continues to apply under NAFTA.<sup>168</sup> Secondly, NAFTA continues to allow for the grandfathering of Canadian bank branches' existing interstate banking privileges.<sup>169</sup>

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160. *Canadian Implementation*, *supra* note 101, at 173.

161. *Id.*

162. Jordan, *supra* note 108, at 21. For the first time, NAFTA contains provisions for binding dispute settlement. Panelists for financial services cases are picked from a special roster of 15 expert panelists. See also *Canadian Implementation*, *supra* note 101, at 173. Financial disputes under the FTA were discussed by the United States Treasury and the Canadian Finance Department, without rules or time limits. *Id.* Furthermore, in recognition of the dynamic nature of the financial services industry, NAFTA created a Financial Services Committee with the mandate of considering future liberalization. *Id.*

163. Jordan, *supra* note 108, at 21.

164. Nalda, *supra* note 105, at 393.

165. Jordan, *supra* note 108, at 21. Negotiations are under way for Chile to be the next member country of NAFTA. See *Canada: Building on Success*, Can. Newswire, Jan. 16, 1995, available in Westlaw, CANWIREPLUS file [hereinafter *Building on Success*].

166. Jordan, *supra* note 108, at 21.

167. *Id.* at 23.

168. *Id.*

169. *Id.* at 24.

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## C. NAFTA CHAPTER 14: FINANCIAL SERVICES.

NAFTA Chapter 14, Articles 1401 through 1416 govern the financial services sector.<sup>170</sup> NAFTA Article 1416 "defines a financial institution as a company authorized to do business and regulated or supervised as a financial institution under the law of the NAFTA country in whose territory it is located."<sup>171</sup> Financial institutions under NAFTA include banks, trust companies, securities brokerage houses, investment banks, finance companies, and insurance companies.<sup>172</sup>

Chapter 14 applies to federal, state, and local government laws and regulations.<sup>173</sup> Self-regulatory organizations are also covered by this chapter if a member country requires membership by financial institutions in the self-regulatory organization.<sup>174</sup> Chapter 14 is designed to protect the rights of financial service institutions, investors in those institutions, cross-border providers, and consumers of the member countries.<sup>175</sup>

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170. North American Free Trade Agreement, drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA].

171. F. Amanda DeBusk, *NAFTA: The Opportunity for Financial Services Providers*, 4 No. 4 MEX. TRADE & L. REP. 15, 15 (1994). The definition of financial institutions is broad enough to permit NAFTA's coverage to apply to not only existing institutions but to new institutions as they emerge. See also NAFTA, *supra* note 168, art. 1416.

172. DeBusk, *supra* note 169, at 15.

173. The North American Free Trade Agreement Implementation Act— Chapter 14: Financial Services, 1993 WL 561162 (N.A.F.T.A.), at 1 (1993) [hereinafter Implementation Act]. NAFTA does not prevent a government from being the only provider of public retirement benefits, social security, or other financial services. *Id.* NAFTA allows member countries to grant a monopoly to private entities providing a public retirement plan or statutory system of social security. See *Canadian Implementation*, *supra* note 101, at 173. NAFTA also does not apply to government-owned entities such as insurance corporations, health care and health care insurance, and workers' compensation programs. *Id.*

174. *Canadian Implementation*, *supra* note 101, at 173.

175. *Id.*

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Article 1403 requires NAFTA members to permit the establishment of foreign financial institutions from other NAFTA countries in their territory on a non-discriminatory basis.<sup>176</sup> Theoretically, investors should have the right to choose which form of establishment, branch or subsidiary, fulfills their needs.<sup>177</sup> However, Article 1403 does not create the right or the obligation for the member countries to allow such a choice.<sup>178</sup> In essence, the provision provides that should the United States decide to allow interstate banking branches, then the member countries will pursue the right to establish branches throughout North America.<sup>179</sup>

Article 1404 prohibits restrictions on cross-border financial services currently permitted under each member country's laws.<sup>180</sup> The Article also establishes the right of consumers to purchase cross-border financial services.<sup>181</sup> However, a provider of such services must first establish in the member country before it can solicit or do cross-border financial service business.<sup>182</sup> The government of each member country may require registration of cross-border firms and financial instruments.<sup>183</sup> Firms doing cross-border business may also be required to keep trust accounts or bonds within that country.<sup>184</sup>

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176. DeBusk, *supra* note 169, at 15.

177. Implementation Act, *supra* note 171, at 2. Trade is enhanced when investors are allowed to choose their own form of establishment without governmental restrictions. *See also Canadian Implementation*, *supra* note 101, at 173.

178. *Canadian Implementation*, *supra* note 101, at 173.

179. Implementation Act, *supra* note 171, at 2. Canada's only obligation until then is to review and assess whether to allow member countries' banks to branch into Canada. *See also Canadian Implementation*, *supra* note 101, at 173-74.

180. Implementation Act, *supra* note 171, at 2. However, both Canada and the United States took a reservation in Annex VII exempting cross-border trade in securities services from most-favored nation obligations. *Id.*

181. *Canadian Implementation*, *supra* note 101, at 174.

182. *Id.*

183. Implementation Act, *supra* note 171, at 2. The purpose of such registration is to protect the investors. *Id.*

184. *Canadian Implementation*, *supra* note 101, at 174. The purpose of keeping the trust accounts or bonds within the country is to keep them within the reach of the local judicial system. *Id.*

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Article 1405 provides national treatment for investors, financial institutions, and cross-border providers.<sup>185</sup> National treatment is defined as treatment "no less favorable" than treatment provided to domestic institutions in like circumstances.<sup>186</sup> The standard for determining national treatment is whether the member country is providing equality of competitive opportunity.<sup>187</sup> "Equal competitive opportunities allow for different treatment of foreign investors or institutions as long as it does not disadvantage the foreign institutions or investors in comparison with their domestic counterparts."<sup>188</sup> Moreover, Article 1405 requires that investors or institutions establishing in a member country receive the best treatment provided for any new entrant, including any domestic institution or investor.<sup>189</sup> If the institution or investor is already established in the country but expanding to a new state or province, the new establishment must receive the best treatment given for any new entrant from the state or province in which it is already established.<sup>190</sup>

Article 1406 provides for most-favored nation treatment by requiring each member country to give financial service providers from other member countries the most favorable treatment that it offers to any country.<sup>191</sup> However, a NAFTA country may receive preferential treatment if the other member countries are given an opportunity to demonstrate that they qualify for similar treatment and that an opportunity to negotiate such treatment is provided.<sup>192</sup> If there is a difference in the treatment provided under the national treatment and most-favored nation treatment clauses, the NAFTA country is entitled to the better of the two treatments.<sup>193</sup>

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185. *Id.*

186. Implementation Act, *supra* note 171, at 2.

187. Powers, *supra* note 144, at 68.

188. *Canadian Implementation*, *supra* note 101, at 174. Changes in market share, profitability or size are not sufficient by themselves to prove lack of equality of competitive opportunity. *Id.* They can be considered as factors in determining whether a member country is providing equality of opportunity and thus, national treatment. *Id.*

189. *Id.*

190. *Id.* The example given is that of an established investor in New York who expands to Ohio must receive the best treatment there that an investor from New York would receive. *Id.*

191. DeBusk, *supra* note 169, at 15.

192. *Canadian Implementation*, *supra* note 101, at 175.

193. Implementation Act, *supra* note 171, at 3.

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Article 1407 requires each NAFTA government to allow financial institutions from other NAFTA countries the right to introduce new financial services that are already permitted under that country's current law.<sup>194</sup> This Article further grants NAFTA countries the right to transfer data across national borders for data processing.<sup>195</sup>

In Article 1408, NAFTA ensures that financial institutions in member countries can hire senior management or other essential personnel regardless of the individual's nationality.<sup>196</sup> Furthermore, a NAFTA government cannot require more than a simple majority of the board of directors to be a combination of nationals or residents of that NAFTA country.<sup>197</sup>

Article 1410 provides that NAFTA does not prohibit member countries from implementing or maintaining other reasonable measures for prudential reasons.<sup>198</sup> NAFTA defines prudential reasons as those with the purpose of protecting the providers of financial services, the consumers of such services, and the integrity of the financial system.<sup>199</sup>

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194. DeBusk, *supra* note 169, at 15. However, the host country can determine the form, branch or subsidiary, through which the service is provided and may require authorization of the service. See also *Canadian Implementation*, *supra* note 101, at 175.
195. Implementation Act, *supra* note 171, at 3. This allows banks in the United States and Canada to utilize their expertise in financial innovation and administrative operations in other NAFTA countries. *Id.* Banks in both countries will also be able to utilize existing processing centers in their own country rather than incurring the expense of building additional buildings and staffing such facilities. See also Karen Macallister, Comment, *NAFTA, Foreign Investment, and the Mexican Banking System*, 17 *HOUS. J. INT'L L.* 273, 292 (1994).
196. NAFTA, *supra* note 168, art. 1408. This protects the rights of NAFTA countries to staff their financial firms and manage their investments with personnel from their own country. See Implementation Act, *supra* note 171, at 3. "These provisions prevent a country from imposing regulations through staffing rather than through laws and eliminate the expense of training nationals of a particular country in the proprietary skills and product knowledge of the institution as a cost of doing business in that country." See also Macallister, *supra* note 193, at 293. Thus, management decisions are based on each institution's own business judgment and goals and not the host country's social or financial goals. *Id.*
197. DeBusk, *supra* note 169, at 16.
198. *Canadian Implementation*, *supra* note 101, at 175. Article 1410 also provides that non-discriminatory monetary, credit and exchange rate policies are not subject to NAFTA. See also Implementation Act, *supra* note 171, at 3. Furthermore, NAFTA governments are permitted to favor their own national firms regarding private social security and public retirement plans. *Id.*
199. NAFTA, *supra* note 168, art. 1410(1).
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Article 1411 focuses on the goal of transparency.<sup>200</sup> Each NAFTA government is required to publicly make available all new draft financial laws and regulations at a recognized inquiry point.<sup>201</sup> All interested parties must be given the chance to comment on the proposed measures with the opportunity to have their questions answered.<sup>202</sup> After new regulations have been adopted, the regulations must be published or made public.<sup>203</sup> All applicants for new financial institutions also have the right to inquire about the status of their application<sup>204</sup> and to have a decision within 120 days.<sup>205</sup>

Article 1412 creates a Financial Services Committee to implement Chapter 14's provisions.<sup>206</sup> The Committee meets annually to discuss the functioning of Chapter 14 and any current financial issues.<sup>207</sup> The Committee will also play a role in the dispute settlement process.<sup>208</sup>

Articles 1413, 1414, and 1415 assure the availability of consultations and dispute settlement mechanisms.<sup>209</sup> If a NAFTA country considers a regulation of another member country inconsistent with Chapter 14, it may request a consultation with the other mem-

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200. DeBusk, *supra* note 169, at 16.

201. Implementation Act, *supra* note 171, at 3. The transparency requirement has a significant impact on the Mexican government which has traditionally exercised broad discretion over publishing regulations. See DeBusk, *supra* note 169, at 16. Now under NAFTA, Mexico must publish its rules and regulations. *Id.*

202. THE GOVERNMENTS, *supra* note 150, at 78.

203. Canadian Implementation, *supra* note 101, at 175.

204. THE GOVERNMENTS, *supra* note 150, at 78.

205. Canadian Implementation, *supra* note 101, at 175. A decision does not have to be made within the 120 days if regulatory hearings are necessary or in situations where 120 days is not a practical limitation. *Id.* In such cases, the applicant must be notified of the delay and a decision made within a reasonable time. *Id.* These limitations ensure transparency in foreign regulation and prompt processing of applications. See also Implementation Act, *supra* note 171, at 3.

206. Implementation Act, *supra* note 171, at 4. The Committee will be comprised of officials from the Canadian Department of Finance, the United States Treasury, and the Mexican Hacienda. See also Canadian Implementation, *supra* note 101, at 175. The Committee will report to the Free Trade Commission. *Id.*

207. Canadian Implementation, *supra* note 101, at 175.

208. *Id.*

209. Implementation Act, *supra* note 171, at 4.

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bers to discuss the issue.<sup>210</sup> If the consultation does not settle the matter, financial experts on a dispute settlement panel are available to help settle the dispute.<sup>211</sup> The dispute settlement panel consists of at least two financial experts from a roster of fifteen financial experts.<sup>212</sup> The articles also insure that no repercussions, such as the suspension of any financial service benefits, will be incurred by the complaining government.<sup>213</sup> The NAFTA countries are given the opportunity to resolve any investment disputes concerning financial services before the matter is brought to an arbitral panel.<sup>214</sup>

#### D. RESERVATIONS AND COUNTRY-SPECIFIC LIMITATIONS IN CHAPTER 14.

Chapter 14 provides a system of reservations to exempt certain laws and regulations in the NAFTA countries that are inconsistent with its provisions.<sup>215</sup> The reservations are organized for each NAFTA government into schedules with three sections.<sup>216</sup> In section A, each government lists the federal, state or provincial, and local laws or regulations which are exempt from Chapter 14.<sup>217</sup> These exempt laws are automatically "grandfathered."<sup>218</sup> A "ratchet" provision provides "that once a reserved law is liberalized it cannot later be made more restrictive."<sup>219</sup> In section B, financial service sectors reserve the right to maintain existing inconsistent federal regulations and to implement new non-conforming regulations.<sup>220</sup> Section C of the governments' schedules lists specific country commitments undertaken by each of the individual NAFTA countries.<sup>221</sup>

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210. *Canadian Implementation*, *supra* note 101, at 175. Each NAFTA country must give sympathetic consideration to requests made by other NAFTA countries with the results of their consultations reported to the Financial Services Committee at its annual meeting. *See also* NAFTA, *supra* note 168, art. 1413(1).

211. *Canadian Implementation*, *supra* note 101, at 175.

212. *Implementation Act*, *supra* note 171, at 4. Roster members may be appointed for terms of three years. *See also* NAFTA, *supra* note 168, art. 1414(2). To be chosen, roster members must have financial expertise, be objective and reliable, and have sound judgment. *Canadian Implementation*, *supra* note 101, at 75.

213. *Implementation Act*, *supra* note 171, at 4.

214. *Id.*

215. *Id.*

216. *Id.*

217. NAFTA, *supra* note 168, art. 1409(1).

218. *Implementation Act*, *supra* note 171, at 4.

219. *Id.*

220. *Id.*

221. NAFTA, *supra* note 168, art. 1409(3).

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Canada's schedule of reservations lists three significant federal law exemptions from NAFTA requirements.<sup>222</sup> First, Canada reserves a retention requirement for re-insurance services in accordance with the Canadian Insurance Companies Act.<sup>223</sup> The Act requires that no more than 25% of re-insurance can be purchased abroad.<sup>224</sup> Second, in section B, Canada reserves the right to introduce new restrictions on cross-border security trade.<sup>225</sup> Finally, Canada limits NAFTA'S benefits to firms in the United States and Mexico that are ultimately controlled by residents of these nations.<sup>226</sup> This is contrary to the general rule which allows any company resident in a NAFTA country, regardless of ultimate ownership, to be considered a NAFTA firm.<sup>227</sup> In addition to the three exemptions, Canada specifically commits to exempt Mexico from the "10/25" rules in which the United States were exempted under the FTA.<sup>228</sup>

The United States' schedule also lists three main exemptions.<sup>229</sup> In the first exception, the United States has grandfathered all restrictions in federal law which are inconsistent with Chapter 14 obligations.<sup>230</sup> The United States parallels Canada's second exemption by permitting new restrictions on cross-border securities trade.<sup>231</sup> The third exemption specifically commits the United States to provide Mexican firms with a five year transition period to conform their activities in the United States to the Bank Holding Company Act of 1956.<sup>232</sup>

Mexico's schedule differs from the United States' and Canada's schedules by establishing market share and capital limits instead of exemptions.<sup>233</sup> Until January 1, 2000, the individual market share of commercial banks owned by the United States or Canada cannot exceed 1.5% of Mexican banking system.<sup>234</sup> Thereafter, these commercial banks

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222. Implementation Act, *supra* note 171, at 5.

223. *Id.*

224. *Canadian Implementation*, *supra* note 101, at 176.

225. Implementation Act, *supra* note 171, at 5.

226. *Id.* The requirement of ultimate ownership to receive NAFTA benefits mirrors Canada's financial institutions laws. *Canadian Implementation*, *supra* note 101, at 176.

227. Implementation Act, *supra* note 171, at 5.

228. *Canadian Implementation*, *supra* note 101, at 176.

229. DeBusk, *supra* note 169, at 17.

230. *Id.*

231. Implementation Act, *supra* note 171, at 8.

232. DeBusk, *supra* note 169, at 17.

233. *Canadian Implementation*, *supra* note 101, at 176. Mexico set ownership restrictions for foreign banks due to worries that its financial institutions would be taken over by Canadian and United States companies. DeBusk, *supra* note 169, at 16.

234. Implementation Act, *supra* note 171, at 6.

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cannot exceed 4% of the total capitalization of Mexico's domestic banking system.<sup>235</sup> Moreover, the aggregate market share of all Canadian and United States bank subsidiaries is limited to 8% as of 1994 with rising annual increments until reaching 15% in 1999.<sup>236</sup> The aggregate market share limitation is eliminated in 2000.<sup>237</sup> However, the Mexican government reserves the right to reimpose the cap should foreign market share reach 25% before 2004.<sup>238</sup>

E. AMENDING CANADA'S BANK ACT TO COMPLY WITH NAFTA.

To implement the provisions of NAFTA's Chapter 14, Canada amended its Bank Act with the NAFTA Implementation Act §§ 22-29.<sup>239</sup> The purpose of these amendments was to exclude NAFTA residents and foreign bank subsidiaries controlled by NAFTA residents from the Bank Act's strict provisions governing non-residents.<sup>240</sup> The amendments fulfill the goals of Chapter 14 by granting national treatment and most-favored nation treatment to NAFTA nations.<sup>241</sup>

Sections 22 and 23 begin the amendments by defining a NAFTA country resident.<sup>242</sup> "NAFTA country residents are natural persons ordinarily resident in a NAFTA country

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235. DeBusk, *supra* note 169, at 16. The limitations do not apply to internal growth such as retained earnings or capital contributions. Implementation Act, *supra* note 171, at 6.

236. Implementation Act, *supra* note 171, at 6.

237. *Id.*

238. DeBusk, *supra* note 169, at 16. The cap can only be reimposed once for a three year period. *Id.* All aggregate market share restrictions must be removed by the year 2007. *Id.*

239. Canadian Implementation, *supra* note 101, at 177. Canada also amended three other financial statutes to implement the provisions of NAFTA's Chapter 14: Cooperative Credit Associations Act, Insurance Companies Act, and the Trust and Loan Companies Act. *Id.*

240. NAFTA Implementation Act, § 22-30 (1994) (Can.) (provided by Canada's Multilateral Trade Insitution) [hereinafter NAFTA Implementation].

241. *Id.* Amendments to Canadian statutes due to the FTA are suspended while NAFTA related amendments are in effect. Canadian Implementation, *supra* note 101, at 177.

242. Canadian Implementation, *supra* note 101, at 177. The purpose of defining a NAFTA country resident is to remove such residents from the application of non-resident ownership rules. *Id.*

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other than Canada and corporations and other entities incorporated ... in a NAFTA country other than Canada that are controlled by one or more natural persons ordinarily resident in a NAFTA country other than Canada.”<sup>243</sup> Section 25 revises the definition of non-resident to exclude NAFTA residents.<sup>244</sup>

Section 24 permits residents and NAFTA residents to own a significant interest in a Schedule II bank for a period of ten years beginning the date the bank came into existence.<sup>245</sup> A significant interest is defined as more than 10% of any class of outstanding shares.<sup>246</sup> Section 24 also authorizes the Minister of Finance to consider the non-financial activities of a resident or a NAFTA resident in deciding whether such a person should be allowed to incorporate or acquire a significant interest in a Schedule II bank.<sup>247</sup>

Section 28 grants foreign bank subsidiaries controlled by Mexican residents the same treatment granted under the FTA to subsidiaries controlled by United States' residents.<sup>248</sup> The section also governs the conduct of a non-NAFTA country bank subsidiary.<sup>249</sup> A non-NAFTA country bank is defined as “a foreign bank subsidiary that is not controlled by a NAFTA country resident.”<sup>250</sup>

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243. NAFTA Implementation, *supra* note 238, § 23. This section defines the test for determining whether a NAFTA resident controls an entity. *Id.* A NAFTA resident controls a corporation if the resident can elect the majority of the directors. *Id.* If it is a non-corporate entity, the NAFTA resident must be able to direct the business and affairs of the entity. *Id.*

244. *Id.* § 25.

245. Canadian Implementation, *supra* note 101, at 177.

246. *Id.*

247. NAFTA Implementation, *supra* note 238, § 24.

248. Canadian Implementation, *supra* note 101, at 177.

249. *Id.*

250. NAFTA Implementation, *supra* note 238, § 28.

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Non-NAFTA country bank subsidiaries are limited to locating one branch and their head office in Canada.<sup>251</sup> Furthermore, no non-NAFTA country bank subsidiary can have average domestic assets exceeding an amount fixed by the Minister of Finance for that subsidiary for any three month period.<sup>252</sup> Non-NAFTA country bank subsidiaries are prohibited from owning more than 12% of the total domestic assets held by all banks.<sup>253</sup> Thus, the Minister of Finance cannot fix the amount of a non-NAFTA country bank subsidiary's average domestic assets above 12%.<sup>254</sup>

Section 29 addresses section 508 of the Bank Act which prohibits foreign banks from conducting business in Canada.<sup>255</sup> The 1992 Bank Act allowed foreign banks to enter into agreements with Canadian banks to permit United States' residents access to their bank accounts through the use of an automated bank machine operated by a Canadian financial institution.<sup>256</sup> The Amendment now allows Mexican residents to receive these same benefits by changing "United States residents" to NAFTA residents.<sup>257</sup>

### III. CURRENT EFFECTS OF NAFTA ON THE CANADIAN BANKING SYSTEM.

#### A. IN GENERAL.

NAFTA is already having a positive impact on the Canadian economy.<sup>258</sup> Overall economic output increased by 4.8% in the third quarter of 1994.<sup>259</sup> Furthermore, Canadian exports of goods and services are at the highest rate ever.<sup>260</sup> In fact, the financial services industry is now a leading export sector.<sup>261</sup> In addition, Canadian unemployment improved by 2% in 1994 due to the creation of 431,000 new full-time jobs.<sup>262</sup>

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251. *Canadian Implementation*, *supra* note 101, at 178. Additional subsidiaries may be opened if the non-NAFTA country obtains permission from the Minister of Finance. *Id.*

252. *NAFTA Implementation*, *supra* note 238, § 28.

253. *Canadian Implementation*, *supra* note 101, at 178.

254. *Id.*

255. *Id.*

256. *Id.*

257. *Id.* at 177.

258. *Building on Success*, *supra* note 163.

259. *Id.* Not only was this increase better than all the other G7 industrial nations, but Canada is predicted to lead the G7 in growth in both 1995 and 1996. *Id.*

260. *Id.* Since 1991, exports to the United States have increased by 65 percent. *Id.*

261. *Id.*

262. *Id.* This is Canada's lowest unemployment rate for the past seven years. *Id.*

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## B. CANADIAN EXPANSION INTO THE UNITED STATES.

Canadian banks have conducted business in the United States since 1850 and continue to have strong presence in the United States' financial sector today.<sup>263</sup> Canadian banks now have 51 subsidiaries, branches, agencies or offices in the United States.<sup>264</sup> The top six banks in Canada all operate uninsured branches and agencies in the United States.<sup>265</sup> The Bank of Montreal is the only Canadian bank with a United States banking subsidiary.<sup>266</sup> Canadian banks are the second largest source of foreign bank loans in the United States.<sup>267</sup> Canadian banks in the United States employ 8500 people and have 17% of their assets in the United States.<sup>268</sup>

In 1984, the Bank of Montreal acquired Harris Bank in Chicago.<sup>269</sup> Since the passage of NAFTA, the Bank of Montreal has embarked on a plan to use Harris Bank to establish the Bank of Montreal as the first North American bank with continent-wide reach.<sup>270</sup> The Harris bank ranks fifth out of sixty United States institutions for its expertise in foreign exchange transactions.<sup>271</sup> By the year 2002, Harris aims to capture 12% of the Chicago market<sup>272</sup> which would produce half of the Bank of Montreal's income in the United States alone.<sup>273</sup> Through the acquisition of Harris, the Bank of Montreal acquired 72 branches which will help the Bank of Montreal reach its goal of 120 branches and 1 million customers in the United States.<sup>274</sup>

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263. Congressional Testimony, *supra* note 38.

264. *Free Trade: U.S., Mexico Reach Pact on Financial Services*, OTTAWA CITIZEN, July 2, 1992, at C12 [hereinafter *Free Trade*].

265. Congressional Testimony, *supra* note 38.

266. *Bank of Montreal Chairman Urges Creation of Western Hemisphere Free Trade Agreement*, PR Newswire, Sept. 8, 1995, available in Westlaw, PRNEWS-C file [hereinafter *Chairman Urges Creation*]. The Bank of Montreal is the tenth largest bank in North America and the only Canadian bank listed on the New York Stock Exchange. *Id.*

267. Congressional Testimony, *supra* note 38. In the second quarter of 1994, Canadian bank loans in the United States totaled \$20.3 billion. *Id.*

268. *Id.*

269. J.P. Donlon & Joseph L. McCarthy, *Southern Strategy; Royal Bank of Canada's plan to expand operations in the US*, CHIEF EXECUTIVE (U.S.), Oct. 1992, at 39.

270. Symonds, *supra* note 9, at 104.

271. *Bank of Montreal-Speech -2-*, Can. Newswire, Jan. 18, 1994, available in Westlaw, CANWIRE-PLUS file [hereinafter *Speech -2-*].

272. Symonds, *supra* note 9, at 104.

273. *Speech -2-*, *supra* note 269. The Bank of Montreal currently earns half of its net income outside of Canada. *Id.*

274. Symonds, *supra* note 9, at 105. To reach their goal, the Bank of Montreal plans to build at least 27 additional branches. *Id.*

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NAFTA has also fostered the expansion of other Canadian banks into the United States. Toronto Dominion Bank opened a trade services office in Houston on March 1, 1995.<sup>275</sup> The trade services office offers core trade finance products with the hope of capitalizing on business with United States exporters.<sup>276</sup> National Bank of Canada has also expanded into the United States by providing financing to small and medium-sized businesses.<sup>277</sup> The Royal Bank of Canada, the fourth largest bank in North America, is also taking advantage of NAFTA by planning to expand into the United States in the area of electronic banking.<sup>278</sup>

### C. CANADIAN EXPANSION INTO MEXICO.

NAFTA has also opened opportunities for Canadian banks to expand into Mexico.<sup>279</sup> Four of the six leading Canadian banks already have representative offices in Mexico.<sup>280</sup> The National Bank of Canada uses its representative office to help its Canadian and United States' customers in Mexico.<sup>281</sup> In addition, the National Bank of Canada has signed a cooperation agreement with the Mexican bank Confia.<sup>282</sup> Both banks will offer their services and business contacts to the clients of the other institution in both countries and around the world.<sup>283</sup>

The Bank of Montreal is also taking advantage of Mexico's resources.<sup>284</sup> Nesbitt Burns Inc., a subsidiary of the Bank of Montreal, signed an agreement with Casa de Bolsa Bancomer, Mexico's second-largest banking group, to exchange business between Canada and Mexico.<sup>285</sup> Nesbitt Burns Inc. will sell Mexican equities and fixed-income products in Canada while Casa de Bolsa Bancomer will sell Canadian securities in Mexico.<sup>286</sup>

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275. *Toronto Dominion Bank Opens Trade Services Office in Houston*, Can. Newswire, Mar. 2, 1995, available in Westlaw, CANWIREPLUS file.

276. *Id.*

277. Arthur Johnson, *Small Risks and Lots of 'Em*, 67 CAN. BUS. REV. 33, 33 (1994.)

278. Donlon & McCarthy, *supra* note 267, at 38.

279. *Free Trade*, *supra* note 262, at C12.

280. *Id.*

281. Johnson, *supra* note 275, at 34.

282. *National Bank of Canada Signs Cooperation Agreement with Mexican Bank*, Can. Newswire, June 9, 1995, available in Westlaw, CANWIREPLUS file. The National Bank of Canada is the sixth largest bank in Canada and generates \$10 billion of its assets through its international operations. *Id.*

283. *National Bank in tie-up with Mexico bank*, Reuters Info. Serv., June 9, 1995, available in Westlaw, REUTERNEWS file.

284. Richard Blackwell, *Nesbitt to Exchange Business with Mexican Broker*, FIN. POST, Nov. 10, 1994, at 14.

285. *Id.*

286. *Id.*

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In addition, the Bank of Montreal joined forces with Grupo Financiero Bancomer SA, Mexico's second largest financial group, to create the First Canadian NAFTA Advantage Fund.<sup>287</sup> The mutual fund is designed to achieve long-term capital growth by investing in NAFTA-oriented companies in the United States, Canada and Mexico.<sup>288</sup> The First Canadian NAFTA Advantage Fund invests 20% of its assets in each of the three NAFTA countries with the remaining 40% allocated based on investment opportunities.<sup>289</sup>

#### D. IMPACT OF WORLD TRADE ORGANIZATION (WTO) ACCORD.

As a reaction to NAFTA and GATT, the World Trade Organization (WTO) has enacted an international agreement to liberalize trade in financial services around the world.<sup>290</sup> The WTO accord provides access to 90% of all international financial business by improving access to new entrants and improving current operating conditions for existing participants.<sup>291</sup> The agreement involves all members of the General Agreement on Trade in Services (GATS) except for the United States who decided not to participate in the agreement during negotiations.<sup>292</sup> The accord is only an interim deal that will expire in 1997.<sup>293</sup> The agreement allows Canada access to \$20 trillion in banking deposits, \$2 trillion of insurance premiums, \$10 trillion of stock market capitalization and \$10 trillion of listed bond values.<sup>294</sup> Under the agreement, Canada guarantees that Ottawa will extend NAFTA benefits to all its world partners.<sup>295</sup> The greatest advantage that Canada realizes under the agreement is improved access to vital Asian and European markets.<sup>296</sup>

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287. Janet McFarland, *B of M, Mexico join to aid NAFTA*, CALGARY HERALD, September 28, 1994, at 3.

288. *Bank of Montreal Customers Can Now Invest in NAFTA*, Can. Newswire, Sept. 28, 1994, available in Westlaw, CANWIREPLUS file.

289. *Fund Will Focus on Growth Due to NAFTA*, CALGARY HERALD, Sept. 30, 1994, at D6.

290. *USA: Commission Welcomes WTO Deal on Financial Services*, PR Newswire, July 26, 1995, available in Westlaw, INT-NEWS-C file [hereinafter *Commission Welcomes WTO*].

291. *Id.*

292. *Id.*

293. *A More Open World Financial Market*, FIN. POST, July 29, 1995, at 16 [hereinafter *More Open World*].

294. *Id.*

295. *Commission Welcomes WTO*, *supra* note 288.

296. *More Open World*, *supra* note 291, at 16.

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#### IV. CONCLUSION.

Through the years, the Canadian banking system has evolved from operating within the constraints of the four pillars to conducting international operations that are blind to national boundaries. NAFTA is the culmination of the liberalization trend in the financial services sector. Moreover, NAFTA has provided the background for continued liberalization in Canada's financial services sector and for future international free trade agreements.

##### A. EXPANSION AND LIBERALIZATION OF NAFTA AND THE BANK ACT.

Recent developments in the government and private banking sector reveal a growing trend for liberalization in the financial services sector.<sup>297</sup> The Canadian House of Commons' industry committee has recommended amending the Bank Act to remove the limits on the size of non-NAFTA foreign bank subsidiaries.<sup>298</sup> Currently, non-NAFTA nations are prohibited from having Canadian subsidiaries with more than 12% of the total domestic assets of Canadian banks.<sup>299</sup> To reduce substantial costs on foreign banks, the committee also recommends allowing foreign banks to operate through direct branches rather than through subsidiaries.<sup>300</sup>

In addition to the federal government, the private banking sector also endorses liberalization in the banking industry.<sup>301</sup> The Bank of Montreal has announced that due to the success of NAFTA, its next major goal will be to pursue a free-trade agreement covering the entire Western Hemisphere.<sup>302</sup> The Bank hopes that such an agreement would stimulate economic growth and provide Canada with access to rapidly growing markets for exports of financial services.<sup>303</sup> Furthermore, the Bank believes a Western Hemisphere free-trade agreement will allow North America to compete with the expansive economic development of China and the South East Asian countries.<sup>304</sup>

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297. *Canadian Panel Proposes Lifting Foreign Bank Rule*, Dow Jones News Serv., Oct. 18, 1994, available in Westlaw, DJNS file.

298. *Id.*

299. *Id.*

300. *Id.*

301. *Chairman Urges Creation*, *supra* note 264.

302. *Id.*

303. *Id.*

304. *Id.*

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## B. NAFTA AND AN INDEPENDENT QUEBEC.

For over a decade, Quebec separatists led by Quebec Deputy Premier Bernard Landry have called for Quebec's independence from Canada.<sup>305</sup> The latest referendum on October 30, 1995 resulted in rejection of independence by a one percent margin of voters.<sup>306</sup> As the results were tallied, the United States and other foreign bond investors who hold 40% of Canada's public debt sighed in relief.<sup>307</sup>

However, the struggle for Quebec's independence is not over due to increasing support that has continued to grow over the years.<sup>308</sup> In the 1980 independence referendum, the voters rejected independence by a 60/40 margin.<sup>309</sup> In the 1995 independence referendum, the margin decreased to 50.5/49.5.<sup>310</sup> Thus, unless the Canadian government pursues major policy changes, future challenges by Quebec separatists are likely to occur.<sup>311</sup>

It is still unclear what the ramifications on NAFTA would be should Quebec secede.<sup>312</sup> Canadian Finance Minister Paul Martin warns that Quebec's membership into NAFTA would not be automatic.<sup>313</sup> In fact, Martin predicts that Quebec would be forced to negotiate for several years and make significant concessions.<sup>314</sup> As a province, Quebec is currently allowed to maintain preferential procurement practices that are not tolerated for national governments under NAFTA.<sup>315</sup> Furthermore, Martin believes that the United States would push for additional concessions that it was unable to obtain from Quebec during negotiations for the WTO accord in exchange for admission into NAFTA.<sup>316</sup>

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305. *Quebec's Landry Denies that NAFTA Entry Would Pose Problems*, Dow Jones Int'l News Serv., Sept. 26, 1995, available in Westlaw, DJINS file [hereinafter *Landry Denies*].

306. Christopher J. Chipello & John Urquhart, *Quebec Rejects Separatist Plan in a Close Vote: Break of Canada Averted But Government Faces Pressure For Changes*, WALL ST. J., Oct. 31, 1995, at A3. See generally, Rex. J. Zedalis, *An Independent Quebec: State Succession to the NAFTA*, *supra* at 3.

307. *Id.*

308. *Id.*

309. *Id.*

310. *Id.*

311. *Id.*

312. Joan Bryden, *Quebec Decides: Separation Expensive, Martin Says, Bouchard Calls Warning Nothing But Fearmongering*, THE OTTAWA CITIZEN, Sept. 27, 1995, at A3.

313. *Id.*

314. *Canada's Martin-Quebec 4: No Automatic NAFTA Membership*, Dow Jones Int'l News Serv., Sept. 26, 1995, available in Westlaw, DJINS file [Canada's Martin].

315. *Landry Denies*, *supra* note 303.

316. *Canada's Martin*, *supra* note 312.

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However, Quebec Deputy Premier Bernard Landry denies that Quebec would have a difficult time gaining admission to NAFTA.<sup>317</sup> Despite the fact that Quebec would have to first gain admission to the WTO which has a waiting list of 30 other countries,<sup>318</sup> Landry contends that only minimal changes would be necessary for Quebec to be admitted to NAFTA.<sup>319</sup> Since Quebec already participates in NAFTA as a part of Canada, Landry suggests that the agreement only needs to be altered to reflect the membership of four countries rather than the current three member countries.<sup>320</sup> A study by Roger & Wells, a New York law firm, supports Landry's position.<sup>321</sup> The study predicts that the United States would treat Quebec as a successor state if the province gains independence from Canada.<sup>322</sup> As a successor state, Quebec would not have an automatic right to participate in NAFTA but the United States would most likely permit Quebec to join NAFTA due to the desirability of continuing current relationships with Quebec businesses.<sup>323</sup>

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317. *Landry Denies*, *supra* note 303.

318. Bryden, *supra* note 310, at A3.

319. *Landry Denies*, *supra* note 303.

320. *Id.*

321. *Study Suggests U.S.-Canada Pacts Would Cover Separate Quebec*, Dow Jones Int'l News Serv., Mar. 13, 1995, available in Westlaw, DJINS file.

322. *Id.*

323. *Id.*

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