THE CANADIAN SECURITIES INDUSTRY AND NORTH AMERICAN FREE TRADE: LEGAL PERSPECTIVES

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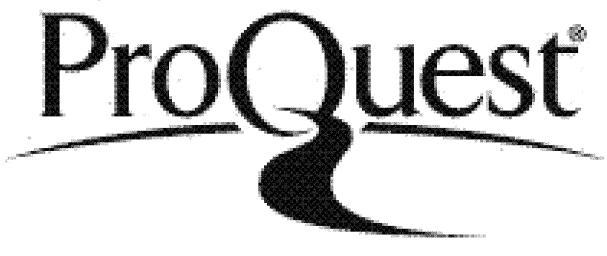

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ABSTRACT

The revolution in the financial services sector is dramatically changing the way in which the securities industry conducts its activities. With existing current differences between nations in the regulation of financial institutions acting as barriers to the efficient operation of markets, cooperation among governments is needed to ensure that the new international setting is both stable and competitive. In North America, fresh initiatives are gradually leading towards the harmonization of regulation, particularly in the securities sector. As a result, the industry must adjust itself to this newly evolving reality.

The aim of this paper is to focus on the principles regulating the Canadian securities industry in its newest configuration under a North American free trade area.

To begin the study, a picture is drawn of the Canadian securities industry itself and of the events leading to the arrival of what is hoped to be an eventual hemispheric free trade area. With the internationalization of Canada's financial markets, Canadian policymakers (both at the federal and provincial levels) have had to make efforts to harmonize and coordinate financial regulation affecting the securities industry. These efforts were accompanied by a series of undertakings leading towards an indisputable "Americanization" of Canadian securities policies.

On another level, an assessment is made of the two most recent developments leading to a lowering of barriers to trade in financial services and to the establishment of foreign financial institutions in North American domestic markets. These are the Canada-U.S. Free Trade Agreement and the North American Free Trade Agreement. Finally, the work examines the impact of North American free trade on the way the players Canadian securities industry now operate at home, in the U.S. as well as in Mexico. In the end, the conclusions help to put in perspective the level of progress attained by Canadians in view of global and regional competition.

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ACRONYMS

ADR	American Depository Receipt
AMEX	American Stock Exchange
BHC	Banking Holding Company
BHCA	Banking Holding Company Act
BSE	Boston Stock Exchange
CACM	Central Latin American Common Market
CANSEC	Canadian Securities and Exchange Commission
CARICOM	Caribbean Common Market
CBA	Canadian Bankers' Association
CBCA	Canadian Business Corporation Act
CBRS	Canadian Bond Rating Service
COSRA	Council of the Securities Regulators of the Americas
CSA	Canadian Securities Administrators
EAI	Enterprise for the Americas Initiative
ECO	Equality of Competitive Opportunity
EDGAR	Electronic Data Gathering and Retrieval System
FBSEA	Foreign Bank Supervision Enhancement Act
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FIPS	Foreign Issuer Prospectus System
FIRA	Foreign Investment Review Act
FRB	Federal Reserve Board
FRN	Floating Rate Note
FRS	Federal Reserve System
FTA	Canada-U.S. Free Trade Agreement
FTAA	Free Trade Area of the Americas
GATT	General Agreement on Tariffs and Trade
GSA	Glass-Steagall Act
IBA	International Banking Act
IBF	International Banking Facility
ICA	Investment Canada Act
IDA	Investment Dealers Association
IOSCO	International Organization of Securities Commissions

LAFTA	Latin American Free Trade Association
LAIA	Latin American Integration Association
LSE	London Stock Exchange
ME	Montreal Stock Exchange
MFN	Most-Favoured Nation
MJDS	Multijurisdictional Diclosure System
MNC	Multinational Corporation
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
NASAA	North American Securities Administrators Association
NASD	National Association of Securities Dealers
NEP	National Energy Program
NPS	National Policy Statement
NSA	National Stock Exchanges
NRSRO	Nationally Recognized Statistical Rating Organization
NYSE	New York Stock Exchange
OECD	Organization of Economic and Development Co-operative
OSA	Ontario Securities Act
OSC	Ontario Securities Commission
OSFI	Office of the Superintendent of Financial Institutions
OTCA	Omnibus Trade and Competitiveness Act
QSC	Québec Securities Commission
SEC	Securities and Exchange Commission
SEDAR	System for Electronic Data Gathering and Retrieval System
SELA	Latin American Economic System
SIA	Securities Industry Association
SRO	Self-Regulated Organization
TSE	Toronto Stock Exchange
UCC	Uniform Commercial Code

Periodical Abbreviations

Am. Rev. of Can. Studies	American Review of Canadian Studies
Ann. can. de droit int'l	Annuaire canadien de droit international
Ariz. L. Rev.	Arizona Law Review
B.C. Indus. & Comm. Law Rev.	B.C. Industrial & Commercial Law Review
B.F.L.R.	Banking and Finance Law Review
Banking L.J.	Banking Law Journal
B.U. Int'l L.J.	Boston University International Law Journal
Brookings Rev.	Brookings Review
Bus. Law.	Business Lawyer
C. de D.	Cahiers de Droit
Cal. W. Int'l L.J.	California Western Law Journal
C.U.B.L.J.	Canada-United States Business Law Journal
Can.-U.S. L.J.	Canada-United States Law Journal
Can. B. Rev.	Canadian Bar Review
C.B.L.J.	Canadian Business Law Journal
Can. Public Adm.	Canadian Public Administration
Cath. U. L. Rev	Catholic University Law Review
Col. J. Int'l. Env. L. & Pol'y	Colorado Journal of International Law & Policy
Colum. Bus. L. Rev.	Columbia Business Law Review
Colum. J. Transnat'l L.	Columbia Journal of Transnational Law
Colum. J. of World Bus.	Columbia Journal of World Business
Cornell L. Rev.	Cornell Law Review
Cumberland L. Rev.	Cumberland Law Review
Dal. L.J.	Dalhousie Law Journal
Denver J. Int'l L. & Pol'y	Denver Journal of International Law & Policy
Det. C. L. Rev.	Detroit College Law Review
Dickinson J. Int'l L.	Dickinson Journal of International Law
Fed. Bar News & J.	Federal Bar News & Journal
Fed. Reg.	Federal Register
Fed. Res. Bull.	Federal Reserve Bulletin
Fla. J. Int'l L.	Florida Journal of International Law
Fordham Int'l L.J.	Fordham International Law Journal
Fordham L. Rev.	Fordham Law Review

F.I.L.J.	Foreign Investment Law Journal
FTU	Free Trade Update
Geo. Wash. J. Int'l L. & Econ.	George Washington Journal of International Law & Economics
Geo. Wash. L. Rev.	George Washington Law Review
Georgia J. Int'l & Comp. L.	Georgia Journal of International & Comparative Law
Gonazga L. Rev.	Gonazga Law Review
Harv. Int'l L.J.	Harvard International Law Journal
Harv. J. on Legis.	Harvard Journal on Legislation
Harv. L. Rev.	Harvard Law Review
Houston J. Int'l L.	Houston Journal of International Law
Int'l Bus. L.J.	International Business Law Journal
Int'l Bus. Law.	International Business Lawyer
Int'l & Comp. L.Q.	International & Comparative Law Quarterly
Int'l Econ. L. Soc. Bulletin	International Economics & Law Society Bulletin
Int'l Econ. L. News	International Economics & Legal News
Int'l Exec.	International Executive
Int'l Fin. L. Rev.	International Financial Law Review
Int'l J.	International Journal
Int'l L. Quarterly	International Law Quarterly
Int'l Law.	International Lawyer
Int'l Tax & Bus. Law	International Tax & Business Law
J. Bus. L.	Journal of Business Law
J. Comp. Bus. & Cap. Mkt L.	Journal of Comparative Business & Capital Market Law
J. Comp. Corp. L. Sec. Reg.	Journal of Comparative Corporate Law & Securities Regulation
J. Contemp. L.	Journal of Contemporary Law
J. Fin. Serv. Res.	Journal of Financial Services Research
J. Interamer. Studies & World Aff.	Journal of Interamerican Studies & World Affairs
J. Int'l Aff.	Journal of International Affairs
J. Int'l Banking L.	Journal of International Banking Law
J.W.T.	Journal of World Trade
J.W.T.L.	Journal of World Trade Law

L. & Cont. Prob.	Law & Contemporary Problems
L. & Pol. Int'l Bus.	Law & Policy in International Business
Loy. Int'l & Comp. L.J.	Loyola International & Comparative Law Journal
Man. L.J.	Manitoba Law Journal
J. Marshall L. Rev.	J. Marshall Law Review
Md J. Int'l L. & Trade	Maryland Journal of International Law & Trade
Michigan L.R.	Michigan Law Review
Mich. Y.B. Int'l Legal Studies	Michigan Yearbook of International Legal Studies
Modern L. Rev.	Modern Law Review
Nation L.J.	Nation Law Journal
Nat'l Banking L. Rev.	National Banking Law Review
New Eng. L. Rev.	New England Law Review
N.Y.L.J.	New York Law Journal
N.Y.U.J. Int'l L. & Pol'y	New York University Journal of International Law & Policy
North Am. Corp. Law.	North American Corporate Lawyer
Nw. J. of Int'l L. & Bus.	Northwestern Journal of International Law & Business
Osgoode Hall L.J.	Osgoode Hall Law Journal
Ottawa L. Rev.	Ottawa Law Review
Q. Rev. of Econ. & Fin.	Quarterly Review of Economics & Finance
Rev. Banking & Fin. Serv.	Review of Banking & Financial Services
R.I.B.L.	Review of International Business Law
Rev. Sec. & Comm. Reg.	Review of Securities & Commodities Regulation
R.G.D.	Revue générale de droit
R.J.T.	Revue juridique Thémis
R.Q.D.I.	Revue québécoise de droit international
St. John's L. Rev.	St. John's Law Review
San Diego L. Rev.	San Diego Law Review
S.C.R.R.	Securities & Corporate Regulation Review
Sec. Reg. L.J.	Securities Regulation Law Journal
Sw. U.L. Rev.	South Western University Law Review

Syracuse J. Int'l L. & Comm.	Syracuse Journal of International Law & Commerce
Tax & Bus. Law.	Tax & Business Lawyer
Texas Int'l L.J.	Texas International Law Journal
Tulane L. Rev.	Tulane Law Review
U. Detroit L. Rev.	University of Detroit Law Review
U. Miami Inter-Am. L. Rev.	University of Miami Inter-American Law Review
U. Pa. J. Int'l Bus. L.	University of Pennsylvania Journal of International Business Law
University of Toledo L. Rev.	University of Toledo Law Review
U. T. Faculty of L. Rev.	University of Toronto Faculty of Law Review
U.T.L.J.	University of Toronto Law Journal
U. Western Ont. L. Rev.	University of Western Ontario Law Review
U.S-Mexico L.J.	U.S.-Mexico Law Journal
Vanderbilt J. Trans. L.	Vanderbilt Journal of Transnational Law
Villanova L. Rev.	Villanova Law Review
Va. J. Int'l L.	Virginia Journal of International Law
Va. L. Rev.	Virginia Law Review
Wake Forest L. Rev.	Wake Forest Law Review
Wash. J. Int'l L. & Econ.	Washington Journal of International Law & Economics
Wash. & Lee L. Rev.	Washington & Lee Law Review
Yale J. on Reg.	Yale Journal on Regulation

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INTRODUCTION

The aim of the present work is to measure the impact of the North American free trade agreements on the Canadian securities industry and to determine the desirability and the efficiency of North American norms and treaties (in the context of the liberalization of trade in services) governing multinational securities-related activities of Canadian financial institutions. In this paper, we focus on the principles for regulating the North American securities-related[1] services offered by Canadian institutions not only because of their particular character, but also, because despite the increasing internationalization of financial services and markets, the national regulatory systems affecting the securities industry in Canada and the United States still differ substantially.

This study could not have been written even a few decades ago because its subject matter did not exist. In recent years, financial markets have grown very rapidly, mainly due to the massive explosion of changes, either domestically or internationally. Globalization of securities markets is a recent phenomenon. Fast growing Euroequity and Eurobond markets, trading in so-called "world class" equities, linked commodity markets, equity markets and clearing agencies, international distributions of privatization issues and domestic mutual funds based on foreign portfolios are the daily facts of the capital markets. Over the past decades, securities legislation has become international in scope and decisions relating to securities regulation and services have increasingly been linked to numerous economic and trade policies.

The search for principles to govern the provision of financial services by foreign firms, whether located inside or outside the respective national market of customers, has taken place in a number of contexts. In view of the fact that internationalization has provided better access to new markets and expanded trade opportunities for the

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[1] Generally, securities-related services are comprised of a variety of subjects serving to provide direct access to capital markets. These include advice, underwriting, investment and portfolio management, dealing and brokerage services. Furthermore, investment banking involves the provision, with merger and acquisition activities, of foreign exchange trading, operations in the Euromarkets and the development of new financial instruments. As for the word "securities", it is a catch-all term for stocks, bonds, and money market instruments. C.R. GIPSON, *The McGraw-Hill Dictionary of International Trade and Finance* (New York, N.Y.: McGraw-Hill, 1994) at 462.

securities industry, the role of regulation is ever growing. Although they have developed into highly sophisticated international markets, securities markets continue to be regulated by national or regional authorities. However, transnational distribution of securities have presented serious challenges to all regulators. The world of finance has been fundamentally and irrevocably transformed by market forces and economic as well as technological factors that have acted as catalysts for these developments. Consequently, sustained and increased cooperation among regulators needs to occur to ensure that the fairly new international setting is both stable and competitive.

The Uruguay Round of trade negotiations within the General Agreement on Tariffs and Trade (hereinafter GATT) included discussions on liberalization of trade in services in addition to trade in goods. The inclusion of services for the first time in GATT (now run by its successor, the World Trade Organization, hereinafter WTO) reflects their increasing importance in international trade, especially over the last decade. Financial services, and banking (including securities-related) services in particular, are now a significant component of international trade in services, in part because of the growing interdependence of national financial markets. Trade in services is conventionally defined on a balance of payments basis to comprise certain non-merchandise transactions between residents and non-residents of a country[2]. Due to the intangibility of services, trade data can generally be derived only from central bank information on flows of foreign exchange or from periodic surveys or censuses of service industries. Exceptional care must therefore be taken in interpreting statistics on trade in services.

In addition to the GATT, there exist unilateral national policies towards foreign providers of financial services, as well as treaties such as the Canada-U.S. Free Trade Agreement (hereinafter FTA)[3] and the North American Free Trade Agreement (hereinafter NAFTA)[4], the supranational rules adopted by the European Union (hereinafter EU), and the multilateral codes of the Organisation for Economic Co-

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2 R. CÔTÉ, *Libéralisation des échanges de services informatiques: enjeux et marge de manoeuvre pour l'État canadien*, (1991) 25 R.J.T. 499 at 504.

3 *Canada - United States: Free-Trade Agreement*, (1988) 27 I.L.M. 281.

4 *Canada - Mexico - United States: North American Free Trade Agreement*, (1993) 32 I.L.M. 605.

operation and Development (hereinafter OECD). In the banking sector, policy makers and regulators must ensure that no institution can escape supervision by moving its activities from one jurisdiction to another and that international movements of funds are properly tracked. Here, cooperation is most advanced in the supervision and regulation of commercial banks, thanks to the efforts of the Bank of International Settlements (hereinafter BIS)[5].

A very successful international attempt at coordinating financial market regulation is the Basle Concordat, drafted by the BIS. The Basle Concordat deals with prudential supervision and solvency[6]. The Concordat incorporates the principle of consolidated supervision which assumes that banking supervisory authorities can only be satisfied with the strength of individual banks when they are able to examine the entirety of each bank's worldwide business. While several difficulties remain in the coordination of the prudential supervision of commercial banks, the Basle Concordat constitutes a first achievement of this kind in international financial markets. Still, other financial institutions (such as securities firms) are active in certain spheres where banks operate but are not subject to the same capital requirements. In the context of relative decline in traditional banking activities and the increase in securities transactions, any divergent treatment can only limit the scope for competition between the various categories of institutions.

Despite the dramatic growth of securities instruments and markets in recent years, progress in the supervision of securities-related activities of financial institutions has been much slower than in the supervision of banking. Because a failure by a series of major securities houses could have serious implications for the stability of the financial industry as a whole, the securities industry ought to have an international body playing a role similar to that of the BIS. Memorandums of Understanding (hereinafter MOUs) have been negotiated between several securities commissions to cover prudential restrictions (such as fraud and disclosure of information). However, the International Organization of Securities Commissions (hereinafter IOSCO) is still in its infancy and has yet to forge any agreement of a critical nature. However, IOSCO's

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5 OECD, *Banks Under Stress* (Paris: OECD, 1992) at 35.

6 GIPSON, *supra*, note 1 at 35.

working groups have made significant progress especially with respect to the need to coordinate capital requirements with those of the BIS[7]. There also exists a growing desire within the organization to adapt itself to the changing world[8]. Nevertheless, based on the fact that it took more than a decade of consultation and cooperation to arrive at the Basle Concordat, rapid breakthroughs in international coordination of prudential supervision in the securities industry cannot be expected, for it is at the same stage of development that coordination in the banking sector was in the 1970s. Although short-term miracles cannot be achieved in this area, a true sense of urgency does exist. This sense of urgency, however, should not serve as an excuse for weak standards. The international coordination of prudential supervision should rely on minimum standards that provide meaningful safeguards. However, current differences between national governments in the regulation of financial institutions continue to act as barriers to the efficient operation of several markets. It would appear that unless there is increased harmonization of regulation, the pace of progress could well slow down over the next few years in part because of the remaining barriers to internationalization[9].

On a broad front, the number of restrictions to market forces, representing obstacles to free competition in financial services, have been reduced during the 1980s through financial deregulation and liberalization. These growing movements have favoured the concept of harmonization of the laws, regulations and other measures. The harmonization of various bodies of laws seems indispensable in the development of agreements establishing free trade such as the FTA and NAFTA. It involves balancing the mere compatibility of judicial systems on the one hand with the unification of

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7 Cooperation between the IOSCO and the Basle Committee on Banking Supervision resulted in May 1995, of a joint report entitled "Framework for Supervisory Information about the Derivative Activities of Banks and Securities Firms" is reproduced in (1995) 18 O.S.C.B. 2005. See Also *News Release — Final Communique of the XXth Annual Conference of the International Organization of Securities Commissions (IOSCO)*, (1995) 18 O.S.C.B. 3356 at 3359. *Remarks of Edward J. Waitzer, Chairman, IOSCO Technical Committee — Cooperation Between Banking & Market Regulators — Some Thoughts on the Role of IOSCO*, (1995) 18 O.S.C.B. 3258.

8 "Valeurs mobilières: la mondialisation appelle des changements fondamentaux" *Le Devoir [of Montreal]* (5 July 1995) B3.

9 For a reference to recent discussions on the establishment of regional financial areas and perspectives on regulatory harmonization, see *News Release, supra*, note 7 at 3361.

various rules of law on the other. The process of harmonization requires the determination of common directions and orientations and establishing common basic ground rules. Thus, harmonized laws are convergent laws. Still, due to the rapid growth of the world's financial marketplace, economic laws (and particularly securities laws and services) must be voluntarily and specifically harmonized. This objective, however, can be difficult to achieve because of the various existing legal structures.

There exist various mechanisms designed to minimize interjurisdictional differences. Harmonization may be spontaneous[10], induced[11], bureaucratic[12] or institutional[13]. The need for interjurisdictional harmonization of law in the context of regulation of the securities industry is highly complex. Generally, the goals of financial regulation are to prevent fraud and theft and, if possible, correct market failures. Nevertheless, harmonization may create a series of problems in achieving satisfactory regulatory framework. For instance, (i) regulation may restrict trade or bring higher "production costs" for financial services; (ii) regulatory restrictions in one regime may lead to innovation in another; (iii) given the fact that regulation generally adopts simple solutions to a series of given problems, it tends to be more remote from the practitioners' expertise; (iv) regulation is less well adapted to individual markets and institutions, and it cannot easily accommodate the differences in the various systems; and (v) since the regulatory process is very political in nature, conclusions or changes in harmonization agreements often require long periods of time and can be difficult to reach[14].

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10 Spontaneous harmonization is the result of the decision made by legislators "[...] to adopt as models aspects of the laws of other jurisdictions". R.C.C. CUMMING, "Harmonization of Law in Canada: An Overview" in Royal Commission on the Economic Union and Development Prospects for Canada, *Perspectives on the Harmonization of Law in Canada* (Research Studies, Vol. 55) (Toronto, Ont.: University of Toronto Press, 1985) (R.C.C. CUMMING, Research Coordinator) 1 at 24.

11 Induced harmonization is a technique used in Canada whereby the federal government uses its constitutional spending power to induce the provinces to accept uniformity. *Ibid.* at 25.

12 Bureaucratic harmonization results from a joint action on the part of bureaucracies to administer regulatory structures. *Ibid.* at 28.

13 Institutional harmonization results from the creation of organization that have a mandate to develop proposals which could form the basis for harmonized law. *Ibid.* at 31.

14 S.M. SCHAEFER, "Financial Regulation: The Contribution of the Theory of Finance" in J. FINGLETON, ed., *The Internationalisation of Capital Markets and the Regulatory Response* (London: Graham & Trotman, 1992) 149 at 152-154.

In Canada's case, the search for a uniform system of financial law has been marked by a series of internal discords created by the constitutional distribution of legislative powers[15]. For many years, the Canadian securities industry lagged somewhat behind its competitors in other countries. One cause for this has been attributed to the difficulty of the federal and the provincial governments to modernize the regulatory system. Canada's largest financial institutions (its chartered banks) are federally regulated while securities dealers and underwriters, investment advisors and portfolio managers have been subject to provincial regulation. Because foreign countries and issuers would much rather deal with a unique set of regulation instead of ten different ones, the lack of adequate level of coordination between the various Canadian supervisory authorities has been a hurdle for a country that could aspire to rapidly move towards an integrated financial market. In their quest to achieve a Canadian "common market" in the distribution of and trading in securities, a very different form of cooperation has been needed among Canadian securities commissions for the system to compete effectively.

Even today, the uniformity of all internal rules has been too difficult to achieve. Instead, the focus has been towards harmonization. The requirements for prospectus clearance serves as an example of a barrier to a fully integrated market[16]. However, some of these restrictions have been tempered by special agreements negotiated with, for example, the U.S. Nevertheless, basic harmonization of broad policies by the federal and provincial governments is still needed to prevent unnecessary duplication and to strengthen the coordination of Canada's financial services sector. Some have suggested that the federal government become responsible for securities regulation. Their argument is that until then, Canada may not be in a position to play as effective a role as is desirable on an international level and make what kind of decisions for its entire market. However, it is not clear that this is an essential approach to be taken. The political reality reaffirms the provincial legislatures' desire to ensure that the federal government does not acquire jurisdiction over securities matters. Whatever

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15 See, *e.g.*, K. NORRIE, R. SIMEON & M. KRASNICK, *Federalism and the Economic Union in Canada* (Toronto, Ont.: University of Toronto Press, 1992) 2.

16 "Instruction générale n°. C-1 - Approbation de documents à l'échelle canadienne" (as modified) in M. THÉRIAULT & P. FORTIN, *Droit des valeurs mobilières au Québec*, Vol. 1 (Montreal, Que.: Wilson & Lafleur, Martel, 1992) (loose-leaf) at E-421.

solution is retained by Canadians, the federal/provincial jurisdictional problems would need to be solved to strengthen the coordination and harmonization of Canada's securities policies.

Harmonization of the rules affecting Canadian securities-related services also comes about from the two major North American free trade agreements entered into by Canada in recent years. Trade in financial services, which is related to, but not identical to, cross-border capital flows, has increased significantly. It most definitely holds an important place in the FTA and NAFTA. A precise definition of "trade in financial services" raises some difficulties. International trade in financial services takes place not only through the provision of these services by an institution or factors of production in one country (i.e. cross-border trade), such as borrowing and depositing across national boundaries, but also through the establishment of subsidiaries, branches or agencies by a financial institution in a country other than its home country (i.e. establishment-related trade)[17]. Overall, discussions between nations have focused on specific aspects of trade liberalization. These aspects include: (i) international capital movements (or cross-border capital flows); (ii) cross-border financial services; and (iii) the right of establishment of the financial services industry[18]. In the context of this work, the main restrictions on the activities of the securities industry concern: (i) the entry and establishment of new foreign securities firms; (ii) the purchase of domestic securities firms, in whole or in part, by foreign securities firms; (iii) restrictions on the operating procedures of foreign-owned securities firms in the domestic market; and (iv) cross-border international operations.

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17 Hence, "[s]ome services, such as underwriting of securities for large corporations and governments, requires a presence in neither the country of the issuer nor the country of the buyers. U.S. securities firms, for example, have been active suppliers of underwriting services to Canadian issuers. Other securities industry services, retail brokerage in particular, require a presence near the customers." J. CHANT, *Free Trade in the Financial Sector: Expectations and Experience*, Studies on the Economic Future of North America (Vancouver, B.C.: Fraser Institute, 1991) at 2.

18 Using this notion, the OECD Committee on Financial Markets adopted a definition of trade in financial services in three points: (i) the selling of financial products to the residents of another country from one's home base (which, in fact,reflects a pure trade approach and replicates the definition of trade in goods); (ii) the selling, by a firm or individual established in a foreign country, of financial products to the residents of third country; and (iii) the selling, by a firm or individual established in a foreign country, of financial products to the residents of that country. OECD, *International Trade in Financial Services* (Paris: OECD, 1984) at 22.

Having said so, the globalization of the securities industry and markets requires that governments develop a coordinated system for the management and regulation of the international financial system. Against the background of the changing nature of the financial services industry and a series of conflicting interests, governments are confronted with far reaching implications of policy issues they must reconcile. Thus, they may have to measure the consequences of granting national treatment[19] to foreign securities firms as well as the impact of an exterior presence on the domestic system. This is of particular concern to smaller nations faced with allowing access to securities firms from other countries with a much larger securities sector and consequently much larger securities firms.

Essentially, free trade in the financial (including the securities) industry refers to the elimination of governmental restrictions with respect to: (i) transactions/transfer of funds (such as exchange control restrictions) involved in international financial operations; or (ii) legal or administrative regulations. The different reasons which motivate domestic governments to impose restrictions on foreign securities firms in each country derive from individual historical factors, the degree of development and sophistication of the domestic securities market and general policy and regulatory attitudes regarding the value, and need for, competition in the domestic securities industry. Nevertheless, there are circumstances when restrictions can exist, if judged to be necessary to meet national and/or international concerns[20]. In other words, liberalization does not absolutely require an obligation to abandon national regulation, nor to harmonize on a regional or multinational standard. Instead, it feeds on a reasonable level of mutual recognition of regulatory standards.

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19 In the context of multinational activities of securities firms and banking affiliates, national treatment means that host states should grant to foreign-controlled enterprises "treatment under their laws, regulations and administrative practices, consistent with international law and no less favourable than that accorded in like situations to domestic enterprises". OECD, *Declaration on International Investment and Multinational Enterprises by the Governments of OECD Member Countries* (Paris: OECD, 1976) at Section II:1 reprinted in OECD, *The OECD Declaration and Decisions on International Investment and Multinational Enterprises — 1991 Review* (Paris: OECD, 1992) at 101.

20 Special restrictions can be necessary to decrease and eliminate the abuses and, to protect essential security interests or maintain public order by preventing illegal activities (such as tax evasion, fraud or money-laundering). OECD, *Liberalization of Capital Movements and Financial Services in the OECD Area* (Paris: OECD, 1990) at 13-14.

The issue of liberalizing trade in services through the development of a mutually agreed international conventions has recently come to the forefront in the international trade arena. For example, the Uruguay Round, under the auspices of the GATT, concluded negotiations on trade in services as part of the multilateral trade negotiations. In the trade discussions between Canada and the U.S. as well as between Canada, the U.S. and Mexico, trade and investment in services (including financial services) were integral and important issues in reaching the trade accords[21]. Thus, the developments in the internationalization of financial services over the past few decades suggest that the supervision of financial institutions can no longer be confined to domestic operations. There still remain a number of philosophical, legal and jurisdictional differences in the process for controlling international financial operations among countries. These regulatory differences pose not only problems for the integration and liberalization of international trade in financial services but also affect the nature and degree of competition in national financial service markets. In spite of the process of domestic financial deregulation which has gradually become self-reinforcing, there are still a number of restrictions which can constitute significant barriers for financial institutions from entering others territories. Existing regulatory and structural asymmetries are particularly obvious when comparing the dual with the universal banking model.

In several countries, different types of financial institutions have traditionally been subject to specific and separate regulation imposing on financial institutions a certain degree of specialization and separation of functions. A particular feature of the segmented financial system of the U.S. is the range of permissible activities. Under the American dual banking model, the *Glass-Steagall Act* of 1933 (hereinafter GSA)[22] established a significant separation between commercial and investment banking in the U.S. Under this law, banks are generally prohibited from underwriting or dealing in securities by applying the restrictions. Foreign institutions are also concerned by the fact that some securities activities of banks are regulated by the

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21 For one of the first works of scholarship suggesting that there should be international regulation for financial services using a method similar to that provided by the GATT. See B. GAVIN, *A GATT for International Banking?*, (1985) 19:2 J.W.T.L. 121.

22 12 U.S.C. §§ 24(7), 377, 378 and 78.

Securities Exchange Act of 1934 (hereinafter Exchange Act)[23] and the *Bank Holding Company Act* of 1956 (hereinafter BHCA)[24]. In spite of the historical reasons which led to the segmented financial system, the recent crumbling of the so-called "four financial pillars" in Canada demonstrates that the trend towards greater participation in securities underwriting is very likely to flow over to the U.S. as well. Thus, in spite of country-specific differences, the universal or "one-stop" banking model (which implies all types of commercial and investment banking activities offered by one entity) should one day become the norm in an integrated North American financial market.

In the meantime, however, the application of broad trade in services principles to the specific requirements of North American trade in financial services agreements has been difficult. The development of trade in financial services accords needed to take into account and satisfy a series of different and competing concerns including: (i) the problem that the conceptual understanding of any of the principles necessary to a trade agreement differs among nations; (ii) the jurisdictional prerogatives of national and sub-national governments differ significantly in both substance and form; (ii) the regulatory powers governing domestic and international operations of financial institutions are shifting in scope and the degree of development of the domestic industry differs in a number of countries; (v) the structure of financial systems and institutions vary from country to country; (vi) the degree of importance of financial institutions and international trade in financial services is stronger in some countries more than others; (vii) the willingness of domestic governments to allow foreign financial institutions to compete in the domestic industry ranges from country to country; and (viii) the degree to which regulatory, solvency and supervisory controls are greater in some nations than in others. Moreover, the FTA and NAFTA had to take into account the constantly changing nature of the industry on an international basis. Therefore, they had to deal with functional basis. Finally, for the trade in financial services agreements to be politically acceptable they had to provide for signatories to periodically opt out. Having said all this, can we say that harmonization occurs through the FTA and NAFTA? The short answer is that it does, but only partially.

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23 48 Stat. 881.

24 12 U.S.C. § 1841.

This study seeks to demonstrate that since the signing of the FTA and NAFTA, there has been clear and measurable progress towards the goal of harmonizing the laws regulating international securities-related activities of North American financial institutions. However, apart from the free trade agreements, some harmonization has been achieved through deliberate cooperation on the part of financial regulators and administrative agencies (such as the various securities commissions). Although the traditional and rigid distinctions between different financial service categories are actually breaking down, the products typically considered to be part of financial services may be classified into three categories: (i) commercial banking services; (ii) securities-related services (or investment banking); and (iii) insurance services[25]. The bulk of this work centres on the Canadian securities industry and the securities-related services it provides rather than a wider spectrum of financial services. However, the Canadian application of the universal banking model requires that we refer to banks. To date, only a few trust, insurance and other financial services companies have entered the Canadian securities business. However, with the introduction of the most recent federal initiative to clarify permitted business activities, more such securities entrants may be expected. Still, we have chosen to avoid discussing the trust[26], insurance and other related financial sectors in this work, unless for special circumstances. Moreover, though technically very different, the words "investment banker"[27], "broker"[28], "dealer"[29] or "securities firm" have been used in a context to allow them to be interchangeable. Finally, the study does not endeavour to address the global dimension of the liberalization of trade in financial services through the

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25 For a similar classification, see GATT Doc., MTN.GNS/W/68 of 4 September 1989 at 3-5.

26 The trust companies, like their counterparts the "thrifts" of the U.S., have not been significantly involved in international business.

27 "The middleman between the corporation issuing new securities and the public". J.M. ROSENBERG, *Dictionary of Banking and Financial Services*, 2nd ed. (New York, N.Y.: John Wiley & Sons, 1985) at 374.

28 "An agent who arranges sales for a commission or fees". GIPSON, *supra*, note 1 at 47.

29 "Traders who buy and sell for their personal accounts. Unlike brokers, who are commission agents, a dealer buys as a principal and attempts to profit from the spread between the selling price and the purchase price in a given transaction". *Ibid.*, at 104.

WTO, this matter being the subject of an on-going debate[30]. Instead, the focus is put solely on the North American norms and treaties (in the context of the liberalization of trade in services) governing multinational activities of the Canadian securities industry.

In the process of undertaking the research for this thesis, a massive amount of material discussing the Canadian financial system, securities regulation and free trade has been examined. It included substantial literature on various aspects of these fields in the legal and financial periodicals. All this is apart from the numerous administrative circulars (containing policies and practice) published by the two most important Canadian jurisdictions, i.e. the Ontario Securities Commission (hereinafter OSC), the Quebec Securities Commission (hereinafter QSC) as well as the U.S. Securities and Exchange Commission (hereinafter SEC). Then, in regards to the implementation of the free trade agreements, it was necessary to examine the many legislative hearings and reports to the U.S. Congress and the Parliament of Canada, as well as the special reports they have produced from time to time. Finally, one important source helping to keep pace with the many changes occurring to the Canadian securities industry and its conduct of the business itself has been the financial press. This work speaks as of the end of December 1995.

The study is organized into three parts. The first one covering the Canadian securities industry in the context of free trade, the second one covering the agreements liberalizing North American trade of financial services, and the third one measuring the impact of liberalized trade on the Canadian securities businesses. Within Part I, the composition of the Canadian securities industry and an overview of the North American free trade era are considered successively. Developments leading towards the emergence of a new Canadian regulatory structure surrounding the securities industry as well as the "Americanization" of Canadian securities policies are treated in a separate title. Part II of this work examines the financial services chapters of the FTA and NAFTA. It assesses the advantages and disadvantages of these accords

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30 See, *e.g.*, "U.S. Against Them" *The Economist* (29 July 1995) 53. "Banking on Sir Leon" *The Economist* (15 July 1995) 58. P. LEWIS, "U.S. Trade Pullback" *The New York Times* (4 July 1995) 47. P. LEWIS, "U.S. Rejects Accord to Free Trade in Financial Services" *The New York Times* (30 June 1995) D1. For a general analysis, see, *e.g.*, E. McGOVERN, *International Trade Regulation* (London: Globefield, 1995).

from the perspective of the Canadian securities industry. Also, it serves to provide a better understanding of the various domestic changes which occur (now and then) in view of the North American liberalization of trade in financial services. Moreover, it serves to determine if the FTA and NAFTA provoked by themselves the harmonization of laws. Both treaties examined under separate titles, are analyzed so as to reflect the prevalent situation before the negotiations, the negotiation objectives of all signatory countries and, in the end, the negotiation results. Finally, Part III reviews the effects of North American free trade on the way the Canadian securities industry conducts its business. The first title examines the existing competition between Canadian and American securities-related financial institutions both in Canada and in the U.S. The second title looks at the means of adaptation by Canadian dealers in the newly opened Mexican market.

PART I: THE CANADIAN SECURITIES INDUSTRY IN THE CONTEXT OF THE LIBERALIZATION OF TRADE IN FINANCIAL SERVICES

The latter part of this century will be remembered as a decade that brought various parts of the world closer together through such developments as the easing of East-West tensions, the building of the single European market, the emergence of stronger economic ties between the countries of the Pacific Rim, and the two major North American trade agreements. Nowhere is the movement towards closer ties among the world's economies more evident than in the globalization of the financial sector. The integration of financial markets around the world and associated financial innovation have brought fundamental changes in the way funds are raised, and in the types of financial instruments that are used.

Our study of the Canadian securities industry in the context of the liberalization of trade in financial services begins with a general description of the leading elements under examination. First, an overview of the nature of trade in relation to the securities helps understand how the recent trends in the international financial marketplace and changes affecting capital market have influenced the ways of doing business in North America and throughout the world.

TITLE I: SETTING THE STAGE

In the past few years, the North American securities industry has been affected by two significant developments: (i) the globalization of the financial marketplace, and (ii) the signing of accords leading towards the regional liberalization of trade in financial services.

CHAPTER I: The Nature of Trade In Services in Relation to the Securities Industry

International operations of financial institutions demand the establishment of a new set of rules to help harmonize recognized standards. However, prior to examining this aspect, it is important to understand how fairly recent developments suggest that multinational banking and securities firms can no longer be supervised solely through

domestic regulation.

1. Preliminary Observations: Trends in the International Financial Marketplace and Changes Affecting Capital Markets

The financial markets permit our modern economies to function and with the increased diversity of economic activity, the financial industry has become increasingly complex[31]. Internationalization is reflected in the increased flows of people, goods, services and knowledge across national borders[32]. In the financial domain, this integration is featured in cross-border capital flows[33]. Providers of capital for the needs of governments, business and individuals make transaction worldwide — the markets have evolved towards a global approach[34]. The financial industry's activities have experienced massive growth due to dramatic changes in the traditional ways of doing business[35]. As a result, the international financial landscape has been completely reformed. Now, almost all international intermediation is carried out in the securities markets or through instruments providing some form of negotiability[36].

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31 On the role of a financial system see, *e.g.*, OECD, *The New Financial Landscape* (Paris: OECD, 1995). C.N. HENNING, W. PIGOTT & H. SCOTT, *Financial Markets and the Economy*, 5th ed. (Englewood Cliffs, N.J.: Prentice Hall, 1988) at 5ff.

32 The collapse of the Bretton Woods Agreement and numerous regulatory changes have been some of the most important factors leading to the globalization of financial markets. B. BECKER, *Global Securities Markets*, (1988) 6 Int'l Tax & Bus. Law 242. M. GRUSON, *The Global Securities Market: Introductory Remarks*, [1987] Colum. Bus. L. Rev. 303 at 306.

33 Essentially cross-border capital flows relate to movement of funds crossing national boundaries (independently of the nationality or residence of the parties involved in the transaction). OECD, *Liberalization of Capital Movements and Financial Services in the OECD Area* (Paris: OECD, 1990) at 75.

34 On the global evolution of financial markets, see, *e.g.*, R. O'BRIEN, *Global Financial Integration: The End of Geography* (London: Pinter, 1992). K. KAUFMAN, *Financial Integration — A Regional or Global Phenomenon?*, Presentation made at the XVIIth Annual Conference of the International Organization of Securities Commissions on October 27, 1992, reproduced in (1992) 15 O.S.C.B. 5198. G. CAPOGLU, *The Internationalization of Financial Markets and Competitiveness in the World Economy*, (1990) 24:2 J.W.T. 111. T.M. RYBCZYKSKI, *The Internationalization of Finance and Business*, (1988) 33:3 Business Economics 14.

35 Generally, this growth is, partly, evidenced in the greater importance of market intermediation of funds (which involves the issuance of and trading in, securities such as stocks or bonds). G. SMITH, *Money, Banking and Financial Intermediation* (Lexington, Ma.: D.C. Heath, 1991) at 527.

36 OECD, *Trends in Banking in OECD Countries*, (Paris: OECD, 1985) at 19.

The securities markets[37] of both the advanced industrial and developing market economies have undergone dramatic changes in recent years[38]. These changes have taken the forms of both globalization[39] and integration[40] of these markets creating "internationalized markets"[41] out of formerly purely national ones. Recent developments in international financial trade, illustrate their expansion.

In the 1970s and 1980s, the rate of growth of international financial trade accelerated tremendously. The largest single factor influencing the growth of the global capital markets in that period has been the appearance of large trade imbalances in the industrial countries. The resulting balance of payments deficits required massive international financing[42]. Corresponding to the massive imbalances in trade, the

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37 A "securities market" is a medium of exchange in which businesses raise capital by issuing stocks and bonds rather than by borrowing from banks. SECURITIES AND EXCHANGE COMMISSION, *Internationalization of Securities Market Report*, Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Commission on Energy and Commerce (Washington, D.C.: Government of the United States, 1987).

38 On the recent changes affecting the securities markets, see generally, OECD, *Securities Markets in OECD Countries* (Paris: OECD, 1995). FINGLETON, ed., *supra*, note 14. O. AYAYI, *International Securities Regulation*, (1992) 5 J. Int'l Banking L. 191. J.A. GRUNDFEST, *Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences*, (1990) 4 J. of Fin. Serv. Res. 349. A. PETERS, *The Changing Structure of the Financial Services Industry and the Implications for International Securities Regulation*, (1989) 46 Wash. & Lee L. Rev. 525. R.P. AUSTIN, *Regulatory Principles and the Internationalization of Securities Markets*, (1988) 50 L. & Cont. Prob. 219.

39 "Globalization" refers to the "rapid growth of formerly insignificant securities markets, as well as the emergence of small dynamic securities markets in nations where none had previously existed". M. A. GERSTENZANG, *Insider Trading and the Internationalization of the Securities Market*, (1989) 27 Colum. J. Transnat'l L. 409 at 415.

40 In this context, "integration" is defined as the "rapid interlocking of national securities markets". *Ibid.* at 411-415.

41 "Internationalization" of securities markets may be thought of as the result of two distinct, yet interrelated, developments of "integration and globalization". *Ibid.* at 411. However, not all scholars have endorsed the theory that securities markets are becoming "global" or "internationalized". D.E. VAN ZANDT, *The Regulatory and Institutional Conditions for an International Securities Market*, (1991) 32 Va. J. Int'l L. 47 at 48, 81.

42 At that time, the post-war position of the U.S. as a generator of surpluses was dramatically reversed to that of a major borrower. At the same time, Germany and Japan became the major creditor nations of the world. IMF, *World Economic Outlook* (Washington, D.C.: IMF, October 1987) Tables A30 and A31.

international capital markets experienced a major restructuring and expansion[43]. Accompanying these developments has been the emergence of transnational entities which, not satisfied merely with trading goods and services internationally, conducted their own operations in many different countries[44]. These multinational corporations (hereinafter MNCs) utilized local organizational-legal structures that are tied together by a shared capital structure[45]. As many MNCs conducted financing activities, they followed in the footsteps of sovereign countries and utilized international securities markets for raising capital from suppliers of many different nationalities[46]. As a result, the past few decades have witnessed the sustained growth of international debt and equity issues through unregulated markets[47]. For instance, in Canada, corporate and government issuers extensively used international capital markets as a source of debt

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43 According to GATT statistics, net international bank lending exhibited an average yearly growth of 15% between 1978 and 1988. This rate far exceeded the 8.5% observed for the volume of world trade. GATT Doc., MTN.GNS/W/68 of 4 September 1989 at 2. B. HOEKMAN & M. LEIDY, "Contingent Commercial Policies and the Credibility of Financial Market Liberalization" in S. HEWIN & R. O'BRIEN, eds, *Finance and the International Economy:4* (Oxford: Oxford University Press, 1991) Introduction. More detailed data about the impressive growth of the financial service sector in general and the different sub-sectors are provided by G. BROKER, "Trends in Banking Structure and Regulation" in OECD, *OECD Countries Competition in Banking* (Paris: OECD, 1989) at 122-124.

44 On trade and transnational entities during that period, see, *e.g.*, J.A. PUTTERMAN, *Transnational Production in Services as a Form of International Trade*, (1992) 16:2 World Competition 123.

45 The motives for international investment are varied and complex and depend to a large extent upon the type of industry involved. For example, by becoming MNCs, securities firms have wanted to protect their present or potential markets by following competitors or customers abroad.

46 One reason for the popularity of international securities offerings is because it provides access to more capital at lower costs. M. ATKIN & J. GLEN, *Comparing Corporate Capital Structures Around the Globe*, (1992) 34 Int'l Exec. 369 at 373.

47 The first stage of internationalization centred around the Euromarket. A Release of the SEC published in 1964 (SEC Release N° 33-4708 (9 July 1964) was an important event in the genesis and development of the Euromarket. E.F. GREENE *[et al.]*, *U.S. Regulation of the International Securities Markets*, Vol. 1 (Englewood Cliffs, N.J.: Prentice Hall Law & Business, 1992) at 187-188. The late 1960s, saw first the growth of the Eurocurrency markets for short term transactions followed by the Eurobond market for the issuance of debt securities and ultimately, in the 1980s, the Euroequity markets, all essentially unregulated markets. See, *e.g.*, H.S. BLOOMENTHAL & S. WOLFF, *International Capital Markets and Securities Regulation*, Vol. 10 (Deerfield, Ill.: Clark Boardman, 1992) at 1-8. Corporations seeking financing on foreign markets have permitted the steady growth of international transactions in all geographic areas. OECD, *Financial Market Trends*, Vol. 52 (Paris: OECD, 1992) at 56.

and equity capital[48]. With this trend, the internationalization of securities trading has become apparent in a number of ways[49].

The development and application of technology communications[50] and computers[51] to the securities industry dramatically improved the conduct of international investment[52]. In numerous countries, listing of foreign securities on stock exchanges has facilitated the enlargement of business activities[53]. The ability to trade the same

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48 "Two Canadian issuers were among the first to make multinational offerings of equity securities in Canada, the U.S. and Europe". *Submission of the Staff of the Ontario Securities Commission to the Securities and Exchange Commission Concerning the Facilitation of Multinational Securities Offerings*, (1985) 8 O.S.C.B. 3972 at 3978.

49 P.E. MILLSPAUGH, *Global Securities Trading: The Question of a Watchdog*, (1992) 26 Geo. Wash. J. Int'l L & Econ. 355. Comment, *International Financial Markets and Regulation of Trading of International Equities*, (1988) 19 Cal. W. Int'l L.J. 327 at 328.

50 See, *e.g.*, L.D. SOLOMAN & L. CORSO, *The Impact of Technology on the Trading of Securities: the Emerging Global Market and the Implications for Regulation*, (1991) 24 J. Marshall L. Rev. 199. P. SHRIVASTAVA, *Strategies for Coping with Telecommunications Technology in the Financial Services Industry*, (1983) 18:1 Colum. J. of World Bus. 19.

51 Widespread use of computers now allows a series of very fast calculations to be made: daily interest, foreign currency exchange rate comparisons, arbitrage opportunities, etc. Computers, too, have already replaced substantial trading volume that once was done between floor traders at many stock and futures exchanges. P. DURIVAGE, "La technologie au service des courtiers" *La Presse [of Montreal]* (26 August 1994) C1. OECD, *Financial Market Trends*, Vol. 54 (Paris: OECD, 1993) at 10.

52 "Changes in technology have been responsible for changes in securities markets, and they make it easier to provide pertinent information to investors. These advancements in technology provide the key to regulatory change". J.M. AALBREGTSE, *Internationalization of the Securities Markets - Moving Away from Section 5*, (1988) 10 U. Pa. J. Int'l Bus. L. 225 at 232. In fact, the new source of competitive advantage in the markets derives from the knowledge of superior and scarce information and the control of this information. See, *e.g.*, J.P. LITTLECHILD, "In the beginning there was the talking computer ... A silent revolution is underway in the banking industry" *Canadian Banker* (August 1990) 31. A. GART, *An Analysis of the New Financial Institutions: Changing Technologies, Financial Structures, Distribution System, and Deregulation* (Westport, CT: Greenwood, 1989). T. COURCHENE, "Trade in Banking Services" in D. CONKLIN, ed., *Trade in Services: Case Studies and Empirical Issues* (Halifax, N.S.: Institute for Research on Public Policy, 1988) 116 at 119-125. G.R. FAULHABER, *Financial Services: Markets in Transition*, Discussion Paper #27 (Washington, D.C.: Fishman Davidson Centre, 1987) at 10-21.

53 See, *e.g.*, A.L. PETERS & A.E. FELDMAN, *The Changing Structure of the Securities Markets and the Securities Industry: Implications for International Securities Regulation*, (1988) 9 Mich. Y.B. Int'l Legal Studies 19 at 50-51. In Canada, the two main exchanges (i.e. The Toronto Stock Exchange and Montreal Exchange) have developed mechanisms to facilitate the entry of foreign issuers to the Canadian capital markets. See, *e.g.*, H.J.F. BLOOMFIELD, "Recent Trends in Securities Regulations Related to International Transactions" in SERVICE DE LA FORMATION PERMANENTE DU BARREAU DU QUEBEC, ed., *Développements récents en droit*

securities in sequence on Asian, European and North American exchanges has essentially created a twenty-four hour trading day[54]. Competition between different markets is accentuated with the ability to obtain price quotes and execute trades in securities on different exchanges. Such inter-market competition has been recognized and formalized by inter-market linkages that transmit pricing between exchanges and execute trades at the most competitive prices available[55]. These developments

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des valeurs mobilières (1992) (Cowansville, Que.: Yvon Blais, 1992) 77 at 78-79.

54 Twenty-four hour trading is also referred to as "globalization of trading". F. KÜBLER, *Regulatory Problems in Internationalization Trading Markets*, (1987) 9 U. Pa. Int'l Bus. L. 107 at 108. On twenty-four hour trading, see, *e.g.*, VAN ZANDT, *supra*, note 41 at 55. SEC STAFF REPORT, DIVISION OF MARKET REGULATION, U.S. SECURITIES AND EXCHANGE COMMISSION, *The October 1987 Market Break, Federal Securities Law Reports*, Number 1271 (extra edition) (Chicago, Ill.: Commerce Clearing House, 1988) at 11-2. S. B. SHOPKORN, *Global Trading: The Current and Future Impact on United States Markets and United States Portfolio Managers*, (1986) 4 B.U. Int'l L.J. 25 at 26. S.E. HUNTER, *The Status and Evolution of Twenty-Four Hour Trading: A Trader's View of International Transactions, Clearance, and Settlement*, (1986) 4 B.U. Int'l L.J. 15.

55 The globalization of securities markets has led to the establishment of market links between certain stock exchanges operating in different countries. B.S. RITTER & W.R. DAUBER, *The Present and Future Role of Electronic Trading Linkage in the Developing International Securities Markets*, (1989) 22 Geo. Wash. J. Int'l L. & Econ. 639. "From Foreign Desk to Foreign Exchange" *The Economist* (23 July 1988) 63. R. P. BERNARD, *International Linkages Between Securities Markets: A Ring of Dinosaurs Joining Hands and Dancing Together?*, [1987] Colum. Bus. L. Rev. 321. In the U.S., the SEC "generally views agreements between U.S. and foreign securities exchanges as positive developments". SEC Release N° 34-27080 cited in GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 380. A linkage program between stock exchanges in Canada and the U.S. was set up to provide greater liquidity and better prices for North American investors. In 1984, the first formal linkage was established between the Montreal Exchange and the Boston Stock Exchange (BSE). SEC Release N° 34-21925 (8 April 1985); SEC Release N° 34-26029 (25 August 1988); SEC Release N° 34-26578 (28 February 1989). Using electronic connections, transactions may be executed on the floor of the different exchanges by traders of either exchanges. This successful linkage has lead to implementation of other similar plans. For instance, in 1985, a linkage between the Toronto Stock Exchange (TSE) and the American Stock Exchange (AMEX) was approved. SEC Release N° 34-22442 (20 September 1985). In 1986, the TSE linked with the Midwest Stock Exchange. SEC Release N° 34-23075 (28 March 1986). Further, linkages were also established with exchanges in other countries, bringing even closer to reality the idea of a world-wide twenty-four hour market linkage system. The first transatlantic exchange link was established between the London Stock Exchange (LSE) and the National Association of Securities Dealers (NASD). SEC Release N° 34-29812 (11 October 1991). However, trade linkages and interlisting of stocks cause regulatory headaches by making it possible to avoid domestic law. P. ANISMAN & P. HOGG, "Constitutional Aspects of Federal Securities Legislation", in P. ANISMAN *[et al.]*, *Proposals for a Securities Market Law for Canada*, Vol. 3, Background Papers (Ottawa, Ont.: Minister of Supply and Services, 1979) 135 at 148-149. One solution to this difficulty might be for various exchanges to adopt a series of unified trading rules combined with supervision, surveillance and

created fundamental problems for the national regulators of securities markets on how to apply purely national securities laws and regulations to international securities transactions that may involve foreign investors, foreign national issuers, and foreign national markets as well as those of the regulator's own country[56]. The trend towards the internationalization of securities markets was accelerated with the removal of restrictions on foreign participation in many of the major securities markets[57]. A dramatic increase in the share of financial services provided by non-residents and by the penetration of domestic markets by institutions from other countries[58] took the form of a rapid increase in the cross-border activities of financial institutions in other countries. These new market conditions created new types of rivalries between the markets themselves. The development of new financial instruments and practices opened up many opportunities for participants in financial markets[59]. In this context,

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enforcement regulations. These could be developed by groups like the International Federation of Stock Exchanges or the International Councils of Securities Dealers and Self-Regulatory Organizations. *"International Links Proposed to Stem Future Market Crisis"*, 2 Int'l Sec. Reg. Rep. (Buriff) 1 (21 June 1989). BLOOMENTHAL, *supra,* note 47 at 1-196, 1-198.

56 H.M. WILLIAMS & L.B. SPENCER, Jr., *Regulation of International Securities Markets: Towards a Greater Cooperation,* (1982) 4 J. Comp. Corp. L. Sec. Reg. 55.

57 The removal of competitive barriers (referred to loosely as "deregulation") has been both a driving force and a political response to internationalization. See generally S.J. KHOURY, *The Deregulation of the World Financial Markets: Myths, Realities, and Impact* (Westport, CT.: Greenwood, 1990). "Deregulation" differs from the term "reregulation" which describes various kinds of legislative activity undertaken to address the perceived shortcomings of regulatory systems in the aftermath of deregulation. E.L. RUBIN, *Deregulation, Reregulation and the Myth of the Market,* (1988) 45 Wash. & Lee L. Rev. 1249. J.R. MACEY, *The Myth of "Reregulation": The Interest Group Dynamics of Regulatory Change in the Financial Services Industry,* (1988) 45 Wash. & Lee L. Rev. 1275. Significant deregulation of financial institutions has occurred in the U.K. — the so-called Big Bang, aimed at removing the barriers to entry both to the U.K. market by foreign firms and across financial sectors previously defined by commercial banking, investment banking, brokers, or insurers. See, *e.g.,* D. WALKER, *Some Reflections on Big Bangs in Financial Systems,* (1987-88) 13 C.B.L.J. 388.

58 D.L. GOELZER, A. SULLIVAN & R. MILLS, *Securities Regulation in the International Marketplace: Bilateral and Multilateral Agreements,* (1988) 9 Mich. Y.B. Int'l Legal Studies 53. PETERS & FELDMAN, *supra,* note 53 at 19.

59 Over the years, several imaginative financing techniques and financial instruments have been developed from interest rate and currency swaps, to floating rate notes (FRNs), options and futures, stock and bond indexes as well as futures and options, to name just a few. See, *e.g.,* OECD, *Banks under Stress, supra,* note 5 at 123. The spread of many of these instruments and practices contributed significantly to the growing use of securities and security-like instruments, which are created through the process of securitization. Securitization has come to mean a bypass of banks. L. BOOTH, *The Regulation of Canada's Financial Markets: A Primer on the Economic*

certain securities regulatory authorities have developed systems[60] to facilitate multinational offerings[61].

CHAPTER II: The Free Trade Era

In recent years, the globalization of the financial marketplace has led to the liberalization of trade in financial services. In North America, the coming about of a regional free trade era is the result of: (i) economic integration; and (ii) the signing of two major free trade agreements.

1. North American Economic Integration

The past few decades have been marked by significant expansion of global trade. For the industrial countries, the consequence of this growth has been an increasing

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Issues, (1990) 3 B.F.L.R. 147 at 164-166. On the increased used of securitized instruments see, *e.g.*, OECD, *Securitisation: An International Perspective* (Paris: OECD, 1995). OECD, *Financial Market Trends*, various issues. O. SHIJURO, R. COOPER & H. SCHULMAN, *International Financial Integration: The Policy Challenges* (Paris: OECD, 1989) at 17-18. The primary sources of innovation have been the securities subsidiaries of U.K. and French banks as well as large American and Japanese non-bank securities houses. OECD, *Systemic Risks in Securities Markets* (Paris: OECD, 1991) at 9.

60 With the growing interdependence of North American markets, the CSA embarked (in 1990) on the development of an electronic filing for all required securities filings. The system (called the System for Electronic Document Analysis and Retrieval or SEDAR) should be implemented by early 1996. This new technology will facilitate the harmonization of securities regulation on an international scale. Hence, in view of the fact that the SEC already uses a similar system (called the Electronic Data Gathering and Retrieval System or EDGAR), discussions have been under way to create an electronic link with all participants in the North American markets. *CSA Notice — SEDAR*, (1995) 18 O.S.C.B. 1892. *CSA Notice — An Electronic System for Securities Filings*, (1994) 17 O.S.C.B. 2857. *Avis des autorités canadiennes en valeurs mobilières — SEDAR*, (1995) 26:15 B.C.V.M.Q. 1. *Avis des autorités canadiennes en valeurs mobilières—système électronique de données, d'analyse et de recherche*, (1994) 25:24 B.C.V.M.Q. 1. On SEDAR, see *Notice — Remarks of Edward J. Waitzer — A Year in the Life of a Regulator*, (1994) 17 O.S.C.B. 5075 at 5076. On EDGAR, see *EDGAR*, (1993) 26 Rev. Sec. & Comm. Reg. 173. J.L. ARNOLD & M.A. DIAMOND, *EDGAR: The SEC's Program and its Impact* (Morristown, N.J.: Financial Executives Research Foundation, 1986). *EDGAR: The SEC's Disclosure System*, (1986) 19 Rev. Sec. & Comm. Reg. 161.

61 See generally, T.R. GIRA, *Toward a Global Capital Market: The Emergence of Simultaneous Multinational Securities Offerings*, (1987) 11 Md J. Int'l L. & Trade 157.

dependence on international commerce[62]. Moreover the world is now increasingly characterized by large regional groupings, with competition shifting rapidly from national to regional and global planes[63]. Undoubtedly, these are new challenges to developing countries at a time when tough economic conditions prevail on many parts of the globe[64].

This distribution of international economic power has had an impact on the ways many MNCs do business[65]. As we examine the Canadian securities industry in the context of North American regionalization, it is important to briefly bring back into focus some of the external factors that free trade must take into consideration. These factors are the legal ramifications of economic integration and the General Agreement on Tariffs and Trade (hereinafter GATT) rules on free trade areas[66].

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62 R. BOUZAS & J. ROSS, eds, *Economic Integration in the Western Hemisphere* (Notre-Dame, IN: University of Notre-Dame, 1994). J.S. FINLAYSON, "Canadian International Economic Policy: Context, Issues and a Review of Some Recent Literature" in Royal Commission on the Economic Union and Prospects for Canada, *Canada and the International Political/Economic Environment*, (Research Studies, Vol. 28) (Toronto, Ont.: University of Toronto Press, 1985) (D. STAIRS & G.R. WINHAM, eds) 9 at 12ff.

63 See, *e.g.*, OECD, *Regional Integration and the Multilateral Trading System: Synergy and Divergence* (Paris: OECD, 1995). K. ANDERSON & R. BLACKHURST, eds, *Regional Integration and the Global Trading System*, (New York, N.Y.: St. Martin's Press, 1993). A.O. KRUEGER, "The Effects of Regional Trading Blocs on World Trade" in R. CUSHING *[et al.]*, eds, *The Challenge of NAFTA: North American, Australia, New Zealand, and the World Trade Regime* (Austin, TX: Lyndon B. Johnson School of Public Affairs, 1993) 21. K. ANDERSON, "NAFTA, Excluded Pacific Rim Countries, and the Multilateral Trading System", *Ibid.*, 33. H.J. JOHNSON, *Dispelling the Myth of Globalization: The Case for Regionalization*, (New York, N.Y.: Praeger, 1991).

64 A key concern for developing countries is whether the grouping of some of the world's most advanced economies will impact on new inflows of FDIs. See, *e.g.*, U. HIEMENZ & R.J. LANGHAMMER, *Regional Integration Among Developing Countries: Opportunities, Obstacles and Option* (Boulder, CO: Westview, 1990) at 14.

65 See generally, I.A. RONKAINEN, "Trading Blocks: Opportunity or Demise for Trade?" *Multinational Business Review* (Spring 1993) 1. UNCTC, *Regional Economic Integration and Transnational Corporations in the 1990s: Europe 1992, North American, and Developing Countries*, Current Studies, series A, N° 15 (New York, N.Y.: UNCTC, 1990).

66 See generally, J.P. BYRLEY, *Regional Arrangements, the GATT and the Quest for Free Trade*, (1991) 6 Fla. J. Int'l L. 323.

Essentially, there are two aspects to the process of international economic integration[67]: (i) liberalization[68]; (ii) harmonization of policy in areas that bear on the economy in general[69]. Often, economic integration has been classified at different levels of coordination – the free trade area, the custom union, the common market and the economic union[70].

The requirements of Article XXIV of the GATT (to which Canada, the U.S. and Mexico are members) have also been Important to the creation of a continental accord[71] for they relate exclusively to trade liberalization[72]. In essence, this provision allows the

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67 For an excellent discussion on economic integration, see, *e.g.*, A.E. SAFARIAN, *Canadian Federalism and Economic Integration* (Ottawa, Ont.: Information Canada, 1974). B. BALASSA, *The Theory of Economic Integration* (London: George Allen & Unwin, 1973).

68 Liberalization entails the abolition of national measures that prevent the free movement of goods, persons, services and capital. H. HUTCHESON, *Vocabulary of Free Trade*, Terminology Bulletin 204 (Ottawa, Ont.: Minister of Supply and Services Canada, 1991) at 135. Insofar as financial services are concerned, "[...] it is useful to distinguish among approaches [...] [r]anging from the most liberal to the less liberal [i.e. (i) common regulation; (ii) mutual recognition; (iii) non-discrimination; (iv) national treatment; (v) cross border trade with limited entry; (vi) cross border trade area without entry]. The distinguishing features of these arrangements are summarized in CHANT, *supra*, note 17 at 3-6.

69 G. HANSSON, *Harmonisation and International Trade* (London: Routledge, 1992) at 25. In Canada, "[t]here is a strong concern that the high standards of securities laws that have been built over the recent years in North America will be subject to compromises in order to achieve a certain degree of international harmonization and integration." S.M. BECK, "Recent Trends in Securities Regulation" in L.S.U.C. Special Lectures, *Securities Law in the Modern Financial Marketplace* (Toronto, Ont.: Richard De Boo, 1989) 1 at 3.

70 See, *e.g.*, M.N. JOVANOVIC, *International Economic Integration* (London: Routledge, 1992) at 9ff. D. CARREAU, P. JUILLARD & T. FLORY, *Droit international économique* (Paris: L.G.D.J., 1978) at 122ff. SAFARIAN, *supra*, note 67 at 2. BALASSA, *supra*, note 67 at 1. Free trade areas entail the removal of discriminatory internal measures insofar as they apply to imported goods or services from the parties to an agreement. Custom unions are, essentially, free trade areas with discriminatory external measures common to all partners; common markets are custom unions with unrestrained labour and capital mobility between participating nations; and economic unions are common markets with coordinated fiscal, monetary, regulatory and social policies.

71 Both the FTA and NAFTA establish "free-trade areas" consistent with Article XXIV of the GATT. FTA, Article 101. NAFTA, Article 101. I. BERNIER & S. DUFOUR, *GATT, Uruguay Round and NAFTA*, (1994) 4:2 FTU 13.

72 In 1995, the number of Free Trade Areas was said to be continuously growing. "The Right Direction?" *The Economist* (16 September 1995) 23. Among the Free Trade Areas created under the authority of GATT Article XXIV, the reader is referred to the following: *Free Trade Area Between Israel and the United States.* Report of the Working Party adopted on May 14, 1989; GATT, *Basic Instruments and Selected Documents*, 34th Supp. (1988), at 58; reprinted in (1985) 24 I.L.M. 653. *Australia/New*

establishment of free trade zones and the elimination of the Most-Favoured-Nation (hereinafter MFN) principle with respect to third parties[73].

In whatever form, integration is, essentially, evaluated in a practical setting. There exists no theoretical predictability about the economic consequence of integration. Different integration levels entail different national sovereignty sacrifices. Therefore, it is useful to consider policy coordination issues carefully and be able to recognize where national policies diverge, as we will later note with respect to securities regulation and laws affecting the securities industry.

2. Structure of the Three Economies

Economic integration of the three North American countries (Canada, the United States and Mexico) is not an entirely new idea[74]. Particularly in Canada, there has

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Zealand Closer Economic Relations - Trade Agreement (ANZCERT). Report of the Working Party adopted on October 2, 1984; GATT, *Basic Instruments and Selected Documents* 31st Supp. (1985), p. 170; reprinted in (1983) 22 I.L.M. 945. *Agreement Between the European Communities and Israel.* Report of the Working Party adopted on July 15, 1976; GATT, *Basic Instruments and Selected Documents* 23rd Supp. (1977), p. 55. *Caribbean Free Trade Area.* Report of the Working Party adopted on November 9, 1971; GATT, *Basic Instruments and Selected Documents* 18th Supp. (1972), p. 129. *Latin American Free Trade Area. Examination of Montevideo Treaty.* Report of the Working Party adopted on November 18, 1960; GATT, *Basic Instruments and Selected Documents* 9th Supp. (1961), p. 87. *European Free Trace Association. Examination of Stockholm Convention.* Report of the Working Party adopted on June 4, 1960; GATT, *Basic Instruments and Selected Documents* 9th Supp. (1961), p. 70. *The Treaties Establishing the European Economic Community and the European Atomic Energy Community.* Report of the Working Party adopted on November 29, 1957; GATT, *Basic Instruments and Selected Documents* 6th Supp. (1961), p. 68.

73 For a recent assessment of Article XXIV of the GATT, see, *e.g.*, J.H. JACKSON & R.H. SNAPE, "History and Economics of GATT's Article XXIV" in ANDERSON & BLACKHUST, eds, *supra*, note 63 at 273. For a Canadian perspective, see S.M. RIERSTEAD, *An International Bind: Article XXIV of GATT and Canada*, (1993) Ottawa L. Rev. 315.

74 See generally J.W. WILKIE & O.M. LAZIN, "Mexico As Linchpin for Free Trade in the Americas" in J.W. WILKIE, ed., *Statistical Abstract of Latin America,* Vol. 31, Part 2 (Los Angeles, CA: UCLA Latin American Centre, 1995) 1175 at 1177 n. 1. T.L. GORDON, *Economic Integration in North America: An Agreement of Limited Dimensions but Unlimited Expectations*, (1993) 56 The Modern L. Rev. 157 at 159. W. McGAUGHEY, Jr., *A U.S.-Mexico-Canada Free-Trade Agreement: Do We Just Say No?* (Minneapolis, MN.: Thistlerose, 1992) at 45ff; S.J. RANDALL, H. KONRAD & S. SILVERMAN, *North American Without Borders? Integrating Canada, the United States and Mexico* (Calgary, Alta: University of Calgary Press, 1992) at 12ff.

been a long interest in (and controversy about) closer economic ties with the U.S. This is not surprising given the fact that each of the two countries is the most important trading partner of the other[75]. Adding Mexico to the equation is, however, a more recent idea[76].

The North American countries vary in degree of development and in foreign trade objectives. Although the continent is a natural geographic unit and, perhaps, an appropriate economic unit, the U.S., Canada and Mexico are plainly quite different[77]. First, Canada and the U.S. are fully industrialized nations while Mexico is semi-industrialized. In the past, integration in other parts of the world usually occurred among countries which were smaller and more equal in size and economic development than is the case in North America. Second, Canada and Mexico are resource rich while the U.S. faces energy problems. Third, the U.S. economy dominates the region to a degree not found in other regional groupings, being roughly ten times the size of Canada and twenty times that of Mexico. Historically, the superpower status of the U.S. has forced Canada and Mexico to fear its

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75 However, prior to its decision to become a full member of the Organization of American States (effective January 1990), "Canada was geopolitically considered as being more part of Western Europe than of the Americas due to its British tradition, its links with France and its membership in North Atlantic Treaty Organization (NATO)". L. PERRET, "Canada, NAFTA and Beyond" in N. LACASSE & L. PERRET, eds, *Free Trade in the Americas (An Hemispheric Approach)* (Montreal, Que.: Collection Bleue, Wilson & Lafleur, 1994) 3 at 3.

76 M. HART, *A North American Free Trade Agreement* (Ottawa, Ont: Centre for Trade Policy and Law, 1990) at 11ff. Note that in the late 1960s, there were talks to create a trilateral free trade association including Canada, the U.S. and ... Great Britain. Hence, in view of France's reluctance towards a British admittance in the EC, Ottawa, Washington and London discussed the possibility of creating the "North Atlantic Free Trade Association" or NAFTA. B. LANDRY, *Commerce sans frontières: le sens du libre-échange* (Montreal, Que.: Québec/Amérique, 1987) at 108. With the stalling of GATT in 1993 and the Maastricht Treaty facing an uncertain future, a similar idea (this time linking the U.S. and the EC, to form a common European American market) was proposed by former British Prime Minister, Margaret Thatcher. Again, however, this "North Atlantic Free Trade Area" did not materialize. J.M. ROSENBERG, *Encyclopedia of the North American Free Trade Agreement, the New American Community, and Latin-American Trade* (Westport, CT: Greenwood, 1995) at 321.

77 For a discussion, see generally J.A. ERFANI, *The Paradox of the Mexican State: Rereading Sovereignty from Independence to NAFTA* (Boulder, Co: Rienner, 1995). R. GRINSPUN & M.A. CAMERON, eds, *The Political Economy of North American Free Trade* (New York, N.Y.: St. Martin's Press, 1993).

domination[78].

These features are likely to present difficulties in the integration process[79]. The extent of the countries' socio-economic disparity is illustrated in Table 1. The GNP and per capita GNP as well as other social factors such as literacy and life expectancy show Mexican development to be far behind its neighbours to the north[80].

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78 In both cases, there is a rational or irrational fear of the economic giant across the border. H.W. KONRAD, "North American Continental Relationships: Historical Trends and Antecedents" in S.J. RANDALL *[et al.], supra*, note 74 at 83. Mexico's contemporary history is characterized by its high degree of nationalism and of suspicion towards foreign investment and ownership in its territory. Political, economic and emotional animosities in Mexico towards the U.S. are well-known. "[O]ne must consider Mexico's nationalistic sensitivity in dealing with a country to which it lost half of its territory in 1848 [...]" F. De ANDREA, "Protecting Strategic and Economic Sectors: Petroleum and Energy in Mexico" in N. LACASSE & L. PERRET, eds, *Doing Business in Mexico: The Free Trade Challenge* (Montreal, Que.: Collection Bleue, Wilson & Lafleur, 1993) 59 at 63. They, like many other Latin-American countries, have viewed U.S. policies as designed to further U.S. citizens' business concerns as well as international strategic concerns. See, *e.g.*, J. GRUNWALD, *Foreign Private Investment: The Challenge of Latin American Nationalism*, (1971) 11 Va. J. Int'l L. 228 at 232. In Canada, there has been a traditional widespread fear that with integration "Canadians will become hewers of wood and drawers of water". R. WONNACOTT & P. WONNACOTT, *Free Trade Between the United States and Canada: the Potential Economic Effects* (Cambridge, MA: Harvard University Press, 1967) at iv. Not too long ago, the former Premier of Ontario mentioned that free trade was a contract leading toward a "piece by piece" annexation with the U.S. M. VASTEL, "Pour l'aider à sauver le Canada d'une annexion aux États-Unis, Bob Rae lance un pressant appel à Robert Bourassa." *Le Soleil [of Quebec]* (9 October 1991) A4.

79 B.W POULSON & M. PENUBARTI, "North-American Trade in the Post-Debt-Crisis Era" in K. FATEMI, ed., *North American Free Trade Agreement: Opportunities and Challenges* (New York, N.Y.: St. Martin's Press, 1993) 84 at 84.

80 See generally, R.S. BELOUS & J. LEMCO, eds, *NAFTA as a Model of Development: The Benefits and Costs of Merging High and Low Wage Areas* (Washington, D.C.: National Planning Association, 1993).

TABLE 1 GENERAL CHARACTERISTICS OF THE THREE ECONOMIES			
1994	U.S.	CANADA	MEXICO
Area (square kilometres)	9,533	9,976	1,973
Populations (millions)	255.4	27.3	86.2
World rank (by population)	4	32	11
GDP (billions of U.S. dollars)	6,738	548	377
GDP per capita (U.S. dollars)	25,788	18,782	4,108
Adult literacy	99.5%	98%	87.6%
Life expectancy, years	76	77	70
Inflation rate (%)	2.2%	0.9%	7%

Source: World Development Report '94, the World Bank; World Competitiveness Report, '94.

Table 2 highlights the structure of the three economies. It shows that each of the three countries experienced a decline between 1960 and 1994, in the share of the labour force and of output devoted to the agricultural sector. While the compensating increase in the U.S. and Canada was in services, in Mexico it was mainly in industry. In 1994, two-thirds of the economic activity in the U.S. and Canada was in services compared to only one third in Mexico. It is a reflection of the differential productivity and stage of development that a full third of the Mexican labour force is still employed in agriculture, compared to 2.9 percent in the U.S.[81]

TABLE 2 STRUCTURE OF THE THREE ECONOMIES						
	U.S.		CANADA		MEXICO	
Distribution of the Labour Force (%)	1960	1994	1960	1994	1960	1994
Agriculture	7%	2.9%	13%	4.5%	55%	33.1%
Industry	36	25.3	35	23.2	20	35.5
Services	57	71.8	52	72.3	25	31.8

Sources: EIU; Statistics Canada; World Competitiveness Report, '94.

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81 A recent study assessed Mexico's productivity. The research found that in most cases (including in the banking industry), Mexican (as well as some other Latin American) firms were less productive than those of Canada and the U.S. The weakness came from ineffective organization (i.e. too many workers, hierarchical structures, bad communications and unnecessary tasks). "Death of an Oxymoron: Latin American Productivity" *The Economist* (25 June 1994) 67.

Table 3 presents the total trade of the three North American countries, as well as their trade with each other. In 1972 and 1994, a quarter of the total U.S. trade was with Canada and Mexico. In the case of Canada, two-thirds of the 1994 imports and exports are with the U.S., and an insignificant proportion with Mexico. Similarly, two-thirds of Mexican trade was with the U.S., and an insignificant proportion was with Canada. This pattern reflects the immense size of the U.S. economy and the geographic proximity of the U.S. between the two other countries. The North American Free Trade Agreement may somewhat stimulate Canada-Mexico trade. Yet, given the existing trade patterns, it is reasonable to consider separately the Canada-U.S., Canada-Mexico and U.S.-Mexico trade flows[82].

TABLE 3

INTRA-NORTH AMERICAN TRADE ($U.S. Billion)

	1972		1994	
U.S.	**Exports**	**Imports**	**Exports**	**Imports**
Total trade	50.0	59.0	512.4	689.3
Trade with Canada	12.4	15.8	114.3	132.0
Trade with Mexico	2.0	2.0	50.8	50.4
CANADA				
Total trade	21.1	19.4	161.3	151.5
Trade with U.S.	14.1	13.1	133.1	99.6
Trade with Mexico	0.1	0.1	715.0	3.4
MEXICO				
Total trade	1.7	2.7	57.0	72.0
Trade with U.S.	1.1	1.6	45.7	50.8
Trade with Canada	0.0	0.1	3.1	0.7

Source: IMF, Direction of Trade Yearbook, 1994.

Despite their differences, increased political and economic pressures around the globe have driven the three countries closer together. As a result, the emerging North American regional market has become a focal point in many firms' strategic outlook[83]

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82 For other statistics, see generally, WILKIE, ed., *supra*, note 74.

83 A recent study has found that this North American focus has two dimensions: (i) the integration of Canadian, U.S. and (somewhat more slowly) Mexican business operations into continental operations; and (ii) the rationalization of production

(including those operating in the securities industry).

3. The Canada-United States Free Trade Agreement: The Rise of a Phoenix

With a gradual economic integration on the way, the first step towards the formalization of a "renewed" trading relationship between Canada and the U.S. has been the signing of the Canada-United States Free Trade Agreement.

3.1 Background and Rationale for a FTA

As we have seen the Canada-U.S. trading relationship is characterized by remarkably high level of economic interdependence with Canada's reliance on the U.S. being considerably larger than *vice versa*[84]. Still, Canada's importance to the U.S. is unquestionable[85].

From time to time in the course of Canadian history, some form of economic integration has been proposed. The issue of free trade with the U.S. is one of

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capacity. S. KRAJEWSKI, S. BLANK & H.S. YU, "North American Business Integration" *Business Quarterly* (Spring 1994) 55.

84 For an historical account of past events leading up to the FTA, see, *e.g.*, H. BELLO & G.R. WINDHAM, "The Canada-U.S. Free Trade Agreement: Issues of Process" in L. WAVERMAN, ed., *Negotiating and Implementing a North American Free Trade Agreement* (Vancouver, B.C.: Fraser Institute, 1992) 29. G.V. DOERN & B.W. TOMLIN, *Faith and Fear: The Free Trade Story Review Essay: The Great Canada - United States Free Trade Debate*, (1992) 21:2 Am. Rev. of Can. Studies 337. E. THÉROUX, *Du traité de réciprocité à l'Accord du libre-échange*, (1991) 25 R.J.T. 227. E.H. FRY, "An Historical Overview of Canada - U.S. Trade Relations" in P.P. PROULX, ed., *Canada-United States Trade Liberalization and Socio-Economic Integration: U.S. Perspectives* (Halifax, N.S.: Institute for Research on Public Policy, 1990) 51. R. WHITE, *Fur Trade to Free Trade: Putting the U.S.-Canada Trade Agreement in Historical Perspective* (Toronto, Ont.: Dundorn, 1988).

85 For instance, apart from supplying the U.S. with large quantities of important raw materials, Canada represents a major market for manufactured goods and the largest proportion of American FDI is located in Canada. Moreover, Canadians are invested largely in the U.S. D. STEGER, "The Impact of U.S. Trade Laws on Canadian Economic Policies" in C.D. HOWE INSTITUTE, *Policy Harmonization: The Effects of a Canadian-American Free Trade Area* (Toronto, Ont.: C.D. Howe Institute, 1990) 73 at 74.

Canada's oldest debates and has been called "the Issue that will not die"[86]. The pervasiveness of the free trade question is also demonstrated by the absence of any exclusive links with the principles and ideas of the different political parties. The first idea of economic integration between Canada and the U.S. can be traced back to the 1840s, when Great Britain ended the Imperial Preferences for its colonies. The British North American colonies turned to trade with the U.S[87]. Since then, many attempts were made to obtain a durable bilateral arrangement on this issue. Twice in Canadian history, free trade with the U.S. was proposed and defeated in federal elections[88]. Nevertheless, trade between the two countries continued to grow.

In 1965, one bilateral trade accord was signed: the Canada-U.S. Automotive Products Trade Agreement (Auto Pact)[89]. Canada's high degree of interdependence and sensitivity to external economic developments became evident in the early 1970s when the U.S. encountered severe economic problems. In addition to Washington refusing to take into account Canada's special position *vis-a-vis* the U.S.[90] These developments led Ottawa to re-examine the Canada-U.S. trade relationship. The impact of these external events was reinforced by a resurgence of Canadian nationalism[91]. However, on the whole, the federal government's attempt to decrease

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86 P. WONNACOTT, *The United States and Canada: The Quest for Free Trade–An Examination of Selected Issues*, Policy Analysis in International Economic N° 16 (Washington, D.C.: Institute for International Economics, 1987) at 1. W. NEIL, *Canada-U.S. Trade Policy Issues: Free Trade Discussions* (Ottawa, Ont.: Library of Parliament, 1985) 1. J.L. GRANATSTEIN, "Free Trade Between Canada and the United States: The Issue That Will Not Go Away" in Royal Commission on the Economic Union and Prospects for Canada, *The Politics of Canada's Economic Relationship with the United States* (Research Studies, Vol. 29) (Toronto, Ont.: University of Toronto Press, 1985) (D. STAIRS & G.R. WINHAM, eds) 11 at 11. B. MACDONALD, *The Issue That Will Not Die* (Toronto, Ont.: Canadian Institute for International Affairs, 1967).

87 CANADA, Royal Commission of the Economic Union and Development Prospects for Canada, *Report*, Vol. 1 (Ottawa, Ont.: Minister of Supply and Services Canada, 1985) at 218-219.

88 C.F. DORAN, *Forgotten Partnership: U.S.-Canada Relations Today* (Baltimore, MD: John Hopkins University Press, 1984) at 15. GRANATSTEIN, *supra*, note 86 at 17-21.

89 K.M. CURTIS & J.E. CARROLL, *Canadian-American Relations* (Lexington, MA: D.C. Heath, 1983) at 19.

90 In 1972, President Nixon essentially ended the special relationship in his address to the Canadian Parliament by pointing out that mature partners should have autonomous and independent policies. DORAN, *supra*, note 88 at 21-23.

91 In the Autumn of 1972, Mitchell Sharp, the Canadian Secretary of State of External Affairs, presented three possible options for Canadian-American relations: "[(i)] maintain the present relationship with the United States with a minimum of policy

Canada's high degree of dependence did not prove to be very fruitful[92]. Under difficult economic circumstances, considerations of economic self interest began to prevail in Canada, and more attention was subsequently given to the Canada-U.S. trade relationship[93].

In the 1980s, the Canadian government recognized the growing interdependence between states as "a fact of life"[94]. Despite the fact the Canadian economy was exposed to all kinds of international developments (for example, its capital markets, for all intents and purposes, being completely integrated with the global market), Canada was one of the few OECD members that did not belong to a free trade area or to a common-market association[95]. In March 1985, Prime Minister Brian Mulroney and President Ronald Reagan met in Quebec City to explore possibilities for

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adjustments; [(ii)] move deliberately towards closer integration with the United States; or [(iii)] pursue a comprehensive long-term strategy to develop and strengthen the Canadian economy and other aspects of our national life and in the process to reduce the present Canadian vulnerability." M. SHARP, "Canada-U.S. Relations: Options for the Future" *International Perspectives* (September/October 1972) 1 at 1. The last option (the so-called "Third Option") became the strategy of the Canadian government in the 1970s and the early 1980s. Many initiatives were taken in the wake of the Third Option, including the creation of the Foreign Investment Review Agency [hereinafter FIRA] (created to screen new investments and to review large foreign acquisitions of existing assets. In 1985, FIRA was abolished and replaced with Investment Canada and screening of foreign investment became less demanding) and the National Energy Program [hereinafter NEP] (introduced in 1980 with the prime objectives of achieving at least 50% Canadian ownership of oil and gas production and self-sufficiency of oil supply by 1990 – in 1984, it was abolished). P. MORICI, A.J.R. SMITH & S. LEA, *Canadian Industrial Policy* (Washington, D.C.: National Planning Association, 1981) c. 3.

92 On U.S. responses to Canadian nationalism, see, *e.g.*, D. LEYTON-BROWN, *Weathering the Storm: Canadian-U.S. Relations, 1980-83* (Toronto, Ont.: Canadian-American Committee, 1985) Chapter 3.

93 P. MORICI, *Meeting the Competitive Challenge: Canadian and the United States in the Global Economy* (Toronto, Ont.: Canadian-American Committee, 1988) at 33-36. P. MORICI, *The Global Competitive Struggle: Challenges to the United States and Canada* (Toronto, Ont.: Canadian-American Committee, 1984) at 87-89.

94 The Third Option policy was openly abandoned when the government of Pierre Elliott Trudeau released a discussion paper acknowledging that decisions and actions of one country increasingly affect others. CANADA, *Canadian Trade Policy for the 1980s: A Discussion Paper* (Ottawa, Ont.: Minister of Supply and Services Canada, 1983) at 40-45.

95 ECONOMIC COUNCIL OF CANADA, *Venturing Forth: An Assessment of the Canada-U.S. Trade Agreement* (Ottawa, Ont.: Minister of Supply and Services Canada, 1988) at 3.

increased trade between the two nations. Free trade talks began on May 21, 1986[96].

Negotiations were difficult[97]. Canada indicated that it would not accept an arrangement which would weaken the Auto Pact, agriculture, regional development and foreign investment rules. In addition, a binding system to settle disputes would have to be included. On the last point, opinions diverged widely. From the outset, Canada wanted a bilateral tribunal with binding powers to deal with American protectionist trade rules. This induced Ottawa to suspend the trade talks on September 23, 1987.

Pointing to the unacceptable concessions Canada would have to make, the opposition parties (the Liberals and the New Democrats) urged the Mulroney government to abandon the free trade idea altogether[98]. At the same time, the powerful province of Ontario reiterated its strong reservations *vis-a-vis* free trade. Despite this pressure[99], bilateral governmental consultations were held in order to resume the negotiations. Both parties realized that time was running out very rapidly: the deadline set by the U.S. Congress for the "fast track" procedure would expire on October 4, 1987[100]. On

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96 On the decision to negotiate the FTA, see G.R. WINHAM, "Why Canada Acted" in W. DIEBOLD, Jr., ed., *Bilateralism, Multilateralism and Canada in U.S. Trade Policy* (Cambridge, Mass.: Ballinger, 1988) 37.

97 For a good insider account, see M. HART, *Decision at Midnight: Inside the Canada-U.S. Free Trade Negotiations* (Vancouver, B.C.: UBC Press, 1994).

98 Commenting over the situation of financial institutions, the government of Canada announced that the FTA would "[...] allow our large world-class financial institutions to tap global financial markets and enhance their financial strength." CANADA, Department of External Affairs, *The Canada-U.S. Free Trade Agreement in Brief* (Ottawa, Ont.: Minister of Supply and Services, 1988) at 7. In contrast, the official opposition in Parliament (i.e. the Liberal Party of Canada) opposed the deal saying "[...] it gives complete access to American companies [...]." LIBERAL PARTY OF CANADA, *Reaching Out: A Liberal Alternative to the Canada-U.S. Trade Agreement* (Ottawa, Ont.: Liberal Party of Canada, 1987) at 33. For its part, the New Democratic Party for many years has tried (and failed) to cancel the FTA by introducing motions in the Canadian House of Commons. See, *e.g.*, K. PUTHON & R. SCHWARTZ, *NDP Attempt to Abrogate FTA Fails,* (1992) 5:6 Canada-U.S. Trade 39.

99 Other reasons given for Canada to abandon the FTA are cited in R.D. ROBINSON, *Canada Should Opt Out of the Free Trade Association with the United States*, (1992) 34 Int'l Exec. 363. CANADIAN CENTRE FOR POLICY ALTERNATIVES, *Paying the Price* (Ottawa, Ont.: Canadian Centre for Policy Alternatives, 1991).

100 In essence the fast track process obliges Congress to review trade agreements within a specified period of time, then either assent to or reject them in their entirety without amendment.

October 1st, the talks were re-opened and a compromise was reached before the deadline with Canada acquiring its bilateral panel. In the end however, both sides appeared to have made major concessions. Prime Minister Mulroney and President Reagan signed the Canada-U.S. Free Trade Agreement on January 2, 1988.

The passage of the Agreement required implementing legislation by the U.S. Congress which was achieved relatively smoothly[101]. The FTA was fully ratified by the time Congress adjourned in October 1988 for national elections. In Canada, however, the situation was very different. The opposition parties opposed the FTA. Nevertheless, the government secured the passage of the implementing legislation by the House of Commons in September 1988. However, when it became clear that the Canadian Senate (controlled by the opposition) would not pass the legislation before a federal election took place, the Prime Minister called one for November 21, 1988[102]. The government was re-elected with a majority and given a mandate[103] to proceed with the FTA which came into effect on January 1, 1989[104]. The FTA provided for an indefinite term but it could be terminated by either country upon giving six months notice[105].

At the time of its signing, the FTA was the single most important trade agreement ever concluded between two countries in that it attacked protectionism and provided for liberalization in all sectors of the economy including commitments on trade in financial services[106]. However, as we shall see, the FTA extends beyond trade in

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101 *United States - Canada Free Trade Agreement Implementation Act of 1988*, Pub. L. 100-449, 102 Stat. 1851 (1988). For the U.S. viewpoint on the implementation of the FTA, see House of Representatives, Committee on Ways and Means, H.R. Doc. 102-36, January 30, 1991, Congressional Information Service 91H780-5, 47p.

102 R. JOHNSTON, "Free Trade and the Dynamics of the 1988 Canadian Election" in J. WEARING, ed., *Voting in Canada* (Toronto, Ont.: Copp Clark Pitman, 1991) 35 at 37.

103 "Opponents of the FTA still maintain that although the Conservative Government that advocated the FTA was reelected in the general election called on the issue of free trade, the majority of Canadians voted against the adoption of the FTA." C. JORDAN, *The Canada-United States Free Trade Agreement*, (1989) 5 Rev. Banking and Fin. Serv. 33 at 34 n. 7.

104 FTA, Article 2105. On the entry into force of the FTA, see U.S. Senate Report N° 100-509, 15 September 1988. (1988) 5 U.S.C.C.A.N. 2395-2468 at 9-10, 43-44.

105 FTA, Article 2106.

106 FTA, Chapter One. For a general assessment of the FTA, see, *e.g.*, N. LACASSE, "Bilan intérimaire de l'Accord de libre-échange Canada-États-Unis" in LACASSE & PERRET, *supra,* note 75 at 149. When the FTA negotiations began, there were

financial services to include long-term securities investment. The FTA has a preamble and is divided into eight parts comprising twenty-one chapters in total[107]. It recognizes the special relationship and mutual interdependence existing between the two countries and supplements (rather than replaces) international and bilateral agreements[108]. However, the U.S. and Canada both had different reasons to join in this accord.

3.1.1 United States' Rationale

Over the years, Americans have seen their relationship with Canadians as non-problematic. For this reason, in the U.S., public attention to the creation of a free trade area with Canada was negligible. While the benefits of free trade would, of course, be of great importance to the comparatively small Canadian economy, they would be less essential to the U.S. economy. The Reagan Administration was determined nevertheless, to pursue a free trade arrangement with Canada. Because of the political sensitivities that could be raised in Canada by an American initiative, U.S. officials were inclined to let Canada take the first step[109].

The Reagan Administration firmly opposed the rising protectionism in the global economy and considered free trade a lever against protectionist countries[110]. At the

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suggestions that trade in financial services should be the subject of a separate agreement to be negotiated by the U.S. Treasury Department and the Canadian Ministry of Finance. However, in the end, it was decided that its mere existence would help for bilateral negotiations. P. MANSON, *Impact of the Free Trade Agreement on Financial Services*, (1988-1989) 3 B.F.L.R. 329 at 331.

107 On the general contents and impacts of the FTA, see, *e.g.*, F. SIDDIQUI, ed., *The Economic Impact and Implications of the Canada-U.S. Free Trade Agreement* (Lewinston, N.Y.: Edwin Mellen, 1991). R.A. SANFORD, *The Canada-U.S. Free Trade Agreement: Its Aspects, Highlights, and Probable Impact on Future Bilateral Trade and Trading Agreements* (1989) 7 Dickinson J. Int'l L. 371. D. STEVENS, *The Canada-United States Free Trade Agreement: An Analyses of its Main Provisions*, (1989) Int'l Bus. L.J. 918.

108 For an understanding of the objectives listed in Article 102 of the FTA, see, *e.g.*, CANADA, Department of External Affairs, *The Canada-U.S. Free Trade Agreement Synopsis* (Ottawa, Ont.: Minister of Supply and Services Canada, 1987) at 14.

109 P. MORICI, *U.S.-Canada Free Trade Discussions: What Are the Issues?*, (1985) 15:3 Am. Rev. of Can. Stud. 311 at 317.

110 P. LOW, *Trading Free: The GATT and US Trade Policy* (New York, N.Y.: Twentieth Century Fund, 1993) at 9. P. MORICI, *A New Special Relationship: Free Trade and U.S.-Canada Economic Relations in the 1990s* (Ottawa, Ont.: Centre for Trade Policy

same time, the Administration wanted to liberalize trade with other countries that were interested in freer trade as well[111]. The emphasis by the U.S. was focused on the concept of "fair trade", whereby it requested foreign countries to eliminate their trade restrictions. If such access was not forthcoming, reciprocal or comparable U.S. legislation would be enacted. The Trade and Tariff Act of 1984 provided the explicit mandate for the Administration to negotiate separate, bilateral arrangements on either a sectoral or comprehensive basis. In March 1985, the first bilateral free trade agreement, although limited in scope, was signed with Israel[112]. Although the economic effects of free trade with Canada would be small for the U.S.[113], an arrangement could ease persistent frictions, increase the chance of future cooperation, and launch a new initiative to get North America "moving again"[114].

The trade policy of the Reagan Administration evoked, however, considerable criticism in the U.S. Congress[115]. In order to save the free trade talks, key members of the Administration lobbied intensively. Eventually, the "fast track" procedure was endorsed, which led to the beginning of the negotiations with Canada. In its pursuit of free trade, President Reagan succeeded in keeping Canada-U.S. trade out of the partisan political debate in Congress. Moreover, the sizeable trade flows with Canada did not become an issue in Congress with respect to the introduction of the Omnibus

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and Law, 1991) at 19ff. J.J. SCHOTT, *More Free Trade Areas?* (Washington, D.C.: Institute for International Economics, 1989) at 11-13.

111 E. NEF, "Looking at Washington" in D. CAMERON, ed., *The Free Trade Papers* (Toronto, Ont.: James Lorimer, 1986) 63 at 65.

112 For an assessment of the U.S.-Israel FTA, see, *e.g.*, A. AMINOFF, *The United States - Israel Free Trade Area: In Theory and Practice,* (1991) 25:1 J.W.T. 5. H.F. ROSEN, "The U.S.-Israel Free Trade Area Agreement: How Well Is It Working and What Have We Learned?" in J.J. SCHOTT, ed., *Free Trade Areas and U.S. Trade Policy* (Washington, D.C.: Institute for International Economics, 1989) 97.

113 For some thoughts on the economic benefits for the U.S., see, *e.g.*, F.C. MENZ & S.A. STEVENS, eds, *Economic Opportunities in Freer U.S. Trade with Canada* (Albany, N.Y.: State University of New York Press, 1991).

114 R.J. WONNACOTT, *Canada/United States Free Trade: Problems and Opportunities* (Toronto, Ont.: Ontario Economic Council, 1985) at 7-10. G.C. HUFBAUER & A.J. SAMET, "A U.S. View of Freer Trade" *International Perspectives* (March/April 1984) 27.

115 See, *e.g.*, CANADA, Royal Commission on the Economic Union and Development Prospects for Canada, *Report*, Vol. 1 (Ottawa, Ont.: Minister of Supply and Services Canada, 1985) 319.

Trade and Competitiveness Act of 1988 (hereinafter OTCA)[116].

3.1.2 Canada's Rationale

Canada always has been a strong supporter of multilateralism on the premise that greater gains can be realized for a relatively small economic entity in a multilateral forum, rather than on a bilateral basis where bargaining strengths are unequal[117]. Nevertheless, there has been a growing feeling in Canada that in a changing world characterized by increasing protectionism and the strengthening of regional trade blocs, a continued adherence to a purely multilateral trade strategy could be harmful for the Canadian economy[118].

This first major advocate of bilateral free trade with the U.S. was the Senate's Standing Committee on Foreign Affairs which concluded that Canada's interests were unlikely to be served by what had become a "Club of Three" (the U.S., the EC and Japan)[119]. A Canada-U.S. arrangement, on the other hand, would certainly strengthen Canada both politically and economically[120]. In 1985, the new Conservative government presented a discussion paper which singled out protectionist pressures in the U.S. and recognized that the multilateral rules were no

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116 A Pub. L. N° 100-418, 102 Stat. 1107. This comprehensive trade legislation, which came into force in August 1988, concentrates on reciprocity and market access. From the Canadian point of view, "[s]everal observers, [...] have recommended that Canada should consider the FTA at an end if a U.S. trade bill is enacted containing seriously protectionist measures affecting Canada." D.P. STEGER, *A Concise Guide to the Canada-United States Free Trade Agreement* (Toronto, Ont.: Carswell, 1988) at 96.

117 R. WONNACOTT, "Bilateral Trade Liberalization with the United States and Multilateral Liberalization in the GATT: Selected Observations" in D.W. CONKLIN & T.J. COURCHENE, eds, *Canadian Trade at a Crossroads: Options for New International Agreements* (Toronto Ont.: Ontario Economic Council, 1985) 335 at 335. K.A.J. HAY, "Canadian Trade Policy in the 1980s" *International Perspectives* (July/August 1982) 16 at 18.

118 S. REISMAN, "The Issue of Free Trade" in CAMERON, ed., *supra*, note 111, 33 at 37.

119 CANADA, Senate Standing Committee on Foreign Affairs, *Canada-United States Relations, Volume III: Canada's Trade with the United States* (Ottawa, Ont.: Minister of Supply and Services Canada, 1982) at 111-115.

120 For a detailed explanation of Canada's objectives in the negotiation with the U.S., see, *e.g.*, ECONOMIC COUNCIL OF CANADA, *supra*, note 95 at 5-6.

longer a sufficient means of managing Canada's most important relationship[121]. At the same time, the Royal Commission on the Economic Union and Development Prospects for Canada (commonly known as the "Macdonald Commission") recommended bilateral free trade as well[122].

Because the linkages between Canada and the U.S. are very comprehensive and complex, this inter-dependence between the two nations must be considered truly unique in the international system. For Canada, the FTA provided many benefits in its relationship with the U.S[123]. It incorporated into a bilateral agreement the rights and protection afforded each country by the GATT and it defined those commitments[124]. Without doubt, free trade with the U.S. has been seen to provide viable opportunities to increase the overall efficiency and productivity of Canadian industry[125].

From a policy-making perspective, the FTA generally did not require Canada to carry

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121 CANADA, Secretary of State for External Affairs, *Competitiveness and Security: Directions for Canada's International Relations* (Ottawa, Ont.: Minister of Supply and Services Canada, 1985) at 30-33.

122 Established in 1983 by the Liberal government, the Commission released a voluminous study on long-term economic prospects and challenges for Canada. See CANADA, *Royal Commission on the Economic Union and Development Prospects for Canada* (Ottawa, Ont.: Minister of Supply and Services Canada, 1985). In 1985, the newly elected Mulroney government accepted the report which offered a "vision of a future agreement [that] was simultaneously bolder and more conservative than the 1988 FTA, depending on the provisions at issue". G.B. DOERN & B.W. TOMLIN, *The Free Trade Story: Faith & Fear* (Toronto, Ont.: Stoddart, 1991) at 56. Apart from the Macdonald Commission, several other private groups endorsed the concept of free trade. MORICI, *supra,* note 110 at 54.

123 Having been one of Canada's biggest supporter of the FTA, the Province of Quebec has largely benefited from free trade. "Free-Trade Agreement Helped Quebec Most, Study Suggests: Province's Exports to U.S. Have Surged Since 1989" *The [Toronto] Globe and Mail* (26 July 1994) A4. At the outset, it was predicted that the eastern and western provinces would perhaps gain more than Ontario and Quebec. ECONOMIC COUNCIL OF CANADA, *supra*, note 95 at 24.

124 For a complete summary of the FTA, see, *e.g.*, P. MORICI, *The Canada-U.S. Free Trade Agreement*, (1989) 3:4 Int'l Trade J. 25.

125 See, *e.g.*, CANADA, Department of Finance, *The Canada-U.S. Free Trade Agreement: An Economic Assessment* (Ottawa, Ont.: Minister of Supply and Services Canada, 1988) at 3. Amongst other things, the FTA provides more secure access to the U.S. as "Canadians wanted to be sure that when they invested to serve the North American market they would not be subject to the whims of American courts and regulators." S. REISMAN, "The Nature of the Canada-U.S. Free Trade Agreement" in M.G. SMITH & F. STONE, eds, *Assessing the Canada-U.S. Free-Trade Agreement* (Toronto, Ont.: Institute for Research on Public Policy, 1987) 41 at 44.

out major modifications in its traditional regulatory instruments. Particularly in an area such as financial services, it was established that most existing practices in both Canada and the U.S. should remain in force[126]. However, future changes in laws and regulations have been subject to the national treatment principle. As we will see, this has led to increased substantial harmonization of Canadian and U.S. policies in numerous areas including the ones affecting the securities industry.

4. The North American Free Trade Agreement: A Challenge from the South

NAFTA is not just a simple trade agreement[127]. Besides being designed to increase trade and investment, it aims to create economic opportunities in various sectors including the financial services industry[128]. Overall, NAFTA helps make a more efficient use of North American resources while favouring competitive market forces[129]. However, it also helps bring in a new player to the trade game — Mexico.

4.1 Background and Rationale for a NAFTA

The FTA has played an indirect role in the creation of NAFTA[130]. Though a provision of the FTA stipulates the right of either Party to enter into other free trade agreements[131], the Canada-U.S. deal was designed as a bilateral agreement. As

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126 MORICI, *supra*, note 110 at 78 n. 13.

127 "NAFTA is neither a piece of domestic legislation design to create jobs nor a mere agreement designed to foster trade among three nations. NAFTA is carefully conceived foreign policy product [...]". J. SIMSER, *Financial Services Under NAFTA: A Starting Point*, (1995) 10 B.F.L.R. 187 at 188. Also, see generally M. DELAL BAER & S. WEINTRAUB, eds, *The NAFTA Debate: Grappling with Unconventional Trade Issues* (Boulder, Co: Rienner, 1994). J. BEAUJEU-GARNIER, *Le continent nord-américain à l'heure de l'ALÉNA*, 2nd ed. (Paris: SEDES, 1994).

128 R.W. FOLSOM & W.D. FOLSOM, *Understanding NAFTA and its International Business Implications* (New York, N.Y.: Matthew Bender Irwin, 1995) at 32.

129 D.C. ALEXANDER, *The North American Free Trade Agreement: An Overview*, (1993) 11 Tax & Bus. Law. 48 at 48.

130 B.W. TOMLIN, *The Stages of Prenegotiation: The Decision to Negotiate North American Free Trade*, (1989) 44 Int'l J. 254 at 254.

131 FTA, Article 104 para. 1. Thus, either country could negotiate its own FTAs with third countries. R.G. LIPSEY & M.G. SMITH, "The Canada-U.S. Free Trade Agreement: Special Case or Wave of the Future?" in SCHOTT, ed., *supra*, note 112, 317 at 325-328.

opposed to NAFTA, the extension of the FTA to other Parties was not included in the Agreement[132]. Its aim was limited specifically to trade measures of Canada and the U.S. A decade ago, FTA with Mexico was not even foreseeable[133]. However, the successful negotiation of the FTA by Canada and the U.S. provided inspiration for Mexico to pursue the same in light of its own new liberalized policies[134].

At first, when the idea emerged in Mexico, the agreement sought was of a bilateral nature with the U.S.[135]. Preliminary studies[136] led to the official endorsement of "a

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132 NAFTA, Article 2205. The existence of this clause has led some authors to say that NAFTA is like a living tree "planted in North America but capable of growing into Central and South America." R.G. DEARDEN, D. PALMETEER, "The "Living Tree" of NAFTA" *CCH NAFTA WATCH* (19 January 1994) 1 at 1.

133 As recently as 1984, American businessmen in Mexico anticipated that in the future, the country would be integrated with Central America. A partnership with the U.S. did not even appear to be a possibility. I. TRIGUEROS, "A Free Trade Agreement Between Mexico and the United States" in SCHOTT, ed., *supra,* note 112, 255 at 258. G.B. BLAKE, "Mexico in the Year 2000" in J.H. CHRISTIAN, ed., *Business Mexico,* (Mexico City: American Chamber of Commerce of Mexico, 1984) at 207. C.H. LEE, "Mexico and Regional Economic Integration" in CHRISTIAN, ed., *Ibid.*, at 213.

134 For an overview of NAFTA's negotiations, see generally L. WAVERMAN, *Negotiating and Implementing a North American Free Trade Agreement* (Vancouver, B.C.: Fraser Institute, 1992). T.H. WILSON & R.R. MEARS, *Let the Games Begin: the Tough Road Ahead of the North American Free Trade Agreement Negotiations,* (1992) 27 Texas Int'l L.J. 865. *The North American Free Trade Agreement: In Whose Best Interest?,* (1992) 12 Nw. L. & Bus. 536.

135 Canada has been aware of this possibility since the beginning, as it participated as an observer to meetings between the Mexicans and the Americans. Canada did not show at first, great interest in the Mexico-U.S. FTA. On the question of a possible free trade agreement between the U.S. and Mexico, and its potential impact on Canada, as debated in the Parliament of Canada, see CANADA, House of Commons, *Minutes of Proceedings and Evidence of the Standing Committee on External Affairs and International Trade,* Issue N° 76, (12 and 13 December 1990) (sixth report of the Committee to the House); Issue N° 71, (7 November 1990); Issue N° 69, (5 November 1990); Issue N° 68, (1 November 1990); Issue N° 66, 23 October 1990); Issue N° 63, (19 October 1990); Issue N° 61, (9 October 1990); Issue N° 59, (28 September 1990); Issue N° 58, (27 September 1990); Issue N° 56, (18 June 1990) at 4-18, 23-25. CANADA, Senate, *Proceedings of the Standing Senate Committee on Foreign Affairs,* Issue N° 33, (23 October 1990); Issue N° 31, (12 June 1990); Issue N° 26, (28 May 1990).

136 On the prospects for and potential of a U.S.-Mexico FTA, as debated in the U.S., see HOUSE OF REPRESENTATIVES, Hearings before the Committee of Ways and Means (Subcommittee on Trade), 14 & 28 June 1990, *Congressional Information Service* 91H781-10, 438p. UNITED STATES INTERNATIONAL TRADE COMMISSION, *The Likely Impact on the United States of a Free Trade Agreement with Mexico.* Report to the Committee on Ways and Means of the House of Representatives and to the Senate Finance Committee, Publication 2353 (Washington, D.C.: United States International Trade Commission, 1991). In addition, see T. WU & N. LONGLEY, *A U.S.-Mexico Free Trade Agreement: U.S. Perspectives,* (1991) 25:3

comprehensive bilateral FTA as the best vehicle to strengthen bilateral economic relations and meet the challenge of international competition" in Washington, D.C. in the Summer of 1990 by then Presidents Bush and Salinas[137]. This Agreement, following the previous example of the FTA, would include the gradual elimination of tariff and non-tariff trade barriers, clear and binding protection of intellectual property rights, the means to expand investment trade and services and the establishment of a dispute resolution mechanism. At that time, Canada showed its interest and joined in the negotiations. These discussions set the stage for a possible NAFTA. The American Congress allowed the NAFTA to be negotiated through the "fast track procedure"[138]. This was in order to guarantee the other Parties to the negotiations that a vote on the Agreement would be held within a fixed period of time without amendments.

After numerous high level encounters and negotiating sessions, each party proposed a NAFTA text in 1991. The aim was to reach an agreement before May 1992, since that would be the deadline for Congress to start the "fast track" adoption of the NAFTA[139]. After that time, the U.S. Presidential election process would hamper all other activities. None of the negotiating teams were willing however to let the May 1992 deadline impinge upon the need to achieve a balanced and beneficial agreement. Parallel to these talks, it was agreed that discussions would be held on labour and environmental issues[140]. In the end, NAFTA was signed by the Canadian

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J.W.T. 5.

137 Text of a letter from the President to the Chairman of the Senate Committee on Finance and the Chairman of the House Committee on Ways and Means dated 25 September 1990 as *reprinted in* R.G. DEARDEN & D. PALMETEER, eds, *Free Trade Law Reporter* (Don Mills, Ont.: CCH Canadian, 1989) at 70,1001 para. 95-101 (loose-leaf). Letter from President Salinas de Gortari to President Bush, *Ibid.* at 70,105 para. 95-105.

138 *Omnibus Trade and Competitiveness Act of 1988*, Pub. L. N° 100-418, 102 Stat. 1107 (Est. Supp. 1989), §§ 2902, 2903, May 24, 1991. H. BELLO & A.F. HOLMER, *"The Fast Track" Debate: a Prescription for Pragmatism*, (1992) 26 Int'l Law. 183.

139 G.N. HORLICK & M.A. MEYER, *Fast Track Authority — The Key to Successful Trade Negotiations*, (1991) 4:3 Canada-U.S. Trade 25 at 25.

140 See, *e.g.*, J. LEMCO & W.B.P. ROBSON, eds, *Ties Beyond Trade: Labour and Environmental Issues under NAFTA* (Toronto, Ont.: Canadian-American Committee, 1993). K.J. READY, "NAFTA: Labour, Industry, and Government Perspectives" in M.F. BOGNANNO & K.J. READY, eds, *The North American Free Trade Agreement: Labour, Industry, and Government Perspectives* (Westport, CT: Praeger, 1993) 3.

Prime Minister and the Presidents of the U.S. and Mexico on December 17, 1992[141]. However, the Agreement's approval process was not easy[142]. The fact that the negotiations were trilateral rendered consensus that much more difficult to achieve. In the negotiations leading to the FTA, the bargaining was done face to face between the U.S. and Canada. Concessions to the other Party were made on the basis of what the first could offer in return. NAFTA changed the picture by bringing Mexico into the negotiating room. In this context, each Party was either an ally or an adversary. The gains of one did not necessarily correspond to the concessions of the other. This rendered the balancing of interests among the three countries much more difficult.

These trilateral regional negotiations were taking place concurrently with the multilateral trade negotiations of the Uruguay Round of the GATT. The evolution of these world negotiations (which lasted seven years) directly affected the nature of both the FTA and NAFTA and *vice versa*[143]. The FTA was partially constructed on the basis of the GATT as it integrated the GATT's principles in its provisions[144]. A similar inter-connection existed between GATT and NAFTA[145].

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141 "The NAFTA Signing in Three Capitals" *The Free Trade Observer* (January 1993) 662. Also, see generally, C. O'NEAL TAYLOR, *Fast Track, Trade Policy, and Free Trade Agreements: Why NAFTA Turned Into a Battle*, (1994) 28 Geo. Wash. J. Int'l L. & Econ. 1. P. HAYDEN, *NAFTA in Effect as of January 1, 1994*, (1994) 12:11 Legal Alert 97.

142 The U.S. Congress narrowly approved NAFTA. See, *e.g.*, "NAFTA Approved by Congress" *CCH NAFTA WATCH* (January 1994) 1. For his part, the newly elected Prime Minister proceeded with implementing NAFTA after having secured a series of improvements requested by the Liberal Party of Canada during the 1993 federal election campaign. "Canada to Proceed With Proclamation of NAFTA" *The Free Trade Observer* (December 1993) 854. On the prospects following a NAFTA failure, see, *e.g.*, CONFERENCE BOARD OF CANADA, *North American Outlook: 1993-1994*, Report Number 1046 (Ottawa, Ont.: Conference Board of Canada, 1994) at 25-30.

143 According to the Counsellor on Economic Affairs at the U.S. Embassy in Canada, "[i]t is [...] noteworthy to recognize the role of the U.S./Canada Free Trade Agreement and NAFTA in the successful completion of the Uruguay Round." M.L. CASSE, *Assessing the Uruguay Round— The U.S. Perspective*, (1994) 7:2 Int'l Econ. L. Soc. Bulletin 8 at 8.

144 S. HACKETT, *United States-Canada Free Trade Agreement: An Introduction to the Free Trade Agreement and the Investment Provisions of Chapter 16*, (1989) 27 U. Det. L. Rev. 283 at 285. See also I. BERNIER, *L'Accord du libre-échange annoté*, (Cowansville, Que.: Yvon Blais, 1990). This monograph establishes a cross reference of the provisions of the FTA and NAFTA to those of the GATT and the relevant jurisprudence.

145 See FTA, Articles 407, 501, 602 and 807.

The aim of NAFTA has been to build an agreement similar in form and scope to the FTA which is suitable for North America. Except for certain residual elements (like some contained in the financial services Chapter), the FTA was integrated into NAFTA and thus, for all intents and purposes, repealed[146]. Maintaining two separate agreements would have led to severe legal difficulties in the field of dispute resolution to name only one potential problem area. For this reason, the main elements of the FTA such as national treatment, investment, financial services, dispute resolution mechanism, etc. were liberalized further or integrated into NAFTA. As with the FTA[147], the Parties agreed that such an Agreement had to respect the principles of Article XXIV of the GATT relating to the establishment of free trade zones[148].

4.1.1 Mexico's Rationale

The NAFTA negotiations were the direct result of Mexico's change of policy towards the international trade regime and its subsequent results[149]. This new policy led to

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146 Since January 1st, 1994, the FTA has been suspended and will remain so, as long as Canada and the U.S. are Parties to NAFTA. Still, rather than being replaced, many provisions contained in the FTA have been incorporated by reference in NAFTA. These FTA provisions remain therefore in force, notwithstanding the coming into force of NAFTA. In the Financial Services Chapter, Annex 1401.4 mentions that Article 1702 paras. 1 and 2 of the FTA is incorporated and made a part of NAFTA. B. APPLETON, *Navigating NAFTA: A Concise Guide to the North American Free Trade Agreement* (Scarborough, Ont.: Carswell, 1994) at 21. I. BERNIER & S. DUFOUR, *NAFTA's Impact on the FTA*, (1994) 4:1 FTU 1 at 1-2. M. SMITH, "The North-American Free Trade Agreement: Global Impacts" in ANDERSON & BLACKHURST, eds, *supra,* note 63, 83 at 85.

147 FTA, Article 101. On the relation between the FTA and GATT, see J.-G. CASTEL, "Consistency of the Canada-U.S. Free Trade Agreement with Article XXIV of the General Agreement on Tariffs and Trade" in M. GOLD & D. LEYTON-BROWN, eds, *Trade-Offs on Free Trade: The Canada - U.S. Free Trade Agreement* (Toronto, Ont.: Carswell, 1988) 47. M.M. HART, *GATT Article XXIV and Canada-United States Negotiations*, (1987) 1 R.I.B.L. 317. Note that prior to the signing of NAFTA, the FTA was assessed by the GATT in view of Article XXIV. I. BERNIER, *Le GATT et les arrangements économiques régionaux: le rapport du groupe de travail sur l'Accord du libre-échange entre le Canada et les États-Unis*, (1992) 33 C. de D. 313.

148 NAFTA, Article 101. L. PERRET, "Canada, NAFTA and Beyond" in LACASSE & PERRET, eds, *supra,* note 75, 3 at 7.

149 C.A. HEREDIA, *NAFTA and Democratization in Mexico*, (1994) 48 J. Int'l Aff. 13 at 15. R.G. CLARK, "The State of the NAFTA Negotiations" in LACASSE & PERRET, eds, *supra,* note 75, 105 at 114. C.A. VEGA, "A Mexican Assessment of the North American Free Trade Agreement Negotiations: Issues and Prospects" in R.E. GREEN, ed., *The Enterprise for the Americas Initiative: Issues and Prospects for a Free Trade Agreement in the Western Hemisphere* (Westport, CT: Praeger, 1993) 67 at 67. J.A.

an immediate increase in trade between Mexico and the U.S. through the booming *maquiladora* industries[150] and increased U.S. investments[151]. Since 1982, the importance of oil as a percentage of Mexico's export income decreased dramatically[152]. With a proportional increase of the export of non-oil products, a higher dependence was created on access to the U.S. market. For Mexico, guaranteed access to its main export market through a free trade agreement was the next logical step for its new policy[153]. Thus NAFTA has been a means of continuing Mexico's economic transformation.

An important element which favoured the ratification of NAFTA was the successful framework trade agreement between Mexico and the U.S. that was signed in November 1987[154]. The framework agreement implemented a bilateral permanent consultation procedure on various issues such as trade investment and other issues of concern to both countries. Along with the increasing two-way trade, the bilateral commission was successful in strengthening the Mexico-U.S. relationship. As a result of these consultations, bilateral agreements followed in the subsequent years on the

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McKINNEY, "Mexico in a North American Free Trade Area" in K. FATEMI, ed., *North American Free Trade Agreement: Opportunities and Challenges* (New York, N.Y.: St. Martin's Press, 1993) 134 at 135. L. RUBIO, "The Rationale for NAFTA: Mexico's New "Outward-Looking" Strategy" *Business Economics* (April 1993) 12 at 13.

150 The *maquiladoras* are manufacturing plants that assemble components imported tax-free for re-export. The chief lure is cheap labour. See, *e.g.*, R. CRANE, "Trade Liberalization and the Lessons of the Mexican Maquiladora Program" in GREEN, ed., *supra,* note 149 at 83.

151 For an account of the unilateral Mexican trade liberalization and the subsequent relations which developed with the U.S. see, *e.g.*, S. WEINTRAUB *[et al.], U.S.-Mexico Industrial Integration — The Road to Free Trade*, (Boulder, CO: Westview, 1990). The possibility for a free trade agreement between the U.S. and Mexico had been rarely addressed before given the Mexican economic policy. See, *e.g.*, S. WEINTRAUB, *A Free Trade Agreement Between the U.S.A. and Mexico?* (Washington, D.C.: Brookings Institute, 1985).

152 S.J. RANDALL, *Oil Industry Development and Trade Liberalization in the Western Hemisphere*, (1993) 14 Energy Journal 101 at 103. "A Sacred Limping Cow" *The Economist* (15 May 1993) 50.

153 "For Mexico, the main rationale of the NAFTA lies in the investment dimension perhaps more than on trade liberalization. A relatively stable access to the U.S. market will encourage long-term investment and will help to attract foreign capital into Mexico." S. LOIZIDES & G. RHÉAUME, *The North American Free Trade Agreement: Implications for Canada*, Report 99-93 (Ottawa, Ont.: Conference Board of Canada, 1993) at 17.

154 *Framework Trade and Investment Agreement, reprinted in* (1988) 28 I.L.M. 438. M.G. SMITH, *The U.S.- Mexico Framework Agreement: Implications for Bilateral Trade*, (1988-89) 20 L. & Pol. Int'l Bus. 655.

aforementioned issues[155].

Mexico accepted Canada as part of the deal since President Salinas, with a long term perspective, was of the opinion that it was in the interest of both countries to be part of a same agreement with the U.S. and not two different agreements. That possibility could have led to a series of bilateral FTA's between the U.S. and other Latin American countries to the detriment of third Parties to such agreements. Also, a foreign investor might have found that by locating in the U.S. he could reap the benefits of serving three markets rather than two[156].

Overall, Mexico has a series of short term, medium term and long term expectations[157]. In the long term, NAFTA constitutes leverage for Mexico's social development (not in terms of aid) but rather by virtue of increased trade. In the medium term, Mexico seeks to participate to a greater extent in world commerce. Finally, its short term aspirations are to build a new kind of relationship with the U.S. (and simultaneously, with Canada). In this context, NAFTA may have been responsible for the fact that Mexico recently joined the OECD[158].

4.1.2 United States' Rationale

For the U.S., the desire to secure investments in Mexico was perceived as attainable under NAFTA[159]. Most Americans found in Mexico's trade proposal great optimism

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155 See, *e.g.*, *Trade and Investment Facilitation Talks, reprinted in* (1990) 29 I.L.M. 36. *Joint Committee for Investment and Trade*, (1990) 29 I.L.M. 40. See also R. SANDOVAL, *Mexico's Path Towards the Free Trade Agreement with the U.S.*, (1991) 23 U. of Miami Inter-Am. L. Rev. 133. J. SILVA & R.K. DUNN, *A Free Trade Agreement Between the United States and Mexico: The Right Choice?*, (1990) 27 San Diego L. Rev. 937.

156 P. MORICI, "Facing Up to Mexico" in K. FATEMI, ed., *North American Free Trade Agreement: Opportunities and Challenges* (New York, N.Y.: St. Martin's Press, 1993) 145 at 147.

157 P.G. OLIVERA, "What Do Mexicans Expect From NAFTA?" *CCH NAFTA WATCH* (26 May 1994) 7.

158 "Mexico Finalizes OECD Membership" *CCH NAFTA WATCH* (14 July 1994) 8.

159 See generally, E.H. FRY & L.H. RADEBAUGH, eds, *Investment in the North American Free Trade Area: Opportunities and Challenges* (Provo, Utah: David M. Kennedy Centre for International Studies, Brigham Young University, 1992). J.H. BELLO & A.F. HOLMER, *Reflections on the NAFTA as a Turning Point in American Foreign Policy*, (1994) 28 Int'l Law. 425.

for their economic and political futures[160]. Economic growth in the U.S. has been predicted by many current studies, as a result of trade liberalization with Mexico[161]. The growing significance of American exports to Mexico has created an opening for a comprehensive trade and investment agreement[162]. Under NAFTA, the U.S. has enlarged its market opportunities in a country where American goods and services are fashionable and has secured access for investment in a rapidly growing economy[163]. In the long run, a prosperous Mexico could indirectly support American economic growth[164]. Moreover, extending the U.S. foreign policy through economic ties with Mexico might serve U.S. political interests[165]. A NAFTA seemed to be only the beginning of a southward expansion of the trade agreement to other Latin American countries for the U.S. By including Canada at the beginning of the process, the door was open to ongoing expansion of the Agreement in pursuit of greater markets[166]. Closer continental economic cooperation would provide the Americans

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160 U.S. DEPARTMENT OF COMMERCE, INTERNATIONAL TRADE ADMINISTRATION, *North American Free Trade Agreement–Generating Jobs for Americans* (Washington, D.C.: U.S. Dept. Commerce, May 1991) at 3ff. See also P. TOWNLEY, "The Business Outlook and the Realities of the North American Free Trade Agreement" *Executive Speeches* (Oct/Nov 1992) 27. C. BEIGIE, *The Anticipated Economic Effect of a North American Free Trade Area on Business in the North American Context*, (1987) 12 Can.-U.S. L.J. 83.

161 For a list of studies see, J.A. McKINNEY, "Potential Effects of NAFTA on U.S. Economy" *Baylor Business Review* (Spring 1993) 29.

162 Opponents of NAFTA have maintained that the Agreement was designed to protect American investors. J. FAUX, "The NAFTA Illusion" *Challenge* (July/August 1993) 4. For a list of other arguments against NAFTA, see, *e.g.*, "Eat Your NAFTA" *The Economist* (13 November 1993) 15.

163 See generally, "Happily Ever NAFTA?" *World Trade* (April 1994) 64. R.A. PASTOR, *Integration with Mexico: Options for U.S. Policy* (New York, N.Y.: Twentieth Century Fund, 1993). J.R. ESPANA, "Impact of the North American Free Trade Agreement (NAFTA) on U.S.-Mexican Trade and Investment Flows" *Business Economics* (July 1993) 41.

164 See, *e.g.*, "After NAFTA" *The Economist* (20 March 1993) 71. USITC, *The Likely Impact on the United States of a Free Trade Agreement With Mexico*, Publication N° 2353, (Washington, D.C.: USITC, 1991) at 2-2ff.

165 J.G. CASTANEDA, "Can NAFTA Change Mexico?" *Foreign Affairs* (Sept./Oct. 1993) 66 at 69. B. HAMEL, *Le nouvel ordre international et la politique commerciale des État-Unis: quelques développements récents*, Cahier de recherche 91-3, Groupe de recherche sur la continentalisation des économies canadiennes et mexicaines (Montreal, Que.: UQAM, 1991) at 2. S. WEINTRAUB, *A Marriage of Convenience — Relations Between Mexico and the United States*, (New York, N.Y.: Oxford University Press, 1990) at 206.

166 On the greater intentions of the U.S., see generally, M. FRECHETTE, *Hemispheric Free Trade: Building on the NAFTA–A U.S. Perspective*, Studies on the Economic Future of North America (Vancouver, B.C.: Fraser Institute, 1993). PROULX, ed.,

with an opportunity to develop their own trading bloc[167].

4.1.3 Canada's Rationale

Historically, the lack of trade with Mexico was due in part to the lack of knowledge and awareness of Canadians about Mexico for purposes other than tourism[168]. This misperception has changed rapidly with the signing of NAFTA. Mexico's opening of its economy has increased its economic ties with Canada[169]. At the same time that free trade talks between the U.S. and Mexico began, bilateral trade agreements were concluded in the early 1990s between Canada and Mexico[170]. These agreements provided a legal framework for the increasing ties and also established the basis for closer cooperation.

Canada was more cautious in its approach to NAFTA, announcing on September 24, 1990[171] that it would participate in preliminary discussions with Mexico and the U.S.

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supra, note 84.

167 "Except for Brazil and Mexico, most Latin American countries stand to gain less from free trade agreements (FTAs) with the U.S. than the U.S. stands to gain from FTA's with them. The main incentive for the Latin American countries to form FTAs with the United States may be to attract investment or to halt the spread of new trade restrictions. Latin American countries do probably stand to benefit long-term export benefits from reduced trade barriers among themselves". R. ERZAN & A. YEATES, *Free Trade Agreements with the United States–What's is it for Latin America?,* Working Paper WPS 827 (Washington, D.C.: World Bank, 1992) 12.

168 R.R. BARACIO, "Mexico's Economic Reform and Business Perspectives with Canada" in LACASSE & PERRET, eds, *supra,* note 78 at 140-141. Note that during the 1970s, some studies gave significant consideration to Canadian relations with Mexico and the rest of Latin America. CANADA, *Foreign Policy for Canadian: Latin America* (Ottawa, Ont.: Queen's Printer, 1970). C.I. BRADFORD, Jr. & C. PESTIEAU, *Canada and Latin America: The Potential for Partnership* (Toronto, Ont.: Canadian Economic Policy Committee of the Private Planning Association of Canada, 1970). However, no sustained efforts were made to facilitate these trade relations.

169 On Canadian economic ties with Mexico, see generally, J. SINCLAIR, ed., *Crossing the Line: Canada and Free Trade with Mexico* (Vancouver, B.C.: New Star Books, 1992).

170 "Canada and Mexico Conclude Bilateral Agreements" (16 March 1990) as *reprinted in* DEARDEN & PALMETEER, eds, *supra,* note 137 at 70,811 para. 96-021.

171 International Trade Minister Crosbie Announces Canada to Participate in Free Trade Talks with Mexico and the United States (24 September 1990) as *reprinted in* DEARDEN & PALMETEER, eds, *supra,* note 137 at 70,125 para. 95-121. Statement to the House of Commons Standing Committee on External Affairs and International Trade, by Honourable John Crosbie, Minister for International Trade Regarding Canada's Participation in North American Free Trade Talks with Mexico and the

to establish the basis for subsequent negotiations on a trilateral FTA[172]. Canada's approach was seen at first as an element of delay by both the Mexicans and the Americans[173]. Mexican negotiators felt unsure of the role Canada would play in the negotiations[174]. Canada and Mexico have common interests, in the field of energy for example, but also compete for the same export market. Mexicans believed that Canada's pursuit of its interests and its desire to preserve the FTA would not make for a strong ally in the negotiation process[175]. With some effort, Canada nevertheless managed to gain its place at the negotiating table[176].

Canada decided to officially join the negotiations February 5, 1991[177] to participate

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United States, *Ibid.* at 70,131 para. 95-131.

172 On the reasons behind Canada's decision to join the free trade preliminary discussions, see, *e.g.*, B.C. SWICK-MARTIN, *Canada-U.S.-Mexico Free Trade*, (1990) 3:10 Canada-U.S. Trade 73. Apprehensions by Canadians concerned the extent to which the trade regimes of the three countries involved would have to be adjusted in order to reach a trilateral accord. See generally, M. HART, *A North American Free Trade Agreement: The Strategic Complications for Canada* (Halifax, N.S.: Institute for Research on Public Policy, 1990).

173 M.W. GORDON, *Economic Integration in North America–An Agreement of Limited Dimensions But Unlimited Expectations*, (1993) 56 Modern L. Rev. 157 at 164. R. WONNACOTT, *Canada's Role in the U.S.- Mexico Free Trade Negotiations*, (1992) World Economy 79 at 81. MORICI, *supra*, note 110 at 151.

174 M.A. CAMERON, L. EDEN & M. APPEL MOLOT, "North American Free Trade: Co-operation and Conflict in Canada - Mexico Relations" in O. HAMPSON & C. MAULE, eds, *Canada Among Nations 1992-93, A New World Order?* (Ottawa, Ont.: Carleton University Press, 1992) 174 at 176.

175 After the signing of NAFTA, President Salinas admitted that "Canada's advice on how to negotiate with the [U.S.] was invaluable in closing deal". J. RIVERA DE LOS REYES, "Mexico and Free Trade Agreements With Latin American Countries" in LACASSE & PERRET, eds, *supra*, note 75, 107 at 113.

176 On Canada's perception of the coming negotiations at the time, see generally, T. THOMAS, *Free Trade Negotiations between Mexico, Canada and the United States*, Research Document LP-234E (Ottawa, Ont.: Library of Parliament, Economics Division 1990). The participation of Canada in the negotiations was not easily granted. Further the role to be played by Canada at the negotiating table was seriously questioned. See, *e.g.*, R.G. LIPSEY, *Canada and the U.S. at the U.S. - Mexico Free Trade Dance: Wallflower or Partner?*, Commentary N° 20, (Toronto, Ont.: C.D. Howe Institute, 1990).

177 "Joint Communique — President Bush, President Salinas and Prime Minister Mulroney" (5 February 1991) *as reprinted in* DEARDEN & PALMETEER, eds, *supra*, note 137 at 70,155 para. 95-151. More specifically, see "Statement by the Minister for International Trade, John C. Crosbie on Canada-U.S.-Mexico Free Trade Negotiations" (5 February 1991) *Ibid.* at 70,165 para. 95-171.

fully in the foundation of NAFTA[178]. This decision was not taken wholeheartedly by Canada[179]. The dominant impression is that it was a choice between the lesser of two evils[180]. Again, the decision by the Canadian federal government to negotiate NAFTA led to another emotionally charged national debate[181]. At the federal level, the Liberal Party of Canada (the then official opposition) said that, if elected, it would renegotiate the FTA as well as certain aspects of NAFTA[182]. For its part, the New Democratic Party vowed to fight the Agreement[183]. Provincially, Quebec was fully in favour of NAFTA[184]. However, Ontario was opposed to the deal[185].

Canada's main objectives at the NAFTA negotiations were to secure better access to

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178 The three main reasons why Canada became a full-fledged participant in the negotiations were: (i) to build on the gains achieved in the FTA; (ii) improve access to the Mexican market; and (iii) enjoy the gains from a more liberalized trade regime. *Canada Will Join United States and Mexico in Negotiations for Free Trade Agreement*, 8 Int'l Trade Rep. (BNA) (6 February 1992) 184.

179 The basis for this decision can be found in CANADA, *Canada and a Mexico – United States Trade Agreement* (Ottawa, Ont.: Working Paper prepared by the International Trade and Finance Branch at the Department of Finance, July 1990).

180 Repeatedly in studies, one of the stated factors justifying Canada's decision to participate in the trade negotiations was that Canada did not have much choice. See, *e.g.*, HART, *supra*, note 76 at 77ff. Some studies supported the assertion that the NAFTA was a much less compelling policy issue for Canadians than was the FTA. See, *e.g.*, G. RITCHIE, *Beyond the Volcano: Canadian Perspective on Trilateral Free Trade*, (1991) Colum. J. of World Bus. 84. Finally, it was said that Canada's principal aim in joining the negotiations was to prevent any dilution of the gains made in the FTA. See, *e.g.*, R. CUERVO-LORENS, *Canada-U.S.-Mexico Free Trade*, (1991) 4:4 Canada-U.S. Trade 26 at 27.

181 The federal government furiously battled the opposition to NAFTA. See, *e.g.*, P. MORTON, "Tory "Slang" Takes Aim at NAFTA Foes" *The Financial Post [of Toronto]* (15 September 1992) 3.

182 "Liberal Party Says it will Renegotiate NAFTA if Elected" *The Free Trade Observer* (September 1993) 806. "Canada's Liberal Party Vows to Renegotiate FTA and NAFTA if Elected" *The Free Trade Observer* (January 1993) 664. "Chrétien Vows to Renegotiate FTA" *The Free Trade Observer* (February 1992) 455.

183 "Parliament Starts Debate on NAFTA – NDP Vows to Fight" *The Free Trade Observer* (November 1992) 632.

184 "Quebec Finds NAFTA Efforts Fruitful" *The Free Trade Observer* (March 1993) 702. "Quebec Plans to Support NAFTA" *The Free Trade Observer* (February 1993) 678.

185 ONTARIO, *Report of the Ministerial Committee Examining North American Free Trade* (Toronto, Ont.: Queen's Printer, 1993). See also, "Ontario Cabinet Opposes NAFTA" *The Free Trade Observer* (June 1993) 745. Note that less than three months before it would come into effect, Ontario's NDP government announced it would challenge NAFTA in courts on grounds that it intrudes on provincial jurisdiction over such areas as financial services, investment services and social services. R. MACKIE, "Ontario to Challenge NAFTA in Courts" *The [Toronto] Globe and Mail* (13 October 1993) B8. However, this idea did not materialize.

the Mexican market, safeguard and improve the gains made in the FTA and maintain Canada as attractive investment location in North America[186]. For the Canadian government, all of the objectives were "fully achieved" and more as the NAFTA deal was said to be the FTA-plus[187]. Surely, Canada was better off as part of the negotiations than as a by-stander[188]. NAFTA gave a chance to Canada to improve its access to the U.S. market in the area of financial services[189]. Moreover, if Canadians had decided not to participate in the Agreement it would probably have lost in terms of investment since establishing an enterprise in the U.S. would have led to preferential market access for the U.S.-based enterprise in the two countries[190]. Further, this precedent could have isolated Canada from the southern expansion of

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186 A. NYMARK & E. VERDUN, "Canadian Investment and NAFTA" in A.M. RUGMAN, ed., *Foreign Investment and NAFTA* (Columbia, S.C.: University of South Carolina Press, 1994) 124 at 131. R.J. WONNACOTT, "Canada's Role in NAFTA: To What Degree Has It Been Defensive?" in V. BULMER-THOMAS, N. CRASKE & M. SERRANO, eds, *Mexico and the North American Free Trade Agreement: Who Will Benefit?* (New York, N.Y.: St. Martin's Press, 1994) 163 at 165.

187 "Canadian Objectives Met in NAFTA, Wilson Said" *The Free Trade Observer* (August 1992) 568.

188 On efficiency gains for Canadian industry under NAFTA, see, *e.g.*, G.R. WINHAM, *NAFTA and the Trade Policy Revolution of the 1980s: A Canadian Perspective*, (1994) 49 Int'l J. 472. S. GLOBERMAN, *Canada's Interests in North American Economic Integration*, (1993) 36 Can. Public Adm. 90 at 93ff. *The North American Free Trade Agreement: Implications for Canada*, Report 99-93 (Ottawa, Ont.: Conference Board of Canada, 1993). L. WAVERMAN, " A Canadian Vision of North American Economic Integration" in S. GLOBERMAN, ed., *Continental Accord*, (Vancouver, B.C.: Fraser Institute, 1991) 31 at 31ff.

189 R.G. CLARK, "The State of the NAFTA Negotiations", LACASSE & PERRET, eds, *supra*, note 75 at 112.

190 This approach qualified as "hub-and-spoke", would have led to the U.S. entering into a series of bilateral Free Trade Agreement with Latin American countries to the continents overall trade. It was first called the "hub-and-spoke" problem by LIPSEY, *supra*, note 176. On hub-and-spoke, see also R.J. WONNACOTT, *NAFTA: A View From Canada*, North American Forum Policy Paper 94-3 (Stanford, CA: Stanford University, 1994). R.J. WONNACOTT, "Liberalizing Trade in the Western Hemisphere: Where Do We Want to Go, and How Do We Get There?" in GREEN, ed., *supra*, note 149, 15. C. KOWALCZYK & R. WONNACOTT, *Hub and Spokes, and Free Trade in the Americas*, Research Report / Department of Economics (London, Ont.: University of Western Ontario, 1992). R.J. WONNACOTT, *The Economies of Overlapping Free Trade Areas and the Mexican Challenge*, (Toronto, Ont.: Canadian-American Committee, 1991) at 22ff. R. LIPSEY, "The Case of Trilateralism" in GLOBERMAN, ed., *supra*, note 188, 89. R.J. WONNACOTT, *Canada and the U.S.-Mexico Free Trade Negotiations*, Commentary N° 21, (Toronto, Ont.: C.D. Howe Institute, 1990). R.J. WONNACOTT, *U.S. Hub-and-Spoke Bilateral and Multilateral Trading System*, Commentary N° 23, (Toronto, Ont.: C.D. Howe Institute, 1990).

the Agreement to the tip of Argentina, should this ever happen[191]. It was in Canada's best interest to be full Party to NAFTA, face the challenge of Mexico and ensure that its interests were defended[192]. In short, for Canada and Mexico, NAFTA opened up an opportunity to create a relationship that was virtually non-existent[193].

5. A Hemispheric Integration: The Rhythm of the Future

Historically, U.S. policy with respect to some type of special relationship with Latin America has been rather mixed. On the one hand, as a member of GATT, the U.S. has generally favoured a multilateral approach in its trade relations. On the other hand, the Americans feared the establishment of a single Latin American integrated area without U.S. participation[194]. With the signing of several Latin American trading arrangements[195] and, in view of the evolution of the European market and the

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191 M.V.M. BRADFORD, "Canada, NAFTA and Its "Domino Effect" in the Americas" in LACASSE & PERRET, eds, *supra*, note 75, 97 at 105. R. CUERVO-LORENS, *NAFTA — A Canadian Perspective*, (1992) 5:3 Canada-U.S. Trade 10 at 11. A. BERRY, L. WAVERMAN & A. WESTON, "Canada and the Enterprise for the Americas Initiative: A Case of Reluctant Regionalism" *Business Economics* (April 1992) 31 at 32.

192 See, *e.g.*, R. YORK, "NAFTA's Implications for Canadian Trade Policy: A Comment" in CUSHING *[et al.]*, eds, *supra,* note 73, 159 at 166. On Canada's broad objectives during NAFTA's negotiations, see generally E.R. BRUNING, "The North American Free Trade Agreement: A Canadian Perspective" in K. FATEMI, ed., *North American Free Trade Agreement: Opportunities and Challenges* (New York, N.Y.: St. Martin's Press, 1993) 117 at 130.

193 R.G. CLARK, "Canada, NAFTA and the Americas" in LACASSE & PERRET, eds, *supra,* note 126, 87 at 90. On January 1, 1994, the Canadian government described its general approach to trade policy and the role of NAFTA in a Statement entitled *North American Free Trade Agreement: Canadian Statement on Implementation*, Canada Gazette Part I, Vol. 128, N° 1 (1 January 1994) 68. See "Canadian Statement Explains NAFTA's Role in Trade Policy" *CCH NAFTA WATCH* (2 February 1994) 2.

194 See, *e.g.*, J. RIVERA DE LOS REYES, "Mexico and Free Trade Agreements With Latin American Countries" in LACASSE & PERRET, eds, *supra,* note 75, 107. S. EDWARDS, "Latin American Economic Integration: A New Perspective on an Old Dream" *World Economy* (March 1993) 317. Also see J.W. CLARK, *Economic Regionalism and the Americas*, (New Orleans, LA: Houser, 1966) at 20ff discussing the proposals for the creation of a Latin American Common Market. V.L. URQUIDI, *Free Trade and Economic Integration in Latin American: Toward a Common Market* (Berkeley, CA: University of California Press, 1964). Eventually, the proposal was not accepted.

195 With the rejection of the proposal for the creation of a free trade area to include all Latin American economies (see discussion in the preceding footnote), many treaties were signed leading to the birth of the Central Latin American Common Market (CACM), The Latin American Free Trade Association (LAFTA) superseded by the Latin American Integration Association (LAIA), the Andean Group, MERCOSUR, the Caribbean Common Market (CARICOM), the Latin American Economic System

discussions hinting to the formation of an East Asian economic grouping, the U.S. chose to stand firmly in favour of a continental economic integration, thus setting the stage for an American Common Market[196].

The Enterprise for the Americas Initiative (hereinafter EAI) was announced by then-U.S. President George Bush in June 1990 as a new partnership for trade, investment and growth[197]. It was not merely a trade policy initiative, but a comprehensive

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(SELA) and other Latin American economic integration associations. In view of NAFTA there is a new enthusiasm about open trade among Latin American countries. See, *e.g.*, OECD, *The Benefits of Free Trade: East Asia and Latin America* (Paris: OECD, 1994). C.J. MONETA, "Latin America Facing the World Economy: Trade and Investments" in LACASSE & PERRET, eds, *supra,* note 75, 463. E. BYRNE, "Trade in the Americas" *Business Mexico* (March 1994) 80. "Patchwork: Latin American Trade" *The Economist* (15 May 1993) 85. J. GRUNWALD, "The Rocky Road Toward Hemispheric Economic Integration: A Regional Background with Attention to the Future" in GREEN, ed., *supra,* note 149, 123 at 128ff. C.I. BRADFORD Jr., *Strategic Options for Latin America in the 1990s* (Paris: OECD, 1993). J.M. ZERIO, *Southern Cone Common Market and North Atlantic Blocs (EC and NAFTA): Problems and Perspectives*, (1992) 34 Int'l Exec. 517. G. PERAZA, *Latin American and Caribbean Institutions of Integration and Zones of Free Trade*, Occasional Paper N° 22 (Ottawa, Ont.: Centre for Trade Policy and Law, 1991).

196 See generally, B. LEVY, *Globalization and Regionalization: Toward the Shaping of Tripolar World Economy?*, (1995) 37 Int'l Exec. 349. O.M. LAZIN, "Emerging World Trade Blocs: The North American Free Trade Area and the European Union Compared" in WILKIE, ed., *supra*, note 74, 1205. S. WEINTRAUB, *NAFTA: What Comes Next* (Westport, CT: Praeger, 1994). P. MORICI, "NAFTA, the GATT, and U.S. Relations with Major Trading Partners" in CUSHING *[et al.]*, eds, *supra*, note 63, 75. CONFERENCE BOARD OF CANADA, *North American Outlook*, Report N° 1000 (Ottawa, Ont.: Conference Board of Canada, 1992) at 15. J.M. ROSENBERG, *The New American Community: A Response to the European and Asian Economic Challenge* (New York, N.Y.: Praeger, 1992). A. FISHLOW & S. HAGGARD, *The United States and the Regionalisation of the World* (Paris: OECD, 1992). L. LANSING, ed., *Reshaping the North American Partnership for the 1990's: A United Europe and Competitive Pacific Rim Necessitate New Strategic Policies* (New York, N.Y.: Americas Society/Canadian Affairs, 1991). In addition, see D. KUJAWA, S.H. KIM & H.-J. KIM, "A North American Free-Trade Agreement: The First Step Toward One America" *Multinational Business Review* (Fall 1993) 12. T.A. STEWART, "The New Face of American Power" *Fortune* (26 July 1993) 70. "The Business of the American Hemisphere" *The Economist* (24 August 1991) 37.

197 On the EAI, see generally, M.R. FRECHETTE, "The Enterprise for the Americas Initiative" in LACASSE & PERRET, eds, *supra,* note 75, 27. J. PAUL, "The New Inter-American Development Policy: EAI and Its Effects on U.S.-Latin American and Caribbean Trade Relations", *Ibid.*, 43. G. FAURIOL, "The Political and Economic Effects of the Enterprise for the Americas Initiative", *Ibid.*, 73. J.J. SCHOTT & C.G. HUFBAUER, "Free Trade Areas, the Enterprise for the Americas Initiative, and the Multilateral Trading Systems" in BRADFORD Jr. & PESTIEAU, eds, *supra,* note 168, 249. E. GITLI & G. RYD, *Latin American Integration and the Enterprise for the Americas Initiative*, (1992) 26:4 J.W.T. 25. WHITE & CASE, *Progress Towards a*

economic market-oriented reform and economic growth approach towards Latin America and the Caribbean. Because trade between the U.S. and Mexico was already considerably advanced when the EAI was proposed, the measure was not intended to extend to Mexico, but was proposed with the rest of Latin America in mind, thus favouring a hemispheric integration[198].

The EAI was based on three core objectives: (i) trade; (ii) investment reforms; and (iii) debt reduction. First, the trade proposal set as a long-term goal the establishment of a comprehensive free trade zone for North, Central and South America. As an intermediate step, the proposal encouraged bilateral framework agreements[199].

Western Hemisphere Free Trade Zone, (1992) 5 C.U.B.L.R. 199. C.F. BARNUM, *Enterprise for the Americas: A New Partnership for Trade, Investment, and Growth*, (1991) 33 Int'l Exec. 47. C. GRAHAM, *The Enterprise for the Americas Initiative*, (1991) 9 Brookings Rev. 22. R.B. PORTER, *The Enterprise for the Americas Initiative: A New Approach to Economic Growth*, (1990) 32 J. Interamerican Studies & World Aff. 2. S. WEINTRAUB, *The New U.S. Economic Initiative Toward Latin America*, (1991) 33 J. Interamerican Studies & World Aff. 1. "The Enterprise for Americas Initiative - A White House Progress Report", *Business America* (15 July 1991) 10. C.B. CLARK, "The Enterprise for the Americas Initiative: Supporting a "Silent Revolution in Latin America" *Business America* (23 September 1991) 6.

198 L. PERRET, "Canada, NAFTA and Beyond" in LACASSE & PERRET, eds, *supra*, note 75, 3 at 10.

199 Since the announcement of the EAI, several Latin American countries have entered into trade and investment framework agreements with the U.S. The framework agreements provide for bilateral discussions leading to trade liberalization. Ironically, Canada joined the NAFTA talks mainly to avoid a "hub-and-spoke" relationship with the U.S. See *supra*, note 190. Hence, despite the presence of a MFN clause, NAFTA offers the possibility of three "hub-and-spoke" arrangements. C. JOLIVET, *Aperçu de la position canadienne dans les négociations de l'ALÉNA sur les services*, (1992) 5:3 C.U.B.L.J. 321 at 323. L. EDEN & N. PATTERSON, "The View from the Spokes: Canada and Mexico Face the United States" in S.J. RANDALL, H. CONRAD & S. SILVERMAN, eds, *North America Without Borders?: Integrating Canada, the United States, and Mexico* (Calgary, Alta.: University of Calgary Press, 1992) 67 at 73. Article 2205 of NAFTA provides that other countries may join NAFTA only on terms and conditions agreed by all three current members. Hence, any of the three countries could choose to begin free trade negotiations with a fourth country. Right now, Mexico has deals signed or in negotiations with many Latin American countries. "Mexico Explores Closer Ties with Latin America" *CCH NAFTA WATCH* (25 February 1994) 3. "Mexican Free Trade Expands to Latin America" *CCH NAFTA WATCH* (19 January 1994) 5. Moreover, NAFTA's accession clause is not geographically limited. Thus, a technical possibility exists for the treaty to extend to countries in the western or eastern hemisphere. V. LOUNGNARATH, *Quelques réflexions d'ordre juridique sur la clause d'adhésion de l'ALÉNA*, (1995) 40 McGill L.J. 1 at 2. M.G. SMITH, "Integration of Mexico into the North American Economies: Immediate Challenges and Longer Term Opportunities" in LACASSE & PERRET, eds, *supra*, note 78, 1 at 9. Canada has briefly examined these prospects but this perspective really appears too far away. P. MORTON, "Canada Launches Study to Examine Asia-NAFTA Links" *The Financial*

Second, the investment proposal sought to unlock the potential for domestic and foreign investment in Latin America and encourage capital flows. Third, the government-to-government debt reduction plan was an extension, on a smaller scale, of the Brady Plan, the Bush Administration's strategy to help heavily indebted countries reduce their obligations to commercial banks[200].

President Bush's general commitment to worldwide trade liberalization such as NAFTA and the EAI's trade components, appeared to be in line with previous Reagan administration policies[201]. For his part, his successor, President Clinton, had several options. The U.S. could either carry on a two-legged policy of going both with NAFTA and the GATT actively or settle on leaving NAFTA with Mexico and concentrating on multilateralism with the GATT. The former option divided into two strategies: (i) make NAFTA into a Western Hemispheric FTA; or (ii) open up NAFTA to countries anywhere[202]. President Clinton chose to make Latin America an important component of its trade policy[203].

Post [of Toronto] (29 July 1993) 3. Taiwan was the first Asian country to publicly express its desire of joining NAFTA. "Calling Poland and Taiwan" *The Economist* (13 March 1993) 19. More recently, the Japan Institute of International Affairs has suggested that the U.S. look into the possibility of agreement that would enlarge NAFTA in the manner of the East Asian Economic Caucus concept, developing in Asia in the long run. J. CHANCELLOR, "The Forces of Changes" *Across the Board: International Industrial Conference* (January 1994) 6. On Japan's desire to explore this avenue, see, *e.g., Japan, the United States, and Latin America: Toward a Trilateral Relationship in the Western Hemisphere* (Baltimore, MD: John Hopkins University Press, 1993). This option is also being considered by other Asia-Pacific countries. "Asian Nations Want Ties With NAFTA Members" *CCH NAFTA WATCH* (13 October 1994) 8. P.J. LLOYD, "A CER-NAFTA Link?" in CUSHING *[et al.]*, eds, *supra*, note 63, 225. F. HOLMES, "NAFTA, CER and a Pacific Basin Initiative", *Ibid.*, 245 at 253ff. J. MATKINS, "A North America-Pacific Accord: Options for the Future" in E.H. FRY & L.H. RADEBAUGH, eds, *The Canada/U.S. Free Trade Agreement: The Impact on Service Industries* (Provo, Utah: David M. Kennedy Centre for International Studies, Brigham Young University, 1988) 63.

200 J.S TULCHIN, "The Enterprise for the Americas Initiative: Empty Gesture, Shrewd Strategic Gambit, or Remarkable Shift in Hemispheric Relations?" in GREEN, ed., *supra*, note 149, 143 at 150ff. In 1989, the Brady Plan proved very favourable for Mexico. Overall, this led Mexico to be seen as a sounder investment to international investors. "The Brady Gamblers Win for Now" *The Economist* (13 February 1993) 19.

201 R.E. GREEN, "Introduction" in GREEN, ed., *supra*, note 149, xv at xviiiff.

202 R.D. BARTEL, "Which Way? Free Trade or Protection?" *Challenge* (January/February 1994) 17.

203 R.L. BERNAL, *From NAFTA to Hemispheric Free Trade*, (1994) 29 Colum. J. World Bus. 22.

In 1994, hoping to move beyond any framework agreements providing for bilateral discussions, the government of Chile requested to join NAFTA[204]. Formal discussions began in May 1995[205]. At that time, the U.S., Canada and Mexico started by assessing Chile's progress toward greater trade liberalization and market opening consistent with NAFTA standards. Often cited as Latin America's star economic performer, Chile has made the most progress in implementing trade and market-oriented reforms[206]. Its steady growth and low inflation rates in recent years are rare on the Latin American continent. It attracts a substantial amount of foreign investment, however, it has had an under-developed domestic capital market[207]. Nevertheless, Chile has been one of the first countries since the debt crisis to return to the "voluntary" international capital markets[208]. Private Chilean companies have also gone to the world capital markets. Thus, Chile stands to gain a great deal from NAFTA. Its addition would be an important step towards a hemispheric integration[209]. Apart from Chile, other Latin American countries may join NAFTA in

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204 "Chile: A Step Closer to NAFTA Accession?" *CCH NAFTA WATCH* (15 April 1994) 8. "Chile: Another NAFTA Party in 1994?" *CCH NAFTA WATCH* (19 January 1994) 3. M.D. ROWAT, "Future Accession to NAFTA: The Cases of Chile and the MERCOSUR" in A.R. RIGGS & T. VELK, eds, *Beyond NAFTA: An Economic, Political and Sociological Perspective* (Vancouver, B.C.: Simon Fraser Institute, 1993) 196. In 1994, Chile was singled out by the Clinton Administration as the only country the U.S. will seek a FTA in the near future. "U.S. Identifies Chile for Next Free Trade Agreement" *CCH NAFTA WATCH* (14 July 1994) 1. M. YOPPO, "The Chilean Perception of the Americas Initiative" in GREEN, ed., *supra,* note 149, 175 at 178.

205 However, note that as of the end of 1995, Chile was still waiting for President Bill Clinton to get fast-track authority from the U.S. Congress to "seriously" negotiate. In this context, Canadian federal officials are carefully considering a Canada-Chile FTA. R. CARRICK, "Canada-Chile Trade Deal Possible As NAFTA Stalls" *The [Toronto] Globe and Mail* (28 December 1995) B2. "Sleeping Giant" *The Economist* (9 December 1995) 46. D. FAGAN, "Rubin Sees No NAFTA Expansion Until 1997" *The [Toronto] Globe and Mail* (1 December 1995) B8. "Banana Republican" *The Economist* (18 November 1995) 48.

206 T.E. DICK *[et al.],* "Western Hemisphere" *Business America* (22 April 1991) 8 at 10. On Chile's recent economic performance, see generally S. de la CUARDA & D. HACHETTE, "Chile" in D. PAPAGEORGIOUS, M. MICHAELY & A.M. CHOKSI, eds, *Liberalizing Foreign Trade: The Experience of Argentina, Chile and Uruguay,* Vol. 1 (Cambridge: MA: Basil Blackwell, 1991) 169.

207 "Chile" *Euromoney World Equity Markets Supplement* (May 1993) 120.

208 For many years Chile's debt has been rated as investment grade. "The Brady Gamblers Win for Now" *The Economist* (13 February 1993) 19 at 19.

209 On a further expansion of the hemispheric economic zone, see, *e.g.,* R. BOUZAS, "Argentina, the Southern Common, and the Prospects for Success of the EAI" in GREEN, ed., *supra,* note 149 at 162.

a not so distant future[210]. In the meantime, however, these countries prepare themselves by constructing bilateral and sub-regional agreements[211].

Overall, although Latin American countries have taken giant strides towards institutionalizing democracy, market economics and hemispheric community, many problems remain to be solved[212]. For that reason, President Clinton needed to persuade the American people of their strong self-interest in the region[213]. At the Summit of the Americas, its intentions were unequivocal when he led an initiative (endorsed by all 34 Western Hemisphere nations) to conclude negotiations for a Free Trade Area of the Americas (hereinafter FTAA) by the year 2005[214] in view of creating a New American Community (hereinafter NAC)[215].

For its part, Canada was fully behind this initiative. The Liberal government in Ottawa, indicated during the course of the 1993 election campaign that it would "play an active and independent role in defining [the free trade] bloc instead of merely reacting to

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210 See, *e.g.*, "Columbia Second in Line for NAFTA Accession" *CCH NAFTA WATCH* (13 June 1994) 8. "Argentina Optimistic of NAFTA Accession ... But Ex-president Warns: Argentina Economy Not Ready" *CCH NAFTA WATCH* (15 April 1994) 8.

211 G.C. HUFBAUER & J.J. SCHOTT, *Western Hemisphere Economic Integration* (Washington, D.C.: Institute for International Economics, 1994) at 97ff. P. MELLER, "A Latin American Perspective of NAFTA" in LACASSE & PERRET, eds, *supra,* note 75, 119 at 140-141. Still, some raise doubts that NAFTA is a suitable model for many of the developing countries in the region. A. WESTON "From FTA to NAFTA — Whither Canadian Trade Policy Towards the South?, *Ibid.*, 195 at 198.

212 For example, there is a widespread dissatisfaction with the unequal benefits of economic reform, growing poverty, corruption, drug trafficking and powerful militaries. "Latin America's Challenge" *The [Toronto] Globe and Mail* (12 December 1994) A20. A.F. LOWENTHAL, "Latin America: Ready for Partnership?" *Foreign Affairs* (January 1993) 74.

213 "Congress Considers Bill to Create Western Hemisphere Free Trade Area" *CCH NAFTA WATCH* (15 April 1994) 3.

214 The negotiation process for the FTAA began with a meeting in January 1995 hosted by the OAS. In the end, this new trade zone will result in a merger of the area's five subregional trading arrangements: NAFTA, CARICOM, MERCOSUR, the Central American Common Market, and the Andean Pact. D. SMITH, "Trade Ministers Discuss FTAA" *The [Toronto] Globe and Mail* (1 July 1995) B17. "The Americas Drift Towards Free Trade" *The Economist* (8 July 1995) 35. "Hemispheric Leaders Unveil Americas Free Trade Zone" *CCH NAFTA WATCH* (15 December 1994) 1. "Summit of the Americas: U.S. Wants Focus on Trade" *CCH NAFTA WATCH* (28 October 1994) 1.

215 ROSENBERG, *supra*, note 27 at 307-308.

Washington's hub-and-spoke approach to trade in [the Western Hemisphere]"[216]. Consequently, since it gained power, Canada's Prime Minister Jean Chrétien has been aggressively pushing his policy of trying to expand its country's trade relations beyond the U.S. by widening the territorial scope of free trade and urging NAFTA partners to admit other countries[217]. As for Mexico, the election of Ernesto Zedillo as President was seen as an endorsement of NAFTA[218]. Nevertheless, there has been caution with regard to foreign investment in Mexico following the 1994 armed uprising in Chiapas, the assassination of a presidential candidate and the 1995 peso crisis. These events may also be signs of the future for the Americas.

TITLE II: TOWARDS THE EMERGENCE OF A "NORTH AMERICAN" SECURITIES BUSINESS

The Canadian financial services system has undergone a series of changes in the past few years which have served to enhance domestic competition and efficiency and to increase foreign participation. Three significant developments have been: (i) the comprehensive reform of federal and provincial services legislation (the crumbling of the four pillars); (ii) the implementation of the FTA; and (iii) the even more recent implementation of NAFTA.

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216 "Canada should be working with other countries to minimize dominance by the strongest partner. A Liberal government will work to build common Western Hemisphere institutions to provide political, demographic, and economic counterweights to the United States." LIBERAL PARTY OF CANADA, *Creating Opportunity: The Liberal Plan for Canada* (Ottawa, Ont.: Liberal Party of Canada, 1993) at 25.

217 In recent months, the Canadian Prime Minister expressed his opinion at the Asia-Pacific Economic Conference [hereinafter APEC], the Summit of the Americas, during a trip to Latin America and even in Europe (where he called for a possible association of the EU and NAFTA countries). D. FAGAN, "Free Trade with U.S. Hailed by New Study" *The [Toronto] Globe and Mail* (1 December 1995) B2. "Canada Explores Free Trade With EU" *CCH NAFTA WATCH* (29 December 1994) 8. J. SALLOT, "Forging Links to Global Economies: Chrétien Has Moved a Long Way Toward His Trade Minister's Ideas About Open Markets" *The [Toronto] Globe and Mail* (9 December 1994) A7. M. DROHAM, "Free-trade Talk Baffles Experts: Europeans Wonder Why Chrétien is Pushing NAFTA" *The [Toronto] Globe and Mail* (3 December 1994) A12. P. MARTIN, "Canada, Israel Talking Free Trade" *The [Toronto] Globe and Mail* (25 November 1994) A1. "A Dream of Trade" *The Economist* (19 November 1994) 35. "Canada Calls for Fast Expansion of NAFTA" *CCH NAFTA WATCH* (13 October 1994) 1.

218 "Zedillo Victory Strengthens NAFTA's Future" *CCH NAFTA WATCH* (15 September 1994) 1.

CHAPTER I: The Changing Face of the Canadian Securities Industry – Impact of the Liberalization of Financial Services on the Canadian Regulatory Provisions Governing the Industry

The existing framework of securities regulation in Canada consists of various federal and provincial statutes[219]. Moreover, administrative agencies, along with a variety of national and self-regulatory organizations, possess some powers over members and issuers. The provincial legislative authority possesses the power to regulate trading in securities[220]. Each of the provinces has a securities statute[221]. Those regulatory regimes set-up securities regulatory authorities empowered to license and require full disclosure of information on issuers offering securities so as to protect the public[222]. In addition to regulations under the statute, each provincial jurisdiction has issued policy statements. Faced with the disparities between each of the governing legislation, such policy statements are the result of efforts to harmonize regulation[223]. Other sources of securities regulation include blanket orders and

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219 On the Canadian securities regulatory structure, see generally, INSIGHT CONFERENCE, *Securities Regulation, Policy and Practice* (Toronto, Ont.: Insight, 1995). E.H. NEAVE, *Canada and the World Financial System: The Role of Securities Regulation*, Working Paper 89-09 (Kingston, Ont.: Queen's University School of Business Research Program, 1989).

220 A.S. ABEL & J.I. LASKIN, *Laskin's Canadian Constitutional Law*, 4th ed. (Toronto, Ont.: Carswell 1975) at 359.

221 In Alberta, British Columbia, Manitoba, Nova Scotia, Ontario, Quebec and Saskatchewan, the acts are administered by a securities commission. In the other provinces, there is not a separate commission but securities administration is handled by specific government officials.

222 The general principle underlying Canadian securities legislation is that of full, true and plain disclosure of all pertinent facts by those offering the securities for sale to the public. However, the broad discretionary powers possessed by Canadian securities regulators create a great deal of uncertainty for market participants planning transactions that may or may not be found to breach the "public interest". In view of this uncertainty, it has been proposed that the regulators consider the adoption of a "no action letter" procedure similar to that used in the U.S. J.G. MacINTOSH, *An Agenda for the Securities Regulators: Part I*, (1994) II:2 Corporate Financing 73 at 73. J.G. MacINTOSH, *Securities Regulation and the Public Interest: Of Politics, Procedures, and Policy Statements–Part I*, (1994) 24 C.B.L.J. 77 at 107

223 The policy statements set out in detail the procedures to be followed in complying with the legislation, and provide guidance as to how administrators (or tribunals) will exercise their discretion. The statements are divided into three groups: national, uniform and local. National policy statements are issued jointly by all ten provincial jurisdictions. Uniform statements were joint policy statements initially passed in 1966 by five jurisdictions (British Columbia, Alberta, Saskatchewan, Manitoba and Ontario). Although they are gradually being replaced by National Policy Statements, a few

notices, decision and ruling issued by the respective securities commissions[224]. For its part, the federal legislative authority can punish fraudulent dealing in securities under the federal Criminal Code[225]. Finally, topics like take-over bids and insider trading are also regulated by the federal and provincial legislatures.

On another level, the Canadian system of securities regulation is highly harmonized with international regulation and Canadian capital markets are very receptive to foreign financing[226].

For the past few years, the Ontario Securities Commission (hereinafter OSC) and the Quebec Securities Commission (hereinafter QSC) have been conducting their activities in view of the many changes on the international (and North American) scene. Both Commissions have adopted the view that regarding regulation and supervision of financial systems, competition requires more international coordination. Thus, they pursue the various initiatives undertaken within task forces of the International Organization of Securities Commissions (hereinafter IOSCO). The OSC has kept pace with the fast-changing international developments by creating an International Markets policy-making branch[227]. It developed its market

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Uniform Policy Statements still remain in force. Local statements are issued by one provincial jurisdiction for application within that province only. M.R. GILLEN, *Securities Regulation in Canada* (Scarborough, Ont.: Carswell, 1992) at 74-75.

224 GILLEN, *Ibid.* at 75-76. "Provincial securities commissions meet regularly to discuss policy matters through an association [named the Canadian Securities Administrators or CSA] that embraces all the provinces. In practical terms, though, the setting of policy for the financial institutions is largely an exercise involving Ontario, Quebec, the federal government and, to a lesser extent, British Columbia." ECONOMIST INTELLIGENCE UNIT, *Foreign Financing Operations (Canada)* (London: Economist Intelligence Unit, 1995) at 13.

225 However, the courts have given a wide scope to the provincial power on certain related matters. P.W. HOGG, *Constitutional Law of Canada*, 2nd ed. (Toronto, Ont.: Carswell, 1985) at 474 n. 119-123.

226 See generally, INSIGHT CONFERENCE, *Canada's Role in the International Securities Market* (Toronto, Ont.: Insight, 1994). INSIGHT CONFERENCE, *Financial Services Forum* (Toronto, Ont.: Insight, 1994). *Notice — Remarks by Joseph J. Oliver - Executive Director of the Ontario Securities Commission in London, England - May 19, 1992: "Access by Foreign Issuers to the Canadian Capital Markets"*, (1992) 15 O.S.C.B. 2369.

227 On the international strategy of the OSC, see, *Notice — Remarks of Edward J. Waitzer, Chairman of the OSC - April 8, 1994: "International Securities Regulation - Coping with the "Rashomon Effect""*, (1994) 17 O.S.C.B. 1719.

technology[228] and established close working relationships with many securities commissions throughout the world including the SEC, the Securities Investment Board in the U.K. and the securities commissions of Italy, France and Australia[229]. A few years ago, it was made public that the international strategy of the QSC is comprised of three axis[230]. Firstly, it recognizes and encourages the deregulation of financial institutions; the creation of new financial products; the exchange of information between different securities commissions; and the use of technology advancements for the acceleration as well as the harmonization of international capital markets. Secondly, the QSC analyzes all questions deriving from bilateral and multilateral talks on uniform standards with a view to ensure the efficiency of capital markets[231].

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228 See, *e.g., Notice — Remarks of Edward J. Waitzer, Chairman of the OSC: June 29, 1994 — "Non-traditional Trading Systems: Striving for Competitive Excellence"*, (1994) 17 O.S.C.B. 3113. *Notice — Electronic Trading Systems in Ontario*, (1994) 17 O.S.C.B. 2512.

229 *Notice — Remarks of Robert J. Wright to the Eglinton Rotary Club — May 19, 1993: "The Work of the Ontario Securities Commission"*, (1993) 16 O.S.C.B 2429 at 2430. See also *News Release–Memorandum of Understanding With the Australian Securities Commission*, (1995) 18 O.S.C.B. 3118.

230 *Avis - Allocution prononcée par Me Paul Fortugno, président de la Commission des valeurs mobilières du Québec, lors d'un déjeuner-causerie devant les membres de la Chambre de commerce de Rimouski, le mardi 17 novembre 1992 — L'internationalisation des marchés financiers: une opportunité incontournable pour le Québec*, (1992) 23:47 B.C.V.M.Q. 1 also *reprinted in* (1993) 27 R.J.T. 541 [hereinafter *Avis du 17 novembre 1992*]. For some comments see, S. ROUSSEAU, *La C.V.M.Q. dans un marché en mutation: les effets de l'internationalisation du marché des valeurs mobilières sur le rôle de la Commission des valeurs mobilières du Québec en matière d'appel public à l'épargne*, (1993) 51 U.T. Fac. L. Rev. 359.

231 For instance, the QSC examined the FTA, NAFTA, the GATT and the OECD Codes of Liberalization. *Avis du 17 novembre 1992, supra*, note 230 at 3; "[N]otre intégration continentale, accélérée par l'existence du Traité de libre-échange américano-canadien, nous suggère une règle où l'harmonisation doit prévaloir". See also COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, "Les activités internationales", in *Rapport annuel 1992 - 1993* (Quebec, Que.: Publications du Québec, 1993) 22. Moreover, the QSC assists certain international organizations like IOSCO. *Engagement d'assistance aux autres membres de l'Organisation internationale des commissions de valeurs (OICV)*, Decision n° 8096, (1987) 18:15 B.C.V.M.Q. A1. COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport d'activités 1987-1988* (Quebec, Que.: Publications du Québec, 1988) 31. About the evolution of Quebec's markets, it has been noted that the "trend towards the "North Americanization" of securities legislation in Quebec is in keeping with the primary responsibility of the Commission, and by extension the objective of the legislator, to ensure the efficiency of capital markets". J. MAVRIDIS, "Materiality: In Search of a Standard for Disclosure in Quebec" in SERVICE DE LA FORMATION PERMANENTE DU BARREAU DU QUÉBEC, ed., *supra*, note 53, 1 at 55-56.

Finally, it provides technical assistance to some emerging markets[232].

At the same time as NAFTA was being negotiated, the Commissions (as well as the SEC and the Mexican authorities) signed an agreement concerning the creation of the Council of Securities Regulators of the Americas (hereinafter COSRA). This occurred during a meeting of the Inter-American Authorities of Securities Regulators, in which delegations of seventeen authorities from sixteen countries of the Americas took part[233]. In its preamble, the Agreement reminds the reader of the fundamental role of securities markets within each country's economy and declares that the internationalization and interconnection of securities markets will contribute to the growth of economies on national and regional levels[234]. This new organization aims at promoting cooperation between the securities regulating authorities of member states. Among the subjects upon which this cooperation is meant to focus, the Agreement mentions the elaboration of reform that would widen participation in securities markets; the protection of investors through the application of strict disclosure requirements and rules of ethics; the definition of incentive measures for securities investment, the abolition of international investment barriers; the development of negotiation systems aimed at increasing the transparency and efficiency of markets; and finally, the establishment of links between markets[235].

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232 The QSC's presence on emerging markets by its will "to extend the zone of international financial stability and contribute to the institution and implementation of harmonized legislative and regulatory frameworks." QUEBEC, Ministry of Finance, *Quinquennial Report on the Implementation of the Securities Act* (Quebec, Que.: Ministry of Finance, 1993) at 74. For example, see *Avis — Signature par la Commission des valeurs mobilières du Québec d'un accord d'échange d'information avec l'Agence des valeurs mobilières de Roumanie*, (1993) 24:40 B.C.V.M.Q. 1. *Avis — Assistance technique canadienne sur le marché des capitaux roumains*, (1993) 24:1 B.C.V.M.Q. 1. *Avis — Signature par la Commission des valeurs mobilières du Québec d'un accord d'échange d'information avec l'agence de supervision des valeurs mobilières de Hongrie*, (1992) 23:10 B.C.V.M.Q. 1; (1992) 124 *G.O. II* 4569 (D. 929-92, 23 June 1992); and, *Avis — Entente de coopération entre la Commission des valeurs mobilières et l'Agence de supervision des valeurs mobilières de Hongrie*, (1991) 22:40 B.C.V.M.Q. 1.

233 OECD, *Financial Market Trends*, Vol. 53 (Paris: OECD, February 1993) at 10.

234 The Charter of COSRA is *reprinted in* SECURITIES AND EXCHANGE COMMISSION, *The SEC Speaks in 1993*, Vol. 2 (New York, N.Y.: Practising Law Institute, 1993) at 379-381.

235 COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, "Les activités internationales" in *Rapport annuel 1992-1993, supra,* note 231 at 22.

For many years the harmonization of securities legislation and regulations has been vigorously pursued in Canada. Because of this fact it is important to underline that the negotiation of the financial services Chapters of the FTA and NAFTA took place at a time of significant legislative and regulatory change. The reform occurring in the Canadian financial service sector has significantly eroded the barriers between different kinds of financial institutions and has given rise to a blend of services offered by securities dealers as well as banks, trust and loan companies and insurance companies. In view of the efforts towards regulatory consistency and of the presence of so-called "universal" banks (which combine banking activities with securities underwriting and market intermediation activities in a single corporate entity)[236], changes in the nature of the traditional activities of Canadian financial institutions require that we briefly examine the activities of some of the main ones comprising the Canadian securities industry, i.e. the banks and the investment dealers.

1. The Canadian Composition of the Securities Industry

Until recently, the Canadian financial system was organized according to the so-called "pillar" system, in which the major financial functions were performed by separate categories of institutions. The original pillar system (based on separate regulation and separate ownership of four broad categories of financial institutions — i.e. banks, securities firms, trust and insurance companies) was put into place in the wake of the Great Depression. In recent years, Canadian financial regulation has undergone significant changes and introduced the concept of universal banking[237]. As a result, the financial services industry increased its number of mergers and acquisitions from within[238]. Canada's securities industry now consists of investment dealers but also of the largest group of financial institutions — the banks.

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236 OECD, *supra,* note 5 at 50. Here it is essentially for the bank to decide if its securities business could be conducted more efficiently through a holding company or through a separately capitalized subsidiary. R. DALE, "Regulating Bank's Securities Activities: A Global Assessment", in FINGLETON, ed., *supra*, note 14, 109 at 111-112.

237 For a recent assessment, see, *e.g.*, M. BABAD & C. MULRONEY, *Pillars: The Coming Crisis in Canada's Financial Industry* (Toronto, Ont.: Stoddart, 1993).

238 For an overview of the key issues that are considered by the Canadian Minister of Finance and the Bureau of Competition Policy when reviewing a financial sector merger, see *Size, Competition and Concentration in Canadian Financial Services*, Report 102-93 (Ottawa, Ont.: Conference Board of Canada, 1993).

1.1 The Investment Dealers[239]

Investment dealers (i.e. members of the Investment Dealers Association of Canada (hereinafter IDA[240])) and brokers (i.e. members of one or more Canadian stock exchanges[241]) perform two basic but complementary services[242]. First, the securities firms bring together those who have a surplus capital to invest in governments and companies who need investment capital. This function is performed on the primary market and it is achieved through the underwriting and distribution to investors of new issues of securities. A second function is providing active and liquid secondary markets for the transfer of existing or already outstanding securities from one owner to another.

The vast majority of Canadian securities houses belong to one or more of the self-regulatory organizations (hereinafter SROs)[243]. Most firms hold multiple

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239 Information about the investment dealers is scarce. A recent survey denounces that fact. E. ROSEMAN, "More Info Sought from Investment Dealers: Trustworthiness Most Important" *The [Toronto] Globe and Mail* (17 September 1994) B18.

240 The role of the IDA is to establish and enforce, through self-regulation, high standards of business procedure and to promote through study, public statements and representations, a framework of policies for savings and investment. IDA's continuing discussions with Canadian securities commissions and stock exchanges are aimed at maintaining uniform and standardized approaches to business conduct in the industry. On the IDA, see generally, CCH, ed., *Canadian Stock Exchanges Manual,* Vol. 1 (North York, Ont.: CCH Canadian Limited, 1994 (loose-leaf)) at 75,001ff.

241 In Canada, five organized stock exchanges (located in Toronto, Montreal, Vancouver, Calgary and Winnipeg) all compete for listings although inter-listing on more than one exchange is possible. They promulgate their own by-laws, rules and policies. However, these must conform to the provincial securities acts as administered by the provincial securities commissions. Based on the value of business, Toronto (with nearly 75%) is the largest Canadian exchange. On the Toronto stock exchange, see G. SAWIAK, *The Toronto Stock Exchange* (Toronto, Ont.: Butterworths, 1986). Toronto is followed by Montreal with nearly 20%. The Vancouver exchange is primarily a market for resources exploration and development company stocks. The Calgary (known as the Alberta Stock Exchange) and Winnipeg exchanges are regional in nature and are very small with few listed companies and little trading volume. ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra,* note 224 at 28.

242 ONTARIO, Ministry of Consumer and Commercial Relations, *Report of the Securities Industry Ownership Committee of the Ontario Securities Commission* (Toronto, Ont.: Government of Ontario, 1972) at 5.

243 The most important Canadian SROs are the IDA and the Canadian stock exchanges. On Canadian SROs, see, *e.g.,* R. SORELL, "Supervision of Self-Regulatory Organizations in Ontario's Securities Market" in QUEEN'S SYMPOSIUM, *Securities Regulation: Issues and Perspectives–Papers Presented at the Queen's Annual Business Law Symposium 1994* (Scarborough, Ont.: Carswell, 1995) 165. D.L.

memberships. As at October 1995, there were 158 firms who were subject to the authority of the SROs[244]. Employment in the industry stood at 24,284[245] and capital employed in the business[246] was Cdn $ 4,779 million dollars in mid-1995[247]. Still, the industry is small compared to other segments of the financial services sector or even to some companies, operating within competing segments. Canada's largest bank, the Royal, for instance, employed over 60,000 people in June 1995, had shareholders' equity of Cdn $ 8.5 billion and total assets of over Cdn $ 173 billion[248]. The entire Canadian securities industry is likewise eclipsed in size by several individual U.S. securities houses[249].

In spite of its comparatively small size, the industry has provided Canada with a quite large and sophisticated capital market. These qualities are measured in terms of the variety and size of new issues brought to the market and the depth and liquidity of secondary trading markets. Today, the industry is highly competitive and becoming increasingly so.

There is a great variety in the type of securities firms in Canada[250]. To satisfy the diverse needs of numerous types of investors, firms in the securities industry exhibit a considerable variety in structure. On the one hand, "fully integrated houses" comprised, in the main, of large firms that offer a broad range of services[251]. On the

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RATNER, *Self-Regulatory Organizations*, (1981) 19 Osgoode Hall L.J. 368.

244 INVESTMENT DEALERS ASSOCIATION, *Securities Industry Statistics, 1995.*

245 *Ibid.*

246 The major components of industry regulatory capital includes capital, retained earnings, subordinated debt and stand-by subordinated debt.

247 INVESTMENT DEALERS ASSOCIATION, *Securities Industry Statistics, 1995.*

248 ROYAL BANK OF CANADA, *Semestrial Financial Report*, June 1995.

249 Recent data shows the top three U.S. securities firms to be gigantic. Ranked first is Merrill Lynch, with a capital of US $ 20.60 billion and over 43,800 employees. Second is Salomon Inc. with a capital of US $ 16.10 billion and 8,600 employees. And third is Lehman Brothers with US $ 14.72 billion in capital and 8,512 employees. "Tomorrow, the World" in "A Survey of Wall Street" *The Economist* (15 April 1995) 3. See also P.J. SPAIN & J.R. TALBOT, eds, *Hoover's Handbook of World Business 1995-96* (Austin, Tx: The Reference Press, Inc., 1995) at 51. G. HOOVER, A. CAMPBELL & P.J. SPAIN, eds, *Hoover's Handbook of American Business 1995* (Austin, Tx: The Reference Press, Inc., 1995) at 107.

250 ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra,* note 224 at 17.

251 They usually maintain underwriting, sales, trading, portfolio management, statistical, research, accounting and delivery departments.

other hand, "specialty houses" may restrict themselves to one or more aspects of the investment business[252]. Thus, as is evident from the preceding, it is not possible to list under definite headings all classifications of firms as there is always some overlapping and variation in the business transacted by each type. Firms range greatly in size from the largest employing about 3,700 persons in some 85 branches across Canada and in major financial centres abroad down to very small businesses[253].

In terms of revenue ranking, Canadian financial services investments dealers do quite well, as illustrated in Table 4[254].

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252 For example, brokerage houses range from those which sell all types of stock to those which specialize in one type of stock (such as mining and oil stock, etc.). There are also discount brokerage firms, which offer trading facilities only. Other areas include, among others, such operations as selling mutual funds or exclusive trading with institutional clients. ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra,* note 224 at 17.

253 For a complete list of securities firms in Canada, see, *e.g., Canadian Almanac & Directory 1995* (Toronto, Ont.: Canadian Almanac & Directory, 1995) at 1-5 to 1-9. *Standard & Poor's Security Dealers of North America* (New York, N.Y.: McGraw-Hill, Summer 1995 Edition) at 1280-1281.

254 The rarity of information makes it hard to have a precise picture of the situation. In its most recent survey, the Financial Post 500 explained that "[t]he reason you won't find ranking of the country's top investment dealers is that there are no public reporting standards by which investment dealers are measured. The FP 500 research team did conduct a survey, but so few investment dealers responded that reporting results would be misleading." M. ANDERSON, "Who's Minding the Store?" *The Financial Post 500 Magazine 1995* (July 1995) 175 at 178.

TABLE 4

INVESTMENT DEALERS REVENUE RANKING

COMPANY AND YEAR END	REVENUE $000	REVENUE % CH'GE	PROFIT $000	PROFIT % CH'GE	RETURN ON CAPITAL 1-YR %	RETURN ON CAPITAL 5-YR %	ASSETS $000	ASSETS % CH'GE
RBC Dominion Securities (Se94)	1,029,180	26	133,300	31	5.89	5.49	18.375,233	30
Midland Walwyn (De94)	480,840	-3	29,077	-54	3.38	-0.57	3.087,907	64
Burns Fry Holdings (Se93)	416,877	16	25,650	50	nm	na	4.617,120	24
Nesbitt Thomson Group (Se93)	335,176	-11	50,016	114	nm	na	18.078,179	302
Fahnestock Viner Holdings (De94)[1]	157,253	3	11,780	-34	8.40	19.12	510,636	26
First Marathon (Dec94)	160,532	-14	25,196	-66	3.69	8.04	2.572,048	80
Marleau, Lemire (De94)[2]	38,465	-1	4,253	-35	5.56	na	224,916	94
Ondaatje Corp. (Mr94)	23,647	64	9,335	172	11.17	4.01	141,443	120
Average		20		22	6.35	5.61		86

[1] Figures are reported in U.S. dollars.

[2] Figures have been annualized in previous 3 through 5 years. na = not available. nm = not meaningful

Source: Report on Business Magazine, July 1995 at 145.

Like other businesses, securities firms are financed by capital originally subscribed by their owner-shareholders, by year-to-year net earnings retained in the business and by loans. Securities firms organized as sole proprietorships or partnerships were once common, but the need for more capital, greater job specialization and more employees and branches has seen few survive. Instead, most firms today are incorporated as private companies with ownership shares limited to officers, directors and employees. The competitive need for a larger capital base has, since 1983, led several securities firms to seek additional shareholder capital by "going public" through the issuance of new shares to the public[255]. Control of such firms was often retained by senior officers and employees by issuing a limited number of voting

255 B. MAROTTE, "Shake-up in Brokerage World" *The [Montreal] Gazette* (14 October 1995) C4.

shares to the public. Non-industry and non-Canadian ownership restrictions prevented firms from being controlled by outsiders or non-residents, with the exception of five U.S. firms long established in Canada who were given "grandfather" exemptions when an ownership moratorium was imposed in 1971. However, as will be discussed later, ownership of the industry has undergone radical change during the past two decades.

The securities industry is highly leveraged. Firms depend on borrowed money to a significant extent to finance their securities inventories, underwriting (including bought deals[256]), trading commitments and client margin accounts. Commissions generated from agency transactions are the main source of revenue for most houses[257]. Earnings arising from capital trading activities and from underwriting are also significant for many firms, with various types of fee revenues making up most of the balance[258]. Employee compensation is normally the largest single expense.

Returns in the securities business tend to be high in bull markets[259]. However, with their heavy exposure to losses in trading and underwriting and their costly and extensive staff and communication networks, securities firms are especially vulnerable to cyclical business swings, not only in Canada but throughout the world. The best recent illustration of this was the October 1987 market crash. However, note that even

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256 A "bought deal" is one where a dealer (sometimes with a partner) buys the entire issue for resale to its clients. The dealer risks his own capital in the bought deal. See, *e.g.*, J.-P. BRÉARD, *Les contrats de souscription à forfait de valeurs mobilières* (Montreal, Que.: Wilson & Lafleur Sorej, 1984) at 8-9.

257 E.H. NEAVE, *Canada's Financial System* (Toronto, Ont.: John Wiley & Sons, 1981) at 298-299. During the first quarter of 1994, commissions earned on trades in Canada climbed to an unprecedented Cdn $ 806 million. The increase in mutual funds sales had a noticeable impact on the rise of commissions earned. Gross mutual funds sales increased by 50% in the first quarter of 1995 over the whole sales for 1994, totalling Cdn $35 billion. Commissions earned on mutual funds sales reached the record proportion of 31% of total brokerage commissions against a 16% average over the past three years. INVESTMENT DEALERS ASSOCIATION, *Securities Industry Statistics, 1995.*

258 Trades on all Canadian exchanges reached Cdn $72 billion in the first quarter of 1995, more than a third of the whole of last year's total volume. Underwriting fees remained roughly the same as last year at Cdn $382 million during that same quarter. Total new corporate stock issues was in the order of Cdn $8.5 billion also in the quarter. INVESTMENT DEALERS ASSOCIATION, *Securities Industry Statistics, 1995.*

259 Total securities industry operating profits reached a record high of Cdn $564 million for the first quarter of 1995, whereas net profits soared to Cdn $238 million thereby beating last year's quarterly average of Cdn $182 million. INVESTMENT DEALERS ASSOCIATION, *Securities Industry Statistics, 1995.*

recently, the Canadian securities industry profits plunged to Cdn $ 421 million from Cdn $ 722 million in 1994[260]. They totalled only Cdn $ 8 million in the last quarter of 1994, reflecting a dramatic drop in corporate finance work and equity issues. As far as the large, established dealers in the securities business are concerned, the tumbling of their profits might have been greater if not for the fact that many of those dealers have extensive retail networks and are now subsidiaries of major domestic chartered banks with strong financial backing.

1.2 The Canadian Chartered Banks

In Canada, chartered banks operate under the *Bank Act* (which is regularly updated). The *Act* sets out specifically what a bank may do and provides operating rules enabling it to function within the regulatory framework. Canadian-owned banks are designated as Schedule I banks and foreign-owned banks are called Schedule II banks.

1.2.1 Schedule I (or Domestic) Chartered Banks

These banks are the giants of Canada's capital markets. There are eight of them[261] with six far out-distancing the asset size of other Canadian-owned banks and non-bank financial institutions. Together, the "Big Six" controlled Cdn $ 760 billion in assets[262]. In terms of total assets, Canadian banks are big by North American standards but not those of Japan or Europe. Accordingly, they are well represented in the North American top 20 by size. By contrast, not even the largest Canadian bank is anywhere near the size of any of Japan's top 10. The major banks have achieved their present asset size largely by establishing a network of over 7,000 retail branches

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260 INVESTMENT DEALERS ASSOCIATION, *Securities Industry Statistics, 1995.*

261 The domestic chartered banks of Canada are, in order of incorporation: (i) Bank of Montreal; (ii) Scotiabank / The Bank of Nova Scotia; (iii) Laurentian Bank of Canada; (iv) Toronto Dominion Bank; (v) Canadian Imperial Bank of Commerce; (vi) Royal Bank of Canada; (vii) National Bank of Canada; and (viii) Canadian Western Bank. ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra,* note 224 at 13. B. LAW, ed., *1995 Corpus Almanac & Canadian Sourcebook* (Don Mills, Ont.: Southam Inc. 1994) at 13-8.

262 *Ibid.* at 15.

and an extensive network of automated teller machines throughout Canada[263]. Banks have also become major participants on the international banking scene.

Where at one time all the banks moved together and followed each other into new lines of business, they are now starting to develop distinct identities and personalities. Since the 1987 big bang in the Canadian securities industry, major changes have taken place and more are still to come. As illustrated in Table 5, the most significant change is that the six largest Canadian-owned Schedule I banks are all now solidly in the securities business[264]. One of them (the Toronto-Dominion or TD Bank) has largely chosen to develop its own securities company subsidiaries. The other five (Royal Bank of Canada or RBC, Scotiabank or Bank of Nova Scotia, Bank of Montreal or B of M, Canadian Imperial Bank of Commerce or CIBC and National Bank of Canada) have each bought control of large national investment firms. These links have created a Canadian investment structure that is significantly larger in its capital base and international exposure[265]. Also, Canadian banks have gained considerable expertise in the securities business. These changes have provided the opportunity to a number of investment dealers to attract large clients and investors in them.

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263 *Ibid.*

264 "Les 50 premières financières" *Commerce* (June 1995) 70ff.

265 "Each to His Own" *The Banker* (August 1994) 46.

Table 5				
OWNERSHIP OF THE CANADIAN SECURITIES INDUSTRY				
Bank	**Full-Service broker**	**Discount broker**	**Major trust company**	**Mutual funds**
Bank of Montreal	Nesbitt Burns	InvestorLine	Trustco	First Canadian
Scotia Bank	Scotia McLeod	Scotia Securities	Montreal Trust	Montreal Trust funds, Scotia funds
CIBC	CIBC Wood Gundy	Investors Edge	CIBC Trust	CIBC funds, Hyperion Talvest
National Bank of Canada	Lévesque Beaubien	National Bank Securities	General Trust NatCan	NatCan funds
Royal Bank of Canada	RBC Dominion Securities	Action Direct	Royal Trust	Royal Trust funds, Royfund
Toronto-Dominion	Evergreen Investment	Greenline	TD Trust	Green Line funds
Laurentian Bank	BLC Rousseau	None	Laurentian Trust	Laurentian funds

Source: 1994 annual reports of respective banks listed in Table 1.

Concerning property, banks in Schedule I have a widely-held capital base. No more than 10% of any class of shares of a Schedule I bank may be held by a person or associated group of persons[266]. The banks' main functions include the creation of deposit facilities and transfer of deposit monies. Moreover, the *Bank Act*[267] prescribes that, in Canada, Schedule I banks can exercise various commercial activities.

Firstly, certain commercial activities can be exercised directly by banks. Banks can directly exercise all the activities linked to "the business of banking" such as the delivery of financial services, act as a financial agent; deliver investment and portfolio

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266 R.S.C., 1985, c. B-1, ss. 8, 372.

267 The Act is updated every five years. *Ibid.*, s. 21. This unique sunset clause allows the regulation of banks to adjust to recent developments in the financial sector. The law is to be updated by March 31, 1997. On the coming reform, see, *e.g.*, D. SLOCUM, "Banks Step Up Insurance Pitch" *The [Toronto] Globe and Mail* (28 December 1995) B2.

management counsel services; and issue payment, credit or debit cards and the use of a system of such cards[268]. Other than these activities, banks may also directly lead all other types of activities such as: to hold movables or make operations concerning them; to exercise certain information business activities in Canada or elsewhere; to promote goods or services with payment, credit card holders that the bank delivers; to sell tickets; and to act as guardian to property, as depository or as liquidator[269].

Second, certain commercial activities are exercised indirectly by banks. As a starting point, the *Bank Act* expressly forbids banks from directly exercising a certain number of activities. In general, it forbids them from exercising any commercial activity such as the sale of goods or merchandise[270]. Further, they may not act in trust in Canada[271]. Finally a bank cannot deal in securities and insurance except to the extent permitted by the *Act*[272]. Banks are, however, authorized to indirectly exercise a certain number of activities. They are entitled to act as proxy or to refer their clients to various businesses where they have acquired or increased a financial group interest, or an interest above 10%[273], in fields such as financial institutions, factoring, leasing, information businesses, investment and portfolio management businesses, mutual fund management, mutual fund brokerage, real-estate brokerage, real-estate, service businesses, special financial businesses, etc.[274]. Banks are therefore able to acquire or increase their financial group interest in businesses that dispense a large array of financial services. To this end, they may exercise control over these subsidiaries in certain cases[275]. In other cases, banks need to obtain a written prior approval from the minister, that may be given upon recommendation from the superintendent[276]. Note that bank investments in other financial institutions are subject to the rules concerning the owners of those institutions. They shall notably

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268 *Ibid.*, s. 409.
269 *Ibid.*, s. 410(1).
270 *Ibid.*, s. 410(2).
271 *Ibid.*, s. 412ff.
272 *Ibid.*, s. 415 and 416.
273 *Ibid.*, s. 10 and 411(1)
274 *Ibid.*, s. 468.
275 *Ibid.*, s. 468(3)(a)(i).
276 *Ibid.*, 468(3)(b)(i).

need to increase their public ownership if their capital reaches or surpasses Cdn $750 million leading to the result that 35% of their shares will then have to be quoted and negotiable on a recognized Canadian stock exchange and become widely held all within a delay of five years[277]. This must be done at the holding level, as much as at the institution level[278]. As a result of all the changes allowing for Canadian domestic chartered banks to be more active in the securities business, the latest year was quite good, as illustrated in Table 6.

TABLE 6

BANKS REVENUE RANKING

COMPANY AND YEAR END	REVENUE $000	REVENUE % CH'GE	PROFIT(1) $000	PROFIT(1) % CH'GE	RETURN ON CAPITAL 1-YR %	RETURN ON CAPITAL 5-YR %	ASSETS $000	ASSETS % CH'GE
Royal Bank of Canada (Oc94)	13,434,000	14	1,169,000	290	15.49	12.22	173,079,000	5
Cdn Imp. Bank of Commerce (Oc94)	11,214,000	9	890,000	22	14.79	13.56	151,033,000	7
Bank of Nova Scotia (Oc94)	9,375,000	13	482,000	-32	17.43	20.70	132,928,000	25
Bank of Montreal (Oc94)	9,108,000	5	825,000	16	18.76	19.63	138,175,000	18
Toronto Dominion Bank (Oc94)	6,999,000	11	683,000	148	16.74	13.88	99,759,000	17
National Bank of Canada (Oc94)	3,591,230	5	217,172	24	12.83	9.76	44.774,288	5
Laurentian Bank of Canada (Oc94)	837,338	2	13,177	-63	4.76	11.81	10,467,527	8
Average		0		47	11.80	12.56		11

(1) The Big Six domestic banks had a record Cdn $5.18 billion profit in the year ended October 31, 1995. D. GOOLD, "The Anatomy of Bank Profits" *The [Toronto] Globe and Mail* (15 December 1995) B11. J. PARTRIDGE, "Bigger Paydays Expected for Top Bankers" *The [Toronto] Globe and Mail* (14 December 1995) B5.

Source: Report on Business Magazine, July 1995 at 145.

In the case of foreign banks, the rules are somewhat different.

1.2.2 Schedule II (or Foreign) Chartered Banks

Subsidiaries of foreign banks have operated in Canada for a number of years and

277 *Ibid.*, s. 411.

278 *Ibid.*, s. 414.

until 1980, unlike domestic chartered institutions, they were not allowed to accept deposits or call themselves "banks"[279]. Most restricted their activities to making corporate loans and collectively their assets grew from a little over Cdn $1 billion in 1974 to about Cdn $12 billion in 1980. The 1980 *Bank Act* revision led to subsidiaries of foreign banks being chartered as Schedule II banks. This move brought them under similar reserve requirements and Canadian government scrutiny and regulation as the Schedule I banks. There are over fifty foreign banks with letters patent to operate as Schedule II banks[280]. The major distinction between the two categories of banks is in ownership rules.

Subject to certain exceptions, no shareholder or group of shareholders may now hold, without authorization from the Minister, more than 10% of shares issued with voting rights inside a Schedule II bank[281]. All the same, authorization from the Minister is required during any share acquisition that confers a person, or the entity under their control, an interest of 10% in a Schedule II bank or anything that increases that percentage[282]. Schedule II banks owned by foreign banks can be closely held indefinitely[283]. A Schedule II bank must become widely held after the first ten years of its existence[284], unless it is owned by a widely held federally regulated financial institution[285]. However, Schedule II banks which surpass the Cdn $750 million limit need to respect the 35% public ownership criterion, meaning that 35% of the shares need to be quoted and negotiable on a recognized exchange in Canada and be widely held within a delay of five years[286].

A Schedule II bank may engage in all types of business permitted to a Schedule I bank. In practice, however, most foreign-owned bank subsidiaries are focusing on commercial loans to companies rather than on retail banking services to individuals.

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279 *Ibid.*, definition of foreign bank in s. 2.

280 ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra,* note 224 at 16. LAW, ed., *supra,* note 261 at 13-11.

281 See, *supra,* note 266, s. 372.

282 *Ibid.*, s. 377.

283 *Ibid.*, s. 375.

284 *Ibid.*, s. 373(1).

285 *Ibid.*, s. 374.

286 *Ibid.*, s. 381.

By allowing these foreign banks to operate in Canada, the government has facilitated the expansion in the operations of Canadian-owned Schedule I banks abroad. The presence of foreign-owned banks in Canada also provides a conduit for investment of foreign capital in Canada, as well as providing Canadian corporate borrowers with alternative sources of funds. Although the Schedule II banks have, as a group, experienced reasonable growth in the first fourteen years of operation, a small number of them have earned satisfactory rates of return as illustrated in Table 7[287].

TABLE 7

FOREIGN BANKS REVENUE RANKING

	REVENUE		PROFIT		RETURN ON CAPITAL		ASSETS	
COMPANY AND YEAR END	$000	% CH'GE	$000	% CH'GE	1-YR %	5-YR %	$000	% CH'GE
Hongkong Bank of Canada (Oc94)	1,050,010	10	85,868	36	18.63	15.62	116,021,222	19
Citibank Canada (De94)	463,477	3	-40,847	42	7.38	3.94	4,210,761	-19
Union Bank of Switz. (Can)(De94)	211,466	26	3,520	-37	5.84	1.61	2,040,800	3
Crédit Suisse of Canada (De94)	171,574	-3	2,005	-75	4.15	4.61	3,698,553	-3
Banque Nat'l de Paris (Can.)(Oc94)	130,449	-14	-29,973	16	-11.47	9.73	2,157,463	-4
Société Générale (Canada) (Oc94)	121,961	39	2,580	113	15.46	0.74	2,521,474	17
Banca Commerciale Italiana(De93)	95,134	8	27	100	1.26	6.53	1,326,476	-6
Bank of Tokyo Canada (Oc94)	87,844	1	-2,555	-8,342	12.85	13.66	1,558,620	-3
Deutsche Bank (Canada) (Dec93)	87,076	-3	6,900	133	11.85	2.70	1,315,241	4
Nat'l Westminister Bank Canada(Oc94)	78,876	17	-13,790	-511	-12.62	2.58	1,875,870	15
Fuji Bank Canada (Oc93)	70,188	6	3,370	114	7.72	-2.32	1,122,000	2
Swiss Bank Corp. Canada (De94)	64,710	-36	-20,780	28	-10.95	-12.27	866,572	-33
Average		7		265	1.99	1.19		8

Source: Report on Business Magazine, July 1995 at 147.

Consequently, the impact of North American free trade on Canadian financial laws

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287 Note that under the 1992 *Bank Act* (s. 412), foreign banks no longer are required to publish financial results, and many of them now choose to keep details of their Canadian operations secret.

regulating the "extended" securities industry has been quite important. Some laws of the governments of Canada and the provinces were modified or passed as a result of this. However, in this context two questions are predominantly important. First, strictly from a constitutional perspective, what is the impact of free trade in relation to Canada's regulatory structure of the securities industry? Second, does the federal government have sufficient power to defend Canadian interests in such negotiations, with the corollary being, should there be a growing federal presence in the field of securities policy?

2. North American Trade Liberalization and the Canadian Regulatory Structure Relating to the Securities Industry: Constitutional Questions

It is generally understood that any international agreement (such as a North American free trade pact) which is binding upon the parties in international law is a treaty[288]. It may take the form of a convention, a declaration, a protocol, a memorandum of understanding or an exchange of notes or letters[289]. Any trade-in-services agreement presumably concerns only trade in services. But, what is a traded service? Many definitions can provide valuable indications[290]. Whatever approach one takes, a traded service transaction is sometimes characterized by an international aspect. With respect to services such as banking and securities services, globalization has lead to situations where it is difficult to conceive of a traded service transaction that is not (at least partly) international in character.

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288 T.A. LEVY, *Provincial International Status Revisited*, (1976) 3 Dal. L.J. 70 at 80.

289 M. AKEHURST, *A Modern Introduction to International Law*, 4th ed., (London: George Allen and Unwin, 1982) at 121.

290 For one, Helena Stalson has divided internationally traded services into two categories: (i) investment-related services that bring the producer to the user; and (ii) true exports (which include services) that bring the user to the producer and those which actually cross a border. H. STALSON, *U.S. Service Exports and Foreign Borrowers: An Agenda for Negotiations*, (Washington, D.C.: National Planning Association, 1985). For its part, Ronald Shelp conceived three categories: (i) trade-related services (such as transportation); (ii) investment-related services (such as banking and securities services); and (iii) trade-and-investment-related services (such as communications or computer services). R.K. SHELP, *Beyond Industrialization: Ascendancy of the Global Service Economy* (New York, N.Y.: Praeger, 1981). For other definitions see, *e.g*, M. JANETTE, *Trade and Investment in Services: An Issue for the 1980's*, (Ottawa, Ont.: North-South Institute, 1984).

The drafting, negotiation and implementation of international agreements on trade in financial services bring about a unique challenge for Canada because of the very nature of Canadian federalism[291]. Constitutionally, the federal government possesses the power to negotiate, sign and ratify international agreements on behalf of the entire country[292].

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291 Basically, difficulties exist because of the separation of powers set out mainly in sections 91 and 92 of the *Constitution Act*, 1867, (U.K.), 30 & 3 Vict., c. 3 [hereinafter *Constitutional Act of 1867*] in R.S.C., 1985, App. II, n° 5. Section 91 provides that the federal government may "make laws for the Peace, Order and Good Government of Canada" not coming within subject matters assigned exclusively to the provinces, including - but not limited to - a number of enumerated subject matters in section 92. Constitutionally, it is unsettled whether the federal government has the ability to deliver on international commitments in relation to the "trade-in-services" regulations of the provincial governments. M. SMITH & D. STEGER, "Canada Constitutional Quandary: The Federal/Provincial Dimension in International Economic Agreements", in *Canadian Trade at a Crossroads: Options for New International Agreements*, (Toronto, Ont.: Economic Council of Canada, 1985) 362. It appears, in the light of the FTA and NAFTA implementing legislations and the position the federal government was taking in the GATT talks, that Ottawa believes it does have the necessary authority. M. CORNELLIER, "Ottawa s'octroie le pouvoir d'empiéter sur les provinces pour faire appliquer l'accord de libre-échange", *Le Devoir [of Montréal]*, (25 May 1988) 8. G.A. DENIS, *Le Canada face aux négociations commerciales bilatérales et multilatérales*, (1987) 50 Les Cahiers Scientifiques 57. There is also a growing body of opinion which supports this position. See, *e.g.*, H.S. FAIRLEY "Implementation of the Canada-U.S. FTA" in D. McCRAE & D. STEGER, eds, *Understanding the Free Trade Agreement* (Halifax, N.S.: Institute for Research on Public Policy, 1988). LEVY, *supra,* note 288, 70. However, some take the view that, with respect to transborder flow of services and capital, the federal jurisdiction is not absolute. R.E. SULLIVAN, *Jurisdiction to Negotiate and Implement Free Trade Agreements in Canada: Calling the Provincial Bluff*, (1987) 24 U.W.O.L. Rev. 63 at 78ff. At the operational level, in the FTA, NAFTA and GATT negotiations, mechanisms for federal - provincial consultation have existed and have been used, although to what extent is not fully clear. D. BARROWS & M. BOUDREAU, "The Evolving Role of the Provinces in International Trade Negotiations" in A.M. MASLOVE & S.L. WINER, eds, *Knocking on the Back Door: Canadian Perspectives on the Political Economy of Free Trade with the United States*, (Halifax, N.S.: Institute for Research Policy, 1987) 144. In any case, on the basis of s. 91, para. 2 of the *Constitution Act of 1867*, the federal government does not have to accept the provinces' views. It may choose only to inform the provinces and listen to advice.

292 It is generally accepted that the executive branch of the federal government has the power to make treaties. See generally, S.A. SCOTT, "NAFTA, the Canadian Constitution, and the Implementation of International Trade Arrangements" in RIGGS & VELK, eds, *supra,* note 204, 238. G.J. SZABLOWSKI, "Treaty-Making Power in the Context of Canada Politics: An Exploratory and Innovative Approach" in Royal Commission on the Economic Union and Development Prospects for Canada, *Recurring Issues in Canadian Federalism* (Research Studies, Vol. 57) (Toronto, Ont.: University of Toronto Press, 1986) (Research Coordinators: C. BECKTON & A.W. MacKAY) 145. However, if the treaty is an important one, the practice is to lay it before the Parliament between its signing and ratification. M. KRASNICK & M. CHARTRAND, *Canada's Negotiations for International Agreements on Trade in Services. Federal - Provincial Issues* (Halifax, N.S.: Institute for Research on Public

Therefore, the provinces cannot deal with matters relating to Canada's external affairs[293].

However, an international agreement can only be part of domestic law if it is implemented by enactment of legislation either by the Parliament of Canada or the provincial legislatures further to the division of powers in the Constitution[294]. Without such legislation making the provisions of an agreement effective as domestic law, Canadian courts will not enforce the treaty. If, for example, the subject of an international agreement relates to a matter of exclusive federal jurisdiction (such as banking)[295], then only the Parliament of Canada would possess the power to enact appropriate legislation. However, if the subject relates to a matter within the exclusive jurisdiction of the provincial legislatures, then only provincial legislatures would have the authority to enact legislation to implement its terms. In this context, the enactment of laws to implement treaties has proven to be the source of many disputes.

If the principal characteristics of a trade-in-services agreement are market access for foreign firms, national treatment and transparency, then a strong case can be made that the subject matter of any such agreement would be exclusively within the federal jurisdiction under section 91 para. 2 of the Canadian Constitution, i.e. the federal

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Policy, 1987) at 2-3.

293 Although, treaty making is beyond the powers of the provincial legislatures, it is admitted that provinces can sign international MOUs with respect to subjects falling within their legislative authorities. On the international activities of Canadian provinces, see, *e.g.*, V. LOUNGNARATH, *L'incidence de l'Accord de libre-échange Canada/États-Unis sur le développement de la paradiplomatie provinciale*, (1992) 26 R.J.T. 301. I. BERNIER & A. BINETTE, *Les provinces canadiennes et le commerce international: dynamisme économique et ajustement juridique* (Quebec, Que.: Centre québécois de relations internationales/Institut de recherches politiques, 1988). J. DAVIDSON, *Uniformity in International Trade Laws: The Constitutional Obstacle*, (1988) 11 Dal. L.J. 677.

294 LEVY, *supra*, note 288 at 80. Thus "[a]lthough the federal executive branch might bind Canada internationally, it might or might not be able to fulfil that commitment depending upon the nature of the subject matter of the international agreement". R. St. J. MacDONALD, *International Treaty Law and the Domestic Law of Canada*, (1975) 2 Dal. L.J. 307 at 315. Both the FTA and NAFTA include treaty commitments which require provincial action.

295 *Constitution Act of 1867* gives the federal Parliament exclusive power to regulate "the business banking" through s. 91(14) ("Currency and Coinage"), s. 91(15) ("Banking, Incorporation of Banks and the Issue of Paper Money"), s. 91(16) ("Savings Banks"), s. 91(18) ("Bills of Exchange and Promissory Notes"), s. 91 (19) ("Interest") and s. 91(20) ("Legal Tender").

trade and commerce power. This section provides for federal jurisdiction with respect to trade in general which arguably includes trade-in-services (but not goods)[296]. However, the tribunals have used a "specific transaction analysis" to examine the question of jurisdiction on a case by case basis[297]. Having said this, it is clear that international services transactions reaching beyond provincial or national boundaries are outside the provincial jurisdiction. Still, the courts have found valid any provincial laws affecting interprovincial or international transactions only incidentally[298].

The problem in many services areas is that although the federal government has certain subject matters allocated to it under section 91 of the Constitution, many other subject areas have, in practice, been the responsibility of the provinces under section 92 para. 13, i.e. the power over "Property and Civil Rights in the Province". Under this heading, services such as securities traditionally have been regulated by the provinces. "Property and Civil Rights" has been interpreted by the courts "to include contracts, dealings with property, and the regulation of businesses, trades and professions."[299]. Financial activity (like any other business activity) is carried out by way of contract. Provincial authority under this section is considered wide in scope, since it encompasses all kinds of business transactions. Under section 92 para. 11 of the Constitution, provincial legislatures to make "laws pertaining to corporate powers

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296 Section 122 of the *Constitution Act of 1867* allocates to the federal government jurisdiction over customs and excise. This section is an important specific allocation of power which, by nature, applies to trade in goods only (and not services).

297 The courts have found that the federal Parliament has the authority to regulate the "flow of commerce" only when the main purpose of the law is to regulate a transaction that reaches across a provincial or national boundary.

298 For example, a provincial securities act applies to brokers in the province whose business involved customers outside the province. *Gregory* v. *Quebec Securities Commission*, [1961] S.C.R. 584. Similarly, a provincial securities act applies to brokers outside the province who sell stocks to customers inside the province *R.* v. *W. McKenzie Securities*, (1966) 56 D.L.R. (2d) 56 (Manitoba C.A.). See, generally, N. ROY, *Mobility of Capital in the Canadian Economic Union, Vol. 66 of the research studies prepared for the Royal Commission on the Economic Union and Development Prospects for Canada* (Toronto, Ont.: University of Toronto Press, 1986) at 26-28. ANISMAN & HOGG, *supra*, note 55 at 144-148. On interprovincial transactions, see, "The Impact of Federal Policies on Interprovincial Activity", in M.J. TREBILCOCK *[et al.], Federalism and the Canadian Economic Union* (Toronto, Ont.: Economic Council, 1983) 201. J. WHALLEY, "Induced Distortions of Interprovincial Activity: An Overview of Issues", in TREBILCOCK *[et al.], Ibid.*, 161.

299 ANISMAN & HOGG, *supra,* note 55 at 144.

organization, internal management, and financing[300]. Although it is arguable that the federal government has jurisdiction over interprovincial and international securities transactions, it has not yet utilized its authority in this area. This dual set of powers means that not only do Canadian policy-makers and legislators have to develop a financial regulatory environment that serves the needs of a very rapidly changing marketplace but they must do so in a timely manner within the framework of Canadian federalism.

Harmonization of the regulatory framework has long been a major source of concern for Canadian politicians, legal experts and scholars alike[301]. The origins of the need for harmonization of the laws governing financial institutions among Canadian jurisdictions results from: (i) the need to arrange regulatory frameworks with measures adopted to facilitate the internationalization of financial markets[302]; and (ii) at the national level, the need to develop policies to prevent problems associated with a diversity of legislation and regulations drawn up by various jurisdictions in Canada.

However, in the securities area, there exists a problem of another dimension. Where both the federal Parliament and provincial regulators have enacted similar legislation with respect to a particular matter, the courts recently have demonstrated an inclination to allow the federal and provincial legislation to co-exist where there is no apparent conflict. The Supreme Court of Canada case, *Multiple Access Limited* v.

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300 W. MOULL, E. WAITZER & J. ZIEGEL, "The Changing Regulatory Environment for Canadian Financial Institutions: Constitutional Aspects and Federal-Provincial Relations" in J. ZIEGEL, L. WAVERMAN & D. CONKLIN, eds, *Canadian Financial Institutions: Changing the Regulatory Environment* (Toronto, Ont.: Ontario Economic Council, 1985) 103 at 105.

301 See, *e.g.*, A.L. CLOSE, *Harmonization of Provincial Legislation in Canada*, (1986-87) 12 C.B.L.J. 425. W.H. HURLBERT, *Harmonization of Provincial Legislation in Canada: The Elusive Goal*, (1986-87) 12 C.B.L.J. 387. T.W. MAPP, *Law Reform in Canada: The Impact of the Provincial Law Reform Agencies on Uniformity*, (1983) 7 Dal. L.J. 277. F. MULDOON, *Law Reform in Canada: Diversity or Uniformity*, (1983) 12 Man. L.J. 257. J.S. ZIEGEL *Uniformity of Legislation in Canada: The Conditional Sales Experience*, (1961) 39 Can. Bar Rev. 165. L.R. MacTAVISH, *Uniformity of Legislation in Canada - An Outline*, (1947) 25 Can. Bar Rev. 36. J. WILLIS, *Securing Uniformity of Law in a Federal System - Canada*, (1943-44) 5 U.T.L.J. 352.

302 Currently, "[t]here are two basic levels at which regulation of international securities transactions can occur: (1) the legislative or governmental level; and (2) the administrative or securities commission level". M. ROPPEL, *Regulation of International Securities Transactions: The Proposed Canada - U.S. Multijurisdictional Disclosure System*, (1991) 10 Nat'l Banking L. Rev. 51 at 55.

McCutcheon [et al.][303] upheld insider trading provisions of the Canadian Business Corporations Act (hereinafter CBCA) applicable to federally incorporated companies which were similar to the insider trading provisions of the Ontario Securities Act (hereinafter OSA)[304]. Here, where the contrast between the relative importance of the federal and provincial laws was not clear, and neither appeared to dominate the other, the Court allowed essentially similar federal and provincial laws to co-exist. Although this case may have served to help the federal government to ascertain its place in the field of securities regulation, the evolution of Canadian laws during both the FTA and NAFTA negotiations have greatly influenced the harmonization process.

3. Recent Evolution of Provincial and Federal Laws Impacting on the Canadian Securities Industry

For many years, capital markets in Canada were structured in an orderly fashion, heavily regulated and protected against overlap and foreign intrusion. In order to curtail conflicts of interest and the potential danger of Canada's vital financial industry becoming dominated by foreigners whose prime loyalties lay outside the country, the concept of four separate sectors (or pillars) became fundamental. Under this principle, government policies prohibited cross-ownership and the establishment of a foreign financial services industry. Rules were erected to protect domestic companies with each of the "four-pillars" as well as the core business carried on by each one. The resulting separation of function enabled each financial sector to pursue its primary purpose vigorously. However, revolutionary changes have recently overtaken traditional practices to create a radically different securities industry structure[305]. The following is a simplified overview.

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303 (1982) 2 S.C.R. 161.

304 Mr. Justice Dickson, writing for the majority, found the federal provisions which established civil liability and accountability for insider trading valid under the federal peace, order and good government clause as an enactment by Parliament in discharge of its company law power over federally incorporated companies. *Ibid.* at 170.

305 For a brief summary on some aspects of Canada's approach to financial liberalization, see, *e.g.*, R. DALE, *International Banking Deregulation: The Great Banking Experiment* (Oxford: Blackwell, 1992) at 120ff.

3.1 Key Provincial Reforms

Provincially, the major reforms resulted from efforts by various governments to assert autonomy in their traditional areas of jurisdiction[306]. In essence, the provinces decided that it would be necessary to make effective use of the financial levers provided by certain institutions, such as securities dealers, to promote their economic development. Reforms were also the result of the growing internationalization of financial markets in the 1970s and 1980s which increased pressure to remove the remaining obstacles to cross-border trade in securities-related services.

In the securities area, the entry of foreign firms into Canada is rather a recent occurrence. The ownership of securities firms in Canada by foreign residents was not a serious issue before the end of the 1960s. Then, the industry was dominated by Canadian firms. However, in 1969, Royal Securities was acquired by Merrill Lynch (a U.S.-based firm). Provinces such as Ontario began to fear growing foreign control of its securities industry. In the early 1970s, regulations were introduced in Ontario establishing a ceiling of 10% on the portion of the shares of a securities firm that a single non-resident and its associates and affiliates could hold, and a ceiling of 25% on the portion that all non-residents could hold[307]. Existing firms owned by non-residents that did not meet the criteria were "grandfathered". In 1974, the "grandfathered" firms were limited to a rate of growth of assets that could not exceed the average rate of major Ontario securities firms. Foreign-owned firms could, however, operate without restriction in the exempt market[308].

In the province of Quebec, the Bouchard Report (written in 1972) recommended that

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306 The rivalry between the provinces of Quebec and Ontario "[...] has, in part, fuelled the pace of change". C. JORDAN, *Canadian Financial Services — The New Broom*, (1987) 3 Rev. Fin. Serv. Reg. 177 at 178.

307 In essence, the rationale of this rule comes from the fact that because national interest required the retention of Canadian control of banks, the same conclusion should apply to securities firms. GOVERNMENT OF ONTARIO, *Report of the Committee to Study the Requirements and Sources of Capital and Implications of Non-Resident Capital for the Canadian Securities Industry* (Toronto, Ont.: Ontario, 1970) at 17.

308 The so-called "exempt" market in Ontario was where government bonds and large blocks of other securities, with a value of Cdn $150,000 or more were traded.

the Quebec securities market remain open to foreigners[309]. Contrary to the prevailing opinion in Ontario, it was felt that foreign participation would reinforce the capitalization of the Quebec securities industry. Consequently, the government of Quebec decided not to impose any restriction on the entry of foreign securities firms into the province or on foreign participation in existing securities firms. In 1983, the QSC ordered the ME to remove its restrictions on membership by foreign participants. Thus, Quebec was the first province to accept the participation of other types of Canadian financial institutions and foreign financial institutions in its securities market[310].

Because the province of Ontario (which houses the highest number of institutions in Canada) continued to maintain strict rules concerning the ownership of securities dealers operating in its territory, Quebec's innovative measure[311] initially had but limited impact[312]. It was to be another four years[313] before Ontario relaxed its rules[314] governing the ownership of securities dealers and allowed financial

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309 QUEBEC, Ministère des institutions financières, *Étude sur l'industrie des valeurs mobilières au Québec*, Rapport final (Quebec, Que.: Éditeur officiel du Québec, 1972).

310 *La propriété et la diversification des firmes de courtage*, Decision n° 6861, (1983) 14:24 B.C.V.M.Q. 2.1.1. COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport d'activités 1983-1984* (Quebec, Que.: Direction générale des publications gouvernementales, 1984) 37.

311 "There is no doubt that Quebec has been an innovative force in the financial services sector, and the catalyst for the recent [Canadian] wave of regulatory change." JORDAN, *supra*, note 306 at 178.

312 In November 1986, the Bank of Nova Scotia (now known as Scotiabank) became the first to register a wholly-owned subsidiary with the QSC as a fully licensed dealer. *Dispense, en vertu de l'article 263 de la Loi, de l'inscription à titre de courtier de la Banque de Nouvelle-Écosse pour la diffusion de la publicité sur les services offerts par 683 657 Ontario Limited*, Decision nº 7991, (1986) 17:47 B.C.V.M.Q. A1.

313 Note that this announcement occurred scarcely a month after the Bank of Nova Scotia registered a securities dealer subsidiary in Quebec. "Toronto was not about to risk taking a back seat to Montreal." JORDAN, *supra*, note 306 at 179.

314 For more information on the subject and on subsequent developments in Ontario, see P.D. MADDAUGH, *International Banking and the Emergence New Regulatory Setting in Canada*, (1988) 4. B.F.L.R. 27 at 43ff. Since no securities firms could allow themselves not to have access to the TSE, Ontario therefore got to control the Canadian securities industry for a while. J.L. DARROCH & I.A. LITVAK, *Gaps, Overlaps and Competition Among Jurisdictions: Evolving Canadian Financial Services Policies and Regulations*, (1992) 26:2 J.W.T.L. 119 at 128.

institutions doing business in Ontario to acquire them[315]. In the end, Ontario's move was provoked by a challenge by TD Bank that proposed setting-up a subsidiary that would offer brokerage services to bank customers[316]. As at June 30, 1987, Canadian banks, insurance companies and trust companies were allowed to own up to 100% of a Canadian securities firm. Also, foreign firms could hold up to 50% of an existing firm or start their own Canadian securities subsidiary, but such businesses were restricted to trades in the exempt securities market for a one year period. The one year restriction was to give domestic institutions a one year head start in organizing their own full-service operations. As of June 30, 1988, foreign firms could then engage in full range of activities in Canadian securities market. Today, there are absolutely no foreign ownership restrictions for securities firms in Canada[317]. A foreign firm may now enter all areas of securities transactions in Ontario upon registration as a foreign dealer. A foreign securities firm may be refused entry, however, if its home country does not allow the unrestrained establishment of Canadian firms in its home market. In addition, all foreign firms must now register with the OSC, since the exempt market in Ontario has been eliminated. Consequently, in addition to the fact that a number of investment dealers have attracted large foreign investors, numerous foreign brokerage firms have acquired a seat on the various Canadian stock exchanges.

3.2 Key Federal Reforms

Until the 1950s, foreign banks with offices in Canada focused their activities on the acquisition of portfolio investments. Even as late as the beginning of the 1960s, the presence of foreign banks was at best marginal. This was a period when a Canadian bank could take over another Canadian bank, even though no law prevented a foreign

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315 *Statement in the Legislature by the Honourable Monte Kwinter, Minister of Financial Institutions: Re: Entry Into and Ownership of the Securities Industry*, (1986) 9 O.S.C.B. 3234. *Statement in the Legislature by the Honourable Monte Kwinter, Minister of Financial Institutions: Re Entry Into and Ownership of the Securities Industry, December 4, 1986*, (1986) 9 O.S.C.B. 6727. See J. RILEY & B. HANSEN, "Canada's Big Bang", *Int'l Fin. L. Rev.* (September 1987) 31. C.L. SUGIYAMA, *Canadian Securities Regulation Update Comment: Canada's "Little Bang"*, (1987) 1 R.I.B.L. 99.

316 CHANT, *supra*, note 17 at 14.

317 The other important Canadian market, British Columbia, also removed its ownership restrictions. W.R. MILES & D.C. FRYDENLUND, *British Columbia's Securities Industry–The Quiet Bang*, (1988) 2 R.I.B.L. 243.

bank from acquiring partial or total control of a Canadian bank, provided the approval of the Minister of Finance had been secured beforehand. In 1963, after the purchase of the Mercantile Bank by the First National City Bank of New York (now Citibank), the Bank Act was revised in 1967 to restrict access to the domestic Canadian market by foreign banks[318]. Here again during this period, FDI in Canada raised much concern about the ability of Canadians to control their own destiny. Thus, restrictions were introduced into laws relating to federal financial institutions to prevent any foreign entry into Canada's banking industry, and limit transfers of shares of other federal financial institutions to foreigners. The 1967 revision of the *Bank Act* also had the effect of expanding the powers of the banks with respect to the consumer loan and mortgage markets[319].

In part, these changes occurred due to the continuing growth of global financial markets. During the late 1970s and early 1980s, large MNCs frequently issued securities usually in the Euromarket, instead of borrowing from their bankers[320]. Countries and institutions that had strong international underwriting and placement capabilities responded well to this demand. Canada's commercial banks were sufficiently large and capitalized to enter the international market. However, their lack of domestic experience due to the existence of the four-pillars regime prevented them from acting in a significant manner. At the same time, Canadian securities firms were too poorly capitalized to strongly attack the Euromarket. These facts support the argument that, if the Canadian regulatory structure could allow Canadian banks to acquire Canadian securities firms or to inject large sums of capital into them,

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318 Here, the rules concerning property prevented banks from entering the market of other financial institutions. No Canadian bank could hold more than 10% of the shares of another Canadian financial institution. In return, the rules concerning property forbade other Canadian institutions from entering banking. No shareholder, resident or non-resident, could hold more than 10% of the shares of a Canadian chartered bank. Rules concerning property also prevented the entrance of foreign banks into Canadian banking. The total number of shares that could be held by non-residents was then set at 25%. *Bank Act* of 1967, R.S.C. 1970, c. B-1, s. 53.

319 *Ibid.*, s. 15.

320 ECONOMIC COUNCIL OF CANADA, *Globalization and Canada's Financial Markets* (Ottawa, Ont.: Minister of Supply and Services Canada, 1989) at 119. ECONOMIC COUNCIL OF CANADA, *A New Frontier: Globalization and Canada's Financial Markets* (Ottawa, Ont.: Minister of Supply and Services Canada, 1989) at 14. ECONOMIC COUNCIL OF CANADA, *A Framework for Financial Regulation* (Ottawa, Ont.: Minister of Supply and Services Canada, 1987) at 26.

Canadian financial institutions could easily adjust to the international competition in securitized instruments[321].

The philosophy behind the four-pillars system was founded on many grounds[322]. Restrictions concerning property or commercial powers were explained by the will of regulatory authorities to diminish the insolvency risk or to prevent conflicts of interest and insider trading. For their part, the restrictions concerning foreign participation was guided by the "national interest" or the declared objective of preserving Canadian control over the Canadian financial industry.

Certain events at the start of the 1980s gave rise to a reexamination of the philosophy behind the four-pillars. Banks were the primary instigators of the renunciation of the philosophy of the four-pillars. They were anxious to enter into other financial sectors. For their part, foreign banks, which could only create "quasi-banking subsidiaries", were looking to enter the Canadian market directly. The first major piece of legislation which marked the end of protectionist trends in the financial sector was the 1980 *Bank Act*[323]. It added a new dimension to the Canadian bank activities by distinguishing between two types of banks: Schedule A and B banks (which later became Schedule I and II banks).

The pressure for the creation of Schedule II banks came from Canadian borrowers who sought greater competition from foreign lenders and foreign banks who saw profitable business opportunities in Canada[324] and from Canadian banks who sought "reciprocal expansion opportunities" abroad[325]. Thus, foreign banks that

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321 B.A. KALYMON, *Global Innovation: The Impact on Canada's Financial Markets* (Toronto, Ont.: John Wiley & Sons, 1989) at 14.

322 For a full rationale of the four-pillars legislation, see W. GROVER & N. CHEIFETZ, "Federal Regulation of Securities Activities of Banks and Other Financial Institutions" in L.S.U.C. Special Lectures, *Securities Law in the Modern Financial Marketplace* (Toronto, Ont.: Richard De Boo, 1989) 9 at 10.

323 K.J. FRIEDMAN, *The Canadian Banks and Banking Law Revision: Competitive Stimulus or Protectionist Barrier ?,* (1981) 13:3 Law & Pol'y Int'l Bus. 483 at 484.

324 For a brief assessment of Schedule II banks see, *e.g.,* D. WALKER, "Pacing Change" *Canadian Banker* (July/August 1992) 12. D. WALKER, "A Good Presence" *Canadian Banker* (April 1987) 16.

325 *Bank Act* of 1980, s. 8. Being analogous to retaliation in trade policy, the principle of reciprocity as it is conventionally applied to trade in financial services implies that a host country discriminates in its treatment of foreign firms by affording each of them

wished to do business in Canada could now do so by establishing banking subsidiaries in Canada that were incorporated following Schedule II of the *Bank Act*[326]. However, they could not open more than one branch in Canada apart from their head office without authorization from the Minister[327]. Overall, the 1980 revisions to the *Bank Act* brought the affiliates of foreign banks under the control of the Canadian regulatory authorities. However, the idea was only to allow entry to foreign banks, not to allow them national treatment. Although, theoretically, they had all the same powers as the Schedule I banks, foreign banks remained subject to many restrictions that limited their operations in Canada. We will examine these more fully when we consider the objectives sought by American banks in the negotiations of the FTA[328].

During the mid-1980s, the government of Canada initiated a major reform of all its financial institutions[329]. In doing so, it could not ignore the new legislative framework of the EU nor the outcome of the American financial reform legislation[330]. This movement was accentuated by certain exterior events such as the bankruptcy of certain banking institutions[331]. It is also important to recall that the calls for reform

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exactly the same treatment that the host country's own firms receive in the foreign firms host country. C.J. LOHMANN & W.C. MURDEN, "Policies for the Treatment of Foreign Participation in Financial Markets and their Application in the U.S.-Canada Free Trade Agreement" in D.M. McCRAE & D.P. STEGER, eds, *Understanding the Free Trade Agreement* (Toronto, Ont.: Carswell, 1989) 147 at 151. "Reciprocity is the threshold of mutual concession that trade partners consider satisfactory enough to sign a trade agreement". P.A. MESSERLIN, "Country Experiences and Perspectives - The European Community" in P.A. MESSERLIN & K.P. SAUVANT, eds, *The Uruguay Round - Services in the World Economy* (New York, N.Y.: International Bank for Reconstruction and Development, 1990) 132 at 142. Note that the policy of reciprocity has occasionally contributed to trade liberalization. OECD, *supra,* note 5 at 69.

326 *Bank Act of 1980*, s. 302. See the definition of foreign bank subsidiary in s. 2 of the *Act*. Foreign banks could also open a representative office, in accordance with s. 302, or create, like before, subsidiaries incorporated in the provinces subject to the restrictions of s. 303.

327 *Ibid.*, s. 173(2).

328 See *infra.* notes 530-538 and accompanying text.

329 See, *e.g.*, J.D. SCARLETT & R.S.G. CHESTER, *Canada Deregulates its Financial Services Industry*, [1987] Int'l Bus. Law. 104. On the consultation process, abundant studies and reports of all kinds, see the complete enumeration given by MADDAUGH, *supra*, note 314 at 28ff.

330 S. HANDFIELD-JONES, *Harmonization in Financial Regulation in Canada*, Report 42-89 (Ottawa, Ont.: Conference Board of Canada, 1989) at vi and 5.

331 See *supra,* note 261.

were set in the context of worldwide deregulation of financial services. At the Canadian federal level, the movement started in 1985 when a policy statement[332] revealed the intention of Ottawa to challenge the division of power in the Constitution[333]. It suggested that the way to solve problems of interprovincial coordination was by centralizing them at the federal level. A committee formed to study this policy statement followed the same path by proposing the establishment of a national financial institutions regulatory and supervisory agency that would replace federal and provincial agencies[334]. In 1986, another report[335] proposed that the federal deposit insurance program[336] apply to securities dealers. The next year, the federal government passed two bills in Parliament: it authorized federally-chartered financial institutions to acquire securities dealers[337] and set up the Office of the Superintendent of Financial Institutions (hereinafter OSFI)[338].

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332 CANADA, *The Regulation of Canadian Financial Institutions: Proposals for Discussion* (Ottawa, Ont.: Minister of Supply and Services, 1985).

333 J. BINAVINCE & H.S. FAIRLEY, *Banking and the Constitution: Untested Limits of Federal Jurisdiction*, (1986) 65 Can. B. Rev. 328.

334 CANADA, *The Report of the Standing Committee on Finance, Trade and Economic Affairs* (Ottawa, Ont.: Minister of Supply and Services, 1985).

335 CANADA, *The Report of the Standing Senate Committee on Banking, Trade and Commerce: Towards a More Competitive Financial Environment* (Ottawa, Ont.: Minister of Supply and Services, 1986).

336 *Financial Institutions Depositors Compensation Act*, S.C., 1985, c. 51.

337 *An Act to Amend Certain Acts Relating to Financial Institutions*, S.C., 1987, c. 26 and Bulletin N° E-1-1, *Shareholdings by Federally-Regulated Financial Institutions in Securities Dealers*, Office of the Superintendent of Financial Institutions, September 1991. Schedule I banks, trust and insurance companies were allowed to own up to 100% of a securities dealer or securities dealer holding company and operate as a full-line securities dealer as at June 30, 1987. They could either purchase an existing dealer firm or start their own. For a detailed discussion of the amendments and repercussion on the Canadian securities industry, see J.M. STRANSMAN & A. GREENWOOD, "Provincial Regulation of Securities Activities of Banks and Other Federal Financial Institutions: The Ontario Perspective" in L.S.U.C. Special Lectures, *Securities Law in the Modern Financial Marketplace* (Toronto, Ont.: Richard De Boo, 1989) 27. A. GREENWOOD, *The Chinese Wall Doctrine: Substantive Legal Theory or Rule of Evidence?*, (1989) 3 R.I.B.L. 271. The reform however did not put Canadian and foreign banks on an equal footing. Foreign banks wishing to gain an important stake in a Canadian securities firm had to obtain authorization from the federal cabinet and proceed to acquire it by means of their Canadian subsidiary. *Bank Act of 1980*, s. 307 and Bulletin N° E-2, *Shareholdings in Investment Dealers by Foreign Banks*, Office of the Superintendent of Financial Institutions, September 1991.

338 *The Financial Institutions and Deposit Insurance System Amendment Act*, S.C., 1987, c. 23.

The consequences of these reforms were soon felt[339]. The large Canadian chartered banks acquired the most important Canadian securities firms. The Japanese, European and Americans also got into position in the market[340]. But the Canadian banks with their established network of branches across the country were well positioned to face foreign competition[341]. These linked operations created a Canadian investment dealer structure that was significantly strengthened in its capital base and in its international presence. At the same time, the Canadian banks were able to acquire significant expertise in the securities business, and could strengthen their ability to participate in the trend to securitization.

For the provinces, however, the permission given to federal financial institutions to acquire securities dealers caused disagreement. In practice, Canada started to experience the birth of a dual-regulation system concerning securities. In fact, the federal government wanted to regulate and supervise this newest category of bank subsidiary as well as its environment to make certain that nothing out of its control would threaten the solvency of the banking system. The OSFI's conditions imposed on federal financial institutions acquiring a securities firm affected several aspects of the securities dealers operations (from the choice of name to the rules governing self-dealing)[342].

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339 MADDAUGH, *supra*, note 314 at 45-46. J.E. FORDYCE & M.L. NICKERSON, *An Overview of Legal Developments in the Banking and Financial Industry in Canada*, (1991) 25 Int'l Law. 351 at 359ff.

340 Many foreign firms bought stakes in a number of Canadian brokerage houses and a number of foreign investment dealers opened offices in Canada. See, *e.g.*, B. McGOLDRICK, "Little Bang Brings Down Barriers" *Euromoney* (November 1988) 159. J. LEWIS, "Little Bang's Sputtering Start" *Institutional Investor* (October 1988) 267. M. CRABBE "Canada: Banking and Dealing — A Question of Synergy" *Euromoney* (November 1987) 67. "Deregulation: Canada Lifts All Barriers Between Banks and Brokers" *Asian Finance* (15 November 1987) 13. D.R. FRANCIS, "Canada's Baby Bang Resounds Beyond Securities Industry" *Financier* (July 1987) 14.

341 G.F. BOREHAM, "The Changing Landscape of the Financial Services Industry in Canada" *Services Industries Journal* (April 1989) 191 at 193. B.M. LEWITT & S.P. BATTRAM, *Canada/United States Trade in Financial Services*, (1987) 3 J. of Int'l Banking L. 159 at 161.

342 The banks that had acquired securities dealers also complicated the separate regulation of the banking and securities businesses even further by sharing premises and personnel. This problem was solved by provincial securities commissions which adopted national regulation principles to distinguish between the activities of a deposit institution and those of its securities-dealer subsidiary. In Ontario, see *Notice — Principles of Regulation; Re: Full Service and Discount Brokerage Activities of Securities Dealers in Branches of Related Financial Institutions*, (1988) 11 O.S.C.B. 4627. In Quebec, see *Avis - L'activité de courtier de plein exercice et de courtier exécutant dans les succursales d'institutions financières*, (1988) 19:46 B.C.V.M.Q. 1.

At the time when the FTA negotiations were under way, the Americans saw the dual-regulation system as constituting an important barrier to trade of securities-related services. While Ontario, Quebec and other provinces had liberalized their securities markets and had welcomed foreign investors, the federal government implemented a policy of reciprocity which held up the application for entry by U.S. securities firms and banks. To better understand this situation, it is necessary to note that the immediate issue that arose from the ownership by Canada banks of the major securities dealers in Canada was that of regulation. A major issue to be determined was the degree to which securities activities ought to be determined by federal banks regulators. In the course of a series of negotiations between the federal government and the province of Ontario, an agreement (commonly known as the "Hockin-Kwinter Accord") was reached in April 1987 as to what types of activities might be carried on in the financial institutions and what activities could only be carried on in the securities subsidiary[343].

Under the Hockin-Kwinter Accord, it was agreed that only a securities dealer or the securities subsidiary of a federal financial institution would engage in the primary distribution of both equity and debt securities, the secondary trading of shares, portfolio management and investment counselling. These activities would have to be regulated at the provincial level. Under the Accord, certain securities-related activities were to be performed by the federal financial institutions and be regulated by the OSFI. Some of these activities included those with respect to government-related securities, money market, debt securities of federal financial institutions (including

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COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport d'activités 1988-1989* (Quebec, Que.: Publications du Québec, 1989) 35.

343 *Federal - Ontario Accord: Securities Related Activities of Banks and Federally Incorporated Insurance Companies*, (1987) 10 O.S.C.B. 2553. The Hockin-Kwinter Accord was incorporated into the regulations under the OSA (R.S.O., 1980, c. 466—O.Reg. 345/87, s. 181). On the Accord. see W. McKEE, "The Federal-Ontario Securities Accord" in Insight Educational Services, *How to Survive in the New Financial Marketplace*, (Toronto, Ont.: Insight, 1987), Tab. 1. STRANSMAN & GREENWOOD, *supra,* note 337 at 28-29. In the other provinces, there was no MOU similar to that of the Hockin-Kwinter Accord. In the case of the province of Quebec, the QSC and the OSFI signed a broader agreement. *Avis — Entente entre la Commission et le Bureau du surintendant des institutions financières*, (1988) 19:14 B.C.V.M.Q. 1.

bankers' acceptance) and all secondary market trades in corporate debt securities[344]. The parent financial institution was permitted, if it chose, to deal in securities which previously had been part of the "exempt market"[345] and, to the extent permitted by the governing statute, engage in investment advisory activities and provide portfolio management services.

The government of Ontario thought the Accord would allow it to keep exclusive jurisdiction over the activities of the securities subsidiaries of federal financial institutions. Ontario (much like the other provinces) was disappointed[346] when during the FTA negotiations, the OSFI published its guidelines G-17(a) and G-17(b)[347]. A rapid analysis of these guidelines lead to three conclusions. First, it was the intention of the federal government to regulate (directly or indirectly) the brokerage activities of subsidiaries of federal financial institutions and foreign brokerage firms. Second, in the name of a political reciprocity, the federal government unilaterally gave itself the right to approve all requests made by foreign banks interested to obtain a participation of more than 10% in the capital of a Canadian broker or interested to establish a Canadian securities brokerage subsidiary[348]. Thirdly, these rules also applied to

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344 *Ibid.*, STRANSMAN & GREENWOOD, *supra*, note 337 at 42. Other in-house securities activities of a federal financial institution not subject to provincial regulation included: (i) capital market activities in syndicated or consortium loans; and (ii) unsolicited participation in secondary trading of equity securities (provided execution is through a registered dealer).

345 Not covered under provincial regulations are exempt securities consisting of government bonds, short-term commercial paper and privately placed corporate securities distributed without prospectus qualification. With respect to the "exempt market": see, *e.g.*, K.G. OTTENBREIT, *Exemptions for Institutional Investors or Concepts of Non-Public Offerings: A Comparative Study – Canada*, (1993) 13 U. of Penn. J. Int'l Bus. L. 477.

346 N. LADOUCEUR, *Le contrôle des conflits d'intérêts: mesures législatives et murailles de Chine* (Cowansville, Que.: Yvon Blais, 1993) at 43. J.P. CRISTEL, "Les barrières canadiennes à l'accès au marché des entreprises de services financiers" in A.L.C. de MESTRAL, ed., *Access to Markets Under the Canada/U.S.A Free Trade Agreement* (Montreal, Que.: Institute of Comparative Law, McGill University, 1988) 61 at 62.

347 Guideline N° G-17(a), *Shareholding in Investment Dealers*, August 20, 1987, and Guideline N° 17(b), *Shareholding in Investment Dealers by Foreign Banks*, August 20, 1987. For full text of the Guidelines, see STRANSMAN & GREENWOOD, *supra*, note 337 at 50-55.

348 After guidelines G-17(a) and G-17(b) were adopted, "[c]omplaints were voiced that the Canadian federal government was deliberately dragging its feet in approving applications by non-residents for entry into the securities industry in an attempt to win concessions from [...] the [U.S.] with respect to the ownership of securities dealers by Canadian banks in such [jurisdiction]". JORDAN, *supra,* note 306 at 181 n. 18.

foreign banks, even if they had no intent to have banking operations in Canada. Moreover, the federal government indicated that it would not approve any request prior to the signing, by the financial institution concerned and its brokerage subsidiary, of all complex contractual undertakings based on guidelines G-17(a) and G-17(b).

In practice, the implementation of the guidelines was considered by some experts to be an interference with the liberalization process which took place under the FTA[349]. Hence, this policy was considered to have compromised the approach of openness undertaken by the provinces towards foreign brokers and financial institutions. Other critics believed the federal government had jurisdiction to apply all its policies, where *de novo* incorporations were concerned[350]. With regards to this controversy, the FTA remained neutral and respected the present *status quo* in that it allowed the federal government to maintain its restrictive and somewhat discriminatory policy towards U.S. brokers and financial institutions, even though all provinces had adopted an open-door policy since 1986[351]. The result was postponement and delayed approval of applications for entry by U.S. brokers and banks[352]. A quick solution was sought to this important problem. To determine who should conduct the audit of securities activities and what rules should apply to deal with conflicts of interest that may arise between the securities subsidiary and its parent financial institution, the province of Ontario addressed the issues in a Memorandum of Understanding

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"Canada Seeking Concessions, Is Stalling Firms Entering Its Securities Fields" *The Wall Street Journal [of New York]* (7 October 1987) 16.

349 CRISTEL, *supra,* note 346 at 63.

350 Their opinion was to the effect that the government had, subject to the expression of principle set out in Article 1703 para. 3 of the FTA, jurisdiction because the liberalization provisions of Article 1703 only apply to "Canadian-controlled financial institutions". See comments made by D.C. ROBERTSON, in de MESTRAL, ed., *supra,* note 346, 64 at 65.

351 FTA, Article 1703 para. 4.

352 For the U.S. the FTA somewhat solved this problem. "[W]hile Ontario, Quebec and other provinces have liberalized their securities markets and have welcomed foreign investors, the Federal government implemented a policy of reciprocity which has held up applications for entry by U.S. securities firms and banks. Under [the FTA] these applications [...] will be reviewed strictly on a prudential basis, just as for Canadian firms, and not on a reciprocity basis". Hearings Before the Committee on Banking, Finance and Urban Affairs (statement of Thomas J. Berger, Deputy Assistant Secretary for Monetary Affairs, Department of the Treasury) May 24, 1988 at 9.

(hereinafter MOU) entered into between the OSC and the OFSI in 1988[353]. Despite this arrangement, the federal government maintained its interest in the area of securities regulation.

In 1989, a federal government study[354] confirmed the intention of Ottawa to intervene in the securities field. This desire of intervention was justified by the fact that it had to achieve its objectives which concern: (i) allocation of investor capital in the economy; and (ii) encouraging the use of savings for certain purposes to which the federal government assigns a high priority (Canadian ownership, etc.). Also, the study reproduced the familiar argument of the "Canadian voice" in other countries[355]. Under this view, only the federal government should hold the power to define, negotiate and participate in decisions taken in international forums on securities issues. In addition, it should protect the integrity of the Canadian regulatory framework against international pressures from other jurisdictions which, in theory, could cause provincial authorities to relax rules governing trade and circulation of securities in Canada. Consequently, Ottawa mounted an attack to gain accrued powers.

As a result, the banks obtained a number of privileges with respect to securities-related activities conducted in bank branches. For instance, numerous provincial regulations now deal with "networking arrangement" entered into between Canadian chartered banks (generally referred to in the regulation as "financial intermediaries") and their securities subsidiaries or affiliates[356]. In addition, the Canadian Securities Administrators (hereinafter CSA[357]) issued a notice dated November 4, 1988 which established "Principles of Regulation" to be applied to arrangements under which securities dealers related to financial intermediaries are permitted to sell mutual funds

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353 *Memorandum of Understanding Between the Office of the Superintendent of Financial Institutions and the Ontario Securities Commission*, (1988) 11 O.S.C.B. 1411.

354 CANADA, *Federal Involvement in the Canadian Securities Industry* (Ottawa, Ont.: Minister of Supply & Services, 1989).

355 This view was reiterated in the 1991 federal government's constitutional proposals for the Canadian economy. M.M. HARRIS, "Securities Regulation: Should the Scope of Federal Regulation Expand?" *Canadian Financial Services Alert* (April 1992) 14.

356 In Ontario, see the Regulation published under the Ontario Securities Act, R.S.O. 1980, c. 466, as amended (hereinafter OSA) at s. 219. In Quebec, see the Regulation published under the Quebec Securities Act, R.S.Q., c. V-1.1 as amended (hereinafter QSA) at s. 236.3.

357 On the CSA, see *supra*, note 224.

through the branch offices of such financial intermediaries[358]. A second notice published by the CSA dated November 17, 1988 established "Principles of Regulation" to be applied to arrangements under which securities dealers related to financial intermediaries are permitted to conduct full service and discount brokerage activities through such branch offices[359]. A third notice dated May 11, 1990 established further "Principles of Regulation" dealing with selling arrangements between related financial institutions and securities firms, transfers of client information between related financial institutions and securities firms and the settling of securities transactions by securities firms through a client's account at a related financial institution[360]. However, having established it wanted more powers, the federal government decided to orchestrate further attacks to regulate the securities sector.

On June 1, 1992, the federal government implemented a framework of the various categories of federal financial institutions[361]. However, this legislative phase of

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358 *Distribution of Mutual Funds by Financial Institutions — Canadian Securities Administrators Principles of Regulation*, (1988) 11 O.S.C.B. 4436. *Avis — Le placement des titres d'organismes de placement collectif par les institutions financières — Principes de réglementation*, (1988) 19:45 B.C.V.M.Q. 1 and 39. COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport d'activités 1988-1989* (Quebec, Que.: Les Publications du Québec, 1989) 29.

359 *Full Service and Discount Brokerage Activities of Securities Dealers in Branches of Related Financial Institutions — Canadian Securities Administrators Principles of Regulation*, (1988) 11 O.S.C.B. 4630. *Avis — L'activité de courtier exécutant dans les succursales d'institutions financières*, (1988) 19:46 B.C.V.M.Q. 1. COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport d'activités 1988-1989, Ibid.* at 35.

360 *Principles of Regulation — Re: Activities of Registrants Related to Financial Institutions*, (1990) 13 O.S.C.B. 1778. *Avis — Les activités de personnes inscrites reliées à une institution — Principes de réglementation*, (1990) 21:19 B.C.V.M.Q. 3; COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport annuel 1990-1991* (Quebec, Que.: Publications du Québec, 1991) 33.

361 On that date, a new framework for competition in the financial sector was put in place by removing many restrictions on financial institutions. See, *e.g.*, F. DANIEL, C. FREEMAN & C. GOODLET, "La restructuration du secteur financier au Canada" *Revue de la Banque du Canada* (Winter 1992-1993) 21. A.L. WOOD, *Canadian Federal Financial Institution Legislative Reform*, (1992) 5:4 Canada-U.S. Trade 25. Overall, legislative reforms broke down barriers and allowed financial institutions to compete more directly with each other. Also it laid the groundwork for discussions on harmonizing the regulation and supervision of all Canadian financial institutions. Changes had to be made to the *Trust and Loan Companies Act*, S.C. 1991, c. 45, the *Bank Act*, S.C. 1991, c. 46, the *Insurance Companies Act*, S.C. 1991, c. 47, and the *Cooperative Credit Associations Act*, S.C. 1991, c. 48. New acts arising from the reform totalled nearly 1300 pages and 2500 sections. The new *Bank Act* has almost

reform raises serious problems in terms of the division of powers[362]. Indeed, some say the reform brings about the superimposition of federal rules on already existing provincial rules[363]. Overall, the reform follows a double objective: to allow greater competition in the financial sector in Canada and to ensure greater protection of consumers.

Rightly so, Canadian banks are described as the big winners of reform[364]. Enlivened by their new powers, they are able to build veritable financial empires or even become, following the expression, financial supermarkets[365]. The reform also had

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twice as many sections as the previous one. A. GREENWOOD, *Federal Financial Reform Legislation — A New Era*, (1993) 8 B.F.L.R. 215 at 236.

362 The intentions of the federal government to touch upon provincial jurisdictional powers were made public a year earlier. In 1991, the federal government put forward proposals *(Shaping Canada's Future Together - Partnership for Prosperity* (Ottawa, Ont.: Minister of Supply and Services, 1991) set out to incorporate both constitutional and non-constitutional changes intended to bring about a new political and economic renewal. The government proposed "to enhance the functioning of the economic union " ... " by working actively with the provinces to clarify responsibilities in the financial sector". To do so, it also proposed to "work closely with the provinces to develop more efficient and better coordinated corporate securities regulation which will be essential in an international environment where unnecessary duplication risks business going elsewhere. It will also be important for Canada to have a more effective presence in international groups dealing with securities matters". *Ibid.* at 31. The federal government's desire to gradually penetrate the securities areas was reaffirmed when it suggested that regulation could develop into a "more formalized federal-provincial action to co-ordinate approaches to regulation, international negotiations and standard-setting, involving securities matters". *Ibid.* at 26. See also J.S. GRAHAM, "Proposed Constitutional Reform - Implications for the Financial Sector" *Canadian Financial Services Alert* (December 1991) 44. D.G. LENIHAM, *L'Union Économique: remarques sur les propositions fédérales*, Réseau sur la Constitution, Dossier spécial, numéro 1, 1991 at 4.

363 According to a former chairman of the OSC, "[e]ven those who are strongest advocates of a federal securities commission shudder at the thought of there being a federal securities regulatory authority superimposed upon the structure which presently exists". K. HOWLETT, "Federal Securities Regulation a Nightmare, OSC Head Says - Wright blasts Ottawa for not Consulting with Provinces" *The [Toronto] Globe and Mail* (25 June 1992) B1. *Notice — Remarks of Robert J. Wright — Toronto Society of Financial Analysts — Wednesday, June 24, 1992,* (1992) 15 O.S.C.B. 2889 at 2891.

364 G.F. BOREHAM, "Three Years After Canada's Little Bang" *Canadian Banker* (May 1990) 6 at 6. P. Durivage, "Entrée en vigueur de la réforme du système financier" *La Presse [of Montreal]* (30 May 1992) H-1. Independent investment dealers argue that Canada's banks already control too much of the industry and want the Bureau of Competition Policy to intervene in a coming federal reform of financial services laws. J. PARTRIDGE & K. HOWLETT, "Watchdog to Aid Reform of Financial Laws" *The [Toronto] Globe and Mail* (1 December 1995) B1.

365 S. HAGGETT, "Banks Become Financial Supermarkets" *The Financial Post [of Toronto]* (Special Report) (10-12 September 1994) S25.

important spin-offs for foreign banks. With the breaking down of the barriers to the entry of foreign firms into the Canadian domestic market, the question of their sensitivity to the host country's national goals became more prominent. The American Express case illustrates the difficulties that can arise when foreign institutions enter markets that are subject to different regulations than their home market[366]. To further understand the FTA and NAFTA and measure their impact on the securities industry in Canada, a brief overview of the salient points of the 1992 reform is necessary. However, the reader should note that it is impossible to summarize and deal with all the relevant sections in one brief commentary within a thesis.

On many aspects, the *Bank Act* is modeled after the *Cooperative Credit Associations Act*, the *Insurance Companies Act* and the *Trust and Loan Companies Act*[367]. The understanding reached in the Hockin-Kwinter Accord has been implemented in the *Bank Act* in a number of places, including the restriction on the securities activities of banks (s. 415), in the Regulations made thereunder and in the inclusion of investment counselling and portfolio management services in the business of banking (s. 409(2)(c)).

A considerable number of regulations have been revoked by the reform of financial

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366 The uproar about the approval, by the federal government, of the application by American Express to establish a Schedule II bank through its Travel Related Services division led to several types of complaints. The first is that the approval came immediately prior to the coming into force of the reform. The second issue is that only a bank may open a foreign-bank subsidiary, and some have argued that the Travel Related Services division did not conform to the definition of a bank. A. TOULIN, "Amex to Launch Bank Before Legislative Reform" *The Financial Post [of Toronto]* (7 February 1990) 1. "Cabinet Gives Approval of American Express Bank" *The [Montreal] Gazette* (27 May 1989) C3. J. KOHUT, "MPs Determined to See Amex File" *The [Toronto] Globe and Mail* (10 May 1989) B1. J. KOHUT, "Bank Regulator Will Not Hold Hearings on Amex Request for Canadian Licence" *The [Toronto] Globe and Mail* (6 May 1989) B5. G. BRETT, "Banks Are Right to Test Amex Bank Decision" *The Toronto Star* (31 January 1989) B6. At one point, American Express was to be followed by Merrill Lynch and become the second U.S. non-bank financial institution to establish a bank in Canada. However, in view of all the controversy, Merrill Lynch dropped its request. J. McNISH, "Merrill Lynch Seeks Bank Licence" *The [Toronto] Globe and Mail* (12 January 1989) B1.

367 In fact, the initial model to all four acts was the proposed Bill C-83 *Trust and Loan Companies Act*, 22nd Sess., 34th Parliament, 38 & 39 Eliz. II, 1989-1990. C.J. BOIVIN, "La nouvelle Loi sur les banques" in SERVICE DE LA FORMATION PERMANENTE DU BARREAU DU QUÉBEC, ed., *Développements récents en droit bancaire (1991)* (Cowansville, Que.: Yvon Blais, 1991) 99 at 100.

institutions[368]. Most of these revoked regulations have been replaced at the time of the reform or shortly thereafter[369]. The core regulations stating the banks' securities powers are entitled the *Securities Dealing Restrictions (Banks) Regulations*[370].

This regulation states that, with respect to primary market activities, a bank may not, in Canada[371], deal in securities if it consists in the distribution: (i) of shares or ownership interests, or warrants; or (ii) of debt obligations of a corporate body[372]. However, a bank is not prevented from dealing in securities (for its own account or any account it administers) where it consists in the distribution of debt obligations or warrants, or is guaranteed by: (i) the federal, provincial or municipal governments (or any agency thereof); (ii) a public utility corporation owned by a government; (iii) a foreign government one of its political subdivision or agency; and (iv) an international agency of which Canada is a member[373]. Moreover, a bank may deal in the same distribution of debt obligations, shares, ownership interests or warrants of the bank itself (or an affiliated entity it guarantees) or that are money market securities[374]. Also, a bank may engage in the effecting of a private placement of securities of a corporation on the basis that it is similar to the basis on which a member of a selling group participates in respect of an underwriting[375]. Further, a bank is not prevented from being part of a consortium or syndicate of financing or lending institutions to effect a loan[376]. Finally, a bank may act as a member of a selling group with an

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368 *Department of Finance Omnibus Revocations Order,* SOR/92-329.

369 For a general description of the new Regulations, see *Regulatory Impact Analysis Statement, Canada Gazette* Part I (22 February 1992) 423.

370 SOR/92-279 modified by SOR/92-364. Compare *Securities Dealing Restrictions (Trust and Loan Companies) Regulations*, SOR/92-272 modified by SOR/92-362. *Securities Dealing Restrictions (Insurance Companies) Regulations*, SOR/92-280 modified by SOR/92-365. *Securities Dealing Restrictions (Cooperative Credit Associations) Regulations*, SOR/92-278 modified by SOR/92-363.

371 On overseas securities activities of Canadian banks, see, *e.g.*, J.C. PATTISON, "Banking the Crucible" *Canadian Banker* (February 1987) 16.

372 *Bank Act, supra,* note 266, s. 2(a), (c). "Astonishingly, until the 1980 revision of the federal *Bank Act* there was no formal prohibition on banks dealing in corporate securities; the banks had voluntarily withdrawn from the market during the 1930s". JORDAN, *supra,* note 306 at 179.

373 *Bank Act, supra,* note 266, s. 3(2), (a).

374 *Ibid.*, s. 3(2)(b), (c), (d).

375 *Ibid.*, s. 3(2)(h).

376 *ibid.*, s. 3(2)(i).

underwriting of securities[377].

As for secondary market activities, a bank may not trade in shares or ownership interests or warrants[378]. However, it may trade shares, ownership interests or warrants if it is done by a registered broker[379]. About mutual fund activities, a bank may not act as a selling agent[380] except in special cases[381]. Currently, banks may establish and manage their own investment funds and may distribute them through their branch network. These activities are subject to regulation under the securities legislation of the various Canadian jurisdictions. Over the last decades, the CSA have been concentrating their efforts in respect of the regulation of the investment fund industry on the development of uniform requirements for investment funds, as evidenced by NPS N^{os} 36[382] and 39[383]. Unless an exemption is granted by the CSA, the Principles of Regulation[384] do not permit a bank (and trust company) to sell third party funds through their branch network although they are permitted to sell third party funds through their discount brokerage firms. Among the reasons for this restriction on the sale of third party funds through branch networks are concerns about the adequacy of the education and proficiency skills of employees of banks (and trust companies) to sell investment fund securities to the public. Also, the traditional bank products substantially differ from investment fund securities. Thus, employees in branches cannot devote their full time and attention to investment fund sales.

The key point of the reform was the removal of the restrictions imposed on banks with

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377 *Ibid.*, s. 3(2)(g).

378 *Ibid.*, s. 2(b).

379 *Ibid.*, s. 3(2)(e).

380 *Ibid.*, s. 2(d).

381 *Ibid.*, s. 3(2)(f).

382 *National Policy Statement N° 36 — Mutual Funds: Simplified Prospectus Qualification System, Avis — Prospectus simplifié de la société d'investissement à capital variable et du fonds commun de placement*, (1985) 16:2 B.C.V.M.Q. 15.

383 *National Policy Statement N° 39 — Mutual Funds*, (1988) 11 O.S.C.B. 5041 (as amended). *Instruction générale n° C-39 — Organismes de placement collectif*, (1988) 19:51 B.C.V.M.Q. 51 (as amended).

384 *Avis — Le placement des titres d'organismes de placement collectif par les institutions financières — Principes de réglementation*, (1988) 19:45 B.C.V.M.Q. 1; 39; COMMISSION DES VALEURS MOBILIÈRES DU QUÉBEC, *Rapport d'activités 1988-1989* (Quebec, Que.: Publications du Québec, 1989) at 35.

respect to providing investment advice and portfolio management. However, according to the Hockin-Kwinter Accord, the removal of these restrictions was not total. Under the Accord, it was agreed that some unspecified portion of investment counselling and portfolio management would be permitted in-house but that the balance would have to be carried on through subsidiaries or affiliates of the bank and would be regulated at the provincial level. The duality of this approach raised several difficult issues such as: (i) where should the dividing line be drawn between activities permitted in-house and those require to be carried out through subsidiaries?; (ii) who should regulate which activities, and should such regulation be overlapping?; (iii) should officers, employees and even premises be separate in order to facilitate regulatory supervision and avoid conflicts? etc. The Hockin-Kwinter Accord addressed these issues only to a limited degree. For this reason, the Accord called for possible further consultation between the two levels of government and recognized the need for harmony between the two sets of regulations.

As of yet, no banking regulation has been promulgated proposing terms or conditions on the provision of investment counselling and portfolio management services (s. 410(3)(b)). However, a draft regulation[385] has been prepared and is being discussed with the various Canadian securities commissions and SROs. These activities have long been a bone of contention between the provinces and the federal government. Traditionally, they have been the territory of provincial regulators, but banks have steadily been pushing into the lucrative, fee-generating business[386]. The federal government's plan has drawn fire from the provinces[387]. Essentially, the draft regulation is intended to apply to the in-house services of federally-regulated financial institutions that are equivalent to those provided by advisory firms registered with

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385 *Portfolio Management Services and Investment Counselling Services (Banks/Insurance Companies/Trust and Loan Companies) Regulations - Draft* (Ottawa, Ont.: Ministry of Finance, 1993). For an overview, see "Background Paper on Portfolio Management and Investment Counselling by Federally-Regulated Financial Institutions" *Canadian Financial Services Alert* (December 1993) 33.

386 G. PITON, "Banks Moving Into Management of Portfolios" *The [Toronto] Globe and Mail* (26 November 1991) C5.

387 H.D. WHYTE, "Ontario May Change Role as Watchdog" *The Financial Post [of Toronto]* (14 November 1992) 8. H.D. WHYTE "Looser Rules Loom for Banks: Provinces Oppose New Ottawa Plan on Investing" *The Financial Post [of Toronto]* (21 July 1992) 3. D. SLOCUM, "Securities Rules Overlap Attacked: Provincial Regulators Want Feds to Keep Out" *The [Toronto] Globe and Mail* (18 September 1992) B7.

provincial securities commissions in the investment counsellor/portfolio manager category. The draft regulation would require that investment advice be formulated and delivered to clients by individuals employed by federally-regulated financial institutions who meet qualifications that are at least as stringent as those that have to be met by registrants under provincial securities legislation in the investment counsellor/portfolio manager category[388]. The draft regulation would also generally track comparable provincial rules with respect to institutional conflicts of interest, duties to clients and supervision.

Some suggest that banks and other federal financial institutions should be required to provide portfolio management and investment counselling services through provincially regulated subsidiaries to provide a more level playing field with other advisors[389]. Others argue that the use of provincially regulated subsidiaries is unnecessary, costly and inefficient[390]. Still, one thing is certain: by gradually expanding the regulated powers of banks, the federal government is able to expand its jurisdiction and control over the financial system[391]. Eventually, if banks can

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388 The draft regulation calls for two different designations for in-house bank portfolio managers and investment counsellors. The banks are expected to perform the regulatory function in both cases. The first category (a qualified advisor) must either be registered with a provincial securities commission or, in the view of the bank, meet the same criteria as a provincially registered counsellor. A list of these non-registered advisers is provided to the OSFI on a periodic basis. There are no set qualifications for the second category (associate advisor). A bank, at its discretion, will be able to appoint employees to use investment portfolios created by the bank's qualified advisors when dealing with clients.

389 C.F.M. WALSH, "Why Worry About PMIC?" *Canadian Financial Services Alert* (December 1993) 37 at 38. H.D. WHYTE, "Big Banks Battling For Slice of Portfolio Management Action" *The Financial Post [of Toronto]* (11 September 1993) 22. H.S. WHYTE, "Banks Rethink Portfolio Management" *The Financial Post [of Toronto]* (11 September 1993) 16.

390 B. GOULARD, "Portfolio Management and Investment Counselling Services: Duplication and Over Regulation" *Canadian Financial Services Alert* (December 1993) 38.

391 J. FERRABEE, "Banks' Power More Worrisome than their Huge Profits" *The [Montreal] Gazette* (9 December 1995) C4. K. HOWLETT & J. PARTRIDGE, "Investment Dealers Warn of Bank Oligopoly" *The [Toronto] Globe and Mail* (6 December 1995) B1. D. WESTELL, "Banks' Securities Practices Spark Complaints by Brokers" *The Financial Post [of Toronto]* (6 December 1995) 3. In 1992, OSC's then-Chairman Wright expressed the view that "there is every indication that the federal government is, whether intentionally or not, developing a parallel system of regulation [...]. *Notice — Remarks of Robert J. Wright — Toronto Society of Financial Analysts — Wednesday, June 24, 1992*, (1992) 15 O.S.C.B. 2889 at 2890.

engage in virtually all financial services, the "financial services" might become equivalent to the "business of banking" referred to in s. 409 of the *Bank Act*[392]. This distinction may be crucial to the Canadian securities industry as a whole when delivering "financial services" or being defined as "financial institutions" under NAFTA.

Having said this, another federal-provincial conflict concerning the securities industry lurks on the horizon and may have a determining effect on the eventual interpretation of NAFTA: the ever-existing possibility of witnessing the creation of a national securities commission.

3.3 Towards a Canadian Securities Commission

The pressures for international rules may be seen in juxtaposition with the long-time controversy in Canada about the desirability of a single national securities commission[393].

As mentioned before, securities legislation was first enacted in Canada at the provincial level[394]. Despite the Depression and a recommendation in 1935 by a Royal Commission that an "Investment or Securities Board" be created to review the capital structure of any federal corporation that wished to sell its securities to the public[395], no attempt was made by the federal government to enter this field, in part, perhaps because of the Privy Council's restrictive interpretations of Parliament's

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392 The concept relating to the "business of banking" existed prior to the reform of 1992. See *Bank Act of 1980,* s. 173 (1). Traditionally, this term has been given a liberal interpretation by the courts. B. CRAWFORD, *Crawford and Falconbridge Banking and Bills of Exchange,* 8th ed., Vol. 1 (Aurora, Ont.: Canada Law Book, 1986) at 11-20, 329-330, 1190-1191.

393 See generally, J.L. HOWARD, "Securities Regulation Structure and Process" in *Proposals for a Securities Market for Canada,* Vol. 3, Background Papers (Ottawa, Ont.: Minister of Supply and Services, 1979) 1607 at 1689-1697.

394 The first statute was enacted in Manitoba; see *Sale of Shares Act,* S.M. 1912, c. 75. See also *Sale of Shares Act,* S.S. 1914, c. 18. The history of Canadian securities regulation is discussed in J.P. WILLIAMSON, *Securities Regulation in Canada* (Toronto, Ont.: U. of Toronto Press, 1960), c. 1. *Supplement* (Ottawa, Ont.: Government of Canada, 1966) c. 1.

395 CANADA, *Report of the Royal Commission on Price Spreads* (Ottawa, Ont.: King's Printer, 1935) at 44.

legislative jurisdiction over matters involving business relations[396]. Whatever the reason, during the succeeding decades, even though there was some dissatisfaction expressed over the inconvenience and cost resulting from a lack of uniformity in the various provinces, local administration of legislation designed to prevent fraudulent sales of securities was generally accepted as preferable to a centralized federal scheme[397]. By 1964 however, a desire for uniform securities laws with "high standards of disclosure, competence and ethics" and an antipathy towards unnecessary duplication under the existing provincial legislation led the Royal Commission on Banking and Finance to recommend the creation of a federal regulatory agency to clear interprovincial and international distributions of securities and to enforce the securities fraud provisions in the Criminal Code[398]. The *Report of the Royal Commission of Banking and Finance* initiated a period of active and constant reconsideration and reform of securities laws in Canada. Also, the Commission's recommendation, with assistance from the Canadian Bar Association directed the attention of the federal government to the securities market. It resulted in the creation of a "Securities Task Force" to examine topics such as criminal law and securities markets, mutual funds and self-regulation[399]. It also considered possible mechanisms for federal-provincial co-operation in light of the Canadian Securities and Exchange Commission (hereinafter CANSEC) proposal circulated by the OSC[400].

Although no bill was introduced in Parliament, the possibility of a federal agency continued to receive attention. The provinces, however, during this period made substantial progress towards uniformity. The Ontario Act had been adopted (with

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396 See, *e.g.*, ANISMAN & HOGG, *supra*, note 55 at 157-158.

397 See, *e.g.*, CANADA, *Report of the Royal Commission on Dominion-Provincial Relations* (Ottawa, Ont.: King's Printer, 1940) at 57-58.

398 CANADA, *Report of the Royal Commission of Banking and Finance* (Ottawa, Ont.: Queen's Printer, 1964) at 348-349.

399 CANADIAN BAR ASSOCIATION, *Aide Mémoire: Re Canadian Securities Legislation and Administration*, Ottawa, April 1966.

400 On the Ontario proposal, see *CANSEC: Legal and Administrative Concepts*, [1967] O.S.C.B. 61. H.H. MAKENS, *An American State-Federal Perspective on the Proposals*, (1981) 19 Osgoode Hall L.J. 424 at 439. See also, R. LANGFORD & J. JOHNSTON, *The Case for a National Securities Commission*, [1968] U. Toronto Commerce J. 21. P.F. De RAVEL D'ESCLAPON, *Fondements constitutionnels d'une réglementation des valeurs mobilières au Canada*, (1968) 3 R.J.T. 377 at 409.

minor modifications) by the other provinces[401]. A series of NPSs applicable across the country plus another series of uniform act policies applicable in some provinces were initiated by the provincial commissions in an attempt to avoid unnecessary delays in processing prospectuses and to ensure consistency of administrative interpretation[402].

In the early 1970s, the federal government examined its policy with respect to the Canadian securities market. In response to the OSC's proposed CANSEC, the federal government indicated a desire to introduce legislation regulating international and inter-provincial issues of and trading in securities[403]. By 1975, the federal government had commissioned the preparation of a draft federal securities act. In 1979, the result was the release of *Proposals for a Securities Market Law for Canada*[404]. Just a few years afterwards, the Supreme Court of Canada opened a door for the creation of a federal securities commission[405]. Later, Ottawa continued to take the view that the federal government should intervene in the securities field but only through a reform of federal financial institutions[406].

However, many provinces wanted Ottawa to act more quickly in creating a CANSEC[407] and seek to harmonize securities regulation as soon as possible[408].

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401 See, *e.g., Notice: Statement by the Honourable Eric A. Winkler, Minister of Consumer and Commercial Relations on Introduction of the Securities Act, 1972, for First Reading, June 1st, 1972*, [1972] O.S.C.B. 94.

402 L. LOCKWOOD, "Procedures in Cross-Country Prospectus Clearance and Regulation by Policy Statement" in L.S.U.C. Special Lectures, *Corporate and Securities Law* (Toronto, Ont.: De Boo, 1972) 111.

403 This desire was articulated in 1971 and 1972, respectively, by various federal cabinet ministers. Z. ZIEGEL, *Canadian Company Law*, Vol. 2 (Toronto, Ont.: Butterworths, 1973) at 370 and 470. In 1972, the joint Senate and House of Commons Committee shared the same views. ROY, *supra*, note 298 at 58.

404 P. ANISMAN *[et al.], Proposals for a Securities Market Law for Canada*, 3 vols. (Vol. 1: Draft Act; Vol 2: Commentary; Vol. 3: Background Papers) (Ottawa, Ont.: Minister of Supply and Services, 1979).

405 *Multiple Access* v. *McCutcheon*, *supra*, note 303.

406 H.D. WHYTE, "Ottawa May Fight to Oversee Securities" *The Financial Post [of Toronto]* (31 May 1989) 4. S.M. BECK *[et al.], Cases and Materials on Partnerships and Canadian Business Corporations* (Toronto, Ont.: Carswell, 1983) at 487.

407 Some of the concern came from the fact that Canada was beginning to have a growing international reputation for easy listing and stock fraud (especially in the VSE). J. WILSON, "How Securities Agencies Could Close Jurisdictional Loopholes" *The Financial Times of Canada* (5 March 1990) 5. H. SOLOMON, "Ottawa Eyes Stocks Role: "Fraud" Concerns Grow" *The Financial Post [of Toronto]* (26 May 1989)

Still, others (like the provinces of Quebec and British Columbia) opposed a federal securities role on the basis that it infringed on provincial responsibilities[409]. For their part, most SROs endorsed the idea of a CANSEC[410]. In order to avoid a political

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1. "Ottawa Considers Regulating Stock Exchanges" *The [Montreal] Gazette* (26 May 1989) B5. J. KOHUT, "Federal Government Considers Creation of a National Securities Commission" *The [Toronto] Globe and Mail* (26 May 1989) B1. H.D. WHYTE, "Bennett Charges Revive Calls for National Watchdog" *The Financial Post [of Toronto]* (1 February 1989) 4. D. FRANCIS, "We Need a National Stocks Watchdog: Fraudsters Are Playing One Province's Regulators Against Another's" *The Financial Post [of Toronto]* (30 January 1989) 3.

408 "Provinces Seek Harmony on Securities Regulations" *The Financial Post [of Toronto]* (25 April 1989) 5. The largest movement came from the Atlantic provinces where the premiers of this region of Canada worked on a uniform securities legislation and a Maritime Securities Commission. M. MacISAAC, "A Maritime Watchdog On Its Way" *The Maritime Report* (October 1991) 2. E. WEISS, "Investors Look at Regional Regulation" *Ibid.*, 1.

409 "Québec s'oppose à un projet visant à confier à Ottawa la compétence en matière de valeurs mobilières" *La Presse [of Montreal]* (27 August 1993) C12. L. LÉVESQUE, "Québec s'oppose à un règlement fédéral" *Le Devoir [of Montreal]* (12 May 1993) A6. EDITORIAL, "Needed: A National Securities Regulator" *The Financial Times of Canada* (6 July 1992) 22. R. DUTRISAC, "Louise Robic craint l'ingérence fédérale dans les valeurs mobilières" *Le Devoir [of Montreal]* (2 July 1992) 5. S. TRUFFAUT, "La CVMQ s'oppose à la création d'une commission fédérale des valeurs mobilières" *Le Devoir [of Montreal]* (19 September 1991) A5. M. VAN DE WALLE, "La CVMQ s'oppose à toute tentative du fédéral de réglementer les valeurs mobilières" *La Presse [of Montreal]* (19 September 1991) D8. C. DONVILLE, "B.C. Minister Rejects Federal Securities Role" *The [Toronto] Globe and Mail* (27 June 1989) B9. P. LUSH, "BCSC Against Federal Regulation" *The [Toronto] Globe and Mail* (19 June 1991) B7. J. KOHUT & K. HOWLETT, "Provinces Oppose Bigger Federal Securities Role" *The [Toronto] Globe and Mail* (27 May 1989) B2.

410 In 1989, the IDA took the stand as being in favour of CANSEC but expressed the view that "[f]or now, the system works". D. HATTER, "Dealers Agree One Securities Body "Undesirable" Now" *The Financial Post [of Toronto]* (7 June 1989) 15. C. DONVILLE, "Investment Dealers to Discuss Merits of a National Securities Commission" *The [Toronto] Globe and Mail* (6 June 1989) B5. Later, the IDA suggested it could become the CANSEC, much to the displeasure of certain provinces. EDITORIAL, "Dealers Deal, Not Watch" *The Financial Times of Canada* (18 November 1991) 38. D. KELLY & C. LAKSHMAN, "Opposition Grows to IDA Self-regulation Proposal" *The Financial Post [of Toronto]* (20 September 1991) 3. K. DOUGHERTY, "Hands Off Quebec, Regulator Tells IDA" *The Financial Post [of Toronto]* (19 September 1991) 3. This stand by the IDA may explain the reason why the QSC has yet to recognize it as a SRO in Quebec. "La CVMQ [...] se dit prête à entendre toute proposition de l'ACCOVAM pour son accréditation au Québec, à la condition toutefois qu'elle respecte la décentralisation [...]." J. PELLETIER, "Paul Fortugno s'oppose à la création d'un organisme pancanadien de contrôle boursier" *Le Journal de Montréal* (19 September 1991) 51. THÉRIAULT & FORTIN, Vol. 2, *supra*, note 16 at A-197. The centralization proposal was also approved by the TSE. K. HOWLETT, "TSE Wants Out of Watchdog Role" *The [Toronto] Globe and Mail* (21 November 1991) B15. D. KELLY, "TSE Set to Go It Alone" *The Financial Post [of Toronto]* (21 November 1991) 14. However, again, the QSC opposed the project as being "a Bay Street plot to centralize watchdog functions". B. McKENNA, "QSC Opposes National Watchdog" *The*

confrontation, Ottawa used diplomatic language[411]. On the one hand, the federal government was rejecting any ideas of forming a national securities commission. On the other hand, however, it was maintaining that more competition from foreign stock brokerage firms and the growing number of international stock deals could force the central government to look at new ways of regulating stock markets.

The 1992 federal reform and the newest pressures on the provinces imposed by the free trade agreements have encouraged the re-examination of the possibility of creating a Canadian securities commission[412]. The latest attempt to set up a CANSEC was initiated by the federal government[413] with the support of the Atlantic provinces[414]. In May 1994, Ottawa presented all the provinces (except Quebec which walked away from the negotiating table in early spring[415]) with a prototype to

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[Toronto] Globe and Mail (19 September 1991) B9. J. RAVENSBERGER, "QSC Rejects Proposal for National Watchdog" *The [Montreal] Gazette* (19 September 1991) D2.

411 R. DUTRISAC, "Ottawa ne créera pas de Commission fédérale des valeurs" *Le Devoir [of Montreal]* (10 June 1992) A5. J. GEDDES & D. KELLY, "Securities Harmony is Urged" *The Financial Post [of Toronto]* (27 September 1991) 4. B. DALGLISH, "National Securities Commission Plans Put on Back Burner" *The [Montreal] Gazette* (28 June 1989) E5. H.D. WHYTE, "Ottawa May Oversee Regulation of Securities Industry: Loiselle" *The Financial Post [of Toronto]* (28 June 1989) 3. "Wilson Rejects the Idea of National Stock Agency" *The [Montreal] Gazette* (6 June 1989) B1. L. WELSH, "Wilson Rejects Federal Agency to Regulate Securities" *The [Toronto] Globe and Mail* (6 June 1989) B1. H.D. WHYTE, "Ottawa May Fight to Oversee Securities" *The Financial Post [of Toronto]* (31 May 1989) 4. EDITORIAL, "A Federal Eye on Securities" *The [Toronto] Globe and Mail* (29 May 1989) A6. "Ingérence fédérale dans les valeurs mobilières" *Le Droit [of Ottawa]* (26 May 1989) 26.

412 Even back in 1991, the financial reform and free trade were cited as key reasons for Ottawa to create a CANSEC and comprehensive securities legislation. A. TOULIN, "Feds Assert Right to Be Securities Policeman" *The Financial Post [of Toronto]* (18-20 May 1991) 1.

413 In its red book of policies, the recently elected Liberals identified the costs of overlapping government as an early priority. LIBERAL PARTY OF CANADA, *supra*, note 216 at 21.

414 J. M. McFARLAND, "Backing a National Watchdog" *The Financial Post [of Toronto]* (19 April 1994) 5. B. DALGLISH, "Trading Places: A National Securities Commission Takes Shape." *Maclean's* (4 April 1994) 38.

415 When Quebec walked out, the proposal was in serious jeopardy. Although Quebec has kept up to date on the discussions with the other provinces, the directors of the financial services policy branch in Ontario's Finance Ministry expressed the view that "if the key jurisdictions are not in, you really have to look at what is the best thing to do. One has to be careful about going with a partial system because the fact is that we have a well-functioning system today." J. McFARLAND, "Provinces Cooling on SEC-type Body" *The Financial Post [of Toronto]* (15 July 1994) 3. "Quebec Balks at National Securities Body" *The Financial Post [of Toronto]* (12 May 1994) 4.

replace the provincial securities commission with a national regulatory body having its headquarters in Toronto with several regional offices[416]. The proposal was different from the U.S. national regulatory system (which allows for some power sharing with the States). Ottawa wanted the provinces to amend their securities acts to delegate jurisdiction to the federal government[417]. According to a MOU draft prepared by federal Finance Department officials, the national commission would be a reality by January 1st, 1996[418]. The draft MOU provides for a complicated process of implementation of federal securities legislation, repeal of existing provincial securities legislation, incorporation by reference of the federal securities legislation into the provincial legislation, and delegation by the provinces of the authority to administer CANSEC. It would resemble the U.S. SEC and be based in Toronto (with regional offices throughout the country). However, negotiations hit an impasse with the provinces[419]. Many of them do not believe CANSEC would reduce costs and overlap. Others are worried that local markets would be trampled[420]. In fact, the differences are so important that some provincial governments are looking at setting their own national commission – without Ottawa. The idea appears to be to maintain a policy network through the CSA and expand it into a national commission which would handle cross-border issues or even replace provincial securities commissions altogether[421]. All these changes are proposed at a time when Ontario looks at

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416 J. MARTEL, "Comments on Coordinated Securities Regulation: Getting to a More Effective Regime" in QUEEN'S SYMPOSIUM, *supra*, note 243, 145 at 146ff.

417 "Ottawa se bute aux réticences de plusieurs provinces" *Le Devoir [of Montreal]* (7 September 1994) 2.

418 The latest proposal arrives at a time when preparations are under way by the federal government to re-examine regulation of the financial services industry. B. McKENNA, "Financial Supervision Under Scrutiny: System 'Not Broken' But Could Use Small Fixes, Peters Says" *The [Toronto] Globe and Mail* (20 September 1994) B4.

419 G. McINTOSH, "Securities Commission Plan Stalls" *The [Toronto] Globe and Mail* (7 September 1994) B10.

420 EDITORIAL, "Need National Securities Rules" *The Financial Post [of Toronto]* (9 September 1994) 10.

421 One recent CSA initiative designed to make the securities industry more efficient was the formation of a committee of industry participants to identify and catalogue opportunities to eliminate duplication and overlap. *NOTICE – "Addressing Duplicative Regulation" – Remarks by Edward J. Waitzer, Chairman of the OSC - March 3, 1994*, (1994) 17 O.S.C.B. 1059 at 1062. Also, see J.J. OLIVER, President & CEO, Investment Dealers Association of Canada, *Structure of Securities Regulation*, (1995) 18 O.S.C.B. 5256. Back in 1990, a similar idea was formulated by some provinces. B. JORGENSEN, "Yes, Virginia, There Is a National Securities Body" *The [Toronto] Globe and Mail* (28 September 1990) B9.

seriously reforming its securities rules[422] following two recent court decisions which confirmed that regulating the securities industry through policy statements is unacceptable[423]. So far, Ottawa's attempt to create a CANSEC does not have enough support[424]. At the same time, the OSFI issued its 1994 annual report stressing the fact that with banks becoming larger players in the securities field (either as owners or traders), both federal and provincial levels of regulation need to work closely together[425]. As an incentive to convince the provinces to accept the plan, Ottawa offered to split Cdn $150 million among provinces agreeing to participate in a CANSEC in order to compensate for lost revenues from surrendering provincial regulatory powers[426]. However, this proposal was not approved.

In view of the fact that globalization is redefining the scope of domestic laws, Canada must improve coordination of securities regulation and find an effective voice in deliberations on international securities regulation[427]. Despite the efforts of the CSA

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422 *Setting an Agenda for the Ontario Securities Commission — Remarks by Edward J. Waitzer, Chairman, December 1, 1993*, (1993) 16 O.S.C.B. 5882. R. DANIELS, "Responsibility and Responsiveness: Interim Report of the Ontario Task Force on Securities Regulation" in SECURITIES SUPERCONFERENCE (Toronto, Ont.: Canadian Securities Institute, 3 & 4 March 1994) at Tab. 1. J.G. MacINTOSH, *The Interim Report of the Task Force on Securities Regulation*, (1994) II:3 Corporate Financing 92. EDITORIAL, "Get On with Securities Reform" *The Financial Post [of Toronto]* (7 September 1994) 12. J. DAW, "New Teeth Urged for OSC" *The Toronto Star* (8 July 1994) B2.

423 In *Re Pezim and Superintendent of Brokers and Two Other Appeals*, (1992) 96 D.L.R. (4th) 137 (B.C.C.A.), Mr. Justice Lambert raised questions as to the validity of a policy statement of the British Columbia Securities Commission. [...] Mr. Justice Blair declared invalid an OSC policy statement because the Commission "exceeded its jurisdiction under its enabling legislation in promulgating it." *Ainsley Financial Corporation [...] v. Ontario Securities Commission [...]*, (1993) 14 O.R. (3d) 280 (General Division) at 306. On the validity of the securities regulatory requirements contained in policy statements, see D. STRATAS, *The End of Securities Regulation by Policy Statements?*, (1994) II:2 Roland on Corporate Litigation 71.

424 N. OLIVARI, "Is a National Commission the Answer?" *Investment Executive* (December 1995) 42. M. INGRAM, "Ottawa Strikes Out With Pitch for Securities Agency" *The [Toronto] Globe and Mail* (21 September 1994) B19.

425 A. TOULIN, "Mackenzie Knocks Links of Banks, Securities Firms" *The Financial Post [of Toronto]* (15 October 1994) 7. "Mackenzie Urges More Co-ordination" *The [Toronto] Globe and Mail* (15 October 1994) B2. "Attention aux empiétements, met en garde Mackenzie" *Le Devoir [of Montreal]* (15 October 1994) B2.

426 J. CHEVREAU, "Ottawa Pushing Securities Plan" *The Financial Post [of Toronto]* (20 September 1994) 1.

427 "Financial Rules Seen As Worldwide Concern" *The [Montreal] Gazette* (21 November 1989) C9. J. MAXWELL, "Need For Financial-rule Harmony Spurred By Outside Competition" *The Financial Post [of Toronto]* (20 November 1989) 12.

in promulgating a series of national policies, the existing regime is costly and difficult to manage inside federalism[428]. While supporters of provincial regulation have expressed the need for control for the benefit of local economies[429], the federal government is bound to pursue an active role in the regulation of financial institutions[430]. To do so, Ottawa could proceed in two ways: (i) negotiate responsibilities with the provinces in a give-and-take manner; or (ii) draft a statute of uniform securities regulations and ask the provincial securities regulators to enforce those rules in return for jurisdiction of securities distribution. Either way, the federal government and the provinces would need to exercise tact to negotiate an acceptable deal. Still, the only viable solution may be to blend these two options together[431]. The recent tentative rules authorizing banks to carry on investment counselling and portfolio management activities directly rather than through subsidiaries signals a new phase in the creation of a CANSEC[432]. In view of the fact that market forces are forcing provincial administrators to agree on a growing series of overlapping regulation and policies, there are fewer obstacles to a more active involvement by the federal government[433]. Although the latest federal by-law on registration of federally regulated financial institutions employees engaged in investment counselling and portfolio management may be another step towards a nationally-oriented system, a federal-provincial co-operation could signal the beginning of a more efficient regulatory

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428 K. HOWLETT, "National Securities Watchdog Urged" *The [Toronto] Globe and Mail* (16 February 1995) B3.

429 QUEBEC, Ministry of Finance, *Promoting the Financial Sector: Dividends for Quebec — Policy Proposals for Quebec's Financial Sector* (Quebec, Que.: Ministry of Finance, 1993) at 15. J. MARTEL, "The General Policy Statement of Louise Robic (March 1993): Promoting the Canadian Financial Space" *Canadian Financial Service Alert* (April 1993) 9.

430 P. ANISMAN, "The Regulation of the Securities Market and the Harmonization of Provincial Laws" in CUMMING, *supra,* note 10 at 129.

431 Recently, it was suggested that two pre-conditions must be satisfied before CANSEC can exist: (i) there must be a political will by all the provinces; and (ii) the conflict with respect to regulatory jurisdiction over the securities activities of federal financial institutions must be resolved. *Federal Securities Regulation–Paper Delivered by J.A. Geller, Q.C.*, (1995) 18 O.S.C.B. 658 at 659.

432 T.N. UNWIN & G. WARREN, "Towards a Federal Securities Law?", *Canadian Financial Service Alert* (December 1992) 25.

433 In 1992, the IDA responded to the federal government's constitutional proposals for the Canadian economy "Canadian Federalism and Economic Union — Partnership for Economic Union". It proposed a framework designed to improve co-operation between the federal and provincial Parliaments. M. M. HARRIS, "Securities Regulation: Should the Scope of Federal Regulation Expand?", *Canadian Financial Service Alert* (January 1993) 14.

framework. In this regard, Australia's experience with cooperative securities legislation may be instructive[434] . However, due to the very nature of Canadian federalism, the intended solution would need to be purely Canadian[435]. Later, these preliminary initiatives could led towards another level of discussion.

Building on the 1979 *Proposals for a Securities Market*, a federal securities Act could be introduced to facilitate national financing. It could be administered provincially (to take advantage of the existing expertise) or within a federal agency (perhaps based in Ottawa in order to alleviate the existing political rivalry between Toronto and Montreal)[436]. At the same time, a provincial law would govern intra-provincial transactions to reflect local market conditions and economic concerns. CANSEC

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434 The Australian experience began in 1974 when a Senate committee recommended that the federal government enact a statute to regulate the field of securities law previously occupied by the states. After a series of various committee hearings, it was found that there was administrative duplication and general inefficiency. The main recommendation was that a single national regime was essential. In 1991, a truly national securities commission (which is required, by statute, to maintain a regional office in each state and territory) began operations. E.J. WAITZER & A. SAHAZIZIAN, "Coordinated Securities Regulation: Getting to a More Effective Regime" in QUEEN'S SYMPOSIUM, *supra*, note 243, 101 at 115-117. P. RAYMOND, *Companies and Securities Law: Commentary and Material* (Sydney: Law Book, 1988) at 37ff. R. BAXT, C. MAXWELL & S. BAJADA, *Stock Markets and the Securities Industry*, 3rd ed. (Sydney: Butterworths, 1988). C.C.H. Company Law Editors, *Proposed National Companies and Securities Legislation Explained* (Sydney: C.C.H. Australia, 1988) at 12ff. UNWIN & WARREN, *supra*, note 432 at 28.

435 However, the "Australian model" is not admired by all Canadian securities experts. "Australia has struggled to adopt old-fashioned British style corporate-securities legislation [...] to a federal state. It has done so through complicated mechanisms that sound rather like those proposed by [Canada's] draft MOU. Australia tied itself in knots". C. JORDAN, "Canada Needs a National Securities Regulator" *The Financial Post [of Toronto]* (24 February 1995) 13. For Australia's reaction to this opinion, see, L. PEARCE, "Australia's Securities Regulation Uncomplicated" *The Financial Post [of Toronto]* (1 March 1995) 14.

436 J.S. ZIEGEL, "A Securities Commission" *The [Toronto] Globe and Mail* (1 March 1995) A21. J.S. ZIEGEL, "Must we Settle for Second Best? Comments on Ed Waitzer's Paper" in QUEEN'S SYMPOSIUM, *supra*, note 243, 129 at 134. If a CANSEC was created, the securities industry has already expressed the view that it should not be affiliated to the OSFI because of problems when the regulation of deposit-taking institutions is mixed in with the regulation of financial intermediaries. As a result, a separate body could be created and report to the same federal minister as the OSFI. B. CRITCHLEY, "National Body for Securities?" *The Financial Post [of Toronto]* (29 March 1994) 5. For its part, the OSC once expressed the concern that if a greater federal involvement occurs, "[t]here is no guarantee [...] that the cooperation that marks OSFI's relationships with commissions [...] will always exist". *Notice — Remarks of Robert J. Wright — Toronto Society of Financial Analysts — Wednesday, June 24, 1992*, (1992) 15 O.S.C.B. 2889 at 2891.

would prove to be of immediate use. The Canadian Securities Commission would have to face the inevitable coming reality of having to deal with a growing number of issues of international importance. Currently, Canada is the only country of the IOSCO to have a multiple representation[437]. This situation may be likely to change in a not so distant future. Having to choose a single representative could prove to be a political problem if no federal representation is in place.

In a nutshell, the current trend is towards harmonizing and streamlining the existing fragmented Canadian financial system rather than trying to confront the political problems of creating a single national regulatory framework[438]. However, the necessity for a rapid solution to this "crisis" may come from the unequivocal tendency to "americanize" the Canadian securities system.

CHAPTER II: Indirect Consequences of North American Free Trade: The "Americanization" of Canadian Securities Policies

Policy harmonization is a sensitive issue because the essence of this process is the modification of national policies. Naturally, whenever national control over policy-making is reduced, there is a curtailment of national sovereignty[439]. This issue is especially sensitive in both Canada and Mexico, because the sheer difference in size *vis-a-vis* the U.S. With the FTA and NAFTA, policy harmonization has involved a substantial degree of policy "americanization" in several sectors of activities[440] (including the securities industry)[441].

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437 The provinces of Ontario and Quebec are both members. On their role at IOSCO, see generally EDITORIAL, "In a Global Market, With Provincial Rules" *The [Toronto] Globe and Mail* (2 July 1992) A25. P. CAMPBELL, "Global Security Rules: Who Speaks for Canada?" *The Financial Post [of Toronto]* (6 October 1989) 11. W. LECLERC, "Who Should Be Securities Regulators" *The Financial Post [of Toronto]* (27 May 1989) 5.

438 D. WESTELL, "Regulators "Lurching" Towards Harmonizing Securities Industry" *The Financial Post [of Toronto]* (30 December 1995) 34. M.D. SHADBOLD, "A Principled Approach to the Reform of Financial Sector Regulation" *Canadian Financial Services Alert* (July 1993) 17.

439 HANSSON, *supra,* note 69 at 25.

440 See, *e.g.,* L. MARTIN, *Pledge of Allegiance: The Americanization of Canada in the Mulroney Years* (Toronto, Ont.: McClelland & Stewart, 1993).

441 R.G.M. SULTAN, "The Impact of Free Trade on Canadian Capital Markets, Pension Funds and Investment Counsellors" *Business Quarterly* (Summer 1989) 76 at 77. Over the past few years, "[t]he active Canadian regulatory focus has been very much on the

The law governing securities transactions has largely been shaped by the demands and the circumstances of the securities markets. Canadian securities markets have always been heavily influenced by events in the much larger markets in the U.S.[442] This has been to such an extent as to warrant judicial notice[443].

In addition to the common law, Canadian statute law relating to securities transactions has been patterned closely after U.S. law[444]. Moreover, some Canadian securities

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United States, largely as a result of the acceleration of integration of North American capital markets [...]." C. JORDAN, "Canadian Participation in International Capital Markets: A Reassessment", in McGILL UNIVERSITY: FACULTY OF LAW, Meredith Lectures 1993, *Crossborder Transactions* (Cowansville, Que.: Yvon Blais, 1994) 1 at 33. In part, this "Americanization" gradually occurs through bodies like the North American Association of Securities Administrators (or "NAASA"). This has led one author to say that "Canadian similarities, except in the forms of government and conduct of courts, are such that one wonders whether or not there has become one Canadian-American nation (less, only possibly, Quebec) with some sixty-odd centres of power. Most assuredly the North American Association of Securities Administrators, in which the Canadian Provinces and territories as well as the states and D.C. fully participate, gives mute testimony. I hasten to say Mexico is a NAASA member." J.A. MAHER, *The North American Free Trade Agreement: Engaged To Be Engaged?*, (1993) 13 Dickinson J. Int'l L. 1 at 5.

442 The U.S. capital markets' influence on other markets appears to have been substantial. OECD, *The Committee on Financial Markets - International Trade in Services: Securities* (Paris: OECD, 1987) at 13-15.

443 For example in the 1911 decision of the Supreme Court of Canada in *Clarke* v. *Baillie*, (1911) 45 S.C.R. 50, Mr. Justice Anglin stated at page 76: "It is common knowledge that the business of stock-brokers in this country is conducted in a manner more closely resembling that which prevails in the United States, and particularly in the State of New York, than that which exists in England. Many customs and usages of English brokers are unknown in Canada; and many practices prevalent in our markets, which have come to us from the United States, would not be recognized on the London Stock Exchange".

444 Even before the introduction of the Canadian Business Corporations Acts, Canadian laws relating to securities trading tended to follow American law. E. GUTTMAN & T.P. LEMKE, *The Transfer of Securities in Organized Markets: A Comparative Study of Clearing Agencies in the United States of America, Britain and Canada*, (1981) 19 Osgoode Hall L.J. 400 at 407. E. GUTTMAN, *The Transfer of Shares in a Commercial Corporation — A Comparative Study*, (1964) 5 B.C. Indus. & Comm. L. Rev. 491. This tendency became more pronounced as the Business Corporations Acts' provisions governing securities transfers were closely based upon the U.S. Uniform Commercial Code ("UCC"). One report referred to "obvious need for uniform laws within the North American securities markets" and stated: "[C]learly it would be preferable for all Canadian jurisdictions ... to adopt a uniform law that adheres as closely as possible to the UCC model ...". R. DICKERSON, J. HOWARD & L. GETZ, *Proposals for a New Business Corporations Law for Canada*, Vol. I, Commentary (Ottawa, Ont.: Minister of Supply and Services, 1971) at 59-60. Also, see F.J. PÉPIN, *Le transfert des valeurs mobilières de corporations commerciales*, (1978) 9 R.G.D. 243 at 250 n. 14. Y. RENAUD & J. SMITH, *Droit québécois des corporations commerciales*, Vol. 2

lawyers have noted the necessity and practical effect of understanding U.S. securities law[445]. However, Canadian law in this area has always been some years behind that of the U.S. In turn, the U.S. law has generally trailed behind events and practices within the securities industry[446].

Generally, it can be said that there are market differences between the U.S. and Canadian parameters with respect to securities regulation[447]. More specifically, Canadian securities regulators have broader range of discretionary powers and they have used them to move into the domain of corporate law to a level not seen in the U.S[448]. However, free trade has had a relative impact on Canadian securities regulators[449]. Even if the FTA and NAFTA do not explicitly put *de jure* pressures on Canadian sovereignty, it can create them *de facto*[450]. These are the policy harmonization pressures Canada may have to accede to in order to remain competitive with U.S. firms in a liberalized trading environment[451]. Because the past

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(Montreal, Que.: Judico, 1975) at 1137.

445 BLOOMFIELD, *supra,* note 53 at 89. J.K. WILLIAM, *1990 Year in Review: Harmonization with U.S. Securities Law Increases Pace of Regulatory Change*, (1990) 5:12 S.C.R.R. 153 at 155.

446 GREENE *[et al.]*, Vol. 1, *supra,* note 47 at 25.

447 R.J. DANIELS & J.G. MacINTOSH, *Towards a Distinctive Canadian Corporate Law Regime*, (1991) 29 Osgoode Hall L.J. 863 at 900.

448 One author points out that the broad discretionary powers by Canadian securities regulators create a great deal of uncertainty for market participants planning transactions that may or may not be found to breach the "public interest". As a solution he suggests that Canadian regulators could consider the adoption of a "no action letter" procedure similar to that used in the U.S. J.G. MacINTOSH, *supra,* note 222, 73 at 73. On the discretionary powers of Canadian securities regulators, see, *e.g.*, R. CRÊTE, "L'appréciation de l'intérêt public dans, le marché des valeurs mobilières: un pouvoir discrétionnaire trop envahissant?" in SERVICE DE LA FORMATION PERMANENTE DU BARREAU DU QUÉBEC, ed., *Développements récents en droit commercial (1992)* (Cowansville, Que.: Yvon Blais, 1992) 21. However, in the province of Ontario, that power has recently been under review. See, *e.g.*, J.G. MacINTOSH, *supra,* note 422.

449 Generally "[GATT and NAFTA] [...] significantly affect the future of [the] domestic financial services industry". J.R. DOTY, *The Role of the Securities and Exchange Commission in an Internationalized Marketplace*, (1992) 60 Fordham L. Rev. S77 at S78.

450 See C.D. HOWE INSTITUTE, *Policy Harmonization: The Effects of a Canadian-American Free Trade Area* (Toronto, Ont.: C.D. Howe Institute, 1986) at 11.

451 However, some critics have not been convinced by this harmonization argument, arguing that Canadian capital markets have distinctive properties that regulators should be sensitive to in formulating policy objectives in order to determine how they impact on the securities regime. DANIELS & MacINTOSH, *supra,* note 447 at 865. Some mentioned the increasing globalization of markets to be the driving force behind

few years have witnessed Canadians securities regulators adopt (sometimes stricter and more detailed) U.S. norms[452], one expert ventured the opinion that Canada has been free riding on the back of Uncle Sam as a regulatory technique[453]. If so, the SEC has a great deal to say as to which way Canadian securities regulation goes.

1. The Influential Role Played by the Securities and Exchange Commission

Prior to the 1980s, the SEC's main focus was on domestic concerns because U.S. investors, issuers and markets were dominating the world capital markets[454]. The rapid growth of the internationalization of securities trading led both individual and institutional American investors to seek higher returns and greater diversification of risk by purchasing foreign securities in foreign markets. As the mobility of the capital increased on a worldwide basis, questions arose as to whether or not to allow more trading of foreign securities to take place within the U.S.[455]. Doing so would require easing foreign access rules. However, in view of market developments, changes would need to be addressed by regulatory authorities if American financial markets wanted to continue to play a leading role. The SEC could no longer avoid its growing international responsibilities.

In determining a pattern for future international policies of the SEC, opposite views revealed the complexity of the problems lying ahead. The first approach was to have

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harmonization, not the U.S. J.F. HELLIWELL, *From Now Till Then: Globalization and Economic Cooperation*, Canadian Public Policy, XV Supplement (February 1989).

452 "Ontario securities "regulation" has changed significantly in both form and substance. Directly inspired by U.S. rules are recent changes, both implemented and proposed, in the area of liability for continuous disclosure, management's discussion and analysis, and, most controversially perhaps, executive compensation." C. JORDAN, *The Thrills and Spills of Free-Riding: International Issues Before the Ontario Securities Commission*, (1994) 23 C.B.L.J. 379 at 381 n. 7. In addition, civil remedies under U.S. (and sometimes U.K.) law are occasionally considered equivalent to Canadian law. See, *e.g., Staff Notice Regarding International Private Placements*, (1995) 18 O.S.C.B. 1350. *Notice–Blanket Ruling for Certain International Offerings by Private Placement in Ontario*, (1993) 16 O.S.C.B. 5888.

453 JORDAN, *ibid.*, at 328.

454 B. LONGSTRETH, *Global Securities Markets and the SEC*, (1988) U. Pa. J. Int'l Bus. L. 183 at 185.

455 B.S. THOMAS, *Internationalization of the World's Capital Markets: Can the S.E.C. Help Shape the Future?*, (1982-83) 15 N.Y.U. J. Int'l L. & Pol'y. 55 at 58.

the SEC adopt a protectionist attitude by rigidly restricting access to American capital markets[456]. The argument was founded on the assumption that such measures would prevent U.S. capital to be diverted from American companies to foreign issuers. This theory was opposed by those who supported the view that the American system should reconcile with an increasingly interdependent world[457]. This second approach suggested that any efforts to restrict the free flow of capital would go directly against the best interest of U.S. business[458]. By closing the doors to foreign companies wishing to raise capital in the U.S., American issuers seeking international financing alternatives could be faced with retaliatory measures by other nations[459]. However, the removal of unnecessary barriers by the SEC could create a more hospitable environment for foreign issuers in U.S. markets, resulting in tangible benefits to the U.S. economy, but without compromising investor protection[460].

In 1984 and 1985, the SEC began articulating its modern thinking by elaborating three "concept releases" which would accelerate the process towards internationalization[461]. Each one was based on the assumption that internationalization is inevitable and desirable, and addressed the technical issue to which it gave rise.

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456 *Ibid.*, at 56 n. 2.

457 B.S. THOMAS, *Internationalization of Securities Markets: An Empirical Analysis*, (1981-82) 50 Geo. Wash. L. Rev. 155.

458 C.C. COX, *Internationalization of Capital Markets: The Experience of the Securities and Exchange Commission*, (1987) 11 Md J. of Int'l L. & Trade 201 at 202.

459 Moreover, "protecting" American companies from competition in the U.S. market "would merely shift the competitive arena to another trading forum such as the Euromarket for debt offerings". THOMAS, *supra*, note 455 at 62.

460 In the U.S., there were no direct barriers to capital trade, but indirect barriers did exist such as the requirement to register under securities law and the potential liability that followed if a trader did make a full entry into capital markets under the *Securities Exchange Act* of 1934. For some other barriers into U.S. securities markets existing at that time, see C.M. NATHAN, *Special Problems Arising as a Result of Trading in Multiple Markets*, (1982) 4 J. Comp. Corp. L. Sec. Reg. 1.

461 A "concept release" is meant to expose a general area for public comment. It can further lead to the formulation of specific rules. On the three releases, see L.B. SPENCER Jr., *The Reaction of the Securities and Exchange Commission to the Internationalization of the Securities Markets: Three Concept Releases*, (1986) 4 B.U. Int'l L.J. 111. R.S. KARMEL, *Can Regulators of International Capital Markets Strike a Balance Between Competing Interests?*, (1986) 4 B.U. Int'l L.J. 105 at 109.

Beginning with the assumption the U.S. has the best capital markets in the world[462], the so-called "waiver-by-conduct" release was concerned with the principle that one who trades in the U.S. has to respect U.S. laws[463]. The purpose of the "waiver-by--conduct" rule was to create an exception to foreign bank secrecy laws. Also it dealt with matters of sovereignty and raised problems of enforcement[464]. However, this proposal could only become effective if accepted by the foreign states concerned[465]. Eventually, it was abandoned altogether.

The Securities Act Release N° 6568[466] discussed revisions of prospectus rules in Canada, the U.S. and the U.K. to alleviate the problems involved in the qualification of a new securities issued for sale in the three countries[467]. The SEC put forward two

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462 Even today, this assumption has not subsided. "It has become [SEC] theology that [its] regulations are the best in the world, and that they best serve the interests of all U.S. investors. Through [IOSCO], the SEC is trying to build an international consensus on the benefits of U.S.-type disclosure rules". W.C. FREUND, "Another SEC Curb on Stock Exchanges" *The Wall Street Journal* (2 September 1992) 2.

463 SEC Release - 30 June 1984. SPENCER Jr., *supra*, note 461 at 113-114. M. FEDDERS *[et al.]*, *Waiver By Conduct - A Possible Response to the Internationalization of the Securities Markets*, (1984) 6 J. Comp. Bus. & Cap. Mkt L. 1.

464 For some views against the "waiver-by-conduct" approach, L. NELSON, *Insider Trading Originating Abroad and "Waiver-by-Conduct"*, (1985) 19 Int'l L. 817. M.U.T., *The SEC's Waiver-by-Conduct Proposal: A Critical Appraisal*, (1985) 71 Va. L. Rev. 1411. P.J. BSCHOOR, *"Waiver By Conduct": Another View*, (1984) 6 J. Comp. Bus. & Cap. Mkt L. 307. J.-L. LÉPINE, *A Response to Fedders' "Waiver By Conduct"*, (1984) 6 J. Comp. Bus. & Cap. Mkt L. 319. E.J. BOYLE, J.C. THAU, *The Newest Configuration of the Ugly American: A Response to Mr. Fedders*, (1984) 6 J. Comp. Bus. & Cap. Mkt. L. 323. W. de CAPITANI, *Response to Fedders' "Waiver By Conduct"*, (1984) 6 J. Comp. Bus. & Cap. Mkt L. 331. E. WYMEERSCH, *Response to Fedders' "Waiver By Conduct"*, (1984) 6 J. Comp. Bus. & Cap. Mkt L. 339. M. SINGER, *The Internationalized Securities Market and International Law — A Reply to John M. Fedders*, (1984) 6 J. Comp. Bus. & Cap. Mkt L. 345.

465 In response to the ambitious extraterritorial application of U.S. laws in American tribunals, a number of countries have enacted blocking statutes. The Canadian federal government enacted the *Foreign Extraterritorial Measures Act*, R.S.C. 1985, c. F-29.

466 *Facilitation of Multinational Securities Offerings*, SEC Release N° 33-6568 (28 February 1985).

467 COX, *supra*, note 458 at 204-205. M.Q. CONNELY, *Multinational Securities Offerings: A Canadian Perspective*, (1988) 50 L. & Cont. Probl. 251. GIRA, *supra*, note 61 at 157. SPENCER Jr., *supra*, note 461 at 115-116. "Canada and England were singled out in the SEC's request for comments because the SEC felt that they were countries that were the closest to those of the United States and that, as a first step, their systems might be a place to start. [...] The SEC's initiative in this area is clearly one that must go forward, and it certainly will not be limited, even in the near term, to the United Kingdom and Canada." B. WHACHTER *[et al.]*, *Harmonization of Company and Securities Law: The European and American Approach*, (Tilburg: Tilburg University Press, 1989) at 115.

possible approaches: (i) a reciprocal agreement between the three countries under which a prospectus would be accepted in each of the other two countries; and (ii) the development of a common prospectus to be filed simultaneously with each country's securities administrators[468]. Commenting on this Release of the SEC, both the OSC[469] and the QSC[470] believed a modified reciprocal prospectus approach should (in the short term) be adopted in order to facilitate securities offerings in Canada and the U.S.[471] Moreover, they proposed that the use of the reciprocal prospectus approach be restricted to senior issuers in order to ascertain its viability and effects on domestic and international capital markets[472]. Finally, the OSC considered the inclusion of the U.K. (either in the reciprocal prospectus or the common prospectus approaches) as a long-term objective[473].

Finally, Exchange Act Release N° 21958[474] discussed the operation of the international trading markets, focusing on the practical problems inherent in global markets[475]. Here, the SEC was primarily concerned by two things: firstly, what steps should be taken to assure that U.S. and global securities markets operate fairly and safely?; and secondly, how should nations and the securities industry cooperate to eliminate disparities and to ensure the existence of an equivalent regulatory treatment on an international scale? To tackle these questions, the SEC identified three issues

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468 The SEC had hoped that the release and response and other initiatives would quickly result in concrete proposals. For a comprehensive summary of the comments see, C.C. COX, "Internationalization of the Capital Markets: The Experience of the U.S. Securities and Exchange Commission" in IOSCO, *Annual Conference of the International Association of Securities Commission*, Vol. 1 (Paris: COB, 1986) 150 at 155-158.

469 *Submission of the Staff of the Ontario Securities Commission to the Securities and Exchange Commission Concerning the Facilitation of Multinational Securities Offerings*, (1985) 8 O.S.C.B. 3972 [hereinafter *OSC's Submission*].

470 *Observations de la Commission des valeurs mobilières en réponse à la demande de la Securities and Exchange Commission des États-Unis (SEC) concernant les placements multinationaux*, (1985) 16:31 B.C.V.M.Q. 9 [hereinafter *QCS's Submission*].

471 OSC's Submission, *supra*, note 469 at 3982. QSC's Submission, *supra*, note 470 at 19.

472 OSC's Submission, *Ibid.*, at 3989. QSC's Submission, *Ibid.*, at 20.

473 OSC's Submission, *Ibid.*, at 3994.

474 SEC Release N° 34-21958 (18 April 1985).

475 SPENCER Jr., *supra*, note 461 at 111-112. For a summary of the comments made by the OSC and QSC, see *Summary of Comments on Concept Release*, Release N° 34-21958, SEC File N° 57-16-85, 1985.

of contention: international trading, multinational distribution of securities and international enforcement problems.

Gradually, the SEC came to realize that the U.S. market was not, by itself, the dominant market, but rather the largest of several, linked globally, competing for investors worldwide. In 1987, a report by the SEC[476] revealed that due to the growth of rival national markets (mainly those of Japan and the EU) and the existence of unregulated international market, the U.S. was gradually losing its dominance as the first primary capital market. To keep the U.S. capital market and its participants competitive, and to promote fair and equal treatment of U.S. shareholders owning securities in foreign companies, the SEC proposed and implemented several initiatives[477]. For instance, the SEC limited the jurisdictional reach of the registration provisions of the Securities Act of 1933 and the Exchange Act of 1934. It eased access to the U.S. institutional market by foreign issuers. In one case, the SEC affirmed that it would follow a policy of national treatment in its regulation of financial institutions, by which U.S. and foreign entities would have the same access to and be treated equally in the U.S.[478]

By adopting these policies, the SEC has been in the forefront of discussions concerning the adoption of an international regulatory scheme. Using a step-by-step approach, the SEC has tried to increase access and to eliminate indirect barriers to

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476 *Internationalization of the Securities Markets*, Report of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce (27 July 1987).

477 In 1990, a former Chief of the Office of International Corporate Finance at the SEC noted that "the SEC wants to meet the demands of U.S. investors to invest in foreign securities [...] [w]hile the SEC does not want to engage in a race to the bottom or lowering of standards, it is willing to be more flexible to increase the attractiveness of U.S. markets." S. HANKS, 22 Sec. Reg. & L. Rep. (BNA) N° 3 at 103 (19 January 1990).

478 "National treatment is important insofar as it means that there is no significant distinction in the U.S. between the powers of a U.S. and foreign registered or regulated entity. In administering a policy of national treatment, however, the SEC has also sought the power to carry out functional regulation, under which all participants in the securities business (i.e. banks and broker/dealers) would be subject to the same rules. To acquire this power, the SEC has been asking the U.S. Congress to enact legislation that would overturn existing distinctions that permit banks to be in the securities business without SEC registration or oversight. To date, Congress has refused to act". GREENE *[et al.]*, Vol. 1, *supra,* note 47 at 25.

foreign participants in U.S. markets and thus assure its dominance of global markets. Regulation S[479], Rule 144A[480] and other initiatives of this nature have all been attempts to increase foreign access to U.S. capital markets[481]. By doing so, the U.S. promoted "the adoption of U.S.-style regulatory regimes and free-riding in the emerging markets"[482]. But more importantly, many of these policies have an impact on the Canadian financial regulatory framework[483].

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479 SEC Release N^{os} 33-6863; 34-27942, as amended. In essence, Regulation S declares that the prospectus filing requirements apply only to offers and sales of securities made in the U.S. GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 191. Regulation S is memorable for its "general statement" which "[...] marks the moment that the United States openly acknowledged the existence of the international capital markets as separate and apart from its own". JORDAN, *supra*, note 441 at 9.

480 SEC Release N^{os} 33-6862; 34-27928. Rule 144A relates to the U.S. private placement market by improving liquidity in the secondary market for large institutional investors. It applies equally to U.S. and non-U.S. issuers and has managed to attract many foreign issuers into the U.S. markets. GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 153-154.

481 On the adoption of Regulation S and Rule 144A, see, *e.g.*, R.W. McQUISTON, *Rule 144A, Regulation S and Amending the Glass-Steagall Act: A new Look at Foreign Banks and Foreign Issuers Participating in the United States Securities Markets*, (1991) 17 Syracuse J. Int'l L. & Comm. 171. H.S. BLOOMENTHAL, *The SEC and Internationalization of Capital Markets: Herein Regulation S and Rule 144A*, (1991) 20 Denver J. Int'l L. & Pol'y 343. A.R. BRANDON, *Securities Regulation - Great Expectations and the Reality of the Rule 144A and Regulation S: The SEC's Approach to the Internationalization of the Financial Marketplace*, (1991) Georgia J. Int'l & Comp. L. 145. N. SILVERMAN & D.A. BRAVERMAN, *Regulation S and Other New Measures Affecting the International Capital Markets*, (1991) 23 Rev. Sec. & Comm. Reg. 179. H.S. BLOOMENTHAL, *The SEC and Internationalization of Capital Markets: Herein Regulation S and Rule 144A*, (1989) 18 Denver J. Int'l L. & Pol'y 83

482 JORDAN, *supra*, note 452, 379 at 386. For some, the SEC has been (and ought to continue to be) a "standard-setter" in the internationalization process. DOTY, *supra*, note 449 at S90. For instance, the regulatory climate in the U.S. has permitted its securities markets to become a leader in financial innovation. This led SEC's then-Chairman Breeden to foresee a role for the Commission as "the world's securities police when the age of global trading arrives". "American Depository Receipts" *The Economist* (15 June 1991) 73.

483 "Regulation S, Rule 144A and, their later companion, the Multijurisdictional Disclosure System have had an impact, both direct and indirect, on the way Canadian issuers raise capital, and in ways that are only now emerging, the Canadian securities regulatory regimes and the industry they govern. All Canadian crossborder financing activities, both inbound and outbound, are now driven by this trio of SEC initiatives [...]. For Canadian regulators, Ontario in particular, the initiatives are shaking the regulatory system to its roots". JORDAN, *supra*, note 441 at 1.

2. Major Identifiable American Regulatory Impacts on Canadian Securities Law

While many U.S. regulation and policy initiatives have influenced the Canadians, explicit cooperation between both countries recently occurred through the signing of MOUs on enforcement and disclosure.

2.1 Cooperation in Enforcement

The U.S. has probably been the country to most aggressively apply its securities laws extraterritorially[484]. To minimize the effects of such behaviour, there has been a recognized need for international cooperation[485]. In recent years, the SEC has relied less on unilateral enforcement activity and more on MOUs surveillance agreements and other arrangements with foreign regulators and markets. Not surprisingly, similarities in securities laws and regulatory structures combined with the great deal of cross-border financial flows have favoured the development of a special relationship between the SEC and Canadian securities commissions.

Until a few years ago, co-operation in the securities field between the two countries generally consisted in trading information and investigating particular problems or collaborating in series of arrests[486]. Stock exchanges implementing market linkage programs have concluded agreements establishing standards of enforcement[487]. So did the SEC and some Canadian securities commissions, who signed a MOU during

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484 J.-G. CASTEL, *Extraterritoriality in International Trade Canada and United States of America Practices Compared* (Toronto, Ont.: Butterworths, 1988) at 118.

485 For the U.S. view on the need for greater co-operation to enforce securities laws, see, *e.g.*, P. JIMENEZ, *International Securities Enforcement Cooperation Act and Memoranda of Understanding*, (1990) 31 Harv. Int'l L.J. 295. D.K. CHARTER & S.M. BECK, *Problems of Enforcement in the Multinational Securities Market*, (1987) 9 U. Pa. J. Int'l Bus. L. 467. E.F. GREENE, A.B. COHEN & L.S. MATLACK, *Problems of Enforcement in the Multinational Securities Market*, (1987) 9 U. Pa. J. Int'l Bus. L. 325.

486 J.P. WILLIAMSON, *Securities Regulation in Canada* (Toronto, Ont.: University of Toronto Press, 1960) at 46.

487 BLOOMFIELD, *supra*, note 53 at 90. At another level, regulatory cooperation among global financial markets expanded significantly with the signing of an information sharing agreement by ten marketplaces in Canada, the U.S., the U.K. and the Netherlands. Montreal Exchange, Circular N° 143-93 (11 June 1993).

the time of the FTA negotiations[488]. It states that the Parties intend to provide the fullest mutual assistance in facilitating the performance of securities market oversight functions, obtaining information, conducting investigations, litigation and prosecution to determine or prove whether the laws or regulations of the requesting authority have been violated[489].

Moreover, it extends to the enforcement of disclosure requirements and fiduciary duties of securities professionals[490]. Another striking feature of the agreement is that the Memorandum applies where there has been a violation of a law which exists only in one jurisdiction; usually in such agreements, a violation must be a violation in both jurisdictions. This provision has not created much difficulty given the similarity between U.S. and the Canadian securities law.

2.2 The Multijurisdictional Disclosure System

The importance of disclosure in securities legislation has continuously gained acceptance throughout North America[491]. However, until a few years ago, there were no comprehensive rules designed to facilitate North American cross-border securities transactions. Essentially, Canadian issuers were treated the same as U.S.

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488 The MOU was signed between the SEC, and the Ontario, Quebec and British Columbia securities commissions. *Memorandum of Understanding with U.S. Securities and Exchange Commission to Enhance Cooperation in Enforcement*, (1988) 11 O.S.C.B. 113. *Avis–Entente avec la Securities and Exchange Commission concernant la coopération dans l'application des lois*, (1988) 19:3 B.C.V.M.Q. 1.

489 C. VAUGHN BALTIC III, *The Next Step in Insider Trading Regulation: International Cooperative Efforts in Global Securities Market*, (1992) 23 Law & Pol. 167. JIMENEZ, *supra*, note 485 at 295. P.J. MAHONEY, *Securities Regulation By Enforcement: An International Perspective*, (1990) 7 Yale J. on Reg. 305. C.T. HAY, *Exchange of Information Among the Canadian Provincial and American Securities Commissions*, (1988) 2 R.I.B.L. 219. H.L. PITT, D.B. HARDISON & K.L. SHAPIRO, *Problems of Enforcement in the Multinational Securities Market*, (1987) 9 U. Pa. J. Int'l Bus. L. 375.

490 However, assistance under this MOU may be denied on grounds of public interest. ROPPEL, *supra*, note 302, at 52.

491 See, *e.g.*, Report on the Securities Markets submitted to the Board of Governors of the New York Stock Exchange (5 August 1971). Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements (February 1970). Report of the Attorney General's Committee on Securities Legislation in Ontario (11 March 1965). Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

issuers for purposes of registration and reporting under the U.S. Securities and Exchange Acts because of their proximity to the U.S. securities market[492]. Canadian issuers were restricted from using documents reserved for foreign issuers and instead had to report securities on forms used by U.S. issuers, thus requiring more comprehensive information in accordance with U.S. domestic standards. In order to facilitate cross-border registration and reporting of securities and to reduce duplicative regulation, a detailed set of rules, forms and schedules was adopted by the SEC and the CSA.

The Multijurisdictional Disclosure System (hereinafter MJDS) was negotiated between the SEC[493] and the OSC[494] and QSC[495] on behalf of all Canadian jurisdictions and became effective July 1 (ironically Canada's national day), 1991[496]. Canada is the first country to establish MJDS with the U.S., but it should not be the last[497]. Hence, the MJDS system was designed by the SEC with the broader goal of

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492 Numerous U.S. and Canadian reports have studied the question of disclosure. GREENE *[et al.]*, Vol. 1, *supra,* note 47 at 30 n. 1. BERNIER, J., "Internationalisation des marchés financiers: le cas du Régime d'information multinational" in SERVICE DE FORMATION PERMANENTE DU BARREAU DU QUÉBEC, ed., *supra,* note 53, 175 at 193-194.

493 The genesis of the MJDS is SEC Release N° 33-6568 (28 February 1985), *supra,* note 466. "[The MJDS] is a hybrid of [the "common prospectus" or "harmonization" approach; and the "reciprocal prospectus" or "mutual recognition" approach]". GREENE *[et al.]*, Vol. 1, *supra,* note 47 at 309 n. 2. It was originally proposed in 1989; see SEC Release N° 33-6841 (24 July 1989) and re-proposed in 1990. See SEC Release N° 33-6879 (16 October 1990). It became effective in 1991. See SEC Release N° 33-6902 (1 July 1991).

494 In Canada, the MJDS was implemented pursuant to NPS N° 45. See *National Policy Statement N° 45*, (1991) 14 O.S.C.B. 2889 (28 June 1991). *Draft National Policy Statement N° 45*, (1990) 13 O.S.C.B. 4573 (2 November 1990). *Multijurisdictional Disclosure System (Outline)*, (1989) 12 O.S.C.B. 2919 (28 July 1989).

495 *Instruction générale n° C-45 - Régime d'information multinational - Annexe 2*, Décision n° 91-C-0194, (1991) 22:26 B.C.V.M.Q. 2, Annex 2 and Annex 4. *Projet d'instruction général n° C-45 - Régime d'information multinational*, (1990) 21:44 B.C.V.M.Q. 16. *Avis - Régime d'information multinational*, (1989) 20:29 B.C.V.M.Q. 1.

496 E. REGULY, "Now ... Free Trade in Stock Markets" *The Financial Post [of Toronto]* (31 May 1991) 1.

497 "The SEC chose Canada as its initial partner for the MJDS because of the similarity of the U.S. and Canadian regulatory regimes and the significant presence of Canadian companies in the U.S. trading market." GREENE *[et al.]*, Vol. 1, *supra,* note 47 at 309-310 n. 2. "[T]he MJDS was developed initially with Canada due to its mature capital markets and strong regulatory tradition" ... and "highly developed accounting and auditing standard". L.C. QUINN, "Internationalization of the Securities Markets" in *Advanced Securities Law Workshop 1991*, N° 748 (Washington, D.C.: Practising Law Institute, 1991) 571 at 593-594. BLOOMENTHAL & WOLFF, *supra,* note 47 at 5A-10.

extending the system to a number of other countries including Mexico[498].

This initiative is designed to facilitate the free flow of capital between Canada and the United States[499]. The MJDS does not change the liability provisions of the securities

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498 Immediately prior to the formal NAFTA negotiations, the SEC announced first step negotiations with Mexico (3 Int'l Sec. Reg. Rep. (BNA) 7 (7 May 1990)) and with Japan (23 Sec. Reg. & L. Rep. (BNA) 42 (11 Jan. 1991)). During the SEC's open meeting at which the MJDS was adopted, the SEC Chairman reaffirmed that the Commission would want to extend the system to Mexico in an effort to create a North American market. Richard C. BREEDEN, then-Chairman, SEC, Opening Statement on Adoption of Rules, Forms and Schedules for Multijurisdictional Disclosure with Canada at Open Meeting (30 May 1991). The U.K. is another logical candidate for the MJDS. *Regulatory Flexibility Agenda*, 56 Fed. Reg. 4586 (22 April 1990). Initially the U.K. was included in the discussions relating to the MJDS. However, it dropped out of the negotiations to turn its attention to the reform concerning financial services in the EU. C. JORDAN, (Address about the MJDS, McGill University, Montreal, Canada, 17 February 1994) [unpublished]. On the extension of the MJDS in the future, see generally, DOTY, *supra*, note 449 at S87 n. 35. So far, however, no other formal measures have been taken toward extending the MJDS to other countries.

499 On the mechanics of the MJDS, see generally, S.H. HALPERIN, "SEC Initiatives Benefit Canadian Issuers" *Nation Law Journal* (18 October 1993) 19. BERNIER, *supra*, note 492. D.R. CRAWSHAW, "Internationalisation des marchés financiers: le cas du Régime multinational"(Address to a conference organized by Service de la formation permanente du Barreau du Québec, 8 October 1992) [unpublished]. T.N. UNWIN, "Introduction of the Canada-U.S. Multijurisdictional Disclosure System" *Canadian Financial Services Alert* (February 1992) 14. GREENE *[et al.]*, Vol. 1, *supra*, note 47, Chap. 8. H.S. BLOOMENTHAL & S. WOLFF, *The Multijurisdictional Disclosure System and Other Cross-Border Offerings*, (1992) 20 Denver J. Int'l L. & Pol'y 551. W.K. ORR & S.E. DUNLOP, *New Developments in Cross-Border Financing: The Multijurisdictional Disclosure System*, (1992) 5:1 Canada - U.S. Trade 1. W.M. AINLEY, *U.S. Cross-Border Financing for Canadian Issuers*, (1992) 1:1 Corporate Financing 3. C. JORDAN, *Securities Law: Proposed Multijurisdictional Disclosure System between Canada and the United States*, (1991) 4 C.U.B.L.R. 141. SHERMAN STERLING, *U.S. Financing After the Multijurisdictional Disclosure System: A Practical Guide for Canadian Issuers* (New York, N.Y.: SHERMAN, STERLING, 1991) (Pamphlet produced and distributed by the law firm). M. PRICHARD, *Proposed SEC Rules for Multi-Jurisdictional Disclosure System*, (1991) 4 C.U.B.L.R. 68. A.T. DRUMMOND, *Securities Law: Internationalization of Securities Regulation — Multijurisdictional Disclosure System for Canada and the U.S.*, (1991) 36 Villanova L. Rev. 774. P.S. HUGHES & M.R. COHEN, "Canada-United States Multijurisdictional Disclosure System" in *International Securities Market 1991: Corporate Law and Practice Course Handbook Series Number 743* (New York, N.Y.: Practising Law Institute, 1991) 93. B. JENKINS & A. HUDEC, *Canada-United States Cross-Border Offerings*, (1991) 8 Bus. and L. 54-56, 60-62. L.C. QUINN, "Internationalization of the Securities Markets", in *International Securities Markets 1991: Corporate Law and Practice. Course Handbook Series Number 743* (New York, N.Y.: Practising Law Institute, 1991) 170. ROPPEL, *supra*, note 302. H.S. BLOOMENTHAL, *The Multijurisdictional Disclosure System (Part 2)*, (1991) 13 Securities and Federal Corporate Law Report 177. H.S. BLOOMENTHAL, *The Multijurisdictional Disclosure System (Part 3)*, (1991) 13 Securities and Federal Corporate Law Report 185. H.S.

laws of the U.S. or Canada nor the discretionary authority of the securities regulatory authorities. In essence, it is intended to ease certain U.S.-Canadian cross-border securities offerings (including those by "substantial" issuers)[500] and, takeover-bids and other filings by permitting such dealings to proceed in both countries on the basis of home jurisdiction disclosure and rules, as well as allowing the use of the system to satisfy the required continuous disclosure requirements[501]. The Canadian MJDS is essentially reciprocal to the MJDS adopted by the SEC[502]. Thus, for example, eligible U.S. issuers may use prospectuses prepared in accordance with SEC requirements to offer securities in Canada (generally without regulatory review). The U.S. shelf rules may be used for MJDS shelf offerings in Canada[503]. Compared to

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BLOOMENTHAL, *The Multijurisdictional Disclosure System (Part 4)*, (1991) 13 Securities and Federal Corporate Law Report 197. A. GOGGINS, *Taking the First Step: The Securities and Exchange Commission's Proposed Multijurisdictional Disclosure System*, (1990) 14 Md J. Int'l L. & Trade 43. H.S. BLOOMENTHAL, *The Multijurisdictional Disclosure System (Part 1)*, (1990) 12 Securities and Federal Corporate Law Report 169. C. JORDAN, *Multijurisdictional Disclosure System*, (1990) 23:6 Rev. Sec. & Comm. Reg. 55. C. JORDAN, *Multijurisdictional Disclosure System: Just Over the Horizon*, (1990) 5 S.C.R.R. 109. E.B. CLAXTON, H.S. FOULKES & K.G. OTTENBREIT, "Multi-Jurisdictional Disclosure: A Practitioner's View", *Int'l Fin. L. Rev.* (October 1989) 11.

500 The core of the MJDS adopted by the SEC is the stipulation of "substantial" Canadian issuers (meaning those meeting certain size or credit rating test and Canadian reporting history) to offer in the U.S. by ways of a prospectus prepared in conformity with Canadian disclosure requirements (with certain U.S. additions). The notion of "substantial" issuer derives from that of "world class" issuer suggested in SEC Release N° 6568 (see, *supra*, note 466). On "world class" issuer, see, *e.g.*, THOMAS, *supra*, note 455, 55 at 65 n. 35.

501 "Inspired by the Euromarket and based on the fact that investment decisions were more influenced by investment grade rating than by prospectus disclosure, the initial idea behind the MJDS was the standardization of the offering documentation for issuance of debt securities. In the end, this simple idea developed into a complex system in which there was even a reference to the recognition of Canada as being a sovereign nation". JORDAN, *supra*, note 441 at 27.

502 "The system, said [SEC's then-Chairman] Breeden, is one of "reciprocity based on quality of reporting and disclosure" and is aimed at improving access and reducing costs for issuers. C. JORDAN, "Cross-border shopping for securities markets?: How rule changes will affect investments in U.S., Canada" *The Financial Post [of Toronto]*, (19 June 1991) 9. Note that "[r]eciprocal recognition, as a regulatory technique, has shown better results, not that it is not a slow and painful process — but it has shown results". JORDAN, *supra*, note 452 at 380.

503 In Canada, NPS N° 44 has formally introduced the shelf prospectus system as well as a system to allow pricing of securities after issuance of the final receipt. *National Policy Statement N° 44 — Rules for Shelf Prospectus Offerings and for Pricing Offerings After the Final Prospectus is Receipted*, (1991) 14 O.S.C.B. 2932. In the U.S., see also *Simplification of Registration Procedures for Primary Securities Offerings*, SEC Release N°s 33-6943, 34-30930. In essence NPS N° 44 follows the

other initiatives undertaken to facilitate international offerings, the magnitude of the MJDS makes it a significant development in the movement towards the globalization of securities regulations. Being a complex initiative, issuers have yet to fully familiarize themselves with the system and evaluate the costs and benefits[504]. Although it may be seen as a means of attracting more Canadian issuers, the MJDS represents, more importantly, a significant milestone for the SEC in terms of its recognition of the securities laws of a foreign jurisdiction. However, its impact on the Canadian capital market has been very significant. Hence, the MJDS has created the infrastructure for an integrated North American capital market based on U.S.-style regulation[505]. The MJDS has increased the awareness of cross-border financing opportunities in both jurisdictions. Overall, it should continue to contribute to a more closely linked and

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similar procedures in the U.S. Rule 415 and Rule 430A of the *Securities Act of 1933*, 15 U.S.C. §77 a ff. Offerings made in reliance upon the SEC's shelf registration and post-effective pricing rules (Rule 415 and Rule 430A) may be made in Canada under the MJDS in accordance with those rules. Canadian issuers are now able to make those offerings in accordance with NPS N° 44 into the U.S. pursuant to the U.S. MJDS. See generally C. JORDAN, "Un nouveau raccourci pour les émetteurs: prospectus préalable", in SERVICE DE LA FORMATION PERMANENTE DU BARREAU DU QUÉBEC, *supra*, note 53, 61. JORDAN, *supra*, note 502. P.S. HUGHES, "Canada Proposes Shelf Prospectus System" *Int'l Fin L.Rev.* (July 1990) 7. However, note that Quebec did not implement NPS N° 44 "compte tenu de son incompatibilité avec certaines dispositions du Règlement." See *Instruction générale n° C-44 — Le prospectus préalable et la fixation du prix après le visa du prospectus*, (1991) 22:18 B.C.V.M.Q. 2 at 2. In all fairness, it is noteworthy to mention that the province of Quebec was the first province in Canada to adopt a shelf prospectus system almost identical to that of the U.S. which still exists in its legal regime today. (QSA, ss. 24.1, 24.1). *QSC's Submission*, *supra*, note 470 at 14.

504 In practical terms, investment grade debt offerings under the MJDS outnumber equity offerings by a ratio of 2:1. *Projet de modification de l'Instruction générale n° C-45, Régime d'information multinational*, (1993) 24:23 B.C.V.M.Q. 12 at 12. In fact, the first offerings by U.S. issuers into Canada only occurred two years after the regime was implemented. "Vigoro Scores at First" *The Financial Post [of Toronto]* (4 September 1993) 17.

505 "So closely linked as it is to the U.S. domestic regulatory regime, [the MJDS] is extremely sensitive to changes in it. [...] It will certainly ensure that Canadian regulators will be compelled to take into account, in a very timely fashion, developments in the United States." JORDAN, *supra*, note 441 at 33. When adopting the MJDS, the QSC said that "[t]he advent of the multijurisdictional disclosure system and the trend towards the "North Americanization" of securities legislation further entrenches the American influence in Quebec securities legislation." MAVRIDIS, *supra*, note 231 at 7-8. Further it has recognized this trend in the introduction to the publication of NPS N° 44. *Instruction générale n° C-44— Le prospectus préalable et la fixation du prix après le visa du prospectus*, (1991) 22:18 B.C.V.M.Q. 2 at 2.

interdependent U.S./Canadian capital market[506].

2.3 Other Canadian Regulatory Initiatives Responding to the North Americanization of Securities Policy

In parallel to the MJDS, a series of new regulatory responses have been adopted in Canada to guarantee, in a sense, reciprocity based on equality of Canadian and U.S. requirements[507] .

Moreover, recent initiatives are in the process of being instigated to help foreign issuers to overcome some regulatory barriers currently hindering global issues on Canadian securities markets[508]. A nation-wide initiative (developed by the OSC) suggests an enhanced access to the Canadian capital markets by all "world-class foreign issuers" of G7 countries. Bowing to pressures from the Canadian securities industry, the move made by the CSA is a recognition of the increasing globalization of securities markets[509]. Interim NPS N° 53[510] is designed to reduce impediments to

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506 K. BENZING, "Job 1 in Securities Sector is Rebuilding Retail Base: More to Continental Market Could Help Woo Investors" *The [Toronto] Globe and Mail* (26 November 1991) C1. CONFERENCE BOARD OF CANADA, *The Canadian Securities Industry: A Decade of Transition* (Ottawa, Ont.: Conference Board of Canada, 1991) at 5.

507 Apart from NPS N° 44 (*supra*, note 503), see, *e.g.*, *OSC Policy Statement 5.1*, (1990) 12 O.S.C.B. 943. *OSC Policy Statement 5.6*, (1991) 14 O.S.C.B. 2956 and QSC Policy Statement Q-26, *Restrictions on Trading During a Distribution by Prospectus*, (1991) 22:35 B.C.V.M.Q. 2. Other examples are cited in GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 309-310, n. 2.

508 JORDAN, *supra*, note 452 at 380. These initiatives came on the heels of an announcement by the OSC expressing its outmost desire to ease large international issuer access to the Canadian markets. *Notice — Remarks of Joseph J. Oliver — Executive Director of the Ontario Securities Commission in London, England — May 19, 1992*, (1992) 15 O.S.C.B. 2369 at 2371.

509 "The investment industry has long complained that the absence of such issuers from the Canadian market deprives securities dealers and investors of lucrative opportunities, and reduces liquidity in the country's securities markets." "Canada Makes It Easier for Foreign Firms to Issue Stock." *The [Montreal] Gazette* (24 August 1993) D3. D. KELLY, "New Regulations Proposed" *The Financial Post [of Toronto]* (24 August 1993) 4. "La CVMQ veut un régime pour émetteurs étrangers." *La Presse [of Montreal]* (24 August 1993) B8.

510 *Proposed Foreign Issuer Prospectus and Continuous Disclosure System (Draft National Policy Statement N° 53)*, (1995) 18 O.S.C.B. 1893. *Avis des autorités canadiennes en valeurs mobilières - Projet de régime du prospectus et de l'information continue pour les émetteurs étrangers (Projet d'instruction générale n° C-53)*, (1995) 26:17 B.C.V.M.Q. 2. B. CRITCHLEY, "OSC Smooth Path for Foreign

these issuers that wish to: (i) include Canada in large international offerings; (ii) increase opportunity for foreign investment by Canadian individuals and institutions in the primary market; and (iii) preserve the potential for Canadian dealers to underwrite such public offerings while maintaining an appropriate level of investor protection. Being a direct outgrowth of the MJDS[511], it is partly designed with coming Latin American privatization in mind[512]. With NAFTA, Mexican capital markets are likely to be centred in the U.S. NPS N° 53 would allow for many large Latin American companies entering the U.S. institutional investor market to leapfrog into the Canadian public markets[513]. Another recent interesting initiative has been Ontario's private placement ruling allowing for the use of foreign offering documentation for a certain number of cases[514].

Issuers" *The Financial Post [of Toronto]* (10 December 1994) 44. The interim policy draws on a *Draft National Policy Statement N° 53 - Foreign Issuer Prospectus and Continuous Disclosure System*, (1993) 16 O.S.C.B. 4125. *Projet d'Instruction générale n° C-53 — Le régime du prospectus et de l'information contenue pour les émetteurs étrangers*, (1993) 24:33 B.C.V.M.Q. 4.

511 The MJDS has served to develop other ideas (which have yet to fully materialize) designed at including Canada in international issues. *Notice — Remarks of Joseph J. Oliver, supra*, note 508 at 2371.

512 JORDAN, *supra*, note 452 at 382.

513 *Ibid.* at 385.

514 *OSC Blanket Ruling: Re Certain International Offerings by Private Placement in Ontario*, (1993) 16 O.S.C.B. 5931. JORDAN, *supra*, note 452 at 382-383.

PART II: FREE TRADE AGREEMENTS IN NORTH AMERICA AND FINANCIAL SERVICES IN RELATION TO THE SECURITIES INDUSTRY

Compared to the domestic situation, the complex financial regulation of foreign providers of financial services in a cross-border context are more difficult. Moreover, the stability of the domestic financial system may be undermined by aggressive foreign competition. For these reasons, many countries restrict foreign ownership of domestic financial institutions and foreign participation in the domestic market for financial services.

The FTA and NAFTA focus on specific aspects of trade in financial services such as the liberalization of cross-border capital flows and FDI in the industry (the so-called "right of establishment"). Issues relating to the right of establishment have a special significance in the financial industry because of the importance that institutions attach to having a physical presence in the markets that they serve.

TITLE I: THE CANADA-U.S. FREE TRADE AGREEMENT

The Canada - U.S. Free Trade Agreement is the first legally binding trade agreement to include the service sector. Its coverage of the financial area is however less extensive than in other categories of services. Because it is tacitly built on the concept of national treatment, the FTA does not achieve convergence of regulation between the two countries. It does, nevertheless, formally establish the principles of freedom of capital movement and of the right of establishment[515].

CHAPTER I: The Prevalent Situation Before the Negotiations

Over the last 50 years, it is interesting to note that while Canada has almost always had a surplus in trade in goods with the Americans, the U.S. has almost always had a surplus in trade in services with the Canadians. In the FTA negotiations, it is

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515 The only guiding principle incorporated in the FTA was to preserve "the access that our respective financial institutions have to each other's market". CANADA, Department of External Affairs, *The Canada-U.S. Free Trade Agreement: Securing Canada's Future* (Ottawa, Ont.: Minister of Supply and Services, 1987) at 249.

understandable that the Americans attached a priority to the negotiations of a framework of rules relating to trade in services[516] (particularly financial services)[517]. Because financial services are not traded goods or services in the conventional sense, it was decided that their negotiations would be kept completely separate from the negotiations on non-financial services[518]. The focus of the talks aimed at the liberalization of financial services and were centred around the right of establishment or the right to operate in the other Party's market[519]. One should recall that the FTA negotiations occurred when the Canadian financial services sector was being restructured at both the federal and provincial levels[520]. At the same time, U.S. policy-makers began to re-examine their methods of ensuring the continued health of American financial institutions[521]. Thus, the FTA must be looked upon against a backdrop of changing regulatory frameworks. Canadian laws imposed some foreign ownership restrictions and limited activities to be carried on by some foreign-owned financial institutions. American financial regulation, although very open in terms of the ability of foreigners to participate, was seen to be very restrictive in terms of the

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516 The FTA broke new ground by establishing firm contractual obligations on services for both the U.S. and Canada. J.J. SCHOTT, *United States–Canada Free Trade: An Evaluation of the Agreement*, N° 24, (Washington, D.C.: Institute for International Economics, 1988) at 31.

517 The inclusion into the FTA of a financial services Chapter "would provide Canada and the U.S. with a useful precedent for bilateral negotiations with other nations and for the GATT negotiations". P. MANSON, *Impact of the Free Trade Agreement on Financial Services*, (1989) 3 B.F.L.R. 329 at 331.

518 D.A. RUTH, "The U.S.- Canada Services Agreement: Review and Assessment" in FRY & RADEBAUGH, eds, *supra*, note 199. Because so technically complex, financial services were negotiated by the Canadian Department of Finance and the U.S. Treasury Department. R.B. POTTER & S.M. LUSSENBURG, *U.S./Canada Free Trade Agreement and Trade in Services: A Timorous First Step or a Bold New Stoke?*, (1988) 2 R.I.B.L. 123 at 125.

519 R. MACINTOSH, then-President of the Canadian Bankers' Association Address (Standing Committee on External Affairs and International Trade, 4 November 1988), [Published in the Proceedings of the Standing Committee at 34:36]. It has been said that the FTA "[...] approach permits each country to maintain most domestic regulation with change required only where operations of other's financial institutions are affected." CHANT, *supra*, note 17 at 2.

520 It has been said that the more open Canadian environment occurred as much because of the deregulation of financial services as the FTA itself. D.D. PETERS & P.L. DRAKE, "Implications for Financial Services of the Canada-United States Free Trade Agreement" in M. GOLD & D. LEYTON-BROWN, eds, *Trade-Offs on Free Trade: The Canada-U.S. Free Trade Agreement* (Toronto, Ont.: Carswell, 1988) 332 at 336.

521 J.R. JOHNSON & J.S. SCHACTER, *The Free Trade Agreement: A Comprehensive Guide* (Aurora, Ont.: Canada Law Books, 1988) at 116.

activities carried on by domestic or foreign financial institutions. Consequently, harmonization of financial regulation between Canada and the U.S. was seen as difficult because their approaches to regulation differed[522].

Before the negotiations, the Canada-U.S. financial markets were, in general, relatively open. The six largest Canadian domestic chartered banks all did business in the U.S.[523] On the American side, no less than seventeen banks had already established banking subsidiaries in Canada[524]. Nonetheless, important restrictions subsisted[525]. In the eyes of the U.S. financial community, the two-level Canadian federal and provincial regulation of financial services was viewed as a significant trade barrier preventing the American export of financial services to Canada. Moreover, they argued that severe restrictions were imposed which prohibited full and fair competition in the Canadian marketplace. For its part, Canada also identified several barriers to Canadian financial institutions in the U.S. market. Before examining the negotiation results, it is important to review the negotiation objectives of both countries and determine the terms of the restrictions affecting the Canada-U.S. financial services business[526].

The American negotiators sought a form of equality of competitive opportunity (hereinafter ECO) for U.S. financial institutions which would permit different regulatory

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522 CHANT, *supra*, note 17 at 6-7.

523 Canadian banks have had roots in the U.S. for many years. For example, the Bank of Montreal has had significant U.S. operations for over 100 years. F. SWEDLOVE, "The Current State of Trade in Financial Services" in CANADA, Department of Justice, *Proceedings of the Ninth International Trade Law Seminar* (Ottawa, Ont.: Minister of Supply and Services, 1992) 105 at 105. MANSON, *supra,* note 517 at 329.

524 B.M. LEVITT & S.P. BATTRAM, *Canada/United States Trade in Financial Services*, (1987) 3 J. of Int'l Bank. Law 159 at 162.

525 POTTER & LUSSENBURG, *supra*, note 518 at 134.

526 For a good understanding of the positions of both the Canadian and U.S. governments with respect to Chapter 17 in general, see various debates and reports (prior and after the coming into force of the FTA). In Canada, see, CANADA, Senate, "*Proceedings of the Standing Senate Committee on Foreign Affairs*" in *Proceedings*, Issue N° 4 (6 June 1989), Issue N° 3 (30 May 1989), Issue N° 28 (26 July 1988) at 7-113, Issue N° 27 (25 July 1988) at 7-29. In the U.S., see U.S. SENATE, Hearings Before the Committee on Banking, Housing and Urban Affairs, May 20, 1988, *Congressional Information Service* 88S241-22. HOUSE OF REPRESENTATIVES, Hearings Before the Committee on Energy and Commerce (subcommittee on Commerce, Consumers Protection and Competitiveness), February 23, March 22 and April 26, 1988, *Congressional Information Service* 88H361-88.

treatment of foreign and domestic institutions although it would allow both to compete on an essentially equal basis[527]. ECO differs from national treatment, both in offering greater regulatory flexibility and in preventing *de facto* discrimination where *de jure* national treatment might create inherent disadvantages for foreign institutions[528].

Coming into the negotiations, the Canadian Bankers' Association (hereinafter CBA) did not embrace the principle of "national treatment"[529]. The reason for that was because the Canadian framework for regulation of the securities industry promised to open up new business possibilities for banks in Canada–possibilities unavailable in the U.S. because of the Glass-Steagall Act (hereinafter GSA). Thus, the CBA favoured the principle of reciprocity in the hope of at least preserving current access enjoyed by securities firms, even once they became bank subsidiaries.

CHAPTER II: Negotiation Objectives of Both Countries

The necessity to conclude a trade agreement between Canada and the U.S. resulted from a desire to lower the barriers as identified by members of the financial communities of both countries. These aspirations constituted the grounds for the negotiation.

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527 "Our objective in these negotiations was to make significant progress in obtaining equality of competitive opportunity for United States financial firms operating in or wishing to enter Canada. Putting it another way, we sought treatment equivalent to that accorded domestic institutions. In a Treasury Department report prepared for Congress in December of 1986 we highlighted the barriers that existed in Canada's financial sector. This document, the National Treatment study, served as our road map in our quest for equal treatment for U.S. firms." Hearing Before the Committee on Banking, Finance and Urban Affairs, *supra*, note 526 at 4. 43 (statement and testimony of Thomas J. Berger, Deputy Assistant for Monetary Affairs, Department of Treasury).

528 For a discussion of various models for the entry of financial institutions into foreign markets, see LOHMANN & MURDEN, *supra,* note 325 at 147.

529 "[A] national treatment agreement is not appropriate to Canada and the United States because the United States government cannot negotiate the right of Canadian banks to establish throughout the United States, while in Canada, the right of establishment is under federal authority only, guaranteeing nation-wide access." LEVITT & BATTRAM, *supra*, note 524 at 163.

1. American Demands

The American demands can be summed up into three major points[530]. First, the U.S. government insisted that the American banks have guaranteed access to information networks, telecommunications and electronic services system distribution. Second, restrictions concerning American banking activity in Canada were to be ended in areas such as: entry on Canadian market; assets held in Canada; commercial loans; parent company loan transfers; foreign bank subsidiaries' funds origin; taxation and data processing.

Under the existing system, foreign banks wishing to enter and do business on the Canadian market did not have the right to choose the form of entry they pleased. They could only enter the market by establishing Canadian subsidiaries as opposed to just branches[531]. Furthermore, foreign banks were not entitled to open more than one branch other than their head office without authorization from the Minister of Finance[532]. As for assets held in Canada, individual domestic assets held by a foreign bank (meaning the total domestic assets of a foreign bank) could not exceed twenty time its authorized capital[533]. At the time of the FTA negotiation, the global amount of domestic assets held by foreign banks located in Canada was limited to

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530 This analysis is taken from the U.S. TREASURY DEPARTMENT, *Study on the Treatment of U.S. Banks in Foreign Financial Markets* (Washington, D.C.: USGPO, 1986). G. LEFEBVRE, *Accord de libre-échange et institutions financières: le cas des banques*, (1991) 25 R.J.T. 345 at 354-356. J.W. SWENDSEN, "A Banking Perspective: Will It Make a Difference?" in E.H. FRY & L.H. RADEBAUGH, eds, *The Canada/U.S. Free Trade Agreement: The Impact on Service Industries* (Provo, Utah: DMK Centre for International Studies of Brigham University, 1989) at 183. M.A. JACOBY, "The U.S. Financial Services Sector: Business Ambitions and Negotiation Realities in the Canadian/U.S. Free Trade Agreement" in E.H. FRY & L.H. RADEBAUGH, eds, *Canada-U.S. Economic Relations.* (Provo, Utah: DMK Centre for International Studies of Brigham University, 1985) 65. POTTER & LUSSEMBURG, *supra*, note 518 at 136-138.

531 This condition was *sine qua non*. *Bank Act of 1980*, s. 173(2).

532 *Bank Act of 1980*, s. 173(2). This provision did not keep foreign banks from opening as many branches as they pleased in Canada. Approval from the minister has always been given to foreign banks that sought it. FORDYCE & NICKERSON, *supra*, note 339 at 358.

533 *Bank Act of 1980*, s. 174(2)(e); 174(6).

16% of total assets held in banks in Canada[534]. With respect to commercial loans, the total amount of loans that could be made to its clients by a foreign bank could not exceed its own funds (nor that of its parent company). Moreover, the loans granted to a single client could not exceed 50% of its own funds[535]. Parent company loan transfers were also limited in order to avoid that foreign banks circumvent the global limit of domestic assets set for foreign banks in Canada. Foreign bank subsidiaries' funds were limited to no more than 50% originating from offshore[536]. Foreign banks could only be granted limited tax deductions for interest on loans obtained by the parent company[537]. Finally, foreign banks had to keep and process in Canada all information or data purporting to keeping or maintaining their bank books[538].

Thirdly, the Americans further demanded that Canadian markets be opened to American banks therefore allowing them to supply financial services to the government and to Canadian governmental entities on par with Canadian financial institutions.

2. Canadian Demands

For their part Canadian financial institutions had demands of their own. Canadian banks insisted on nine points[539], beginning with free access to the American securities market through the withdrawal of the GSA.

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534 *Bank Act of 1980*, s. 302(8). Note that this restriction never really had any impact on the activities of foreign banks in Canada. FORDYCE & NICKERSON, *supra*, note 339 at 358. "For instance, in 1986 foreign banks' assets were only about 80 percent of their potential markets, determined by the asset ceiling". S. MAGUN *[et al.], Open Borders: An Assessment of the Canada-U.S. Free Trade Agreement*, Discussion Paper N° 344 (Ottawa, Ont.: Economic Council of Canada, 1988) at 128.

535 These rules are now included in the Guideline N° B-2: *Limits Concerning Important Engagements*, Office of the Superintendent of Financial Institutions, 1991.

536 Guideline N° G-6: *Funding of Canadian Dollar-Dominated Assets of Foreign Bank Subsidiaries*, Office of the Superintendent of Financial Institutions, 1988.

537 *Bank Act of 1980*, S.C. 1970-71-72, c. 63, s. 18(4).

538 *Bank Act of 1980*, s. 157(4). This provision was abandoned in the *Bank Act of 1991.*

539 This analysis is taken from the Canadian Bankers' Association, *Submission to United States International Trade Commission on Free Trade on Financial Services Between the United States and Canada*, November, 1986, at 15. MANSON, *supra*, note 517, 329 at 331-332. LEFEBVRE, *supra*, note 530 at 360-362. LEVITT & BATTRAM, *supra*, note 524 at 163-164. POTTER & LUSSEMBURG, *supra*, note 518 at 135-136.

2.1 The Case of the Glass-Steagall Act

In many securities markets outside the U.S., banks (or their affiliates) are major participants as underwriters, dealers and brokers. However, the U.S. legal framework in many respects is frozen in an earlier era of the financial history of the nation[540], when banks and investment companies saw one another as complementary players rather than direct competitors[541]. The increasing globalization of both securities and banking activities, combined with the growing overlap between the two areas have enticed U.S. banks to obtain increased securities opportunities (both at home and abroad)[542]. In addition, foreign banks (using the investment banking aspects of "universal banking")[543] have also sought additional opportunities to do business in the U.S[544].

For the Canadian securities industry, the fragmented system of the U.S. has, for many years, created serious difficulties. Under the GSA[545], banks[546] and their affiliates

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540 For a brief summary of the reasons leading to the enactment of the GSA, see, *e.g.*, "The Sound of Breaking Glass", A Survey of Wall Street *The Economist* (15 April 1995) 27. ECONOMIST IINTELLIGENCE UNIT, *Foreign Financing Operations (United States)* (London: Economist Intelligence Unit, 1995) at 8. H. ROSE, *The Changing World of Finance and its Problems,* Issue Paper N° 2 (Washington, D.C.: British-North American Committee, 1993) at 30. J.J. NORTON, *Up Against "The Wall": Glass-Steagall and the Dilemma of a Deregulated ("Reregulated") Banking Environment,* (1987) 42 Bus. Law. 327 at 334.

541 The GSA "[...] is currently one of the most controversial and beleaguered statutes in the United States, pitting the community of securities dealers against the commercial banking community in a leviathan struggle over territory." JORDAN, *supra,* note 103 at 36.

542 F.M. TAVELMAN, *American Banks or the Glass-Steagall Act–Which Will Go First?,* (1992) 21 Sw. U. L. Rev. 1511. P.J. FERRARA, *The Regulatory Separation of Banking From Securities and Commerce in the Modern Financial Marketplace,* (1991) 33 Ariz. L. Rev. 583. C.E. ENGROS, Jr. & P.K. SCHLEGEL, *Integrating the U.S. into Global Securities Markets,* (1991) 24 Rev. Sec. & Comm. Reg. 169 at 170.

543 For comments on the rejection of the efficiency justification for the dual banking system being used in the U.S. see, *e.g.*, H. BUTLER & J. MACEY, *The Myth of Competition in the Dual Banking System,* (1988) 73 Cornell L. Rev. 677.

544 R. TORTORIELLO, "Glass-Steagall Act: Current Issues Affecting Bank Underwriting, Dealing and Brokerage Activities" in the 12th Annual Institute, *Securities Activities of Banks* (Englewoods Cliffs, N.J.: Prentice Hall Law & Business, 1992) 77.

545 Actually, what is commonly known as the GSA is not a self-contained law. Instead, it consists of several sections (§§16, 20, 21 and 32) of the *Banking Act* of 1933 (now codified as 12 U.S.C §§ 24(7), 377, 378 and 78 respectively). The *Banking Act* was passed by the U.S. Congress after the 1929 market crash and subsequent waves of bank failures, see, *e.g.*, FAULHABER, *supra,* note 52 at 2ff.

have been subject to severe limitations on permissible securities underwriting and dealing activities. These restrictions have had a direct impact on certain beneficiaries of the recent Canadian deregulation. Hence, a short period of time after the Canadian legislative changes during the FTA negotiations in 1987 that allowed banks to acquire and own securities firms[547], most of the underwriting capacity of the Canadian securities industry gradually came under the control of banks[548]. By doing so, Canadian banks infringed on the GSA due to the fact they possessed securities affiliates principally engaged in non-permissible activities[549].

In essence, the GSA imposes prohibition against commercial banking and investment banking in the same entity. It is supplemented by the Bank Holding Company Act of 1956 (BHCA)[550] and the International Banking Act of 1978 (IBA)[551]. On the one hand, §§ 16 and 21 of the GSA approach the legislative goal of separating "the securities business" from the "business of banking" from different directions. Section

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546 The GSA defines a "bank" as an organization engaged "in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor..." 12 U.S.C. §378 (a)(2).

547 *Supra*, note 337.

548 However, remember that the Canadian model of "universal banking" provides for investment banking activities to only be conducted (with certain exceptions) by affiliates.

549 POTTER & LUSSENBURG, *supra*, note 518 at 135. DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,108 para. 38-405.

550 12 U.S.C. § 1841, as amended. A "BHC" is "[...] any company which has control over any bank or over any company that is or becomes a bank holding company [...]." 12 U.S.C. § 1841 (a)(1). In the context of the GSA, Section 4(a) of the BHCA prohibits a BHC and its non-bank affiliates from engaging in any non-banking activities (such as dealing in, underwriting or purchasing securities) except as otherwise provided in the BHCA. Generally, "[t]he standard for determining whether a BHC subsidiary may engage in a particular activity (including securities-related activity) under § 4(c)(8) of the BCHA is whether the proposed activity is "so closely related to banking ... as to be a proper incident thereto"." GREENE *[et al.]*, Vol. 2, *supra*, note 47 at 721.

551 12 U.S.C. § 3101, as amended. Until the enactment of the IBA in 1978, banks organized under non-U.S. law (i.e. foreign banks) were regulated only by state law. Therefore, because federal banking laws did not apply to foreign banks, Congress felt they had a competitive advantage over U.S. domestic banks. The IBA eliminated these disparities. GREENE *[et al.]*, *supra*, note 47. In the context of the GSA, the IBA "[...] applies the non-banking activity limitations of the [BHCA] to foreign banks that have U.S. branches or agencies or certain other U.S. banking interests." *Ibid.*, Vol. 1 at 14.

16 places a limit on the power of a bank to engage in securities transactions[552]. Hence, §16 prevents national and state member banks from "dealing in underwriting and purchasing" securities, subject to certain exceptions[553]. Section 21 prohibits deposit-taking by any entity "engaged in the business of issuing, underwriting, selling or distributing ... securities" except as permitted by §16 or in certain other cases[554]. On the other hand, §20 forbids any Federal Reserve System (hereinafter FRS) member bank (including a national bank) from being "affiliated"[555] with an entity "engaged principally" in the "issue, flotation, underwriting, public sale or distribution" of securities. Section 32 prohibits certain interlocks to occur between FRS member banks (including a national bank) and entities "primarily engaged" in the securities activities mentioned in §20 (except as permitted by the FRB)[556].

However, §§16 and 21 by their terms (and §20 by interpretation) specifically provide for certain important exemptions. Thus, in general terms, banks may: (i) do brokerage for customers; (ii) underwrite and deal in certain government securities; and (iii) purchase and sell various securities as an investor[557].

2.2 Other Canadian Demands

The power to establish and exploit branches in many American states was sought after by demanding the withdrawal of the IBA which forbade interstate banking and

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552 According to §5(c) of the *Banking Act* of 1933 (now codified as 12 U.S.C. §335), §16 of the GSA applies to state member banks. Moreover, the provisions of §16 also apply to both federal and state chartered branches of foreign banks by virtue of §§4(b) and 7(b)(2) of the IBA.

553 Until the FTA was entered into by the U.S., section 16 set forth categories of eligible securities which included the following: (i) obligations of the U.S.; (ii) general obligations of any State or any political subdivision thereof; and (iii) obligations listed in section 16 as obligations issued under specified statutory authority or as obligations issued by specified governmental subordinate agency. GREENE *[et al.]*, Vol. 2, *supra*, note 47 at 716ff.

554 For a list of other cases, see, *e.g.*, DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,103 para. 38-405.

555 For this purpose, "affiliates" are subsidiaries, parent or sister companies or other companies being, to some degree, interlocked. See 12 U.S.C. §221(a)(b).

556 12 C.F.R. §218.108.

557 GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 718.

subjected foreign banks to the same restrictions as U.S. banks[558]. Canadian banks also sought the right to acquire local banks in certain states[559] and lead banking activities in others without having to establish a commercial presence. Exemption from the discriminatory tax provisions of certain states was also requested by Canadian banks. The possibility of no longer having to get their letters of credit issued by certain governmental agencies confirmed by American banks was yet another Canadian concern, as was obtaining deposit insurance more easily from the Federal Deposit Insurance Corporation (FDIC) for sums deposited by their clients. Finally, Canadian banks wished for the power to transfer employees more easily to the U.S. and to be protected from the extra-territoriality policy of American law.

CHAPTER III: Negotiation Results

When it was signed, the FTA was unique in that it addressed financial services[560] in a comprehensive manner[561]. The entirety of this aspect of the Agreement between Canada and the U.S. is comprised in Chapter 17[562]. Thus, except for the parts of

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558 L. BIERMAN & D.R. FRASER, *The Canada-United States Free Trade Agreement and U.S. Banking: Implications for Policy Reforms*, (1989) 29 Va. J. Int'l L. 1 at 24-29.

559 On the possibility of acquiring local banks, see, *e.g., ibid*, at 12ff.

560 The FTA is embodied in a 315 page document and is divided into eight Parts and twenty-one Chapters. It comprises 126 Articles, various Annexes and Schedules, a Preamble, and three sets of Letters. Of all this, sixty-eight pages, two Parts (Four and Five), four Chapters (Fourteen to Seventeen inclusive) and thirty Articles are devoted to Services. Of these, one Part (Five) and one Chapter (Seventeen), encompassing all of six Articles, are specifically concerned with financial services.

561 *United States-Canada Free Trade Agreement: Hearings Before the Subcommittee on Trade of the House Committee on Ways and Means*, 100th Congress, 2nd Session, 10-11 (1988) [hereinafter Hearings Before Subcommittee on Trade] (statement of James A. Baker, III, Secretary of Treasury). At the time the FTA was signed, the only other free trade agreement to take-up financial services was the Israel-U.S. FTA. See *supra*, note 72. However, it contains only a non-binding Declaration on Trade in Services and does not specifically name the securities industry.

562 FTA, Article 1701 para. 1. Preliminary transcripts of the negotiations did not indicate that financial services were to be treated separately. CANADA, Department of External Affairs, *Preliminary Transcript–Canadian - U.S. Free Trade Agreement, Elements of the Agreement* (7 October 1987). Interestingly enough, insurance is not covered by Chapter 17 but by the general "Services" provisions of Chapter 14. Unlike Chapter 17, Chapter 14 applies at both federal and the state or provincial level and is subject to the dispute resolution mechanism of the FTA. Moreover, Chapter 14 (again unlike Chapter 17) expresses agreement on a code of conduct in the area of trade in services and each provision is equally applicable to both the U.S. and Canada.

the FTA which it specifically incorporated, Chapter 17 stands alone[563]. The preamble (of Chapter 17) clearly sets the scope for the FTA in financial services. Neither of the countries wished to move towards an integrated and harmonized financial sector. Instead, the intention seems to have been the preservation of the existing integration of the financial systems in the face of changing regulation[564].

Both in Canada and the U.S., an important problem concerned the constitutional powers of political subdivisions. Hence most of the interesting questions related to the relationships between: (i) Canadian federal and U.S. federal regulators; (ii) Canadian federal and provincial regulators; and (iii) U.S. federal and state regulators. In the FTA, the financial services Chapter does not apply to "a political subdivision of either Party"[565]. Furthermore, the Agreement does not have an effect on future restrictions at provincial or state level. As a result, U.S. state restrictions remain in place. On the Canadian side, provincial laws (such as the various securities acts) governing financial services are not affected by the Agreement[566]. Thus, provincially regulated securities dealers do not come within the terms of the FTA[567]. However, the Canadian deregulation of financial services undertaken by the provincial and federal governments has rendered it more difficult to specify which level of government

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563 Some incidental provisions are incorporated in Chapter 17. Those relate to Chapters 16, 20 and 21. More specifically, they refer to: (i) the investment provisions (Article 1601); (ii) the Canada - U.S. Income Tax Convention (Article 2001); (iii) balance-of-payments trade measures (Article 2002); (iv) maintaining or designating a monopoly (Article 2010); (v) statistical requirements (Article 2101); (vi) amendments (Article 2105); and (vii) duration and termination. (Article 2106). PETERS & DRAKE, *supra,* note 520, 332 at 334-335. JOHNSON & SCHACTER, *supra,* note 521 at 122 n. 68. The fact that Chapter 17 stands alone means that Chapter 13 (respecting government procurement) and 19 (referring to dispute settlement do not apply to trade in financial services). Moreover, Article 1701 "[...] does not include application of the preamble and Chapters 1 and 2 to the Financial Services Articles for interpretational purposes." DEARDEN & PALMETEER, eds, *supra,* note 137 at 27,054 para. 38-215.

564 CHANT, *supra,* note 17 at 10.

565 FTA Article 1701 para. 2. A "political subdivision" is defined in Article 1706 as a province, state and local government of either Canada or the U.S.

566 Article 1703 para. 1 of the FTA specifically excludes "provincially constituted financial institutions" from the "commitments of Canada". "The major financial institutions not subject to the commitments of Canada in the FTA are provincially incorporated insurance companies, financial cooperatives, i.e. credit unions and caisses populaires (which are owned cooperatively by their members), investment dealers and mutual funds." DEARDEN & PALMETEER, eds, *supra,* note 137 at 27,204 para. 38-705.

567 POTTER & LUSSENBURG, *supra,* note 518 at 140. DEARDEN & PALMETEER, eds, *supra,* note 137 at 27,051 para. 38-205.

regulates what. In view of what was mentioned earlier concerning CANSEC, the federal government in Canada could have alleged the federal supremacy to enact legislation concerning the securities sector. However, it was not prepared to take the internal political risk, especially when both countries were just beginning to explore the subject of trade in financial services[568].

The FTA states that "financial service" is defined as a service of a financial nature offered by a "financial institution", which institutions are defined as those authorized to do business relating to financial institutions under the laws of a Party or its political subdivisions[569]. This definition implies that the scope of authorized services remains within the sole jurisdiction of each Party or its subdivisions. Therefore, when federally regulated companies were allowed into the provincially regulated securities industry, the question of jurisdiction finally had to be resolved by agreements between Ottawa and Ontario[570] and between Ottawa and Quebec[571]. This is only an example of how access to the Canadian financial market by virtue of federal regulation can in some cases be blocked by provincial regulation, depending on whether the federally-regulated institution is Canadian or foreign-owned.

On another aspect, the principle of ECO is more apparent in Chapter 17 than is reciprocity. However, some elements of national treatment can also be found[572].

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568 MANSON, *supra*, note 517 at 334.

569 FTA, Article 1706.

570 See, *supra*, note 343.

571 *Ibid.*

572 The FTA did not explicitly define "national treatment". PETERS & DRAKE, *supra*, note 520 at 332-333. "[B]oth sides were unable to agree on a definition of "national treatment" in the financial services area. But the consultative mechanism should help to resolve, in a practical way, major differences in this area." Hearing Before the Commission on Banking, Housing, and Urban Affairs. May 20, 1988, *supra*, note 526 at 80 (testimony of Robert D. Hormats, Vice Chairman, Goldman Sachs International Corp.). However, the problems surrounding the negotiations of a concept which would please all parties were explained by former Canadian ambassador to the U.S. Allan Gottlieb when he said that "[t]he negotiators struggled with various concepts to address the asymmetries. They debated applying the reciprocity principle, equality of access, various discriminatory models, *de jure* national treatment and so on down the list of concepts. In the end, the two sides opted for what has been styled "equality of competitive opportunity" and that is not a bad way of putting it. Although *de jure* national treatment was not accepted, the approach of "equality of competitive opportunity" looks a lot like *de facto* national treatment". See "Comments by Allan Gottlieb" in *The Future of Financial Services: The Michigan Conference — Proceedings*

Chapter 14 of the FTA (which applies to services in general but not to Chapter 17) is based on the concept of allowing national treatment to entities of the other country providing traded services (i.e. services sourced and provided from the other country). In the financial sector, most industrial countries (including Canada and the U.S.) regulate financial services on the basis of such services being offered within their borders or to residents or citizens of their country. Still, the uniqueness of Chapter 17 appears to be a series of exchanges of concessions between the countries[573].

Some major points of the Agreement consisted of: (i) the exclusion of financial services from the Chapter concerning services; and (ii) the disenfranchisement of future differences in financial service matters from the general system for resolving differences[574]. It is important to note that neither the International Trade Commission (created in Chapter 18) nor the dispute settlement provisions of Chapter 19 have jurisdiction over financial services[575]. Instead, it has been replaced by a consultative process between the Canadian Department of Finance and the U.S. Department of Treasury. Moreover, note that the nullification and impairment provisions contained in Chapter 20[576] and the Chapter 13 provisions relating to government procurement do

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(Detroit, Mich.: Michigan Financial Institutions Bureau, May 1990) 21 at 22.

573 Nonetheless there is confusion on that matter. For example, certain authors maintain that the key principle of the financial Chapter is "national treatment". BIERMAN & FRASER, *supra,* note 558 at 3. A. SAUMIER, "The Canada-U.S. Free Trade Agreement and the Services Sector" in GOLD & LEYTON-BROWN, eds, *supra,* note 520 at 328.

574 FTA, Article 1702 para. 1. A consulting mechanism between the Canadian Department of Finance and the U.S. Treasury Department was established instead. FTA, Article 1704 para. 2. This includes prior notice of any proposed legislative or regulatory changes in order to give time for comment. G. LOHMANN & R. LABROSSE, "The Canada-U.S. Free Trade Agreement and Financial Services" in J. CHACKO, ed., *The Future of Canadian and U.S. Financial Services in the Global Context* (Windsor, Ont.: Centre for Canadian-American Studies, 1990) 90 at 92.

575 It has been said that Chapter 17 was exempt from the general dispute settlement provisions to avoid a situation where "a panel would be second-guessing the court system" if there already exists a FRB or court decision. *United States-Canada Free Trade Agreement: Hearings Before the House Committee on Banking, Finance and Urban Affairs,* 100th Congress, 2nd Session 16-17 (1988) [hereinafter *Hearings Before Comm. on Banking, Finance and Urban Affairs*] (statement of Thomas J. Berger, Deputy Assistant Secretary for International Monetary Affairs, Department of Treasury). On the other hand, some say that the consultative process gives the U.S. Treasury a greater influence over Canadian legislation as Canada continues its liberalization program. JORDAN, *supra,* note 103 at 40.

576 FTA, Article 2011.

not apply to Chapter 17. Finally, it should be pointed out that there is no mechanism provided to enforce the Financial Services Articles nor is there any route for the hearing of complaints voiced by the private sector with respect to same. Presumably, the only recourse of the securities industry in either country, if it believes that a law or a practice of the other Party unfairly favours or restricts the free-flow of financial services, is to complain to its own government and to request that the two governments "consult" on the issue.

Moreover, Canada and the U.S. made one commitment jointly and each made three commitments separately. Jointly, they respectively agreed to continue to provide each other's financial institutions with the rights and privileges they enjoyed as a result of existing laws, regulations, practices and stated policies. However, this "standstill" approach is further complemented by an agreement to consult with each other regarding liberalization of their rules governing financial services and to extend the benefits of any such liberalization to each other's financial institutions[577]. Thus, if one Party fails to extend the benefits of liberalization to the other Party, the "injured" Party is no longer obliged to fulfil the "standstill" commitment. The negotiators thought that this mechanism would encourage dispute resolution through consultation. In that vein, note that Article 1704 para. 1 requires each Party (to the extent possible) to make public and allow opportunity for comment on legislation and proposed regulations resulting from the agreement on financial services[578]

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577 This vague commitment to liberalization is referred to in Articles 1702 para. 4 and 1703 para. 4. However vague it is, this commitment sparked considerable debate in the U.S Congress. BIERMAN & FRASER, *supra*, note 558 at 4 n. 17. Hence, "[s]ince Canada has already advanced far beyond the United States with respect to "liberalization" or "deregulation" of its financial markets, in an agreement based on the principle of national treatment of each side's financial institutions, only the Canadian side had to gain from a commitment of the other side further to liberalize financial markets." JORDAN, *supra,* note 103 at 39. Therefore, the language to the effect that the financial services Chapter does not represent "the mutual satisfaction" of the parties is probably of Canadian origin.

578 "This commitment to public consultation on proposed legislation is somewhat novel for Canada although it is a more common practice in the United States. This requirement for public consultation softens somewhat the impact of the lack of a dispute settlement mechanism for the financial services sectors." DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,052 para. 38-205.

1. Specific Commitments of Both Countries

Before analysing the various commitments of both the U.S. and Canada it is important to keep in mind that Chapter 17 (as elsewhere in the FTA)[579] states that the Parties have made clear that benefits may be denied to a company of the Other Party if the Party establishes that the company is controlled by a person[580] of a third country[581].

Having said so, it is important to distinguish between the provisions applying to a "bank" and those applying to a "financial institution". In essence, Part Five of the FTA relates only to the "banking sector". Due to the fact that banking fell under federal jurisdiction in Canada and the U.S.[582], Canadian Finance and U.S. Treasury officials were able to act fairly easily[583]. Still, we see here that the negotiators were careful to avoid the areas where there exists substantive provincial and state jurisdictions. Hence, references to investment dealers are made only sporadically in the FTA (Annex 1408 and Annex 1502.1) and their employees are given free access between both countries. However, to the extent that deregulation rocked the four-pillars system,

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579 See FTA, Articles 1406 (Services) and 1611 (investment: definition of "investor of a Party").

580 "Person" is not defined in Chapter 17 but presumably includes individuals and corporations.

581 FTA, Article 1705 para. 2. "Arguably, this provision is unnecessary because the benefits of Chapter Seventeen are only available to Canadian and United States-controlled financial institutions and United States persons ordinarily resident in the United States". JOHNSON & SCHACTER, *supra*, note 521 at 122. According to Article 1706 of the FTA, "Canadian-controlled" means controlled directly or indirectly by one or more individuals who are "ordinarily resident" in Canada. The expression "ordinarily resident" is also defined at Article 1706 and means sojourning in that country for at least 183 days during the relevant year. "United States-controlled" means either *de facto* or *de jure* control held, directly or indirectly, by one or more "United States nationals". For the purposes of Chapter 17, a "United States national" is an individual who is a citizen or permanent resident of the U.S. DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,053-27,054 para. 38-210.

582 In the domain of "banking", the U.S. federal jurisdiction is autonomous (if not exclusive) where banks can be set up under either federal or state statute.

583 Still, "[i]t is probably safe to conclude that the lack of post-implementation change is due more to the comparative strengths of Canadian banks, the weak American financial sector, and the fact that both markets were relatively open prior to 1987, than to any provision of the FTA." S. COOPER, "Trade in Financial Services: The Canadian Banks' Perspective" in CANADA, Department of Justice, *Proceedings of the Ninth International Trade Law Seminar* (Ottawa, Ont.: Minister of Supply and Services, 1992) 115 at 116.

the narrow "bank" focus of Part Five of the FTA proved to be less critical than it appeared at first sight.

2. Canadian Gains: Minimal and Symbolic[584]

Under Article 1702 para. 1 of the FTA[585], the U.S. agreed (to the extent that the domestic and foreign banks are permitted to engage in the dealing in, underwriting and purchasing of debt obligations backed by the full faith credit of the U.S., its states or political subdivisions) that Canadian, American and foreign banks (including holding companies) and their affiliates be permitted to engage in the dealing in, underwriting and purchasing of debt obligations backed by the Canadian equivalent of the full faith credit of Canada, its provinces or political subdivisions[586]. This includes not only federal, provincial and municipal bonds, but also debt obligations of "agents" such as

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584 For an understanding of the position of the U.S. government with respect to its commitments towards Canada, see U.S. SENATE REPORT, N° 100-509, September 15, 1988. (1988) 5 *Code Congressional and Administrative News* 2395 - 2468 at 67. HOUSE OF REPRESENTATIVES, Report of the Committee on Banking, Finance and Urban Affairs N° 100-816(V), August 5, 1988, *Congressional Information Service* 88H243-6. HOUSE OF REPRESENTATIVES, Hearings before the Committee on Banking, Finance and Urban Affairs, May 24, 1988, *Congressional Information Service* 88H241-37.

585 "[I]t is interesting to note that the only implementing legislation necessitated by the U.S. commitments in Article 1702 was the amendment to section 16 of the [GSA] pursuant to paragraph 1702(1)." DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,122 para. 38-455. JORDAN, *supra*, note 103 at 36. In comparison, the Canadian legislation designed to implement the FTA contained amendments to 27 federal statutes.

586 About the mere existence of that provision, it has been said that it has "more to do with the marketing of Canadian public debt in the United States than with the liberalization of trade in financial services." JOHNSON & SCHACTER, *supra*, note 521 at 118. Also, it was predicted that it would "significantly affect the future ability of Canadian governmental entities to finance their debt." BIERMAN & FRASER, *supra*, note 558 at 7. One effect of the change, however, has been to allow Canadian bank-owned dealers to continue to underwrite Canadian government debt in compliance with the GSA. Historically, government debt underwriting was an important component of the Canadian securities dealers operating in the U.S. M. LALONDE, *Trade in Financial Services Under the Canada-U.S. Free Trade Agreement: A Canadian Perspective* (Washington, D.C.: American Bar Association — National Institute of United States/Canada Free Trade Agreement, 1988) 161 at 173. It has even been a greater component of the business since U.S. subsidiaries of Canadian securities firms that were acquired by Canadian banks had to stop transacting in corporate securities under the GSA. C.S. MORTON, *The Impact of the Free Trade Agreement on the Flow of Services Between Canada and the United States*, (1991) 16 Can.-U.S. L.J. 91 at 99.

federal and provincial Crown corporations (provided that these are fully backed[587] by the Canadian government)[588]. Although bankers and their affiliates have gained access to what is called the "Canadian Yankee market" for U.S.-dollar bonds issued or guaranteed by Canadian governments, this American commitment did not "undermine the basic tenets of the Glass-Steagall Act"[589]. Since the bulk of the underwriting is done in New York[590], this enables the different levels of Canadian government a considerable saving on servicing the debt which is estimated to be in the billions of dollars yearly[591]. Hence, it was considered that the sale of these securities by banks in the U.S. would promote competition and afford their holders greater market liquidity[592]. Consequently, the rate of interest paid on the debt of Canadian governmental entities would be lower[593]. However, this assurance does not address the requirements of state securities laws (which, of course, concern the

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587 "This full faith credit standard is not free from uncertainty. In the U.S., for example, obligations of certain entities that are not instrumentalities of the U.S. government, such as the Federal Home Loan Mortgage Corporation, do not bear the express full faith and credit backing of the U.S. Nevertheless, the Federal Home Loan Mortgage Corporation is recognized as a government sponsored agency and viewed as bearing an implied full faith and credit backing of the U.S. Similar uncertainties may arise with respect to certain Canadian obligations." DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,104 para. 38-405.

588 LALONDE, *supra*, note 586 at 161. In other words, "Article 1702.1 for purposes of restrictions on dealing in and underwriting securities, equates Canadian government securities with U.S. government securities." JORDAN, *supra*, note 103 at 35. The FRB supported this kind of underwriting activity "that with respect to U.S. Government and State and local government obligations, [...] can be undertaken by banking institutions" in the U.S. Hearing Before the Committee on Banking, Finance and Urban Affairs, *supra*, note 526 at 9 (statement of Michael Bradfield, General Counsel, Board of Governors, Federal Reserve System).

589 *Fact Sheet–Canada-U.S. Free Trade Agreement* released by the White House (Office of the Press Secretary) on January 2, 1988 at 34; as *reprinted in* the Hearing Before the Comm. on Banking, Housing and Urban Affairs, *supra*, note 526 at 46 (May 20, 1988).

590 R. LIPSEY & R.C. YORK, *Evaluating the Free Trade Deal: A Guided Tour through the Canada-U.S. Agreement*, Policy Study N° 6, (Toronto, Ont.: C.D. Howe Institute, 1988) at 91-92.

591 BIERMAN & FRASER, *supra*, note 558 at 19. Since the 1950s, Canada has run a current account deficit for every year (except for 7 years of surpluses). At the end of 1994, the net external debt amounted to a record Cdn $ 637.6 billion. STATISTICS CANADA, Catalogue N° 67-202, *System of Nation Accounts: Canada's International Investment Position*, 1994, Table 1 at 45.

592 It was said that this "relatively modest step" should be beneficial "by providing a larger market for [...] governments' securities". See Hearings Before the Comm. on Banking, Finance and Urban Affairs, *supra*, note 526 at 2-3 (comment by Rep. Chamlmers P. Wylie).

593 *Ibid.*

securities offered within state boundaries)[594].

The second U.S. commitment relates to interstate banking facilities[595]. Here, the U.S. agreed not to adopt or apply any measure that would accord treatment less favourable to nationals of Canada than (such treatment already) accorded under §§ 5 and 7 of the IBA. These sections contain "grand-fathering" provisions for foreign banks relating to interstate branching and non-banking activities[596]. In other words, Canadian-controlled banks[597] that operated branches in many American states prior to October 4, 1987[598] are able to continue doing so at the level permitted by the federal regulation under the IBA. This protected the major Canadian banks with a significant number of branches in the U.S.[599]. The FTA does not, however, provide any assurances that the U.S. will extend to Canadian-controlled banks provisions for future interstate expansion beyond those provided under the IBA on October 4, 1987. Moreover, the U.S. would not agree to give Canadian banks a right of establishment in all states, interstate banking not being a matter that the U.S. federal government is constitutionally empowered to regulate[600]. Note that these were preserved with the coming of the IBA which contained a safeguard clause to that effect. The FTA freezed

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594 MANSON, *supra*, note 517 at 332.

595 FTA, Article 1702 para. 2. For a detailed understanding of the interstate banking commitment under the FTA, see, *e.g.*, DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,115 to 27,121 paras 38-410 to 38-450.

596 Article 1702 para. 2 of the FTA protects Canadian-controlled banks that are foreign banks for the purpose of the IBA in maintaining their interstate banking networks established prior to July 27, 1978. On the day the FTA was signed, 8 Canadian banks operating 15 subsidiary banks, 18 branches and 14 agencies were existing under this provision. Hearings Before the Comm. on Banking, Finance and Urban Affairs, *supra*, note 526 at 9 (statement of Michael Bradfield, General Counsel, Board of Governors, Federal Reserve System). The effect of the FTA was to "lock in this grandfathering so it would not be changeable by subsequent legislative action." *Ibid.*

597 The term "Canadian-controlled" is defined in Article 1706 and relates to beneficial ownership of more 50 percent of the shares which can elect the board of directors, or to control as a fact. DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,115 para. 38-415.

598 October 4, 1987 is the date on which Canada and the U.S. agreed in principle on the elements to be included in the FTA. CANADA, Department of Finance, *The Canada-U.S. Free Trade Agreement: An Economic Assessment* (Ottawa, Ont.: Minister of Supply and Services Canada, 1988) at 23.

599 LEFEBVRE, *supra,* note 530 at 369. POTTER & LUSSENBURG, *supra,* note 518 at 142 n. 55. MACINTOSH, *supra,* note 519 at 34:47 and 34:56. It was estimated that probably 40 or 50 branches of Canadian banks were affected. However, their number dwindled as operations proved uneconomical. JORDAN, *supra,* note 103 at 36.

600 DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,122 para. 38-450.

this benefit. This is not really a gain for Canada, for a future modification to the safeguard clause was, according to certain authors, highly unlikely[601]. Still, this second commitment of the U.S. has become less significant as states have moved to open up interstate branching[602].

Finally, the U.S. undertook to treat Canadian-controlled financial institutions in the same way as American financial institutions during any future modification of the GSA and associated legislation and resulting amendments to regulations and administrative practices[603]. Of course, there is no guarantee that the GSA will be amended[604]. Thus, the members of the Canadian industry would have preferred more assurance[605]. They are just guaranteed that if any changes to the GSA caused by a protectionist attitude of the Congress is to occur, this will not affect them. Some maintain this is yet another symbolic and useless provision[606]. They state that the IBA aims at putting all banks on an equal stand and that any future amendment will do so as well. This reasoning is somewhat simplistic however. Since it was negotiated under a protectionist context in the U.S., it is clearly a non-negligible extra insurance

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601 BIERMAN & FRASER, *supra,* note 558 at 25-26. "Although the inapplicability of Chapter 17 to political subdivisions has [...] greatly undercut the significance of Article 1702.2, to Canada it may represent the preservation of the last vestige of privilege." JORDAN, *supra,* note 103 at 36.

602 On the rapid growth of interstate banking, see, *e.g.*, "Interstatic" *The Economist* (4 June 1994) 80. Note that it has been argued that "[the *Foreign Bank Supervision Enhacement Act* of 1991] requires foreign banks to obtain [FRB] approval before establishing a branch agency or acquiring control of a commercial lending company. By imposing a requirement that approval be obtained where none was previously required, this federal measure arguably accords less favourable treatment than existed on October 4, 1987." J.R. JOHNSON, *The North American Free Trade Agreement: A Comprehensive Guide* (Aurora, Ont.: Canada Law Book, 1994) at 355. However, against this requirement, it has been said that "[w]hile the negotiations protected against *de jure* changes in policy, it did not protect against discretionary changes in application of regulation." CHANT, *supra*, note 17 at 18.

603 FTA, Article 1702 para. 3. This guarantee by the Americans did not require any implementing legislation. DEARDEN & PALMETEER, eds, *supra,* note 137 at 27,122 para. 38-455.

604 SEC's then-Chairman Ruder, in his testimony on behalf of the SEC before the Senate Committee on Banking, and Urban Affairs on December 3, 1987, and before the Subcommittee on Financial Institutions Supervision, Regulation, and Insurance of the House Committee on Banking, Finance, and Urban Affairs on December 9, 1987, stated that the SEC is unable to support any proposals to repeal the GSA unless investor protection concerns arising from the entry of banks into securities activities are simultaneously addressed.

605 MACINTOSH, *supra,* note 519 at 34:57.

606 BIERMAN & FRASER, *supra,* note 558 at 21.

for Canadian banks. Eventually, this commitment from the U.S. could help bridge the gap between the pace of regulatory change in the financial communities of both countries.

Finally, thanks to the provisions of Chapter 15 concerning temporary visiting rights for business people, Canadian banks have been able to transfer employees more easily to the United States[607].

3. American Gains: Much More Considerable

As mentioned above, the commitments of the U.S. are mostly vague and phrased in general terms. However, the commitments of Canada are very specific and required legislative amendments to several Canadian statutory provisions. Canada agreed that U.S. nationals and U.S.-controlled companies receive treatment as favourable as Canadian nationals with respect to their ability to purchase shares of Canadian-controlled financial institutions[608].

Following the coming into effect of the FTA, many modifications were brought to the *Bank Act*[609]. American residents[610] are no longer considered as non-residents with

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607 MANSON, *supra*, note 517 at 336.

608 FTA, Article 1703 para. 1. In other words, Canada committed itself not to use specified sections of various named statutes to restrict U.S. ownership of the various financial institutions governed by these pieces of legislation: (i) the *Bank Act*, R.S.C. 1970, c. B-1, s. 110(1); (ii) the *Canadian and British Insurance Companies Act*, R.S.C. 1970, c. I-15, ss. 19(1), 20(2); (iii) the *Investment Companies Act*, S.C. 1970-71-72, c. 33, ss. 11(1), 12(2); (iv) the *Loan Companies Act*, R.S.C. 1970, c. L-10, ss. 45(1), 46(2); and (v) the *Trust Companies Act*, R.S.C. 1970, c. T-16, ss. 38(1), 39(2). These rules are generally referred to as the "10/25 rule". More precisely, these provisions limit the percentage of shares which can be held in these financial institutions by non-residents of the total amount of shares in circulation and that of an individual non-resident at 10%. However, note that Article 1703 para. 1 *in fine* specifically exempts provincially-incorporated financial institutions from the application of this preferential treatment given to the U.S. Nevertheless, remember that as far as securities brokerage firms are concerned, foreign entry in domestic markets was open before the ratification of the FTA.

609 S.C. 1991, c. 46 [hereinafter referred to as the *Bank Act of 1991*]. This act replaces the *Bank Act*, R.S.C. 1985, c. B-1 [hereinafter the Bank Act of 1980] as modified by the *Act to Implement the Free Trade Agreement Between Canada and the United States of America*, s. 47. Note that some modifications were brought to acts concerning Canadian financial institutions other than banks. The modifications concern the *Insurance Companies Act*. (S.C. 1991, c. 47 replacing the *Canadian and British*

respect to the application of certain provisions which limit foreign ownership of banks under Canadian control. To be more precise, it is the provisions preventing non-residents from holding more than 25% of the total shares of a given category in circulation of a bank under Canadian control[611]. Such a modification was required by Article 1703 para. 1(a) of the FTA[612]. Consequently, banks under Canadian control, meaning the banks listed in Schedule I, are available for American control. Therefore, in theory at least, U.S. citizens could control, for example, the Royal Bank of Canada[613]. American residents remain subject to rules concerning property stating that banks listed in Schedule I must have a wide-spread capital base. A non-resident cannot hold more than 10%[614] of the total shares in a given category in circulation of a bank under Canadian control[615]. However, such a limit applies to

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Insurance Companies Act, R.S.C. 1985, c. I-12, as modified by the *Act to Implement the Free Trade Agreement Between Canadian and the United States of America*, s. 134, repealed by S.C. 1991, c. 47, s. 761), and the *Trust and Loan Companies Act*, (S.C. 1991, c. 45 replacing the *Trust Companies Act*, R.S.C 1985, c. T-20, and the *Loan Companies Act*, R.S.C. 1985, L-12 as modified by the *Act to Implement the Free Trade Agreement Between Canada and the United States of America*, ss. 139 and 147, and the *Investment Companies Act*, (R.S.C. 1985, c. I-22, as modified by the *Act to Implement the Free Trade Agreement Between Canada and the United States of America*, s. 138. These provisions, all of which are identical, are treated similarly.

610 The term "American residents" is defined in section 397 (3) of the *Bank Act of 1991*.

611 *Ibid*, ss. 397 (2) and 399. Note that in order to give effect to the Agreement establishing the WTO, Canada had to make related or consequential amendments to the *Bank Act of 1991*. As a result, ss. 397 and 399 were repealed on January 1st, 1995. *An Act to Implement the Agreement Establishing the World Trade Organization*, S.C., 1994, c. 47, s. 20. However, Canada has retained its right to reinstate ss. 397 and 399 with respect to a country that is not a WTO Member. *Ibid.*, s. 13(2).

612 CANADA, Senate, *Proceedings of the Standing Senate Committee on Foreign Affairs*, Issue N° 2 at 39-48 and Appendix "FA-2A" (28 December 1988).

613 In the case of a U.S. BHC wishing to acquire a Canadian bank (that in turn owns, for example, a securities firm), the FRB would need to approve the acquisition to make sure it is safe and sound. One issue of safety would require the continuing assessment of the Canadian system of firewalls. See *Hearings Before the Comm. on Banking, Finance and Urban Affairs*, *supra*, note 526 at 11; 14-16. (Statement by Michael Bradfield, General Counsel, Board of Governors, Federal Reserve System).

614 See, *supra*, note 266. According to this rule, no individual (Canadian or otherwise) acting alone or in association, can own more than 10% of a Schedule I bank. "The 10% rule avoids concentration of ownership of Canadian domestic banks (considered to be good public policy), does not constitute a limitation on foreign ownership, and is not affected by the FTA". JORDAN, *supra*, note 103 at 37.

615 The commentary by the government of Canada said that because of that 10% rule, "control of our financial system will be maintained in Canadian hands". CANADA, Department of External Affairs, *supra*, note 562 at 250. However, this statement was misleading for: (i) it did not emphasize the fact that the 10 percent rule does not apply

both Canadian residents and non-residents[616]. Note that the adoption of these new rules concerning property led to the registration of Canadian banks on the New York Stock Exchange[617]. Indeed, the restrictions that limited foreign participation in Canadian banks have been a major obstacle in the past[618]. Note that another set of rules applies to Canadian financial institutions other than banks[619].

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to the entire financial system (so nothing would prevent Canadian-controlled trust and insurance companies from being dominated by American residents); and (ii) it suggests that this rule makes it impossible for a U.S. resident to own the majority of a Canadian bank (which is not so). In this case, nothing would prevent a majority of a bank's shares from being acquired by a group of Americans. On that second point, however, the CBA argued that this hypothesis is unlikely to materialize. See Testimony of Robert MacIntosh, *supra*, note 519 at 34:51. Furthermore, "[o]ver the last 15 years [prior to the signing of the FTA], foreign ownership of the big six banks has actually declined – from about 25 per cent to 5 per cent." MAGUN *[et al.]*, *supra*, note 534 at 127. Still, there is no guarantee that in the future, the shareholder profile will not change. Thus, in view of the fact that banks control the ownership of the major brokerage firms, the Canadian securities industry could (theoretically) come under the control of foreigners. P. ROCHON, *Strengthening Market Access in Financial Services Provisions of the Canada-U.S. Free Trade Agreement* (Ottawa, Ont.: Conference Board of Canada, 1989) at 8. A. CHAPMAN, *Canada-U.S. Free Trade Agreement* (Ottawa, Ont.: Minister of Supply and Services Canada, 1988) at 34. J.-P. CARON, "Les banques face au libre-échange" *Le banquier* (April 1994) 40 at 41.

616 *Bank Act of 1991*, s. 372.

617 See *Infra.*, Part III, Title I, Chapter III.

618 Such a commentary also applies to other Canadian financial institutions, such as trust and loan companies. G. DAVIS & B.W. PUSCH, "Financial Services" in DEARDEN & PALMETEER, eds, *supra,* note 137 at 27,203 para. 38-705.

619 In the case of Canadian financial institutions other than banks, note that following the coming into effect of the FTA, American residents (as defined in *Investment Companies Act*, s. 141.1 para. 2; *Insurance Companies Act*, s. 427 para. 3; and *Trust and Loan Companies Act*, s. 395 para. 3) are no longer considered as non-residents with respect to the application of the provisions of these acts limiting foreign property of financial institutions under Canadian control. Such modifications were required by Article 1703 para. 1(b), (c) and (d) of the FTA. Unlike the situation prevalent in banking matters, the acts concerning financial institutions other than banks, impose no restriction on the percentage of share that can be held by an individual Canadian resident. (*Investment Companies Act*, s. 15 para. 1; *Insurance Companies Act*, s. 429 para. 1; and *Trust and Loan Companies Act*, s. 397 par. 10). Consequently, an individual American resident, just as an individual Canadian resident can acquire more than 10% of the aforementioned institutions. MACINTOSH, *supra*, note 519 at 34:51. Many observers have underlined, and rightly so, that American financial institutions were thus enabled to take control of Canadian financial institutions other than banks. For example, see FORDYCE & NICKERSON, *supra,* note 339, 351 at 365. Such a statement however needs some distinguishing. The engagements of Chapter 17 concerning financial services only apply to the federal government, not the provinces. American financial institutions, that wish to do business in the more important Canadian provinces remain subject to the rules of property regulating such financial institutions. In the field of securities brokerage, the Americans find no provincial restrictions to investment. However, the FTA would not preclude the provinces from creating such a condition in the future. STEGER, *supra,* note 85 at 59.

The modifications to property rules on chartered banks for Americans have brought correlative modifications to provisions of the *Bank Act* which limit the exercise of voting rights pertaining to shares held by non-residents. The following limits no longer apply to American residents: (i) the suspension of voting rights pertaining to bank shares held by a non-resident if he already owned more than 10% of the total shares of a given category in circulation[620]; and (ii) the absence of voting rights pertaining to banks shares held by a resident in the name of or for a non-resident[621]. Again, different rules apply to Canadian financial institutions other than banks.

At the time of the 1980s reform, the Canadian government opened the door to foreign banks that could not obtain a bank charter before. In that sense, it created the bank categories found in Schedule II of the *Bank Act*. Under this scheme, foreign banks wishing to do business in Canada could now do so by establishing banking subsidiaries in Canada[622]. However, they remained subject to many restrictions in the running of their banking activities in Canada. The FTA has eliminated some of these restrictions for American banks[623]. However, despite many changes, U.S.-controlled Canadian banks may be created only as a Schedule II bank subsidiary, and this has not changed under the FTA.

The banks listed in Schedule II controlled by American residents may now open branches in Canada without having to obtain prior authorization from the minister[624].

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620 *Bank Act of 1991*, s. 397 para. 2 and s. 400 para. 1. As of January 1st, 1995, these concessions were extended to all WTO members. See the Act implementing the WTO, *supra*, note 611, ss. 19 and 21.

621 *Ibid.*, s. 397 para. 2 and s. 401. Again, as of January 1st, 1995, these concessions were extended to all WTO members. See the Act implementing the WTO, *supra*, note 611, ss. 19 and 22.

622 *Bank Act of 1980*, s. 302. See the definition of foreign bank subsidiary in section 2 of the Act. They could also establish representative offices, following section 302, or create, like before, incorporated subsidiaries in the provinces.

623 However, note that during the FTA negotiations, "Canadian federal regulators have insisted on maintaining the foreign bank subsidiary structure (and have not succumbed to pressures to permit Canadian branches of U.S. banks) on the grounds that unlike their American counterparts, Canadian regulators do not indulge in the extraterritorial application of Canadian banking laws; they [are] applied only to Canadian entities. The Canadian regulators, however, wish to ensure that there is a Canadian entity to be regulated". JORDAN, *supra*, note 103 at 38.

624 *Bank Act of 1980*, s. 173(2.1) as modified by the *Act to Implement the Free Trade Agreement Between Canada and the United States of America*, s. 48. This provision has been reproduced in full in the *Bank Act of 1991*, s. 422(2). "[S]uch ministerial

Such a modification was required by Article 1703 para. 2(c) of the FTA. In addition, the last provision of Article 1703 para. 2 (which is of relatively limited significance) permits a U.S.-controlled Schedule II bank to transfer loans to its parents (subject to prudential requirements of general application)[625].

The FTA then dispensed American banks from the application of rules concerning individual and collective assets that can be held by foreign banks in Canada. Subsidiaries of foreign banks controlled by American residents are no longer subject to rules limiting the global domestic assets of foreign banks in Canada[626]. Also, foreign banks subsidiaries controlled by American residents are no longer subject to rules limiting individual domestic assets held by a bank listed in Schedule II[627]. Such modifications fulfilling Canada's undertakings in the FTA[628], ensure the future growth of American banks in Canada. In fact, except for the obligation of American banks wishing to do business in the Canadian market to first establish Canadian subsidiaries constituted under Schedule II before opening branches[629], they now benefit from the

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approval has never been denied in the past. Thus, dropping of the requirement of ministerial approval merely removes and irritant." MAGUN *[et al.]*, *supra*, note 534 at 128. BIERMAN & FRASER, *supra*, note 558 at 27. JORDAN, *supra*, note 103 at 38. Note that the other foreign banks cannot open more than one branch in Canada (except for their head office) without prior authorization from the minister. *Bank Act 1991*, s. 422(1).

625 "With some limited exceptions, current Canadian tax regulation, which requires withholding on interest payments made to non-residents of Canada on certain debt obligations, is a strong disincentive to such transfers." JORDAN, *supra*, note 103 at 38.

626 Prior to the signing of the FTA, there existed a 16% ceiling on total authorized capital of foreign-owned banks as a percentage of total assets of all banks in Canada. *Bank Act of 1980*, s. 302(8). Later, that ceiling was lowered to 12%. However, with the FTA American banks are now excluded from this calculation following s. 302 (8.1) of the *Bank Act of 1980* as modified by the *Act to Implement the Free Trade Agreement Between Canada and the United States of America*, s. 49. This provision has been reproduced in full in the *Bank Act of 1991*, s. 424(2). On January 1st, 1995, the 12% ceiling stopped to apply to foreign banks subsidiaries other than U.S.-controlled Schedule II banks. Note, however, that s. 424 was repealed on January 1st, 1995 as a goodwill gesture towards WTO members. See the Act implementing the WTO, *supra*, note 611 s. 25.

627 *Bank Act of 1991*, s. 423. No foreign bank subsidiary may, during any three month period, have average domestic assets exceeding an amount fixed by order of the Minister. For further details on the mode of calculation of domestic assets, see the *Domestic Assets Regulations*, Canada Gazette Part I, p. 429.

628 Article 1703 para. 2(b) and (c).

629 See, *supra*, note 622 and accompanying text.

national treatment[630]. Thus, U.S. commercial banks are allowed to establish or acquire securities firms or federally regulated Canadian insurance and trust companies in the same manner as Canadian banks.

According to Article 1703 para. 3 of the FTA, Canada is not to use review powers governing the entry of U.S.-controlled financial institutions in a manner inconsistent with the aims of the Financial Services Articles. This provision is in place of the general relaxation of investment review as set out in Chapter 16. Hence, following the coming into force of the FTA, modifications were brought to the *Investment Canada Act* (hereinafter ICA)[631]. The level of examination for a direct acquisition of control of a Canadian business by an American[632] has progressively been raised from Cdn $5 to 10 million, whereas the examination level for an indirect acquisition involving a Canadian business, which was set at Cdn $50 million before the adoption of the FTA, has been progressively eliminated during the same period[633]. Such modifications were required by Article 1607 para. 3 of the FTA and Schedule 1607.3 para. 2 and

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630 MANSON, *supra*, note 517 at 332. FORDYCE & NICKERSON, *supra*, note 339 at 365. On this aspect of the FTA, the CBA was greatly disenchanted with the result of the negotiations. "The problem with national treatment — as opposed to some form of reciprocity — is that it does not take into account the disparity in the level of financial sector liberalization between the two negotiating parties. COOPER, *supra*, note 583 at 116. However, note that "[o]n April 19, 1988, the American Bankers Association and the [CBA] joined together in a joint letter to the chairman and ranking member of the Senate Foreign Relations Committee, expressing support for the [FTA] because it would provide "equality of treatment within the national boundaries" of the [U.S.] and Canada for banks and securities firms of both nations." Hearings Before the Comm. on Banking, Housing and Urban Affairs, May 20, 1988, *supra,* note 426 at 69 (Statement of Edward L. Yingling, Executive Director, American Bankers Association).

631 R.S.C. 1985 (1st Supp.), c. 28 modified by *Act to Implement the Free Trade Agreement Between Canada and the United States of America*, s. 135-137. "Statutory limitations on foreign investment in Canada have always been particularly irksome to the United States (which has eschewed formal limitations), even where such limitations were more in the nature of political window dressing than effective obstacles." JORDAN, *supra,* note 103 at 37. More generally, C. JORDAN, *Bye-Bye Investment Canada*, (1988) 1 Int'l L. Prac. 29. For a brief overview of the Canadian implementing legislation, see, *e.g.*, D. LEMIEUX, *La mise en oeuvre de l'Accord de libre-échange entre le Canada et les États-Unis en droit interne*, (1992) 22 C. de D. 385. H.S. FAIRLEY, *Once More With Feeling: A Brief Commentary on Re-Legislating the Canada-United States Free Agreement*, (1989) 3 R.I.B.L. 57.

632 Definition in *ICA, ibid.*, s. 14.1 para. 9.

633 *Ibid.*, s. 14.1 para. 1 and 7.

3[634]. In the post-FIRA period initiated by the Conservatives in 1984, American businesses were mostly looking to prevent a return to FIRA or to equivalent investment rules[635]. In practice, the majority of American investments subject to examination procedure in the past have now fallen below levels determined under the ICA because of the FTA[636]. These new examination levels also prevail during the acquisition of a Canadian business under American control by a non-Canadian other than an American. In order to determine if a business is under American control, the existing rules on the Canadian status of the business find application for Americans with the appropriate changes in terminology[637]. In this context, it should also be noted that the law has been modified to enable application of the Minister's opinion in order to determine if the business is American[638]. However, it is of paramount importance to mention that the new examination levels do not apply to the acquisition of a controlling interest in a Canadian business operating in certain strategic sectors[639]. More accurately, this means amongst others the financial services business[640]. The exclusion of financial institutions businesses (except insurance companies, which are concerned by Chapter 14 rather than Chapter 17) echoes Articles 1601 para. 2(a) of the FTA[641]. Nevertheless, Article 1703 para. 3 allows Canadians to apply the same type of discretion to the incorporation of federally-regulated financial institutions by Americans as it applies to the incorporation of such

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634 Commenting the investment provisions in the FTA, SEC's then-Chairman Ruder said he was troubled by the fact that the U.S. entities would continue to be subject to the ICA. (Letter of SEC's David S. Ruder in response to questions by Sen. Jim Sasser as *reprinted in* Hearings Before the Comm. Banking, Housing, and Urban Affairs (20 May 1988), *supra*, note 426 at 66.

635 See Hearings Before the Comm. on Banking, Finance and Urban Affairs, May 24, 1988 *supra*, note 426 at 28 (testimony of Stephen J. Canner, Director, Office of International Investment, U.S. Department of Treasury). MORTON, *supra*, note 586, 91 at 97.

636 G. ADDY, "Investment" in DEARDEN & PALMETEER, *supra*, note 137 at 25,014 para. 35-000. R.B. LECKOW & I.A. MALLORY, *The Relaxation of Foreign Investment Restrictions in Canada*, (1991) 6 F.I.L.J. 1 at 7.

637 *Investment Canada Act*, s. 14.1 para. 10, s. 26 paras. 1 and 2, s. 27.

638 *Ibid.*, s. 37 para. 1.

639 *Investment Canada Act*, s. 14.1 para. 8.

640 *Ibid.*, s. 14.1 para. 8(c). Here "financial services" stand for the services included in the definition of Article 1706 of the FTA. *Ibid.*, s. 14.1 para. 9.

641 MORTON, *supra*, note 586, 91 at 98.

institutions by Canadians[642]. This vague commitment might be relied upon in the consultation process found in Article 1704.

Finally, thanks to the provisions of the general Chapter on services (Chapter 14), American banks now have guaranteed access to information and telecommunication networks as well as to electronic services distribution systems[643].

As could be predicted, non-U.S. foreign bank subsidiaries have not been enthusiastic about the advantages given to American foreign bank subsidiaries. Immediately after the signing of the FTA, non-U.S. competitors lobbied the Canadian governmental authorities to have the same benefits extended to them[644]. However apart from Mexico (as we will later see), their requests have yet to be heard.

4. A Balanced Exchange of Concessions?

Generally, Chapter 17 of the FTA falls short of the objectives of both Parties in numerous areas. If we consider each country's goals during the negotiations, we are forced to admit that very few gains have been made with the FTA[645]. But given the results achieved, is it a balanced exchange? In our opinion, the U.S. has had the upper hand over Canada which made no "substantial gains in trying to get better

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642 This provision may have been useful to the U.S. in light of the Canadian government plan allowing the federal Minister of Finance to review transactions involving changes to the ownership of federally-regulated financial institutions. A. WOOD, *Chapter 17 of the Free Trade Agreement–Trade in Financial Services One Year Later,* (1990) 3:4 Canada-U.S. Trade 25. JORDAN, *supra,* note 103 at 38-39. "[R]equests for incorporations may be turned down for valid prudential reasons, including the past history of the applicants or the fact that they are not of "good character" in the opinion of the regulatory authorities." DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,205 para. 38-715.

643 MANSON, *supra*, note 517 at 336.

644 WOOD, *supra*, note 642 at 26.

645 Articles 1702 para. 4 and 1703 para. 4 of the FTA underline the fact that the financial services Chapter "shall not be construed as presenting the mutual satisfaction of the Parties concerning the treatment of their respective financial institutions." Such wording has led some experts to view Part Five of the FTA as representing "an incomplete, piecemeal approach to some isolated issues in the financial services area that are not the same on both sides of the border." *A Guide to the Canada - United States Free Trade Agreement* (Toronto, Ont.: Fraser and Beatty, 1988) at 49 (Pamphlet).

access to the U.S. financial market[646]. Despite supporting it[647], Canadian financial institutions and the CBA expressed concern over Chapter 17[648]. American financial institutions greatly benefited from the FTA and the reform of financial institutions in Canada with a greater access to the Canadian market than Canadian banks and securities firms to the U.S. market[649]. Even though the primary impact of the FTA has been to make the Canadian financial market more competitive[650] some pessimistic commentators have expressed the view that the implementation in Canada of Chapter 17 would result in "increased American takeovers of Canadian financial institutions and an expanded American presence in financial markets"[651]. In

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646 P.S. PETTIGREW, "Free Trade: A Challenge for Canada's Industrial Heartland" in F.C. MENZ & S.A. STEVENS, eds, *Economic Opportunities in Freer U.S. Trade with Canada* (Albany, N.Y.: State University of New York, 1991) 127 at 128. The reason for an unbalanced exchange of concessions may be explained by the fact that, while the U.S. approached the FTA negotiations table with a list of irritants it wanted to eliminate, Canada felt uneasy with the protectionist attitudes present in Congress. Thus, "[m]aintance of the status quo for the Canadian side was considered a victory". JORDAN, *supra,* note 103 at 40.

647 POTTER & LUSSENBURG, *supra*, note 518 at 150 n. 72.

648 WOOD, *supra*, note 642 at 25. Because of the FTA's treatment of GSA issues, Canadians were clearly frustrated by what they perceived as the Agreement's imposition of an "unfair playing field". BIERMAN & FRASER, *supra*, note 558 at 21. However, "[w]hat's good for Canada is good for its banks" was the brave face put on by the CBA. "Canadians Bank Free Trade Pact Though U.S. May Get a Better Deal" *American Banker* (18 March 1988) 2 at 2.

649 JORDAN, *supra,* note 103 at 33-34. After expressing the opinion that Chapter 17 led to significant access to the Canadian market, one U.S. senator was happy to point out that in return the Americans were "asked to make only [...] very minor, noncontroversial changes in U.S. law". See Hearing Before the Comm. on Banking, Housing and Urban Affairs, *supra*, note 426 at 23 (May 20, 1988) (statement of Senator John Heinz).

650 "[T]he Canada-U.S. agreement on trade in services, including financial services, is likely to have a minor impact on the flow of business services between the two countries. By providing national treatment for new regulations and by guaranteeing reciprocal access to service and sales personnel, it will likely improve competition, lower prices, and give some stimulus to employment and output." ECONOMIC COUNCIL OF CANADA, *supra,* note 95 at 13-14. MAGUN *[et al.], supra*, note 534 at 128-129.

651 K. FALCONER, "The Trade Pact, Deregulation and Canada's Financial System" in D. CAMERON, ed., *The Free Trade Deal* (Toronto, Ont.: Lorimier, 1988) 156 at 163. "[M]any major U.S. banks see Canada's deregulated banking environment as something of a "training ground" for U.S. banks when greater banking deregulation hits the United States. [...] For this reason alone, and geographic risk diversification issues aside, it is likely that many U.S. banks will buy major stakes in Canadian banks." BIERMAN & FRASER, *supra*, note 558 at 9 n. 50. "Financial Concerns React Favourably to U.S.-Canadian Trade Agreement" *American Banker* (19 November 1987) 2 at 2. However, others argued that, although "Americans will enjoy Canada's more relaxed regulations, [...] they will discover that the highly competitive Canadian

this context, no one was surprised by the results of a study made by the American Treasury Department in 1990 revealing that conditions had greatly improved for U.S. financial institutions doing business in Canada[652]. Such a situation could eventually change with a deregulation (perhaps better described as "re-regulation") of financial services in the U.S., as was proposed by the American Treasury Department in 1991[653]. However, many years after the signing of the FTA, liberalization of the U.S. markets has been discussed but no significant progress has helped the Canadian securities industry[654].

The only real concession given to Canada in the area of securities services under the FTA concerns underwriting and trading in Canadian governmental securities. For the purposes of the GSA, the Canadian government securities are considered to be "exempt securities" (as are U.S. government securities)[655] and not subject to GSA prohibition on underwriting and dealing by banks and bank holding companies[656]. As

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market affords less room for exploiting those advantages." LIPSEY & YORK, *supra*, note 590 at 91. The same argument was used by MORTON, *supra*, note 586 at 98. SAUMIER, *supra*, note 573 at 329. JORDAN, *supra*, note 103 at 40. In the end, it appears that during post-implementation of the FTA, "American banks [were] in such a financially precarious state and preoccupied with domestic restructuring, they [could not] afford, from both a financial and managerial perspective, to take advantage of new opportunities made available in Canada." COOPER, *supra*, note 583 at 116. CHANT, *supra*, note 17 at 17.

652 U.S. TREASURY DEPARTMENT, *National Treatment Study: Report to Congress on Foreign Treatment of U.S. Financial Institutions* (Washington, D.C.: USGPO, 1990), as cited in United States International Trade Commission. "The Economic Effects of Significant U.S. important Restraints, Phase III: Services with a Computable General Equilibrium Analysis of Significant U.S. import Restraints", a report on the Committee on Finance of the United States Senate on investigation N° 332-262 under section 332 of the *Tariff Act of 1930*, USITC publication 2422, September 1991, (1991) 15:1 World Competition 47 at 77.

653 U.S. TREASURY DEPARTMENT, *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks* (Washington, D.C.: USGPO, 1991) as cited in LEFEBVRE, *supra*, note 530 at 359. Some experts expressed the idea that the FTA forced the U.S. to question the existence of their state banking regulation and dual banking system. BIERMAN & FRASER, *supra*, note 558 at 11-17.

654 "It is somewhat ironic that deregulation in [Canada] was initially modeled on proposed or supposed U.S. initiatives. While it has progressed [in Canada] it is fairly stalled [in the U.S.]..." SAUMIER, *supra*, note 573 at 330 n. 6.

655 *Exchange Act* of 1934, §15.

656 Note that for many years, Canada has been very aggressive in protecting its "territory" in the U.S. "Even before the coming into force of Article 1702.1 [...], Canadian banks by order under the [BHCA] obtained permission for their securities dealer subsidiaries in the [U.S.] to continue activities in Canadian government securities on an interim basis, pending implementation of the FTA". JORDAN, *supra*, note 103 at 41.

a result, Canadian bank-owned dealers in the U.S. can remain in the Canadian government securities business, which represents a major percentage of their activities[657]. In view of the fact that at the time of the negotiations there existed a high degree of protectionist sentiment in Congress[658] that was an important concession[659].

Unfortunately for the Canadian side, the U.S. commitments under the FTA have not been viewed by many Americans as commitments at all[660]. Article 1702 para. 3 demonstrates that the FTA does not take into account the differences between the Canadian and the U.S. laws. At one time in the future, if the GSA permits (for example) a bank to conduct both banking and commercial activities under a holding company and Canadian law does not, could the Canadian banks engage in both banking and commerce in the U.S.? If the major reference to the GSA is with respect to the securities business, how long will Canadian banks have to wait to fully enter this field, all the while during which time U.S. banks already operate in the business in

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657 At the time when the FTA was signed, Canadian governments' business was said to represent up to 90% of activity for Canadian bank-owned dealers. P. WOOD, "Free Trade and Canada's Financial Services Industry" *Int'l Fin. L. Rev.* (December 1988) 11 at 12. WOOD, *supra*, note 642 at 26. JORDAN, *supra*, note 103 at 35. J. STEPTOE & J. JOHNSON, "The Canada-United States Free Trade Agreement in BUREAU OF NATIONAL AFFAIRS, *U.S.-Canada Free Trade Agreement: The Complete Resource Guide; Volume II: A Legal Guide* (Washington, D.C.: Bureau of National Affairs, 1988) at E-79.

658 See the comments by Rep. Jim Leach in Hearings Before the Comm. on Banking, Finance and Urban Affairs, *supra*, note 426 at 13.

659 W. GROVER, "The Free Trade Agreement and Financial Services" in GOLD & LEYTON-BROWN, eds, *supra*, note 520, 340 at 341. PETERS & DRAKE, *supra*, note 520 at 336. DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,122-27,123 para. 38-455.

660 Many examples can be cited. According to one U.S. administration official, Article 1703 represented only "general verbiage". BIERMAN & FRASER, *supra*, note 558 at 17-18. Concerning the commitment towards further liberalization of the rules, the language of Article 1702 para. 4 was in the eyes of the Americans, "state-of-the-art", meaning no specific commitment was associated with that language. Hearings Before the comm. on Banking, Finance and Urban Affairs, *supra*, note 426 at 12 (statement of T.J. Berger). In replying to questions by Rep. St-Germain, Rep. Berger also said that the FTA committed neither party. "Banking Committees Approve Provisions of U.S.-Canada FTA", BNA Banking Report (May 30, 1988) 919. About Article 1702 para. 2, Rep. Dingell said the "like other banking provisions in the FTA, [it] is primarily symbolic in nature". JORDAN, *supra*, note 103 at 36.

Canada? These questions remain unanswered[661]. Still, some experts predicted that the FTA would lead to demise of the "dual banking system" in the U.S.[662]. However, others have said that changes of this sort were not likely to occur in the near future[663]. For their part, Canadian financial institutions vowed to press hard for U.S. domestic reforms. Moreover, the increasing familiarity by U.S. financial institutions operating under the Canadian regime may also accelerate the pace of reform in the U.S.[664]

Another problem in the FTA comes from the fact that the various terms and definitions to be found in this Chapter are sometimes vague and imprecise[665]. For instance, the FTA does not define the word "bank". In view of the reform of the Canadian financial institutions, may we associate a "trust company" as being a "bank"? Moreover, Article 1706 vaguely defines a "financial institution" since the words "as defined by a Party" cannot easily be identified. Finally, does the term "administrative practices" refer to the SEC, the Bank of Canada or another financial regulator? Here, Canada and the U.S. are left to define individually both terms. At the outset, experts were baffled[666]. In Canada, there is no singular definition of "financial institution" or "financial service"[667]. Similarly, the American definition of these terms is ambiguous[668].

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661 "U.S. issues which concerned the Canadians, such as the Glass-Steagall Act, interstate banking restrictions and unitary taxation, were problems of fundamental U.S. policy which will only be resolved for Canadians when they are solved for Americans". MANSON, *supra*, note 517 at 333.

662 BIERMAN & FRASER, *supra*, note 558 at 12.

663 J.W. SWENDSEN, "A Banking Perspective: Will It Make a Difference?" in FRY & RADEBAUGH, eds, *supra,* note 530, 183 at 188-189.

664 It has been suggested that "[t]he pressures created by the principle of national treatment will undoubtedly compel a certain degree of harmonization of the regulatory regimes, and initially most of the pressure will flow from the north." JORDAN, *supra,* note 103 at 41. U.S. financial institutions stand to profit "from their experiences under the Canadian regulatory regime, experiences that can suggest solutions to some of the very hard questions facing U.S. regulators." *Ibid.* at 42.

665 MANSON, *supra,* note 517 at 335.

666 "It is difficult to understand how the Parties will enforce the provisions of the Financial Services Articles if each is left to unilaterally define what the parameters of the sector in question are" DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,052 para. 38-210.

667 It has been suggested that "[b]ased on the approach adopted by the Hockin Paper and other industry reports [...], it appears that all the institutions referred to in Chapter Seventeen, as well as provincially regulated [...] securities dealers [...] might [at one point in the future] be considered "financial institutions". JOHNSON & SCHACTER, *supra*, note 521 at 117. According to the recent Canadian federal financial institution

Would it have been preferable to build an agreement on a reciprocity basis rather than on an exchange of concessions[669]. In the past, U.S. retaliatory threats quite often encouraged its trading partners to open their markets to U.S. exports. One factor that seemed to have contributed to the success of threats is the existence of an anti-protectionist coalition within the country targeted for retaliation. Similarly, the strength of the U.S. coalition favouring the use of retaliatory threats is another important variable. However, the U.S. has created dangerous precedents and policy instruments that it would probably not accept being used against it by other countries. Therefore, at some point, other economic superpowers (i.e. either the EU or Japan) may choose to imitate U.S. retaliatory policy to the detriment of U.S. firms[670].

Specifically in the securities sector, the U.S. retaliatory threats have worked against large traders such as Japan and the EU. A 1987 amendment to the Omnibus Trade Bill concerned Japanese firms[671]. It required that the FRB deny Japanese firms "primary dealer" status[672] if U.S. firms did not receive reciprocal treatment in Japan. As a result, U.S. policy changed from national treatment to reciprocal national treatment. The threat worked so well that within two weeks of the passage of the 1988 Omnibus Trade Bill, Japan announced a substantial liberalization of its bond markets.

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legislative reform, a financial institution includes "an entity that is incorporated of formed by or under an Act of Parliament or the legislature of a province and that is primarily engaged in dealing in securities, including portfolio management and investment counselling." See the definition of "financial institution" of the *Bank Act of 1991* s. 2. On the other hand, because the federal authorities see the term "financial services" as continually evolving, it was purposely left undefined in the *Bank Act*. GREENWOOD, *supra*, note 337 at 272.

668 DELOITTE & TOUCHE, "FRB Redefines Financial Institution" *Int'l Fin. L. Rev.* (May 1994) 39.

669 On reciprocity, *supra*, note 325 [and accompanying texts].

670 According to a U.S. Chamber of Commerce report, "Europe will eventually become the richest market in the world with enough clout to demand changes in the U.S. legal and regulatory system". *The Financial Observer* (March 1991) 5.

671 T.O. BAYARD, *Comments on Alan Sykes' Mandatory Retaliation for Breach of Trade Agreements: Some Thoughts on the Strategic Design of Section 301*, (1990) 8 B. U. Int'l L.J. 325 at 327. W. COOPER, "Banking: The Financial Services Trade War", *Institutional Investor* (November 1987) 203.

672 "Primary dealers" solely are authorized to deal with the Federal Reserve. In NAFTA, Annex VII (Schedule of the United States), Section A, refers to the U.S. *Primary Dealers Act of 1988* (22 U.S.C. §§ 5341-5342) which "prohibits a foreign firm from being designated as a primary dealer in U.S. government debt obligations unless [...]" ECO is accorded.

Now, in the context of the FTA negotiations, would it have been possible for Canada to force the Americans to accept an accord founded on reciprocity? If so, this would have certainly helped the Canadian securities industry to do business in the U.S. In the past, other countries have already attempted to obtain reciprocity with the U.S. only with relative success[673].

Even though most of the U.S. financial community supports a wide liberalization to improve their competitiveness in global markets, it appears Congress still refuses to react and create a "big bang". Whether or not further retaliatory threats by economic giants would work, it has yet to be demonstrated. In any case, being far less than a small economic power compared to the U.S. giant, Canada has been unable to achieve this through the FTA negotiations. Although it would have been difficult in light of the differences in regulatory structures of both countries[674], this would have been, in our opinion, more advantageous for the Canadian securities industry[675]. Hence, Canada might have designed a plan to apply a reciprocity policy[676] aimed at preventing U.S. banks' subsidiaries and securities firms to accede to the Canadian securities market until the time the GSA was eliminated (or at least exempt the Canadians from it). Instead, the strategy may have backfired.

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673 DARROCH & LITVAK, *supra,* note 314 at 123. For many years the EU has maintained that the American federal regulatory system constitutes an obstacle to the financial services business. EU Commission, *Report on United States Trade Barriers and Unfair Trade Practices*, 1990 at 54-57, as cited in United States International Trade Commission at 51.

674 MACINTOSH, *supra,* note 519 at 163. POTTER & LUSSENBURG, *supra*, note 518 at 150.

675 See also MADDAUGH, *supra,* note 314 at 48. DARROCH & LITVAK, *supra,* note 314 at 123.

676 For many years, Canada has employed this policy for its financial sector. *Supra,* note 325. "[Reciprocity] has established effectively bilateral horse-trading which has made [...] financial services somewhat unique in the trading context relative to other tradeable goods." F. SWEDLOVE, "The Current State of Trade in Financial Services" in CANADA, Department of Justice, *Proceedings of the Ninth International Trade Law Seminar* (Ottawa, Ont.: Minister of Supply and Services, 1992) 105 at 106. Most recently, while the word "reciprocity" is not used, s. 24(b) of the Canadian *Bank Act*, R.S.C. 1985, c. B-1, prohibits the issuance of a bank charter to a foreign bank subsidiary unless "the Minister [of Finance] is satisfied that [...] treatment as favourable for [Canadian] banks to which this Act applies, exists or will be provided in the jurisdiction in which the foreign bank principally carries on business, either directly or through a subsidiary." Since its inception, the Canadian *Bank Act* policy of reciprocity has not been a problem of U.S. bank subsidiaries in the Canadian banking industry.

At the end of 1986, Canada's chief free trade negotiator Simon Reisman convinced the Ontario Minister of Consumer and Corporate Affairs Monte Kwinter to open the doors to unlimited competition[677]. Reisman's objective appears to have been the elimination of the state banking laws which restricted Canadian banks to operations in one state only. Although the U.S. chief free trade negotiator Peter Murphy appeared flexible, this highly emotional issue was negotiated by the hard-nosed U.S. Treasury Department. With this, Canada introduced its committee on financial trade issues formed with experts from the Department of Finance. About the impact of this negotiation strategy, some critics say that, considering the relatively small size of the Ontario securities market compared to the U.S., liberalization of Ontario's securities industry was not "a lost bargaining chip"[678]. Others believe that the Canadian markets were already under-capitalized and had to react to threats to the effect that much of the trading activity on the Canadian exchanges (mainly in Toronto and Montreal) might migrate from Canada to the U.S. (such as through trading of inter-listed Canadian stocks) if U.S. brokers had to continue to share their commissions with their Canadian agents[679]. However, in view of the fact that the OSC (Canada's most influential securities commission) decided during the FTA negotiations to lower barriers of entry to foreign firms, it is quite possible this move may have hindered Canada's chances to obtain better concessions from the U.S.[680]

In any case, the use of reciprocity by Canada towards the U.S. could have resulted in a worse situation. For instance, to counter Canada's use of reciprocity to discriminate against the U.S. securities industry, the Americans could have prohibited the entry of Canadian banks as a branch of a parent. The situation would have been worse than the *status quo*. Overall, despite the fact that the financial service component of the FTA did not achieve very much, it had the merit to force discussions over the U.S. bank regulatory structure which affects the Canadian securities industry as well as to open some doors for the NAFTA negotiations, and that was no insignificant

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677 "Capital-Market Changes Linked to Trade Talks" *The [Montreal] Gazette* (5 December 1986) B1.

678 LOHMAN & MURDEN, *supra*, note 325 at 151.

679 H. LAZAR, A. MAYRAND & K. PATTERSON, *Global Competition and Canadian Federalism: The Financial Sector*, (1992) 20 C.B.L.J. 1 at 25.

680 SAUMIER, *supra*, note 573 at 327-328.

achievement[681].

TITLE II: THE NORTH AMERICAN FREE TRADE AGREEMENT

As already discussed before, NAFTA has become an important economic charter which will have an ongoing impact upon the economic, legislative and legal development of its Parties for a long time to come. While NAFTA was built upon the framework set up by the FTA, it is a fundamentally different document. Thus, in order to understand what NAFTA means, it is not enough to merely rely upon that earlier bilateral treaty.

NAFTA's Financial Services Chapter applies its commitments to all financial institutions and services in Canada, the U.S. and Mexico. The Chapter also contains a list of specific financial service commitments from each NAFTA country. Moreover, the Agreement breaks new ground for international treaties by creating an ability for individual investors to challenge governments before international arbitration tribunals if a NAFTA investment obligation has been impaired.

CHAPTER I: The Prevalent Situation Before the Negotiations

The NAFTA negotiations in the financial sector (like those in most other sectors) did not take place on a clean slate. Already, Canada and the U.S. had set a pattern through FTA negotiations that provided a starting point for many of the more difficult problems posed by the financial sector. The most extreme commitment (i.e. a "common market" in financial services with fully harmonized regulation) was not an issue in the FTA negotiations. Both Canada and the U.S. were committed to their own distinct approaches to regulation. This stance was repeated during the NAFTA negotiations. However, of all the NAFTA Parties, Mexico was under the greatest pressure to amend its laws to make them consistent with the trilateral Agreement.

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681 Some authors predicted that the FTA would "serve as a catalyst for reform". BIERMAN & FRASER, *supra,* note 558 at 32. Also, see, M. HART, *Reconcilable Difference Negotiating the Free Trade Agreement* (Ottawa, Ont.: Centre for Trade Policy and Law, 1992) at 27. H. HASSANWALIA, "Financial Services and the Canada-U.S. Free Trade Agreement" in F. SIDDIQUI, ed., *The Economic Impact and Implications of the Canada-U.S. Free Trade Agreement* (Queenston, Edwin Mellen, 1991) at 209.

Consequently, many sections of NAFTA were to be negotiated on account of the absence of certain laws in Mexico relating to many issues.

CHAPTER II: Negotiation Objectives of All Three Countries

Foreign policy objectives of the signatories varied greatly. Trade, and more specifically, the preservation of a trading relationship with the U.S. were important to Canada. For the U.S. NAFTA offered an opportunity to ensure long-term access to a large and underdeveloped market. Finally, the Mexicans saw NAFTA as the culmination of the economic reforms that began in the 1980s.

1. Mexican Demands

Not long ago, Mexico started to replace its decades-old and very protectionist regime[682]. To the Mexicans, need for reform followed a series of economic crisis through the 1970s and 1980s (including huge problems with foreign debt). Because the intervention of the IMF limited the options of the government, Mexico looked to the private sector for solutions. Freer trade was encouraged through a series of economic reforms and the injection of foreign capital[683]. As a result, the past several years have brought important changes to the Mexican financial sector[684]. Until 1978,

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682 In the early 1990s, Mexico's then-President, Carlos Salinas de Gortari announced he would transform the "[...] backyard, protected and centralized [Mexican] economy into a market economy open to all comers." R. GWYN, "Salinas Must Make Democracy His Top Priority" *The Toronto Star* (6 February 1994) B1 at B6. U.S. CONGRESSIONAL BUDGET OFFICE, *A Budgetary and Economic Analysis of the North American Free Trade Agreement* (Washington, D.C.: U.S. Government Printing Office, 1993) at 56ff. J.F. TORRES & R. LANDA, *The Changing Times: Foreign Investment in Mexico*, (1991) N.Y.U.J. Int'l L. & Pol'y 801.

683 I.P. ALTSCHULER & C.G. PASCHE, *The North American Free Trade Agreement: The Ongoing Liberalization of Trade with Mexico*, (1993) 28 Wake Forest L. Rev. 7 at 9.

684 For an excellent summary of these reforms, see, *e.g.*, E. LEROUX, *South of the Rio Grande, the Financial Landscape Changes Rapidly: A Review of the Liberalization of the Mexican Financial Market Prior to and After the Peso Crisis*, (1995) 5:2 FTU 11. R. BRAVO, *Mexican Legal Framework Applicable to Operations Involving Financial Services*, (1994) 25 St. Mary's L.J. 1239. SIMSER, *supra*, note 127 at 212-215. J.W. KOLARI, "A North American Free Trade Area: Implications for Commercial Banking" in S.R. STANLEY, ed., *International Financial Market Integration* (Cambridge, MA: Blackwell, 1993) 212. T. HEATHER, *Comments on Financial Services, Other Services, and Temporary Entry Rules*, (1993) 1 U.S.-Mexico L. J. 73 at 90-91, 95-97. C. NALDA, *NAFTA, Foreign Investment and the Mexican Banking System*, (1992) 26

foreign banking institutions had the limited rights to establish representative offices in Mexico[685]. After the nationalization of commercial banks in 1982, the government slimmed down the number of banks from almost 60 to just 19[686]. In the same year, 18 of these banks, in which the government had a majority shareholding, were returned to private ownership[687]. In 1993, the total number went up to 30 after authorization was given for the establishment of new domestic licences to subsidiaries of Canadian and American banks. Moreover, there was also a significant increase in the number of all financial entities following a series of new foreign investment regulations[688].

As far as the securities industry is concerned, an important element of the financial markets is the Mexican stock exchange, known as the *Bolsa Mexicana de Valores*

Geo. Wash. J. Int'l L & Econ. 379 at 384. The far-reaching changes in Mexico were recently compared to London's "Big Bang". "A Survey of Mexico". *The Economist* (13 February 1993) at 16.

685 UNITED STATES INTERNATIONAL TRADE COMMISSION *The Likely Impact on the United States of a Free Trade Agreement with Mexico* (Washington, D.C., USITC, 1991) at 4-41. For some time, foreign banks were banned from setting up branches in Mexico. The only exception was Citibank. Its right to operate comes from an historical accident. LEROUX, *Ibid.* at 11. L.A. GLICK, *Understanding the North American Free Trade Agreement*, Second Edition (Boston, MA: Kluwer, 1994) at 31. S. ANDERSON, J. CAVANAGH & S. GROSS, *NAFTA's Corporate Cadre: An Analysis of the USA/NAFTA State Captains* (Washington, D.C.: Institute for Policy Studies, 1993) at 10. C. MITCHELL, *NAFTA, and Financial Services in Mexico*, (1993) 209 N.Y. L.J. 1 at 3. G.C. HUFBAUER & J.J. SCHOTT, *North American Free Trade: Issues and Recommendations* (Washington, D.C.: Institute for International Economics, 1992) at 310.

686 For a detailed description of the nationalization process, see, *e.g.*, J.J. NORTON, *NAFTA: A New Framework for Regulation and Supervision of Financial Services in the Americas*, (1994) J. Bus. Law 394 at 396ff. UNITED STATES INTERNATIONAL TRADE COMMISSION, *Operation of the Trade Agreements Program*, 42nd Report (Washington, D.C.: USITC, 1991) at 90.

687 J. CAMIL, *Mexico's Motivation to Enter intro NAFTA*, (1993) 15 Loy. Int'l & Comp. L. J. 909 at 913. J. CAMIL. *Mexico in Contemplation of NAFTA: Is the Government Abdicating the Rectoria del Estado?*, (1993) 15 Loy. Int'l & Comp. L. J. 761 at 761-763, 765-766. G.C. HUFBAUER & J.J. SCHOTT, *North American Free Trade: Issues and Recommendations* (Washington, D.C.: Institute for International Economics, 1992) at 305-326. "Mexico: Suddenly, this Summer" *The Banker* (September 1991) 22 at 26-27. Revenues from the sale amounted to US $ 12.4 billion and the average weighted price amounted to more than three times book value. S. JOHNSON, "North America's Financial Hot Spot" *Canadian Banker* (November/December 1993) 20 at 21.

688 See, *e.g.*, C. Von WOBESER, "New Mexican Foreign Investment Law" in *Doing Business with Mexico: Recent Developments and Innovations*, Vol. 1 (Irvington-on-Hudson, N.Y.: Transnational Juris Publications, 1994) at 82. A BERDEJA-PRIETO, "Mexico Streamlines Foreign Investment Law" *Int'l Fin. L. Rev.* (February 1994) 31.

(hereinafter Bolsa)[689]. Federal regulation of the securities markets falls under the National Securities Commission or *Comisión Nacional de Valores* (hereinafter CNV). The CNV is a unit of the Finance Secretariat. It is charged with regulating all aspects of the securities industry. The CNV also maintains general supervisory control over the largely self-regulating, self-registration system by which securities firms are asked for formal registration. Apart from the *Bolsa*, the leading SRO is the Mexican Association of Brokerage Houses, known as *Associación Mexicana de Casas de Bolsa*, which represents all securities firms in the country. The Securities Market Law provides the legal and regulatory framework for securities operations in Mexico. Mexican regulations allow simultaneous issuance of shares in Mexico and the U.S., and procedures generally conform to U.S. practice. In 1994, there were 26 brokerage houses in Mexico[690]. These firms were operating close to 200 branches nationwide, as well as 13 in the U.S. Mexican securities houses are authorized to act as full service investment firms, offering underwriting, corporate finance and mergers and acquisitions, in addition to securities trading. As for banks, their role in the securities markets has been expanded to allow them to compete for some securities business. Conversely, securities firms are generally barred from providing commercial banking services.

Mexico's objectives were quite simple: gain greater access to Canada and the U.S. and; try to obtain from the Americans certain concessions not granted to Canada through the FTA (like obtaining movement on the interstate bank branching and GSA provisions)[691].

2. American Demands

Both Canada and the U.S. were dissatisfied with the results of the FTA negotiations[692]. The U.S. negotiators were not satisfied with the fact that foreign banks could only carry on banking activities in Canada solely through foreign bank

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689 BOLSA MEXICANA DE VALORES, *Mexico Company Handbook* (Mexico City: ICH International Company Handbook, 1994) at 5-6.

690 *Ibid.*, at 30-34.

691 JOHNSON, *supra*, note 602 at 374.

692 See, *supra*, note 645.

subsidiaries[693]. Thus, the chief U.S. negotiating objective consisted in obtaining the right for U.S. banks to branch directly into Canada[694]. The Americans saw the negotiations as providing an opportunity to open up Mexican financial markets to U.S. financial institutions[695]. This approach was a logical follow up to the U.S. agenda started in the early 1980's directed towards the opening of financial markets throughout the world. The U.S. negotiators favoured a principle-based approach[696].

3. Canadian Demands

While the banking and securities industries supported the FTA, they were disappointed with Chapter 17. For that reason, they saw the NAFTA negotiations as having two major objectives: (i) to gain entry to Mexico; and (ii) to improve access to American financial services markets[697]. However, for Canada, the negotiations of NAFTA came at a very hard time domestically[698].

When negotiations started, Mexican institutions had no presence in Canadian financial

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693 JONHSON, *supra*, note 602 at 355.

694 C. JORDAN, *Financial Services Under NAFTA: The View from Canada*, (1993) 9 Rev. Banking & Fin. Serv. 45 at 53.

695 J.F. CHANT, "The Financial Sector in NAFTA: Two Plus One Equals Restructuring" in S. GLOBERMAN & M. WALKER, eds, *Assessing NAFTA: A Trinational Analysis*, Studies on the Economic Future of North America (Vancouver, B.C.: The Fraser Institute, 1993) 173 at 180. P.A. LONDON & J. WHITTLE, *Investment, Trade, and U.S. Gains in the NAFTA: The Economic Impact of the North American Free Trade Agreement on the United States: A Review of the Debate* (Washington, D.C.: U.S. Council of the Mexico - U.S. Business Committee, 1992) at 13ff. Also, see, generally U.S. Congress Senate Committee on Finance, *North American Free Trade Agreement*, Hearings 102nd Congress, 2nd Session. September 8-30, 1992 (Washington, D.C.: G.P.O., 1993). *U.S. Trade Policy and NAFTA Hearing*, 103d Congress, 1st Session, March 9, 1993 (Washington, D.C.: G.P.O., 1993).

696 The U.S. Treasury wanted "to use NAFTA (and the GATS) as a mean of anchoring trade-liberalizing principles in a legally binding treaty to which future domestic legislation would need to conform." P. SAUVÉ & B. GONZALES-HERMOSILLO, *Implications of the NAFTA for Canadian Financial Institutions*, Commentary N° 44 (Toronto, Ont.: C.D. Howe Institute, 1993) at 5.

697 This analysis is taken from Canadian Statement on Implementation, *supra*, note 193 at 172-173. COOPER, *supra*, note 583 at 118-121. N.M. GRETENER, *Canada - U.S. Trade Update*, (1992) 5 C.U.B.L.R. 343. CANADA, *Canada and a Mexico-United States Trade Agreement* (Ottawa, Ont.: Working Paper prepared by the International Trade and Finance Branch at the Department of Finance, July 1990).

698 "[T]he economy was mired in recession and the political leaders absorbed by a national referendum on the future of the Canadian confederation." JORDAN, *supra*, note 694 at 51 n. 38.

markets. Likewise, there were no Canadian financial institutions operating in Mexico (either on a branch or subsidiary basis). A certain number of Canadian banks had Mexican representative offices for marketing purposes only. Apart from syndicated loans to Mexico (which totalled almost Cdn $5 billion for all Canadian banks in early 1990), there was no other direct dealing by Canadian financial institutions in Mexico[699].

The genesis in Mexico by Canada's financial institutions interest came largely from the improved economic management and outlook for the country[700]. Any increase in trade was expected to result in greater opportunities for Canadian financial institutions to service the companies involved in that trade. Moreover, when negotiations began, Mexico had just completed a comprehensive deregulation of its financial sector industry. Still, Canadians believed the Mexican financial system to be ill-prepared for the demands that would be made on it by the post-NAFTA marketplace[701]. For that reason, they were prepared to offer logistical and technological support to Mexican banks and securities firms. But, more importantly, Canada sought assurance that Canadians would be allowed to establish full-service operations and have an ability to invest in existing non-core financial institutions in Mexico[702]. For its part, the IDA was asking for "unrestricted limits" on entry into Mexico[703].

While the Canadian financial industry was greatly interested in the new opportunities in Mexico[704], the U.S. market remained of vital interest to them[705]. The most

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699 *Ibid.*, at 47.

700 The greatest involvement came from the banks. Canadian banks have maintained a market presence throughout most of the 20th century. However, the relationship was strained during the early 1980s due to the problems of LDC debate. JORDAN, *supra*, note 694 at 51 n. 38.

701 R. GAFFORD, "The Financial Services Chapter of NAFTA: The Canadian Banks' Perspective" *Canadian Financial Services Alert* (December 1992) 56 at 57.

702 CHANT, , *supra*, note 695 at 180. *House of Commons, Minutes of Proceedings and Evidence of the Sub-Committee on International Trade of the Standing Committee on External Affairs and International Trade*, 9 February 1993, Issue N° 32 (Statement of Helen Sinclair, President of the CBA) at 32:4. *Senate of Canada, Proceedings of the Standing Committee on Foreign Affairs*, 34th Parliament, 3rd Session, 19 May 1992, Issue N° 12 (Statement of Helen Sinclair, President of the CBA) at 12:18.

703 "The NAFTA Blueprint" *The Financial Post [of Toronto]* (6 March 1992) 6.

704 *Senate of Canada, Proceedings of the Standing Committee on Foreign Affairs*, 34th Parliament, 3rd Session, 11 May 1993, Issue N° 22 (Statement of Robert Clark, Deputy Chief Negotiator, Office of NAFTA) at 21:22.

important negotiating objectives related to the GSA and interstate branching restrictions[706].

Based on a set of trade principles to govern a multilateral trade agreement on financial services, Canada proposed a framework for the purpose of the trilateral negotiations[707]. The more salient principles consisted in: (i) a commitment to progressive liberalization; (ii) the recognition of *de facto* national treatment; (iii) the establishment of a dispute settlement mechanism applied to financial services; (iv) restrictions on extra-territorial application of domestic laws; (v) regulatory transparency; (vi) inclusion of sub-national governments and SROs; (vii) mobility of business personnel; and (viii) protection of core financial institutions.

CHAPTER III: Negotiation Results

The NAFTA is embodied in a 1016 page document divided into eight Parts and twenty-two Chapters, and is comprised of 270 Articles, a Preamble and various Annexes. Of all this, one Part (Five), six Chapters (Eleven to Sixteen inclusive), eighty-two Articles and seven Annexes are devoted to Investment, Services and Related Matters. Of these, one Chapter (Fourteen) encompassing all of nineteen pages and three Annexes (I, II and VII), are specifically concerned with financial services[708].

Generally, NAFTA replicates the basic provisions of the FTA and extends them to Mexico[709]. Moreover, it goes well beyond the FTA in widening and deepening the

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705 SIMSER, *supra*, note 127 at 199. JOHNSON, *supra*, note 602 at 355.

706 CHANT, *supra*, note 17 at 18. SIMSER, *supra*, note 127 at 199. JORDAN, *supra*, note 694 at 49.

707 JORDAN, *ibid.*, at 48.

708 On many issues, note that financial services are subject to provisions of other chapters of NAFTA, sometimes as the result of cross-references (see, *e.g.*, NAFTA, Articles 1401 para. 2, 1412 para. 2, 1414, 1415, 1416) or, in other times, because some provisions of NAFTA apply to all chapters of the Agreement (see, *e.g.*, NAFTA, Articles 105, 201, 1101 as well as Chapters 20 to 22).

709 "NAFTA reaffirms [FTA] principles governing trade in services. In particular, NAFTA reaffirms and strengthens [FTA]'s "bill of rights" [...]." B.J. ZANGARI, *NAFTA: Issues, Industry Sector Profiles and Bibliography* (Commack, N.Y.: Nova Science, 1994) at 26. V.J. McNEVIN, *Policy Implications of the NAFTA for the Provincial Services Industry*, (1994) 5 Col. J. of Int'l Env. L. & Pol'y 369 at 370.

scope of financial services deregulation and limiting the power of governments[710]. When FTA negotiations began, it was suggested that financial services be excluded from negotiations. However, that impression proved to be wrong and the negotiations proceeded in part to serve as a precedent for negotiations with other nations and for the GATT negotiations[711]. The same can be said about the NAFTA negotiations.

NAFTA is consistent with the GATT[712]. Unlike the FTA, the trilateral agreement incorporates some general principles similar to those proposed under the GATT[713]. It reflects an attempt to apply trade policy concepts to the financial services sector, an innovation stemming from prior efforts to develop the GATT[714]. These include: (i) treatment and access; (ii) the MFN clause; (iii) a dispute settlement mechanism; (iv) transparency; (v) coverage of sub-national governments; and (vi) extra-territoriality. Moreover, in addition to listing a series of commitments, each country submitted a list of exclusions which allow the adoption or maintainance of measures that do not comply with provisions respecting MFN treatment, national treatment or market access, or pertaining to the place of residence and nationality of the board of directors and senior managers.

International trade may have been the major item on the NAFTA agenda, but the U.S., Canada and Mexico did not simply negotiate a trade agreement — they have

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710 CHANT, *supra,* note 695 at 180. C. JORDAN, "The Problem with Banking on NAFTA", *The [Toronto] Globe and Mail* (27 April 1993) A19.

711 MANSON, *supra,* note 517 at 331.

712 J.H. JACKSON, *Reflections on the Implications of NAFTA for the World Trading System,* (1992) 30 Colum. J. Transnat. L. 501 at 503-505.

713 More specifically, the trade principles invoked in NAFTA have been developed from the experience of the GATS, the committee-level discussions of the OECD in the late 1980s and the Basle Committee on Banking Supervision at the BIS. SAUVÉ & GONZALES-HERMOSILLO, *supra,* note 696 at 5. JOHNSON, *supra,* note 602 at 356.

714 J.J. NORTON, *NAFTA: A New Framework for Regulation and Supervision of Financial Services in the Americas,* (1994) J. Bus. L. 394. P. SAUVÉ & B. GONZALES-HERMOSILLO, *Financial Services and the North American Free Trade Agreement: Implications for Canadian Financial Institutions,* unpublished paper (Ottawa, Ont.: External Affairs and International Trade Canada and Bank of Canada, 1993). W.P. BRYSON, "Free Trade and Financial Institutions" in CANADA, Department of Justice, *Proceedings of the Ninth International Trade Law Seminar* (Ottawa, Ont.: Minister of Supply and Services, 1992) 109 at 109.

negotiated a "special relationship"[715]. However, this is not to pretend that NAFTA is a step towards a political and economic union, despite the fact that most of the discussion surrounding the negotiations has focused on specific economic and technical issues[716].

NAFTA (as the FTA before that) is designed to help cure the economic ills by increasing trade and investment with the U.S., a major trading partner and source of capital[717]. In turn, it presents a unique opportunity for the U.S. to try to have an impact on the development of both Canadian and Mexican political and economic life. Hence, by using "free access" to U.S. markets as a lure, the Americans hope to influence Canada and Mexico into making changes in their domestic legislation[718]. In other words, the U.S. can use these two agreements (i.e. the FTA and NAFTA) to "Americanize" its closest neighbours[719]. This "Americanization" began by the insertion into the NAFTA discussions of important non-trade issues either: (i) as a part of the formal NAFTA negotiations, or (ii) in parallel discussions and negotiations that are taking place outside of NAFTA between U.S., Canadian and Mexican agencies.

Chapter 14 is comprised of three related sections: (i) one section dealing with general principles; (ii) a second section describing the specific liberalization commitments made by all three Parties to the Agreement; and (iii) a final section outlining each

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715 Some even view the "special relationship" to have been negotiated mainly between Mexico and the U.S. S. WEINTRAUB, *A Marriage of Convenience: Relations Between Mexico and the United States, 1990; Symposium, Mexico and the United States: Strengthening the Relationship*, (1989) 18 Cal. W. Int'l L.J. 1.

716 The NAFTA does not refer to the conclusion of a free trade agreement as a step towards a more complete unification. In the long term, however, future historians will have to decide the long-term geopolitical significance of NAFTA.

717 A. DRISCOLL, "Embracing Change, Enhancing Competitiveness" *Business America* (18 October 1993) 27.

718 NAFTA imposes obligations with regards to "measures" (like laws, regulations and related requirements) of each Party to the Agreement (including the measures of any state, province or local government in a NAFTA country). NAFTA, Article 1401 para. 1 as well as Articles 105, 201 para. 2 and 2409 para. 1. For a brief analysis of the impact of NAFTA on internal Mexican law see, *e.g.*, R. PATIÑO MANFER, "Effets de l'Accord de libre-échange nord-américain sur le droit interne mexicain" in LACASSE & PERRET, eds, *supra* note 75, 217. R.I.R. ABEYRATNE, *The Legal and Economic Effects of NAFTA on Canada, Mexico and the United States*, (1994) 18:2 World Competition 139.

719 That is to promote a political and economic system that more closely reflects the American one.

NAFTA country's reservations.

1. Major Principles of the Agreement on Financial Services

NAFTA includes many "non-trade" chapters[720], one being the financial services chapter (Chapter 14)[721]. The inclusion of non-trade subjects in the FTA and NAFTA is indicative of a trend pushed by the U.S. to incorporate into international trade negotiations the conclusion of agreements on subjects that lie beyond the treatment of exports and imports of goods[722]. Of course, the incorporation of these subjects into NAFTA creates special problems and raises a new concern, that is, whether the international trade regime should be used to further the harmonization of domestic laws covering non-trade subjects[723].

In each of the "non-trade" areas covered in the FTA and NAFTA, some Canadian laws have been criticized by U.S. government and business groups as limiting U.S. interests and slowing down economic development[724]. By including these subjects in the Agreements, the U.S. has undertaken to make Canadian law reflect more accurately the approach taken by the U.S. in these areas. Still, from a Canadian standpoint, the provisions of Chapter 14 of NAFTA have had little immediate impact on Canadian financial institutions[725]. Even though NAFTA has resulted in the opening of Mexico's financial services markets to Canada and *vice versa*, the

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720 "Non-trade" issues are subjects that are either indirectly related or unrelated to international trade in goods.

721 Other "non-trade" chapters concern investment (Chapter 11), cross-border trade in services (Chapter 12), telecommunications (Chapter 13), competition policy (Chapter 15), and intellectual property (Chapter 17). Chapter 6 (dealing with the energy and petrochemical sector) also includes non-trade subjects. On the differences between Chapters 11, 12 and 14, see, JOHNSON, *supra*, note 602 at 356-359. However, note that some service industries (like maritime shipping and Canada's cultural industries) are exempted from NAFTA. ZANGARI, *supra*, note 709 at 31.

722 This was evident in the last Round of trade negotiations in the GATT, which included important new proposals to conclude a GATS.

723 On this subject, see, *e.g.*, K. ABBOTT, R. HUDEC & J. BHAGWATI, *Research Project Launched on the Use of Trade Law to Promote Harmonization of Domestic Law*, (1992) Int'l Econ. L. News 17.

724 ZANGARI, *supra*, note 709 at 31.

725 Prior to NAFTA, profound regulatory changes already occurred in Canada with respect to financial institutions. Also, the FTA helped draw the rules with the U.S. CHANT, *supra*, note 17 at 6-7.

business that flows between the two countries is not very significant[726].

Compared with the FTA[727], NAFTA generally creates a regime based on defining principles (instead of one based on piecemeal concessions)[728]. Hence, much like the domestic laws of the three Parties, NAFTA's provisions are largely institution-based rather than product-based[729]. This means that NAFTA focuses on "financial institutions" rather than on specified "financial services"[730]. Thus, the provisions of Chapter 14 apply only to the following[731]: (i) "investors of a Party"[732]; (ii) "financial

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726 SENATE OF CANADA, *Proceedings of the Standing Committee on Banking, Trade and Commerce*, 34th Parliament, 3rd Session, 14 November 1991, Issue N° 2 (Statement of Nicholas Le Pan, Assistant Deputy-Minister, Financial Sector Policy Branch, Department of Finance, Government of Canada) at 2:15.

727 Summarizing Canadian financial industry views on the FTA, a CBA official noted that "[...] the FTA is a static document, allowing little room for change and allowing no real incentives for further liberalization or regulatory cooperation." R. GAFFORD, "Three for Free Trade" *Canadian Banker* (March/April 1992) 99 at 99.

728 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 3-5. F. SWEDLOVE & P. EVANOFF, "Financial Services in the NAFTA Free Trade Agreement: A Canadian Perspective" *Canadian Financial Services Alert* (December 1992) 49 at 49. However, note that the bilateral commitments between Canada and the U.S. made under the FTA are carried forward under the new agreement. NAFTA, Article 1401 para. 4 and Annex 1401.4. Commenting on the different approaches between the FTA and NAFTA, the Canadian lead negotiator for the NAFTA negotiations in financial services explained Canada's point of view: "[i]f you look at Chapter 17 of the [FTA], you will find that there is no statement of principles. That is because we were extremely concerned as a government in 1987 about what such principles would lead to in the financial services area. So the FTA was very much an exchange of concessions and not a statement of principles. Well, we've learned quite a bit since that time and we do feel more comfortable with the concept of principles. [...] By having principles established, it allows us to more easily determine what we actually will get at the end of the day from our trading partners. So we have very much become a proponent of these concepts of principles." F. SWEDLOVE, "The Current State of Trade in Financial Services" in CANADA, Department of Justice, *Proceedings of the Ninth International Trade Law Seminar* (Ottawa, Ont.: Minister of Supply and Services, 1992) 105 at 107.

729 JOHNSON, *supra*, note 602 at 355. J. ROBINSON, *NAFTA and Doing Business with Mexico: Financial Services Under NAFTA* (Toronto, Ont.: Canadian Institute Conference, 1994) at 5. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 6.

730 K.L. BACHMAN, J.S. MURPHY, S.N. BENEDICT & A. ANZALDUA, "The Financial Services Provisions of the Proposed North American Free Trade Agreement" in R.E. HERZSTEIN & E. ROBERTS LEWIS, eds, *Mexico Investment and Trade: Progress and Prospects* (New York, N.Y.: Practising Law Institute, 1993) 244 at 250. K.L. BACHMAN & R.A. ANZALDUA MONTOYA, *South of the Border, NAFTA Boosts Financial Services*, (1993) 209 N.Y.L.J. S5. A.V. GIL, *NAFTA to Open Most Mexican Markets*, (1992) 15:10 Nat'l L.J. 19 at 24.

731 NAFTA, Article 1401 para. 1.

732 NAFTA, Article 1416. The same Article defines an "investment" as meaning generally the term in Chapter 11. NAFTA Article 1139. However, an exception to that treatment exists with respect to "debt securities" and "loan". NAFTA, Article 1416. Finally, note

institutions of another Party"[733]; and (iii) "financial service providers of a Party"[734].

NAFTA greatly liberalizes trade and investment in financial services among all three signing countries[735]. Basically, Article 1401 states that NAFTA covers: (i) regulated financial institutions from another NAFTA country; (ii) investments in financial institutions by investors from another Party to the Agreement; and (iii) cross-border trade in financial services[736]. In order to benefit from the provisions of Chapter 14, financial institutions and investors (or their investments) must satisfy a number of "rules of origin"[737]. Under these rules a Party to the Agreement can deny the benefits of NAFTA to a financial service provider that : (i) is owned or controlled by

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that for the purposes of NAFTA's market access provisions, an "investor of another Party" is defined more specifically as an investor engaged in the business of providing financial services in the territory of that Party. NAFTA, Articles 201 and 1403 para. 5. JOHNSON, *supra*, note 602 at 356-357.

733 NAFTA, Article 1416. The same Article defines a "financial institution" as being any financial intermediary or other enterprise that is authorized to do business and regulated as a financial institution under the law of the Party in whose territory it is located. JOHNSON, *ibid.*, at 356.

734 NAFTA, Article 1416. The same Article defines a "financial service" to mean a service of a financial nature and a service incidental or auxiliary to a service of a financial nature. However, note that some types of services, like those provided by government-related entities or backed by government resources, are excluded from the Agreement. See, *e.g.*, NAFTA, Articles 1401 and 1410 para. 3, Annex VII (B)(15), Schedule of Mexico, Annex VII (A), Schedule of the United States. Note that "[t]he definition includes insurance but does not mention any other activity, and "financial nature" is not defined." JOHNSON, *supra*, note 602 at 358.

735 This is especially true in Mexico which has significantly opened its markets for the first time in fifty years. R.S. WEINERT & P. SINCLAIR, *NAFTA and Financial Services*, Paper 7 (Coral Gables, Fla.: The North-South Centre, 1994) at 4. Also, see generally, H.J. JOHNSON, *Banking Without Borders: Challenges and Opportunities in the Era of North American Free Trade and the Emerging Global Marketplace* (Chicago, Ill.: Probus, 1995).

736 NAFTA, Article 1401 para. 1. "Chapter [14] does not cover laws of general application in a NAFTA country that affect the ability of investors of other NAFTA countries to invest." JOHNSON, *supra*, note 602 at 357-358.

737 "Both Mexico and the U.S. opted for a liberal approach by choosing to apply the criteria of "country of incorporation"." SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 9. In this context, these sets of rules (incorporated by reference from the Chapter on Cross-Border Trade in Services) are used to differentiate between financial services originating in one country from those originating in another for the purpose of application of trade measures. NAFTA, Articles 1211 and 1401 para. 2. One of the most important concern of many financial institutions from non-NAFTA countries relates to the possibility for them to share in the opening of the Mexican financial markets. Mexicans have decided to allow outside firms to benefit from NAFTA treatment through expansion into Mexico from their American or Canadian operations. SAUVÉ & GONZALES-HERMOSILLO, *Ibid.*

nationals or entities of a non-NAFTA country; and (ii) that does not have substantial business activities in any NAFTA countries[738].

As a matter of law, the most difficult problem comes from the fact that only the federal governments of Canada, the U.S. and Mexico are "Parties" to NAFTA. However, each of the federal governments commit to enforce the Agreement on their respective sub-national governments. NAFTA obliges each respective federal government to "ensure that all necessary measures" are taken to enforce the rules of the Agreement[739]. The stronger provisions of NAFTA commit each Party to use all its powers to compel compliance even in the areas of exclusive provincial jurisdiction and without provincial consent[740]. Note, however, that there is an exception in the area of securities where Canada has reserved the right to adopt new measures which are not consistent with NAFTA[741]

1.1 National Treatment

Under Article 102 of the NAFTA (corresponding to Article 105 of the FTA), national treatment applies to trade in goods, services and investment. The extraordinary scope of national treatment creates much uncertainty. Since its rules now apply to services and investment, the GATT may provide guidance for the interpretation of this concept. However, its definitive meaning will have to await a litigation and dispute settlement under NAFTA.

One notable difference between the FTA and NAFTA concerns the underlying principle of national treatment[742]. Chapter 14 states that the Parties must give investors, financial institutions and cross-border providers of other NAFTA Parties a

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738 NAFTA, Article 1211 para. 2. For its part, Canada has chosen to establish more severe rules of origin by reserving its right to deny the benefits of NAFTA to any enterprise not controlled by persons from NAFTA countries. NAFTA, Annex VII (B) para. 2, Schedule of Canada.

739 NAFTA, Article 105.

740 NAFTA, Article 105. Canadian Statement of Implementation, *supra*, note 193 at 77-78. D. RADOCCHIA, "NAFTA and Financial Services: A Provincial Perspective" *Canadian Financial Service Alert* (December 1992) 52 at 52.

741 NAFTA, Annex II (C) 7, Schedule of Canada.

742 NAFTA, Article 1405.

treatment that is no less favourable than they give their own domestic providers "in like circumstances"[743] (further defined by ECO)[744] with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of an institution or investment or with respect to the provision of a financial service[745]. However, the concept stops short of requiring the *de facto* national treatment[746]. Thus, different treatment may be accorded to NAFTA investors, institutions or service providers, provided that they are not disadvantaged thereby relative to their domestic counterparts. Differences in market share, profitability or size (while not sufficient to show inequality of competitive opportunity) may be evidence of the same[747]. In practical terms, Article 1405 allows for the investors or financial institutions establishing for the first time in a country to receive the best treatment offered to new entrants (including any domestic investors)[748]. Moreover, those investors or institutions already established in a country and wishing to expand their activities into a new province or state also have the right to receive the best treatment given any investor or institution coming from the province or state

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743 NAFTA, Article 1405 paras 1 to 4. The ambiguous notion of "like circumstances" has caused some problems in the financial services area. As the U.S. Treasury reported to Congress in its various National Treatment studies (1979, 1984, 1986, 1990), the use of "like circumstances" notion can result in restrictive practices. LOHMAN & MURDEN, *supra*, note 325 at 154. JOHNSON, *supra*, note 602 at 362.

744 "National treatment does not mean identical treatment. It only means no less favourable treatment. The effect of the "competitive opportunities test" of compliance allows somewhat greater latitude for differential treatment than applies with national treatment provisions set out elsewhere in NAFTA." JOHNSON, *supra*, note 602 at 363.

745 NAFTA, Article 1405 para. 5. From the Canadian perspective, "[e]qual 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. Change in market share, profitability or size alone is not sufficient indicator of a denial of equality of competitive opportunity, but such changes can be considered when determining whether a Party provides equality of competitive opportunity and, therefore, national treatment." Canadian Statement on Implementation, *supra*, note 193 at 174. Generally this concept places the country with the more liberalized market at a disadvantage. Article 1405 para. 5 seems to be based on Article XVII:3 of the GATS. APPLETON, *supra*, note 146 at 106. Note that under NAFTA, Article 1409 para. 4, "[...] reservations from NAFTA 1102 such as that taken by Canada under Annex I in respect of the [ICA] [...] apply to [...] NAFTA 1405." JOHNSON, *supra*, note 602 at 367. NAFTA, Annex I, Schedule of Canada, para. 8; Description.

746 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 7.

747 NAFTA, Article 1405 para. 7. "In other words, opportunity, not outcome, is the determining factor". SIMSER, *supra*, note 127 at 206.

748 JOHNSON, *supra*, note 602 at 362.

it is established[749].

On the surface, it appears that because broker-dealer regulatory requirements are not greatly different for U.S.-based firms and those that are not[750], NAFTA does not have a great impact on U.S. regulation of broker-dealers[751]. Still, the possibility exists for a Canadian or Mexican firm to challenge some SEC requirements[752] or SRO's special rules[753] imposed solely on non-resident brokers.

Besides an absence of "like circumstances", a type of defence to an allegation that a measure is contrary to national treatment is the prudential carve-out. It is all encompassing. The prudential carve-out allows the annulment of any term of Chapter 14 by a "reasonable" measure that is adopted or maintained for prudential reasons[754]. NAFTA offers some examples of prudential reasons. As could be expected in the context of financial regulations, the term includes measures such as: (i) the protection of investors or depositors or financial market participants[755]; (ii) the maintenance of the soundness and integrity of financial institutions or cross-border

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749 Canadian Statement on Implementation, *supra*, note 193 at 174-175. From Canada's point of view, while it need not ensure that the provinces treat NAFTA financial institutions, investments and service providers equally, they must treat them no less favourably than they treat Canadian institutions, investors and service providers.

750 L. LOSS & J. SELIGMAN, *Securities Regulation*, 3rd ed., Vol. VI (Boston, MA: Little, Brown, 1990) at 3002.

751 GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 389. In the case of foreign banks, "the U.S. government has followed a general policy of national treatment [...] since the [IBA] of 1978." ZANGARI, *supra*, note 709 at 32.

752 Regarding some requirements imposed by the SEC on non-resident broker-dealers, see, *e.g.*, GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 401.

753 Regarding certain of the special rules imposed by the U.S. SROs on non-resident broker-dealers, see, *e.g., Ibid.*, at 404.

754 NAFTA, Article 1410 para. 1. "Typically [prudential carve-out] means that regulators are not convinced that a company has the resources or expertise to compete or that their products or practices are hazardous to consumers or the system as a whole. While such concerns may seem in terms of general services to be rather paternalistic, they are considered appropriate in financial services because of the sector's role in the overall economy." W.P. BRYSON, "Free Trade and Financial Institutions" in CANADA, Department of Justice, *Proceedings of the Ninth International Trade Law Seminar* (Ottawa, Ont.: Minister of Supply and Services, 1992) 109 at 111.

755 In addition, reasonable measures for prudential reasons may be taken to protect "policy- holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service provider". NAFTA, Article 1410 para. 1(a). However, note that it is puzzling to have included in that list measures adopted for the protection of financial market participants.

financial service providers[756]; and (iii) stability and integrity of a financial system[757]. Because the extent of the financial service obligations were narrower, the FTA did not contain any provision similar to the NAFTA prudential exception. Although NAFTA's prudential exception has its limits, these can be assessed by the Free Trade Commission (during any investor-state dispute)[758] and the dispute settlement panel (during a state-to-state dispute)[759].

1.2 Market Access

The market access principle prohibits a jurisdiction from adopting any measures that restrict commercial presence and cross-border services by financial providers of other countries[760]. Because NAFTA limits this benefit to financial service providers, it presupposes that an "investor of another Party" is already engaged in providing financial services[761].

NAFTA states that financial services providers of a Party that does not own or control a financial institution in the Party's territory may establish one in that territory[762]. Concurrently, a Party may require an "investor of another Party"[763] to incorporate under its domestic law[764] and impose terms and conditions consistent with the

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756 NAFTA, Article 1410 para. 1(b).

757 NAFTA, Article 1410 para. 1(c).

758 NAFTA, Article 1415 para. 2.

759 NAFTA, Article 1414. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 9.

760 NAFTA, Article 1403. JOHNSON, *supra*, note 602 at 360. Note that, although NAFTA urges the Parties to recognize certain principles with respect to market access, the Parties are not required to amend their domestic laws to reflect those principles. However, the Parties will review and assess market access sometime in the future. NAFTA, Article 1403 para. 3. Note that Article 1403 para. 3 and Annex 1401.4 (through its extension of the FTA) both indicate that Canada and Mexico will be able to benefit from future liberalization in the U.S. G. DUNNE, *The Glass-Steagall Wall: Subtle Hazards Revisited*, (1994) 111 Banking L. J. 115.

761 NAFTA, Article 1403 para. 5.

762 NAFTA, Article 1403 para. 4. JOHNSON, *supra*, note 602 at 360. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 6.

763 This term refers to "an investor of another Party engaged in the business of providing financial services in the territory of that Party". Article 1403 para. 5.

764 NAFTA, Article 1403 para. 4(a). Consequently, a NAFTA country may bar entry by direct cross-border branching. NAFTA, Article 1403 para. 4. Note that direct bank branching is a special matter which would, at one time in the future, be reviewed by the Parties to the Agreement. NAFTA, Article 1403 para. 3. JOHNSON, *supra*, note 602 at 361. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 6-7. In this

national treatment obligation contained in Chapter 14.[765].

In principle, the U.S., Mexico and Canada agree on the fact that the enhancement occurs when investors can choose the juridical form of their investment (i.e. subsidiary or branch)[766]. Moreover, it is recognized by all Parties to NAFTA that an investor of another Party to the Agreement should be able to provide a range of financial services in a market through separate financial institutions (as may be required by domestic law), expand geographically within a territory, and not be subject to any ownership requirements specific to foreign institutions[767]. Still, Article 1403 paras 1 and 2 do not consist of a "statement of willingness to act in any given manner"[768].

Chapter 14 also applies to SROs. In this context, a SRO is a non-governmental body (including any securities or futures exchange or market, clearing agency, or other organization or association) exercising regulatory or supervisory authority over financial service providers[769]. As a result, any requirements imposed upon a financial service provider requiring it to be member of, participate in, or have access to an SRO, by a NAFTA country, must respect the principles of Chapter 14 (i.e. national treatment, MFN treatment, etc.)[770]

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context, Canada has expressed its point of view by stating it would assess the situation in view of the state of the GSA and other constraints on market access in the U.S. *Canadian Statement on Implementation, supra,* note 193 at 173-174.

765 NAFTA, Article 1403 para. 4(b).

766 NAFTA, Article 1403 para. 1. SIMSER, *supra*, note 127 at 204.

767 NAFTA, Article 1403 para. 2. All three of the foregoing principles are already applicable to the U.S. as a result of the FTA and they have now been extended to Mexico. JOHNSON, *supra*, note 602 at 361. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 6.

768 Canadian statement on implementation, *supra*, note 193 at 173.

769 NAFTA, Article 1416.

770 NAFTA, Article 1402. NAFTA applies to a SRO only if it is mandatory to be a member in order to conduct financial operations. Thus Chapter 14 applies to the Mexican *Bolsa* and to the NASD but not to the TSE or the NYSE. HOUSE BANKING COMMITTEE, *Aspects of NAFTA Affecting the Financial Services Industry*, 103rd Congress, 29 September 1993 at 23.

1.3 Cross-Border Trade[771]

In essence, cross-border trade refers to transactions by which services are supplied by financial firms from their home country to customers in another country. Given a recent history of substantial interferences to cross-border trade in financial services in Mexico, the issue was comprehensively treated by NAFTA[772]. It is also bound to become an even more important issue if the Agreement is extended to additional countries.

Chapter 14 addresses the issue of mobility in cross-border trade from two distinct perspectives[773]. First, citizens and residents of each NAFTA country are permitted to purchase the financial services of a provider located in the territory of another Party to the Agreement (upon condition it satisfies Chapter 14's rules of origin)[774]. Having said this, no obligation requires the Parties to permit providers of other NAFTA countries to do or solicit business in their respective territories unless established there[775]. Second, each Party agrees that existing restrictions respecting the provisions of cross-border trade in financial services have been frozen[776]. However, this "standstill" rule has a number of exceptions. The most notable concerns trade in securities between Canada and the U.S.[777] Another exception relates to cross-

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771 "The concept of "cross-border" is identical to that in Chapter Twelve." JOHNSON, *supra*, note 602 at 358.

772 "Issues of cross-border trade were given little attention in the FTA because the degree of interference with freedom of trade in these services between Canada and the U.S. has been rare in its extent and duration." CHANT, *supra*, note 695 at 182.

773 SIMSER, *supra*, note 127 at 204-205. K.L. BACHMAN, S.N. BENEDICT, R.A. ANZALDUA, *Financial Services Under the North American Free Trade Agreement: An Overview*, (1994) 28 Int'l Law. 291 at 296. Note that it has been suggested that, while considerable energy was expended on these provisions, their impact will not be significant. ROBINSON, *supra*, note 729 at 9-11.

774 For a discussion of the rules of origin for financial services, see *supra*, notes 737, 738 and accompanying text.

775 GOVERNMENT OF THE UNITED STATES OF AMERICA, *The North American Free Trade Agreement Implementation Act: Statement of Administrative Action* (Washington, D.C.: Government of the United States of America, 1993) at 164. Thus, each NAFTA country can adopt its definition of "soliciting" and "doing business". NAFTA, Article 1404 para. 2. JOHNSON, *supra*, note 602 at 362.

776 NAFTA, Article 1404 para. 1. JOHNSON, *supra*, note 602 at 361. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 7.

777 NAFTA, Annex VII (B) para. 1, Schedule of Canada; Annex VII (B), Schedule of the United States. For a summary of these commitments, see *infra*, note 906 and accompanying text.

border insurance services[778]. However, all three countries have agreed to consult (no later than January 1, 2000) on the possibility of further liberalization on cross-border trade in financial services[779].

1.4 Most-Favoured-Nation Treatment

NAFTA makes the concept of MFN treatment applicable to financial services. According to Article 1406, any concession granted by one Party to investors, financial institutions and cross-border financial service providers of another Party or of a non-Party must be given to the same of any other Party in "like circumstances"[780]. However, there is a possibility that mutual recognition[781] of regulation results in preferential treatment of one NAFTA partner's institution. Such recognition may be awarded unilaterally, obtained through means like harmonization or based upon an agreement or arrangement concluded with another Party or a third country[782].

The resulting preferential treatment will be allowed to continue as long as any other Party obtains the possibility to demonstrate that it qualifies for similar treatment, and is given an adequate opportunity to negotiate such recognition[783]. This provision permits, for example, the continuation of the arrangements that already exist between the SEC and the securities commissions of various Canadian provinces. In practical terms, the MJDS may be a good example[784].

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778 NAFTA, Annex VII (A), Schedule of Mexico.

779 NAFTA, Annex 1404.4. ZANGARI, *supra*, note 709 at 40. JOHNSON, *supra*, note 602 at 362.

780 NAFTA, Article 1406 para. 1. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 8.

781 "This concept, similar to the GATT concept, provides that two countries may come to an agreement that does not necessarily have to be extended to a third party. For example, the [SEC] [(through the MJDS)] has a special relationship with provincial securities commissions that results in the unique treatment of Canadian securities firms operating in the [U.S.]." SIMSER, *supra*, note 127 at 206.

782 NAFTA, Article 1406 para. 2. If the U.S. proceeds with bilateral treaties with Central or South America or the Caribbean countries, "Canada and Mexico could benefit from a more liberal American trade regime." SIMSER, *supra*, note 127 at 206.

783 NAFTA, Article 1406 para. 4. JOHNSON, *supra*, note 602 at 364. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 8.

784 BACHMAN *[et al.]*, *supra*, note 773 at 295.

1.5 New Financial Services and Data Processing

National treatment is also to be accorded with respect to the provision of new financial services by financial institutions of another Party of a type similar to new services that the host Party permits its own financial institutions to provide[785]. However, the host Party remains free to determine the institutional and juridical form through which such new services may be provided[786]. The host Party may also require authorization for the provision of the new service, which authorization may only be refused for prudential reasons (for example, safety and soundness of regulatory concerns)[787]. Parties must also permit the financial institutions of another Party to transfer information in electronic or other form into and out of the host Party's territory for data processing, if the transfer is required in the ordinary course of business of such institutions[788].

1.6 Nationality Requirements

A Party may not impose nationality requirements for senior management or boards of directors of the financial institutions of another Party other than the requirement that a simple majority of the board of directors be composed of nationals of the last Party[789].

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785 NAFTA, Article 1407 para. 1. JOHNSON, *supra*, note 602 at 364-365.

786 For instance, a provider may be limited to offering the new service through a separate subsidiary. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 9.

787 *Ibid.* See, also G.B. KNECHT, "Major U.S. Banks Plan Units in Mexico: Move Could Help Modernize Financial Structure" *The Wall Street Journal [of New York]* (31 May 1994) A13. S. JOHNSON, "North America's Financial Hot Spot" *Canadian Banker* (Nov./Dec. 1993) 20 at 23. G.E. BAROUDI "Banking on Business in Mexico: There's an Exciting New Financial Frontier South of the Rio Grande" *The [Toronto] Globe and Mail* (23 November 1993) C3. C.M. NALDA, *NAFTA Foreign Investment and the Mexican Banking System*, (1992) 26 Geo. Wash. J. Int'l L. & Econ. 379 at 398, 411.

788 This issue caused frictions under the FTA because some U.S. firms complained that data processing within Canada's borders increased costs. BACHMAN *[et al.], supra,* note 773 at 297.

789 NAFTA, Articles 1407 and 1408. "NAFTA 1407 permits nationality or residency requirements respecting boards of directors but unlike NAFTA 1107, without the *caveat* that the requirement does not impair the ability to exert control." JOHNSON, *supra*, note 602 at 365. To comply, Canada had to amend its Bank Act which now requires a bare majority of Canadians for NAFTA country bank subsidiaries but requires that at least three quarters of the directors of any (local) bank be Canadian. *Bank Act*, s. 159. SIMSER, *supra,* note 127 at 208. However, the U.S. has taken reservation to preserve citizenship and residency requirements for national bank

1.7 Transparency

As a means of injecting greater transparency into the financial services sector[790], Parties are required to provide advance notice to all interested persons of measures of general application; to make available their respective requirements for completing applications relating to the provision of financial services; to inform applicants of the status of their applications upon being requested to do so; to make administrative decisions on completed applications within 120 days, such period can however be extended where meeting the 120-day deadline is not practicable; and finally, to maintain inquiry points to which persons can turn for information and relevant documentation[791]. Overall, the transparency obligations are proving to be useful to Canadian and U.S. firms operating in Mexico given the long-standing complaint that Mexico often changes regulations without prior consultation with the private sector[792].

1.8 Exceptions and Reservations

An important exception to Chapter 14 obligations which would otherwise apply is made in respect of prudential concerns. Thus, all three Parties remain free to adopt or maintain non-conforming measures that are reasonably necessary for prudential reasons (such as the protection of investors and the maintenance of the safety, soundness, stability and integrity of financial institutions, cross-border service providers or financial systems)[793]. Parties may also maintain non-discriminatory measures of general application taken by any public entity in pursuit of monetary and

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management under existing law. NAFTA, Annex VII (A), Schedule of the United States.

790 The transparency provisions have an impact on all Parties to the Agreement, In Mexico, its effects are easy to see with the country's massive bureaucracy. In the U.S., it can be said that § 20 orders are a change to the provisions of the GSA without a change in the law. In Canada, the regulatory practices of the OSFI do not always comply with NAFTA's obligations. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 5. CHANT, *supra*, note 695 at 179. DUNNE, *supra*, note 760 at 119. ROBINSON, *supra*, note 729 at 13. SIMSER, *supra*, note 127 at 207-208.

791 NAFTA, Article 1411. JOHNSON, *supra*, note 602 at 365.

792 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 7.

793 NAFTA, Article 1410 para. 1. SIMSER, *supra*, note 127 at 209-210.

related credit policies or exchange rate policies[794]. Moreover, each Party has taken reservations that permit them to derogate from otherwise applicable NAFTA obligations[795]. In the case of Canada, for example, reservations were taken that will permit the adoption and maintenance of measures relating to cross-border trade in securities.

1.9 Special Commitments and Reservations of All Three Countries

Generally, a Party to the Agreement may not enforce any federal, provincial, or state measure that does not follow the rules of NAFTA. With regards to market access, many specific commitments and undertakings have been made by all Parties. However, each NAFTA country has "reserved" a number of measures by including them in a special list[796]. These reservations (aimed at preserving certain existing discriminatory practices or take exception to specific provisions under the Agreement) modify Chapter 14 in important ways, especially with respect to Mexico. Thus, a real understanding of the provisions relating to market access can only be obtained by a careful review of these annexes[797].

Annex VII (which must be read together and in the context of Chapter 14) sets forth reservations which consist of two types[798]. First, each of the three Parties have taken reservations (listed in Annex VII, Part A) to preserve its right to enforce current measures that do not conform to Articles 1403 to 1408[799], provided the measure

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794 NAFTA, Article 1410 para. 2. "However, this exception does not affect the obligations respecting performances requirements in NAFTA 1106 or transfers in NAFTA 1109." JOHNSON, *supra*, note 602 at 366.

795 NAFTA, Article 1409. UNITED STATES GENERAL ACCOUNTING OFFICE, *North American Free Trade Agreement: Assessment of Major Issues*, Vol. 2 (Washington, D.C.: Government of the United States of America, 1993) at 44.

796 NAFTA, Article 1409. The reservations taken by each NAFTA country with respect to the financial services Chapter are set out in Annex VII and in the Annexes to many specific articles of Chapter 14.

797 In other words, "[u]nder the NAFTA's negative-list approach to coverage, failure to list a nonconforming measure within the agreed time frame implies its full and immediate liberalization." SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 6.

798 BACHMAN *[et al.], supra*, note 773 at 299.

799 NAFTA, Article 1409 para. 1. JOHNSON, *supra*, note 602 at 367.

existed on January 1, 1994[800]. Second, reservations listed in each NAFTA country under Part B of Annex VII must also be taken only against certain provisions of Chapter 14 but are not limited to pre-existing measures[801]. As for Annex VII, Part C, it sets forth a series of commitments of all NAFTA countries that modify or expand provisions with regard to market access issues.

1.9.1 Mexico

As with trade in goods, there is a general understanding that opening all trade immediately on the entry into force of NAFTA would be too disruptive to the local Mexican economy. For that reason, Mexico is allowing any financial institution established pursuant to the laws of another NAFTA country to set up or acquire financial institutions in Mexico. Once established, U.S. and Canadian financial service investors are eligible to form a Mexican "financial group holding company" to expand their activities into various types of services (on the same terms as domestic Mexican investors)[802].

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800 NAFTA. Article 2203. JOHNSON, *Ibid.* However, the deadline for listing such reserved measures varies. Existing non-conforming federal and Canadian provincial measures as well as measures of six states (California, Florida, Illinois, New York, Ohio and Texas) had to be listed by January 1, 1994. NAFTA, Article 1409 para. 1 (a)(i) and (ii); Annex 1409.1. As for the remaining U.S. states, reservations had to be listed by January 1, 1995. NAFTA, Article 1409 para. 1 (ii); Annex 1409.1. Because Mexican states do not regulate financial services, Mexico did not take reservations for state measures. As for measures of local governments, they may be reserved without being listed. NAFTA, Article 1409 para. 1 (iii). Finally, all the above-mentioned measures may be amended, so long as there is no decrease of the measure's conformity of the Agreement. NAFTA, Article 1409 para. 1 (b), (c). On another front, it has been suggested that the importance of many state and provincial reservations was reduced by the prudential carve-out. S. OTTEMAN, *Canadian Row With Provinces Delays Financial Exemptions Reporting*, (1994) 1:1 Inside NAFTA 1.

801 NAFTA, Article 1409 para. 2. JOHNSON, *Ibid.*

802 NAFTA, Annex VII (C) para. 5, Schedule of Mexico. BACHMAN *[et al.], supra,* note 773 at 305. SIMSER, *supra*, note 127 at 212. S.T. ZAMORA, *Comments on the Regulation of Financial and Legal Services in Mexico under NAFTA*, (1993) 1 U.S.-Mexico L. J. 77 at 77. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 10-11. The entities of the financial group (or *grupo financiero*) are essentially holding companies for a series of financial operations. They can own 100% of banks and certain other financial institutions. In fact, all of the 18 reprivatized banks were bought by financial groups organized for the purpose and owned by brokerage houses. The regulations governing financial groups allow holding company groups, bank groups and brokerage groups. If a group is headed by a bank, it cannot have a brokerage member and vice versa. However, a holding company group can combine both a bank and a brokerage, as has been the case with most of the major groups formed to date.

Market access to U.S. and Canadian financial service providers and investors seeking access to Mexico is limited by a number of conditions and restrictions listed in Annex VII[803]. Under NAFTA, Mexico may require a U.S. or Canadian financial service investor to already be engaged in providing the same general type of service in its home jurisdiction[804]. Moreover, it may limit ownership to no more than one financial institution of each type[805]. Also, the Mexicans may require that a financial institution (to be established or acquired by U.S. or Canadian investors) be wholly-owned[806].

Annex VII, Part B of Mexico's Schedule allows U.S. and Canadian banks, securities firms and insurance companies to establish wholly-owned subsidiaries in Mexico immediately upon the entry into force of the Agreement[807]. However, during a transitional period[808], a cap has been placed on the size[809] of foreign financial affiliates[810] to prevent the establishment of foreign-owned firms that would capture a sizeable portion of the Mexican market[811]. Generally Mexican-chartered firms owned by NAFTA investors, enjoy the same powers (but are subject to the same limits) as locally owned companies. Still, there are some exceptions to this rule regarding: (i)

ECONOMIST INTELLIGENCE UNIT, *Financing Foreign Operations (Mexico)* (London: Economist Intelligence Unit, 1995) at 21. WEINERT & SINCLAIR, *supra*, note 735 at 3.

803 "The mode adopted by Mexico for limiting U.S. and Canadian access to the Mexican financial services industry is a Canadian one, a market share variation on the 10/25 rule." JORDAN, *supra*, note 694 at 53.

804 NAFTA, Annex VII (B) para. 14 (a), Schedule of Mexico. JOHNSON, *supra*, note 602 at 371.

805 NAFTA, Annex VII (B) para. 14 (b), Schedule of Mexico.

806 NAFTA, Annex VII (B) para 12, Schedule of Mexico. Note that investments in insurance companies are excluded from that requirement. NAFTA, Annex VII (B) para. 4, Schedule of Mexico.

807 ECONOMIST INTELLIGENCE UNIT, *supra*, note 802 at 15-16.

808 The transitional period is "the period beginning with the date of entry into force of this Agreement and ending on the earlier of January 1, 2000, or six years from the date of entry into force of this Agreement". NAFTA, Annex VII (B), Schedule of Mexico, paras 1, 9 and (c) Definitions.

809 Mexico limits the size of an affiliate owned by a NAFTA country investor. NAFTA, Annex VII (B), Schedule of Mexico, paras 1 to 8. These limits (referred to as "market share limits") relate to: (i) regulatory capital requirements (paras 1 to 7) and; (ii) assets (para. 8).

810 "Foreign financial affiliate" has been defined to mean "a financial institution established in Mexico and owned and controlled by an investor of another Party". NAFTA, Annex VII (C), Schedule of Mexico, Definitions. JOHNSON, *supra*, note 602 at 368.

811 NAFTA, Annex VII (B) paras 1 to 6, Schedule of Mexico.

capital[812] and asset limits; and (ii) the establishment of offices, branches, or subsidiaries outside Mexico[813].

First, in the case of capital and asset restrictions, there are 2 types of market share[814] limits: (i) individual limits (established for foreign-owned firms); and (ii) aggregate limits (for all foreign-owned financial service companies of the same type)[815]. In the case of banks and securities affiliates, these limits can be summarized briefly[816]. During the transitional period, Mexico has set a 1.5% ceiling on the individual market share of foreign commercial bank affiliates[817], and 4% on the individual market share of foreign securities firm affiliates[818]. By January 1, 2000, all Mexican restrictions will be eliminated[819]. Thereafter, temporary safeguard provisions may be applicable in the banking and securities sectors and may be imposed for a further seven years[820]. On another front, if a Canadian or American firm acquires a Mexican financial institution in Mexico, the sum of the authorized capital of the foreign financial affiliates already controlled by the acquiring firm and that of the acquired institution cannot exceed a preset limit[821]. During the six-year

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812 "Capital" is "as defined in Mexican measures, applied on a national treatment basis". In the case of commercial banks, this concept refers to *capital neto*, while for securities firms it means *capital global*. NAFTA, Annex VII (C), Schedule of Mexico, Definitions.

813 NAFTA, Annex VII (B) para. 12, Schedule of Mexico.

814 Market share is measured by the ratio of the capital of one or all foreign affiliates to the aggregate capital of all financial institutions of the same type doing business in Mexico. NAFTA, Annex VII (B), Schedule of Mexico, para. 2.

815 NAFTA, Annex VII (B), Schedule of Mexico, paras 2, 5 and 6.

816 As of the insurance sector and other financial services, see BACHMAN *[et al.], supra,* note 773 at 308-310. Note that foreign exchange and mutual fund management firms are not subject to capital limits. *Ibid.* at 309.

817 NAFTA, Annex VII (B) Schedule of Mexico, para. 13. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 11.

818 NAFTA, Annex VII (B), Schedule of Mexico, para. 2.

819 NAFTA, Annex VII (B), Schedule of Mexico, paras 5, 9.

820 More specifically, until 2004, Mexico may (under certain conditions) extend and freeze (for a period of 3 years) the total capital limit of foreign-owned banks and securities firms. NAFTA, Annex VII (B), Schedule of Mexico, para. 9.

821 "This prohibition effectively fences off from foreign acquisition the [...] largest [financial institutions] operating in Mexico." ZANGARI, *supra*, note 709 at 37. The fencing off "is not opposed by the U.S. [...] in the context of the overall achievements of [NAFTA]. [I]t should not set the standards for future negotiation, however, and must be viewed in the context of the recent [liberalization of financial institutions]." *Ibid.*, quoting *Potential Impact on the U.S. Economy and Selected Industries of the North American Free Trade Agreement*, Publication N° 2596 (Washington, D.C.: U.S. International Trade Commission, 1993).

transition period, Mexico will limit aggregate market capitalization of the market in the following way[822]. Mexico will gradually increase from 8 to 15% the maximum share of the Mexican banking services market open to foreign commercial bank affiliates[823]. The maximum share of the Mexican market allowed to foreign securities firm affiliates will gradually rise from 10% (in the first year of the transition period) to 20% in the last[824]. As of the year 2000, Mexico may continue to partially protect from foreign control its overall banking system and securities sector. In the event that all foreign commercial bank affiliates (whether acquired or established) accounted for 25% of the capital of all institutions of this type doing business in Mexico, the Mexican government could freeze this percentage for up to three years, but only once during the period from 2000 to 2004[825]. Furthermore, in the case of foreign securities firm affiliates, the government could intervene where such subsidiaries account for 30% of the aggregate capital of institutions of this type[826].

Second, with regards to the establishment of offices, branches or subsidiaries outside the country, NAFTA gives Mexico a right to approve any affiliation between a foreign bank or securities firm and a commercial or industrial corporation established on its territory[827]. However, Mexicans may consider (on a case-by-case basis) exempting a bank or securities firm from this restriction if: (i) the affiliation is "harmless"; and (ii) 90% of the income of the commercial corporation derives from financial-related activities. Moreover, such affiliations are permitted to U.S or Canadian investors seeking to own Mexican financial services companies if made with non-resident

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822 *Ibid.*

823 NAFTA, Annex VII (B), Schedule of Mexico, para. 5.

824 NAFTA, Annex VII (B), Schedule of Mexico, para. 5. JOHNSON, *supra*, note 602 at 370.

825 "Even if Mexico implements the onetime moratorium, there will be no permanent caps on banking or securities firms, either in terms of aggregate market share or in terms of individual firm size, after the year [2007]." ZANGARI, *supra*, note 709 at 37.

826 However, note that temporary limitations on market participation are not the only possible solutions to the problem. Hence, Mexico may request consultations with Canada and the U.S. to discuss the situation. If such consultations do not result in a consensus, arbitration under NAFTA may be sought by any Party. NAFTA, Annex 1413.6 (B). Annex VII (B), Schedule of Mexico, para. 9; (c) Definitions. JOHNSON, *supra*, note 602 at 371.

827 "According to a U.S. negotiator, this provision means, for example, that the Mexican government will be able to prohibit the Mexican subsidiary of a U.S. bank or securities firm from establishing a branch or subsidiary in Israel, Costa Rica, the [U.S.] or any other foreign country". ZANGARI, *supra*, note 709 at 35-36.

commercial or industrial companies operating only outside Mexico[828]. On the other hand, Mexico has until January 1, 1996 to decide whether or not to authorize a new type of securities firm[829]. If permitted to exist, such firms could be subject to lower capital requirements than what is required from full-service Mexican firms (i.e. *casas de bolsa*). However, the new firms would have very limited powers.

1.9.2 United States

Under Chapter 14, the U.S. has taken many reservations[830] and it granted little to Mexico and Canada in the way of new concessions[831]. The Americans did not provide the same concessions to Mexico under NAFTA as some of those granted to Canada under the FTA[832]. NAFTA countries generally have agreed not to increase impediments to cross-border trade. However, the U.S. has excluded from trilateral trade negotiations any measure pertaining to cross-border trade and MFN treatment with respect to cross-border trade in services related to securities with Canada, even though such an agreement does exist between the U.S. and Mexico[833].

1.9.3 Canada

Compared to Mexico, Canada has taken fewer reservations but has made fewer commitments. Moreover, some benefits offered to the Mexicans are an extension of

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828 NAFTA, Annex VII (C) para. 1, Schedule of Mexico. JOHNSON, *Ibid*, at 372.

829 NAFTA, Annex VII (C) para. 3, Schedule of Mexico.

830 NAFTA, Annex VII (A), Schedule of the United States. The U.S. took a reservation respecting the obligation for all directors and the president of a national bank to be American citizens. Also, certain reservations were taken respecting the BHCA and the IBA. Other reservations have been taken similar to the one respecting primary dealers in U.S. government debt obligations. NAFTA, Annex VII(A) Schedule of the United States. Moreover, there are reservations non-conforming state measures. (NAFTA, Article 1409, Annex 1409.1). JOHNSON, *supra*, note 602 at 372-373.

831 E. LEROUX, *Canadian Financial Institutions and Canada-U.S. Free Trade: Is NAFTA About to Fulfil its Promises?*, (1995) 5:1 FTU 3.

832 "In particular, the [U.S. has] not [been] amending its *National Bank Act* to permit domestic and foreign banks and [BHCs] to deal in, underwrite, and purchase without limitation Mexican government-backed debt securities. The [Americans have] not, moreover, [exempted] Mexican-based broker-dealers that conduct securities activities in the [U.S.] from the requirement to maintain reserves in the [U.S.]." SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 13.

833 NAFTA. Annex VII (B), Schedule of the United States. JOHNSON, *ibid*, at 373.

those already enjoyed by the U.S. under the FTA.

Canada has chosen to elaborate two stripes of reservations. The first concerns specifically the adoption of measures relating to cross-border trade in securities services. Section B of Canada's Schedule establishes similar restrictions as Section B of the U.S. Schedule, except that a portion also applies to Mexico. In essence, Canada has chosen the option to adopt measures that derogate from Article 1404 para. 1 of NAFTA or, with respect to the U.S., that derogate from Article 1406[834]. By the same token, Canada has also taken many reservations with respect to any existing non-conforming provincial measures[835].

The second set of reservations relates to restrictions that limit foreign ownership of Canadian-controlled financial institutions and for purposes of restrictions on total domestic assets of foreign bank subsidiaries in Canada[836]. Under NAFTA, Canada exempts Mexican bank subsidiaries in Canada from requirements to obtain approval from the Minister of Finance prior to opening branches in Canada[837]. Mexicans are allowed to control Canadian financial institution subsidiaries operating under a federal charter (without regards to the 10/25 investment rules)[838], which foreigners other than Americans could not do[839]. Furthermore, Mexican bank subsidiaries operating in Canada are no longer subject to the aggregate ceiling applicable to foreign banks of 12% of total domestic assets of the banks established in Canada[840]. U.S. bank subsidiaries established in Canada already benefit from these advantages.

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834 NAFTA, Annex VII (B), Schedule of Canada, para. 1.

835 NAFTA, Article 1409 para. 1. Annex 1409.1. One set of reservations affecting the securities industry in Canada relates to Ontario laws covering securities brokers and dealers. NAFTA, Annex VII(A), Schedule of Canada (Ontario). Similar reservations cover laws of other provinces. JOHNSON, *supra*, note 602 at 368. See *infra*, notes 895 to 897 and accompanying text.

836 NAFTA, Annex VII (B), Schedule of Canada, para. 2. SIMSER, *supra*, note 127 at 210. SWEDLOVE & EVANOFF, *supra*, note 728 at 51.

837 NAFTA, Annex VII (C), Schedule of Canada, para. 2. Remember that the FTA also extended this benefit to U.S.-controlled bank subsidiaries. FTA, Article 1703 para. 2(c).

838 NAFTA, Annex VII (C) Schedule of Canada, para. 1.

839 FTA, Article 1703.

840 NAFTA, Annex VII (C), Schedule of Canada, para. 1.

1.10 Dispute Settlement

In order to avoid the invocation of dispute settlement procedures to the maximum extent possible, NAFTA requires that each Party give "sympathetic consideration" to the request of another Party to consult with respect to matters affecting financial services. The basic idea is that officials of designated government departments of the three Parties[841] shall (and the regulatory authorities of the consulting Parties may) participate in such consultations[842].

In NAFTA, the issue concerning the settlement of disputes that may arise with respect to an investment is somewhat complicated. For matters relating to financial services, the Free Trade Commission (hereinafter FTC) is the institutional body that oversees the smooth operation of NAFTA and its annexes and the procedures available to the signatories to settle disputes that may arise[843]. The FTC is comprised of cabinet-level representatives of the three nations' governments. It supervises the implementation of NAFTA, oversees its further elaboration, resolves disputes that may arise regarding its interpretation and supervises the work of various committees established under NAFTA, including the Financial Services Committee (hereinafter FSC) which supervises the implementation of Chapter 14, considers financial services issues referred to it by any NAFTA country and participates in dispute settlement procedures[844]. The FSC meets every year and reports to the FTC.

Before the member countries submit a dispute to the FTC, they must make every attempt to arrive to a mutually satisfactory resolution of the matter through consultation[845]. Should they fail to reach agreement, the dispute is then brought

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841 The three designated government departments are: (i) in Canada, the Department of Finance; (ii) in the U.S., the Treasury Department; and (iii) in Mexico, the Finance Secretariat.

842 NAFTA, Article 1413. JOHNSON, *supra*, note 602 at 373. According to Article 1413, if a Party requests consultations with another Party, that Party "shall give sympathetic consideration to the request". "Given the hard-nosed reputation of the U.S. Department of Commerce and the Treasury, "sympathetic consideration" is a lot to expect." JORDAN, *supra*, note 694 at 52.

843 NAFTA, Article 2001.

844 NAFTA, Articles 2001 paras 2 (d) and 3; Annex 2001.2. The FSC is composed of financial services regulatory officials from all three NAFTA countries. NAFTA, Article 1412; Annex 1412.1. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 10.

845 NAFTA, Articles 1413 and 2003.

before the FTC[846]. If a dispute arises that cannot be resolved by the Parties, then according to the Chapter 20 mechanism, any NAFTA country involved may request the establishment of an arbitration panel chosen from a trilaterally approved roster of experts[847]. The Chapter 20 mechanism may result in a final report by the panel, but the recommendations are not binding on the Parties[848]. If the recommendations are not followed by the disputing Parties, retaliation by the prevailing Party is possible but only through denying benefits in the financial services sector that have an equivalent effect of the offending measure[849].

The dispute resolution provisions address many important issues, such as the interrelationship of proceedings under NAFTA, alternative dispute resolution programs[850] and other trade agreements[851]. There are three main dispute settlement mechanisms established by NAFTA: (i) the mechanism in Chapter 11 for the settlement of investment disputes; (ii) the mechanism created by Chapter 19 for the settlement of disputes related to anti-dumping and countervailing duties; and (iii) the mechanism in Chapter 20 for other disputes under NAFTA. For financial services, the Investment Chapter and Chapter 20 are the most important.

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846 In this case, the FTC meets within 10 days of delivery of the request and attempts to settle the dispute as quickly as possible. It may call upon technical advisors, have recourse to conciliation and mediation and ultimately make recommendations. NAFTA, Articles 1414, 1415, 2003, 2004, 2006 and 2007.

847 NAFTA, Articles 1414 and 2008 to 2011. The arbitration panel is a "state-to-state dispute settlement panel". It is made up of five panellists with expertise or experience in law and international trade and financial services matters drawn from a special roster of up to 15 individuals agreed upon by the member countries for a period of three years. The experts must be independent of, and not be affiliated with or take instructions from, the government of any NAFTA country. The panel's hearings, deliberations and initial report are strictly confidential. The final report is issued within the prescribed deadline and submitted to the FTC, which may publish it within 15 days of receipt. SIMSER, *supra*, note 127 at 209. JOHNSON, *supra*, note 602 at 500, 510. SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 9-10.

848 NAFTA, Articles 2016 to 2018.

849 NAFTA, Article 1414 para. 5. Compare NAFTA, Article 2019. JOHNSON, *supra*, note 602 at 500.

850 NAFTA, Article 2022.

851 R.G. LIPSEY, D. SCHWANEN & R.J. WONNACOTT, *The NAFTA: What's In, What's Out, What's Next*, Policy Study 21 (Toronto, Ont.: C.D. Howe Institute, 1994) at 122-123. BACHMAN *[et al.], supra*, note 773 at 304. A Party could choose to bring a dispute under either GATT or NAFTA (understanding that the selection of one forum excludes the other). NAFTA, Article 2006. As for disputes between Canada and the U.S., it remains unclear if the FTA's dispute resolution procedures could be used.

Chapter 20 covers most NAFTA-related disputes. A private person may not initiate an action against a country by alleging that the country in question has failed to comply with NAFTA[852]. Only a country may lodge a complaint against another country on points of interpretation and application of NAFTA[853]. The chapter on financial services incorporates certain sections of Chapter 11's dispute resolution procedures[854]. Investment disputes that fall into this category are resolved under Chapter 11 arbitration proceedings, which can result in binding decisions which are enforceable in court[855]. In this context, investors have the power to initiate an arbitration with respect to two key areas of concern: (i) transfer to investors by way of dividends, profits or royalty payments[856]; and (ii) expropriation and just compensation[857].

The non-binding Chapter 20 approach governs disputes on financial services unless the dispute involves an investment issue covered by Chapter 11 and specifically incorporated into Chapter 14[858]. When an investor's claim is countered by the "prudential reasons" defence, the Tribunal shall refer the matter in writing to the FSC. The Committee shall then decide whether "prudential reasons" is a valid defence to the investor's claim, but the ultimate result is that the Parties are subject to Chapter 11 binding arbitration.

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852 NAFTA, Articles 2004 and 2021. JOHNSON, *supra*, note 602 at 501.

853 NAFTA, Article 2004. In the case of dispute between private parties, NAFTA encourages and facilitates recourse to arbitration. Each country has adopted procedures to ensure observance of the agreements to arbitrate. It is the Advisory Committee on Private Commercial Disputes that advises the FTC on matters such as the existence, use and effectiveness of arbitration procedures in the free trade area and makes recommendations in this respect. NAFTA, Article 2020.

854 In the case of a violation of certain provisions of Chapter 11, a private investor may bring a claim directly against a NAFTA country. NAFTA, Articles 1116 and 1117.

855 NAFTA, Articles 1118 to 1138 and 2020. JOHNSON, *supra*, note 602 at 502. "Whereas the FTA applied only to business enterprises, the NAFTA investment provisions will apply to all forms of investments, including minority equity interests certain forms of debt securities, and intangible property." SWEDLOVE & EVANOFF, *supra*, note 728 at 52.

856 NAFTA, Article 1109.

857 NAFTA, Article 1110.

858 Note that "[d]isputes involving [securities dealers] may be subject to both the general regime of state-to-state dispute settlement and a wider regime of investor-state arbitration." RADOCCHIA, *supra*, note 740 at 53.

The following examples illustrate the effects of Chapters 11 and 20[859]. For instance, assume that a Canadian securities firm applies to the Mexican government for a permit to establish a Mexican subsidiary that would engage in the securities brokerage business. The Mexican government denies the permit on the grounds that the authorized capital of the subsidiary would exceed the maximum 4% of the Mexican industry's aggregate capital. The investor claims that Mexico overcalculated the proposed company's authorized capital or that it undercalculated the aggregate capital of the Mexican securities industry. This dispute does not involve any of the Chapter 11 provisions incorporated into Chapter 14. Therefore, the investor would have to convince the Canadian government to initiate a proceeding under Chapter 20. The Canadians could request consultations with the Mexican government or a meeting of the FTC under NAFTA. If the matter defied resolution, the Canadian government could demand the establishment of an arbitral panel, chosen from a roster of financial experts. The final report of the arbitral panel would be issued to the disputing parties, but it would not be binding on the losing party and would not be enforceable in court.

On the other hand, suppose that a Canadian brokerage firm established with a permit from the Mexican government is expropriated and the investor believes the expropriation is in violation of NAFTA (perhaps because the compensation, according to the investor, is not equivalent to fair market value) then the investor can directly seek a remedy under NAFTA. According to Chapter 11, expropriation matters should be settled under binding arbitration. The Canadian investor could initiate arbitration without the need to persuade the Canadian government to do so.

Now, if we assume that the same firm has not been expropriated but that the Mexican government has announced that the investor must meet performance requirements involving a restriction on the transfer of funds by the Mexican subsidiary to its Canadian parent, the matter would be governed by a Chapter 11 provision incorporated into Chapter 14 so that the investor could initiate arbitration procedures that would lead to a binding award. On the other hand, if the Mexican government says the Canadian firm must buy computers from Mexican suppliers approved by the

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859 APPLETON, *supra,* note 146 at 154-155.

government, such a performance requirement would appear to breach NAFTA's provisions. However, because this situation is not covered under Chapter 11 provisions incorporated into Chapter 14, the dispute would be settled under the non-binding Chapter 20 procedure. The investor would have to convince the Canadian government to initiate a Chapter 20 proceeding that would lead to a non-binding recommendation by the arbitral panel.

Note that although recommendations from a Chapter 20 panel are not binding, a Party which fails to comply with such recommendations in a financial services dispute will run the risk that the other Party may deny benefits in the same sector[860]. Thus, if Mexico fails to comply with a Chapter 20 panel's report that Mexico wrongfully denied a Canadian investor's application to establish a Mexican brokerage, the Canadian government could deny a Mexican investor's otherwise valid application to establish a Canadian bank.

Despite the fact that Chapter 14 creates important dispute settlement mechanisms for Parties to the Agreement as well as private interests in each Party, it raises an important cause for concerns for the provincial and state governments. Disputes can involve provincial or state measures. Yet, NAFTA does not contemplate any particular role for provincial governments. Provinces and States do not have the right to make submissions to dispute settlement panels, to make complaints before the FTC, or to request consultations with other Party officials. Only the federal governments enjoy these rights. Consequently, these rules have an important effect on new provincial policy initiatives. Many specific policies are limited or prohibited by NAFTA. Therefore, virtually any provincial or state measure may be subject to complaint under the Agreement's nullification and impairment provisions[861].

Overall, all three North American countries are affected by the provisions of NAFTA. Having said that, the principal gains from financial integration of this sort have largely to do with the efficiency of rules governing the financial services industry. In this context it seems, that the implications of NAFTA are likely to be greater for the

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860 NAFTA, Article 2019.
861 NAFTA, Annex 2004.

relatively closed Mexican financial system than for the financial systems of either the U.S. or Canada.

2. Mexican Gains: Fewer than Few

Since the end of the 1980s, the Mexican financial system has undergone major liberalization, the most important of these reforms being the establishment of a universal banking system[862]. Foreign minority ownership has been permitted since 1989[863]. The right for banks to have a representative office in Mexico was maintained and foreign participation up to 30% was permitted in Mexican banks, with an individual limit of 10%[864]. The new regulation also allowed foreign participation up to 30% in Mexican securities firms, with an individual limit of 10%[865]. Following the December 1994 peso crisis, Mexico decided to raise the limit to 49%[866]. Finally, financial groups were permitted by way of a holding company controlling different types of financial institutions[867]. However, control of these groups was kept in Mexican hands because of a limit to foreign participation in holding companies set at

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862 MITCHELL, *supra*, note 685 at 1. WEINERT & SINCLAIR, *supra*, note 735 at 3. ECONOMIST INTELLIGENCE UNIT, *supra*, note 802 at 9. S. WOLFF & J. LIZARDI CALDERON, *The Securities Market and Regulation Of Mexico*, (1991) 19 Denver J. Int'l L. & Pol'y 569 at 611.

863 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 14. A.E. SAFARIAN, *Harmonizing Investment Policies in Canada, the United States and Mexico: Is Liberalization Possible?,* Studies on the Economic Future of North America (Vancouver, B.C.: Fraser Institute, 1993) at 4.

864 Y.E. LEPAGE & D. BAYROCK, "Mexico Improves Foreign Access to Financial Services Sector" *Int'l Fin. L. Rev.* (April 1994) 10. N. LUSTING, *Mexico: the Remaking of an Economy* (Washington, D.C.: Brookings Institute, 1992) at 129. UNITED STATES INTERNATIONAL TRADE COMMISSION, *The Year in Trade: Operation of the Trade Agreements Program*, 43rd Report (Washington, D.C.: USITC, 1992) at 4. P. MORICI, *Trade and Talks with Mexico: A Time for Realism* (Washington, D.C.: National Planning Association, 1991) at 29. J. SILVA & R. K. DUNN, *A Free Trade Agreement Between the United States and Mexico: The Right Choice*, (1990) 27 San Diego L.R. 937 at 970.

865 BERDEJA-PRIETO, *supra*, note 688 at 32. L. CONGER, "The Banks Go on the Black" *Institutional Investor* (March 1991) 123 at 124.

866 ECONOMIST INTELLIGENCE UNIT, *supra,* note 802 at 39. W. ACWORTH, *Foreigners Allowed Up to 51% of Mexican Banks, but Banamex, Bancomer and Serfin Seen Out of Reach*, (1995) 9:5 LDC Debt Report /Latin American Markets 6.

867 G. NEWMAN & A. SZTERENFELD, *Business International's Guide to Doing Business in Mexico* (New York, N.Y.: McGraw-Hill, 1993) at 247-248. For a current list of the most active financial groups, see, *e.g.*, ECONOMIST INTELLIGENCE UNIT, *supra,* note 802 at 22-23.

30%. In February 1995, these limits were raised to 49% and 20% respectively[868]. However, although the Mexican government has made numerous changes to its banking and financial laws and regulations since the late 1980's, Mexico continued to prohibit the establishment and limited the operations of foreign banks, securities firms and insurance as well as other nonbank financial services providers. NAFTA allowed financial institutions from both Canada and the U.S. to gain significant access to the restricted and protected financial services market.

Not only is the financial services regulation exclusively federal, but there are no impediments to market access, like the GSA[869]. In some respects, the Mexican financial system resembles that of Canada. The similarities include: (i) an important concentration in the banking and securities sectors; (ii) little restrictions to branching throughout Mexico; and (iii) a financial sector in the process of being restructured[870]. NAFTA (much like the FTA) may have a fairly limited short-to-medium term impact on domestic legislation and the securities industry initiatives[871]. But, overall, did the Mexicans manage to get a better deal under NAFTA than Canada did under the FTA? For the Mexicans, negotiations in the financial sector required a trade-off between the preservation of a national presence in the financial system and necessary concessions. In fact, the Mexican government did not obtain the same preferential treatment under NAFTA as Canada managed to negotiate for itself under the FTA. For instance, Mexico did not obtain national treatment for its government securities in the U.S., such as Canada obtained under Article 1702 para. 1 of the FTA. This is not surprising given the fact that the Mexican debt-crisis is less than fifteen years old. By comparison, the Canadian government debt securities are relatively strong.

On the other hand, Mexico surprised Canada by making the Americans reexamine their approach to the Mexican securities industry operating in the U.S. On the surface, Mexico seems to have made a breakthrough. Here, one very important concession obtained from the Americans concerns a limited exception to the provisions of the GSA. According to NAFTA, the U.S. agreed (subject to some limitations) to allow for

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868 ACWORTH, *supra*, note 866.
869 NALDA, *supra*, note 684 at 380.
870 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 15.
871 *Ibid.*, at 12.

a Mexican financial group created prior to January 1, 1992, and that acquired a Mexican bank and securities company owning or controlling an American securities company to pursue the activities in which the U.S. firm was engaged for a period of no more than five years from the acquisition[872]. While this relief from the GSA appears significant, the fact that it is limited to a five-year period and to a small number of grandfathered groups present in the U.S. on the first day of 1992 are frozen as of that date[873]. Nevertheless, this favourable treatment may be seen as a symbolic victory for the Mexicans.

As for the international operations, it was agreed that no Canadian and American institutions are obliged to set up operations in Mexico but may nonetheless sell financial services to residents and citizens in Mexico, except for transactions denominated in Mexican pesos[874]. This restriction regarding the peso has been adopted to avoid interference with the application of Mexican monetary and exchange rate policies[875]. However, considering that all Parties to NAFTA have agreed to consult before the year 2000 on the possibility of further liberalization[876], this restriction could very well disappear altogether.

In Canada, NAFTA extends the benefits gained by the Americans under the FTA to the Mexican financial institutions. Here, the Canadian commitment involves specific statutory changes to restrictions on foreign ownership and access to financial markets. For instance, Canada permits Mexican investors to establish subsidiary financial institutions that are exempt from the 10/25 ownership rules. Also, a Mexican-

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872 NAFTA, Annex VII (C), Schedule of the United States. JOHNSON, *supra,* note 602 at 373.

873 "This [...] waiver, would appear to benefit only a few Mexican banks that became affiliated with Mexican securities firms (and their U.S. securities operations) during the privatization of Mexican state-owned banks in 1991." BACHMAN *[et al.], supra*, note 773 at 312.

874 NAFTA, Annex VII(B) para. 16, Schedule of Mexico.

875 B. DAVIS, "Mexico's Commercial Banking Industry: Can Mexico's Recently Privatized Banks Compete with the United States Banking Industry After Enactment of the North American Free Trade Agreement?" in B. KOZOLCHYK, ed., *Making Free Trade Work in the Americas: Towards Seamless Boarders* (Tucson, AZ.: National Law Centre for Inter-American Trade, 1993) 289 at 292. R.O. KING, *The North American Free Trade Agreement: Liberalizing Trade and Investment in Insurance* (Washington, D.C.: Congressional Research Service, 1993) at 7.

876 NAFTA, Article 1404 para 4, Annex 1404.4.

controlled Schedule II bank subsidiary does not have to obtain Canadian Ministry of Finance approval before opening additional branches in Canada[877].

3. American Gains: Constant

According to U.S. negotiators, NAFTA (unlike the FTA) is more advantageous[878]. Instead of the barrier-removal approach used in the FTA, NAFTA includes a very detailed set of principles governing trade and investment. It also differs from the FTA in that it covers state or provincial laws in the banking and securities field. Moreover, NAFTA provides a "standstill" approach for state or provincial laws which do not respect the terms of the Agreement.

Although NAFTA does not provide American and Canadian firms with additional access to each other's market as agreed in the FTA, they gain major access to the restricted and protected Mexican market[879]. The fact that NAFTA enables American banks and securities firms to establish full-service offices in Mexico for the first time in more than half a century is greatly significant. In addition, U.S. (and Canadian) securities firms can now assist Mexicans in issuing securities on the Mexican market, thus helping to expand the size of the Mexican *Bolsa*[880]. However, note that the American negotiators failed to persuade either Canada or Mexico to surrender their requirements that foreign banks carry on business through subsidiaries[881].

4. Canadian Gains: Mixed

The shortcomings of the FTA was acknowledged by both Canada and U.S. through Articles 1702 para. 4 and 1703 para. 4. From the Canadian standpoint, NAFTA was particularly important in order to redress the FTA's flaws. Because no new liberalization commitments was secured from the U.S. under the NAFTA (beyond those agreed in the FTA), the impact of the Agreement on American operations of

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877 NAFTA, Annex VII (C), Schedule of Canada.

878 ZANGARI, *supra*, note 709 at 33.

879 *Ibid.* at 34-35.

880 In the past, "[...] according to [U.S.] negotiators, Mexican companies [were] borrowing abroad to finance a substantial part of their domestic needs." *Ibid.* at 35.

881 JOHNSON, *supra*, note 602 at 374.

Canadian financial firms is marginal[882]. In its ongoing struggle with the U.S., Canada did little better under NAFTA than it did under the FTA. Given the underlying principle of national treatment, this was only to be expected. In the context of the negotiations, the chief Canadian objective *vis-a-vis* the Americans consisted of obtaining relief from both the GSA and the *McFadden Act*. Recognizing that a complete repeal of either laws was unlikely, Canada sought to obtain regulatory accommodation aimed at allowing Canadian financial institutions to widen the scope of their American operations[883]. However, the adoption of national treatment prevents Canadian banks from being even stronger in the U.S. Hence, given their experience in operating as universal banks, the Canadian industry can make full use of this competitive advantage in Mexico but not in the U.S.[884] While Canadians may be concerned by the lack of new market opening commitments by the U.S., NAFTA's liberalization principles are an improvement over the FTA. Hence, advantages may be gained from the adoption of a principle-based approach and the development of a dispute settlement mechanism. On another front, NAFTA's establishment provisions may pressure Canada to allow U.S. banks the right to branch directly into Canada[885].

Canadian firms wishing to enter the Mexican market must respect NAFTA's transitional market-share limitations. However, if Canadian financial institutions do not act before those limits are reached, their market share position in the Mexican market may be much more difficult to achieve and certainly costlier[886].

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882 WEINERT & SINCLAIR, *supra*, note 735 at 4.

883 CHANT, *supra*, note 17 at 18.

884 After NAFTA was negotiated, the CBA expressed the view that its objective was not met. JORDAN, *supra*, note 694 at 53 n. 49.

885 The right to branch directly into a country is recognized as a trade-liberalization principle. Of course, the danger for Canada comes from the fact that "[...] when a country permits [bank] entry by a foreign branch, it is implicitly or explicitly accepting the adequacy of home-country [in this case, the U.S. or Mexico] regulation and supervision, including the enforcement of those rules." S.J. KEY & H.S. SCOTT, *International Trade in Banking Services: A Conceptual Framework*, Occasional Paper (Washington, D.C.: Group of Thirty, 1991) at 21.

886 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 18.

5. A Genuine Balanced Exchange of Concessions?

In financial services the existing differences between the American and Canadian regulatory regimes were offset to a large degree by the similarities of the economies. However, Mexico was a very different case. Many events were all within recent memory: nationalizations, currency controls and the debt crisis. For this reason, many of the provisions of a tripartite agreement would need to necessarily be directed towards Mexico.

NAFTA offers significant new opportunities for Canadian providers of financial services to enter the potentially large Mexican market. However, Canada and the U.S. missed an opportunity to further liberalize trade in financial services with each other and to redress some of the imbalances contained in the financial services chapter of the FTA. In that respect, NAFTA's results are particularly disappointing for the Canadian financial community[887]. Nevertheless, all is not lost because the commitments made in the context of the FTA are now subject to dispute settlement under NAFTA. Also, in the long run, it is not impossible that NAFTA's principles of ECO[888] and market access could lead to: (i) a greater liberalization of restrictions still facing the Canadian financial services industry doing business in the U.S.; (ii) the lifting of rules currently preventing American banks to branch directly into Canada; and (iii) increased regulatory harmonization within North American countries.

The most contentious issue in NAFTA is market access. Here, Canada feels disadvantaged[889]. Since the liberalization of Canada's financial services regulation, the only restriction on American banks has been the Canadian *Bank Act* requirements that their operations be conducted through a Canadian-incorporated subsidiary. Then,

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887 J. McFARLAND, "U.S. Still Restricted, Canadian Banks Say" *The Financial Post [of Toronto]* (14 August 1992) 6.

888 "NAFTA on financial services enlarges the meaning of [ECO] by allowing considerations of market size, concentration and profitability in the assessment of market opportunities." D. CHAPUT, *Regulatory Issues and Cross-border Investment in Financial Services After NAFTA: A Canadian Perspective*, Report 94-06 (Montreal, Que.: Centre d'études en administration internationales, 1994) at 9.

889 Note that it has been said that "[t]he potential competitive advantage of the Canadian and Mexican corporate structures for financial institutions could have materialized in the U.S. market only under the reciprocity principle." *Ibid.*, at 6.

the subsidiary may set up branches throughout Canada[890].

Given that the gradual opening of Mexico's financial markets involves the maintenance of aggregate foreign-market share limitations, the treatment afforded by Mexico to non-NAFTA firms may prove controversial. This could be the case in instances during the transition period, when aggregate ceilings are close to be met, if Mexico was to choose to give preference to American or Canadian financial firms over non-NAFTA applicants[891].

NAFTA constitutes a compromise between three federal governments. The national treatment principle applied to Canada and the U.S. guarantees nationwide market access for foreign financial institutions. On the other hand, Mexico's regulation of financial services is solely federal[892]. In this context, NAFTA does not require local governments to remove regulatory obstacles to the creation of a nationwide market for foreign or domestic institutions or to harmonize their regulations on foreign ownership in the financial sector[893]. Thus, sub-national governments may maintain and renew any existing measure that does not conform with NAFTA. Hence, there is an implicit assumption in the accord that the required disclosure of state and provincial regulations that are not consistent with the national treatment principle is a step towards a future round of negotiations on market access involving both levels of government jurisdiction.

As of now, all the Canadian provinces and U.S. states have listed the measures they wish to maintain[894]. With regards to the securities sector, the province of Ontario took reservations against Articles 1404, 1405 and 1408. The protected measures relate to provisions in provincial legislation that enable Ontarians to maintain control

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890 Hence, note that Canada negotiated that it would consider permitting direct cross-border branching of commercial banks into Canada only at such time as the Americans permit interstate branching in the U.S. NAFTA, Article 1403 para. 3. SIMSER, *supra*, note 127 at 212. CHANT, *supra*, note 17 at 19.

891 U.S. CHAMBER OF COMMERCE, *A Guide to the North American Free Trade Agreement: What It Means for U.S. Business* (Washington, D.C.: U.S. Chamber of Commerce, 1992) at 14.

892 NALDA, *supra*, note 684 at 380.

893 Early, the federal governments of all three countries made specific commitments and submitted reservations. NAFTA, Article 1409 para. 1 a)(i); Annex VII(A).

894 NAFTA, Annex 1409.1.

over financial institutions along with those that allow regulatory authorities to use their discretionary powers when the economic viability of financial institutions is at stake[895]. The province of Quebec took reservation against Article 1408[896]. The other Canadian provinces also submitted their lists of non-conforming measures[897]. Note that Canadians declare an important reservation, i.e. the right to adopt a "control test" as the rule of origin for Chapter 14[898]. This approach contrasts with the "residency rule" adopted by the U.S and Mexico[899].

The impact of NAFTA on institutions operating in the field of capital markets is significant[900]. It permits American and Canadian firms to establish subsidiaries in Mexico that will benefit from national treatment[901]. As a result, they are able to develop some capabilities in the peso market[902]. However, note that NAFTA does not address in any consistent way the subject of harmonization of internal regulations over the financial services industry. A *de facto* tendency does exist, however. As is already evident in Canadian securities law reforms to date, there has been a natural

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895 *Securities Act*, R.S.O. 1990, c. S-5; NPS N° 39.

896 *Regulation Respecting Securities*, Order in Council 660-82, 30 March 1983, (1983) *G.O. 2*, 1269 (eff. 83-04-06), s. 203ff. which broadly state that a securities dealer must have a principal establishment in Quebec under the direction of a person who is an officer residing in Quebec.

897 Newfoundland (reservations: 1404 and 1408); *Securities Act*, R.S.N. 1990, c. S-13; NPS N° 39, s. 7. Prince-Edward Island (reservations: 1403 and 1405); *Securities Act*, R.S.P.E.I. 1988. British Columbia (reservations: 1404 and 1408); *Securities Act*, S.B.C. 1985, c. 83; NPS N° 39. Manitoba (reservation: 1404); *Securities Act*, R.S.M. 1988, c. S-50. New Brunswick (reservation: 1404); *Securities Act*, R.S.N.B. 1973; NPS N° 39, s. 7. Alberta (reservations: 1403, 1404, 1405 and 1408); *Securities Act*, S.A. 1981, c. S-6.1. Saskatchewan (reservations: 1403, 1405 and 1408); *Securities Act*, S.S. 1988, c. S-42.2. Nova Scotia (reservations: 1404, 1405 and 1408); *Securities Act*, R.S.N. 1989, c. 418; NPS N° 39, s. 7.

898 NAFTA, Annex VII (B), Schedule of Canada paras 1 and 2. "Under Canada's control test, only foreign-owned financial services providers controlled by one or more residents of the [U.S.] and for Mexico (i.e. individual(s) own(s) more than a 50-percent interest) will be considered a resident of NAFTA party and thus eligible for NAFTA benefits, such as national treatment." ZANGARI, *supra*, note 709 at 34.

899 Here, a company incorporated in a NAFTA country possessing a "substantial interest" (whether or not it is the subsidiary of a third country such as Japan) could benefit from the Agreement. ZANGARI, *Ibid.*

900 However, note that "[l]ike the European program for a unified financial market, NAFTA on financial services [has] little direct influence on capital markets." CHAPUT, *supra*, note 888 at 1. JORDAN, *supra*, note 694 at 53.

901 PAUL, HASTINGS, YANOFSKY & WALKER, *North American Free Trade Agreement: Summary and Analysis* (New York, N.Y.: Matthew Bender, 1993) at 72.

902 WEINERT & SINCLAIR, *supra*, note 735 at 6. E. ORTIZ, "NAFTA and Foreign Investment in Mexico" in RUGMAN, ed., *supra*, note 186, 155 at 174.

tendency among Canadian securities legal reforms to look to U.S. examples in seeking regulatory solutions to new problems. In Mexico, securities regulation has also changed as the financial system gradually opened up to the American influence.

One of the difficulties experienced by Canada under FTA has been the lack of measures to ensure compliance with Chapter 17. For instance, if the FRB exempted certain holding companies of American financial institutions from the application of the GSA and refused to exempt a Canadian firm, Canadians could not obtain relief under the FTA. NAFTA allows the Canadian institution to complain that it has been denied national treatment[903]. Note that in the context of the national treatment standard, it could be argued that the effect of the GSA contravenes the principle of the *de facto* national treatment. In this regard, the most important complaint voiced by Canadian financial institutions relates to the §20 limited exemption from the GSA restrictions[904]. However, note that Canadian laws preventing foreign banking institutions from branching directly into Canada have also been viewed as preventing full and effective access in the Canadian market[905]. Thus, given the nature of such interpretation, the principle of *de facto* national treatment may well need to be administered using the dispute settlement mechanism.

Another concern relates to the "standstill" provision. Although Articles 1702 para. 4 and 1703 para. 4 were used to inspire NAFTA's "standstill" provision, a real failing of the tripartite Agreement becomes apparent where the securities area becomes concerned[906]. Part B of Annex VII of the Canadian and U.S. Schedule means that

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903 SIMSER, *supra*, note 127 at 209.

904 CANADIAN BANKERS' ASSOCIATION, *A Canadian Banking Perspective on Trade in Financial Services under North American Free Trade Agreement* (Toronto, Ont.: Canadian Bankers' Association, 1991) at 7.

905 National Treatment Study 1990, *supra*, note 530 at 122.

906 "[W]ith respect to cross-border trade in securities, Canada (generally perceived to have the most permissive set of regulations) did not commit the standstill – largely in response to the refusal by U.S. negotiators to grant Canadian securities firms equivalent crossborder access into the U.S. market. Consequently, the [U.S.] also declined to commit to a standstill in the area of crossborder trade in securities with Canada, while they did commit to one *vis-a-vis* Mexico." SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 7. CANADA, *supra*, note 770 at 174. JORDAN, *supra*, note 694 at 53-54. SWEDLOVE & EVANOFF, *supra*, note 738 at 51. B. DIETRICH, "Implications and Opportunities Created by the NAFTA in the Securities Sector in Canada" *Canadian Financial Services Alert* (December 1992) 56 at 56.

all existing measures in the area of securities designed to harmonize the regulation between the two countries (like the MJDS) may be at risk of disappearing or being altered significantly[907]. Nevertheless, keep in mind that this restriction may be abolished if coming consultations on future liberalization of cross-border trade in financial services allow corrections[908]. Among the issues to be addressed in the future, the Mexicans agreed to conduct a study two years after the coming into force of NAFTA to determine the possibility of requiring smaller capital requirements for securities firms[909].

Overall, NAFTA's long list of exclusions, reservations and commitments as well as detailed annexes and the inclusions of a dispute resolution process will most certainly lead to a number of interpretations by all three Parties. As a result, the interrelationships among NAFTA's various chapters, provisions and annexes may lead to some disputes between the signatories of the Agreement.

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907 BACHMAN *[et al.]*, *supra*, note 773 at 299.

908 See *supra*, note 779.

909 "The Mexican government sets a minimum capital requirement of [U.S.] $10 million to establish a securities firm in Mexico. According to Treasury Department officials, this substantial downpayment could prohibit smaller U.S. firms that provide limited services from establishing a commercial presence in Mexico." ZANGARI, *supra*, note 709 at 40-41 n. 50.

PART III: THE EFFECTS OF NORTH AMERICAN FREE TRADE ON THE WAY OF DOING BUSINESS OF THE CANADIAN SECURITIES INDUSTRY

With the occurrence of new sets of regional trading rules surrounding the financial services industry, some restrictions gradually eroded. However, the approach of dealing with new rules and new competitors vary greatly in the U.S. and Mexico. For the Canadian securities industry, the post-free trade era marks the beginning of a redefined way of doing business in North America.

TITLE I: THE CANADIAN SECURITIES INDUSTRY *VERSUS* ITS U.S. RIVALS

The signing of the FTA and NAFTA is progressively leading the Canadian securities industry on a new path towards excellence. However, Canadian securities firms face great competition from the Americans who play under a different set of domestic regulation. Still, the MJDS is indirectly changing the way the game is being viewed in both countries. For that reason, the Canadian players are starting to position themselves for a coming North American confrontation.

CHAPTER I: The Canadian Securities Industry and The Post Free Trade Era

For many years the GSA was understood to bar banks (and their affiliates) from engaging in securities activities other than those activities explicitly permitted by the Act. During the time preceding the signing of the FTA, U.S banks lobbied strongly to repeal the GSA in order to broaden their range of services[910]. The effect of the GSA

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910 U.S. banks claimed that they were losing business to other international firms. Today, the ranks of the world's largest banks are now dominated by other than U.S. institutions. On the possible repeal of the GSA prior to the coming into force of the FTA, see, *e.g., Requiem on the Glass-Steagall Act: Tracing the Evolution and Current Status of Bank Involvement in Brokerage Activities*, (1988) 63 Tulane L. Rev. 157. M.L. FEIN, *Facing the Future Without Glass-Steagall*, (1988) 37 Catholic University L. Rev. 281. C. POLK, *Banking and Securities Law: The Glass-Steagall Act — Has It Outlived Its Usefulness?*, (1987) 55 Geo. Wash. L.R. 812; *Beyond the "Wall": The American Financial System and the Glass-Steagall Reform*, (1987) 62 St. John's L. Rev. 67. W.M. ISAAC & J.J. NORTON, *Up Against "The Wall": Glass-Steagall and the Dilemma of a Deregulated ("Reregulated") Banking Environment*, (1987) 42 Bus. Law. 327. *Fifty-Two Years After the Glass-Steagall Act: Do Commercial Bank Securities Activities Merit a Second Look?*, (1984) Det. C.L. Rev. 933. *A Banker's Adventure in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, (1983)

restrictions have been eroded by various courts and administrative decisions and are subject to a number of exceptions. The move towards broader securities powers to banks mainly occurs on two fronts. While Congress has been debating extent to which deregulation would occur[911], state regulators have been easing the way domestically[912]. More importantly, the Federal Reserve Board (hereinafter FRB) has been able to use its role as regulator to expand permitted banking activities[913].

1. The *Glass-Steagall Act* and Section 20's Canadian Subsidiaries

The U.S. restrictions of bank activities in the fields of underwriting and dealing in securities have had a direct impact on certain beneficiaries of the recent Canadian deregulation. Hence, a short period of time after the Canadian legislative changes in 1987 that allowed banks to acquire and own securities firms, most of the underwriting capacity of the Canadian securities industry gradually came under the control of banks. By doing so, Canadians infringed on the GSA due to the fact they possessed securities "affiliates" principally engaged in impermissible activities. Here, Canadian securities businesses could still do a traditional order-taking brokerage business, acting as agents for clients who wanted to buy or sell stock, and they could still collect fees for such work as advising companies on mergers and acquisitions. But they were barred from trading stock with their own money, which meant they could no longer do

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81 Michigan L. R. 1498. H.L. PITT & J.L. WILLIAM, *The Glass-Steagall Act: Key Issue for the Financial Services Industry*, (1983) 11 Sec. Reg. L.J. 234. J.A. ADAM, *Market Mutual Funds: Has Glass-Steagall Been Cracked?*, (1982) 99 The Banking L.J. 4.

911 W. ROGER, *Banking Reform in the 102d Congress–Glasnost for Glass-Steagall?*, (1991) 22 University of Toledo L. Rev. 1003. E.J. MARKEY, *Why Congress Must Amend Glass-Steagall: Recent Trends in Breaching the Wall Separating Commercial and Investment Banking*, (1990) 25 New Eng. L. Rev. *Destroying the Barriers Between Commercial and Investment Banking: Should Congress Repeal the Glass-Steagall Act?*, (1988) 45 Wash. & Lee L. Rev. 1115. R. NATTER, *Glass-Steagall Act Reform: The Next Banking Issue on Congressional Agenda*, (1988) 35 Fed. Bar News & J. 185. C. McGARVEY, *Federal Regulation of Bank Securities Activities: Will Congress Allow Glass-Steagall to be Shattered?*, (1986) 12 J. Contemp. L. 99.

912 P.B. SABA, *Regulation of State Nonmember Insured Banks' Securities Activities: A Model for the Repeal of Glass-Steagall?*, (1986) Harv. J. on Legis. 211.

913 The courts have reviewed several FRB authorizations in the securities area. For example, in 1984, it affirmed the FRB order of BankAmerica Corp. (a bank holding company) to acquire 100% of the voting shares of Charles Schwab Corp. (a company engaged, through a wholly-owned subsidiary, in retail discount brokerage). *BankAmerica Corp.*, (1993) 69 Fed. Res. Bull. 105. LOSS & SELIGMAN, *supra*, note 750 at 2998-2999.

any underwriting (i.e. buying and distributing blocks of newly issued stocks) nor operate in the over-the-counter market, where dealers act as principal rather than as agent. To solve this problem, Canadian banks cited Section 20's limitation on affiliation with companies in the investment business[914]. Moreover, they held that the securities brokerage services offered by the subsidiaries were "closely related" to banking within the meaning of Section 4(c)(8) of the *Bank Holding Company Act* (hereinafter BHCA)[915].

The primary vehicle for engaging in underwriting activities in the U.S. are the so-called "Section 20 subsidiaries" which, subject to a number of conditions and restrictions, may engage in equity underwriting activities[916]. In essence, a Section 20 exemption lets a bank subsidiary get into an otherwise forbidden or "ineligible" business provided that it is "not principally engaged" in that business and that it does not collect more than 10% of its total revenue from "ineligible" sources[917]. Section 20 subsidiaries

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914 LOSS & SELIGMAN, *Ibid*, at 3002. In 1991, the FRB adopted Regulation K to govern the international operations of U.S. banks and the U.S. operations of foreign banks. 56 Fed. Reg. 19549 (29 April 1991) (adoption of final provisions); 55 Fed. Reg. 32424 (9 August 1990) (notice requesting comments or proposed revisions to Regulation K). *Fed Eases Underwriting, Equity Rules for International Banking Under Reg. K*, 23. Sec. Reg. & L. Rep. (BNA) 475 (1990).

915 M.R SCHROEDER, *The Law and Regulation of Financial Institutions*, Vol. 1 (Boston, MA: Warren, Gorham & Lamont, 1995) (loose-leaf) at 8-76ff. The FRB has adopted, in §25 of Regulation Y, a list of activities which it has determined to be closely related to banking (12 C.F.R. §225.25(b) et ff.).

916 Breaches of the GSA wall occur on a case-by-case basis. In 1987, the FRB authorized bank holding companies for the first time to underwrite and deal in certain limited types of ineligible securities. *Citicorp, J.P. MORGAN & Co. Incorporated and Bankers Trust New York Corporation*, (1987) 73 Fed. Res. Bull. 473. The FRB has effectively applied the provisions of Section 20 to the U.S. affiliates of foreign banks by virtue of Section 8 of the IBA. In 1989, the FRB expanded the scope of securities that could be underwritten and transacted so as to include all types of debt and equity securities. *J.P. MORGAN & Co. Incorporated, the Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp and Security Pacific Corporation*, (1989) 75 Fed. Res. Bull. 192. It also permitted underwriting and dealing in securities of affiliates where the securities are rated by an unaffiliated nationally recognized statistical rating organization (NRSRO). Immediately after that decision, several Canadian banks or their subsidiaries applied for underwriting powers in the U.S. K. YAKABUSKI, "Canadian Dealers Eyeing U.S. Stock Underwriting Powers" *The Toronto Star* (25 September 1990) E3.

917 In 1989, the FRB placed at 10% the revenue limit on the amount of total revenues a holding company subsidiary may derive from ineligible securities underwriting and dealing activities. See *Orders Approving Modifications to Section 20 Orders*, (1989) 54 Federal Register 26840. Initially, the limit was set at 5%. *Limited §20 Order*, (1987) 73 Fed. Res. Bull. 479. J.L. BERNIER, "Internationalisation des marchés financiers: le

are subject to a number of firewalls[918] limiting the role of affiliated banks in its underwriting activities. However, many foreign banking organizations (including Canadian banks) do not have a bank holding company along the U.S. model. Thus, if the Section 20 requirements imposed by the FRB were rigidly imposed on Canadian banks wishing to conduct securities activities in the U.S., Canadian banks could not conduct securities activities in the U.S. unless they adopted a holding company structure. But on January 4, 1990, this situation changed when the FRB approved applications by CIBC, RBC and Barclays Bank PLC to engage in limited securities underwriting and dealing activities through Section 20 subsidiaries[919]. The FRB made an important concession to the structural requirements of the foreign banks by permitting the parent foreign banks to directly own and fund their Section 20

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cas du Régime d'information multinational", in SERVICE DE FORMATION PERMANENTE DU BARREAU DU QUÉBEC, ed., *supra*, note 53, 174 at 199. The revenue limit is consistent with the non-banking standards the FRB is required to apply under section 4(c)(8) of the BHCA. This important exemption from a general prohibition on non-banking activities contained in Section 4(c)(8) of the BHCA allows bank holding companies to own shares of companies which engage in activities which the FRB has determined are "closely related to banking". See generally, F.E. DANGEARD, *Le droit financier américain* (Paris: Forum européen de la communication sarl, 1989) at 55. In 1990, three Canadian banks operating Section 20 subsidiaries, filed a request for relief from the revenue limit arguing they would suffer competitive harm in view of the increase in offerings as a result of the MJDS. Their request remained unanswered. PRACTISING LAW INSTITUTE, *Securities Regulation of Banks and Thrifts 1991*, N° 738 (New York, N.Y.: Practising Law Institute, 1991) at 41.

[918] GREENE *[et al.]*, Vol. 2, *supra*, note 47 at 732ff and Appendix B at B-141ff. The firewalls are aimed at preventing a spill-over of risks from the securities affiliate to the bank and to the federal safety net, to prevent conflicts of interest and to preserve competitive equality with independent securities companies. R. DALE, "Regulating Banks' Securities Activities: A Global Assessment" in SINGLETON, ed., *supra*, note 14 at 109.

[919] *Canadian Imperial Bank of Commerce, The Royal Bank of Canada and Barclays PLC, Order Approving Application to Engage, to a Limited Extent, in Underwriting and Dealing in Debt and Equity Securities*, (1990) 76 Fed. Res. Bull. 158. "CIBC, Royal Get Nod to Deal in Securities in U.S." *The Financial Post [of Toronto]* (5 January 1990) 4. H.D. WHYTE, "Three Banks Seeking Licenses to Crack U.S. Securities Market" *The Financial Post [of Toronto]* (8 December 1989) 5. "CIBC, Royal Seeking to Establish U.S. Securities Units" *The [Toronto] Globe and Mail* (19 October 1989) B22. In essence, the application argued by its terms that the GSA "[...] prohibition against the affiliation of a bank and an organization principally engaged in underwriting the public sale of securities [did] not apply to Canadian banks to the extent that they and their subsidiaries are not members of the [FRB] [...]". JORDAN, *supra*, note 103 at 41. JORDAN, *supra*, note 694 at 49. Also, see "Banks Asked Fed for Power to Underwrite Securities", *The New York Times* (26 October 1988) 29. "US Federal Reserve to Allow Banks to Enter Securities Underwriting Market" *The [Toronto] Globe and Mail* (19 January 1989) B2.

subsidiaries, without the necessity of establishing a holding company structure. Moreover, the FRB decided that the Canadian banks, insofar as their foreign offices and operations are concerned, would be treated as bank holding companies for purposes of Section 20 conditions. Also, the responsibility for compliance with Section 20 conditions was placed on the Section 20 subsidiaries rather than the parent Canadian bank, in order to avoid U.S. regulation having an extraterritorial impact. Finally, minor adjustments to the firewalls were approved and it was determined that personnel interlocks between the applicants and their securities subsidiaries would be permitted. In October 1990, the FRB extended the powers of Canadian bank-owned firms by allowing the securities arms of RBC, CIBC and Bank of Nova Scotia (later to become Scotiabank) to underwrite debt issues in the U.S. Then, by mid-January 1991, the FRB allowed RBC and CIBC's brokerage firms to underwrite and sell stocks in the U.S. market[920]

Although not directly implicated in these Section 20 orders, the FTA and NAFTA help to provide the broader context in which they operate. In essence, Canadian banks and their securities dealer subsidiaries possess a unique cross-border expertise that is considered when such orders are granted. Moreover, the argument that U.S. banks and securities dealers operating in Canada partly owe their recent expanded range of activities to the interaction of the FTA and NAFTA has been used as an argument upon which to base (through section 20 orders) expanded Canadian bank powers in the U.S.[921]. Although Canadian banks have to concede that nothing in the free trade agreements requires the U.S. to change its policy, Canadians nonetheless always argued that the policy unfairly put them at a disadvantage[922]. The Canadian bank subsidiaries appear to be getting equal consideration when Section 20 exemptions are

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920 Note that when giving the approvals, the FRB underlined these were accepted on a case-by-case basis "[...] with a very critical eye to the financial strength of the institution involved". K. HOWLETT, "Fed Opens Doors to CIBC, Royal Bank" *The [Toronto] Globe and Mail* (16 January 1991) B1.

921 JORDAN, *supra*, note 103 at 41.

922 "The CBA [wants Canadian banks to have] their freedom to do business in the [U.S.] [...]. Part of the impetus comes from a feeling that Canada's financial institutions got a raw deal out of NAFTA. "We gave a lot more than we received." says the CBA's [senior vice president Mr. Allan Cooper]. D. GOOLD, "Grouse Hunting With J.P. MORGAN" *The [Toronto] Globe and Mail* (25 April 1995) B13. J. SAUNDERS, "Banks Call for Removal of U.S. Barriers" *The [Toronto] Globe and Mail* (20 October 1990) B5.

handed out but they question whether it is an even trade, considering that U.S. brokers now have unlimited rights to grow in Canada regardless of who owns them. Another argument used by Canada to entice the gradual removal of at least some of the traditional barriers between the U.S. banking and securities businesses has been the implementation of the MJDS.

2. The Resounding Impact of the MJDS

Despite the implementation of the FTA, the Canadian securities industry continued its attacks on the GSA prohibitions restricting activities in the U.S. However, the battleground shifted away from trade to sectorial arrangements. During the MJDS negotiations, Canadian brokerage firms (all controlled by banks) tested the U.S. attitude towards free trade in financial services by asking for a special deal relating strictly to securities issued by Canadians, arguing this would let them compete on equal terms with U.S. firms wishing to handle cross-border issues. The MJDS was temporarily held hostage over the GSA issue. The Canadian bank-owned securities industry mounted a campaign to delay the implementation of the MJDS[923]. This attempt to try blocking implementation of the MJDS proved unsuccessful. However, these grievances were heard by the entire financial community. The fears of the Canadian securities industry came about from the very existence of the MJDS. In theory, the MJDS enhances the free-flow of capital between the two countries. In practice, however, the flow of issuances of securities (most of it being in the form of debt) under the MJDS has been (mainly) from Canada to the U.S[924]. There are reasons explaining this phenomenon[925]. First, the vast majority of Canadian companies can meet their capital requirement by tapping into markets in this country. Second, with a few exceptions, Canadian companies are not well-known to U.S. investors and it can take a long time to raise their American profile before a cross-border offering is feasible[926]. Third, the Canadian recession (the beginning of which

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923 Canadian bank-owned dealers expressed the view that "[i]f the U.S. banks and investment firms are allowed to do certain things in Canada, we think it should be a level playing field [in the U.S.]." Their submission was supported by the CBA in a letter to the OSC. H.D. WHYTE, "Cross-border Equities Plan May Hurt Canada's Dealers" *The Financial Post [of Toronto]* (13 July 1990) 10.

924 See JORDAN, *supra*, note 452 at 389.

925 JORDAN, *supra*, note 441 at 25.

926 D. KELLY, "New Setup Panned" *The Financial Post [of Toronto]* (1 October 1991) 16.

coincided with the introduction of the MJDS) has been longer and deeper than the U.S.'s. Consequently, many Canadian companies did not qualify for the MJDS[927]. Fourth, the necessity for Canadian issuers to have financial statements that are in conformity with U.S. generally accepted accounting principles (hereinafter GAAP) has been a costly and time-consuming process[928]. At first, Canadian securities firms were confident that the MJDS would not be detrimental to them[929]. However, due to the fairly infrequent use of the MJDS by Canadian issuers, *"Canadian dealers, (despite the existence of operations in the U.S.) have been virtually shut out of the U.S. syndicates for MJDS distributions of Canadian securities in the United States"*[930]. Canadian dealers may have been partly responsible for their exclusion of U.S. syndicates[931]. However, the MJDS should have come with a reciprocal recognition of broker-dealers. In Canada, this problem is in the process of being addressed.

In order to ease Canada-U.S. cross-border trading, the CSA and Canadian SROs are developing new techniques helping Canadian brokers to compete for additional business from various local and foreign sources. For example, the TSE has recently

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927 In early 1993, the OSC and the SEC considered reducing the "threshold" requirement to accommodate Canadian issuers. E. REGULY, "Free Trade Not "Hot" in Securities Sector" *The Financial Post [of Toronto]* (13 March 1993) 22. However, nothing concrete emerged from these discussions.

928 In 1993, the first steps towards addressing this problem came in the form of a report prepared by the Office of the Chief Accountant of the OSC. See *Notice — Report of the Study of Differences Between Canadian and United States Generally Accepted Accounting Principles*, (1993) 16 O.S.C.B. 2195. On the re-thinking of the OSC's approach to foreign issuers and GAAP reconciliation, see *Notice — Remarks of Joan Smart Made to the International Conference on Strengthening Capital Markets in Latin America: The Ontario Experience: Coming to Grips With Financial Reporting Issues in a Global Market*, (1992) 15 O.S.C.B. 5795.

929 "[...] Canadian underwriters won't disappear under free trade because they know Canadian stocks better and often can place them more expertly than their U.S. counterparts. That means smart Canadian issuers will ensure Canadian dealers are included in their U.S. syndicate. It also means that American companies that want to sell securities in Canada will be loath to eliminate Canadian underwriters from their team. Bay Street has developed a vast distribution system in Canada; Wall Street has not, nor is it likely to." E. REGULY, "Securities Dealers Are Safe Under Free Trade" *The Financial Post [of Toronto]* (28 June 1991) 11.

930 JORDAN, *supra*, note 694 at 50.

931 Generally, "[...] the Canadian dealer community's view [the] use of the MJDS by Canadian issuers [to be] detrimental to Canadian dealer interests. Better to keep the transaction in Canada than to risk being frozen out of a large U.S. tranche by U.S. dealers." JORDAN, *supra*, note 441 at 30.

amended its policies to extend the class of "eligible clients" to qualified institutional buyers under Rule 144A and to domestically registered investment counsellors and portfolio managers[932]. For its part, the OSC has proposed a waiver of certain requirements for sales persons (and their supervisors) registered and resident in the U.S.[933] Subject to compliance of some requirements, such persons could register with the OSC and be subject to dual supervision by the U.S. broker-dealer and its affiliated Canadian dealer. Here, all transactions with Ontario residents and the issuance of confirmations and statements would be the responsibility of the Canadian dealer[934]. Subject to access by the OSC, record-keeping functions could be kept outside of Canada[935].

Following these Canadian initiatives, it is possible that the SEC may be in favour of re-examining an interesting concept release (which appears to have been abandoned some years ago) on the recognition of foreign broker-dealers[936]. At the same time when Regulation S, Rule 144A and the MJDS were being drawn, the SEC proposed (and requested comments on) the concept of a conditional exemption from registration for certain foreign broker-dealers located in foreign countries: (i) that have regulatory schemes comparable to that provided by the Exchange Act; and (ii) whose local securities authority and the SEC have in place a MOU or treaty providing "*the fullest mutual assistance possible*"[937]. For many years, the CSA (as well as the IDA and

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932 See Amendment to Part XXX of the TSE Policies (29 March 1994). "It should be noted that an eligible client must still utilize the services and facilities of a TSE member to enter orders into the Exchange. Interestingly, a proposal to extend the class of eligible clients to U.S. broker-dealers was rejected by the Exchange's Board of Governors." *Notice — Remarks of Edward J. Waitzer, Chairman of the OSC - April 8, 1994: "International Securities Regulation - Coping with the "Rashomon Effect""*, (1994) 17 O.S.C.B. 1719 at 1722 n. 16.

933 *Notice — Review of Residency Requirements for Salespersons and Supervisors of Registered Canadian Subsidiaries of U.S. International Dealers*, (1994) 17 O.S.C.B. 1215.

934 "Rashomon", *supra*, note 932.

935 Note that this proposal differs from the OSA's "international dealer" registration category which allows the dealing in certain securities with specified institutional clients without the need for substantive requirements for registration.

936 SEC Release N° 34-27018 (11 July 1989).

937 Note that on the same day that Release N° 34-27018 was made public, the SEC adopted a series of exemptions available to foreign broker-dealers regarding registration requirements. See SEC Release N° 34-27017 (11 July 1989). GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 368ff.

TSE) has been asking the SEC to exempt Canadian dealers from Rule 15a-6[938] that limits the activities of foreign brokerage firms in the U.S.[939] It has been suggested that the SEC did not pursue this line of thinking because of pressures by U.S. registered broker-dealers who may not have wanted to be at a disadvantage in competition with foreign broker-dealers subject to a less restrictive scheme[940]. Still, these initiatives and proposals recognize a growing desire by several market participants to be fully recognized, particularly when adequate standards apply elsewhere.

On the issue of how much freedom Canadian investment dealers have in the U.S., the IDA has been very frustrated by what it sees as American protectionism in the securities market. Essentially, the IDA has argued that, despite the coming about of the MJDS, U.S. dealers have much more flexibility and freedom in Canada than Canadian dealers in the U.S. In Ontario, the only thing that a U.S. dealer has to do is to go through the relatively easy process of registering as an international dealer with the OSC. However, if a Canadian firm wants to tap into the vast U.S. market, it has to go through the laborious and expensive process of setting up a Wall Street subsidiary, (with employees and capital) and making sure it complies with the rules of the SEC, state regulators and the NYSE. The other option open for a Canadian dealer is to forge a link with a U.S. firm that will act as its "provider" by booking the Canadian firm's orders (of course, in return for a commission). In the end, even if a Canadian firm becomes a full U.S. registrant, the GSA puts a strangle on its permissible activities. Despite these many clear differences, Canadian dealers have had difficulties levelling the existing playing field. First, Canadian firms cannot exactly be called powerhouses in the U.S. Thus, they have little influence over the SIA, the SEC and the dismantling of the GSA. Second, the U.S. firms see GSA as a fact of life

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938 On the same day that SEC Release N° 34-27018 was made public, the SEC adopted SEC Release N° 34-27017 (11 July 1989) which is cited as "Rule 15a-6 Adopting Release". See also SEC Release N° 34-25801 (14 June 1988) which is cited as the "Rule 15a-6 Proposing Release".

939 H.D. WHYTE, "Canadian Dealers Seek Financial U.S. Status" *The Financial Post [of Toronto]* (18 June 1990) 3.

940 GREENE *[et al.]*, Vol. 1, *supra*, note 47 at 380.

which does not discriminate against Canadian dealers but treats everyone the same[941]. In the meantime, there has been a Canadian concern that the GSA puts Canadian bank-owned dealers at a disadvantage in competing for underwriting assignments when Canadian issuers use the MJDS to finance in the U.S. As a result of the GSA, these dealers are currently subject to various restrictions on their U.S. underwriting activities (which includes a limit on the dollar volume). This revenue limit was arrived at by the FRB because Section 20 of the GSA prohibits a member bank of the FRS from being affiliated with any corporation which is "engaged principally" in underwriting or distributing securities. Because the 10% revenue ceiling currently in place, these underwriting subsidiaries typically are the principal vehicles of the affiliated banks and BHCs for underwriting and dealing in eligible securities[942]. The greater the revenue derived from eligible securities activities, the greater the amount of revenue that can be derived from ineligible securities activities. A Canadian chartered bank or a Canadian-controlled registered BHC which already engages to a significant extent in underwriting and dealing in Canadian bonds of the types which have become eligible securities as a result of the FTA, and which seeks to expand its securities activities in the U.S., could use its activities in Canadian bonds which are eligible securities as the base for supporting ineligible securities activities. Moreover, the securities affiliates of U.S. BHCs may be expected to have greater interest in underwriting and dealing in these kinds of Canadian bonds because of the benefits for their ineligible securities business.

At about the time the FTA was implemented, the Canadian bank subsidiaries saw the 10% limit as constituting an important restriction. In that regard, the U.S. position was difficult to understand in view of the fact that: (i) most U.S. brokers were not faced

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941 However, note that "[o]ne reason why calls for repeal of [the GSA] have recently become louder is that the [FRB]'s habit of granting banks *ad hoc* [Section 20] exemptions was seen as a poor way of making public policy." "Trading Places" A Survey of Wall Street *The Economist* (15 April 1995) 26 at 28.

942 "The chief source of revenue attributable to eligible securities activities [...] is government securities activities. Activities with respect to these securities are generally intensely competitive and have low profit margins. [As a result,] §20 [a]ffiliates that are part of a foreign bank organization are particularly disadvantaged in expanding eligible securities activities, and thus ineligible revenues, since activities in U.S. government securities [...] do not form as relatively large or as natural an asset base for foreign banks as they to do for U.S. banking organizations [...]". GREENE *[et al.]*, Vol. 2, *supra*, note 47 at 730-731.

with such restrictions (not being owned by banks); and (ii) the U.S. and Canadian securities regulators were near an agreement on the MJDS. Considering that, under the MJDS, a company wanting to sell a stock or debenture issue in both countries would have to prepare only one set of regulatory documents (in its own country), the Canadian bank subsidiaries saw this new convenience as an "inconvenience" to them[943]. Hence, its was argued that the MJDS would encourage Canadian corporations to attempt more cross-border offering, tapping the big U.S. market without the extra cost of dual filings. Under the 10% rule, a bank-backed broker might find itself unable to bid for the U.S. slice of such an issue. It might thus lose the whole deal, and the client, to a U.S.-based rival or one of the few Canadian brokers not linked to a bank. That is why certain Canadian banks made a novel sort of a plea to the FRB on behalf of their securities arms.

In a new set of applications[944], the banks said their subsidiaries deserved a special "Canadian-only" break. They wanted to be allowed to handle any volume of Canadian corporate securities in the U.S. without worrying about the 10% limit. As they saw it, this would at least give them a fair shot at winning business from their "natural" clientele (i.e. Canadian corporations) and would partly offset what they regarded as an imbalance in the U.S. policy[945]. In the end, the Canadian requests remained unanswered by the FRB, probably considering them to be premature and inappropriate.

At the time NAFTA was negotiated, The Canadian Department of Finance clearly indicated that Canada was pressing for the right of Canadian bank-owned securities dealers to compete for U.S. corporate public financing[946]. It is plausible that the inflexibility of the U.S. to continue to ease these restrictions may have created an insecure climate for the negotiation of Chapter Fourteen with respect to cross-border

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943 J. SAUNDERS, "Banks Call for Removal of U.S. Barriers" *The [Toronto] Globe and Mail* (20 October 1990) B5.

944 (1990) Fed. Res. Bull. 3240.

945 As the RBC's filing put it: "[t]he 10[%] revenue limitation is a virtually perfect example of a regulatory constraint that is even-handed in concept but operates in practice to deny equality of competitive opportunity".

946 "Canada Makes Gain in NAFTA: Financial Sector has Mexican Entry" *The [Toronto] Globe and Mail* (26 June 1992) B1 at B2. "Greater Disclosure sought by Exchanges: Global Training on the Increase" *The [Toronto] Globe and Mail* (24 June 1992) 4.

activities of securities firms. However, a recent initiative has been undertaken by twenty U.S. banks and ten foreign institutions to pressure the FRB for permission to expand their securities-related businesses may benefit the Canadians[947]. In essence, the banks want to see a raise in the revenue cap (from the present 10% to 25%) of the total revenues a BHC subsidiary may derive from ineligible securities underwriting and dealing activities. Although the FRB has yet to respond to the request of raising the revenue cap to 25%, it has recently suggested changes in the way the 10% cap is calculated[948].

The most recent initiative undertaken by some Canadian banks to increase their amount of corporate underwriting and other private-sector investment banking business in the U.S. has been to apply for a licence to act as primary dealers[949]. There are currently 38 primary dealers in the U.S. and only B of M (through its Chicago-based subsidiary Harris Bankcorp Inc.) is Canadian[950]. By being able to underwrite U.S. treasuries, Canadian banks could more easily develop revenues from "eligible activities".

Since the middle of 1991, the CSA has been monitoring the effects of the MJDS on the Canadian dealer community[951]. Many months after the review date of the MJDS, there has not been a demonstration of any material adverse effect on the Canadian dealer community which would justify the CSA and the SEC to commence rule-making proceedings to alleviate such adverse effects. Nevertheless, under NAFTA, these securities firms may wish to point out that they do not enjoy ECO with securities firms owned by major U.S. banks due to the relatively limited extent of the eligible underwriting activity in the U.S. by the Canadian-owned firms. Thus, NAFTA leaves

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947 "U.S. Lenders Seek More Securities Business" *The [Toronto] Globe and Mail* (19 July 1994).

948 Instead of using total revenues as a base, the FRB has proposed using total assets or sales volume as a base. See (1994) 59 Fed. Reg. 747.

949 J. PARTRIDGE, "CIBC Wants to Underwrite U.S. Treasuries" *The [Toronto] Globe and Mail* (12 July 1995) B2.

950 *Ibid.*

951 According to the final text of the MJDS, as it was implemented in 1991, Canada and the U.S. agreed that "[t]he CSA will monitor the effect of the MJDS and obtain input from Canadian dealers and otherwise monitor the dealer community." SEC Release N° 33-6902 at 30049-30050. Although specifically mandated in the implementation of the MJDS, it is unclear if the CSA has thoroughly reviewed the system to measure its impact on Canadian-owned dealers. JORDAN, *supra*, note 441 at 29 & 30.

unclear the question of the GSA's compliance with a broad principle of *de facto* national treatment. At one point during NAFTA negotiations, cooperation between the SEC and the CSA was moving in the direction of U.S. recognition of Canadian broker-dealer requirements. However, this all changed with Canadian concerns about the lack of any Canadian Nationally Recognized Statistical Rating Organizations (hereinafter NRSROs), the most important ones being the Canadian Bond Rating Service (hereinafter CBRS) and the Dominion Bond Rating Service (hereinafter DBRS).

Hence when the MJDS was implemented, the CSA determined that for a period of one year, Canadian issuers would be required to have their debt and preferred securities rated by one of the Canadian rating organizations prior to an offering of their securities being made using Form F-9[952] adopted by the SEC under the MJDS[953]. This requirement was adopted because Canadian bond rating agencies were not recognized as NRSROs by the SEC and, therefore, securities of Canadian issuers would need to be rated by one of the U.S. rating organizations if such securities were offered in the U.S. using Form F-9[954]. The expiry date for this requirement was extended until November 30, 1993 because the Canadian bond rating organizations had not yet been recognized as NRSROs, although they actively pursued recognition with the SEC[955]. This recognition finally occurred in late

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952 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 7032 (1 July 1991). MJDS, General Instructions I.B., Instruction 2. Note that the U.S. MJDS introduced Securities Act Registration Form F-7, F-8 and F-10 available to qualified Canadian private issuers.

953 "Form F-9 is limited to investment grade debt securities or preferred stock offered for cash or in connection with an exchange offer by a Canadian private issuer or crown corporation that has been subject to the continuous disclosure requirements of any Canadian securities commission or equivalent regulatory authority for thirty six consecutive months [...] and is currently in compliance with such reporting requirements [MJDS, General Instruction I.A - I.B.]. The investment grade refers to the four highest grades accorded by at least one nationally recognized statistical rating organization. [MJDS, General Instruction I.A.]." H.S. BLOOMENTHAL & S. WOLFF, *The Multijurisdictional Disclosure System and Other Cross-border Offerings*, (1992) 20 Denv. J. Int'l L. & Pol'y 551 at 557.

954 C. JORDAN, "Benefits of Cross-border Security Law" *The Financial Post [of Toronto]* (9 September 1991) 6. Note that the SEC is presently considering dropping the NRSRO tag entirely, thus creating a free market in ratings. "Rating the Rating Agencies" *The Economist* (15 July 1995) 53 at 54. "Will the Agencies Be SEC Puppets" *Euromoney* (November 1994) 26.

955 Section 7 of the Canadian MJDS as modified by *National Policy Statement N° 45 - Multijurisdictional Disclosure System (NPS N° 45) Canadian Rating Organizations*, (1993) 16 O.S.C.B. 2819; *Instruction générale n° C-45*, Decision N° 93-C-0203,

1993[956].

On another front, the MJDS forces Canadian dealers to adapt to a series of new rules and affects the habits of their top executives. Not surprisingly, the greatest impact of the MJDS has been on the Canadian domestic securities regime. In essence, the "Canadianization" of U.S. domestic rules implemented by the MJDS has been intended to ease the regulatory burden imposed by duplication. Apart from the introduction of a national shelf prospectus, pressures of convergence between the Canadian and U.S. systems have not diminished since the introduction of the MJDS. The system has led to a certain harmonization of both prospectus disclosure and continuous disclosure. Certain changes to U.S. short form prospectus eligibility requirements has resulted in changes to the MJDS and the domestic Canadian prompt offering prospectus (POP) system[957]. In addition, the MJDS introduced into Canada a furious debate[958] over disclosure on executive pay[959]. Until the year the MJDS came into effect, several Canadian-based companies had to disclose individual executive salaries because their shares traded in the U.S. and they were bound by the regulation of the SEC. In 1991, the SEC gave Canadian companies the choice of following its regulations or those of their home jurisdiction. Many Canadian companies chose to follow Canadian rules, which required less disclosure. However, Canadian shareholders of public corporations wanted to see the installation of a regime similar

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(1993) 24:27 B.C.V.M.Q. 4.

956 Consequently, the requirement that debt and preferred securities offered by a Canadian issuer using the U.S. MJDS Form F-9 receive a rating by CBRS and DBRS was deleted. One other important amendment to the Canadian MJDS consisted in reducing the reporting history requirement from 36 months to 12 months for debt and equity offerings. With these changes, the Canadian MJDS conformed to that of the U.S. *Modification de l'Instruction générale n° C-45–Régime d'information multinational (Amendment of National Policy Statement N° 45 — Multijurisdictional Disclosure System)*, Decision N° 93-C-0399, (1993) 24:47 B.C.V.M.Q. 9.

957 JORDAN, *supra*, note 441 at 31.

958 H.D. WHYTE, "Cross-border Plan Hides Pay of Executives" *The Financial Post [of Toronto]* (3-5 November 1990) 1.

959 For a history of this debate, see *Notice — Remarks of Edward J. Waitzer, Chairman of the OSC at Executive Compensation Disclosure Insight Conference, Toronto: "Who's Afraid of Pay Disclosure?"*, (1994) 17 O.S.C.B. 490 at 490. M.R. COHEN & R.B. PAVALOW, "Disclosure of Executive Compensation" *Canadian Financial Services Alert* (January 1994) 45.

to the one existing in the U.S.[960] in order to evaluate the compensation given to each top executive and be able to judge the truth of a company's claim when it said it was reducing executive compensation because of declining performance[961]. For their part, executives opposed fuller disclosure on the grounds of infringement on privacy[962].

In the latter part of 1993, the government of Ontario, whose securities law sets the standard generally followed in the rest of the country, decided to move forward and adopted an OSC proposal[963] which was very much like the U.S. model.[964]

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960 "The [MJDS] [...] eliminates lot of paperwork [...]. But loss of the salary disclosure feature for large Canadian companies subject to SEC filing is regrettable. The situation could easily be remedied if Canadian regulators imposed a more complete disclosure requirement on Canadian companies. Why do they not see the shareholder interest in such disclosure?" EDITORIAL, "Too Much Secrecy on Top Salaries" *The Financial Post [of Toronto] (6 November 1990) 14.*

961 The debate over compensation disclosure has been connected with the one over corporate performance or compensation. See generally, "A Survey of Corporate Governance" *The Economist* (29 January 1994). For a Canadian perspective of the debate, see INSIGHT CONFERENCE, *Executive Compensation Disclosure* (Toronto, Ont.: Insight, 1994). *Notice — Edward J. Waitzer, "What's Right About Corporate Governance?"*, (1993) 16 O.S.C.B. 5575 at 5576. E. HEINRICH, "Regulator Warns Boards" *The Financial Post [of Toronto]* (14 September 1993) 5. T. CORCORAN, "Fad or Not, Corporate Governance is Hot" *The [Toronto] Globe and Mail* (24 August 1993) B2.

962 For an opinion against disclosure, see J.D. McNEIL, "Why Make Executives Disclose Their Salaries?" *The [Toronto] Globe and Mail* (29 October 1993) A21.

963 *Press Release — Ontario Moves to Individual Disclosure on Executive Pay*, (1993) 16 O.S.C.B. 5126. See also *Notice — Disclosure of Executive Compensation*, (1993) 16 O.S.C.B. 5886. J. FERRABEE, "Disclosure Opens Debate On Top Executive's Salaries" *The [Montreal] Gazette* (18 December 1993) C1. T. VAN ALPHEN, "Veil Lifted On Top Bosses' Pay" *The Toronto Star* (15 October 1993) E1. J. RUSK, "CEOs Required to Reveal Salaries" *The [Toronto] Globe and Mail* (15 October 1993) B1. B. POWELL, "Ontario Executives Will Have to Reveal Salaries Under New Rules" *The [Montreal] Gazette* (15 October 1993) B4. P. WALDIE, "Pay Disclosure Called Dangerous" *The Financial Post [of Toronto]* (15 October 1993) 3. D. KELLY, "Ontario Lifts Lid on Executive Pay" *The Financial Post [of Toronto]* (15 October 1993) 1. B. MOONY, "Des compagnies canadiennes ne divulguent plus la rémunération de leurs dirigeants" *Les Affaires [of Montreal]* (17 April 1993) 2. M. GIBB-CLARK, "Investors Seek More Disclosure of Executive Pay" *The [Toronto] Globe and Mail* (18 March 1993) B5. Surprisingly, Quebec did not follow in the footsteps of Ontario. "Remuneration of senior executive officers is a legitimate concern for corporation's shareholders. [...] The scope of this shareholders' right, however, must take into account the situation of senior officers of business in Quebec, the vast majority of which are small or medium-sized business." QUEBEC, Ministry of Finance, *Quinquennial Report on the Implementation of the Securities Act* (Quebec, Que.: Ministry of Finance, 1993) at 33. K. DOUGHERTY, "Ontario Urged to Rethink Disclosure" *The Financial Post [of Toronto]* (22 December 1993) 15. J. HEINRICH,

Consequently, executives of major Canadian corporations (like financial institutions) found themselves complying indiscreet compensation disclosure rules.

In a nutshell, it is fair to say that with the FTA and NAFTA, the Canadian securities industry had a golden opportunity to obtain a special treatment with respect to the GSA. However, despite the fact that Canada did not fully benefit from this chance, the GSA (which seemed doomed in the mid-1980s) does appear to be on its way to crumble soon. Although certain members of Congress, mindful of the collapse of the savings and loan industry and the near collapse of the banking industry, are fearful of exposing government-insured banks to the riskier business of securities underwriting and trading, new pressures are being exerted on Congress to have the GSA abolished within a few years (if not months)[965]. Still Canadian dealers, by continuing to pressure the U.S., could force changes in areas beyond the scope of the GSA. For instance, in view of the MJDS, Canadian dealers ought to convince the Americans that they could sell Canadian securities in the "secondary" market to U.S. registrants without having to become full-fledge U.S. registrants or employ a U.S. "provider". Moreover, the 10% underwriting restriction could become more flexible.

However, the Canadian crusade promises to be long and difficult. Negotiations over access by U.S. firms to video screen systems of Canadian inter-dealer bond

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"Salaries Should Be Secret: Robic" *The [Montreal] Gazette* (22 December 1993) D1. For reactions of Quebec's stance, see J. HEINRICH & L. WARWICK, "Quebec's Disclosure Position Could Be Harmful" *The [Montreal] Gazette* (24 December 1993). However, the newly-elected Quebec government has indicated that it would favour a system like that of the U.S. V. BEAUREGARD, "Salaire des cadres: Campeau veut la transparence" *La Presse [of Montreal]* (29 October 1994) C1. For a comment of these rules, see R.J. DANIELS, *Compensation, Accountability, and Disclosure: An Assessment of the Revisions to the Securities Act Regulations Governing Executive Compensation*, (1994) 2:1 Corporate Financing 3.

964 H.D. WHYTE, "New Rules Mirror More Detailed U.S. Regulations" *The Financial Post [of Toronto]* (15 October 1993) 3. However, in the case of Ontario, publicly traded companies only have to disclose the salaries of their CEO and their four other highest paid executives.

965 See, *e.g.*, "Break Glass-Steagall" *The Economist* (1 July 1995) 15. "A Wall Not Yet Shattered" *The Economist* (24 June 1995) 66. "America's Latest Financial Fling" *The Economist* (24 June 1995) 65. "The Walls Come Down" *The Banker* (June 1995) 22. R. WATERS "Big U.S. Banks Eye Wall Street Brokers as Deregulation Nears" *The Financial Post [of Toronto]* (4 May 1995) 5. "Breaking Glass-Steagall" *The Economist* (4 March 1995) 77. K. BRADSHER, "White House Is Joining in Efforts to Loosen the Limits on Banking" *The New York Times* (27 February 1995) A1. "Banking on Change" *The Economist* (19 November 1994) 87.

brokerages are a case in point. The screens set a market by displaying anonymous bid and ask prices for government bonds. Many years ago, the bond screens were penetrated by U.S. dealers who obtained a free and unregulated ride into Canada's insider market for bonds. In 1992, after more than two years of heated disputes, a compromise was struck[966]. The U.S. dealers would retain their access to the bond screen — in exchange they would have to pay a fee to the IDA and the Canadian Investor Protection Fund (hereinafter CIPF). In the end, this deal may be viewed as unfair because Canadian dealers do not have easy access to the U.S. bond market. However, Canadians know (perhaps more than anyone) that the Americans are tough bargainers when comes the time to negotiate matters relating to securities regulation. Nevertheless, there are cases when the Americans must adapt themselves to the current situation in Canada. For instance, the huge Canadian debt is forcing international primary dealers (including the U.S. ones) to change certain ways in which they to business.

3. The Evolutionary Presence of American Dealers in Canada

For many years, several major U.S. and other foreign securities firms have been expanding or opening branch offices in Toronto or Montreal. Ever since the deregulation of Canada's securities industry, the presence of these firms has been constant[967]. At the early stage of the reform, Canadian brokers feared that American, European and Japanese securities houses would overrun Canadian capital markets once they became deregulated[968]. At one point, the OSFI became

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966 D. KELLY, "IDA Makes Regulatory Deal With U.S. Firms" *The Financial Post [of Toronto]* (7 February 1992) 4. "IDA, U.S. Brokers Close to an Agreement" *The [Toronto] Globe and Mail* (30 November 1991) B6. Earlier, the IDA dropped its demands that U.S. firms be required to open subsidiary offices in Canada and become members of the IDA.

967 For a brief overview of the many foreign dealers operating in Canada, see, *e.g.*, ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra*, note 224 at 17-18. A. HUSDAL ed., *The Guide to the Canadian Financial Services Industry, 1995* (Toronto, Ont.: Globe Information Services, 1995) 3-6.

968 "U.S. Domination Called Threat to Financial Firms" *The Toronto Star* (22 November 1989) F1. M. MITTELSTAEDT, "Foreign Brokers Plan Canadian Presence" *The [Toronto] Globe and Mail* (4 April 1989) B4. J.-P. DÉCARIE, "Les étrangers viendront, viendront pas?" *Le Journal de Québec* (21 February 1989) 22. J.-P. DÉCARIE, "Les firmes de courtage américaines courtisent le marché francophone" *Le Journal de Québec* (20 February 1989) 21.

concerned that a certain number of troubled Canadian financial institutions could become takeover targets for U.S. concerns[969]. That fear has since subsided[970]. The big brokers now have even bigger Canadian banks behind them, while others have decided to forge ties with foreign banks. Hence, most Canadian brokers have recognized their own strategic vulnerability, which was due to their weak capitalization and lack of size. Their response has been to seek mergers with the much larger and, generally, more internationalized commercial banks. Such linkages improve the capability of the dealers to participate in the evolving global markets, and to compete against foreign brokers in the domestic market. Nevertheless, what the Americans have going for them in the equation is something most Canadian ones no longer have: independence. Although the Canadians may feel better placed financially because of the backing of their owners, it must be underlined that universal banks (involved in every financial service possible) do not necessarily stimulate competition or creativity. Still, the Canadian bank-broker firms have now become leaner, meaner and a lot hungrier.

The Canadian securities industry has evolved to become an oligopoly: the large

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969 "Regulator Worries About U.S. Buying Financial Firms" *The [Montreal] Gazette* (11 May 1989) H5. "Financial Institutions "Vulnerable" to U.S. Bids" *The Financial Post [of Toronto]* (11 May 1989) 5.

970 For example, this was certainly the case when, at one time, a big U.S. firm closed its Canadian retail operations. A. SHORTELL, "Global Brokerage Never Made Sense" *The Financial Times of Canada* (3 December 1990) 6. B. CRITCHLEY, "Merrill Lynch Canada Tumbles From Top to Status of Bit Player" *The Financial Post [of Toronto]* (4 January 1990) 1. A. WILLIS, "Sale Seen As Sign of Tough Competition Among Brokers" *The Financial Post [of Toronto]* (4 January 1990) 4. M. MITTELSTAEDT, "Securities Firms Reorganize for Tough Times" *The [Toronto] Globe and Mail* (4 January 1990) B1. More recently, other foreign firms abandoned the idea of expanding into Canada. See, *e.g.*, D. SLOCUM, "Bank of America Sells Burns Stake: Bank of Montreal Paying $103.7 Million for 25.7% of Canadian Brokerage" *The [Toronto] Globe and Mail* (19 July 1994) B10. G. IP, "BankAmerica Cuts Burns Fry Stake" *The Financial Post [of Toronto]* (27 January 1994)3. D. SLOCUM, "U.S. Firms Sells Midland Stake" *The [Toronto] Globe and Mail* (21 May 1994) B1. Still, Canadian-owned firms ought to be concerned with the most recent move undertaken by Goldman Sachs Canada Ltd. to become the only U.S.-owned investment house to do equity trading in Canada. J. McFARLAND, "Goldman Sachs to Launch Equity Trading in Canada" *The Financial Post [of Toronto]* (18 January 1995) 3. Moreover, some very relaxed rules put in place recently by the OSC may have something to do with further involvements by foreign brokers. K. HOWLETT, "OSC Removes Residence Rules for Brokers" *The [Toronto] Globe and Mail* (2 September 1995) B1. J. McFARLAND, "OSC Opens Door to U.S.-based Brokers with Change in Residency Requirements" *The Financial Post [of Toronto]* (2 September 1995) 13.

houses dominate the Canadian market, and a handful of small boutiques handle the few remaining leftovers. For their part, foreign dealers fill the vacuum in between[971]. The foreign firms are generally well capitalized and have highly internationalized operations. Many firms are financial innovators, with such innovation providing their competitive advantage. They draw on a large pool of experience in financial product technology. However, Canadian domestic markets are viewed as secondary targets because most corporate Canadian firms are not considered to be very big. Thus, the focus of foreign investment dealers has generally been non-corporate mandates[972]. Essentially, Canada has become very attractive for non-Canadian firms because of the size of the soaring federal and provincial deficits[973].

In Canada, current account deficits and corresponding growth of foreign debt are a major source of concern[974]. At the end of 1994, half of Canada's external liabilities was in the form of portfolio investment (mostly bonds)[975]. Foreign portfolio investment in Canadian bonds is not a new phenomenon. Its rapid growth can be traced back more than 40 years[976]. Now, holdings by foreigners are gigantic. By the end of 1994, non-residents held Cdn $301 billion of Canadian bonds (meaning more than 33% of all bonds outstanding)[977] including Cdn $235.1 billion in government bonds alone[978].

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971 N. BRADBURY, "Playing Lean and Mean in Canada" *Euromoney* (November 1993) 92.

972 ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra*, note 224 at 17.

973 J. McFARLAND, "U.S. Brokers Make Move Back Into Canada" *The Financial Post [of Toronto]* (27 June 1995) 16. S. DE SANTIS "Canadian Brokers Bolster for Wave of U.S. Competitors" *The Wall Street Journal [of New York]* (4 April 1995) B4. J. WILLOGHBY, "U.S. Investment Banks Go North In Race For Canadian Business" *Investment Dealers Digest* (13 March 1995) 5. K. HOWLETT, "Foreign Invasion of Bay Street Continues" *The [Toronto] Globe and Mail* (9 March 1995) B1. J. McFARLAND, "U.S. Dealers Invading" *The Financial Post [of Toronto]* (17 January 1995) 1. J. McNISH, "U.S. Brokers Invading Canada". *The [Toronto] Globe and Mail* (22 July 1994) B1.

974 On the Canadian deficits and debt owed to foreigners, see *supra*, note 591 at 460.

975 The other half comprised of one quarter in the form of direct investment and the other quarter of foreign capital was widely spread in Canadian financial markets. Statistics Canada, Catalogue N° 67-202 (1994), Table 1 at 54.

976 Statistics Canada, Catalogue N° 67-202 (1926 to 1992), Table 48 at 133.

977 Statistics Canada, Catalogue N° 67-202 at 20.

978 Statistics Canada, Catalogue N° 67-002, Canada's International Transactions in Securities, 1995, Table 19 (Non-resident Holdings of Canadian Bonds by Sector) at 40.

On the domestic level, Canadian dealers are generally chosen to lead a debt issue[979]. However, because of the magnitude of the debt, Canadian governments wishing to tap the international markets have generally preferred to use foreign firms (which can do a faster job due to the specific expertise they possess). Over the past few years, most of that debt was sold by U.S. dealers. Traditionally, they have sold Canadian governments debt from their trading desks in New York[980]. Now, U.S. dealers are expanding into Canada so as to obtain a larger share of commissions earned by selling the securities to foreign investors. Increased competition and some political pressure have caused U.S. dealers to set up shop in Canada[981]. As U.S. dealers earn bigger commissions from the rising tide of government debt sales outside Canada, Canadian governments have asked their U.S. underwriters to increase their Canadian operations if they wanted to keep their business[982]. Thus, only brokers with Canadian offices can qualify as primary underwriters of Bank of Canada debt issues[983].

Having said this, the Canadian mutual fund industry is also reacting to the changes

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979 For example, under the rules laid down by the province of Ontario, only six chosen dealers are allowed to put up a proposal and lead a financing in the domestic markets. B. CRITCHLEY, "Richardson Greenshields' Chance to Lead" *The Financial Post [of Toronto]* (9 August 1994) 5. Note that in this case, Canadians ought to remember the obvious reciprocity considerations. "If the authorities choose to exclude particular foreign [securities] firms from operating in their domestic securities markets, then their domestic firms may be excluded from the foreign market concerned. Thus [, at one time,] Canadian (i.e. Ontario) securities firms [were not] allowed to manage an issue of securities in London because British-controlled subsidiaries in Canada [were not] allowed to lead an underwriting in Toronto". R.C. de GREY, *The Service Agenda* (Halifax, N.S.: Institute for Research on Public Policy, 1990) at 110.

980 For a brief historical account, see, *e.g.,* B. CRITCHLEY & B. BAXTER "Merrill Trims Duties of Canadian Subsidiary" *The Financial Post [of Toronto]* (7 February 1989) 48.

981 M. INGRAM, "Salomon Sets up Bond Trading Office" *The [Toronto] Globe and Mail* (19 June 1994) B2. According to the head of Salomon Brothers Inc.'s Canadian Unit: "[...] if you look at the growth since 1989 in provincial and federal debt, "it just made sense" to come to Canada".

982 "Morgan Stanley triple sa présence au Canada" *Les Affaires [of Montreal]* (18 March 1995) 53. J. FERRABEE, "Morgan Stanley Reopens Office Here to Expand Its Bond Business" *The [Montreal] Gazette* (11 March 1995) G4. M. INGRAM, "Morgan Stanley Expanding in Canada" *The [Toronto] Globe and Mail* (5 October 1994) B5. V. BEAUREGARD, "Le courtier new-yorkais Morgan Stanley prévoit s'installer à Montréal" *La Presse [of Montreal]* (21 July 1994) A1.

983 "To be registered [with the Bank of Canada to underwrite Canadian government bonds and Treasury bills] [...], foreign firms must have an active presence in the domestic securities markets." ECONOMIST INTELLIGENCE UNIT, *FFO (Canada), supra*, note 224 at 14.

brought about by North American free trade. With the U.S. firms being fiercely active during the post free trade era, Canadians are rapidly changing their approach to the "game".

CHAPTER II: The Changing Face of the Mutual Fund Industry

The investment world keeps changing as many American mutual fund giants are rapidly expanding their operations in the U.S. and abroad. Many portfolio managers running mutual funds or pension funds are abandoning their low inflation economies and financing the more profitable efforts of those in poorer countries (who will furnish the rich countries with cheap goods)[984]. In essence, there is currently a massive redistribution of wealth[985]. Over the past decade, FDIs have increased drastically in middle-income and poor nations. Portfolio investments have also grown rapidly. Fuelling this phenomenon are mutual funds and American Depository Receipts (hereinafter ADRs)[986].

Its been said that North American free trade in mutual funds (and the benefits that could result for Canadians) would take years (if ever) to happen[987]. Many reasons can explain this delay. In order to play by Canadian rules, U.S. companies had to establish subsidiaries (meaning hire employees and invest capital). Still, in the early 1980s, many American firms attempted to expand into Canada. However, most

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984 Because their money is more fluid, big U.S. mutual funds are showing increasing clout in developing countries (particularly Latin America). Essentially, they are trying to pressure governments to adopt a series of policies that will maximize their returns. G. TERRIES & T.T. VOGEL Jr., "The Long Arm of the Funds" *The [Toronto] Globe and Mail* (17 June 1994) B1.

985 On the recent Canadian popularity of Latin American funds, see, *e.g.,* R. LUKKO, "Why the New Emerging Funds Are So Hot" *The Financial Times of Canada* (22 October 1994) 11. J. CHEVREAU, "Latin American Funds Buoy Summer Mutual Fund Turnaround" *The Financial Post [of Toronto]* (17 September 1994) 24.

986 ADRs are tradable stocks from developing countries which do not have to meet tough listing rules. ADRs pay dividends in U.S. dollars and are called receipts because they are guaranteed by U.S. banks which have receipts to equities held in trust abroad for the bank. Over the past few years, Mexico has raised a lot of capital through ADRs traded primarily on the NYSE. Several major Mexican brokerage houses now have operations in New York, primarily to facilitate such trading activity. WEINERT & SINCLAIR, *supra,* note 735 at 8.

987 A. CORELLI, "U.S. Firms Eye Canada" *The [Toronto] Globe and Mail* (21 April 1994) C10.

abandoned their quest at the time of the recession when the Canadian industry was experiencing far less growth. Other factors explaining the differences between U.S. and Canadian securities rules and tax laws as well as the size of the Canadian market (which is too small to bother — especially if all documentation must be translated into French[988] and approved by ten provincial regulators). However, a recent wave of expansion is taking place, perhaps because of the expansion of free trade. When NAFTA was being negotiated, the U.S. mutual fund industry association, the Investment Company Institute (hereinafter ICI), put pressure on the Investment Funds Institute of Canada (hereinafter IFIC)[989] to have free trade in the mutual funds arena[990].

While U.S. firms may see Canada as a country that holds only one-twentieth of what the Americans have invested in funds, others project that the Canadian market could triple in size (to Cdn $ 400 billion) by the year 2000[991]. For that reason, many U.S. mutual fund firms are increasingly looking to move to Canada and establish Canadian operations or form joint-ventures with already established financial institutions, independent fund firms or broker-dealers. For their part, Canadian firms (which are much smaller in size than their American counterparts) are slowly prospecting the U.S. market[992].

In mid-1994, the OSC started a review of the regulation of mutual funds on the basis that the industry expanded by such proportions that it has outgrown the existing regulatory framework[993]. In essence, mutual fund regulation is rooted in provincial securities acts which originally embodied the laws to govern the issue of, and trading in securities other than mutual funds. Over the years, many accommodations have

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988 S. 40.1, QSA, *supra*, note 356.

989 The IFIC represents mutual fund managers, banks, trust companies, life insurance companies, brokers, distributors and others. It is not a SRO. However, some provincial securities regulators are pushing the IFIC to assume SRO status. A. CORELLI, "Self-regulation Urged for IFIC" *The [Toronto] Globe and Mail* (15 December 1994) C10.

990 L. GROGAN-GREEN, "U.S. Funds Eye Access to Canada" *The Financial Post [of Toronto]* (22 February 1993) 17.

991 R. LUUKKO, "U.S. Funds March North" *The Financial Times of Canada* (18 June 1994) 1.

992 *Ibid.*

993 K. DOUGLAS, "The Timing Is Right for a Mutual Fund Industry Review by the OSC" *The Financial Post [of Toronto]* (21 May 1994) M2.

been made to existing securities and income tax regulation in order to add laws and policy statements. The result has been a regulatory regime for mutual funds within a system designed to regulate other kinds of securities. With substantial changes on the horizon, the provincial governments want to ensure that when stock markets fall again, the many new and unsophisticated investors will be adequately prepared and made aware of the risks. At the same time, as preparing for the reform, Canada has had to deal with a strong American lobby wishing to ease access to the protected Canadian market.

At the end of 1993, cross-border marketing of mutual funds was addressed by the IFIC at the request of its U.S. counterpart, the ICI. They began to examine the possibility of permitting the sale of U.S. funds and vice-versa. At the same time, the IFIC prudently advised both levels of government that significant impediments to interprovincial transactions needed resolving before the border be opened up to the Americans[994]. The initial idea of cross-border marketing developed into a more concrete initiative designed to allow foreign companies to become more prominent in Canada by waiving residency requirements for salespeople. U.S.-based Goldman Sachs & Co. filed such a proposal with the OSC[995]. The IFIC and the IDA opposed the idea arguing that the abolishment of compulsory requirements imposed upon foreign firms to establish offices and employee presence in Canada would strangle the Canadian industry by favouring the arrival on the market of too many giant U.S. funds. Moreover, the Canadian players (most of them being set up as trusts) stressed the fact that they did not have such access (yet) to the U.S. market without having to change their structure to a corporation. According to the IDA, "to go ahead with this proposal unilaterally [would mean] to give away one's bargaining chips before the negotiations begin[996]." Despite these apprehensions, Ontario reacted rapidly. Within months of the proposal by Goldman Sachs & Co., the OSC agreed to allow non-resident portfolio managers without offices or staff to do business in the province of

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994 M. McHUGH, "Funds Industry Has Message For Liberals" *The Financial Post of [Toronto]* (2 November 1993) 22.

995 M. URLOCKER, "Volatility and Regulation: Is the Party Over?" *The Financial Post [of Toronto]* (21 May 1994) M1.

996 *Ibid.* However, this observation appears to have been incorrect. E. ROSEMAN, "OSC Opens Doors to U.S. Funds" *The [Toronto] Globe and Mail* (1 September 1994) B1 at B2.

Ontario, if they complied with certain basic requirements (such as proficiency, capital, financial reporting, business practices and record-keeping). Despite the fact that the decision did not prevent investors from having to buy the funds through the same channels (i.e. independent brokers and dealers, marketers located in Canada or through banks or trusts), the IFIC vigorously denounced Ontario's move to allow this U.S. intrusion in the Canadian market[997].

Note however that the OSC impose stringent conditions on foreign advisers[998]. They have to show the OSC they understand how the investment returns of their Canadian customers are affected by their various tax laws. Also, they have to name a local agent who could be served with lawsuits, agree to abide by the rulings of Ontario regulators and courts, and disclose in their prospectus that they are non-resident. Also, the OSC reserves the right to impose additional terms and conditions on a case-by-case basis. Although the new OSC rules have eliminated the current formal requirements for the IFIC exams, foreign portfolio managers still have a fiduciary responsibility to consider the impact of Canadian laws. Although the newly arrived U.S. funds have shaken up the Canadian industry, their presence has given Canadian investors more choices and price breaks on management fees (not from U.S. firms) but from Canadian funds wishing to retain their clients[999]. Also, it is likely to bring about a major consolidation of the Canadian industry, resulting in fewer players and larger funds[1000]. For the time being however U.S. mutual funds seem to give little

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997 *Staff Notice of Change in Administrative Policy Regarding Residency Requirements for Certain Non-Resident Salespersons and Supervisors*, (1995) 18 O.S.C.B. 3905. The IFIC believed this decision raised many problems, like: (i) "[i]nvestors who get bad advice will have to pursue a non-resident adviser in U.S. court"; (ii) the OSC's decision to act without consulting the other provinces may lead to a "patchwork response to this important issue"; and (iii) "since the OSC did not define *non-resident* [...] there could be and influx of investment adviser from countries that are not as well regulated as Canada and the United States." ROSEMAN, *supra*, note 996 at B2. Moreover, it felt that every portfolio managers should have a clear understanding of Canadian securities rules and tax laws. J. McFARLAND, "OSC Okays Non-Resident Advisers and Mergers" *The Financial Post [of Toronto]* (1 September 1994) 6.

998 R. LUUKKO, "The OSC Welcomes Foreign Funds – Who Will Win and Lose" *The Financial Times of Canada* (3 September 1994) 5.

999 R. LUUKKO, "The Next Frontier: Free Trade in Funds" *The Financial Times of Canada* (8 June 1994) 7.

1000 A. CORELLI, "Mutual Fund Boom Reshapes Industry" *The [Toronto] Globe and Mail* (26 July 1994) B21.

priority to an invasion of Canada[1001].

Still, NAFTA is indirectly responsible for cross-border traffic becoming two-way, as Canadian firms intending to sell funds look to the south. At the end of 1994, some Canadian banks jumped on the band-wagon of Latin American funds[1002]. The first to do so joined forces with a Mexican bank to set up a mutual fund to invest in NAFTA-oriented companies in Canada, the U.S. and Mexico[1003]. This announcement coincided with news that top Canadian banks decided to make use for the first time of a newly granted right to finance their own activities on the NYSE in order to execute the strategies that will allow them to prepare for the post free trade era.

CHAPTER III: Preparing for the Future: Listings on the U.S. Exchanges

At a time when the North American market for financial services is undergoing a far-reaching process of consolidation, restructuring and regulatory change, some Canadian banks are changing their strategy in order to compete successfully with U.S. banks in either Canada, the U.S. or Mexico.

1001 E. ROSEMAN, "Canada Low on U.S. Mutual Fund's List" *The [Toronto] Globe and Mail* (2 September 1994) B3.

1002 Since the early 1990s, Canadian banks have acted as active participants in the mutual fund business. T. DELANEY, "Banks Push Mutual Funds" *The [Toronto] Globe and Mail* (17 September 1992) C5. D. SLOCUM, "Banks Make Big Waves in Mutual Fund Industry" *The [Toronto] Globe and Mail* (25 July 1992) B5. E. ROSEMAN, "Big Financial Houses Become Major Forces" *The [Toronto] Globe and Mail* (19 December 1991) C1. M. GIRARD, "Les banques de plus en plus présentes dans les fonds mutuels" *La Presse [of Montreal]* (25 September 1991) C1. H.D. WHYTE, "A Welcome Addition to Mutual-fund Arena" *The Financial Post [of Toronto]* (19 November 1990) A3. G. TOOMEY, "Peddling a Piece of the Market" *The [Montreal] Gazette* (4 November 1989) G1.

1003 W. ACWORTH, "Bank of Montreal Launches NAFTA Fund" *International Banking Regulator* (7 November 1994) 4. B. MOONEY, "La Banque de Montréal lance un fonds ALÉNA" *Les Affaires [of Montreal]* (8 October 1994) 53. D. GOOLD, "New Fund Hedges Bet on Mexico" *The [Toronto] Globe and Mail* (6 October 1994) B11. J. McFARLAND, "B of M, Mexico Join to Aid NAFTA" *The Financial Post [of Toronto]* (28 September 1994) 3.

The Bank of Montreal[1004], RBC[1005], CIBC[1006] and TD Bank[1007], for instance, are all trying to offer a wide range of services across the borders[1008]. In essence, this approach is designed to react against a possible attack by American "superbanks"[1009]. Despite the current Canadian federal regulations that prohibit any investor to hold more than 10% of a bank's total shares[1010], the effect of NAFTA and a trend towards deregulation suggest that the protection may not last forever. Moreover, although the traditional U.S. banking industry has been extremely fragmented and hamstrung by a number of state and federal regulations, the last few years have seen the emergence of a new set of powerful and territorially expansive banks. Thus, from a Canadian standpoint, the strategy is to have banks perform well enough and be big enough to prevent any future takeover bids by U.S superbanks.

1004 R. BLACKWELL, "B of M Establishes Merchant Banking Unit" *The Financial Post [of Toronto]* (9 December 1995) 4. K. HOWLETT, "Nesbitt Burns to Open U.S. Bank" *The [Toronto] Globe and Mail* (9 December 1995) B7. J. HEINRICH, "Bank of Montreal Plans to Expand in the United States" *The [Montreal] Gazette* (18 January 1994) D6.

1005 B. MILNER, "Royal Bank has Quiet Debut on Big Board in New York" *The [Toronto] Globe and Mail* (17 October 1995) B7. R. BLACKWELL, "Royal Bank Eyes NYSE Listing" *The Financial Post [of Toronto]* (7 September 1995) 5. S. GITTINS, "Royal Bank Will Become North American Giant" *The Financial Post [of Toronto]* (19 March 1993) 1.

1006 C. CLARK, "CIBC Buys Junk-bond Firm in U.S." *The [Montreal] Gazette* (2 August 1995) E3. Y. KANTROW, "With Purchase of Argosy Group, CIBC is Suddenly a Junk Player" *Investment Dealers Digest* (24 April 1995) 10. J. PARTRIDGE, "CIBC Poised to Buy N.Y. Junk Bond Dealer" *The [Toronto] Globe and Mail* (18 April 1995) B1. J. PARTRIDGE, "CIBC Puts Price on Growth Strategy: U.S. Thrust to Cost $500-Million Over Next Few Years" *The [Toronto] Globe and Mail* (15 November 1994) B6.

1007 "TD Gets Note to Initiate U.S. Securities Operation" *The [Toronto] Globe and Mail* (12 August 1995) B3. R. BLACKWELL, "TD Gets Green Light to Expand New York Securities Unit" *The Financial Post [of Toronto]* (12 August 1995) 4.

1008 However, keep in mind that "[t]he Big Six maintain large London offices and have substantial Eurodollar, foreign currency and derivatives trading operations. Although the emphasis of their business has moved to North America, the banks still maintain an extensive network of overseas branches, with particular emphasis of the Caribbean, Europe and Far East." ECONOMIST INTELLIGENCE UNIT, *FFO (Canada)*, *supra*, note 224 at 16.

1009 On the continuous growth of U.S. banks, see, *e.g.*, "Banks Break the Mould: The Consolidation of U.S. Banks Is Unstoppable" *The Banker* (June 1994) 37. Back in 1991, there were rumours to the effect that some Canadian banks might be eyed by U.S. banking institutions. T. CORCORAN, "Are Our Banks in a Growth Straitjacket?" *The [Toronto] Globe and Mail* (24 July 1991) B2. J. McNISH, "Big U.S. Banks Contemplate Marriages of Convenience" *The [Toronto] Globe and Mail* (2 February 1991) B1. H.D. WHYTE, "Canada's Banks Deny Merger Talks With U.S. Counterparts" *The Financial Post [of Toronto]* (1 February 1991) 28.

1010 Some foreign banks are also taking the same approach. "They look upon North America as one region." B. CRITCHLEY, "More Banks Eye Regionalization." *The Financial Post [of Toronto]* (21 July 1995) 5.

Because Canadian banks can expect to face much more intense competition from American banks in Canada, some have chosen to become full-service, continent-wide North American banks instead of waiting to find themselves as branch-plant operations[1011]. Their expansion has and will revolve around the formation of gradual U.S. (and eventually Mexican) operations designed to serve the small-business market and the ever growing number of Canadian snowbirds[1012] and pensioners in those markets. Also, most of the banks' wholly-owned securities brokerage firms will be able to work better in North American and perhaps make acquisitions[1013].

In order to finance their expansion, Canadian banks are making use for the first time of a newly granted right to finance their own operations on the NYSE. Until more recently, no Canadian bank had even been listed on the NYSE, nor had any Canadian bank ever become a reporting issuer under the Exchange Act of 1934[1014]. The re-classification of U.S. shareholders as "Canadian" for purposes of ownership restrictions of Canadian banks removed a great barrier against Canadian banks listing on the NYSE[1015]. At the end of 1994, the Bank of Montreal became the first of a series of Canadian banks that are (in fact or considering) listing in the U.S.[1016] As a result, the bank's U.S ownership started heading towards the 50%

1011 *Ibid.*

1012 "Snowbirds" is the name given to Canadian residents who flee come winter for a warmer climate. Once abroad, many will buy U.S. mutual funds. E. ROSEMAN, "Investors Foot the Bill for Sales Incentives" *The [Toronto] Globe and Mail* (7 September 1994) B13.

1013 L. CLOUTIER, "Objectif USA: les banques canadiennes convoitent le voisin et envisagent plusieurs acquisitions" *La Presse [of Montreal]* (15 July 1995) E1. One major Canadian securities firm owned by a bank has reacted to seeing its "best Canadian clients [...] financing more easily and at better prices in New York." It plans to obtain a share of the underwriting revenues from Canadian provinces and seeks to develop specialized investment and banking niches to serve Canadian and U.S. corporate borrowers. J. McNISH, "CIBC Takes On New York" *The [Toronto] Globe and Mail* (1 July 1994) B1.

1014 DEARDEN & PALMETEER, eds, *supra*, note 137 at 27,203 para. 38-705.

1015 See *supra*, note 617.

1016 M. TISON, "La Banque de Montréal se voit une banque «nord-américaine»" *La Presse [of Montreal]* (28 October 1994) C2. The base for the Bank of Montreal's U.S. expansion is its subsidiary Harris Bankcorp Inc. of Chicago (purchased in 1984). Harris recently expanded when it merged with Suburban Bancorp Inc. As a result, it became one of the largest financial institutions in the Chicago area. J. PARTRIDGE, "B of M to Register for U.S. Stock Listing" *The [Toronto] Globe and Mail* (19 April 1994) B1. R. BLACKWELL, "B of M Set for Listing in the U.S. After Deal" *The*

objective aimed at helping it generate half its net income from the U.S. by the start of the next century[1017].

However, because the trading of bank stocks has traditionally represented an important portion of the total volume of Canadian Stock exchanges, the decision by the Canadian federal government to change laws that barred Canadian banks from listing their shares for trading on the U.S. exchanges might have dire consequences for the securities industry in certain regional financial centres of Canada. A 1992 report prepared by the ME[1018] stressed the fact that its long-term survival might be threatened if banks (which represent almost 10% of the total volume of the trading of shares on the ME) all list in the U.S.[1019]. At the present time, more and more trading of stocks of major Canadian-based multinationals occurs in the U.S. with the rest of it being done on the TSE[1020]. The same situation could happen with bank stocks. As a result, the report suggests the Montreal market might become an empty shell at the decision-making level in the securities brokerage industry. Moreover, note that this phenomenon combined with NAFTA could have an impact on the equity

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Financial Post [of Toronto] (19 April 1994) 21. "Bank of Montreal to Buy Chicago's Suburban Bancorp" *The [Montreal] Gazette* (16 April 1994) G3.

1017 R. BLACKWELL, "B of M Sees 50% U.S. Ownership" *The Financial Post [of Toronto]* (28 October 1994) 1. Note that the bank's target was revealed in the early days of 1990. R. GIBBENS, "Bank of Montreal Aims to Double U.S. Income" *The Financial Post [of Toronto]* (16 January 1990) 7.

1018 BOURSE DE MONTRÉAL, *La Bourse de Montréal et la réforme des institutions financières* (Montreal, Que.: Bourse de Montréal, May 1992).

1019 A. McINTOSH, "U.S. Trading of Bank Shares Could Damage ME" *The [Montreal] Gazette* (29 September 1994) D1.

1020 P. DURIVAGE, "Les grandes sociétés canadiennes se tournent de plus en plus vers les bourses yankees" *La Presse [of Montreal]* (27 May 1994) C1. E. REGULY, "Canadian Firms Flock to American Stock Exchange" *The Financial Post [of Toronto]* (17 November 1993) 13. D. KELLY, "U.S. Exchange Woos Canadians" *The Financial Post [of Toronto]* (8 November 1991) 11. Recently, the president of the ME suggested that Canada's four stock exchanges would have to get more cooperative if they want to avoid losing more business to huge capital markets in the U.S. A. McINTOSH, "Do We Need a National Stock Exchange?" *The [Montreal] Gazette* (3 May 1995) E3. K. LEGER, "ME Seeks Truce in Exchange Turf Wars" *The Financial Post [of Toronto]* (19 April 1995) 34. C. TURCOTTE, "Montréal souhaite une plus grande synergie boursière avec Toronto, Calgary et Vancouver" *Le Devoir [of Montreal]* (11 April 1995) B2. A. McINTOSH, "Stop the Infighting" *The [Montreal] Gazette* (11 April 1995) C1. These comments came at a time when the giant U.S. NASDAQ stock market expressed a desire to install its stock-trading computer terminals in Montreal. K. LEGER, "Nasdaq Proposal Irks Canadians" *The Financial Post [of Toronto]* (15 April 1995) 12. A. McINTOSH, "QSC Chief Worried About Nasdaq's Scheme" *The [Montreal] Gazette* (15 April 1995) C4.

values of Canadian banks[1021].

TITLE II: CANADIAN DEALERS IN MEXICO

Financing has been, and continues to be a significant barrier to establishing, expanding, or modernizing an enterprise in Mexico. Major strides have been taken, however, to increase available financial services and to extend them outside Mexico's main commercial centres. With privatization of banks and the formation of financial investment groups, Mexico's financial services sector is being transformed[1022]. The advent of open trade policies and NAFTA has created opportunities for foreign banks and securities firms to enter Mexico by acquiring an interest in a Mexican institution or by establishing representative offices[1023]. Regional banks are being promoted, and

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1021 In 1989, it was determined that the FTA combined with a major anticipated shift in the nature of Canada's banking regulations eroded the competitive position of Canadian banks and affected their daily stock market prices. L. BIERMAN, D.R. FRASER & A. ADKISSON, *Effects of the Canada-United States Free Trade Agreement on the Equity Values of U.S. and Canadian Banks*, (1989) 10 Nw. J. of Int'l L. & Bus. 268. Note that the phenomenon appears to be widespread. "[Fifteen years ago], if the Dow Jones [index] went up or down, Canadian markets marched virtually in lock step. Then a curious thing occurred. Most noticeably since 1987 (ironically, about the time of the [FTA]), the harmony of U.S. and Canadian equity markets began to dissipate. [...] A recent U.S. study shows that despite greater economic integration, the correlation between Canadian and U.S. equity markets declined to 60[%] in 1993 from 80[%] in 1975". D. BEST, "A Cross-border Case for Canadian Stocks" *The [Toronto] Globe and Mail* (1 April 1995) B18.

1022 J. COBAIN, "Opening Doors to Mexico" *United States Banker* (January 1995) 64. "Latin Notes: Banking the Mexico Way" *The Banker* (January 1995) 33. "Mexico Fires the Starting Gun" *The Banker* (December 1994) 58. T. GOLDEN, "In Opening Its Finance, Mexico Bets Long Term" *The New York Times* (19 October 1994) D2. T. GOLDEN, "Markets Opened By Mexico" *The New York Times* (18 October 1994) D1. "Revolution in Motion" *The Banker* (August 1994) 31. The reform of Mexico's financial system is a three-stage process. First, the government has privatized the 18 financial institutions which it controlled. Second, new banks are gradually being authorized to do business. Third, "internationalization" of the system is the final step envisioned. "NAFTA Spurs Additional Reforms to Mexican Banking System" *CCH NAFTA WATCH* (29 April 1994) 5.

1023 D. CLARKE, "Magnetic South America" *Canadian Banker* (May/June 1995) 19. Recently, new provisions for the establishment of representative offices of foreign securities firms were established. "Mexico Issues Rules for Foreign Brokerages" *CCH NAFTA WATCH* (28 July 1994) 6. "[I]t is appropriate to mention that within the [Mexican] Ministry of Finance, a new bureau [was] created with two main purposes, first to assist in the preparation of specific regulations to accomplish the NAFTA's requirements and, second, to monitor the establishment of foreign [financial service providers] in Mexico and [their] representatives offices". MITCHELL, *supra,* note 685 at 7.

the government has allowed several private conglomerates with multiple commercial interests to buy into financial institutions. This is all the more true since the beginning of the Mexican economic crisis[1024]. However, while the government is closely regulating this industry during the conversion, controversy over reforms is high and many programs have yet to be implemented. The goals of regulators involve the hope that a foreign presence will strengthen the whole national system by providing expertise, technology, capital and healthy competition[1025]. However, the limitations placed on foreign financial operations and the relatively small market share allotted to them under NAFTA suggest that neither side is likely to be fully satisfied with the results for some time[1026].

The Mexican financial system at large does have pockets of sophistication and dynamism. However, it is generally acknowledged to be underdeveloped, inefficient, and lacking in technology, trained personnel or adequate exposure to international operating standards[1027]. Today, Mexico is underbanked, underbranched, undermortgaged, underinsured, and lacking in corporate financial and securities services[1028]. Nevertheless, it is fair to say that Mexico has improved radically during

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1024 With the recession resulting from the recent economic crisis, many Mexican banks have had to cope with high interest rates and bad debts. Consequently, Mexicans hope to solve their financial problems by offering foreign banks an option to them to swap their debt for equity in Mexican banks. "An Urgent Case of Disrepair" *The Economist* (1 July 1995) 69.

1025 One example of the modernization of the Mexican financial system relates to the possibility of creating a cross-border transfer system among Mexican, Canadian and U.S. banks. "Bank of Mexico Studies Cross-border Transfers" *CCH NAFTA WATCH* (29 April 1994) 5.

1026 W.S. HARAF, "NAFTA Opens Doors to Mexican Markets for U.S. Banks" *Bank Management* (January/February 1994) 26 at 30. R.L. THOMAS, "NAFTA Changes the Game: A U.S. Perspective" *Bank Management* (May/June 1994) 55.

1027 CHAPUT, *supra,* note 888 at 15. L. RODRIGUEZ, "Financing to Secure the Future" *Business Mexico* (September 1994) 6.

1028 W.R. WHITE, *The Implication of the FTA and NAFTA for Canada and Mexico,* Technical Report N° 70 (Ottawa, Ont.: Bank of Canada, 1994) at 16. SAUVÉ & GONZALES-HERMOSILLO, *supra,* note 696 at 14. In early 1994, it was estimated that more than 94% of Mexico's non-urban population did not have access to financial services. "NAFTA Spurs Additional Reforms to Mexican Banking System" *CCH NAFTA WATCH* (30 March 1994) 6. However, note that while Mexico may be underbranched, and while "[...] rising incomes [...] are expected to increase the demand for [financial] services by Mexicans, most of whom live outside the major cities and currently have no banking relationship at all", Mexican firms have well-established positions in the retail market, which Canadian and U.S.-owned institutions may have difficulty achieving. C. MANSELL CARTENS, "The Social and Economic Impact of the Mexican Bank Reprivatization" *Journal of Bank Research* (January 1993) 4 at 9. Still, the CBA

the past several years and that it is virtually certain to improve to an even greater degree, and at even faster pace, in the future (and that, despite the recent pesos crisis)[1029].

As previously mentioned, Canadian and U.S. financial institutions wishing to do business in Mexico have been greatly advantaged by NAFTA[1030]. The provisions on financial services opens the sector to foreign investment, reversing decades-old restrictions. Prior to NAFTA, no more than 30% of the equity in banks and securities firms could be held by foreigners. Now, by being able to establish *grupos financieros*, foreign firms have unprecedented access to the Mexican market[1031].

With the liberalization of trade in North America, Canadian and American MNCs increasingly want their domestic financial institutions to serve all their needs in all three markets as a one-stop shop. In order to comply with this desire of their corporate clients, North American banks and securities firms are expanding (or planning expansions) into all three countries[1032].

In view of the fact that it has the least developed financial services sector of the signatory Parties, NAFTA's foreseeable impact on capital markets and retail financial services within Mexico is greatly significant. Since the Brady Plan was put into place in 1989[1033], Mexico has attracted large inflows of portfolio investment. Another

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believes that "[t]here are many opportunities for Canadian banks in Mexico in areas where Mexican consumers are under-served." GAFFORD, *supra*, note 701 at 58.

1029 "Down But Not Out" *The Banker* (March 1995) 41.

1030 I.J. MATTHEWS, "Competition Is All" *Canadian Banker* (January/February 1993) 18 at 18. Still, despite the fact that NAFTA helped to bring closer all three countries, the same basic considerations need to be addressed by a Canadian or U.S. financial institution seeking to conduct business in Mexico, i.e. (i) tax considerations; (ii) foreign currency fluctuations; (iii) cultural differences; (iv) political risks; and (v) language differences. P. LEE, "NAFTA and Mexico: Commercial Finance Opportunity" *Secured Lender* (November/December 1994) 104 at 106.

1031 See, *supra*, notes 701 to 711 and accompanying text.

1032 L. IOANNOU, "Better Banking with NAFTA" *International Business* (January 1994) 40 at 42. "Eight Key Banking Provisions of NAFTA" *ABA Banking Journal* (November 1993) 56. However, note that given the opportunities in their home market, Mexican financial institutions are not focused on greatly expanding beyond their borders. A. KATTER, "The North American Free Trade Agreement and the Banking Industry" *Journal of Commercial Lending* (December 1992) 11 at 14.

1033 See, *supra*, note 200.

determining factor in the growth of Mexico's capital markets has been the Mexican government's privatization program[1034]. This initiative has enabled many large equity issues to be successfully placed abroad. While many investors have been lured to the Mexican market over the past few years by significant returns, the ratification of NAFTA has helped decrease the perceived risk of investing in Mexico. Because of the particular size and configuration of the *Bolsa*, international offerings are very popular.

Until now, the overwhelming share of securities traded in the Mexican *Bolsa* has been of government issue[1035]. Because of the thinning of the financial markets for non-government borrowers, firms that could go abroad for funding already have. It has been common for Mexico's great conglomerates to issue securities in the U.S., and it is not unusual for the government to do the same. As a result, Mexico imports a large amount of brokerage services from the NYSE through ADRs and the large flotations from PEMEX[1036], some large banks and other large firms. The worldwide revolution in information processing that has increased the abilities of securities industry to tailor debt and equity issues to the special needs of particular borrowers is bound to continue affecting Mexican domestic financial markets[1037].

Overall, Mexican firms may be increasingly able to offer services at a greater level than that which has up to now been restricted to bank lending. However, the same is true for Canadian and American securities firms that enter Mexican markets under NAFTA. Moreover, Canadian and U.S. firms already have experience and technology in areas that Mexican institutions are now gaining. Accordingly, this is the area of the Mexican financial market that may see the greatest foreign penetration. Another reason that most entries under NAFTA are likely to be in securities brokerage is the Agreement's relatively favourable treatment of this industry[1038]. During the NAFTA

1034 R.P. McCOMB & W.C. GRUBEN, *Preparation and Performance in the Mexican Market*, (1994) 34 Q. Rev. of Econ. & Fin. 217 at 219.

1035 ECONOMIST INTELLIGENCE UNIT, *FFO (Mexico), supra*, note 802 at 39.

1036 "A World-Class Credit" *Euromoney Supplement* (January 1992) 10.

1037 I. WATERS, *A Framework for the Optimum Structure of Financial Systems*, Working Paper Series N° S-92-47 (New York, N.Y.: New York University Salomon Centre, 1992) at 20.

1038 For a recent overview of the activities of the various brokerage houses operating in Mexico, see, *e.g.*, ECONOMIST INTELLIGENCE UNIT, *FFO (Mexico), supra*, note 802 at 39-40.

talks, Mexico sought to protect its financial services industry, which had recently undergone an extensive privatization and liberalization in its restructuring. Specifically, Mexico sought to restrict market access by limiting the right of entry of particular institutions and to establish a progressive liberalization of the system that would gradually ease the restrictions within the financial services sector. With the establishment of NAFTA, Mexico was partially successful. The relatively quick opening of securities services should facilitate early foreign penetration into that area.

Stimulated by the increased interest from international investors, U.S. and Mexican securities firms have already used these opportunities to expand their business. While U.S. firms managed to underwrite many debt and equity issues for Mexican clients, Mexican firms are gradually developing their U.S. business (which has led several of them to establish offices in New York)[1039]. Consequently, easier access to global capital markets by the Mexican companies has been very lucrative for both U.S. and Mexican firms which have closely cooperated in managing many new issues[1040]. For their part, the Canadian securities industry has not participated significantly in these developments and are, comparatively inactive in this area[1041].

In view of the fact that many Mexican blue chip stocks are traded on the NYSE, certain U.S. firms feel they do not have a significant presence in Mexico. However, several others see a series of opportunities offered to them if they have their foot set on Mexican ground. Because NAFTA allows Canadian and U.S. firms to establish subsidiaries in Mexico on easier terms then ever before, the Mexican securities industry is bound to face a harsh competitive challenge from heavily capitalized firms with superior international distribution capabilities[1042].

On the other hand, a certain detail may offer a useful perspective on the extent of

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1039 In view of the growing number of Mexican and Canadian dealer subsidiaries that choose to establish offices in New York, it has been observed that "New York City and New York State should be the big beneficiaries of [NAFTA]". T. PRATT, "Street Firms Prepare to Reap Concrete Benefits from NAFTA" *Investment Dealers Digest* (22 November 1993) 6.

1040 SAUVÉ & GONZALES-HERMOSILLO, *supra,* note 696 at 16.

1041 Here, "[...] Canadian dealers are not competition for the big New York investment banks." JORDAN, *supra,* note 694 at 53.

1042 IOANNOU, *supra,* note 1032 at 41.

competition that Canadian and U.S. financial institutions could face from Mexican entities. Although the Mexican bank nationalization that occurred in 1982 formally removed only bank directors and left other employees at their desks, many of these directors departed for securities firms, which took on a rising share of financial activities[1043]. Later, securities firms turned out to be the major purchasers of privatized banks[1044]. Since many securities industry executives were bankers before the nationalization, the recent financial deregulation has meant a reunification of financial products and personnel. Does this mean that Mexican securities firms have an information advantage that would make a Canadian or U.S. firm's entry into the Mexican market a highly competitive event? It seems to suggest that, because of personnel movement out of banking and into the securities business (and then back to banking for some of them), the expertise appropriate to the joint provision of securities may be particularly significant in the Mexican financial system.

The Mexican financial system, although not too competitive at present, shows signs that very soon the institutions and markets will offer better financial services at significantly lower cost[1045]. But a number of questions remain. One concerns the role that banks will play relative to securities markets. The remaining statutory barriers to entry in Mexican banking indicate that banks will maintain a privileged position in the Mexican financial market for many years to come[1046]. But the erosion of banking in Canada and the U.S. caused in part by changes of the regulatory framework and technological advance in information processing and financial instruments has given securities markets an edge, as witnessed by the increase in securitization[1047]. If Canadian, U.S. and Mexican securities firms can offer their services more efficiently than banks, then one would expect the importance of banks to diminish. The favourable treatment of securities brokerage by NAFTA would be

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1043 WEINERT & SINCLAIR, *supra*, note 735 at 3.

1044 ECONOMIST INTELLIGENCE UNIT, *Country Profile: Mexico (1994-95)* (London: Economist Intelligence Unit, 1995) at 23.

1045 SAUVÉ & GONZALES-HERMOSILLO, *supra*, note 696 at 15.

1046 In early 1994, it was estimated that Mexico's banks controlled 94% of all Mexican financial services transactions. R.S. POTHIER, "Mexico's Banking System is Key to NAFTA's Success" *CCH NAFTA WATCH* (16 May 1994) 7.

1047 G.G. KAUFMAN, *The Diminishing Role of Commercial Banking in the U.S. Economy*, Working Paper N° WP-1991-11 (Chicago, Ill.: Federal Reserve Bank of Chicago, 1991) at 17.

expected to promote such a competitive process. These considerations make projections of the future structure of the Mexican financial system extremely difficult.

In the end, it is unlikely that Canadian and U.S. firms will try to outmanoeuvre Mexicans by establishing large offices in order to equal their vast penetration of customers[1048]. In the field of retail services, it may be reasonably thought that many large Canadian and U.S. financial institutions are likely to be active. However, the Mexicans possess huge advantages due to their networks and name recognition. Moreover, they have a cultural advantage over the Canadians and the Americans in their home market[1049].

Nevertheless, while large Mexican firms are likely to continue to thrive, the same cannot be said about a series of smaller firms[1050]. As may be expected, the increased competition in their own market will lead to an eventual consolidation in the Mexican financial sector[1051]. At that time, Canadian and U.S. securities firms could prove to be attractive for these firms seeking acquisitions, joint ventures or simply strategic alliances with stronger foreign firms[1052]. While the most powerful Canadian and U.S. institutions are choosing to develop their own business through wholly-owned subsidiaries, the option remains open for the smaller rivals. However, most Canadian or U.S. firms looking to penetrate the Mexican market are likely to opt for the formation of joint ventures. Here, financial institutions do not have the constraints of committing themselves for a strategic alliance or an acquisition. They can only choose to cooperate with marketing or processing a single product or service. In

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1048 IOANNOU, *supra,* note 1032 at 42.

1049 For that reason, numerous foreign firms with plans to establish sale offices in Mexico have recruited several experienced Mexican executives to help in their quest to conquer Mexico. T.R. HAMER, "The Hunt for Local Talent" *Business Mexico* (June 1993) 4. D. CAREY, "Ascent of the Headhunter" *Institutional Investor* (May 1994) 86.

1050 The recent peso crisis most likely had the same devastating impact on certain securities firms as it had on some small and medium-sized Mexican banks. "Expensive Crutches" *The Economist* (8 April 1995) 66.

1051 "Although it is too early to expect consolidation in the Mexican financial system, it should happen over time" "Banks Act to Boost Their Capital Bases" *Euromoney Supplement* (January 1994) 22 at 24. R. GONZALEZ, "New Competition in Financial Services" *Business Mexico* (April 1994) 4 at 5. J. RUSSELL, "Continental Banking: Integration of Financial Services Across the Border" *Business Mexico* (May 1992) 44.

1052 M. GARCIA BARRAGAN CORDOVA, "Mexican Banks Ready for New Competition" *CCH NAFTA WATCH* (10 November 1994) 7.

return, the Mexicans may get what they greatly need from Canadian and U.S. firms, namely make use of technology and management expertise. Here, opportunities for cooperation are extensive[1053].

In this context, Canadian and U.S. financial institutions all have various experience and expertise to trade with their Mexican counterparts[1054]. Likewise, the U.S. firms can trade their knowledge of dealing with the Mexicans to the Canadians who have little experience themselves in that part of the world. For their part, Canada and Mexico both share similar regulatory frameworks, which have led to nationwide and universal banking systems. Also, both countries share the same fear of domination by the U.S. Consequently, these factors may lead to some forms of strategic alliances between the financial institutions of both Canada and Mexico[1055]. Nevertheless, a series of other factors may delay the arrival of some firms into the Mexican market[1056].

Although interested in doing business in Mexico, many foreign securities firms are wary of a direct commitment for a variety of reasons. Despite the opportunity to participate in a major opening in a rapidly developing economy, these foreign firms worry that they could be treated as second class alien corporate citizens. Few are willing to accept a subordinate minority position from which they feel they would be unable to exercise adequate control. Others are worried that they would lose control over expensive technology and other information or be seen as a deep pockets source for special interest or otherwise speculative projects. They also worry that, as foreign partners, they could be restricted to doing marginal business. Thus, as an alternative to taking an official minority ownership position, many foreign institutions are considering project-specific joint ventures designed to enter particular areas of

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1053 R.S. SCZUDLO, "NAFTA: Opportunities Abound for U.S. and Canadian Financial Institutions" *Bankers Magazine* (July/August 1993) 28 at 32. CANADA, *L'ALÉNA: Qu'en est-il au juste?* (Ottawa, Ont.: Affaires extérieures et Commerce extérieur Canada, 1993) at 83.

1054 On the methods of negotiations between Mexican and U.S. business people, see, *e.g.*, B.W. HUSTED, *Bargaining with the Gringos: An Exploratory Study of Negotiations Between Mexican and U.S. Firms*, (1994) 36 Int'l Exec. 625.

1055 E.P. NEUFELD, "NAFTA Changes the Game: A Canadian Perspective" *Bank Management* (May/June 1994) 55.

1056 C. LODISE, "Pulling for U.S. Banks" *Business Mexico* (March 1995) 43.

business on a stronger, more independent footing.

In a nutshell, NAFTA's impact on corporate strategy of financial institutions has been important. However, the Mexican peso crisis has affected the pace of foreign investment[1057]. While the effect of the peso devaluation on the North American outlook has been limited, the impact on the Mexican economy has been devastating[1058]. Nevertheless, medium and long-term prospects remain very encouraging[1059].

1057 Yet, investments have not completely stopped. See, *e.g.*, "It Doesn't Have to Be American ..." *Euromoney* (April 1995) 45.

1058 CONFERENCE BOARD OF CANADA, *North American Outlook: 1995-1996, a Research Report*, Report N° 1100-95-RR (Ottawa, Ont.: Conference Board of Canada, 1995) at 9-10. CONFERENCE BOARD OF CANADA, *World Outlook: Global Economic Trends and Prospects* (Ottawa, Ont.: Conference Board of Canada, 1995) at 3. ECONOMIST INTELLIGENCE UNIT, *Country Report: Mexico (2nd quarter 1995)* (London, Economist Intelligence Unit, 1995) at 4.

1059 W. WILLITTS, Taking the Long View: Canadian Banks Keep Investing in Latin America" *The [Montreal] Gazette* (4 October 1995) F2. L. FICKENSCHER, "Pesos Crisis: Battening Down to Focus on Long Haul" *The American Banker* (7 February 1995) 17. C. TORREN, "Opening of Mexico's Financial System Won't Bring Any Immediate Rewards" *The Wall Street Journal [of New York]* (24 October 1994) A10. Still, the immediate risks remain high. For example, Scotiabank took a massive hit on its stake in *Grupo Financiero Inverlat SA*. B. MORISSETTE, "Les banques mexicaines sont en difficulté; Scotia radie 145 M$ d'actif" *Les Affaires [of Montreal]* (9 December 1995) 17. J. PARTRIDGE, "Mexico Rescues Banco Inverlat" *The [Toronto] Globe and Mail* (1 December 1995) B1. J. PARTRIDGE, "Scotiabank Undecided on Mexican Investment" *The [Toronto] Globe and Mail* (27 June 1995) B7. "Scotiabank Invests in Mexico" *The [Toronto] Globe and Mail* (29 August 1995) B5.

CONCLUSION

North American free trade has caused the Canadian securities industry to face a new reality. By placing the sector under the spotlight and under international scrutiny, the way business is conducted is changing. With respect to a unanimously accepted hemispheric system which would offer a total liberalization of the financial sector, any prospects for the immediate future appear remote. The point is not, however, to waste time ruminating over the immediate unlikelihood of the adoption of a series of uniform continental rules surrounding the industry but rather examine, as we have done throughout, possible alternatives on the national level, while continuing to pursue workable international solutions.

Most financial markets, regardless of how they are regulated, are national in scope[1060]. That is certainly true of banking activities and securities trading. Furthermore, financial markets extend beyond national boundaries. International harmonization cannot be achieved unless there is some form of harmonization within the country itself. This is particularly true in the case of Canada, since this calls for cooperation and harmonization, not only between various provincial jurisdictions but also between countries. Cooperative efforts, nationally and internationally, are needed because financial transactions do not respect barriers between the provinces or nations. However, in Canada there is a trade-off between uniformity and the principle of federalism[1061]. There are also some benefits from competition in regulation, whereby different authorities struggle against each other towards the most efficient regulatory framework. A diversity of regulatory authorities contributes to such competition but also leads to the fragmentation of the regulatory system. The differences in legal treatment would be of less concern if the regulatory authorities cooperated more effectively with one another.

For many years, Canadian securities authorities (i.e. securities commissions and other provincial securities authorities) have worked together to develop regulatory systems

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1060 ROSENBERG, *supra*, note 76 at 427.

1061 "An uncompromising commitment to uniformity, however, may be contrary to one of the fundamental premises of federalism, namely, the ability of individual provinces to develop their own policies to address local needs and goals." ANISMAN, *Ibid.*, at 81.

that take the specific features of each region of the country into account, while seeking to harmonize rules as much as possible. In doing so, they have tried not only to increase market efficiency, but also the industry's competitiveness, and to reduce costs. This collective interprovincial harmonization effort is largely recognized by international regulatory authorities. For instance, the OSC and QSC have signed many international agreements, particularly with the SEC. In this context and given the proximity of the U.S. market, Canada has used the MJDS to build this recognized level of comparability. As a result, there is currently a rapid level of harmonization between the two regulatory regimes.

The reform of the Canadian federal legislation regarding financial institutions resulted in a series of new pieces of legislation that became effective June 1, 1992. The federal legislator then granted federally-incorporated financial institutions the ability to directly offer investment counselling and portfolio management services according to terms and conditions prescribed by federal regulations. In the case of banks, these services were even included in the statutory definition of the "business of banking", with the federal legislator appropriating the power to regulate the conditions under which banks can provide such services[1062]. The federal regulatory system for the banking sector and the clear Indication of a federal intent to continue in that direction are of enormous concern to a certain number of provinces who consider this federal initiative an unjustifiable intrusion in a field of provincial jurisdiction. For them, such a regulatory system can only lead to a duplication of rules and supervision as well as higher administrative and financial costs for issuers, investors, and intermediaries.

Any analysis of the system requires that an evaluation be made of the competitiveness of institutions, the fairness with which they are treated by the regulatory system and the quality of supervision of the securities sector. In this context, how and in what way can a CANSEC (assuming it can exist under the Canadian Constitution) meet the specific needs of the provinces more efficiently than the current system? Some provinces (like Quebec) are worried they would lose control of important levers of their economic development. Opponents to the creation of a CANSEC fear the centralization of power would eliminate the benefits of diversity,

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[1062] In particular, see ss. 409(2)c), 410(3) and 415 of the *Bank Act of 1991* (as amended).

namely, innovation and regulation that takes the specific needs of the regions into account. Having said this, can provincial rules be reconciled with the federal government's proposed regulatory exercise? Ideally, the two-fold regulatory system should make way for a single one. This approach would be the best way to dissipate any confusion and uncertainty in capital markets, not to mention the cost to the industry. However, as long as there exists a duplicate approach in this field of jurisdiction, both levels of government will need to coordinate their activities to achieve their respective objectives in the current process of harmonization of securities regulatory systems.

Given the growing internationalization of financial activities, differences in regulatory systems between countries assume greater importance. Because of the changes that are occurring elsewhere, Canada's relative position is continually shifting. Whereas it used to be viewed as quite restrictive in its separation of financial functions, Canada is considered to be less so today, especially when compared with the U.S., which has been slow to revise its regulation of the banking and securities business. To some extent, at least, the regulatory structure in Canada is moving towards what is often regarded as the European norm, with banks increasingly becoming involved in the securities sector[1063].

Because many securities firms are affiliated to banks, the federal government should not leave the task of regulating the industry to the provinces alone. The constitutional authority of the federal government on the subjects of interprovincial and international trade and commerce are in direct relation with its authority to legislate directly on matters pertaining to competition and solvency. Nevertheless, although Canadian federalism has the necessary flexibility (through intergovernmental negotiation and co-operative agreements) to accommodate itself to the opportunities presented by global markets, the division of responsibilities within Canadian system creates a barrier which, over time, may emerge as a hinderance to the ability of the country to rapidly co-ordinate its action towards integration into the evolving world markets.

[1063] While the basic principles under NAFTA are working towards universal banking in North America, there are forces working in the other direction. WHITE, *supra*, note 1028 at 18.

As the barriers to the establishment of foreign securities firms in domestic markets continue to be lowered through NAFTA, a number of challenges remain for Canadian policymakers. While there are clear benefits to be drawn from the entry of foreign dealers, this could become problematic if it resulted in too great a dominance of the Canadian market. The competitiveness of Canadian firms must be preserved and enhanced, particularly while they are losing market share, but not at the cost of the stability of the financial system. As foreign dealers continue to penetrate domestic markets, the need for cooperation becomes even more urgent. Consequently, major steps ought to be taken in the relatively near future. In delaying action on these fronts, Canada is still running counter to world trends. It can no longer afford internal rivalries. In order to meet foreign competition (particularly in the context of the new North American business dynamic), Canadians must show a common front or risk being ignored by large MNCs, thus reducing the number of possible securities issues/transactions and FDIs in Canada. However, due to the political sensibility of this topic, this objective may only occur if the federal government follows a strategy of gradual intervention in this sector.

As for the means of arriving at harmonization and coordination outside Canada, international organizations (such as the WTO, the OECD and the IOSCO) have important roles to play. Moreover, the "spontaneous" harmonization phenomenon[1064], which leads countries to change their legislation voluntarily by taking into account the legislation in force in other states, should not be disregarded[1065]. "Spontaneous" harmonization is not an international nor a regional phenomenon. The idea is to make the law of a certain state to evolve to levels almost identical to that of neighbouring judicial systems. For instance, Canada has adopted numerous national policies towards foreign intermediaries of securities services and international capital movements based on American models. In this context, compatibility is more important than harmonization *per se*. This development can be observed through the law and the jurisprudence. With respect to the law itself, it is expressed in different ways. One example may be the integration, in the national legislation, of a series of concepts proposed by an international organization. Another

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1064 See, *supra*, note 10.

1065 F.C. COLLART DUTILLEUL, *L'harmonisation internationale du droit privé*, (1993) 24 R.G.D. 227 at 234.

example may be the adoption of a double legislation: one to solve internal conflicts and the other for international relations. As to the jurisprudence, the role of the courts and arbitration tribunals along with their openness towards foreign laws must not be completely neglected. However, in view of what was discussed, three questions arise. Firstly, must harmonization of trade in securities services be sought on a regional (notably continental) level or on a global level? Secondly, must it be sought within public or private organizations? Thirdly, should it be a "codified" concept or a "Common Law" one?

In North America, the Canadian securities industry is bound by the rules of the FTA and NAFTA. These two treaties led to a lowering of barriers to trade in financial services and to the establishment of foreign financial institutions in North American domestic markets. With the FTA, the Canadian securities industry gained limited access to the huge American market. In return, Canada opened the door to a U.S. industry which fully benefited from the deregulation of the Canadian financial sector. As a result, a new ground for competition between firms from the U.S. and Canada started to develop on the eve of the signing of NAFTA. The North American Free Trade Agreement presented a new opportunity for Canadians to break open into the U.S. market and gain access to a newly liberalized Mexican playing field. In the end, the Americans refused to concede any significant ground to the Canadian securities industry and the Mexicans allowed only partial access to their appealing territorial market. In appearance, Canada does not appear to have been too well served by these bilateral and trilateral talks. However, in retrospect, should Canadians have stuck solely to multilateral trade negotiations? Surely not.

Concepts of regional and global harmonization are not incompatible. For instance, in North America, while the prime model for NAFTA is the FTA, it draws upon ideas elaborated in agreements themselves developed in the negotiations of the Uruguay Round. Still, disagreements occur between countries concerning the respective powers of regional and global organizations. Nevertheless, regional harmonization has its limits. For example, it is clear that problems related to securities fraud are of global concern. In view of that fact, both public (such as some organs of the United Nations, like the WTO) and private (such as the various stock exchanges and specific-industry groupings) organizations have a role to play in the quest for the development of rules

for services relating to securities. Whether or not all concepts need to be codified is not of relevance. A common feature of harmonization measures is the loss of freedom of action on the part of participants. While harmonization does not involve an irrevocable surrender of legislative jurisdiction on the power to enact legislation, it involves constraint. Thus, legislators wishing to undertake actions in harmony with other legislators must ask themselves: to what extent will a new legislation or treaty create disharmony? Harmonization mechanisms must try to identify public demand for harmonization and to seek to fulfil that demand. If harmonization is approached in this way, the restrictions to freedom of action become less objectionable.

Many differences exist between countries with respect to securities regulation (i.e. prospectus requirements, accounting procedures, and clearing and settlement mechanisms) or regulation of securities-related services. The fact that different approaches exist in different countries may simply reflect the ways in which traditions have developed in these countries. Hence, it would be wrong to emphasize the superiority of one regulatory scheme over another. For instance, the renown of the U.S. and Canadian securities markets attests to the overall efficiency of the regulatory scheme as a mechanism of the promotion of investor confidence and the protection of investor interests. While harmonization of the U.S. and Canadian securities laws could be achieved with relative ease due to the fact that both countries follow similar high standards, it would most certainly prove to be more difficult with the involvement of other nations[1066]. For example, an eventual harmonization of the rules with certain countries of Central and South America would require compromises on the basic principle of full disclosure and fair dealing in the market. The achievement of a certain degree of international harmonization of the securities regulation may also only be wishful thinking for several years to come. Despite these differences, an agreed upon minimum standard would seem to be sufficient for the adequate protection of investors in an international market.

According to the recent "Market 2000" study produced by the SEC, securities regulators should concentrate on protecting investors, facilitating fair competition and

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[1066] S.M. BECK, "The Recent Trends in the Securities Regulations" in L.S.U.C. Special Lectures, *Securities Law in the Modern Financial Marketplace* (Toronto, Ont.: Richard De Boo, 1989) 1 at 3.

promoting full disclosure rather than imposing entry barriers[1067]. In this regard, harmonization and mutual recognition of foreign regulatory systems have become the newest difficulties (and necessities) for modern-day regulators. Over the past few years, IOSCO has been promoting harmonization and mutual recognition as the leading principle for the regulation of global markets. However, negotiations towards the removal of the structural impediments to competition between domestic and foreign intermediaries have their limits. Hence, while a detailed agenda can be drawn, this may be counter to a "market driven" harmonization. Because a well-functioning global securities environment depends on the regulatory provisions defining the permissible spheres of activities for foreign and domestic financial institutions, the reality of the marketplace confirms the necessity to develop a series of international rules specifically adapted to govern the trade of securities-related services. Hence, well-designed regulations might be very beneficial to an experienced Canadian securities industry.

In the end, it is important to measure the impact of the various aspects of North American cooperation on the ways the Canadian securities industry does business. Achieving cooperation is not an easy task. It requires agreement on common principles, guidelines, and methods of implementation. But differences in legal and institutional frameworks and in national objectives, dictated by significant differences between nations make such agreements more difficult[1068]. In North America, some progress has been achieved. Changes in domestic regulation (driven by the demands of a more global marketplace) have brought some convergence in regulatory frameworks. North of the 49th parallel, the Americanization of the Canadian Securities regulation and industry has not necessarily been a bad thing. This phenomenon has forced Canada to make hard regulatory choices by taking into account developments that occur south of the border. Also, it has favoured the introduction of a U.S.-style

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1067 On Market 2000, see, generally, *Symposium: Market 2000*, (1994) 29 J. of Corp. L. 437ff. T. RUSSO & R. CHASE, *Comment on the Long-waited Market 2000 Report*, I.F.L. Rev. (April 1994) 9. J.M. DOYLE, "SEC Report Stresses Putting Investor First" *The [Toronto] Globe and Mail* (28 January 1994) B8. A. RAGHAVAN, "Proposed Rules in Market 2000 Study Fall Short of Exchanges' Suggestions" *The Wall Street Journal [of New York]* (28 January 1994) C1. For the impact of "Market 2000" on Canadian regulators, see, J. McFARLAND, "SEC Reform Plan Likely to be Canadian Model" *The Financial Post [of Toronto]* (28 January 1994) 5.

1068 ROSENBERG, *supra*, note 76 at 177.

regulation in Canada (with all its complexity and formalization). With the Canadians free-riding on the back of the Americans and recognizing compliance with this foreign regime, the Canadian securities industry has been kept on top of the "world game". However, the FTA and NAFTA appear not to have provoked – at least by themselves – the harmonization of laws governing the securities industry[1069]. The large increase in the number of foreign participants in the Canadian market, the growth of international activities of Canadian-controlled firms, and the proliferation of new financial instruments have all contributed to affect the manner in which the Canadian securities industry conducts its activities. In the U.S., free trade negotiations have allowed the Canadian securities industry to benefit from a series of adjustments and changes in the application of the GSA. The implementation of the MJDS has also partially served to gradually remove some of the traditional barriers between American banking and securities businesses. However, despite these efforts to harmonize the way of doing business in North America, many differences subsist. Still, to remain competitive in an ever changing financial and regulatory environment, Canadian firms are rapidly adapting themselves by consolidating and restructuring their activities in the U.S. In Mexico, recent transformations in the financial services sector combined with the implementation of NAFTA create a series of opportunities for the American and Canadian securities industries. However, the new rules made in the context of North American free trade are not serving all partners the same way[1070]. Even though all jurisdictions have been able to participate in continental harmonization efforts, the small less powerful jurisdictions (like Canada and Mexico) had, or were perceived as having, less ability to influence the form of harmonization proposals put forward by the more powerful jurisdiction, the U.S. Nevertheless, in the years ahead, the progressive harmonization of regulation occurring through international cooperative efforts among supervisors of the industry may be crowned, in a not so distant future, by the emergence of a higher uniformed series of rules which could be extended throughout the hemisphere. Although still far from enjoying all-around acceptance, discussions leading towards such a possibility testifies to its significance.

1069 "With some exceptions, NAFTA does not address in any consistent way the subject of harmonization of internal regulations over service industries. A *de facto* tendency towards harmonization does exist, however." S. ZAMORA, *The Americanization of Mexican Law: Non-Trade Issues in the North American Free Trade Agreement*, (1993) 24 L. & Pol'y Int'l Bus. 391 at 410.

1070 CHAPUT, *supra*, note 888 at 6-7.

Such aspirations would have been unthinkable only a couple decades ago. That it is thinkable today shows how far the conception of free trade in financial services has developed and will continue to develop. However, the U.S. is the maestro of this symphony of changes. Thus, to fully benefit from the advantages brought about by continental free trade, the Canadian securities industry may need to continue to adapt its ways and play the American concerto.

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