

Current issues in the Canadian financial sector



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Canada remains subject to a number of confusing, and perhaps conflicting, political agendas which limits the necessary comprehensive structural changes to its financial intermediaries and capital markets. The financial institution merger question remains in limbo, with most of the likely players reluctant to put their hand up in the absence of an announced change permitting mergers among banks and between different kinds of financial institutions. A similar issue is being debated in the communications sphere, with Canada's largest telecommunications company Bell Canada being subject to an auction process in which foreign private equity firms are significant participants. Additional policy questions arise from the need for simplified securities regulation and accommodation of cooperative financial institutions.

Canada's telecommunications industry and financial services retain the vestiges of Canada's 1970's protectionist policies which limit foreign ownership. These limitations are less severe for financial institutions under rules that regulate ownership on a basis which limits ownership by anyone to stated percentages. The telecommunications industry retains the full panoply of Canadian owned and controlled regulation.

The merger debate started with the 1998 announcement by Royal Bank of Canada and Bank of Montreal, two of Canada's largest banks, that they would merge, subject to receipt of the necessary Federal Government approval. The merged entity would have ranked (based on market capitalization) as one of the top ten banks in North America and among the top 25 banks in the world. More importantly, it would have created a platform for substantial North American expansion by the merged bank. Two other banks subsequently announced a merger proposal. Both these proposals were rejected by Canada's Minister of Finance. Subsequent proposals that were never officially announced suffered a similar fate.

This debate is also relevant to two other current issues, (i) the need for a federal securities commission; and (ii) modernization of the credit cooperative financial system. Cooperatives are essentially affinity enterprises which enjoy many bank-like powers. Originally, founded as agrarian movements in western Canada and Quebec, they are emerging as competitors to Canada's major financial players for retail and small-to-medium sized business enterprise customers. The problems they are encountering as they become national players include multiple and overlapping regulatory regimes and access to prime branch locations. There is also a concerted effort to create federal legislation, under the Federal Governments' broad constitutional authority to legislate in respect of banks and banking, to enhance their powers and preclude provincial regulation. The credit cooperatives are integral to the merger question as they address the key questions of (i) will there be meaningful customer choice (i.e. no diminishing of competition)? and (ii) who will take the branch sites? (which are likely to be required to be disposed of for the same competitive reasons).

The Federal Government in its 2007 budget announced a number of measures intended to enhance Canada's global capital market competitiveness. This new policy has four building blocks, namely (i) proportionate principal based regulation (under a common securities regulator); (ii) strengthening market integrity through enhanced policy resources and stronger inter-agency cooperation (including the appointment of Nick LePan, the former superintendent of Financial Institutions, to help improve the effectiveness of the integrated market enforcement teams (pools of RCMP investigators, Department of Justice legal advisors, securities regulators and local law enforcement agencies); (iii) pursuing free trade in securities with the G-9 countries; and (iv) enhanced consumer financial literacy.

The Federal Government's initiative has once more engaged it in the single regulator debate, replacing Canada's current regime of 13 provincial and territorial regulators. Canada is the only one of the approximately 100 advisory members of the International Organization of Securities Commissions that is not represented by a national regulator. The government has not proposed a federal regulator. Instead, it has proposed a single securities act to be adopted by all participating jurisdictions, administered by a common securities regulator (with regional presence) and having a separate tribunal.

This proposal attempts to bridge the gap between the current provincial embryonic passport system (where one regulator takes carriage of a regulated entity or offering) and a single federal regulator administering federal securities legislation. In the 1970s the Federal Government released a comprehensive proposal for federal legislation which was based on the evolution of constitutional law, favouring an interpretation of Canada's constitution as providing the authority for the Federal Government to enact federal securities legislation. The resistance to a federal securities regime is political. Several of the provincial governments believe a federal regime may erode their political authority and otherwise prejudice their residents' capital raising ability. Although this new initiative may have some utility, it still has a made in Canada compromise quality that is less than optimal.

The evolution and range of possible resolution of these issues will depend on difficult policy choices for the current Conservative minority government. These will, however, remain as important issues in the context of growing concerns for the hollowing out of Canadian business, tax base erosion and the future for meaningful job creation.