The Political Economy of Canada's "Widely Held" Rule for Large Banks

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I. INTRODUCTION: A TALE OF TWO COUNTRIES

When representatives of the United States, Canada, and Mexico signed the North American Free Trade Agreement1 ("NAFTA") in 1992, the schedule of reservations and commitments on the annex relating to financial services gave the distinct impression that Mexico and Canada were not inclined to embrace fully the idea of free and unfettered trade in banking services. While NAFTA broke new ground by setting out a principles-based approach to liberalized trade in financial services,2 Canada and Mexico made it clear that they intended to keep in place the non-tariff barriers3 that ensured that their largest banks would remain under domestic control.

At the outset, it appeared that Mexico had a stronger commitment to banking protectionism.4 At the time of NAFTA's negotiation, Mexico's banking market was dominated by six large national banks, with seven regional institutions playing a secondary role.5 Prior to NAFTA, Mexico's banking market was closed to U.S. and Canadian banks.6 NAFTA changed that by permitting U.S. and Canadian banks to establish wholly owned banking subsidiaries in Mexico.7 But while Mexico opened its banking system through NAFTA, it also negotiated for some

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4. Mexico's reservations and commitments in the general Annex VII totaled twenty-two pages, while Canada's were only four pages long. NAFTA, supra note 1, Annex VII, 32 I.L.M. at 769-76.
protections to prevent foreign domination of the Mexican banking industry; specifically, Mexico set out aggregate capital limits for foreign subsidiaries. 8

As originally conceived, U.S. and Canadian institutions would have been permitted to acquire outright existing Mexican banks after a transition period, subject to the limitation that the sum of the capital of the acquired bank and any affiliate of the foreign acquirer not exceed four percent of the aggregate capital of all commercial banks in Mexico. 9 The clear purpose of these restrictions was to protect Mexico's six largest banks from foreign acquisition. 10

Events overtook the original protectionist plan, however, forcing Mexico to liberalize its foreign ownership rules. 11 Viewed through the lens of history, this turn of events is not surprising—throughout its past, Mexico has been dependent on foreign capital for economic development. 12 The NAFTA provisions were intended to break that cycle of foreign dependence and continue the revitalization of the Mexican banking industry initiated by the reprivatization of the state-controlled banks in 1990-92. 13 Nevertheless, the protectionist provisions clearly

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8. When foreign banking was first permitted in 1994, the aggregate capital share of foreign subsidiaries in the Mexican domestic market was limited to eight percent. The Mexican plan called for an increasingly liberal scheme of foreign ownership over a six-year transition period, which in the last year of the transition would have permitted foreign banks to control an aggregate of 15% of the capital in the commercial banking market. NAFTA, supra note 1, Annex VII (B)(9), 32 I.L.M. at 774. At the end of the transition period, the aggregate capital limits would have lapsed subject only to Mexico's reserved right to impose additional limitations on banking competition if foreign banks control 25% of the Mexican banking market before January 1, 2004. See Ramon Bravo H., Mexican Legal Framework Applicable to Operations Involving Financial Services, 25 St. Mary's L.J. 1239, 1249-51 (1994).


10. See Naida, supra note 5, at 407.


12. After three centuries of Spanish colonial exploitation, Mexico won its independence in 1821, but had very little financial infrastructure in place to support an independent economy. See Nalda, supra note 5, at 380-81. After independence, Mexico rarely had the sustained domestic tranquility necessary to develop that infrastructure. In the 1800s, Mexico resisted an invasion from Spain, two invasions from France, and significant border battles and outright war with the United States. Id. These geopolitical troubles not only hampered Mexico's development of a domestic financial system, but forced Mexico to obtain financing from foreign sources.

appear to have failed in their goal of safeguarding domestic banks from foreign control.

The protectionist provisions were designed to nurture the recently privatized Mexican banks, but, ironically, the privatization process itself sowed the seeds of the protectionist scheme’s demise. After reprivatization in the early 1990s, Mexican banks grew at a furious rate. Most banks were owned by financial groups dominated by securities firms with high risk tolerances, and the bank managers hired to run these institutions felt pressure to recover the rich premiums paid to acquire the banks. Consequently, loan quality dropped, while loan growth soared; eventually, banks had to increase significantly their loan loss reserves. The devaluation of the peso in late 1994, together with the credit quality problem, sent Mexico’s banks into crisis. In response to the crisis, international and Mexican banking concerns took action to stabilize the Mexican banking system.

In the immediate aftermath of the 1994 peso crisis, Mexico modified, but did not abandon, its foreign ownership rules to permit greater foreign influence in the banking system. As times got more difficult, however, Mexico once again turned to foreign capital. Although Mexican banks showed a revival and demand for peso-denominated loans had been increasing, the weaknesses in the banking system were

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16. See Karaoglan & Lubrano, supra note 14, at 27 (noting the increase of loan loss reserves).

17. See Norwood, supra note 6, at 173-174. See generally Javier Gavito et al., Mexico’s Banking Crisis: Origins, Consequences and Countermeasures, in REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS IN THE NAFTA COUNTRIES AND BEYOND (George M. von Furstenberg ed., 1997) [hereinafter REGULATION AND SUPERVISION] (providing a detailed history of the peso crisis and the response thereto); Fluckiger, supra note 15 (outlining the regulatory changes brought about by the crisis); Karaoglan & Lubrano, supra note 14 (describing the government’s response to the peso devaluation).

18. In February 1995, Mexico liberalized the rules for foreign ownership of its banks. See Fluckiger, supra note 15, at 79 (describing changes in Mexican law that expand but do not eliminate the NAFTA foreign ownership limits).


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serious, and Mexican banks had a great deal of difficulty attracting capital.\textsuperscript{20} Politically, it became extremely embarrassing for the Mexican federal government to bail out the troubled banking institutions, especially as political reforms permitted the formation of meaningful opposition to the ruling Institutional Revolutionary Party in Congress.\textsuperscript{21}

In December 1998, Mexico changed its domestic banking laws in a way that rendered the NAFTA restrictions almost moot. Today, Mexico allows broad foreign ownership of its banks, subject to regulator approval.\textsuperscript{22} Some of Mexico's largest banks are now foreign-owned,\textsuperscript{23} though the Mexican government retains the right under NAFTA to freeze foreign ownership if foreign-owned institutions control more than twenty-five percent of the market.\textsuperscript{24} While Mexico has changed its foreign ownership rules, in part due to its need for foreign capital, part of the liberalization may also be attributed to a belief in the benefits of barrier-free trade.\textsuperscript{25} Other sectors of the Mexican economy have been participating in free trade with great enthusiasm and success.\textsuperscript{26} It is

\begin{itemize}
\item \textsuperscript{22} See Del Cueto & Martinez, \textit{supra} note 11, at 62-63.
\item \textsuperscript{23} See Peter Fritsch, \textit{Bank Deal to Create New Mexican Behemoth}, \textit{Wall St. J.}, June 13, 2000, at A19 (reporting on the takeover of Bancomer by Spanish banking concern Banco Bilbao Vizcaya Argentaria SA to create the largest bank in Mexico—controlling about 30% of the banking market); \textit{see also} Pamela Druckerman, \textit{Spain’s BSCH Wins Major Mexican Bank}, \textit{Wall St. J.}, May 9, 2000, at A23 (reporting that the Spanish firm Banco Santander Central Hispano SA won an auction for the Mexican Grupo Financiero Serfin SA).
\item \textsuperscript{24} See John Rogers et al., \textit{The Restructuring of Mexican Financial Services and the Application of Chapter 14 of NAFTA}, \textit{7 U.S.-Mex. L.J.} 67, 67 (1999).
\item \textsuperscript{25} See David Friedman, \textit{Hidden Order} 282-87 (1996) (providing a simple mathematical proof of why elimination of tariffs, even on a unilateral basis, is wealth maximizing); N. Gregory Mankiw, \textit{Macroeconomics} 202-04 (3d ed. 1997) (setting forth the widely accepted view that while protectionist trade policies have no affect on the trade balance, they do affect the amount of trade, and that trade benefits all countries, whereas protectionism makes everyone worse off even if it produces some winners within a society).
\end{itemize}
possible that the forces of political freedom that are reshaping Mexico believe that less-restrictive cross-border trade in financial services will increase competition; reduce prices; help eliminate inefficient regulation; and otherwise improve the market for financial services and the overall climate for business growth in Mexico.

The experience of foreign bank ownership in Mexico since NAFTA, then, is one of abandonment of protectionist ownership rules and an acquiescence to, if not an embracing of, the free market for bank control. Canada is a different story. While the Canadian Bankers Association touts international banking as the ideal export, Canada has not openly embraced unfettered international access to its own banking system. Instead, Canada has aimed to give the appearance of liberality, while jealously guarding its largest banking institutions against the possibility of foreign takeover. Canada has clung to this strategy even while engaging in a series of sweeping banking law reforms designed to modernize the Canadian banking system and make it internationally competitive.

Unlike Mexico, where changes in the banking regulatory scheme have been precipitated by crises, Canada subjects its banking law to periodic and systematic reconsideration, resulting in major revisions about once every ten years. The use of these regular reviews, together with the different political dynamic of the parliamentary system, among other factors, has allowed Canada to modernize its financial system quite quickly. On its face, the trend in Canadian banking law reform has been to eliminate the traditional product line restrictions in

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27. The recent election of Vicente Fox has been seen by some as evidence that free markets and free politics go hand-in-hand. See Editorial, Mexico: Open Markets, Open Politics, Bus. Wk., July 17, 2000, at 164, 164 ("Fox’s election is a rousing vindication of the principle that open markets can be a positive force for political change."); see also Peter Fritsch, Mexican Economy Drives Political Shift, WALL ST. J., June 26, 2000, at A21 (comparing the implementation of NAFTA to the fall of the Berlin Wall).

28. See Ernesto Aguirre, International Economic Integration and Trade in Financial Services: Analysis from a Latin American Perspective, 27 LAW & POL’Y INT’L BUS. 1057, 1060 (1996) ("liberalization may raise the average efficiency of industry, and this should be reflected in lower prices for financial services and products").

29. See CAN. BANKERS ASS’N, CANADIAN BANK FACTS 4 (2000) [hereinafter CBA FACTS] (noting that Canadian banks are major-exporters, generating 49% of the their earnings abroad, while having 90% of their workforce located in Canada and paying 77% of their taxes in Canada).


the financial services sector and to permit easier foreign entry into the Canadian banking market. For example, at the time NAFTA was adopted, Canadian law prohibited non-Canadians from owning more than twenty-five percent of the shares of a domestic bank. Under NAFTA’s general national treatment requirement, Canada had to give the United States and Mexico relief from that provision. Shortly after providing that relief, Canada proceeded to repeal the foreign ownership law altogether, in order to comply with the World Trade Organization Agreement (“WTO Agreement”). So, while Canada appeared to be making foreign access more liberal, it really only did away with an obviously unacceptable protectionist provision that would not pass muster in the international arena.

Similarly, in 1980, Canada appeared to liberalize foreign access to the Canadian market by permitting foreign banks to establish so-called Schedule II banks as subsidiaries. The Schedule II banks were permitted, subject to the caveat that together they could not control more than eight percent of the nation’s banking assets. Over the years, the

32. Those restrictions were formerly found in the Bank Act, but were repealed in 1994. R.S.C. ch. B-1.01, § 399(1) (1985), repealed by ch. 47, 1994 S.c. 20 (Can.).

33. The Bank Act now makes special provision for “NAFTA country residents.” See Bank Act, R.S.C. ch. B-1.01, § 11.1 (Can.).

34. See CAN. BANKERS ASS’N, OUR VISION OF THE future of the CANADIAN FINANCIAL SERVICES SECTOR: SUBMISSION to the TASK FORCE 44 (1997) [hereinafter CBA SUBMISSION].

35. See FREEDMAN, supra note 30, at 8-9 & n.14. One might argue, with some justification, that the 1980 amendments did not improve the situation for foreign firms servicing the Canadian market, but in fact made it more expensive for foreign banks to do business there. See John Harman, Working the Corners, CAN. BANKER, May/June 1996, at 23, 24-25 (providing an interesting perspective on the significance of the 1980 amendments as they related to foreign entry). Harman states:

Before 1967, foreign banks operated relatively unfettered, as either branches or banks. But in a wave of nationalistic fervor, the 1967 Bank Act effectively excluded foreign bank subsidiaries. The result was not what the government had intended ... Between 1967 and 1981, foreign banks operated in Canada as incorporated entities, raising capital through the Canadian money market, usually with the backing of their parent banks, among the world’s largest. Since these “near-banks” were operating outside the Bank Act, they weren’t required to maintain reserves with the Bank of Canada, which gave them a 50- to 75-basis-point advantage on loan rates ... Working in this fashion, the foreign banks prospered. They were able to compete effectively for corporate business, both with Canadian companies and subsidiaries of companies that their parent banks were already dealing with. Indeed, many of them would have been satisfied to continue operating in this way.

Id. at 24.
asset limitations were raised, and then eliminated altogether, as Canada made commitments under the U.S.-Canada Free Trade Act, NAFTA, and the WTO Agreement. Nevertheless, the foreign-owned Schedule II subsidiary was a second-class Canadian citizen even without the asset limitations. Until the branching legislation adopted in 1998, foreign-owned Schedule II banks had to comply with additional restrictions not required of Canadian banks in order to establish branches across Canada. Even with the branching legislation, however, the Schedule II bank structure provides non-Canadians less than perfect access to the Canadian market, because the required juridical form for cross-border retail banking—the subsidiary—is not as beneficial to the foreign institution as cross-border branching.

Although NAFTA liberalized access to the Canadian banking market, it did not eliminate all obstacles to cross-border banking. Indeed,

36. See CBA SUBMISSION, supra note 34, at 47.
38. All other things being equal, from the point of view of the parent banking organization, cross-border banking should be more economically attractive than setting up a foreign subsidiary because capital, accounting, and legal costs can be shared more easily. See Stephen Zamora, Comments on the Regulation of Financial and Legal Services in Mexico Under NAFTA, 1 U.S.-MEX. LJ. 77, 79 (1993). In addition, loans generated by a branch may rely on the capital of the home bank in the home country instead of on the branch’s capital. See Michael Gruson & Ralph Reisner, Regulation of Foreign Banks, at I-26 (2nd ed. 1995). On the other hand, liabilities of the branch will be imposed on the home office more readily than would the obligations of a separately organized subsidiary. See Wells Fargo Asia, Ltd. v. Citibank, N.A., 936 F.2d 723, 727-28 (2d Cir. 1991), cert. denied, 505 U.S. 1204 (1992) (holding that absent a contractual restriction on the place of collection, a customer of a foreign branch may recover the amount of the obligation from the bank’s home U.S. office). The risk of foreign sovereign actions that make meeting obligations impossible was addressed somewhat by amendments in 1994 to the Federal Reserve Act and the Federal Deposit Insurance Act, which changed the law to hold the home U.S. offices liable for such obligations only if agreed to in writing. See Palace, supra note 7, at 169 (describing the amendments).
39. One of the biggest obstacles to cross-border banking remaining in place involves the permissible legal structure of banking enterprises in the member countries. The NAFTA left the issue of cross-border branching for future resolution, and memorialized that compromise in article 1403(3), which states:

at such time as the United States permits commercial banks of another Party located in its territory to expand through subsidiaries or direct branches into substantially all of the United States market, the parties shall review and assess market access provided by each party ... with a view to adopting arrangements permitting investors of another Party to choose the juridical form of establishment of commercial banks.

NAFTA, supra note 1, art. 1403(3), 32 I.L.M. at 657.
prior to 1998, Canada was one of only two countries in the top fifty market economies that did not permit branching within its territory by foreign banks.\footnote{40} In theory, NAFTA adopted an approach to cross-border expansion that would have allowed foreign banks to decide whether to branch or establish a subsidiary.\footnote{41} In reality, through a scheduled exception to NAFTA, foreign banks were not permitted to branch into Canada, but instead were required to establish a Canadian bank subsidiary.\footnote{42} In 1998, Canada changed its branching policy to permit foreign banks to branch into Canada, thereby appearing to advance the NAFTA goal of free trade in financial services. Once again, however, the changes were less than they appeared.

Canada’s branching legislation liberalized its market entry requirements sufficiently to conform with the commitments Canada made as part of the General Agreement on Trade in Services ("GATS") of the WTO.\footnote{43} But it seems that Canada consciously emulated American branching requirements,\footnote{44} which appear liberal, but on closer inspection are rather difficult for foreign banks to exploit. Canadian law now permits foreign banks to branch into Canada subject to the following restrictions, among others: (1) only foreign banks with assets of at least $35 billion are permitted to branch; (2) foreign branches may not take

\footnote{40. See Larry M. Greenberg, Canada’s Banks Question Their Cocoon, WALL ST. J., Apr. 16, 1998, at A17.}
\footnote{41. Section 1403(1) says that investors of a Party should be free to establish financial institutions in the other countries "in the juridical form chosen by such investor." NAFTA supra note 1, art. 1403(1), 32 I.L.M. at 657. The import of that provision is that banks should be able to expand across borders by establishing either branches or subsidiaries as dictated by their business plan rather than by banking law.}
\footnote{42. See Greenberg, supra note 40. To the extent foreign banks are present in Canada, they do business through Schedule II banks, which account for about 12% of the banking assets in Canada.}
\footnote{44. Regulatory harmonization in North America is often characterized by "regulatory emulation." See Arthur J. Cockfield, Tax Integration Under NAFTA: Resolving the Conflict Between Economic and Sovereignty Interests, 34 STAN. J. INT’L L. 39, 45-46 (1998) (describing the idea of regulatory emulation in North America in the tax context). For example, Canada and Mexico tend to change their policies to be at least as liberal as the United States in order to ensure that they have not erected obstacles to the movement of international resources that would favor investment in the United States over either Canada or Mexico. Id. On a broader level, the United States is such an important player in the world economy that its regulatory schemes affect other countries in at least three ways: (1) U.S. initiatives produce a competitive dynamic such as the emulation just described; (2) other countries imitate U.S. policies; and (3) the United States applies direct pressure on other countries to conform their laws to the U.S. scheme. See STEVEN K. VOGEL, FREER MARKETS, MORE RULES 36-37 (1996).}
retail deposits; (3) the Canadian regulator may require maintenance of assets in Canada to cover branch liabilities; (4) foreign branches must maintain, with a Canadian depositary institution, an amount equal to at least five percent of branch liabilities; (5) the home bank must meet certain standards of supervisory review; (6) the foreign branch is subject to Canadian reporting, auditing, and taxation requirements; and (7) the Canadian bank regulator has the power to seize all assets of the foreign bank to satisfy the liabilities of a branch. While giving the appearance of providing greater access to the Canadian market, these requirements go a long way toward completely eliminating the benefit of the branch form of expansion, thereby shielding Canadian banks from the competition that might have resulted from this form of lower-cost foreign entry.

II. GENESIS OF THE WIDELY HELD RULE

All of the recent changes in foreign access to Canada’s banking market have been essentially cosmetic—appearing to make foreign access more liberal while in reality changing the status quo very little. On one point, the so-called widely held rule, Canada does not even bother to pretend that its banking law is friendly to foreign entrants. Under this rule, no person or group may control ten percent or more of a Schedule I bank unless one first obtains the approval of the Minister of Finance. This rule makes foreign acquisition of a Schedule I bank virtually impossible.

The widely held rule was enacted in 1967 in response to the acquisition of Mercantile Bank by First National City Bank (predecessor to today’s Citicorp) and the fear that Toronto-Dominion Bank was an intended target of a hostile takeover from Chase Manhattan. The rule

45. See Elliott, supra note 43, at 55.
46. All banks are federally chartered and fall into one of two categories, referred to as “Schedule I” and “Schedule II” banks. See Bank Act, R.S.C. ch. B-1.01, § 14 (1996) (Can.); see also Jordan, supra note 2, at 46 & n.8. At present, the Schedule I banks are the “Big Five”—Royal Bank of Canada, Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, and Toronto Dominion Bank—together with National Bank of Canada, Laurentian Bank, and Canadian Western Bank. See CBA FACTS, supra note 29, at 28-30 (listing the chartered banks of Canada and indicating whether they are Schedule I or Schedule II banks).
47. See Bank Act, R.S.C. ch. B-1.01, § 370(2) (1996) (Can.).
was clearly intended to thwart foreign takeovers of Canadian banks, especially by American banks. In case the purpose of the law was not transparent to all, the widely held rule was originally coupled with an additional restriction that foreigners could not own twenty-five percent or more of the total equity in a bank.\(^{50}\) The widely held rule acts like a statutory poison pill, making acquisition of a Schedule I bank impossible. For the past thirty-three years, therefore, the big Canadian banks have operated free from the fear of hostile takeover and especially free from foreign takeover. Yet times do change, and the protectionist sentiment that prevailed in the late 1960s in Canada may be succumbing to international norms of free trade that are contemptible of laws like the widely held rule.

The Canadian Parliament therefore is currently considering changes to the widely held rule with an eye toward enhancing competition. The new scheme will subject banks to different ownership rules based on the size of the institution. Banks with equity of less than $1 billion will have the most flexibility for ownership options.\(^{51}\) These small banks may be wholly owned by a single shareholder, even a commercial enterprise.\(^{52}\) This is a departure from the current law, which permits most Schedule II banks to be wholly owned, but requires some of them to become widely held after ten years, regardless of size.\(^{53}\) Banks with equity between $1 billion and $5 billion will be subject to a less flexible ownership rule.\(^ {54}\) These medium-sized banks will be permitted to be closely held but must have at least thirty-five percent of their shares held by the public and listed on a Canadian stock exchange.\(^ {55}\) These publicly owned shares may not be owned by individuals with a significant interest in any class of voting shares.\(^ {56}\) Finally, banks with equity in excess of $5 billion will continue to be subject to the widely held rule,

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50. See Bank Act, R.S.C. ch. B-1.01, § 399(1) (1985), repealed by ch. 47, 1994 S.C. 20 (Can.). Prior to the repeal of the foreign ownership restriction, the widely held rule was known as the "10-25" rule. See CBA SUBMISSION, supra note 34, at 44.


52. See Harvey Schachter, Ottawa Unveils its Plans for Financial Services, CAN. BANKER, July-Aug. 1999, at 26, 29 [hereinafter Schachter, Ottawa].

53. Id.

54. At present this medium size category only covers one Schedule I bank—the National Bank of Canada. See Schachter, Vision, supra note 51, at 12.


56. See Schachter, Ottawa, supra note 52, at 29.
but on more liberal terms.\textsuperscript{57} Instead of the current restriction that no shareholder own more than ten percent of the equity of a Schedule I bank, the new legislation will permit investors to hold up to twenty percent of the class of any voting shares, and up to thirty percent of the non-voting shares of the larger banks (subject to a test of their suitability as prospective owners and the soundness of their business plans). This liberalized scheme is ostensibly designed to provide flexibility for banks to enter into joint ventures and strategic alliances.\textsuperscript{58}

It is important to note that under the proposed legislation the widely held rule will be liberalized, but not eliminated. In an era of increasing international free trade, what is one to make of Canada's barriers to foreign entry, such as Schedule II bank restrictions; restrictive branching requirements; and, especially, the widely held rule? On first blush, these measures seem like classic examples of rent-seeking behavior by a regulated industry seeking protection by its government overseers.\textsuperscript{59}

This simplified public choice explanation has special intuitive appeal in Canada because the banking industry is so highly concentrated,\textsuperscript{60} and hence banking policymakers get a clear picture of what the industry wants. It would be quite easy for policymakers to provide the banking industry the rent it seeks in exchange for political and other considerations.\textsuperscript{61} The simple public choice description, however, would not be an apt one in this situation because the Canadian banking industry does not, at present, especially want the widely held rule.

\textsuperscript{57} This is the category that covers the "Big Five" banks—Royal Bank of Canada, Bank of Montreal, Canadian Imperial Bank of Commerce, Toronto-Dominion Bank, and the Bank of Nova Scotia.

\textsuperscript{58} See Schachter, Ottawa, supra note 52, at 26.

\textsuperscript{59} This would certainly be the standard interpretation under the "public choice" model of legislation, which holds that laws are little more than a product sold in a political marketplace that effects a wealth transfer from one group to another. For a general discussion, see generally Robert D. Tollison, Public Choice and Legislation, 74 VA. L. Rev. 339 (1988).

\textsuperscript{60} Instead of the thousands of independent banks found in the United States, Canada is dominated by five (or six, depending on who is counting) large institutions with nationwide branching networks: the Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada, and Toronto Dominion Bank (and, more marginally, National Bank of Canada). See James R. Kraus, Canadian Government's Fears of Concentration Seen Threat to Megadeal, AM. BANKER, Feb. 12, 1998, at 20.

\textsuperscript{61} See generally Eric J. Gouvin, Banking in North America: The Triumph of Public Choice over Public Policy, 32 CORNELL INT'L L.J. 1, 13-15 (1998) (discussing public choice theory in the regulation of banking in North America). Public choice scholars would have little trouble describing this dynamic as a bargained for exchange between a powerful interest group and a governmental actor. See id. at 30-31 (describing the Canadian banking scene).
In its submission to the McKay Task Force on the Future of Canada's Finance System, the Canadian Bankers Association ("CBA") provided a detailed discussion of the widely held rule and ultimately recommended that the rule be reexamined against current social, economic, and political conditions.62 The CBA's discussion provided a list of the reasons for retaining the widely held rule63 and for eliminating it.64 It is clear from the tone of the CBA's remarks, however, that the bankers would like to see the widely held rule repealed; every reason for retaining the rule was accompanied by a short rejoinder stating why the reason was not a sound one, while none of the reasons for eliminating the rule was accompanied by such rebuttals. Overall, perhaps because of the audience of the CBA's submission and its public nature, the reasons offered for and against the rule were quite polite and diplomatic. Furthermore, the document did not candidly address the real reasons why the bankers would like the rule eliminated or the real reasons why the federal government is unlikely to eliminate the rule. The following provides a more candid analysis of the reasons for and against the widely held rule.

62. See CBA SUBMISSION, supra note 34, at 43-46.

63. Included on the list of reasons for retaining the rule are the following: (1) to avoid the extraterritorial application of U.S. law designed to further U.S. foreign policy objectives; (2) to avoid foreign ownership of Canadian banks in order to protect Canadian businesses from lack of access to credit in the event of an economic downturn in the foreign bank's home country; (3) to maintain the ability of Canadian regulators to use "moral suasion" to achieve Canadian national objectives for the financial services sector; (4) to guard against the withdrawal of services in Canada due to a downturn in the home country of foreign-owned institutions; (5) to limit the ability of commercial firms to own banks; and (6) to safeguard the existence of a Canadian banking system as a tool of national policy implementation. See id. at 44.

64. Included on the list of reasons to eliminate the rule are the following: (1) the rule is ineffectual as a protection against foreign ownership, because listing the banks on international stock exchanges or by having ten foreign persons acting in concert can circumvent the rule's goal of ensuring Canadian-ownership; (2) the rule has the effect of limiting the size of Canadian institutions and hampering their ability to obtain economies of scale and scope; (3) from the point of view of employment policy, foreign entry is not a bad thing; (4) Canadian investors could receive an attractive return from investing in foreign banks as easily as investing in Canadian banks; (5) foreign banks could still rise to dominate Canada's market through other modes of entry besides a takeover of a Schedule I bank; (6) the rule deprives Schedule I bank shareholders of the control premium; (7) the physical location of financial service providers is increasingly irrelevant in the current era of technology and communication; (8) the rule might create too much insulation from market discipline for the management of Schedule I banks; (9) the rule puts Schedule I banks at a disadvantage vis-à-vis other financial service providers who are not subject to the rule; and (10) the protections the rule provides against self-dealing are overstated. See id. at 45.
III. REASONS FOR REPEALING THE WIDELY HELD RULE

The bankers would like to see the rule eliminated for several reasons.

A. Market Forces Protect the General Canadian Retail Banking Market from Foreign Competition, so the Rule is Unnecessary to Protect Canadian Banks.

Canadian bankers do not need the widely held rule to protect them from foreign competition and have not needed its protections for a long time. The Canadian domestic banking market is relatively small and thoroughly controlled by the Schedule I institutions. The Canadian banking market is an over-banked, mature market in which the big banks have long customer relationships and efficient operations.65 Foreign competitors have recognized that the Canadian retail banking market is not worth fighting over.66 Although many U.S. banks maintain a presence in Canada, it is clear that they will never be major players there.67 Yet the big Canadian banks do have something to fear from foreign competition.

In the last two revisions of the Bank Act, Parliament has implemented commitments made under various trade agreements and expanded foreign access to the Canadian financial services market. In the traditional full-service retail banking segment, these more liberal access provisions are not particularly worrisome for Canadian banks because foreign financial service providers, including firms from the United States, have found it very difficult to establish profitable retail banking operations in Canada.68 From the point of view of potential new entrants, the Canadian banking market suffers from some serious disadvantages. First, it is a relatively small market, so creating a bank with real growth potential on the strength of only Canadian banking relationships is difficult, simply because the population of the country is too small. Second, the small market that exists is already adequately served by the banks, credit unions, and other intermediaries currently

65. See James R. Kraus, Canada Plan Would Permit Cross-Border Branches, AM. BANKER, May 22, 1997, at 22 (quoting Canadian banking experts who state that Canada has a technology and cost efficiency edge on U.S. banks resulting in lower spreads and the need for high volume to cover costs).

66. See Aaron Elstein, Canada Bars 2 Megadeals, Sees Threat to Competition, AM. BANKER, Dec. 15, 1998, at 1 (noting that market conditions discourage foreign buyers: “For all its size, Canada’s population is slightly smaller than California’s.”).


68. See id. (noting that foreign banks in Canada have failed to achieve rates of return on equity that even equal the return available from Canadian treasury bills).
in existence. There may not even be an unmet demand for banking services or a competitive opportunity sufficiently rich to be worthy of development. Third, like the rest of Canada's economy, Canada's banks are linked to natural resources and energy.\textsuperscript{69} Swings in those sectors affect the banking business as well. To address these problems, the Canadian banking industry has diversified its assets in overseas markets.\textsuperscript{70} As with other sectors, the government has encouraged the export of financial services as a way to permit Canadian banks to continue to grow despite the constraints of the domestic market.

Consequently, foreign financial service providers that have ventured into Canada have left the general banking market to the Canadian banks and instead have focused on exploiting niche businesses like credit cards and business lending.\textsuperscript{71} This niche strategy is really just cream skimming—taking the profitable lines that used to belong to the Schedule I banks and leaving the unprofitable aspects of the Canadian banking market for the Canadian banks to maintain.\textsuperscript{72} In the end, the profitable lines of business (and geographic regions) will see intense competition, but the Schedule I banks will be saddled with a far-flung (and largely unprofitable) branch network that is no longer being subsidized by more lucrative banking business.\textsuperscript{73}

\textsuperscript{69} See ANDREW H. MALCOLM, THE CANADIANS 246 (1986).


\textsuperscript{71} See CHARLES FREEDMAN & CLYDE GOODLET, THE FINANCIAL SERVICES SECTOR: PAST CHANGES AND FUTURE PROSPECTS 25 (March 1998) (noting that the dominant position of Canada's banks will be challenged by "global" banks and niche players). See generally Harman, supra note 35 (giving a thorough overview of the various niche business strategies of the many foreign-owned banks operating in Canada).

\textsuperscript{72} See Elstein, supra note 66, at 30 (noting that MBNA has become a major player in credit card operations, Wells Fargo has gone after small business, and ING has made inroads in virtual banking).

\textsuperscript{73} Of course the Canadian banks are well-run businesses, and the cream skimming of the new arrivals will not automatically result in loss of those lines of business. To date, even in niche markets, foreign concerns have encountered a fierce home court advantage in favor of the
But niche markets aside, no amount of maneuvering in Ottawa is going to make the Canadian general retail banking market more attractive to foreign entrants. The unattractiveness of the Canadian market is evidenced by the number of new entrants seeking to do business in Canada as Schedule I banks. In the period between 1987 and 1999, Canada granted only two new Schedule I bank charters, while in the United States 207 new bank charters were issued in 1997 alone. The government acknowledges that the lack of new entrants hurts consumer interests. While some of the unattractiveness of starting a new Schedule I bank can be attributed to the legal restrictions on that kind of bank, even if the government changes the Bank Act to make entry easier, the economic situation may nevertheless preclude new entrants from venturing into a full service retail banking business in Canada. Therefore, while the retail banking market remains firmly Canadian, Canadian bankers are nevertheless witnessing the end of their protectionist advantage as foreign competitors wrest away the most profitable lines of business. Industry players seem to be chafing at the protectionist bent of existing law, and that sentiment may presage a change in policy.

B. There is a Political Quid Pro Quo that is no Longer a Good Deal for the Banks.

The widely held rule has dampened competition in the banking market and allowed the big banks to operate without fear of foreign takeovers. Yet the protection has come at a price. For reasons that are more political than economic, the big Canadian banks maintain an extensive branch network across the country. Of course most of the rural branches do not pay for themselves, yet from a political point of view it is quite difficult to close a branch. For years, Canadian bankers have recognized that maintaining a branch system is a cost of doing business and that the banks’ profitable lines of business have subsidized Canadians. For example, since Canada has permitted banks to acquire securities dealers as subsidiaries, all of the major Canadian securities dealers are now owned by banks, and all three U.S. brokerage firms with a presence in Canada in 1987 withdrew from the market by 1994. See White, supra note 67, at 10.

74. See Urquhart, supra note 55.

75. See Schachter, Ottawa, supra note 52, at 29 (reporting on a government study that found the “lack of new entry is not in the best interest of Canadian consumers.”).

76. See Greenberg, supra note 40 (“Most bank chiefs themselves say the costs of preferential treatment outweigh the benefits.”).

77. See id.
their community banking activities in small towns across the country. From the perspective of banking law as social policy that cross-subsidization is probably desirable, but from the bottom line point of view of running a business it is impractical. As foreign competitors skim off the profitable lines of business that subsidized the rural branches, banks feel the squeeze.

In the CBA submission to the McKay Task Force, there is a long section that sets out to refute the perception that banks are “privileged institutions.” The fact that the CBA felt compelled to spend thirteen pages of its submission refuting these allegations speaks volumes about the realpolitik of Canadian bank regulation. Perhaps because of their size and power, the Big Five Schedule I banks suffer from a negative public image. There is a perception that the widely held rule; foreign bank entry restrictions; the too big to fail doctrine; deposit insurance; access to the Bank of Canada as lender of last resort; and access to the payments system are special benefits bestowed on banks. On the political level, in exchange for the special treatment, banks must provide certain benefits to Canada, such as maintaining a nationwide bank system. While the public complains about the privilege end of the deal, the banking industry objects to the public benefit end of the deal. Banks are expected to extend an ever-increasing level of support for social programs as part of the quid pro quo for being a chartered bank. Indeed, the Schedule I banks complain that the banking system

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78. See Malcolm, supra note 69, at 242 (1986) (noting the role that Canadian banks play in the community, and the opportunity for employment and social mobility afforded by banks in rural areas).

79. See Information Morning: Interview with Prof. Bernard M. Wolf on Bank Branch Closings (CBC One radio broadcast, July 31, 2000) (discussing with a professor from York University the economics of branch banking in light of announcements by the Bank of Nova Scotia that it will close some branches in rural locations).

80. See CBA Submission, supra note 34, at 43-56.

81. See Peter C. Newman, Titans: How the New Canadian Establishment Seized Power 291 (1998) (“... the public perception is set in concrete: they are too big and too powerful; they make huge profits and pay minimum taxes; they short-change small business, charge their customers extravagant fees, and would gladly tax sex if that would expand their already bloated bottom lines”); see also Simon Hally, Food for Thought, CAN. BANKER, Sept.-Oct. 1998, at 5, 5 (providing an interesting comparison between the respective public images of supermarkets and banks).

82. See CBA Submission, supra note 34, at 43-56.

83. See Harvey Schachter, Beyond the Bottom Line, CAN. BANKER, Sept.-Oct. 1996, at 24, 24; see also Banks, Social Groups Aim to Improve Availability of Services to the Poor, CAN. BANKER, Sept.-Oct. 1996, at 8, 8 (discussing the political pressure on banks to provide check cashing services or low cost accounts to the poor).
is being treated like a quasi-public utility. The banks would like to eliminate the widely held rule as part of a multi-prong attack on the privileged institution characterization. The ultimate goal of this attack is to end the political perception that banks owe the government certain favors, thereby relieving the political pressure on the big banks to be all things to all customers in all parts of Canada. This desire to be let out of the political deal that has bound the country, and the banking industry, for so long is merely symptomatic of the changing of the guard in Canada's business establishment from the old-line, clubby power brokers to a more bottom-line focused international group.

C. Lack of the Possibility of a Control Premium Increases the Cost of Capital.

The widely held rule has been a statutory poison pill, in effect insulating Schedule I banks from hostile takeover and protecting the management of those banks from the operation of the market for corporate control. With surprising candor, the CBA admitted that one of the ill effects of the widely held rule is that it might make the management of Schedule I banks less attentive to market discipline. The CBA also noted that the widely held rule has deprived the shareholders of Schedule I banks from ever receiving the value of the control premium for the shares of the bank. The control premium problem only received a one sentence bullet in the CBA's submission since an elaborate discussion of the issue would have only served to highlight the possibility that the banks will be sold to the highest bidder if the shares could be traded without restriction. Probably seeking to avoid such politically dangerous associations, the CBA submission skimmed over the control premium problem, but it deserves more attention.

Research on U.S. corporate share prices shows that management implementation of a poison pill drives down share prices and therefore

84. See CBA SUBMISSION, supra note 34, at 60 (stating that banks should be perceived by regulators as "responsible businesses, not public utilities"); Greenberg, supra note 40 (quoting A. Charles Baillie, chairman of Toronto-Dominion Bank, as saying "the public is treating us [Canada's big banks] more and more like quasi-public institutions.").
85. See generally Newman, supra note 81, at 276-338.
87. See CBA SUBMISSION, supra note 34, at 46.
increases the cost of capital. Other studies, using more recent data in which shareholder reaction has been informed by experience with the poison pill mechanism and perhaps an understanding that pills tend to result in negotiated takeovers with high premiums, however, tend to show an insignificant effect on stock price. The widely held rule, however, is more than just a shareholder rights plan adopted by and waiveable by a bank’s board of directors—it is a statutorily imposed restriction that effectively precludes takeovers altogether and will not result in a higher-premium negotiated deal. Therefore, even if the research on garden variety poison pills indicates they are having little negative impact on share prices, the widely held rule nevertheless falls into a different category.

There has been some research on the effect of statutory poison pills on share prices. In a study of the set of anti-takeover laws adopted in Ohio in the mid-1980s, researchers found that the corporations most susceptible to takeover bids incurred a loss in market value of approximately 4.5% after Ohio adopted its anti-takeover legislation. The Ohio legislation was more than just a poison pill, and seemed to be a message of governmental hostility to unwanted takeovers, thereby making a direct correlation specifically to the poison pill issue a bit tenuated. In any event, the widely held rule is probably better compared to the Ohio statute study than to the studies of share price changes from firm-specific poison pills.

If the lesson to be drawn from the statutory poison pill studies is that erecting obstacles to the realization of a control premium adversely affects stock price and therefore increases the cost of raising capital, 


89. See, e.g., Robert Comment & G. William Schwert, Poison or Placebo? Evidence on the Deterrent and Wealth Effects of Modern Antitakeover Measures, 39 J. FIN. ECON. 3, 19-21 (1995) (observing that older studies found a negative impact on share prices from adoption of poison pills but that more recent adoptions have produced insignificant changes in stock price).

the widely held rule hurts Schedule I banks. The Schedule I banks are in need of capital to expand their operations both overseas and domestically, yet the price they must pay for that capital is artificially increased. The CBA states its concern over the effect of the widely held rule as a poison pill in terms of the inability of shareholders to realize a control premium, but the real problem is one for the banks' corporate treasurers in seeking additional capital.

D. In an Era of Free Trade, Being too Closely Bound to the Canadian Market Hinders the Banks.

Canada is and always has been a trading nation. Indeed, the Canadian banks understand that aggressive development of the international banking market is essential to their long-term health. Yet as Canada pursues the ideal of free trade generally, it will also find that economic forces will deploy resources to more fully exploit areas in which Canada enjoys a comparative advantage. One can expect strong sectors such as mineral extraction and other staples—long the mainstays of Canada's economy—to grow stronger, and weaker sectors, perhaps including the banking sector, to grow weaker. Because Canada's largest banks are hemmed in from growing through merger and acquisition, and because Canada has a policy that big banks shall not buy other big banks, it seems unlikely that Canadian banks will be able to hold their own against their larger foreign rivals in a world of reduced trade barriers, in which comparative advantage is translated into economic gain. Indeed, Canada's financial centers are already quite marginalized,

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93. Witness the refusal of the Finance Minister to permit the combination of Royal Bank and Bank of Montreal or the Toronto-Dominion Bank with CIBC. See Elstein, supra note 66, at 1 (quoting Finance Minister Paul Martin as saying that Royal Bank of Canada's proposed merger with Bank of Montreal and Toronto-Dominion Bank's proposed merger with Canadian Imperial Bank of Commerce would "lead to an unacceptable concentration of economic power in the hands of fewer, very large banks.")

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surpassed by London, New York, Tokyo, and Hong Kong, where greater market depth, historical international orientation, larger players, and commitment to innovation leave Toronto, Montreal, and Vancouver at a distinct disadvantage. By some measures, the world is already passing by the Canadian banks. The big Canadian banks grow smaller by global standards with each passing year. Citicorp alone has a bigger market capitalization than the Big Five combined. While the size of an institution is not necessarily a guarantee of business success, in the financial services marketplace size has some significance, especially in an area that Canadian banks have identified for growth: trade finance. Canadian banks find their options for raising capital limited by their inability to sell out to a foreign banking organization; to be acquired by a large commercial concern; or even to give a substantial equity stake to another Canadian bank. If Canadian banks intend to continue pursuing the international activity they have initiated, they will need to find some way to increase the pool of capital on which they may draw. 

Ironically, the widely held rule and the "big shall not buy big" doctrines—both of which are designed to maintain a truly "Canadian" banking system—are forcing Canadian banks to look to the United States for growth opportunities. The Canadian banks have recognized that domestic operations provide little room for growth, and have sought opportunities outside Canada. As Canadian banks expand their operations in the United States, what one observer has called the "Nortelization" of the Canadian banks may occur, whereby they maintain their nominal headquarters in Canada but become essentially U.S. businesses.

94. See Dobilas, supra note 91, at 92.
95. See Peter C. Newman, When the Banks Lost, Canada Lost, Too, MacLEAN’S, Dec. 28, 1998, at 76, 76 (pointing out that Canada’s banks rank between 70th and 80th worldwide in terms of size).
97. See James R. Kraus, Swing to Import Finance Favoring Big Banks, AM. BANKER, Nov. 19, 1998, at 20. But see FREEDMAN & GOODLET, supra note 71, at 17-21 (challenging the assertion that Canada needs large banks to stay competitive in the international market).
98. See Dobilas, supra note 91, at 94.
99. See Weber, supra note 70, at 112 (noting that Canadian banks are looking south for growth).
100. See Eric Reguly, Feds Beware: The Nortelization of the Banks has Begun, THE GLOBE AND MAIL, June 22, 2000, at B15 (observing that Royal Bank’s acquisition of U.S.-based Liberty Insurance is evidence that the Canadian banking industry is taking its first steps toward ‘Nortelization’ (i.e., the process by which the banks, like Nortel Networks, retain headquarters in Canada but create most of the jobs south of the border)).
E. Other Countries Could Retaliate Against Canada Citing a Lack of Reciprocity and Deny Canadian Acquisitions.

The widely held rule may haunt Canadian banks seeking to acquire institutions in other countries. If banks in foreign countries are prohibited from acquiring Canadian Schedule I banks, those countries might with good conscience throw barriers in the way of Canadian bank acquisition of their institutions as a matter of reciprocity. Because Canadian banks need to grow, and because Ottawa would prefer that they grow by acquiring banks in other countries, there could be very real pressure on Canada to bring its bank ownership rules into harmony with international norms. Canada will face increasing pressure to liberalize trade restrictions and gain access to non-NAFTA markets. Indeed, the regional trade blocks may end up in competition with one another and hopefully lead to further reductions in trade barriers. As trade in financial services plays an increasingly important role in these trade pacts, the obstacles to unfettered cross-border activity will be subject to intense pressure.

Finally, the North American banking industry inevitably will find itself subject to an increasing number of international agreements affecting the trade of services generally, and the regulation of banking in particular. Although multinational trading agreements covering industries as complicated as the financial services industry take a long time to evolve, on the regulation front, banking regulators have begun moving toward greater cooperation.

101. While the goal of NAFTA has never been the large scale harmonization of legal regimes in North America, see Joel P. Trachtman, Trade in Financial Services Under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis, 34 COLUM. J. TRANSNAT'L L. 97, 94 (1995) (noting that the NAFTA does not require financial regulation harmonization), Canada and Mexico often find themselves pushed in the direction of increased harmonization in any event. See supra note 44.

102. For example, Canada (1996) and Mexico (1991) have already negotiated free trade agreements with Chile. GEORGE M. VON FURSTENBERG, THE BANKING AND FINANCIAL STRUCTURE, supra note 31, at XIII (1997).

103. One way to look at NAFTA is as a competitive response by the North American countries to the increased unification represented by the European Union.

104. For example, the General Agreement on Trade in Services ("GATS") effects on the international provision of banking services. See generally, Jeffrey Simser, GATS and Financial Services: Redefining Borders, 3 BUFF. J. INT'L L. 33, 40 (1996) (describing the structure of the GATS and its implications for the trade in financial services).

IV. REASONS FOR RETAINING THE WIDELY HELD RULE

Given these arguments against the widely held rule, why does the new legislation propose only a liberalization of the rule instead of its outright elimination? The following section outlines several possible explanations.

A. For Historical Reasons Involving Nation-Building and the Complicated U.S.-Canadian Relationship, the Widely Held Rule is a Necessary Evil.

Given an incredibly wealthy endowment of land and natural resources, but relatively few people and very little capital, early Canadian governments faced the daunting task of building a nation with the resources at hand, while holding off American expansion. With its relatively few people scattered across the continent, Canada's domestic market was small and often easily served from the United States. Faced with the challenges of a thin and dispersed market, together with the challenge of inventing a nation where no natural forces for nationhood existed, Canadian policymakers fashioned a distinctively Canadian form of business-government relationship. Explicit government policies designed to promote domestic enterprise typify the traditional Canadian business-government relationship, and the Canadian government has long played an important role in shaping the economic landscape by providing a legal and policy framework conducive to economic growth.\(^\text{106}\) Of course, although the Canadian government is not reluctant to use its power to protect domestic commercial concerns and promote domestic social goals such as full employment, Canada's economic policies cannot fairly be characterized under the "social market" model of the business-government relationship, the left-leaning tendencies of the New Democratic Party notwithstanding.\(^\text{107}\)

\(^{106}\) PROCEEDINGS OF THE 53RD ANNUAL COUCHICHING CONFERENCE ON CANADA'S ECONOMIC FUTURE, FREE ENTERPRISE AND THE STATE: WHAT'S RIGHT? WHAT'S LEFT? WHAT'S NEXT?, at 100-04 (1985) (comments of Maurice Strong). Canadian governmental agencies such as Industry Canada illustrate the sort of activist tendencies the Canadian government brings to the task of promoting national industrial policy aimed at creating jobs and boosting exports. For more information about Industry Canada, see Industry Canada home page, available at http://info.ic.gc.ca.

\(^{107}\) The comments of the late J.C. Weldon, one of the intellectual leaders of the New Democratic Party ("NDP"), illustrate some of these social democratic tendencies. See J.C. Weldon, An Academic's Perspective, in GOVERNMENT AND THE ECONOMY—HOW MUCH? 45, 46 (Can. Found. for Econ. Educ. ed., 1977) [hereinafter GOVERNMENT AND THE ECONOMY] (noting that the government "cannot sensibly avoid trying to determine the production and distribution of those goods the market cannot handle.") It should be noted that the NDP has never won control of the federal government.
Although Canada does provide benefits to its citizens and its businesses through economic intervention, those benefits are grafted onto an essentially liberal model, though not one exactly like those in the United States or Great Britain. While the rise of conservatives in Canadian politics has pushed government policy in the direction of free trade, Canada remains politically committed to preserving its industrial policies. In part, this commitment springs from Canada’s long history of disappointment with market forces that has left the country highly skeptical of laissez-faire policies.

One manifestation of government policy has been to minimize inter-provincial barriers to trade in the hope that national businesses could take root and thrive. Canada’s banks benefited from that policy. The decision to permit nation-wide banking figured into the nation-building strategy, and also made the most sense for pooling the little capital that was available. The Canadian banking industry consolidated early, creating a handful of nation-wide institutions that dominate the field today. Indeed, Canada’s huge national banks are among the few truly national institutions in the country.

But nothing in Canada’s protectionist-leaning model of business-government relations required the creation of the widely held rule. Indeed, Canada’s banking industry developed very nicely prior to 1967 without the benefit of the widely held rule. The widely held rule does not primarily serve to promote the development of the domestic banking industry and protect it from unfair competition from outside Canada. Instead, the widely held rule probably owes its existence to the most powerful force in Canadian economics, culture, and politics—the desire to be different from the United States. It is sometimes said that the only definition of Canada acceptable to all Canadians is that it is not

108. See Judith Maxwell, The Role of Government: Searching for a Balance, in GOVERNMENT AND THE ECONOMY, supra note 107, at 37, 37; Preface, In Search Of Canada, at vii, viii (Stephen R. Graubard ed., 1989) [hereinafter IN SEARCH OF CANADA] (“Canada is not simply a version of other modern industrial societies. While it owes much to Great Britain, France, and the United States, it is not like any of them; this is a fact too rarely acknowledged.”)

109. See Watkins, supra note 92, at 33 (noting that free trade was the core policy of the Canadian right wing).

110. See MALCOLM, supra note 69, at 27 (“In part because of the failure of market forces to provide a balance of economic opportunities within the country, Canadians throughout their history have remained basically suspicious of a laissez-faire marketplace.”).

111. See id. at 241. Like every nation, Canada has its own set of national images, legends, and myths, some of which are in national institutions. See generally DANIEL FRANCIS, NATIONAL DREAMS: MYTH, MEMORY, AND CANADIAN HISTORY (1997) (deconstructing such cherished Canadian institutions as the Canadian Pacific Railroad and the RCMP).
the United States. The looming presence of its huge southern neighbor informs many policy choices, including banking policy.

Because Canada is a trading nation, in an ideal world it would embrace free trade principles in every aspect of its economic policy, including trade in financial services. In the real world, however, Canada must be constantly aware of what the United States is doing.112 Much of Canadian industry consists of the Canadian operations of U.S. firms, yet Canada bridles at the prospect of "branch plant" capitalism that places Canada in a subservient role. Canadians constantly debate the appropriate extent of foreign investment in Canada and the power of multinational corporations.113 Many sense a threat to Canadian sovereignty as economic power shifts to corporate headquarters in the United States and Great Britain.114

Consequently, Canada historically has employed strategic protectionist policies to insulate its banking industry from U.S. domination.115 The political reality of foreign dominance in the Canadian economy has pushed banking policy in the direction of protecting the core of the Canadian banking system from foreign domination, not because the Canadian banks need protection from competition, but rather because the government fears what might happen to national self image and pride if the largest institutions were to cease being Canadian and become mere branch offices of foreign financial giants.

112. See David H. Flaherty, Who Rules Canada?, in IN SEARCH OF CANADA, supra note 108, at 99, 115 ("Canada also views the exercise of its power in the context of relations with the United States. The argument of political economists is that economic and cultural realities severely limit Canada's ability to exercise its independence...").

113. See id. at 114 ("Another way to understand the limits of political and economic power in Canada is to consider the international forces that have an impact on its use. An argument can be constructed that Canada is ruled from abroad and/or by forces of international capitalism.").


115. A deliberate policy to contain U.S. influence in the economy has been part and parcel of Canadian banking since the first bank in the country, the Bank of Montreal, was chartered in 1821. Its charter, the charter of all nineteenth century banks thereafter, and Canada's national banking legislation up through the mid-1980s, restricted bank directorships to British subjects. Some banks imposed additional residency requirements. See GORDON LAXER, OPEN FOR BUSINESS: THE ROOTS OF FOREIGN OWNERSHIP IN CANADA 216 (1989) (providing a brief history of the British subject clause).
B. Canadian Policymakers Have a Legitimate Fear of Undue Concentration in the Canadian Banking Industry.

Canada already has a very concentrated banking market. A handful of nation-wide institutions control the lion's share of the market. The widely held rule may help keep the concentration of economic power in check to some degree. Of course, the banks as institutions can exercise immense power over the Canadian economy, but the widely held rule ensures that the banks themselves are not owned by a mere handful of private shareholders. The widely held rule combats concentration on the ground that it would not be good for the Canadian economy, regardless of whether that tiny, powerful group owning the banks is composed of foreigners or Canadians.

C. The Public Choice Explanation: Rent-Seeking Regulators will not Voluntarily Relinquish Their Turf.

Like regulators everywhere, Canadian bank regulators are not willing to give up their regulatory power without a fight. This fact of life was illustrated during the negotiation of both the U.S.-Canada Free Trade Agreement and NAFTA, when it was widely understood that Canada opposed cross-border branching in part due to the desire of Canadian banking regulators that there be a Canadian bank that they could regulate. Canadians also resented what they considered to be the propensity of U.S. regulators to seek extraterritorial application of U.S. law. The turf war mentality is consistent with a public choice view of the world, which sees regulators as managers who seek to maximize the value of their enterprises. If Canada's banks were no longer subject to the widely held rule, some or all of them might be taken over by non-Canadian concerns, which would have the effect of paring away some of the current regulatory load of the Canadian banking regulators who are primarily responsible for the banks chartered within their

116. See Jordan, supra note 2, at 48 (voicing the opinion that the Canadian trade negotiators did not yield to the pressures to permit U.S. branches because "Canadian regulators . . . wished to ensure that there was a Canadian entity to be regulated.").

117. See id. (noting that "Canadian regulators do not indulge in the extraterritorial application of Canadian banking laws"); see also CBA SUBMISSION, supra note 34, at 44 (noting the use of the widely held rule as a tool for restricting extraterritorial application of U.S. law).

118. See Edward J. Kane, Tension Between Competition and Coordination in International Financial Regulation, in GOVERNING BANKING'S FUTURE: MARKETS VS. REGULATION 33, 34 (Catherine England ed., 1991) [hereinafter GOVERNING BANKING'S FUTURE] (describing the need for regulators to maximize the value of their enterprise within the confines of something he calls the "microeconomic analysis of regulation," which is consistent with the public choice view).
respective territories. 119 The banking regulators who have a vested interest in the current system will not give up their authority without a fight.

Yet while Canadian banking regulators necessarily must worry about domestic policy matters, they also must contend with the more difficult problem of international regulatory competition. 120 Viewing the market for regulation as a dynamic international marketplace, if Canada is too far out of step with other countries, the Canadian banking regulators will lose market share to other more flexible banking regimes. In order to maintain their regulatory enterprise, Canadian bank regulators will continue to feel pressure to harmonize Canadian law with the larger North American regulatory scheme. The concept of regulatory emulation is one such pressure urging change, 121 but more subtle pressures also exist. The mere existence of cross-border commerce, combined with increased contact between policy-makers and business people, will likely lead to the adoption of the “best” policies if only because that is what the market for regulation demands. 122 Indeed, in the securities arena, U.S. and Canadian regulators already have achieved considerable harmonization of federal, state, and provincial securities regulation. 123 To the extent competition for customers between securities firms and banks is skewed in favor of securities firms because of the greater harmonization, Canadian bankers may mobilize additional

119. Subsidiaries are regulated primarily in the jurisdiction in which they are chartered. The regulation of branches is more complicated: for prudential matters, such as capital levels and management competence, the home country regulator has priority, but for market matters, the host country regulates. See Michael G. Martinson, Consolidated Supervision of Cross-Border Banking Activities: Principles and Practice in the NAFTA Context, in Regulation and Supervision of Financial Institutions in the NAFTA Countries and Beyond, 217, 217 (George M. von Furstenberg ed., 1997) [hereinafter FINANCIAL INSTITUTIONS IN THE NAFTA COUNTRIES].

120. See Kane, supra note 118, at 34 (“individual regulatory enterprises are in competition with each other for whatever it is they maximize.”).

121. See supra note 44 and accompanying text.

122. See generally Alfred C. Aman, Jr., A Global Perspective on Current Regulatory Reforms: Rejection, Relocation, or Reinvention?, 2 Ind. J. Global Legal Stud. 429 (1995) (arguing that global political and economic forces push national policies towards various forms of deregulation and privatization); Stephen Zamora, NAFTA and the Harmonization of Domestic Legal Systems: The Side Effects of Free Trade, 12 Ariz. J. Int’l. & Comp. L. 401 (1995) (arguing that increased cross-border contact between businesspeople, bureaucrats, lawyers, academics, and others will inevitably lead to an exchange of ideas and accommodation in each of the three countries of the cultural differences of the others).

123. See Jordan, supra note 2, at 53 (noting that the Canadian scheme of securities regulation is modeled after the U.S. scheme and that the regulators have achieved considerable integration).
political resources to put pressure on their regulators to ease off on the widely held rule.

On the other hand, given the effects of path dependence and the different initial conditions of banking policy in Canada, even if liberalization and competition create some pressure for the convergence of banking regulatory schemes in the NAFTA countries, that convergence is likely to be incomplete. Where key decision makers are also rent receivers in the existing system and can block change, the existing system will tend to persist. So, even with the pressures for greater North American harmonization and integration, Canadian regulators may still have room to maneuver to stake out distinctly Canadian policies, perhaps including a domestic ownership requirement.

D. Policymakers Misapprehend the Importance of Economies of Scale.

Canadian banking policy is founded on the premise that economies of scale are important and fundamental to the viability of banks. Because Canada's population is so thin and spread out, Canada has never sought to hem in its banking institutions within provincial or regional lines. Instead it was understood early on that in order to obtain critical mass, Canadian banks needed to be as large as possible to establish a sizeable pool of capital in a nation with such a small population. The scale economy strategy worked in establishing a strong and viable commercial banking industry in Canada. Today, however,

124. See Lucian Bebchuk & Mark J. Roe, A Theory of Path Dependence in Corporate Ownership and Governance, in CORPORATE GOVERNANCE TODAY 575, 585-96 (Mark J. Roe ed., 1998) (describing the view that difference in corporate governance might persist provided that the costs of a Coasian bargain are not trivial) [hereinafter CORPORATE GOVERNANCE TODAY]; see also Lawrence J. White, Competition Versus Harmonization—An Overview of International Regulation of Financial Services, in INTERNATIONAL FINANCIAL MARKETS: HARMONIZATION VERSUS COMPETITION 5, 10-12 (Claude E. Barfield ed., 1996) [hereinafter INTERNATIONAL FINANCIAL MARKETS] (providing an overview of the competition versus harmonization debate). But see J. Mark Ramseyer, Are Corporate Governance Systems Converging?, in CORPORATE GOVERNANCE TODAY 537, 545-48 (1998) (arguing that systems of successful firms are shaped by economic logic and, over time, different systems will tend to converge).

125. See generally George Hoberg, Canada and North American Integration, 26 CAN. PUB. POL’Y, at S-35 (2000) (surveying studies of North American integration and finding that the consequences of North American integration have not been as formidable as widely believed and noting that Canadian policymakers still have room to create policy even in areas highly affected by economic integration).

126. When a firm’s average cost of production decreases as its level of output increases, economies of scale exist. See Loretta J. Mester, Efficient Production of Financial Services: Scale and Scope of Economies, FED. RES. BANK OF PHILA. BUS. REV., Jan.-Feb. 1987, at 15, 16.
Canadian regulators and Canadians generally may be too impressed with the idea of economies of scale to let go of the widely held rule.

Intuitively, it seems obvious that economies of scale, at least on the product-specific level, should exist in banking. But the existence of important scale economies in banking generally is not taken as gospel. The banking industry generally may or may not exhibit such economies. Recent studies have concluded that moderate to substantial

127. As an example, in order to produce consumer loans, banks must invest in a certain amount of legal work, form preparation, training, record keeping, and other start up costs. Banks incur these costs irrespective of the number of loans actually made. Because there is a large fixed-cost start-up expense, the average cost per loan should decrease as a function of the number of loans made because the start up cost will be spread over a larger number of loans. Therefore, the bank that produces more consumer loans should, all things being equal, be able to produce those loans at a lower average cost than its less productive competitor. Indeed, some studies have tended to show that some product-specific economies of scale do exist. See Peter Maloney, Merging Trust Operations, U.S. BANKER, June 1, 1989, at 37, 37-38 (finding that banks can capitalize on significant economies of scale by combining trust departments in one operational unit); John P. Mara, The New Economics of Mortgaging, MORTGAGE BANKING, Mar. 1989, at 89, 89-94 (reporting that evidence suggests technologically induced economies of scale exist in mortgage banking and servicing and do not diminish until volumes reached about $2.5 billion). More recent studies have specifically investigated whether the production of consumer loans, which have high regulatory compliance costs, display scale economies. One study found substantial economies of scale in compliance with the regulatory burden. Larger banks spent more on compliance than smaller banks, but a 5.7% change in compliance cost was accompanied by a 10% change in the amount of credit extended. See Neil B. Murphy, Economies of Scale in the Cost of Compliance with Consumer Credit Protection Laws: The Case of the Implementation of the Equal Credit Opportunity Act of 1974, 10 J. BANK RES. 248, 250 (1980). But see Gregory Elllehausen & Robert D. Kurtz, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, SCALE ECONOMIES AND COMPLIANCE COSTS FOR CONSUMER CREDIT REGULATION: TRUTH-IN-LEYING AND EQUAL CREDIT OPPORTUNITY LAWS, Staff Study number 144, at 1 n.3 (1985) (criticizing the Murphy study because it was based on a very small sample of banks and evaluated the costs of compliance at the very outset of Regulation B's existence, so that the data might not reflect long run compliance costs).

128. Although researchers have studied the existence of economies of scale in the banking industry, the results of those studies do not paint a clear picture. The earliest empirical studies of economies of scale tended to show that scale economies in banking were relatively unimportant. Richard W. Nelson, Economies of Scale v. Regulation as Determinants of U.S. Banking Structure, in PROCEEDINGS OF A CONFERENCE ON BANK STRUCTURE AND COMPETITION 462, 463 (1983) [hereinafter BANK STRUCTURE AND COMPETITION]. Studies during the 1960's, however, found significant economies of scale in the banking industry. Frederick W. Bell & Neil B. Murphy, ECONOMIES OF SCALE IN COMMERCIAL BANKING 8-9 (1967) (analyzing data obtained in 1965, showed that unit costs declined significantly as banks expanded operations); George J. Benston, Economies of Scale and Marginal Costs in Banking Operations, 2 NAT'L BANKING REV. 507, 541 (1965) (using data from the early 1960s concluding that economies of scale were observed in each of several different banking services analyzed). Studies in the 1970's and 1980's evaluating the existence of overall economies of scale in the banking industry almost unanimously concluded that economies of scale either did not exist or were exhausted for the most part by the time banks reach the asset size range of $25
economies of scale may exist in the banking industry. 129 Recent studies of scale economies in banking seem to point to a number of conclusions: (1) within banking organizations scales of economy are modest; (2) with regard to specific high volume products such as credit cards and checking accounts, the scales of economy may be significant; and (3) large money center banks do appear to enjoy a cost economy in that they can attract capital at a lower cost than their competitors. 130 As discussed above, the cost of capital for Schedule I banks is artificially increased because of the poison pill effect of the widely held rule, so one of the possible benefits for large banks—attracting capital at lower cost—is counterbalanced by other effects of Canadian law.

Despite the evidence that economies of scale are not the most powerful economic force in the banking industry, in the Canadian context, policymakers and the general public may harbor the concern that the banking sector could have such significant economies of scale that large international banking organizations inevitably will come to dominate the market. 131 Even though the data do not support that conclusion, the perception of a threat is as good as a threat for political

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130. See Peter S. Rose, Banking Across State Lines: Public and Private Consequences 106-07 (1997) (discussing economy of scale studies); see also Patrick H. McAllister & Douglas McManus, Resolving the Scale Efficiency Puzzle in Banking, 17 J. Banking and Fin. 389 (1993) (examining returns to scale generally and finding significant scale economies for banks below about $500 million in assets, but also finding significant cost advantage for big banks over smaller banks for financial capital, thereby negating any diseconomies of scale in pure operating costs).

131. Of course the data do not support clearly the contention that large banks enjoy economies of scale. Hence, the predictions of the demise of the small community bank appear to be greatly exaggerated. See generally Donald R. Fraser & James W. Kolari, The Future of Small.
purposes; populist forces in Canada may rail against eliminating the widely held rule on the theory that by dint of economics alone, U.S. money center banks or other global banking behemoths will squeeze Canadian banks of all sizes out of the competitive picture entirely.

E. **Policymakers may Sincerely Believe that Forcing the Banks to be Canadian is Actually Good for Them.**

It is possible that the policy makers think they know what is best for Canada's banks, and will impose this blessing on Canadian bankers whether they want it or not. First, Canadian banks enjoy a significant safety net subsidy, and one which is probably higher than the "safety net subsidy" bestowed by many other countries on their banks. The size of the subsidy is a function of the strength of the government's commitment to the stability of the banking system, characterized by the credibility of government support for failing banks, the availability of deposit insurance, the availability of a lender of last resort, and bank access to a risk-free payments system.\(^{132}\) Canada's safety net subsidy is apparently large by international standards. Canadian regulators may understand the limitations of the widely held rule, but reason that as a package of legislation that protects Canadian banks, it actually bestows a generous subsidy on them for which they should be grateful and which they can use for good competitive effect in the international banking market.

In the international setting, however, such an argument misses the mark because all important banking countries bestow some form of systemic default guarantee that acts to protect depositors and subsidize banks.\(^{133}\) The mere existence of such a subsidy does not explain one country's competitive success in the banking market vis-à-vis banks from other countries, but rather success is more likely determined by a combination of "comparative advantage, the fundamentals of each economy, together with governmental support in the form of safety net

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\(^{132}\) See Reforms Needed for Financial Services to Flourish Says CBA, CANADA NEWSWIRE, Ocl. 29, 1997, Lexis, Nexis Library, Canada NewsWire File (reporting on CBA report that urges reevaluation of the "special privileges" accorded to Canadian banks, such as deposit insurance, liquidity support from the Bank of Canada, and access to the payment system).

CANADA'S "WIDELY HELD" RULE

policies." On the international level, the important question to ask is "how big is one subsidy compared to the subsidies provided by the other countries?"

In the United States, banks have rebutted the safety net subsidy argument by pointing out that any benefits conferred are offset by the costs incurred to obtain those benefits such as compliance with capital requirements, payment of deposit insurance premiums, and regulatory restrictions. In Canada, however, one might surmise from the lighter regulatory burden and the much lower failure rate of Canadian banks that the net subsidy to Canadian banks exceeds the U.S. subsidy and could be a credible benefit that the regulators sincerely believe helps Canadian banks.

Second, being Canadian gives the Schedule I banks an advantage in the world marketplace. In the global marketplace for financial services, perhaps the biggest advantage to Canadian banks is that they are not


135. It appears from the available evidence, for example, that the safety net subsidy enjoyed by Japanese banks is greater than the subsidy bestowed upon U.S. banks. See generally id. (noting the relative stability of Japanese banks generally compared to U.S. banks and noting that creditors will demand higher interest rates from U.S. banks because the overall risk of lending to U.S. banks is higher).

136. See Jaret Seiberg, Banks' Plea To Fed: Stop Saying We're Subsidized, AM. BANKER, Nov. 5, 1997, at 1; Bert Ely, Greenspan's Deposit Insurance Subsidy Argument Is Nonsense, AM. BANKER, June 6, 1997, at 3 (stating that deposit insurance has never cost taxpayers a cent, loans from the discount window must be collateralized and the small risk of intraday overdraft risk can be minimized by proper management and concluding there is no meaningful subsidy); see also John D. Hawke, Jr., Reflections on the Ongoing Effort to Modernize Financial Services Regulation, 49 MERCER L. REV. 777, 779 (1998) (expressing skepticism of the existence of a net subsidy); Olaf de Senerpont Domis, Helfer, Ludwig Insist Deposit Insurance Doesn't Give Banks an Unfair Advantage, AM. BANKER, Mar. 6, 1997, at 2 (recounting the testimony of Comptroller of the Currency Eugene Ludwig and Federal Deposit Insurance Corporation Chairman Ricki Helfer that the Fed's subsidy argument is incorrect because it does not take regulatory compliance costs into account).

137. There is a significant difference between U.S. and Canadian banks in terms of the regulatory burden shouldered by each. As a telling illustration, in the early 1990s there were an estimated 220,000 pages of U.S. banking law and regulation at the federal level (not including state level regulation), while in Canada the entire Bank Act and associated regulations amounted to no more than 530 pages. See John C. Pattison, Trade in Financial Services in NAFTA: A Public Choice Approach, REGULATION AND SUPERVISION, supra note 31, at 145, 148-49. Another explanation for the difference is the willingness of Canada's banks to adopt voluntary guidelines in order to prevent the need for legislated solutions to perceived problems. See GENERAL ACCOUNTING OFFICE, BANK OVERSIGHT STRUCTURE: U.S. AND FOREIGN EXPERIENCE MAY OFFER LESSONS FOR MODERNIZING U.S. STRUCTURE 72 (1996) (noting the voluntary adoption by Canadian banks of consumer and small business lending guidelines to prevent legislative solutions).
U.S. banks. In a world where some international borrowers may have political difficulties borrowing from the United States, Canada stands ready to serve their needs. In addition, Canadian banks have access to relatively low cost U.S. dollars because much trade in Canada is conducted in U.S. dollars, often purchased at a discount from market prices. 138 The combination of not being American, yet having access to U.S. dollars, gives Canadian banks an edge vis-à-vis other non-U.S. banks in dealing in dollar-denominated assets, especially in areas such as oil and mineral extraction, where they have great expertise.

F. Canada Needs Some Large Banks under its Jurisdiction to Help in the Implementation of Social and Governmental Goals.

Finally, Canada may need the widely held rule simply because having some substantial Canadian banks is important for the implementation of government policies. Indeed, some bankers have supported the rule on essentially protectionist grounds, arguing that lifting the widely held rule would jeopardize the Canadian banking industry and important national objectives. 139 The implied argument supporting the protectionist position is that as long as the largest domestic banks are Canadian, they will continue to serve national interests, especially the implementation of monetary policy, the provision of credit throughout the country, and the generation of jobs. Job growth in the financial services sector is strong. From 1995 to 1997, jobs in the financial services sector grew 5.1%, compared to 3.9% for the economy generally. In a country with chronic employment problems, an industry that creates new jobs is very valuable.

In addition, banking regulators can cite legitimate public policy problems that weigh in favor of maintaining a domestic banking industry, including the need to protect bank customers and investors from asymmetric information problems, guard against systemic failure, and work toward fair trade. There is, therefore, some force to the position that regulators should retain the right to fashion their own domestic regulatory scheme. 140

138. See Malcolm, supra note 69, at 155 (“Canadian stores almost anywhere routinely accept United States currency, though at an exchange rate that certainly benefits the home team.”).


140. See Jean Dermine, International Trade in Banking, INTERNATIONAL FINANCIAL MARKETS, supra note 124, at 49, 70 (reaching conclusion that some autonomy in domestic regulation is
IV. OPTIONS FOR CANADIAN BANKS UNDER THE NEW WIDELY HELD RULE

On balance, it appears as though the widely held rule is here to stay—at least for the foreseeable future. That being the case, what options are available for Canadian banks under the new widely held rule? Several thoughts (by no means covering the entire topic) are discussed below.

A. Maintain the Status Quo.

After the proposed changes to the widely held rule become effective, Canadian banks do not have to do anything differently from the way they have done things in the past. The new widely held rule continues to supply a statutory poison pill for Canada's largest banks, making hostile acquisition virtually impossible. Therefore, the managers of Canada's largest banks can stay in their current positions without worrying about losing their jobs. But if they follow that course of action, the rest of the world market will proceed without them.

Although Canada's banking sector has a solid history of good performance domestically and a real presence in international trade finance, they are not growing as quickly as their international competitors. Staying put will only insure the increasing irrelevance of the Canadian banking industry.

B. Seek a Strategic Alliance with a Canadian Bank.

In response to the proposed mergers in 1998 involving four of the Big Five, Ottawa sent a message that "big shall not buy big." Yet, it may be possible that the liberalized widely held rule could permit domestic institutions to take twenty percent stakes in each other and enter into strategic alliances that would permit some joint operations that are susceptible to scale economies, such as a consolidation of their branch networks and back office operations. Indeed, three of the Big Five already have engaged in a joint effort to consolidate data process-

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necessary to address problems of asymmetric information, systemic failure, and fair trade problems, but going on to consider whether the best approach in the international context should be national treatment or reciprocity).

141. See Elena Cherney, Canada's Five Big Banks Report Higher Profits, WALL ST. J., June 2, 2000, at A6 (reporting strong earnings from Canada's largest banks in part due to cost cutting and niche global expansion).
142. See Elstein, supra note 66, at 1.
Assuming such investments would be permitted by the Finance Minister, the alliances so created could provide cost savings and functionally larger banks, even while retaining the separate legal organization of each institution.

C. Seek a Strategic Alliance with a U.S. Bank.

Recognizing that the U.S. market provides the most opportunities for growth, big Canadian banks might look south to form strategic alliances. Of course, some Canadian banks already have substantial operations in the United States, but short of outright acquisition Canadian banks could also participate in joint ventures. Canadian banks possess a good deal of knowledge about retail banking operations and trade finance. An ideal U.S. partner would be one with an interest in remaining independent, with an international portfolio and access to low cost funding sources. It would not be outside of the realm of possibility, for instance, to imagine a strategic alliance between Scotiabank and FleetBoston. The two institutions are linked by the history of significant trade ties between the Maritimes and New England, by the proximity of their regions of origin, and by their business strategies—with strengths in retail banking, small business lending, and trade finance. From Scotiabank’s point of view, FleetBoston would give it access to a much deeper pool of resources and allow it to generate bigger credits through pre-arranged loan participation. From FleetBoston’s perspective, it would obtain a proven worldwide trade finance player to help put its resources to work, the benefits of loan participation and immediate access throughout Canada. Together the two banks get a much stronger worldwide presence and an increased opportunity to engage in project finance and other large-scale activity not available to them now.

The form of such a strategic alliance might include the following points: (1) each bank takes a sizeable equity position in the other, limited by applicable law; (2) they sign a mutual defense pact in which they give each other the right to buy additional shares on favorable terms if the other is subject to an unsolicited offer (even though


144. For example, Bank of Nova Scotia is one of the leaders in syndicated loans in the United States. See Diane Maley, Building the Bank of the Future, CAN. BANKER, Jan.-Feb. 1996, at 21, 23; see also supra note 70.
currently that would not be such an important matter for the Canadian institution); and (3) they enter into a plan for coordinated international business involving consolidation of redundant resources and an agreement for loan participation. Such an alliance could prove mutually beneficial in the brave new world of global financial services.

D. Seek a Strategic Alliance with a Non-U.S. Bank.

Although U.S. affiliation might make sense, there is some value to not being American.\textsuperscript{145} While Canada has long and strong ties with the United States, it also has ties to England, Scotland, Ireland, and France, among other nations. Banking institutions in those countries seeking expansion in North America could do so on a joint venture basis with a Canadian bank and achieve the same advantages described above, especially with banks that already have substantial U.S. operations, such as Bank of Montreal.

E. Acquire Other Institutions in an Attempt to Become Too Big to be Acquired.

One way for Canadian banks to plan for the future and remain distinctly Canadian would be to use the higher permissible ownership level to acquire other institutions using the bank's stock as consideration. Indeed, this was one of the reasons for the proposal to increase the ownership limit from ten percent to twenty percent.\textsuperscript{146} The goal of this strategy would be to grow so large that if the widely held rule is ever eliminated, the bank would be too big to be acquired. This is likely to be a flawed strategy because it is increasingly difficult to imagine an institution that is too big to be acquired. The huge combinations in the United States between Travelers and Citicorp, Bank of America and NationsBank, and BankersTrust and Deutsche Bank make this strategy a long shot. Given where the Canadian banks are starting out, they would have a long way to go before achieving the requisite size to be truly unacquirable.

\textsuperscript{145} See MALCOLM, supra note 69, at 197 (Canada is "notably free of the political and ideological baggage often attached to such deals by the Americans. While remaining inextricably tied to the United States economically, politically, and militarily, Canadians had become skillfully adept at appearing to be separate from the Yanks.").

\textsuperscript{146} See Urquhart, supra note 55 (noting that some bankers believe the relaxed restrictions will help them make acquisitions by allowing them to issue larger amounts of stock to sellers of acquisition targets).
V. Conclusion

The Mexican experience may, in the end, prove instructive for Canadian banking policy. Market forces have proven to be almost irresistible in causing changes in the bank regulatory scheme. Mexico wanted to protect its banks, but in the end realized it could not do so. Canada may reach the same conclusion.

The widely held rule made sense in the context of the highly nationalistic, somewhat paranoid, undoubtedly anti-American period of the late 1960s. As we move further from that time, the rule is increasingly out of sync with global free trade norms. Like many protectionist measures before it, the rule may ultimately hurt the banks it was designed to promote. The big Canadian banks are chafing under the widely held rule. They want to be free of the political quid pro quo that comes with protection and they want their shareholders to be able to receive a control premium from the sale of a Canadian bank on the open market.

On the other hand, the widely held rule has permitted the Big Five to remain distinctly Canadian. By keeping the country's largest banks Canadian, Ottawa will be able to use those banks to serve national interests, especially the implementation of monetary policy, the provision of credit throughout the country and the generation of jobs. More importantly, Canada needs to protect its large banks for obvious political reasons. The blow to national pride and sense of independence from the acquisition of one of the Big Five by non-Canadians would be politically unacceptable. Canada will likely leave the widely held rule in place until such time as international pressure for trade liberalization forces its hand. In that scenario, at least Canada will be able to save face by extracting some offsetting benefits by abandoning the rule, rather than throwing away a possible bargaining chip by unilaterally dropping the restriction.

There will be pressure on Canada to abandon the widely held rule. The current proposal before Parliament is a half measure that is better than nothing, but short of where the law should be. The power of the Finance Minister to approve transfers of control only to “fit and proper” persons should be enough power to keep Canadian banks in good hands. Canada may eventually discard the rule, and one hopes that this will occur before the banking industry falls too much farther behind its international rivals.