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An Overview of Legal Developments in the Banking and Financial Services Industry in Canada

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ARTICLES

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I. Background

Over the last ten years the financial services industry in Canada has been exposed to significant pressures, both internally and externally generated, which have prompted a process of adaptation to permit Canadian financial institutions to cope with a new environment. As part of this adaptive process, in September 1990, the Canadian government announced its long-awaited policy for reform of the industry and tabled a draft of the first of a series of pieces of legislation to implement such reforms.

In order to appreciate some of the complexities of the reform process in the Canadian financial services industry, it is helpful to have some understanding of the background of the reform process, both in constitutional and historic terms, and of the economic (or competitive) factors that motivated and continue to influence these developments.

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A. Constitutional Framework

1. *Overview of Federal Jurisdiction*

Under Canada's Constitution, "Banking, the Incorporation of Banks and the Issue of Paper Money" is the exclusive preserve of the federal government.[1] In addition, it has long been recognized that the federal government has the authority, in concurrent jurisdiction with the provinces, to incorporate companies, including financial institutions, and to regulate their corporate affairs. The exclusive jurisdiction over the banking sector, as well as the ability to regulate the affairs of other federally incorporated financial institutions such as trust, loan, and insurance companies, has resulted in the federal government being the primary regulatory authority for the Canadian financial industry, particularly as the majority of the large nonbank financial institutions are federally incorporated.

The federal government also has the exclusive constitutional power to legislate for the "Regulation of Trade and Commerce."[2] However, historically the development of federal legislation under this head of power has been less extensive than one might think having regard to the breadth of the language. There have, however, been relatively few court decisions that would limit the federal government's jurisdiction under this head of power. Indeed, the Supreme Court of Canada has, in obiter, suggested that federal activity respecting regulation of interprovincial trading in securities may be supportable under the trade and commerce power, in much the same way as federal securities regulation in the United States has been upheld under the commerce clause in the United States Constitution.[3]

In this day and age, in view of the globalization of the financial services industry, one might consider the potential for further federal intervention in the regulation of sectors of the financial services industry, such as securities dealers, which, historically, the provinces have dealt with. Such intervention could be based upon an assertion of jurisdiction under the trade and commerce power. Indeed, in 1979 the federal government published a study advocating the creation of a federal authority to regulate the securities industry on a national basis. However, this study has never been acted upon, and given the regulatory lead taken by the provinces in this field, the relative degree of accommodation and cooperation that now appears to exist between the federal and provincial authorities, and the relatively smooth functioning of arrangements among the various provincial securities regulators, the expectation of a high level of federal intervention is politically unrealistic. Nevertheless, the scope for federal intervention in the regulation of the securities industry has been enhanced as a result of recent changes in legislation that now allow banks to own securities dealers.[4]

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1. Constitution Act, 1867, 30–31 Vict., ch. 3 (U.K.), as amended, § 91(15).
2. *Id.* § 91(2).
3. *See* Multiple Access Ltd. v. McCutcheon, [1982] 2 S.C.R. 161.
4. *See infra* text at Section II.A.3 *Interim Reforms*.

2. *Overview of Provincial Jurisdiction*

The Canadian Constitution grants to the provinces the exclusive legislative jurisdiction over "Property and Civil Rights" in the province.[5] Not surprisingly, courts have broadly construed this clause over the years,[6] and under its umbrella most provinces have enacted comprehensive legislation governing all aspects of the financial industry other than the federally regulated banking sector.[7]

As there is no exclusive federal power to regulate the financial services industry, except in matters relating to banking, provincial regulation touches not only the affairs of provincially incorporated financial institutions, but also the business activities of federally incorporated financial institutions that are carrying on business within a particular province. The courts have limited the jurisdiction of a province to regulate the activities of a bank or other federally regulated financial institution only in the case of a direct and clear conflict between the provincial and the federal legislation applicable to the institution. Under legislation such as the various Securities Acts and Loan and Trust Corporations Acts, the provinces may, and do, regulate provincially incorporated entities. They may also assert jurisdiction, through licensing requirements and other means, over federally established institutions, including banks and foreign financial institutions, seeking to participate in provincially regulated areas of the financial services industry, such as securities, insurance, and trust operations.[8]

B. HISTORICAL FACTORS

1. *The "Four-Pillars" Regime*

Partly because of the split of constitutional powers along institutional lines and partly as a result of the much more limited scope of the Canadian financial services industry when the federal and provincial regulatory legislation was first developed some sixty to seventy years ago, the legislation, and hence, the form of regulation governing financial institutions in Canada has followed, until re-

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5. Constitution Act, 1867, 30–31 Vict., ch. 3 (U.K.), as amended, § 92(13).

6. *See, e.g.*, Re Bergethaler Waisenamt, [1949] 1 D.L.R. 769 (Man. C.A.), in which the court held that § 92(13) also encompassed provincially created business, such as credit unions and caisses populaires, even when such businesses included deposit-taking activities that, in certain contexts, might appear to be banking business. *See also* Canadian Pioneer Management Ltd. v. Labour Relations Board of Sask., [1980] 107 D.L.R.3d 1, in which the Supreme Court of Canada held that the business of loan and trust companies was included within the scope of § 92(13), even when such companies are federally incorporated. In Multiple Access Ltd., [1982] 2 S.C.R. at 161, the Supreme Court confirmed the provincial authority in the securities field, notwithstanding virtually identical provisions in the federal company law regime.

7. *See, e.g.*, Loan and Trust Corporations Act, 1987, S.O. 1987, ch. 33, as amended, which regulates loan and trust companies in the province of Ontario; Securities Act, R.S.O. 1980, ch. 466, as amended, which regulates the conduct of securities activities in Ontario; and Insurance Act, R.S.O. 1980, ch. 218, as amended, which regulates insurance companies in Ontario.

8. *See, e.g.*, Loan and Trust Corporations Act, *supra* note 7, § 3(1), which states that the "Act applies to all [loan and trust] corporations unless specifically limited to provincial corporations." Section 31(1) provides for registration, inter alia, of federal loan and trust corporations.

cently, what has become known as the "four-pillars" approach. Under the four-pillars regime, each of the banking, insurance, securities and trust sectors was strictly limited by its governing legislation with prohibitions designed to ensure that each institution kept to its core business under one of the pillars.[9] In addition, the legislation imposed prohibitions on cross-ownership of, or by, financial institutions and also imposed significant limitations on commercial activity by financial institutions. Foreign entry into the financial services industry was also restricted since Canadian control of financial institutions was viewed as being important to the national interest. These provisions were intended to prevent excessive exposure to risk by limiting the scope of activity of a financial institution to a single pillar, and to minimize the conflicts of interest that might arise if an institution were permitted to be active in more than one sector of the industry.

2. *The Climate for Change*

a. Increased Competition

During the 1970s the approach to financial services regulation described above began to be viewed less as a protection and more as a restriction on the efficiency, growth, and development of the Canadian financial services industry. A number of factors contributed to this change in attitude. Increased competitive pressure arose from the imposition of more competitive practices, such as negotiated fees for stock exchange transactions and increased pressure for entry into the Canadian financial markets by foreign players, most notably in the banking and securities sectors. Additional factors that created a climate for reform were developments that tended to blur the four-pillars concept. These included, for example, the expansion of powers of the banks over the last twenty years in areas such as mortgage lending and consumer credit, as well as the migration by trust companies into retail banking, and the growth in importance of financial products such as mutual funds, registered retirement savings plans, and other tax-sheltered investment funds, which were not expressly reserved to a particular sector under the four-pillars regime, and thus, could be offered by all sectors of the financial industry. The growth and internationalization of the exempt market,[10] in which all financial institutions including foreign entities are players, has also been of significant importance, as noted below. All these factors have stimulated intense competition across the entire financial services industry and have tended to create a desire, shared by all sectors, to break the confines of the four-pillars approach.

9. *See, e.g.*, Trust Companies Act, R.S.C. 1985, ch. T–20, § 71, as amended, which sets out the powers of a federally incorporated trust company and Bank Act, R.S.C. 1985, ch. B–1, § 173, as amended, which sets out the business and powers of a bank.

10. The exempt market is the market in securities traded among institutional investors or in foreign markets where neither the securities nor the participants in the market were required to be registered under securities legislation in Canada.

b. Financial Institution Failures

Other more recent factors that have had an effect on the scope and speed of the change in the regulatory process have included several major collapses of financial institutions in the mid-1980s, including two Canadian banks.[11] These collapses rocked the industry and the federal and provincial governments, not so much by reason of the size of the failures, but because there had not been a bank failure in Canada for some sixty years, which in turn had led, to some extent, to a complacent attitude that "It can't happen here." These failures were followed by the near-failures of two other small domestic banks, which were taken over by larger banks with the blessing and assistance of the federal regulatory authorities. Also contributing to concerns over the scope of existing regulations were the collapses of several trust companies, and on a lesser scale, several insurance companies.[12] These failures and the investigations that followed them[13] provided graphic illustrations of the risks to financial institutions in the breakdown of the four-pillar structure and the scope for abuses such as self-dealing. They also pointed out the need for increased powers of, and supervision by, regulatory authorities in the context of a more liberalized legislative framework for the financial services industry.

c. Growth of Commercial Links

On another front, two large takeovers of financial institutions by commercial enterprises lent further urgency to the reform of the financial services industry in Canada. In 1986, Imasco Limited[14] acquired Canada Trust, Canada's second largest trust company, and then in 1989, BCE Inc.[15] acquired Montreal Trust, also a major trust company. These acquisitions placed increased emphasis on concerns with regard to mixing commercial enterprises with financial institutions.

d. External Factors

Events occurring outside of Canada were also having an influence. These included, of course, deregulation of the financial services industry in the United

11. In 1985 two western Canadian regional banks, the Northland Bank and the Canadian Commercial Bank, failed. These two banks represented approximately 1 percent of the value of the Canadian banking system measured by assets or earnings. The collapses resulted from the improvident lending practices of the banks as a result of rapid growth. Both banks also suffered due to excessive concentration in a limited geographic area.

12. In 1985 Pioneer Trust Company, Western Capital Trust Company, Continental Trust Company, Ideal Mutual Insurance Company, and Northumberland General Insurance Company all collapsed.

13. A Royal Commission was ordered to enquire into the collapse of the Canadian Commercial Bank and the Northland Bank. The Commission issued its Report in August 1986.

14. Imasco Limited is a federally incorporated holding company. Its holdings include Imperial Tobacco and Shoppers Drug Mart, respectively the largest cigarette manufacturer and drugstore chain in Canada. Imasco Limited also has extensive holdings in the United States, including Hardee's Restaurants.

15. BCE Inc. is a federally incorporated holding company that owns, inter alia, Canada's largest telephone company. It is also the majority owner of Northern Telecom Limited, one of the largest manufacturers of telephone equipment in the world.

Kingdom, as well as the liberalizing effects on the financial services industry in Europe arising from the 1992 process. At the same time, Canada was embarking on free trade negotiations with the United States, and the Free Trade Agreement that resulted from these talks has made profound changes in the manner in which U.S. entities can participate in the Canadian financial services industry.[16]

II. The Road to Reform

Initiatives by the federal and provincial governments with regard to regulatory reform in the financial services industry have been, to a large extent, complementary, and quite often have resulted from intense intergovernmental negotiation.

A. Completed Federal Reforms

1. *Bank Act Revisions*

a. Schedule I Banks

Prior to 1980 the structure of the Canadian banking industry was relatively straightforward. The field was restricted to widely held, Canadian-controlled players, and was dominated by a few large banks operating on a nationwide basis with huge retail branch networks. Under the Bank Act no single shareholder and no group of associated shareholders, Canadian or foreign, could hold more than 10 percent of a bank, and the aggregate nonresident ownership was limited to 25 percent.[17] Thus, there was no possibility of nonresidents entering into the sector, whether by way of acquisition or by green-field investment, nor was it possible to have a closely held bank even if Canadian controlled.

This state of affairs still prevails today in respect to domestic banks, or what are now known as Schedule I banks.[18] However, during the 1970s, two phenomena in particular set the stage for changes. First, the international activities of Canadian banks underwent a vast expansion, and second, foreign banks began to be attracted to the Canadian market, and not being able to enter the banking sector directly, set up "near-bank" subsidiaries, functioning for practical purposes as wholesale banks, but outside the regulatory net applicable to the banking system.

b. Foreign Schedule II Banks

Recognizing the need to provide a degree of reciprocity if Canadian banks were to be able to continue to operate successfully in the markets of other countries, and desiring to extend the regulatory regime to cover the activities of the near-banks operating in Canada, the federal government brought in signifi-

16. *See infra* text at section II.C *Effect of the United States-Canada Free Trade Agreement.*
17. Bank Act, *supra* note 9, §§ 110(3) & 110(1), respectively.
18. Widely held domestic banks are listed on Schedule I to the Bank Act.

cant changes in the 1980 revision of the Bank Act.[19] This revision accomplished a sweeping modernization of the corporate governance rules applicable to banks, but more importantly opened the way for entry into the Canadian banking sector by foreign banks, while not entirely abandoning the traditional view that banks should be widely held and kept in Canadian hands.

Under the revised legislation, foreign banks are now permitted to establish banking subsidiaries (known as Schedule II banks) in Canada, subject to permission from the Minister of Finance. A foreign bank is now prohibited from carrying on banking business in Canada in any manner other than through a Schedule II bank.[20] Those foreign banks operating as near-banks have thus been compelled to convert to foreign bank subsidiaries governed under the Bank Act, and a considerable number of other international banks have since taken advantage of this opportunity to enter the Canadian banking market despite the restrictions (described below) placed on Schedule II banks. Indeed some of the Schedule II banks, including Hong Kong Bank Canada and Citibank Canada, have become major players in the Canadian banking sector. This influx of foreign banks has sharpened the competition in the Canadian banking sector by intruding on the territory of the few widely held Canadian banks that formerly had the commercial banking market substantially to themselves. More importantly, however, the new legislation signaled a major change in regulatory thinking and retreat from the proposition that all participants in the banking sector should be Canadian controlled.

c. Restrictions on Foreign Schedule II Banks

While the 1980 revisions open the Canadian market to a degree of international competition, they still do not provide full national treatment for foreign banks. Foreign banks may only enter the system by establishing a Schedule II bank subsidiary, rather than a branch.[21] Additionally, the legislation contains general restrictions that affect, at least in theory, the degree to which Schedule II banks can penetrate the market. These restrictions include a deemed authorized capital amount set for each Schedule II bank,[22] coupled with both a limit on domestic assets for each bank equal to twenty times the deemed authorized capital, and a limit on aggregate capital for all Schedule II banks equal to 12 percent of the aggregate capital of all banks in Canada.[23]

19. The Bank Act is subject to a mandatory legislative review every ten years.

20. Bank Act, *supra* note 9, § 302.

21. The government has explained this on the basis that the regulation of a foreign bank operating a branch in Canada would involve extraterritorial application of Canadian law.

22. Bank Act, *supra* note 9, § 174(6) gives the Governor in Council the authority to deem the authorized capital of a Schedule II bank to be any amount up to the authorized capital specified in its charter.

23. *Id.* §§ 174(2) (e), 302(8), (8.1), *amended by* S.C. 1988, ch. 65, § 49. Initially the limit was 12 percent. It was later increased to 16 percent and was reduced again to 12 percent as a result of the United States-Canada Free Trade Agreement, which freed U.S.-owned Schedule II banks from the capital limitations.

In practice, these restrictions have not had a serious impact on the operations of Schedule II banks, since the level of market penetration has mainly been driven by the difficulty in competing with the well-established major domestic banks. Furthermore, the aggregate capital limit has never been reached. (When there appeared to be a possibility that it would be reached, the limit was raised.) Therefore, the Minister of Finance has had scope to increase the deemed authorized capital of each Schedule II bank whenever it has been requested, in order to accommodate the growth of the bank. However, since there is discretion in granting requests for additional capital, the mechanism can serve as a way of controlling what the regulators may view as unhealthy expansion.

A further restriction is represented by the requirement for Schedule II banks (other than U.S.-owned banks) to obtain ministerial consent to open additional branches.[24] Again, in practice this requirement has not proved a problem since consents have been readily forthcoming. In reality, few Schedule II banks have ventured into retail banking (with Hong Kong Bank of Canada being a notable exception), but rather, have limited their branching to the establishment of a few regional offices to serve their commercial clientele.

d. Domestic Schedule II Banks

It is possible under the 1980 revision for a Canadian financial institution that is not a bank to convert to, or to establish a subsidiary as, a Schedule II bank. However, in this case the new bank must, within a ten-year period, become widely held, so as to meet the ownership requirements of, and be converted to, a Schedule I bank.[25]

In summary, the result of the 1980 revisions was to leave the Canadian banking sector with two parallel sets of institutions, the domestic Schedule I banks, required to be widely held and Canadian controlled, and the foreign-controlled Schedule II banks, which must be subsidiaries of foreign banks (or holding companies of such institutions) and are expected (although this is not always the case, especially with banks owned by foreign governments) to be widely held.

2. *Prohibition on Commercial Links for Banks*

Until 1987 the four-pillars principle remained applicable to all banks, domestic and foreign, with the result being that no bank was permitted to own in excess of 10 percent of any other Canadian corporation, whether it was carrying on a commercial enterprise or was a financial institution. This restriction did not include those holdings taken temporarily, usually in connection with realization of security for a loan, or bank service subsidiaries that might (and in some cases, were required to) be utilized to carry on some ancillary activities such as leasing, factoring, mortgage lending, and the like.[26]

24. *Id.* § 173(2), (2.1), *amended by* S.C. 1988, ch. 65, § 48.
25. *Id.* § 110(13).
26. *Id.* § 193(2), (3), (12), (13).

Quite complex rules are in place to ensure that foreign banks that own a Schedule II bank in Canada are put on the same footing as Canadian banks in relation to this prohibition, even where, under their home country jurisdictions, such banks would be entitled to have significant shareholdings in other companies. Essentially, the rules "grandfather" any holdings that were owned at the time the Schedule II bank was established, but prohibit further acquisitions or incorporations of subsidiaries or affiliates in Canada or increases in grandfathered holdings after such time.[27]

3. *Interim Reforms*

In June 1987 legislative amendments were brought in to permit banks to own up to 100 percent of a Canadian securities dealer[28] and to reform the regulatory system applicable to federal financial institutions. The regulatory reforms responded in large part to the concerns raised by the bank failures in 1985, mentioned above, and to the recommendations of the Royal Commission that investigated those failures. The reforms were also made in the broader context of the need for a complete overhaul of the regulatory regimes in order to place the regulators in a better position to deal with the riskier environment of a post four-pillars financial services industry.

One of the objectives of the 1987 reforms was to centralize the supervisory functions over all federally regulated financial institutions and thus eliminate the splitting of such functions by type of institution. Previously the regulatory authorities for banks had been quite separate from those for insurance companies and loan and trust companies. Under the revised regime the Office of the Superintendent of Financial Institutions (OSFI) was created, uniting the former functions of the Office of the Inspector General of Banks and the Department of Insurance.[29]

Another objective involved a significant increase in the powers of the Superintendent of Financial Institutions. Among other things, the OSFI now has the power to take temporary control of the assets of a bank that in the view of the Superintendent, is in serious financial difficulties. In addition, the Minister of Finance may, after an informal hearing, restrict a bank licence and require the OSFI to take control of a bank if a state of affairs exists that may be materially prejudicial to the interest of the depositors or creditors of the bank.[30] These changes were coupled with contemporaneous amending legislation to enhance the powers of the Canada Deposit Insurance Corporation, a federal agency that

27. *Id.* § 305. Note also that, in addition to restricting further acquisitions or incorporations, the terms under which a Schedule II bank is granted its charter may also restrict the expansion of business in the "grandfathered" holdings.

28. *See infra* text at section II.B.2 *Opening up the Industry.*

29. *See* Financial Institutions and Deposit Insurance System Amendment Act, S.C. 1987, ch. 23, §§ 3–6.

30. Bank Act, *supra* note 9, §§ 278–279.

insures the deposits in most financial institutions in Canada, both federally and provincially regulated, up to a maximum of $60,000 per customer per institution.[31]

B. Provincial Initiatives

1. *Securities Industry Background*

As might be expected, the main focus in the regulatory reform process in the provinces has been on the securities industry. However, significant changes have been made in the legislation applicable to loan and trust companies and insurance companies both in Québec and Ontario, which may be considered to be the lead provincial jurisdictions for the Canadian financial services industry.

To a very significant extent, developments in the regulation of the securities industry were prompted by growth, over the course of the last decade, of the exempt market. The increased participation of banks, other Canadian financial institutions and foreign investment dealers in this market, which, to a large extent, involved placement abroad of Canadian-issued securities, placed increased competitive pressure on domestic dealers, while at the same time expanding their markets and increasing their capital requirements.

In addition to this participation by unregistered intermediaries in international markets, banks and foreign dealers had, for some time, been interested in the Canadian domestic securities markets. As an example, Merrill Lynch acquired a Canadian investment dealer in 1969. This acquisition raised concerns over foreign penetration into the Canadian market, and in 1971 Ontario passed legislation limiting foreign ownership of a securities dealer to 25 percent in the aggregate, with a limit of 10 percent for any single nonresident or nonresident associated group. Although existing dealers controlled by nonresidents were grandfathered, their ability to expand was restricted.

As late as 1984 this defensive posture still characterized industry thinking, with advocacy of maintenance of the restriction on foreign participation, continued separation of the four-pillars, and requirements that participants in the exempt market be registered in Ontario. However, it became clear that if Canadian securities dealers, including the banks, which had become large-scale players in the international markets, were to continue to have access to foreign markets and if access to sufficient capital was to be obtained by Canadian dealers, the industry had to be opened both to Canadian entities that were not existing members of the industry and also to nonresidents.

2. *Opening Up the Industry*

Québec was the first to remedy this problem by legislation. In 1982 Québec carried out significant reforms to its Securities Act, including the removal of

31. The Canada Deposit Insurance Corporation is regulated under the Canada Deposit Insurance Corporation Act, R.S.C. 1985, ch. C-3 *amended by* Financial Institutions and Deposit Insurance System Amendment Act, S.C. 1987, ch. 23, §§ 55-81.

restrictions on ownership of a securities dealer by another financial institution. In contrast to Ontario, Québec had dropped restrictions on foreign entry into the securities industry in the early 1970s.

Despite the liberalization of the Québec legislation, it was not until late 1986 that the Bank of Nova Scotia first incorporated a securities dealer in Québec. This move anticipated the federal government's amendments to the Bank Act, permitting banks to own up to 100 percent of securities dealers. Partly in reaction to the Québec initiatives, Ontario was also considering the issue of permitting outside financial institutions to own securities dealers in the province. A report issued in 1985 by the then-Chairman of the Ontario Securities Commission, Peter Dey, recommended proceeding in this direction, and ultimately, by early 1987, the decision was made to permit both Canadian and foreign financial institutions to own or establish securities dealers in Ontario. By June 30, 1987, both the Ontario legislation and the federal legislation permitting banks to own securities dealers were in effect. (The rights for foreign entities were fully phased in by June 30, 1988.) As a result of this liberalization, controlling interests in many major full-service Canadian securities dealers were quickly acquired by the large Canadian banks,[32] and many of the large U.S. and Japanese investment houses now have established a presence in Ontario.

3. *Federal-Provincial Jurisdictional Issues*

During the period between the end of 1986 and the implementation of the liberalizing legislation in June of 1987, intensive federal-provincial discussion took place over the issue of regulating securities dealer activities carried on by banks and other federal financial institutions either directly or through securities dealer subsidiaries. The provincial position was that all financial institutions, including banks, should be registered with the Ontario Securities Commission as dealers and, hence, regulated under the Ontario Securities Act; the federal position maintained the principle of exclusive federal jurisdiction over federal financial institutions, particularly banks. As a result of these negotiations, an agreement was reached in April 1987 between the Ontario and federal governments, known as the Hockin-Kwinter Accord. The accord outlines the degree to which securities activities would be permitted to be carried on in-house by federally regulated institutions and regulated solely under the federal umbrella and which securities activities must be carried out by a securities dealer subsidiary subject to provincial regulation. Essentially, the activities of primary distribution of equity and debt securities and secondary trading of equity securities are

32. In September 1987 the Bank of Montreal acquired a 75 percent interest in Nesbitt Thomson Deacon Inc. In March 1988 the Royal Bank of Canada acquired a 70 percent interest in RBC Dominion Securities. In April and June of 1988 The Bank of Nova Scotia and the Canadian Imperial Bank of Commerce acquired controlling interests in McLeod Young Weir Limited and Wood Gundy Inc. respectively. Only the Toronto Dominion Bank has developed its securities arm internally, rather than through acquisition, with the establishment of Toronto Dominion Securities.

the exclusive preserve of the securities subsidiary, while other securities industry activities may be carried out within the other institution. This accord was followed in 1988 by a memorandum of understanding between the Ontario Securities Commission and the Office of the Superintendent of Financial Institutions. The memorandum related to certain regulatory matters and also to details of the procedure for the federal government's consent to the ownership of a securities dealer by a federally regulated financial institution in order to ensure that this procedure will not impinge on provincial jurisdiction. Subsequently, similar memoranda of understanding have been entered into by the federal government with Québec and British Columbia, although Québec has maintained its opposition to assertion of regulatory authority by the federal government in respect of any securities industry activities of federally regulated financial institutions.

4. *Universal Registration*

Contemporaneously with the opening of the doors to entry of nonresidents into the Ontario securities industry, the new Ontario legislation sought to tighten access to the exempt market through the imposition of a universal registration regime that requires registration of virtually all market intermediaries participating as principal or agent in exempt market transactions. In order to reduce the regulatory burden for market intermediaries with limited contact with the domestic Ontario market, new categories of registrants have been created that provide for limited registration obligations, but correspondingly limit the scope for activity in the domestic market.[33]

5. *Controls on Self-Dealing and Conflicts of Interest*

As noted above, the liberalization of the financial services industry and the collapse of the four-pillars principle create opportunities for self-dealing and for potential conflicts of interest. In response, the Ontario government has passed regulations relating to conflicts of interest.[34] The regulations do not contain detailed provisions, such as requiring a percentage of independent directors on the board of a dealer or specifically regulating related party transactions. However, they do set forth a general duty of fairness, honesty, and good faith in dealings with clients. Most of the other provisions of the regulations focus on

33. The new categories include international dealers, which are limited to international transactions, such as the Euromarkets, and which trade with Ontario institutions, and financial intermediary dealers whose activities cover those permitted to be carried on in-house by federally regulated financial institutions. As a result of the Hockin-Kwinter Accord, federally regulated financial institutions are not required to register under this category; however, other entities carrying on such activity must do so. The international dealer registration provisions are found in the Regulations made under the Securities Act, R.S.O. 1980, ch. 466, § 180, as amended. However, the whole system of universal registration is being reexamined by the Ontario Securities Commission, which released proposals for amendment to the system in the December 21, 1990, issue of the Ontario Securities Commission Bulletin.

34. *Id.* pt. XII.

participation in decision-making by disinterested parties and disclosure as a means designed to highlight any conflicts of interest.[35]

In addition, limitations have been placed on networking. The restrictions are designed to curb abuses with regard to referrals of clients, joint offerings by a dealer and another financial institution of securities combined with goods or services, and offerings by a dealer of securities and goods or services of another financial institution. Any networking arrangements must be precleared with the Ontario Securities Commission.

6. *Other Changes*

As a further measure, the rules with regard to the exempt market have been tightened. They now require delivery of prospectuses with respect to offerings of previously exempt mutual funds; and the monetary threshold for the private placement exemption was raised to $150,000.[36]

7. *Loan, Trust, and Insurance Companies*

a. Ownership Restrictions

Since 1986 both Ontario and Québec have carried out extensive changes to legislation governing loan and trust corporations and, in Québec, insurance companies. The provincial legislation replaces the antiquated rules previously in force by modernizing the corporate governance provisions and bringing in the more flexible concept of the prudent investment test for permitted investments by financial institutions. Both Ontario and (for the time being) Québec have retained the restriction on foreign ownership of loan and trust companies that limits aggregate nonresident investment to 25 percent and that of any single nonresident or associated nonresident group to 10 percent of the voting rights.[37] However, the Ministre déléguée aux Finances recently announced in a speech that the Québec government intends to introduce legislation shortly that will do away with the 10 percent and 25 percent restrictions on nonresident ownership of insurance companies and replace these with a single 30 percent aggregate nonresident ownership restriction. The Ministre has also indicated that such proposed changes will most likely form the basis for similar changes, within the next two years, to trust company legislation.

In Ontario, a nonresident may hold an interest in excess of 50 percent in a financial institution as long as the interest is acquired at a time when the insti-

35. The regulations require every registrant to file a statement of policies with the Securities Commission that identifies the registrant's related issuers and sets out the registrant's policies regarding the activities the registrant will engage in respect to its related issuers' securities. This statement of policies must also be provided to clients.

36. *See* Regulations made under the Securities Act, *supra* note 33, § 19.

37. Loan and Trust Corporations Act, *supra* note 7, § 60 and An Act Respecting Insurance, R.S.Q. 1977, ch. A-32, § 45, *amended by* Qué. Stat. 1984, ch. 22, § 15.

tution is not registered in Ontario.[38] Upon its registration in Ontario, the limitation on nonresident holdings is suspended in respect of that institution until such time, if any, as the nonresident holding drops below 50 percent. In Ontario, however, any transfer of voting shares in a financial institution in excess of 10 percent must be approved. This requirement applies to indirect transfers by way of transfers of shares of a holding company and applies equally to residents and nonresidents.[39]

b. The "Equals Approach"

Under a principle known as the "equals approach," which is really a euphemism for two layers of regulation, a loan or trust company, including a federal institution wishing to carry on business in Ontario, must register under the provincial Loan and Trust Corporations Act and must undertake to abide by certain provisions of the Ontario legislation, including rules relating to nonresident ownership, director qualifications, and conflicts of interest.[40] Thus, in Ontario both federal and provincial approvals may be required for any person, resident or nonresident, to acquire an interest in excess of 10 percent in a holding corporation for a federally incorporated trust company, and, to the extent that Ontario's rules are more restrictive than those applicable under the federal jurisdiction or than the rules of other provinces, the more restrictive rules will apply.

C. EFFECT OF THE UNITED STATES-CANADA FREE TRADE AGREEMENT

While on the domestic front the regulatory reform and deregulation process was proceeding as outlined above, the federal government and the United States Government were in the process of negotiating the United States-Canada Free Trade Agreement (the FTA), which took effect on January 1, 1989. In the context of the creation of a free trade area and an agreement to accord national treatment to each party with respect to investment and trading of goods and services, the provisions relating to most financial services were separately negotiated and comprise a separate chapter of the FTA. However, insurance is dealt with in the main body of the FTA under the general services provisions set out in chapter 14. Chapter 17, which deals with financial services, does not apply to provincial legislation in Canada or state legislation in the United States, unlike the general provisions of the FTA relating to services.

Since this article focuses on developments in Canadian law, it does not deal with the provisions of the FTA relative to access by Canadian financial institutions to the U.S. market. Worth noting in passing, though, is the controversy over whether the provisions relating to access to the U.S. market for Canadian

38. Loan and Trust Corporations Act, *supra* note 7, § 59(5).
39. *Id.* § 63.
40. *See supra* note 8.

institutions constitute a fair quid pro quo to the provisions permitting United States access to the Canadian market.

Under the FTA, Canada gave very specific commitments with regard to access to its financial services industry. First, with respect to foreign ownership restrictions, U.S. persons (generally, U.S. citizens or entities controlled by U.S. citizens resident in the United States) are no longer subject to the limitations on foreign ownership under the Bank Act and under the federal legislation governing insurance companies, investment companies and loan and trust companies. In the case of banks, U.S. persons are now subject to the same ownership rules as Canadians, namely that no single individual, acting alone or in association with other holders, may hold more than 10 percent of the voting shares of a Schedule I bank. There is at present no overall limitation on ownership of loan and trust corporations or insurance companies by a single Canadian or associated Canadian group. Therefore, under the FTA exemptions, a U.S. person could acquire control of such an institution (subject to the Ontario rules, outlined above, relating to the requirement for governmental consent to the acquisition of more than a 10 percent interest in a financial institution, other than a bank, registered to carry on business in Ontario).

The FTA also eliminates, in the case of U.S. controlled Schedule II banks, the limitations on total domestic assets that are generally applicable to Schedule II banks. In addition, the restrictions on Schedule II banks relative to opening additional branches and the limitation on domestic Canadian assets as a multiple of deemed authorized capital are no longer to be applicable to U.S. controlled Schedule II banks. Thus, except for the requirement that participation by U.S. banks in the Canadian banking sector be carried out through a Schedule II bank, as opposed to a branch, U.S. banks now have substantially similar treatment to that accorded to domestic Canadian banks.

III. Current Reform Proposals

For all of the reasons discussed above,[41] the federal government has been under intense pressure from all sectors of the financial industry to introduce industry reforms so as to enable federal financial institutions to expand their services and meet the competitive challenge both within Canada and internationally. During the past six years there have been numerous government studies and policy papers issued on the subject of financial reforms. In 1984, a White Paper was issued setting out lines of reform along which the government intended to proceed. In 1985, a Green Paper was issued setting out further reform proposals for discussion. In 1986, the government published a policy paper, *New Directions for the Financial Sector,* and in April of 1990, the Standing Senate Committee on Banking, Trade, and Commerce issued its report, *Canada 1992:*

41. *See supra* text at section I.B.2 *The Climate for Change.*

Toward a National Market in Financial Services. However, the only substantive amendments brought in to date, have been the amendment to allow banks to own up to 100 percent of a securities dealer and the amendments to the regulatory regime, both of which arose out of the 1986 policy paper.

As a result of the delay in implementation of the reforms, banks, trust companies, and insurance companies have all been jockeying for position in anticipation of eventually obtaining greater flexibility in the types of services they may provide. Also, especially in the insurance industry, they have been lobbying to ensure that other financial institutions are not permitted to invade their own territory. In addition, with the modernization of the Québec and Ontario legislation, the two largest trust companies threatened, at their 1990 annual meetings, to move to a provincial jurisdiction if the federal legislation was not forthcoming soon. Recognizing this possibility, in April 1990 Québec announced that it would bring in legislation during the course of the year to permit financial institutions to own commercial enterprises.

Finally, on September 27, 1990, the federal government released the first piece of its reform package. The complete package included legislation to amend the Bank Act, Insurance Companies Act, Cooperative Credit Associations Act, and various sections of related legislation. As a first step the government has tabled a draft bill[42] to amend the federal loan and trust companies legislation (the draft Bill) and has issued a policy paper entitled: *Reform of Federal Financial Institutions Legislation: Overview of Legislative Proposals* (the Policy).[43] However, the government has made it clear that although the legislation is being tabled as it is drafted, all pieces of legislation will come into force at the same time. Accordingly, it is likely that some time will pass before we actually see the reforms enunciated in the draft Bill and Policy become effective.[44]

The government's stated objectives set out in the Policy include encouraging increased competition and variety for services offered by financial institutions and creating a framework for strong national institutions that are better able to compete in Canada and internationally. Generally, these goals are to be achieved through modernizing the structures of the financial services industry and its participants, broadening the scope of financial services that may be offered by a federal financial institution, expanding rules requiring widely held ownership, and toughening controls on self-dealing.

A. Modernization of Corporate Structures

One of the objectives of the Policy includes the modernization and harmonization of the corporate structure and governance provisions contained in

42. Bill C-83, Trust and Loan Companies Act [hereinafter draft Bill].

43. Reform of Federal Financial Institutions Legislation, Overview of Legislative Proposals, issued by the Department of Finance, Fall 1990 [hereinafter Policy].

44. The federal government introduced Bill C-95, containing the proposed amendments to the Bank Act, on December 19, 1990.

legislation relating to federally regulated financial institutions. This applies particularly to those other than banks, since some modernization of the corporate structure and governance rules applicable to banks was achieved in the 1980 revision of the Bank Act. However, federal trust companies and insurance companies are operating under legislation that, in the main, dates back to the 1920s and 1930s and that, despite some legislative tinkering in recent years, badly needs updating. The thrust of these proposals is not to provide a single statute governing all types of federal financial institutions, but rather, to achieve harmony, insofar as possible, between the corporate structures of insurance companies, trust companies, and banks.

B. Dismantling of the Four Pillars

The Policy proposes reforms that expand the powers of federal financial institutions to enable them to compete, directly or through financial subsidiaries, in new markets, thus effectively breaking down the traditional barriers among the four pillars of the financial sectors. First, subject to approval, banks would be permitted to own trust and insurance companies; life insurance companies would be permitted to own trust and loan companies; and widely held trust, loan, and stock life insurance companies and mutual insurance companies would be permitted to own Schedule II banks. In each instance the new activity could be commenced either through the acquisition of an existing operation or the start-up of a new operation.

Secondly, the Policy provides trust, loan, and insurance companies with full consumer lending powers, and subject to maintenance of a capital base of at least $25 million and supervisory approval, full commercial lending powers. Such institutions without the necessary capital base would be required to restrict their commercial lending to 5 percent of their assets.

Banks and loan companies would be permitted to provide portfolio management and investment advice in-house, as trust companies, life insurance companies, and securities dealers already do. Although banks would not be permitted to provide trust services in-house, as indicated above, they would be able to do so through a trust company subsidiary.

Financial institutions would be permitted generally to network financial services offered by affiliates or independent financial institutions. However, deposit-taking institutions would be prohibited from offering most insurance services on behalf of insurance companies, and all financial institutions would be subject to restrictions on the sharing of confidential information concerning customers. Banks, trusts, and loan companies would be permitted to promote goods and services, including insurance, to their credit card holders.

Competition between different institutions would be further enhanced by all institutions having substantially similar and enlarged investment powers. The current limit on the level of investment in a downstream commercial enterprise is maintained at 10 percent of the votes or (the Policy has added) 25 percent of

the shareholders' equity of a business. However, the number of exceptions to these ownership restrictions has been increased to permit holdings of up to 100 percent of corporations engaged in investment counselling and management, real property brokerage, real property holding, broader merchant banking services, and broader information services.

C. Prudential Safeguards

1. *Restrictions on Self-Dealing*

In addition to the increased supervisory powers of the regulatory authorities,[45] the Policy proposes further protection for depositors and policyholders in the form of restrictions on transactions between a financial institution and persons who are in positions of influence over, or control of, the institution. These rules against self-dealing would extend to the purchase of services and assets from related parties, as well as loans and investments. The definition of related party is principally aimed at persons having an interest greater than 10 percent in the company, as well as the company's directors and officers and the spouses and minor children of all such persons.[46]

The approach to self-dealing taken by the Policy involves a general ban on non-arm's-length transactions, except for specifically enumerated exempt transactions that must be approved by a special committee of the board of directors of the institution, the conduct review committee. The provisions of the draft Bill exempt nominal or immaterial transactions[47] and also set out a limited range of specific exemptions for borrowing transactions and asset transactions.[48] In ad-

45. *See supra* text at section II.A.3 *Interim Reforms.*

46. Draft Bill, *supra* note 42, § 464(1) provides that a related party of a company includes a person who

(a) beneficially owns or controls more than 10% of any class of shares of the company;
(b) is a director or officer of the company or of a body corporate that controls the company or is acting in a similar capacity in respect of an unincorporated entity that controls the company;
(c) is a spouse or minor child of any such persons;
(d) in certain circumstances, is an entity in which the company's directors or officers, a person who controls the company, or any of their spouses or minor children have a substantial investment; or
(e) is an entity controlled by any of the above.

47. *See id.* § 468. Note, however, that the conduct review committee of the board of directors must establish criteria for materiality that must be approved by the Superintendent of Financial Institutions.

48. *See id.* §§ 469–471 (with respect to exemptions for borrowing transactions) and § 472 (with respect to asset transactions). In particular, the draft Bill permits a company to make loans to related parties that are fully secured by government securities; to make mortgage loans secured by the principal residence of the related party, provided the loan does not exceed 75 percent of the value of the residence; to acquire government securities, or assets backed by such securities, from a related party; and to acquire or lease, from a related party goods (other than real property or financial assets) used by the institution in the ordinary course of business.

dition to the asset transactions specifically exempted, the Bill provides that an institution may acquire from, or dispose of any assets to, a related party as part of a restructuring, provided the arrangements have been approved by the Superintendent of Financial Institutions.

The Policy also contains general exemptions for the provision or purchase of certain services used or offered to the public in the ordinary course of business and network arrangements with related parties for the sale of services on an agency basis.[49]

In an effort to ensure that the rules are flexible enough to accommodate reasonable business opportunities, the Superintendent of Financial Institutions would also have the authority to exempt transactions on a case-by-case basis provided the Minister of Finance is satisfied that the transaction is not influenced by a related party. The Policy also provides that the regulations to the legislation would prescribe certain exemptions for certain classes of transactions, such as participation by an institution with related party financial institutions in a syndicated loan arrangement.[50]

In addition to these provisions, the Policy also proposes rules regarding the extension of loans to directors or officers or loans to, or investments in, companies owned by directors or officers.[51] The conduct review committee of the board of directors of a financial institution would also have to be satisfied that each permitted related party transaction is on terms at least as favorable as market terms and conditions.

2. *Strengthening the Role of Directors*

The Policy proposes to strengthen the role of directors of a financial institution and to mandate increased reliance on self-supervision. It proposes that a minimum of one-third of the board of directors of a federal financial institution be composed of unaffiliated directors,[52] although the Policy provides that federal financial institutions that are wholly owned subsidiaries of other federal financial institutions would not be subject to this one-third rule. In addition to the requirement for unaffiliated directors, the Policy proposes that no more than 15 percent

49. *See id.* § 473. Note, however, that the draft Bill restricts the exemption for services used in the ordinary course of business or network arrangements to contracts that do not exceed five years.

50. The Policy, *supra* note 43, also specifically indicates that the ban on related party transactions will not restrict a securities dealer subsidiary from underwriting an issue for a related party of its parent financial institution.

51. The Policy, *supra* note 43, proposes that the amount of such loans and investments, excluding mortgage loans, would be restricted to a limit of 50 percent of an institution's capital. Large loans would require the approval of two-thirds of the board of directors.

52. An affiliated person is defined to include officers and employees of the company or its affiliates and other persons who have a significant investment in, or business association with, the institution, including significant borrowers from, or persons who have a loan not in good standing from, the institution or any affiliate.

of the directors may be employees of the institution or its affiliates.[53] As noted above, the board of directors would be required to establish a conduct review committee to supervise the institution's compliance with the legislative requirements, including, in particular, review of all related party transactions. The conduct review committee and the audit committee would have to have a majority of unaffiliated directors, and the remainder of the directors of such committees could not be officers or employees of the institution.

In addition, the Policy proposes that a financial institution with a shareholder owning in excess of 10 percent of any class of voting securities be required to adopt cumulative voting procedures for the election of directors[54] so as to ensure that public minority shareholders have the ability to elect directors who are not part of the management slate.

3. *Additional Prudential Safeguards*

In order to augment the supervisory role of the regulators, the Policy proposes that the Superintendent of Financial Institutions also be provided with the general authority to require an owner of a federal financial institution, or an affiliate, to provide information. Many of the reporting requirements found in the draft Bill, and proposed to be carried into the subsequent legislation, are modeled on the current Bank Act requirements.[55] However, the Policy provides the Superintendent of Financial Institutions with greater flexibility in obtaining the information necessary to ensure that the legislation is being complied with and that the institution is in sound financial condition.

In a further effort to forewarn the regulators of any impending solvency problems, the Policy proposes to require a director or officer who resigns as a result of a disagreement with other directors or officers to submit a written statement to the Superintendent of Financial Institutions setting out the nature of the disagreement.[56] An auditor who is being replaced would be required to provide a similar statement to the Superintendent.

53. However, the Policy proposes that to accommodate companies with small boards they would be permitted an exception to allow up to four employee directors, provided they did not constitute a majority.

54. Cumulative voting provides shareholders with votes equal to the number of shares held multiplied by the number of directors' seats to be filled. The shareholder may cast all or any number of his votes in favor of any one director with the intent that minority shareholders be in a position to obtain board representation.

55. Draft Bill, *supra* note 42, §§ 486–488 relate to returns for deposit accounts that remain inactive and bills of exchange that remain unpaid for a period of nine years, as required under Bank Act, *supra* note 9, § 226. Draft Bill, *supra* note 37a, §§ 489–491 relate to information concerning directors, auditors, and copies of bylaws, all as required by Bank Act, *supra* note 9, §§ 228, 233.

56. Under the current provisions of the Bank Act a director is entitled to submit a statement to the company concerning the reasons for his resignation, but is not required to do so.

D. Investment Powers

As part of the increase in flexibility for federally regulated financial institutions, the Policy also proposes reform of the antiquated rules with regard to permitted investments by trust companies and insurance companies. These would be abolished in favor of a "prudent portfolio" approach. The prudence of an investment would become the responsibility of the institution's board of directors and would be required to be determined in the context of the particular institution's predetermined goals and policies. However, certain overall portfolio limits would be retained, limiting aggregate and individual investments in certain types of assets to specified percentages of an institution's regulatory capital.

E. Ownership of Financial Institutions

Ownership policy for financial institutions has stimulated much controversy, with pro and con arguments requiring financial institutions to be widely held and for and against commercial linkages with financial institutions. Foreign ownership has also been an issue. The Policy recognizes the variety of ownership structures currently in place in the Canadian financial industry and does not propose moving to a single ownership structure. Nor does it propose a total ban on ownership of financial institutions by commercial enterprises, or as noted above, on financial institutions owning certain types of commercial enterprises.

1. *Ownership Approval Process*

Currently, the Minister of Finance has the authority to approve, under the applicable legislation, all start-ups of federal financial institutions; however, subsequent changes in ownership do not always require approval. Accordingly, the Policy proposes that all significant changes in ownership would be subject to the approval of the Minister of Finance. This requirement would ensure that a takeover is in the best interest of the financial industry and that new owners have the expertise, financial resources, and plans necessary to run a sound financial institution. Such approval would be required in order to buy shares of a federal financial institution that would result in the investor owning more than 10 percent of any class of shares. If the investor already owns in excess of 10 percent of any class of shares, approval would be required for any additional acquisition of shares. The approval requirement would also apply to the acquisition of control of a company that is linked to a financial institution where, as a result, there would be a change in a significant ownership interest in the institution.[57] The Policy would permit small fluctuations in the level of a person's significant interest without requiring ministerial approval.

57. Throughout the legislation, control is defined to extend to control in fact and not simply legal control.

2. *Bank Ownership*

The Policy proposes that banks could be widely held, on a path to wide ownership, or wholly owned by widely held financial institutions. Schedule I banks would continue to be widely held, with no single shareholder or group of associated shareholders permitted to own in excess of 10 percent of the shares of any class. Furthermore, the provisions permitting the establishment of a Canadian Schedule II bank (provided it becomes widely held within ten years) would be retained. Foreign banks could still apply for a Schedule II bank licence, as at present.

In addition, however, widely held regulated financial institutions,[58] both Canadian and foreign, would be permitted to wholly own Schedule II banks. Such Schedule II banks would not be subject to the ten-year divestiture requirement. As with foreign banks desiring to establish Schedule II banks, one of the factors that the Policy identifies as relevant to the approval decision would be the nature and extent of nonbanking activities carried on by the applicant. In this way the regulators would be able to ensure some measure of a level playing field. In the event that ownership of a Schedule II bank changes through a change in ownership of its parent and becomes owned by a nonregulated entity, the bank would be required to become widely held within ten years.

3. *Ownership of Other Financial Institutions*

The Policy provides that at least 35 percent of the voting rights in federally regulated loan, trust, or stock insurance companies would have to be widely held and listed on a Canadian stock exchange within five years of reaching a consolidated capital of $750 million or more. In the case of those companies that already have such a level of capital, the same percentage of voting rights would have to be widely held and listed on a Canadian stock exchange within five years of the enactment of the legislation.[59] However, the policy does provide that, subject to ministerial approval, the 35 percent ownership requirement may be met at the institutional level or at the level of its holding company, provided the parent company is primarily engaged in financial activities.[60] In addition, a ministerial exemption is proposed for companies that reach the threshold capital level through internal growth or, on a case-by-case basis, if the level is reached through a number of small acquisitions.

58. Such institutions would include trust or loan companies, stock life insurance companies, mutual insurance companies, and widely held securities dealers.

59. The five-year time limit could be extended where general market conditions warrant and the Minister of Finance is satisfied that the institution has used its best efforts to satisfy the 35 percent rule.

60. If the parent company is not a federally regulated financial institution it must also agree to adopt the cumulative voting procedures for the election of its directors and be subject to the 35 percent widely held ownership rules as if it were such an institution.

The Policy proposes that a Schedule II bank would only be subject to the 35 percent public ownership rule if it reached the $750 million capital threshold through the acquisition of another federal financial institution that was already subject to the rule.

4. *Foreign Ownership*

The Policy does not propose any significant change to the current foreign ownership regime for banks. However, the Policy does indicate that the foreign bank guidelines would be amended to permit nonresident widely held regulated financial institutions that are not banks, such as insurance companies and securities dealers, to establish Schedule II banks. In addition, the 10 percent individual and 25 percent aggregate foreign ownership restrictions would be somewhat loosened through a broader definition of control. As noted earlier[61] U.S. persons are not subject to the 10 percent/25 percent rules.

IV. Conclusion

In reviewing the past decade of the financial services industry in Canada, it is quite clear that change has been driven by development in the markets and by competitive challenges and opportunities. Unfortunately, the reforms enacted up to now have only been the minimum necessary to accommodate these developments. The delay by the federal government in the introduction of the needed reforms amidst the numerous policy papers and discussions has resulted in uncertainty in the industry. Financial participants have been jockeying for position in anticipation of eventually obtaining greater flexibility in the types of services they may provide. Disharmony has increased between the federal and provincial governments, as the provinces have threatened to provide provincial institutions with the powers and flexibility that the federal government has failed to provide.

The introduction of the federal reform package should serve to alleviate a large measure of the uncertainty in the industry. These reforms are needed if the Canadian industry is to remain healthy and competitive on an international basis. Although it may still be some time before the entire package becomes effective, the next few years are likely to be a period of development and transition as new relationships are formed and horizons expanded.

61. *See supra* text at section II.C *Effect of the United States-Canada Free Trade Agreement.*