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REGULATING FINANCE TO PROMOTE GROWTH: THE QUEBEC EXPERIENCE IN PERSPECTIVE

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EXECUTIVE SUMMARY

While financial regulation is meant to promote stability, it is just as important for it to promote growth, development and competition in the financial sector, something Quebec has been focussed on since the 1960s.

This paper provides a brief history of Quebec's financial legislative and regulatory policies from the 1960s to now. Quebec's views on financial regulations are tied to the idea that a competitive market, stable financial institutions and protecting financial product consumers are key factors to building an effective and sustainable financial system. This paper looks at how Quebec has responded to federal regulatory changes to ensure Quebec-owned financial institutions remained successful and competitive compared to federally licensed institutions, how Quebec adapted to the deregulation reforms of the Canadian financial system and, finally, the adoption of a unified financial regulator.

Quebec's adoption of a unified agency model of financial regulation, which most other Canadian provinces do not have, provides an opportunity to examine and compare which policies and regulations have been most effective, what role the unified agency model played and how the unified agency compares to other regulatory regimes adopted by other Canadian provinces.

One of the key factors to successful financial regulation is the ability to keep up with the rapidly changing financial business and services, including regulatory standards nationally and internationally. Canada's financial regulatory system is shared between the federal and provincial governments. Federal and international regulations tend to force provincial regulations to converge, resulting in harmonized financial practices. Quebec's goal was to promote Quebec-owned financial institutions, strengthening Montreal's position as an international financial centre. Montreal is 27th in the top 100 global financial centres.

How did Quebec's financial regulation evolution and current model perform? Rapid technological advances can pose a variety of challenges for provincial financial regulations, including the large investments needed to keep up with technology, a flexible regulatory process that can keep up to the rapidly changing market dynamics and the ability to create legislation to protect consumers and monitor market conduct. Quebec's unified model, while having some quirks, is able to address many of these challenges. The use of private bills to accelerate and customize the legislative process has been a key factor in giving

financial institutions the leeway and flexibility to deal with some of these expected challenges. The government's confidence in the unified agency to supervise the restructured financial institutions, along with Quebec's consistency in its financial regulations, regardless of the political party in power, has also contributed to the province's success.

> *"Financial regulation needs to catch-up with innovation."*
>
> Henry M. Paulson Jr. (2013)

INTRODUCTION

Canada has one of the largest and most developed financial systems in the world. At the end of 2018, total assets of financial institutions reached 626 per cent of GDP, placing Canada ahead of Japan, France, the United States and Germany on this metric; outstanding debt securities and stock market capitalization amounted to 252 per cent of GDP (IMF 2019).

Canada's financial system is highly concentrated. Each segment of the financial system is among the largest in the world in nominal terms. The six largest banks and Quebec's Mouvement Desjardins — designated as financial institutions of national importance — account for about 90 per cent of deposit-taking institutions' assets, while the three largest life insurers account for about 70 per cent of total net premiums.

Canada's financial regulatory system is decentralized with responsibilities shared between the federal and provincial governments. In addition to federally incorporated or licensed financial institutions, a wide range of deposit-taking institutions and insurance companies are provincially incorporated or licensed and, therefore, supervised by provincial authorities for solvency and market conduct. Securities, financial derivatives and commodities exchange markets regulation rests in the provinces' domain in co-ordination with the Bank of Canada, which has oversight responsibilities for systemically important payment, clearing and settlements systems.

Despite the overlap in regulatory functions, a number of interactions between the federal and provincial regulatory systems create a symbiotic relationship that is strongly influenced by actions taken at the federal level. Since the chartered banks, payment systems and most large insurers fall under federal jurisdiction, the impact of changes to the federal regulatory framework ripples through the financial industry and exerts pressure on provincial regulatory regimes to converge. These dynamics are reinforced by the prevalence of international standards that promote harmonization and convergence of financial norms and practices.

While prudential and business conduct and the promotion of systemic stability are the primary domain of financial regulation, it is important not to lose sight that another key objective of financial regulation is to stimulate the growth, development and competitiveness of financial firms and markets (Pan 2008). A robust financial sector fosters improved productivity and long-term growth through an optimal allocation of resources within the economy, generates above average employment growth in complementary service sectors and employs, directly and indirectly, a greater proportion of highly skilled people than other sectors (Kronick and Omran 2021). Thus, it is a rational endeavour for national, regional and large metropolitan governments to promote the growth and depth and encourage innovation of their financial sector.[1] It is noteworthy that despite its relatively small population and economic size, Canada has four cities in the top 100 global financial centres: Toronto (19th), Montreal (27th), Vancouver (28th) and Calgary (41st). Only three much larger countries have more financial centres in this category than Canada: United States (6), China (6) and Germany (5) (GFCI 2021).

In 2002, Quebec adopted the unified agency model of financial regulation and supervision which entrusted to the Autorité des marchés financiers (the Autorité) not only prudential supervision of all financial firms and intermediaries and market infrastructure organizations to a single agency (the integrated agency model), but also responsibility for the regulation and supervision of business practices and market conduct in the distribution of financial products and services, including that of voluntary retirement savings plans (the unified model).[2] This institutional structure of financial regulation, which differs from the one adopted by most other Canadian jurisdictions, provides fertile ground for a comparative examination, especially since it is set in the same constitutional and macro-economic environment as other Canadian provincial jurisdictions.[3]

Adoption of the new paradigm for Quebec's institutional structure of financial regulation and supervision did not occur by happenstance. It is the latest outcome of an evolution in the scope and structure of Quebec's financial legislative and regulatory regime that began in the mid-1960s. Quebec's approach towards financial regulation stems from a widely held belief that an effective and efficient financial system is a cornerstone of sustainable growth, economic and social development and individual prosperity. This belief and recognition that markets compete with each other has fuelled an ongoing quest over several decades to ensure that Quebec's financial regulatory regime is effective in guaranteeing the competitivity and soundness of financial institutions and intermediaries under its jurisdiction, in regulating the conduct of financial firms and promoting the protection of consumers of financial products and services. This is considered the most effective bulwark against the federal government encroaching on Quebec's jurisdiction.

This research paper is a historical account of the evolution of Quebec's financial sector policies, the evolution of the scope and structure of financial regulation since the mid-1960s and the factors driving the changes, rather than an analysis based on economic models.

For simplicity, the term "financial regulation" is used to refer to the full array of official policies, statutes, regulations and supervisory practices influencing financial sector activities. The paper begins with a review of the policy initiatives Quebec took in the mid-

1 The history of the geography of finance tells us that the development and sustainability of a significant financial centre as an engine of growth is an arduous process that depends on a number of factors, the most important of which are the clustering of key financial functions, the ability to recruit skilled people from the local labour pool, the proximity of large professional firms (e.g., legal, management and IT consulting) and a regulatory system that is perceived to be responsive to the interests of financial firms (Kindleberger 1973).

2 At the federal level and in several provinces, the agency responsible for prudential regulation regulates and supervises private pension plans organized under their government jurisdictions. In Quebec, the responsibility to regulate and supervise supplemental pension plans and voluntary retirement saving plans is assigned to Retraite Québec, a specialized agency that administers the Quebec Pension Plan and public sector pension plans.

3 New Brunswick and Saskatchewan have also adopted the unified regulatory architecture.

1960s and 1970s in response to changes in the regulatory framework at the federal level. These initiatives ensured that Quebec-owned financial institutions would not be placed at a disadvantage relative to federally licensed institutions and the upheaval that shook Quebec's financial sector in the latter part of the 1970s. It continues with an overview of the impact of the deregulation reforms of the Canadian financial system that ushered in the collapse of the four pillars architecture and the demutualization of the capital structure of mutual insurance companies and the measures Quebec took to adapt to the new environment. The rationale put forward to adopt a unified financial regulator is then examined along with some peculiar aspects of Quebec financial regulations of dubious merit. The chronicle follows with a description of the financial measures the Quebec government adopted to increase the volume of equity capital available to Quebec companies and strengthen Montreal's position as an international financial centre with an assessment of the results these policies have achieved. We follow with examples which demonstrate that although efficient regulation is necessary to foster and nurture a strong and stable financial sector, it is not sufficient to ensure the development and growth of financial firms and markets, as the key drivers are entrepreneurship and innovation by financial organizations.

The overview of Quebec's approach to financial regulation over the last six decades allows us to identify the policy initiatives and regulatory practices that had the largest impact on the development and competitiveness of Quebec-based financial institutions and intermediaries in local and external markets and to ascertain the extent to which the unified regulatory agency, established in 2002, has contributed to these achievements.

THE INTELLECTUAL UNDERPINNINGS OF THE QUEBEC APPROACH

At the inception of Quebec's Quiet Revolution, the erosion of Montreal's status as a financial centre was at odds with the place and role envisaged for Quebec in the Canadian economy. The relative decline of Montreal vis-à-vis Toronto had been a long-simmering process; already in the 1930s, Toronto surpassed Montreal for the value of stock exchange transactions and cheques clearing. Between 1941 and 1961, 23 Montreal-based insurance companies transferred their head offices to Toronto whereas only two went in the opposite direction.

Spurred by the release of the report of the Royal Commission on Banking and Finance (the Porter Commission) in 1964 and the impact that implementation of its recommendations would have on the province's financial sector, in 1965 Quebec established a blue-ribbon committee of experts (the Comité) chaired by Jacques Parizeau to review the activities of financial institutions under its jurisdiction (Gouvernement du Québec 1967, 1969).[4]

The Comité observed that the lines between different types of financial firms were blurring. This occurred in response to customer demand and the initiatives of some financial firms that took advantage of the open field created by regulations which limited the ability of other types of firms to offer certain financial products and services but did not apply to them. This led the Comité to conclude that the regulatory framework should strive to

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[4] The other members of the Committee were Michel Bélanger, Robert Desprès, Douglas H. Fullerton and Yves Pratte.

establish a level playing field to encourage competition among different types of financial firms offering similar or substitutable products or services (Chaput 1969). On this point, as on many others, the Comité agreed with the Porter Commission that "the premise that investment restrictions are the main safeguard of the depositors" was a fallacy when, in fact, "this now depends almost entirely on the skill and maturity of management and on thorough government inspection and supervision."

The Comité held firmly to the view that a high degree of Quebec ownership of financial institutions and intermediaries is inherently healthy and desirable. It followed that Quebec needed to act to promote the growth and development of competitive financial institutions under its jurisdiction and ensure they not be placed at a disadvantage vis-à-vis federally regulated institutions. To this end, the Comité made three major recommendations:

1. Enhance the influence of the Caisse de dépôt et placement du Québec (CDPQ) created in July 1965 and its role as an asset manager and major international investor by requiring that the net financial assets held by the public and para-public sector be managed and administered by the CDPQ;[5]

2. Amend credit union and caisses populaires legislation to liberalize their lending powers and eliminate restrictions on the types and amount of assets in which they may invest. The Comité believed that credit unions and the caisses populaires should have the flexibility to adapt to the changing character of the communities they served and, therefore, should be given the same degree of freedom to meet this challenge as banks, their principal competitors, which operated soundly under competent inspection and supervision. Left unsaid was the Comité's clear objective to provide the Mouvement Desjardins the latitude and means to develop and grow into a financial conglomerate;

3. Establish a deposit insurance fund. This measure was deemed necessary to ensure that deposit-taking institutions under Quebec's jurisdiction, notably the caisses populaires Desjardins, would not be at a disadvantage compared to those under federal jurisdiction, which were covered by the Canada Deposit Insurance Corporation (CDIC), created in March 1967.

From its inception in the early 1900s, the Mouvement Desjardins has promoted the importance of savings and the idea of community and mutual aid in economic, financial and social affairs. Beginning in the late 1950s, this discourse was challenged, notably by André Raynauld (1956, 1966), an influential economist, who argued that the caisses populaires Desjardins were fulfilling a banking function. To support Quebec's economy and their own development, the caisses populaires needed to rebalance their asset mix — which Raynauld said was too heavily weighted toward residential mortgage, personal loans and municipal and government bonds — by increasing their participation in industrial and commercial financing (Raynauld 1956, 1961, 1966). The need to make this shift was gradually recognized internally as the changing demands of new generations of Quebec consumers of financial services exerted pressure on the caisses populaires to adapt to the new social and economic environment (Tremblay and Fortin 1964). The estrangement of the large Canadian banks and financial institutions from Quebec's francophone population further

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5 The CDPQ manages the assets of 42 public and para-public sector depositors. The most important depositors are: (i) the Public Sector Pension Plans; (ii) the Quebec Pension Plan; (iii) the Construction Industry Pension Plan; (iv) the Public Sector Insurance Plans; and (v) the Government Debt Sinking Fund. At the end of 2020, the value of these net assets was $365.5 billion.

exacerbated the situation. As Peter C. Newman (1995) observed, "... of Canada's Big Five banks, only one had a French-Canadian executive of vice-presidential rank or higher." Consequently, the Comité's recommendation came at a time when there was a broad consensus on the overdue need to modernize the legislation governing the Mouvement Desjardins.

Since then, the Mouvement Desjardins and the Quebec government have shared the quest for a strong Quebec financial institution. An important step in this direction was the creation, through a private bill in 1979, of Caisse centrale du Québec (NAQ 1979) as the conduit for Mouvement Desjardins to access outside capital to pursue its expansion and diversification strategy. To strengthen the financial position of Mouvement Desjardins and integrate its treasury functions, the Autorité later approved the amalgamation of Caisse centrale with Mouvement Desjardins, which became effective on January 1, 2017.

The financial regulations governing the operations of Mouvement Desjardins differ significantly from the regulatory regimes for credit unions in other provinces. Each of the 300 caisses populaires Desjardins in Quebec and 13 in Ontario is a distinct legal entity; they are assembled under a single federation, the Fédération des caisses Desjardins du Québec. Under Quebec law, the Fédération is given very significant powers over the caisses populaires Desjardins and full authority over capital investment. Desjardins is thus recognized by rating agencies and regulators alike as a unique entity. Moreover, Quebec's approach to financial regulation has allowed Mouvement Desjardins to enter several sectors: life insurance, P&C insurance, investment banking and securities and real estate brokerage, and grow into a full-fledged financial conglomerate (Table 1).

TABLE 1: Diversification of Income—Desjardins vs Largest Credit Unions and Canadian Banks (2016–2020, average)

	10 Largest Credit Unions	Mouvement Desjardins	All Canadian Banks
Other Income/Total Income (%)	24	58	46

Source: David O'Neill Losier (2021).

Today, the value of its assets in relation to the Quebec economy amounts to 66.4 per cent,[6] while the same assets-to-GDP ratio for credit unions in Alberta, British Columbia and Ontario is 7.6 per cent, 27.9 per cent and 7.9 per cent respectively. Mouvement Desjardins provides about 56 per cent of total bank and credit union loans in Quebec, while in the rest of Canada, credit union loans represent only 10 per cent of total loans. Alberta stands at eight per cent (Losier 2021). This situation has major implications for productivity and economic dynamism, as the Canadian banks' lending behaviour to SMEs does not compare well with their international peers. Compared to other OECD countries, Canada ranks last in terms of the share of outstanding SME bank loans to total outstanding business loans (OECD 2019), is near the bottom in terms of small business lending as a percentage of GDP and has the largest gap between SME and large business lending interest rates, despite having a significantly lower 90-day loan default rate than the United States (Omran and Kronick 2019).

6 This ratio stood at 47.1 per cent of GDP in 2007.

TOWARDS THE INSTITUTIONALIZATION OF FINANCIAL REGULATION

Aware of the measures being considered at the federal level with respect to financial regulation and concerned that federal legislation may encroach on Quebec's jurisdiction, the Comité published an interim report in March 1967. The report led to the immediate adoption of two important pieces of legislation: the *Institutions, Companies and Cooperatives Department Act* (SQ 1966–67, c.72) and the *Deposit Insurance Act* (SQ 1966–67, c.73, s.1).

The first consolidated, under the newly created department, the responsibility to administer "the laws respecting the incorporation, operation, inspection and winding-up of financial institutions, companies and cooperatives doing business in the Province, and of the laws respecting trading in securities, real estate brokerage and the receipt of deposits" (1966–67, c.72, a.1). The Commission des valeurs mobilières du Québec (CVMQ) remained an independent body reporting to the minister. The second created the Régie de l'assurance dépôt (the Régie), whose mandate was to supervise and control the activities of licensed deposit-taking institutions. Its purpose was to ensure that deposits in deposit-taking institutions under Quebec's jurisdiction would enjoy the same protection as deposits in CDIC member financial institutions. In addition to the line of credit established with the Quebec government, the Régie entered into a financing agreement with the CDIC in 1969 under which it could borrow funds to deal with major distress situations.

The equal protection policy is still considered necessary to ensure that Mouvement Desjardins and other Quebec-licensed deposit-taking institutions are not put at a disadvantage compared to the banks. Lately, Quebec has increased certain features of the Régie's deposit protection to match the expanded deposit protection offered by CDIC as of April 2020. The legislation was amended at the same time to give the minister of finance the power to extend insurance coverage for up to two years to avoid gaps between the changes made by CDIC and the unavoidable delays in enacting matching adjustments to the coverage offered by the Régie.

In the late 1960s, a major issue that occupied financial policy-makers was the entry of U.S. investment firms in Canada and the capitalization of the Canadian investment industry.[7] The Canadian, Montreal, Toronto and Vancouver stock exchanges and the Investment Dealers' Association (IDA) established the Moore Committee to study the situation. Its report released on June 15, 1970 recommended that:

1. Foreign companies should no longer be allowed to acquire ownership interest in Canadian securities firms;
2. Canadian securities firms not be allowed to go public;
3. The majority of voting shares should at all times be owned by officers and employees actively engaged in the operation of the business; and
4. A general loosening of existing regulations governing the raising of capital by Canadian investment firms.

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[7] In 1969, Merrill Lynch obtained a seat on the Montreal and Toronto stock exchanges (TSE) through the acquisition of Royal Securities Corporation, a U.S. firm, that became a member of the TSE in 1925.

Following the publication of the Moore Report (1970), both Quebec and Ontario established a committee to study the issues. In Ontario, the Royce Committee established by the OSC essentially endorsed the Moore Committee's recommendations (Royce Report 1972). In Quebec, the Bouchard Committee (Gouvernement du Québec 1972) took a broader view that focused not only on the Canadian scene but on the contribution to the Quebec economy of investment dealer firms which had their head office outside the province.[8] In its final analysis, the Bouchard Committee saw the entry of foreign investment dealers as beneficial to the Quebec economy because these foreign firms were expected to increase the level of competition with non-Quebec-based Canadian investment dealers and facilitate access to foreign capital markets by public and private organizations. The Bouchard Committee recommendations were not well received by the Toronto investment dealers' industry. Although the Quebec government did not follow through in enacting the recommendations into legislation, the attitude that underlined them continued to influence decisions by the CVMQ, and later by the Autorité.

In 1973, the Quebec government's main priority shifted to the need to ensure that Quebec's securities legislation was harmonized with the one in Ontario.

In the wake of the publication of the Kimber Report (1965), the Ontario government proceeded to incorporate provisions governing take-over bids in the *Securities Act* of 1966 (Ontario Legislature 1966; Falby 1967). Influenced by the legislative and regulatory developments in the United States, provisions were incorporated in the Ontario *Securities Act* in 1972 that introduced the concept of reporting issuers and an integrated and continuous disclosure reporting system (Ontario Legislature 1972; Emerson 1972). Quebec's harmonization objective was accomplished the following year with the adoption of Bill 6 amending the Quebec *Securities Act* (NAQ 1973).

In 1975, the focus of the department drifted toward issues unrelated to financial regulation and was renamed Department of Consumers, Cooperatives and Financial Institutions, to reflect its new missions. The major accomplishment under its aegis was the adoption in 1977 of the *Régie de l'assurance automobile du Québec Act* which legislated a pure no-fault public automobile insurance plan for bodily injuries resulting from an automobile accident.[9]

Beginning in 1977, there was a renewed emphasis on financial regulation. The impetus was the evisceration of Montreal's financial sector that followed the election of the Parti Québécois on November 14, 1976, the enactment of the *Charter of the French Language* (Bill 101) and the imposition of punitive levels of taxation on high-income earners that set off a massive exodus of head offices and highly qualified people with a concomitant impact on Quebec's financial industry ecosystem (Linteau 2017). For instance, the MSE's share of stock trading relative to the Toronto Stock Exchange (TSE) that stood at 41 per cent in

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8 Initial members of the committee included Louis-Philippe Bouchard (deputy minister, Institutions, Companies and Co-operatives), Marcel Cazavan (deputy minister of Finance), Claude Prieur (president, CDPQ), Marcel Lajeunesse (president, CVMQ), Charles B. Neapole (president, MSE), Louis Rousseau (president, Molson, Rousseau & Cie. Limited) and Paul McDonald (president, Grant & Johnston). Marcel Lajeunesse was later replaced by Fernand Lalonde (CVMQ). Pierre Brunet (Lévesque, Beaubien) and Jean Labrecque (Hydro-Québec) were subsequently named to the committee.

9 The law provides that anyone injured in auto accidents in Quebec cannot resort to tort law to sue for damages due to injury. It also sets a mandatory minimum amount of coverage for damage to third-party property to be held by all drivers in Quebec. Coverage for the driver's own car for accidents and other perils such as fire and theft is optional. The mandatory third-party property and optional property damage coverage are provided by private insurers. The rates are regulated by AMF on a file-and-use basis.

the 1960–1964 period dropped to 16 per cent in the 1975–1979 period. The movement was further accentuated in January 1978 by the provincial government's and Hydro-Québec's decision to restructure their underwriting syndicates, downgrading the traditional leader A.E. Ames and other Toronto-based investment dealers and elevating Quebec-based firms (Cloutier 1978). The move resulted in a significant loss of revenues for the downgraded firms and a reduction of their personnel and level of activity in the province.[10]

Quebec's loss was Toronto's gain, reinforcing its financial infrastructure which could be reproduced in miniature in other major Canadian cities but not completely duplicated. No amount of tinkering with financial regulation could compensate for the damage inflicted on Quebec's financial ecosystem. It is observed that once a move of financial institutions away from a financial centre begins, it becomes cumulative given the importance of external economies of scale (Davis 1990). Oblivious to the dire situation, the new government's first step was the creation of a working group on savings in 1977 — the level and amounts available and their use (Gouvernement du Québec 1980). The Groupe de travail first proceeded with an analysis of the flows of money and the demand for funds in the various sectors of the Quebec economy which they followed with an examination of the status and regulation of financial institutions under Quebec's jurisdiction and the Régie de l'assurance-dépôt. This led them to challenge the idea that deposit insurance was a public good and, therefore, it should not be a free-of-charge universal deposit protection insurance regime, as was the case at the time. They recommended that deposit institutions insured by the Régie de l'assurance-dépôt pay a premium calibrated to the level of risk they represented for the Régie.

The structural differences in the balance sheets of the four types of credit unions that existed at the time, caisses populaires, the caisses d'épargne et de crédit, the caisses d'établissement and the caisses d'entraide économique, were well documented by the Groupe de travail. Unfortunately, their main recommendation — that the rules applied to ensure the solvency of financial co-operatives should be based on the capitalization of the caisses and credit unions, the level of provisioning for impaired loans and the liquidity of their assets, rather than on limitations on the type of loans and investments they were allowed to make — came too late. In 1981, in the context of a severe recession and high interest rates, the Fédération des caisses d'entraide économique and its 59 affiliates faced a major liquidity crisis that strained the resources of the Régie, which had to borrow $25.2 million from the Quebec government and $30 million from CDIC (all of which were repaid in due course). The solvent credit unions then converted into a corporation which merged with the Fédération des caisses d'établissement and its affiliates in 1988. The combined entity was eventually acquired by Laurentian Bank of Canada in 1992.

The lesson for the government was that the agency responsible for monitoring the conduct, practices and solvency of financial institutions must be independent. This was done on April 1, 1983 when the law that had created the Department of Financial Institutions and Cooperatives was repealed and the department's financial regulatory responsibilities were assigned to the Inspector General of Financial Institutions, an independent agency reporting to the minister of finance. In this capacity, the inspector general also served as president of the Régie de l'assurance-dépôt.

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[10] The restructuring did not, however, have an impact on the issuance of bonds by the province, Hydro-Québec and other Quebec government entities because, since the election of Daniel Johnson Sr. and the Union Nationale in 1966, financial institutions outside Quebec generally refrained from purchasing such debt securities (Cloutier 1973, 1977).

Coincidentally, with this structural reform, the *Securities Act* of 1982 came into force on April 6, 1983. Drafted in civil law mode, this modernized *Securities Act* was considered at the time to be "the most innovative of recent Canadian securities market regulation acts," in part, because of the variety of influences that went into its drafting (Larochelle et al. 1983). For example, the act provided for access to the short-form prospectus on much more liberal terms than in other provinces. To encourage small businesses to access public capital markets, issuers could use an abridged prospectus in lieu of the regular prospectus for stock issues under $5 million. This option had no equivalent in other Canadian securities laws.

A NEW CANADIAN FINANCIAL SYSTEM IN THE MAKING

Unforeseen at the time was the structural transformation of the Canadian financial industry that was about to unfold as a result of a fundamental shift in the paradigm that had, until then, guided Canada's financial regulation policies.

On December 18, 1986, Thomas Hockin, minister of state (finance), tabled a blue paper entitled "New Directions for Financial Institutions," which proposed a sweeping deregulation reform of the Canadian financial system similar to that of the U.K.'s Big Bang. The main elements of the proposed reform included: (i) eliminating restrictions on the common ownership of financial institutions; (ii) increasing consumer and corporate lending powers of trust, loan and life insurance companies; (iii) allowing banks to provide investment advice, portfolio management and other fiduciary services; (iv) restrictions on the ability of commercial interests to acquire or increase ownership positions in non-bank financial institutions; and (v) creation of the Office of the Superintendent of Financial Institutions (OSFI) to bring all federally regulated financial institutions under one authority.

For Quebec, the blue paper's deregulatory aspects were consistent with the theme underlying Quebec's financial regulatory policies. This was manifested in Quebec's decisions to grant TD Green Line Investor Services a licence to serve retail investors in 1984 and later, in November 1986, to allow the Bank of Nova Scotia to establish a full-service securities dealer in the province under a special provision of the *Bank Act*. This was followed by amendments brought to the *Trust Companies Act* in 1987 that gave Quebec trust companies some banking powers, including the right to make loans to businesses.

The major bone of contention with the federal government's financial industry restructuring proposal, a concern shared by four other provinces, was the limits imposed on commercial interests holding or seeking to acquire an ownership position in a trust company. The measure reflected an abundance of caution on the part of senior officials.[11] It meant that Power Corporation of Canada, which controlled Montreal Trustco and Imasco, which owned 99 per cent of Canada Trust — both headquartered in Montreal — would have been forced to divest a significant portion of their position. With a change of minister in this portfolio, the measure was dropped.

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[11] The collapse of the Canadian Commercial Bank and Northland Bank in 1985, the first bank failures in Canada since 1925, created much concern. The two bank failures led to a public inquiry under the chairmanship of Supreme Court of Canada Justice Willard Z. Estey. The failure of the Bank of British Columbia in 1986 did nothing to alleviate the concerns.

Another major concern was that with the entry of banks into the securities industry, OSFI would be invading an area of provincial jurisdiction. This issue was resolved in Ontario with the Hockin-Kwinter Accord (Federal–Ontario Agreement 1987) and with Quebec by the March 1988 Canada-Quebec/QSC–OSFI Agreement regarding the supervision of securities subsidiaries of federally regulated financial institutions. The federal government provided guarantees that OSFI, through its policy guidelines, would not begin regulating securities brokers and advisors as subsidiaries of federally regulated financial institutions. Broad provisions on information sharing between the provincial and federal regulators were central to the agreements.

COUNTDOWN TO AN OPEN SECURITIES MARKET

The structural reform of Canada's financial sector began with the 1987 amendments to the *Bank Act* and to Ontario's securities legislation which removed most restrictions on the types of securities-related activities in which banks could engage; allowed banks to manage portfolios and provide investment advice in Canada; removed all limits on investment by Canadian financial institutions in securities companies; and, subject to corresponding provincial legislation, eased the rules regarding non-resident investment in securities companies and direct access to a province's securities markets.

The collapse of the four pillars regulatory framework marked the beginning of a period of profound and rapid structural change in the financial sector. In a short time, Canadian chartered banks acquired all major investment dealers (Table 2).

TABLE 2: The Acquisition of Investment Dealers by Canadian Chartered Banks

Acquiring Bank	Acquired Investment Dealer	Date
Canadian Imperial Bank of Commerce	Gordon Capital	7/17/87
Bank of Montreal	Nesbitt Thomson	8/13/87
Bank of Nova Scotia	McLeod, Young, Weir	9/30/87
Toronto Dominion Bank	Guardian Group	10/16/87
Royal Bank of Canada	Dominion Securities	12/1/87
Canadian Imperial Bank of Commerce	Wood Gundy	1/26/88
National Bank of Canada	Lévesque Beaubien	7/1/88
Royal Bank of Canada	Pemberton Securities	4/18/89
Bank of Montreal	Burns Fry Ltd *	7/19/94

Source: L. Kryzanowsky and N. Ursel, "Market Reactions to Announcement of Legislative Changes and Canadian Bank Takeovers of Canadian Investment Dealers," *Journal of Financial Services Research*, 1993: 171–185.

* The firm was acquired through a merger with BMO's subsidiary, Nesbitt Thompson.

Faced with the crumbling of the four pillars financial industry structure, Quebec adopted in 1989 the *Act Respecting Market Intermediaries* (Quebec National Assembly 1989) which, in 1998, was superseded by the *Act Respecting the Distribution of Financial Products and Services* (Quebec National Assembly 1998). The latter thoroughly opened the way to multi-disciplines at the distribution level of financial products and services including insurance savings types and mutual fund products. The oversight of the mutual fund distribution component of that industry was transferred from the CVMQ to a newly created entity, the Bureau des services financiers (BSF). Clearly, the long-term view was that the securities and insurance distribution part of their respective regulatory regime would be merged at some point. It is in this context that the Fonds d'indemnisation des services financiers, a new compensatory scheme, was created.

The ensuing years have seen significant consolidation in the Canadian securities industry, due in large part to the pressure on firms to evolve, invest in new technology and comply with ever-increasing compliance costs. As a result of a series of mergers and acquisitions, the number of member firms of the Investment Industry Regulatory Organization of Canada (IIROC) dwindled to 171 and the number of member firms of the Mutual Fund Dealers Association (MDFA) to 87 as of December 2021, compared to 214 and 159 respectively in 2008. The impact was particularly severe for Quebec, and was accentuated by the fall-out from the March 1999 agreement between Canadian stock exchanges that saw the MSE exit stock trading in exchange for an exclusive position in financial derivative markets. Between 2004 and 2017, the level of employment in the Quebec securities and investment industry grew by only eight per cent compared to 50 per cent, 79 per cent and 31 per cent in Ontario, Alberta and British Columbia, respectively.

The second phase of Canadian financial sector reform came into effect in June 1992. The most significant provisions were the removal of restrictions on cross-ownership. Banks were now permitted to purchase trust companies and insurance companies, and trust companies and insurance companies, in turn, were permitted to acquire other financial institutions. Taking advantage of the new regime, Canadian banks quickly acquired Canada's largest trust[12] and asset management companies. For example, Scotiabank acquired the well-known asset management firm Jarislowsky Fraser Ltd. of Montreal, while National Bank acquired Wellington West Holding Ltd. and a significant stake in Fiera Capital. In the insurance sector, INTACT acquired the Canadian operations of AXA Canada in 2011 and Manulife acquired the Canadian operations of Standard Life in 2014. These transactions further strengthened Toronto's position as a financial centre as the acquired operations were located in Montreal.

DEMUTUALIZATION OF THE CAPITAL STRUCTURE OF MUTUAL INSURANCE COMPANIES

Beginning in the mid-1980s, interest in converting mutual insurance companies into stock insurance companies gained momentum. Without access to risk capital financing, mutual insurance companies had to resort to internal financing by means of corporate debt, unsecured bonds and notes. In contrast, the stock form of organization offered advantages over mutual, such as (a) the flexibility to acquire or be acquired by another company; (b) access to capital markets to finance acquisitions and the ability to use one's own stock as a currency in these transactions; and (c) the ability to issue stock to increase the company's capital base and, therefore, the ability to grow the business. It was also suggested that the stock form of organization was more conducive to adopting business

[12] Scotiabank acquired Montreal Trust and National Trust, Royal Bank acquired Royal Trust, TD Bank acquired Canada Trust and National Bank acquired Trust Général du Canada followed by the acquisitions of Family Trust Corporation and The Municipal Savings & Loans Corporation.

strategies based on efficiency, adaptability, growth and the development and expansion of new product lines. Interestingly, subsequent studies have shown that, indeed, demutualized life insurance companies demonstrated greater efficiency in their operations, higher growth and greater profitability (Chugh and Meador 2006).

As far back as 1987, a proposal for a common legislative framework for demutualization was made in Quebec. Given the wide variety of insurance policy types, the wide range of internal company rules and the complexity of conversion, it was concluded that a case-by-case approach was preferable and the proposed framework was abandoned.

In 1985, Laurentian Group Corporation, headquartered in Quebec City, undertook a reorganization to facilitate its access to equity capital by creating a public financing vehicle of the same name. This was followed by the adoption of a private bill in June 1988 (Quebec National Assembly 1988) which converted Laurentian Mutual Insurance Company into a capital stock insurance company, Laurentian Life Insurance Company Inc., and changed the legal structure of the Laurentian Group Corporation so that its insurance operations, the operations common to Laurentian Life and the Corporation's other subsidiaries, would be situated downstream of it. The company lost no time in using its new corporate structure. In January 1987, it acquired a 45 per cent equity position in the holding controlling the investment dealer Geoffrion, Leclerc, Inc. This was followed by the acquisition of a majority position in the Montreal City and District Savings Bank, renamed the Laurentian Bank of Canada, soon followed by the acquisition of two insurance companies in the United States[13] and the sale of Laurentian Life to Imperial Life Insurance Company in 1993.

In July 1990, Assurance-vie Desjardins, a mutual insurance company was amalgamated with La Sauvegarde, a capital stock life insurance company; the combined company under the corporate name of Assurance-vie Desjardins Inc., was continued as a capital stock company in accordance with the provisions of private Bill 249 (Quebec National Assembly 1990). This was followed in 1992 by the acquisition of the individual group and accident insurance portfolios of Les Coopérants.

Quebec resorted once again to its demutualization formula in 1991 with the adoption of a private bill that authorized Les Coopérants, Société Mutuelle d'Assurance-vie, which had merged with Les Artisans, Société cooperative d'Assurance-vie in December 1981, to demutualize (Quebec National Assembly 1991).

In December 1993, a private bill was adopted to allow the merger of the Laurentian Group with the Mouvement des caisses Desjardins (Quebec National Assembly 1993); Desjardins Life Assurance became Desjardins Laurentian Life Assurance (DLLA). Desjardins Group followed with the purchase of Imperial Life in 1994. In 2001, DLLA merged with Imperial Life to become Desjardins Financial Security Life Assurance Company.

The federal government took a different approach to demutualization. In 1991, amendments were brought to the *Insurance Act of Canada* (C.47, S.237, 1991) to allow federally incorporated Canadian mutual life insurance companies with assets of less than $7.6 billion to convert into corporations. Further amendments to the *Insurance Act* were adopted

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[13] Following the merger, Desjardins-Laurentian Financial Corporation (DLFC) became the new majority shareholder of Laurentian Bank of Canada. DLFC sold part of its holding in 1997 which allowed Laurentian Bank to become a Schedule 1 institution.

in March 1999 to extend the conversion option to all Canadian mutual life insurance companies governed by the act. This legislative change was consistent with developments in the United States, where 15 U.S. life insurers, including five of the 15 largest, demutualized between 1997 and 2001.

The demutualization policy responded to the new environment in the life insurance industry characterized by: (1) declining consumer interest in traditional life insurance products, while revenues from wealth management and annuities offered new growth opportunities; and (2) deregulation of the financial services industry that removed restrictions on common ownership of financial institutions. Concerned that demutualized insurance companies could become potential takeover targets, the legislation maintained the principle of wide ownership of large banks. It provided that, in the two years following demutualization, no individual or entity would be allowed to own more than 10 per cent of the shares of the company. In addition, no mergers among, or acquisitions of, demutualized firms were allowed during this two-year transition period.

Within a year of implementing legislation, four of the largest federally regulated mutual life insurance companies had completed the process: Manulife (1999), Canada Life (1999), Clarica Life — formerly Mutual Life (2019)[14] and Sun Life of Canada (2020).[15] The prompt embrace of the possibilities offered by the new federal legislation does not belie the fact that the demutualization process proved to be a complex and costly exercise. The lesson was not lost in Quebec. As with the approach taken for the Laurentian Group, changes to the legislative framework governing mutual life insurance companies were accomplished through the adoption of private bills tailored to the characteristics and needs of each company.

In November 1999, the Quebec National Assembly adopted a private bill (Quebec National Assembly 1999) to allow Industrial Alliance and Life Insurance Company to demutualize in an orderly and transparent process that promoted the fair and equitable treatment of policy-holders. The act incorporated the principle of wide ownership by providing that no individual or entity would be allowed to own more than 10 per cent of the company's shares. This legislation was further amended by a private bill in 2018 (Quebec National Assembly 2018) to allow for the restructuring of the organization whereby the life insurance company would become a wholly owned subsidiary of a newly created holding company, IA Financial Corporation Inc., which is subject to the same ownership rule. These changes were enacted to facilitate the diversification of Industrial Alliance's financial services and its expansion across Canada and in the United States. Today, 60 per cent of its revenues originate from outside Quebec, compared to two per cent in 1982. This company is now the sixth largest insurance company in Canada.

Regulatory capital requirements exert a major influence on the latitude insurance companies have to make acquisitions. The federal government's adoption of more stringent capital requirements in 1990 was a damper. In Quebec, the Autorité deviated by maintaining less onerous capital requirements compared to those set by OSFI when

14 Sun Life acquired Clarica Life in May 2002.
15 On January 1, 2020, the amalgamation of the Great-West Life Assurance Company, London Life Insurance Company and the Canada Life Assurance Company, and their holding companies, Canada Life Financial Corporation and London Insurance Group Inc., became effective. The new entity is known as the Canada Life Assurance Company.

a life insurance company acquired a P&C insurance company. This policy explains why all Quebec life insurers are active in both industries when this is not generally the case elsewhere in Canada. In the same vein, for several years, the Autorité applied a factor-based methodology using an insurer's own internal model approved by the AMF to calculate the risks and determine the regulatory capital requirements for segregated funds (SGF).[16] The AMF approach led to less stringent but better tailored capital requirements than the ones determined in accordance with OSFI rules. Taking advantage of this situation, IA Financial Group has established a leading position in the Canadian segregated funds market. As of June 30, 2022, it held a 17.8 per cent market share (third position) for SFG in force and a 31.5 per cent market share for new business acquired in the April–June 2022 period.[17]

Recognizing that size was an important competitive factor, La Capitale Financial Group and SSQ merged in 2020 to form Beneva. The merger of these two mutual life insurance companies was authorized through the adoption of a private bill (Quebec National Assembly 2020). Today, three of the top 10 insurance companies in Canada are based in the Quebec City area.

Table 3: Quebec Top Insurance Companies in Canada as at June 30, 2021

Ranking in Canada	Insurance Company	Total Assets (CAN$ bn)
3	Desjardins	389,778
6	Industrial Alliance Financial Corp.	88,997
9	Beneva	25,035

Source: ADV Ratings (2021).

This concentration is not unrelated to initiatives taken by Université Laval which began offering actuarial courses in 1951 to prepare students for the Society of Actuaries examinations. The program was expanded in 1968 to the level of a BSc. in actuarial studies. In 1988, the university created the École d'actuariat. Recognized as a centre of actuarial excellence by the Society of Actuaries, it offers a full academic program from undergraduate to graduate degrees (MSc. and PhD) in actuarial studies. The combination of competent leadership at the helm of Quebec's insurance companies and the willingness of government authorities to adopt legislative changes reflecting the new competitive environment through an accelerated and customized legislative process explain much of the current favourable situation.

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16 The methodology was defined in Chapter 6 of the January 2014 AMF "Capital Adequacy Requirements Guideline, Life and Health Insurance."

17 The entry into force of the International Financial Reporting Standard 17 – Insurance Contracts (IFRS 17) that became effective in Canada on January 1, 2023, will eliminate the differential.

A NEW PARADIGM FOR THE INSTITUTIONAL STRUCTURE OF QUEBEC'S FINANCIAL REGULATOR

In the context of the new financial industry structural environment, the effectiveness of the Quebec regulatory apparatus established in 1983 and, concomitantly, the blurring of the boundaries between financial products and services that occurred since and the costs it imposed on financial institutions and intermediaries became a subject of contention with the Quebec industry. To address the issues, a committee was formed in 2001 to examine how best to structure the financial regulatory system. The committee (Gouvernement du Québec 2002) spent considerable time consulting with financial firms and self-regulatory organizations (SROs). It also consulted with experts from Australia, France and the United Kingdom who had recently been involved in restructuring the financial regulatory systems in their respective countries.

The committee noted that the distinctions between deposit-taking institutions, securities firms and insurance companies had broken down and that securities issuers, financial firms and investors were often confronted by a maze of regulations from overlapping agencies. The failure of the Inspector General of Financial Institutions to recognize in time that the rapid diversification of Les Coopérants in commercial real estate and other financial businesses was unsustainable and to take early actions that could have prevented the first bankruptcy of a Quebec life insurance company in 1992, exemplified the fact that complexity has external properties that make risk more difficult to monitor and manage, not less. Adamant that the regulatory system should be designed to promote competency and convinced that the manner in which it is structured can have a significant influence in furthering this objective, the members were swayed by the main arguments in favour of unification:

EFFICIENCY IN THE SUPERVISION OF FINANCIAL CONGLOMERATES

Fragmentation of supervision impairs the ability of financial sector supervisors to obtain a consolidated assessment of the institution's risks and to ensure seamless, gap-free supervision. Because it facilitates a holistic approach to risk management, the unified regulatory structure is seen as better able to meet the criteria of efficiency in dealing with the risks inherent in complex group structures and the cross-system complexity arising from intra-financial system exposure chains (Abrams and Taylor 2000).

From the financial institution's perspective, a unified regulatory system reduces the costs imposed by fragmentation of supervision and avoids redundancy where different parts of the system have overlapping responsibility over a particular financial activity or entity.

PROMOTION OF COMPETITIVE NEUTRALITY

The consolidated approach makes it easier to ensure that different products and institutions are treated equally and supervisory arbitrage is avoided.

REGULATORY FLEXIBILITY AND IMPROVED ACCOUNTABILITY OF REGULATION

Dealing with one regulatory agency facilitates the development of regulatory arrangements compared to what can be achieved with separate agencies. Unification makes it easier to hold regulators to account for their performance against their statutory objectives, for the costs of regulation, for their disciplinary policies and for regulatory failures. By creating a single management structure, it helps make it clear to government authorities, the industry and the public who should be held to account for particular regulatory actions or failures.

ECONOMIES OF SCALE

It is difficult to deny the benefits of unification for the administrative and analytical functions of the various supervisory functions when the financial system and the supervisory agencies are small. The broader scope of a unified regulator makes it easier to develop and retain a competent body of professionals. According to the committee, economies of scale and scope would be achieved by merging the organization of the Inspector General of Financial Institutions with the CVMQ, and a single regulatory organization would reduce the incidence of regulatory failures and, therefore, regulatory costs.

The proposed structure was closely modelled on the U.K.'s FSA model presented by the U.K. Chancellor of the Exchequer on May 20, 1997 (Brown 1997)[18] and Germany's single financial regulatory BaFin, created in January 2001 through the merger of three existing banking, securities and insurance regulators (Schuler 2004). The committee discounted the two main arguments against unification — that unification would lead to a lack of clarity in the objectives of the regulatory agency and the unpredictability of the change process, if and when a decision is made to create a unified oversight body.[19] The prevailing view in the committee and in government was that the unified regulatory system is aligned with the objective of creating and assisting diversified Quebec-based financial organizations grow and develop across Canada and in other foreign markets and that it is best positioned to meet the challenges of regulating large financial conglomerates in the province to international standards.

Not much was said at the time about the relevance, design and scope of coverage of the then-existing industry compensation schemes established by Quebec legislation, except a broad recommendation to merge all of them into a single patrimoine d'affectation whose fiduciary responsibility would be transferred to the Agence, the newly unified regulator.

The act creating the Agence nationale d'encadrement du secteur financier was adopted in December 2002 (SQ 2002, c. 45); in 2004, the name was changed to Autorité des marchés financiers (the Autorité) (SQ 2004, c. 37, S. 90). The act directs the AMF to perform its functions and exercise its powers in such a way as "to see to the establishment of an effective and efficient regulatory framework that promotes the development of

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18 In December 2012, the U.K. reversed course, splitting the FSA into two separate regulatory authorities: the Financial Conduct Authority and the Prudential Regulation Authority.

19 To ensure that the establishment of the new unified regulatory agency was conducted efficiently and avoid squabbling between the organizations to be merged, the act creating the Agence established a transition bureau with the mission to: (i) set up the Agence; (ii) facilitate the implementation of the new regulatory framework for the financial sector: and (iii) make the promotion thereof among the practitioners of the financial industry (Gouvernement du Québec 2004).

the financial sector and facilitates innovative management and commercial practices." Its regulatory mandate differs from that of financial regulators in the large majority of other Canadian provinces in that it is mandated to supervise in a unified manner insurance, securities, derivatives, deposit institutions (other than banks), the distribution of financial products and services, mortgage brokerage, credit assessment, the implementation of protection and compensation programs for consumers of financial products and services, and to administer the compensation funds mandated by law. Thus, the Autorité is responsible for exercising the functions of prudential regulation and the supervision of business conduct practices while, at the federal level for example, the Office of the Superintendent of Financial Institutions (OSFI) and the Financial Consumer Agency of Canada (FCAC) share responsibilities for regulating federally chartered depository institutions and insurance companies according to the tenets of prudential regulation (i.e., OSFI) and business conduct regulation (i.e., FCAC).

In addition to the duties conferred on it by its constituting act, the Autorité also administers the statutes governing each of the areas it oversees. In exercising its functions and powers, the Autorité has an explicit mandate to ensure that its actions: (i) promote the development of the financial sector; (ii) facilitate innovative management and commercial practices; and (iii) promote the availability of high-quality competitively priced financial products and services in all regions of Quebec. Its broad mission is summarized in Appendix 1.

PAN-CANADIAN SECURITIES REGULATION HARMONIZATION

Quebec has been a strong advocate for the harmonization of securities laws and regulations across Canada and, to the extent possible, with U.S. securities laws. Given that Quebec's legal tradition is the civil law system, while the common law prevails in the rest of Canada and the United States, the need to bridge the gap between the two legal systems and eliminate the causes of litigation and disputes was paramount. This was done with the adoption of the new *Quebec Securities Act* in 1982.

In 2004, Quebec's regulatory reform priority shifted towards harmonization on a pan-Canadian basis of securities regulation. The new focus followed the signature by all members of the Council of Ministers of Securities Regulation, except Ontario, of the Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation (MOU). A mutual recognition system, the passport regime envisaged in the MOU, required a highly harmonized securities regulatory framework to work. Quebec has been a leader in adopting these rules, which, with the exception of Ontario's obstinacy, has significantly reduced regulatory complexity. The passport system became effective in March 2008 for issuers and in September 2009 for registrants. It provides a single window of access to Canada's capital markets for domestic and foreign issuers. It enables participants to clear a prospectus or obtain a discretionary exemption and to register as a dealer or adviser by obtaining a decision from the securities regulator in their home province or territory and have that decision apply in all other jurisdictions.[20]

[20] Non-Ontario market participants can obtain access to the market in Ontario through an interface system in which the Ontario Securities Commission (OSC) makes its own decision but generally relies on the review by the principal regulator. To achieve maximum efficiency for the market's benefit, the passport regulators accept the OSC's decisions under passport.

PECULIAR ASPECTS OF QUEBEC FINANCIAL REGULATIONS

Nevertheless, the reasonableness of two particular provisions of the Quebec financial regulatory framework is questionable. The first concerns the decision of the Autorité not to recognize the Mutual Fund Dealers Association (MFDA) as a self-regulatory organization (SRO) and the resulting consequences for the protection of Quebec mutual fund investors. The second concerns the language requirements imposed on existing public companies wishing to access the primary market in Quebec for the first time.

COMPENSATION OF CONSUMERS OF FINANCIAL PRODUCTS AND SERVICES

The compensation mechanisms against losses arising from the insolvency of financial institutions and market intermediaries under Quebec's jurisdiction are equivalent to those in the rest of Canada, with the exception of mutual fund dealers. The protection extends to: (i) deposit institutions (credit unions and caisses populaires), trust companies and insurers authorized to receive deposits; (ii) insurers as part of their insurance activities; and (iii) investment dealers. To conduct insurance operations in Quebec, an insurer must be a member of Assuris for life insurance and of the Property and Casualty Insurance Compensation Corporation (PACICC) for property and casualty insurance, the two compensation organizations that protect policy-holders across Canada. As well, investment dealers operating in Quebec must be members of IIROC, which results in automatic coverage by the Canadian Investor Protection Fund (CIPF).

The Autorité does not recognize the MFDA as a self-regulatory organization (SRO).[21] The part of the usual role of an SRO that pertains to approved persons was fulfilled by the Chambre de la sécurité financière until June 2018 when the Autorité ority took over the task. The critical part of prudential regulation is performed directly by the Autorité. In practice, although the regulatory framework governing mutual fund dealers is substantially harmonized with Canadian regulations, it remains that the current structure imposes added costs for all MFDA mutual fund dealers operating in Quebec who are thus subject to both MFDA and Autorité audits. The most consequential peculiarity of the Quebec regulation of mutual fund dealers is the requirement for registered representatives to carry professional liability insurance. In the rest of Canada, in accordance with NI 31-103, mutual fund dealers must maintain fidelity insurance. This aspect of the Quebec regime has several untoward consequences:

1. The overarching objective of prudential regulation is to ensure the capital adequacy of financial firms under unforeseen circumstances. Fidelity insurance is a quasi-universal means to achieve this purpose with respect to covered events. Professional liability insurance falls short on this critical dimension because it covers only errors and omissions; not fraud and, in most instances, not gross negligence. Fidelity insurance covers errors, omissions, fraud, fraudulent tactics and embezzlement committed by an employee or agent. It is considered in all other jurisdictions in Europe and North America as the best approach to protect consumers from misconduct, including fraud;

2. Since theft, embezzlement and other fraudulent misappropriation of assets constitute one of the major causes of financial injuries to consumers, the absence of insurance

[21] The MFDA is recognized as an SRO by the Alberta Securities Commission MDFA/ACFM, 2018 ABASC 53.

coverage for such events leads inexorably to the need to adopt another means to indemnify financial consumers against fraud committed by representatives or other employees of a mutual fund dealer. Hence, the creation and singular mandate of the Quebec Financial Services Compensation Fund (FISF). It is noteworthy that securities firm members of IIROC active in Quebec are required to maintain fidelity insurance coverage — not professional liability coverage — and, consequently, are excluded from coverage by the FISF.

FISF is not a dealer insolvency protection insurance fund.[22] By design, all European Union and North America schemes, except FISF, are insolvency schemes. Consequently, Quebec investors in mutual funds are protected if the dealer's bankruptcy is the direct result of fraud on Quebec financial consumers. However, they are out of luck if the failure results from any other cause or the bankrupt firm is domiciled in another province.

The recent decision by the Canadian Securities Administrators (CSA) to create a new single self-regulatory organization (SRO) to succeed IIROC and MFDA and the approval of MFDA and IIROC members in September 2022 to create this new SRO should, once implemented, not only reduce the overall regulatory burden on the industry, but also resolve the disparity in financial consumer protection that exists in Quebec (De Laurentiis 2019).

DYSFUNCTIONAL LANGUAGE REQUIREMENTS

The adoption of the *Charter of the French Language* (the Charter) in 1977 imposed language requirements on the conduct of business in the province. Issuers of securities in the public market were thereafter required to provide a prospectus in French to all Quebec investors interested in participating in the financing. Meeting this requirement is not an onerous task that is generally considered reasonable given the characteristics of the Quebec retail market. The cost-benefit balance changed significantly in 1983 when an amendment was made to the *Quebec Securities Act* to expand the list of documents required to be available in French, including all documents incorporated by reference in a prospectus or other similar document prescribed by regulation (Quebec National Assembly 1983). This means, for example, that a reporting issuer not operating in Quebec that accesses the Canadian market with a short-form prospectus cannot access the Quebec market unless the French versions of its interim financial statements, annual report and proxy solicitation documents already filed pursuant to continuous and periodic disclosure obligations incorporated by reference in the prospectus are available in French. This requirement defeats the system's purpose.

In proposing this amendment to the *Quebec Securities Act*, the CVMQ claimed that it would have no impact on the attractiveness of the Quebec market (CVMQ 1983). Contrary to the CVMQ's assertion, experience to date shows that many Canadian and foreign-listed companies accessing the primary market in Canada shun the Quebec market even though, in several cases, they have substantial business operations in the province. Available data indicate that since 2009, less than 45 per cent of prospectuses filed in Canada have been

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[22] As the FISF is not an insolvency protection scheme, it cannot obtain the status of a customer compensation body under the *Bankruptcy and Insolvency Act*. This status provides the right to participate in the administration of a bankruptcy estate by appointing an inspector and to be consulted by the trustee in bankruptcy. As a result, Quebec financial services consumers would be at a distinct disadvantage in a bankruptcy proceeding, particularly if the bankrupt business were domiciled in another province.

filed in Quebec. This legal requirement is also detrimental to the development of asset management companies that have not yet reached the size and scope necessary to justify establishing a licensed subsidiary in another Canadian jurisdiction. And, since it pertains to existing documentation filed with securities commissions years and months prior to the financing and there is no prohibition for Quebecers to acquire shares of a company listed on the TSX, TSX(V) or abroad that does not produce any documentation in French, the policy's incoherence makes it a real loss and no gain.

STRENGTHENING THE CONTRIBUTION OF THE FINANCIAL INDUSTRY TO ECONOMIC GROWTH

The contention that the development and depth of the financial system enhances economic growth is supported by a large body of academic research (Levine 2011). The primary transmission mechanism from financial development to growth is the central role played by financial institutions and intermediaries in allocating capital to its best possible use, which helps determine long-term economic growth rates and income distribution. Two major financial policy initiatives were adopted to leverage this mechanism through the promotion of equity investments in Quebec-based companies. Another major policy aimed to build a dense web of relationships with financial institutions in other markets.

THE QUEBEC STOCK SAVINGS PLAN

The first step was the introduction of the Quebec Stock Saving Plan (QSSP) in June 1979. The main motive for the plan was to counter the effects of the hike of the tax rates imposed on middle- and high-income earners in the 1978 budget (Duchesne 2002).[23] Modelled on Le Plan Monory in France, individual investors could deduct from their Quebec taxable income the amount invested in new publicly traded shares of Quebec corporations headquartered in the province, up to an amount equal to 20 per cent of earned income and not exceeding $15,000. To enhance the political acceptance of the plan, the minister of finance stated that, concurrently, it would serve to increase Quebecers' propensity to invest in shares of companies, which at the time was among the lowest in Canada and, thus, strengthen the capitalization of Quebec companies.

The QSSP was a popular measure. At inception, and in line with its central objective, newly issued common shares of all Quebec-headquartered companies were eligible for the same tax deductions. This feature caused the flow of QSSP investments to be directed towards large corporations. Indeed, during the plan's existence (1979–1984), large, seasoned issuers raised $3.4 billion in QSSP eligible issues out of a total of about $7 billion (Suret and Cormier 1997). Since the shares of these companies were traded across Canada and given their large float, the QSSP tax deduction did not affect their market price and thus conveyed a real tax benefit to Quebec retail investors. Admittedly, this was inconsequential on their capitalization or ability to access the capital market, except for a few already exchange-listed Quebec companies (e.g., Provigo, Bombardier, SNC-Lavalin, Vidéotron, Québecor, among others) that took advantage on more than one occasion of the favourable market conditions for seasoned QSSP issues to finance their expansion outside Quebec.

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[23] For 1979, the personal combined maximum marginal tax rate in Quebec was 68.9 per cent.

Recognizing that the initial rules did nothing to strengthen the capital structure of Quebec small and medium-sized companies, changes were introduced in May 1983 to tilt the investment attractiveness towards them. This redesign of the QSSP led to a wave of medium and small-sized business IPOs. Between 1983 and 1987, Quebec companies of all sizes raised close to $5.1 billion in new shares through 307 issues, of which 177 were IPOs (Carpentier and Suret 2006).

A concomitant impact was the development of teams of investment bankers and professionals in accounting and law firms to support companies accessing public markets. A survey of professional firms involved in public financings of Quebec companies revealed that between 1980 and 1986 the number of: (i) investment dealers' firms increased from two to eight; (ii) lawyers engaged in securities matters increased from 33 to 92; and (iii) financing professionals (accountants, consultants, etc.) increased from 15 to 57 (Denis 1986).

Interviews with senior executives of QSSP mid-size companies revealed that prior to their IPOs these companies were undercapitalized; 80 per cent of them had a debt ratio higher than that of their peers in the same industry in the rest of Canada. Of those companies, 52 per cent had a debt ratio that exceeded their industry average by more than 25 per cent (19 per cent had a debt ratio that surpassed their industry average by 50 per cent or more). Overly leveraged, their access to additional bank financing was severely limited. QSSP financings had a significant impact as the majority of the companies used the new capital to restructure their balance sheets. The proportion of companies with a debt ratio higher than their industry peers now stood at 45 per cent and only 17 per cent had a debt ratio exceeding their industry average by 25 per cent (Denis 1986). Better capitalized, these companies were in a position to pursue — and finance — a deliberate investment program that significantly strengthened their competitiveness (Desroches and Jog, 1989; Brunet et al. 2011).

As shown in Table 4, some of the companies that went public during this period have become world-class.

TABLE 4: Examples of Initial Public Offerings Stimulated by QSSP

Company	Date of IPO	Market Capitalization* (CAN - M/$)
Alimentation Couche-Tard	1986	57,770
Cascades	1982	1,210
CGI	1986	22,340
Cogeco	1985	1,010
Héroux-Devtek	1986	515
Gildan Activewear	1998	7,440
Métro	1986	16,540
Richelieu Hardware	1993	1,960
Saputo	1997	11,180
Transcontinental	1984	1,331

* As of May 6, 2022.

The QSSP was successful in encouraging Quebecers to invest in stocks. In 1977, only 4.4 per cent of Quebecers owned shares in their portfolio; this proportion stood at 16 per cent in 1987, a ratio close to the prevailing Canadian average of 18 per cent.

The change made to the plan in 1983 proved not to be innocuous, precipitating a dash of IPOs by small companies. Whereas this category of companies had raised a total of $10.4 million between 1979 and 1982, the amount of equity capital raised in the 1983 to 1987 period amounted to $1,077.42 million (Suret and Cormier 1997). The small float of these small unseasoned issuers translated into a lack of market liquidity for the majority of these companies that heightened the volatility of their stock price. This led many investors to lose money, an outcome that was greatly accentuated by the stock market debacle of October 1987. The experience fuelled disaffection with QSSP stocks except those issued by large corporations which constituted the vast majority of QSSP eligible issues. The QSSP was replaced by the SME Growth Stock Plan in April 2005, which did not produce the expected results and was ended on December 31, 2009.

Unfortunately, the momentum created by the QSSP lost steam. Today, the number and market capitalizations of Quebec-based companies listed on the Toronto Stock Exchange and TSX Venture Exchange (six per cent and 13 per cent respectively) are significantly lower than Quebec's share of the Canadian economy (21 per cent), while Alberta-based companies represent nine per cent of issuers listed on the Toronto Stock Exchange and TSX Venture Exchange, with a market capitalization close to 150 per cent of that of Quebec issuers (TMX 2022).

VENTURE CAPITAL LABOUR-SPONSORED FUNDS

The second step was the adoption of legislation to allow the creation of labour-sponsored venture capital corporations (LSVCC).

The Quebec economy went through a very serious recession from the last quarter of 1981 to the third quarter of 1982, marked by an unemployment rate approaching 14 per cent and a crisis in public finances. At an economic summit conference to build a consensus on how to deal with the situation, Louis Laberge, then president of the Fédération des Travailleurs du Québec (FTQ), proposed that Quebec adopt a law enabling Quebec unions to establish a type of open-ended mutual fund to invest in small and medium-sized Quebec companies. The measure was seen as an effective means to democratize private equity investment for retail investors and encourage greater participation in long-term investments. To support the growth of such funds, tax credits would be provided to investors and these investments would also be eligible for RRSPs. Laberge also convinced then-prime minister Brian Mulroney to have the federal government support the Quebec initiative with tax credits on investments in LSVCCs.

Soon after the summit, Quebec passed legislation to establish the Fonds de solidarité des travailleurs du Québec (FSTQ) (Quebec National Assembly 1983). Similar legislation was adopted in 1995 to create Fondaction at the request of the Confédération des syndicats nationaux (CSN) (Quebec National Assembly 1995). In 2001, the concept was borrowed by the Mouvement Desjardins and applied to regional development. Enabling legislation was passed in 2001 (Quebec National Assembly 2001).

The federal government and some provinces have adopted legislation modelled on the Quebec example. For a variety of reasons, these LSVCCs have produced stagnant returns, attracting negative academic analysis (Cumming and MacIntosh 2007). In the absence of demonstrable results, these jurisdictions have progressively reduced or eliminated the tax benefits associated with investments in LSVCCs.

The growth path of the Fonds de solidarité FTQ, Fondaction (CSN) and Capital régional Desjardins has been markedly different from the experience in other provinces. By 1999, the constraints on eligible investments imposed at the inception of the funds were no longer appropriate due to the size achieved by each fund and the need to protect investors with a diversified portfolio. As a result, legislation was passed in 1999 to relax the investment requirements to allow investment in out-of-province companies operating in Quebec and in public companies.

TABLE 5: Performance of Quebec LSVCC (2021)

		Compound Investment Return *			
	Net Assets ($B)	10 Years (%)	5 Years (%)	3 Years (%)	1 Year (%)
Fonds de solidarité FTQ	20.4	7.5	8.9	9.3	20.3
Fondaction	2.96	5.9	9.0	11.6	17.0
Capital régional Desjardins	2.595	5.0	6.2	5.3	10.3

* Returns prior to impact of tax incentives; Funds annual reports.

In terms of financial regulation, the CVMQ has adopted specific rules for labour-sponsored investment funds and regional development funds that differ from the fully harmonized regulations applicable to mutual funds, but are consistent with the regime generally applicable to investment funds.[24] In addition, the acts respecting FSTQ, Fondaction and Capital régional Desjardins (the funds), have mandated the Authority to annually inspect the internal affairs and operations of the funds to ensure compliance with their constituting acts.

A DISTINCTIVE PERFORMANCE

The contention that LSVCCs will outbid private equity and drive private equity firms out of business has not materialized in Quebec. The market is characterized more by co-operation and joint investments than by raw competitive behaviour. In addition, private equity and venture capital firms tend to specialize in particular industries, reflecting the experience and networks of the firm's management, whereas the Fonds de solidarité and Fondaction are more generalist.[25]

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[24] The highly harmonized regulatory regime applicable to investment funds compels investment funds managers to file prospectuses. Once receipted by the appropriate securities regulators, unit distributions need to proceed through dealers and representatives duly registered. Advisors ought to be registered with securities regulators; so must managers.

[25] This is illustrated by Inovia Capital's recent announcement that it had raised US$325 million for its fifth early-stage fund. Focused on technological start-ups, Inovia is specialized in financing firms with a software as a service (SAAS) business model.

A detailed examination of private equity deals in Canada between 2013 and June 2018 revealed that the number of interprovincial deals was very low. On average, the size of private equity investments in Quebec was about one-fifth the size of private equity deals in Ontario and one-quarter the size of private equity deals in Alberta (Lortie 2019). This may be a reflection of the proportion of start-ups in the mix. The Global Startup Ecosystem Index 2021 ranks Montreal sixth in the category of cities in 100 countries with a population of one to three million (Startup Blink 2021).

Table 6: Distribution of Number and Value of PE Deals in Selected Provinces 2013–June 2018

		Volume of PE Deals		Value of PE Deals	Per Cent of Canada's Real GDP
	Nb	Per Cent of Total Canada	C$ (B)	Per Cent of Total Canada	2020
Alberta	346	14.0	32.3	24.6	21.0
British Columbia	255	10.3	9.8	7.5	15.0
Ontario	535	21.7	54.6	41.6	45.0
Québec	1198	48.5	30.6	23.3	23.0
Canada (total)	2,470	–	131.3	–	–

Source: Lortie 2019

It is well established that credit to SMEs is both less available and less affordable in Canada than in other major OECD countries (Omran and Kronick 2019). Interestingly, the data and value of PE deals across Canada during the period 2013–June 2018 show that 82 per cent of the total number of venture debt deals were completed in Quebec. The vast majority of these venture debt deals were completed by Desjardins Capital (63 per cent) and Fondaction (19 per cent), filling a need that Canadian banks are not effectively addressing (Lortie 2019).

An overview of the Canadian private equity market for 2021 reveals that $18.1 billion was invested in 799 deals. The results confirm Quebec's strong presence in this market: 60 per cent of PE deals representing 51 per cent of the total investment value were made by Quebec-based investors. Notably, 142 deals in Quebec ($4 billion) were PE growth deals, compared to 44 such deals ($1.78 billion) in Ontario and 17 deals ($490 million) in Alberta (CVCA 2022). There is no doubt that, in addition to the network of private equity and venture capital firms based in Quebec, these results are helped to a large extent by the concentration of a vibrant asset and wealth management industry in Montreal. Quebec is home to four of Canada's 13 largest asset and wealth management firms, ranked by total assets under management: Third: Power Corporation of Canada (through its major subsidiaries); eighth: Caisse de dépôt et placement du Québec; 11th: PSP Investments; 13th: Fiera Capital, and all have extensive operations and presence abroad. In addition, about 250 pension funds including the large Hydro-Québec, Air Canada and CN pension funds are headquartered in Montreal. Their concentration in the Montreal area has attracted a large number of investment management professionals who strengthen the asset management industry in the province.

The focus on equity financing is a pro-growth policy. From a macroeconomic perspective, analyses show that a positive shock to the market value of private or public equity leads to a positive response in Canada's real GDP, employment rate, firm fixed capital formation, R&D and net exports (Lortie 2019). At the firm level, recent empirical studies show that the average performance of Canadian firms that received private equity capital financing is significantly superior to that of comparable non-venture-capital-backed firms on key metrics: (i) stronger revenue growth; (ii) sales growth; (iii) headcount growth; and (iv) asset growth and R&D expenditure growth (Industry Canada and CVCA 2013). Other studies show that capital markets play a critical role in providing alternative sources of financing for high-growth and innovative companies and recommend fostering the development of junior markets (Nassr and Wehinger 2015). In Canada, the average performance of VC-funded SME-like companies that have raised capital through the TSX(V) compares favourably to those that have chosen the private equity financing option (Carpentier and Suret 2018), in part because going public induces a shift toward a commercialization strategy to increase profitability (Larrain et al. 2021).

GROWING A DYNAMIC FINANCIAL INDUSTRY

The size of the financial sector depends in large part on local demand for financial services and, hence, on demography. This is clearly the case in Canada where there is a close correlation between population growth in the four large provinces and the growth of job creation in the finance and insurance industries. However, this view is incomplete because it ignores the fact that expansion into external markets and innovation are the two main sources of growth for firms in all sectors and among the factors that drive the geo-localization of financial activities. London, New York City and other global financial sectors maintain their status precisely because they export their financial services. This in turn depends on local organizations led by competent and dynamic financial executives and entrepreneurs, supported by highly skilled personnel.

ENTREPRENEURSHIP AND INNOVATION: THE DRIVERS OF LOCAL FINANCIAL INSTITUTIONS GROWTH

To contribute endogenously to wealth creation and create a sustainable competitive advantage for a region, financial innovations must be embedded in local organizations. The ability to draw heavily on unique elements of local history, character and specialized skills and resources are key determinants of competitive success (Porter 1990). Innovative regulatory policies typically fail on this critical dimension because they can easily be adopted by other jurisdictions, erasing the originator's competitive advantage in the process. The capital pool program developed by the Alberta Stock Exchange (ASE) in close co-operation with the Alberta Securities Commission (ASC) in 1986, now widely used in markets around the world, serves as a cautionary tale (Mintz et al. 2021).

The development of exchange-traded financial futures and options provides an example of how significant innovations can be leveraged to successfully create a vibrant local financial industry. These new financial instruments are the result of a healthy combination of entrepreneurship with the findings and support of leading academics in the field of finance at the University of Chicago. The spark was the launch of a futures market on foreign currencies at the International Money Market in 1972, a division of the Chicago Mercantile

Exchange. Another significant innovation of this class was the 1973 launch of exchange-traded options on common stocks at the CBOE, a subsidiary of the Chicago Board of Trade. The success of these financial derivative markets was soon followed by the development by Chicago exchanges of futures markets on mortgages (GNMAs), treasury bills and long-term treasury bonds and, shortly thereafter, by a new wave of innovation in the form of stock index futures.[26] The growth of the derivative exchanges has led to the development of large proprietary trading firms located near the Chicago Loop district. Today, the Chicago metropolitan area is home to more than 45,000 jobs in the derivatives and related industries.

Chicago's example demonstrates that innovation, entrepreneurship and deep knowledge are critical ingredients for the establishment of a competitive position in global financial markets. To a large extent, emulating Chicago has proven a good recipe for Montreal, and a major factor in arresting the decline of the Montreal Exchange.

In the late 1960s, the reputation of Montreal's stock markets was tarnished by the activities taking place at the Canadian Stock Exchange (CSE), a small-cap stock exchange where penny stock promoters and fraudsters, such as Irving Kott and out-of-province boiler rooms, dominated trading activities. The election of a new Quebec government in April 1970 brought a new minister to head the Department of Institutions, Companies and Cooperatives. Closer to Montreal's financial and industrial sectors, Robert Bourassa and several of his ministers in charge of economic portfolios were aware of and concerned about CSE's poor reputation and the shadow it projected on the Montreal Stock Exchange (MSE) and its Quebec-based members. To remedy the situation, the government appointed Robert Demers[27] as president of the CVMQ in 1972 with the explicit mandate to clean up the sector. This nomination was quickly followed by the election of Michel Bélanger[28] as president of the Montreal Stock Exchange in 1973. He immediately set about merging the Canadian Stock Exchange with the Montreal Stock Exchange, reforming the listing requirements and strengthening the supervision of exchange members.

Under the leadership of these two individuals working together, the MSE began its transformation into a financial derivatives exchange with the establishment, in September 1975, of Canada's first stock options exchange and the Montreal Options Clearing Corporation. The pace of innovations continued unabated with the acquiescence of the CVMQ. In the early 1980s, the MSE established the specialist market-making system on the floor of the exchange and deployed an electronic order routing and execution system (MOORE), a first in Canada, that guaranteed securities brokerage firms that their retail orders for Canadian-listed stocks from anywhere in Canada would be executed and confirmed within seconds at the best price available in Canada. The impact was an

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[26] The development of exchange markets in stock index futures was made possible by a fundamental change in regulations. Up until 1974, the design of futures contracts was constrained by the requirement that the holder of the futures contract had to have the right to demand physical delivery of the underlying commodity because the laws of most states, particularly Illinois, considered that absent this right, futures were subject to gambling laws. In 1974, these state laws were superseded by the federal regulatory statute that established the CFTC and gave the agency sole jurisdiction over futures markets. Since there was no federal prohibition of gambling, cash settlement became conceivable.

[27] Robert Demers served as secretary, legal advisor and director of listings during 1962–1964. He was the chief representative of the Quebec government for the negotiations with the FLQ during the events of October 1970 before his appointment as president of the QSC.

[28] Michel Bélanger was secretary of Quebec's Treasury Board prior to his appointment as head of the MSE. In 1976, he became president and CEO of the Provincial Bank of Canada. In 1979, he spearheaded the merger of the Bank with the Banque Canadienne Nationale to form the National Bank of Canada, which he headed until 1990.

increase in MSE's market share from 16 per cent in 1979 to an average of 26 per cent in the 1980–1984 period.

Building on its financial derivatives market infrastructure, the MSE expanded the range of products with the 1982 establishment of the first transatlantic trading link and common clearing house with the European Options Exchange in Amsterdam, which allowed continuous trading of options on gold and silver across the North American and European time zones. This was followed later during the year with the establishment of currency options. Stock index options were introduced for trading in 1984. In 2000, the Montreal Exchange acquired ownership of the Canadian Derivatives Clearing Corporation (CDCC). The following year, it became the first traditional exchange in North America to complete the migration to a fully automated system with its proprietary electronic platform Sola Trading. This enabled the Montreal Exchange to become the sole provider of electronic trading and support systems for the Boston Options Exchange (BOX) and acquire a 31.4 per cent interest in BOX (increased to 51 per cent in 2009). A major expansion of operations occurred in 2009 when CDCC was selected as the central counterparty clearing facility for the Canadian repo market and in 2011 when its services were adapted to include clearing of OTC fixed income and foreign exchange transactions.

Today, the Montreal financial derivatives organization (the Montreal Exchange and the CDCC) is the 16th largest financial derivatives exchange in the world.

Table 7: Ranking of 20 Largest Financial Derivative Exchanges by Number of Contracts Traded and/or Cleared (Jan. – Dec. 2021)

Ranking	Exchange	Volume
1	National Stock Exchange of India	17 255 329 463
2	B3 (Brazil, Borsa, Balcao)	8 755 773 393
3	CME Group	4 942 738 176
4	Intercontinental Exchange	3 317 893 282
5	Nasdaq	3 292 840 477
6	CBOE Holdings	3 095 692 862
7	Zhengzhou Commodity Exchange	2 582 227 206
8	Shanghai Futures Exchange	2 445 774 713
9	Dalian Commodity Exchange	2 364 418 367
10	Korea Exchange	2 281 738 234
11	Moscow Exchange	2 101 589 316
12	Borsa Istanbul	2 081 042 040
13	Eurex	1 703 293 825
14	BSE	1 607 775 410
15	Miami International Holdings	1 338 182 359
16	Montreal Exchange (TMX Group)	613 028 878
17	Hong Kong Exchanges and Clearing	433 092 595
18	Taiwan Futures Exchange	392 202 371
19	Japan Exchange Group	333 638 732
20	Singapore Exchange	232 104 773

Source: FIA 2020. In 2021, 54 financial derivative exchange groups reported their statistics to the Futures Industry Association.

PROMOTING INTERNATIONALIZATION TO MAXIMIZE SPILLOVER EFFECTS

At the instigation of the Montreal business community, Quebec passed the *Act Respecting International Financial Centres* in 1999 to "promote and support the development of Montreal as a centre of international financial activity" and to "promote and solicit the establishment of new international financial centres and new international financial activities in the Greater Montreal area," primarily through tax incentives (Quebec National Assembly 1999).

To date, Montreal International, which administers the program, has attracted nearly 50 international financial centres to Montreal. The program has spurred the development of significant businesses and deep world-class expertise in financial software development. Morgan Stanley employs more than 1,500 people in software development at its Montreal technology centre, which is the bank's largest technology site. The centre has a global mandate for low-latency and electronic trading systems, cloud engineering, cyber-security, artificial intelligence/machine learning and end-user technologies. Société Générale, in partnership with Montreal-based CGI, has established a software integration, maintenance and development team to support the bank's operations in New York. The impact of participation in the development of these cutting-edge technologies and systems is reflected in the growth of Quebec-based IT firms such as CGI and FX Innovation that have a presence and are competitive in major financial centres such as Boston, Chicago, New York, Toronto and several others in the United States and Europe. The benefits that flow from this vast pool of specialized talent extend to many other types of organizations. For example, Montreal-based International Air Transport Association (IATA) is responsible for and manages the world's most advanced, extensive and sophisticated non-bank multi-currency financial and payment system.

THE START-UP ECOSYSTEM

International comparisons indicate that Canada is a relatively fertile ground for start-ups, ranking fourth as a country for three years in a row. The data show that large cities generally outweigh small ones: eight of the top 10 start-up ecosystems have populations greater than 10 million. Table 7 shows the ranking of Canadian cities. Internationally, Montreal ranks sixth in the group of cities with populations of one to three million. Vancouver's high ranking (for its size) is an indication of the importance of the TSX(V) as an effective route to capital for start-ups.

Table 8: Global Start-Up Ecosystem Index 2022 – Ranking of Canadian Cities

	Ranking		
	National	Global	Total score
Toronto	1	24	31,262
Vancouver	2	40	18,880
Montreal	3	45	15,084
Ottawa	4	89	7,943
Kitchener Waterloo	5	91	7,916
Calgary	6	104	6,997
Edmonton	7	140	5,306
Quebec City	8	142	5,239
Kingston	9	183	4,495
Victoria	10	184	4,490

Source: Start-up Blink 2022

In 2016, the securities regulators of Ontario, Saskatchewan, Manitoba, Quebec, New Brunswick and Nova Scotia adopted Multilateral Instrument 45-108 crowdfunding (45-108 exemption). Also, in 2016, the Alberta Securities Commission adopted ASC Rule 45-517 Prospectus Exemption for Start-up Businesses (ASC Rule), which created a prospectus exemption similar to start-up crowdfunding but without a funding portal requirement.

The start-up crowdfunding exemptions and the ASC Rule were intended to provide an alternative source of capital to non-reporting issuers at an earlier stage of development. By contrast, the ASC 45-108 exemption is available to both reporting and non-reporting issuers and provides a higher offering limit than under start-up crowdfunding. While changes have been proposed by securities regulators in Alberta, British Columbia and Saskatchewan to increase access to capital, the fact remains that the 45-108 and 45-517 exemptions are underused and Canada lags behind the U.K., Australia and the U.S. in the adoption of fintech.

The Canadian Securities Administrators (CSA) has devoted significant resources to supporting the fintech sector, including defining the regulatory perimeter and enforcement of securities regulation. At the Canadian level, the CSA has adopted a sandbox approach to foster new businesses and innovation by providing a harmonized regulatory approach across Canada, where CSA members review regulatory and exemption applications in a co-ordinated and flexible manner.

In Quebec, the Autorité has taken several initiatives to strengthen its knowledge of new technologies in order to effectively exercise its regulatory role in a digital environment. It has set up a FinTech group with about 60 employees dedicated to monitoring fintech innovations, contributing to work aimed at maintaining a Quebec regulatory framework adapted to market realities and helping innovative firms comply with the laws administered by the Autorité. It has created a FinTech lab to test prototypes and new technology developments. It has also established a research partnership program in which academic institutions and other external organizations are invited to submit projects for funding that address specific issues and needs related to the Autorité's mission. It also funds the AMF-Finance Montreal Fintech Research Chair at UQAM, whose mission is to develop cutting-edge knowledge on the impacts of information and communication technologies.

Putting this knowledge advisedly in practice does not come easy. In June 2018, Quebec enacted Bill 141, which contains sweeping reforms to the laws governing the financial sector, including provisions allowing the sale of insurance and financial products and services online (Quebec National Assembly 2018). To implement the measure, the Autorité adopted the Regulation Respecting Alternative Distribution Methods, which aims to clarify the rules applicable to insurers and intermediaries selling insurance through digital means. While intended to support innovation and new distribution approaches, the regulation is prescriptive and rule-based with significant implications for website and application architecture. The effect has been a retreat of some online and digital insurance offerings previously available in Quebec, defeating the purpose of the legislative provision. More generally, international ratings suggest that these initiatives on the part of the Autorité have not translated into stellar results. Table 1 shows that Montreal ranked 40th for the fintech ranking in the Global Financial Centres Index 2021, compared to Toronto (19th), Vancouver (25th) and Calgary (47th). The low level of entrepreneurial activity and funding in Quebec fintechs is surely a contributing factor behind this situation.

A QUALITATIVE ASSESSMENT

Despite events in the late 1970s that have seriously undermined the strength of Quebec's financial industry, the province's share of Canadian employment in finance and insurance is equal to its share of Canadian GDP and it now stands in second place among the provinces in terms of the finance and insurance industry's contribution to GDP. This suggests that part of Quebec's financial sector activities is supply driven.

Table 9: Relative Importance of the Finance and Insurance Industries (F&I)

F&I Employment 2021				F&I share of GDP 2020
	F&I Employment (nb)	F&I Employment vs Population (%)	Share of Canadian F&I Employment (%)	
Alberta	65,107	1.46	9	5.35
British Columbia	90,821	1.7	12	6.12
Ontario	355,174	2.4	47	10.36
Quebec	155,654	1.8	20	6.59

Source: Statistics Canada, Employment by Industry, annual, Table 14-10-0202-01, 2022-03-29; and Statistics Canada, Table 36-10-0400-01 – Gross domestic product (GDP) at basic prices, by industry, provinces and territories percentage share

These results are not inconsequential. In Canada, two per cent of the population is employed in the finance and insurance sector. This proportion has remained stable over the 2011–2021 period despite major investments to digitize the financial services offerings, modernize IT platforms and automate many tasks. Their main effect has been to accelerate the centralization of staff, particularly in head offices. This has resulted in a gain in the share of employment in Ontario and an erosion of the share in the other provinces. Regarding Alberta, employment in the finance and insurance industries would be 24,081 jobs higher if Alberta's ratio of F&I employment to population were equal to the Canadian average and by 15,162 additional jobs if it were at the level of Quebec.

Creating a sound regulatory environment is not a one-time job that once achieved allows officials to relax. Financial regulation is a dynamic game, not a static one. The financial system is constantly innovating around existing rules, and regulators need the power — and incentives — to monitor these changes and to adapt their policies to the new circumstances and respond where warranted. This is particularly important in Canada where, owing to the constitutional division of authority, various regulatory agencies regulate banking, insurance, securities and credit unions. At the federal level, the OSFI is responsible for determining whether federally chartered or licensed depository institutions, insurance companies and private pension plans in Canada are financially sound and in compliance with regulatory and supervisory requirements (i.e., prudential regulation), while FCAC's mandate focuses on market conduct and compliance with the consumer provisions of the various federal financial services statutes. Both agencies share responsibility for regulating banks in close co-ordination with the Bank of Canada in charge of monetary policy, market stability, oversight over systemically important payment, clearing and settlements systems, supervision of payment service providers and also serves as the lender of last resort. The mandate to ensure compliance of businesses subject to money laundering and terrorist financing legislation is vested with the Financial Transactions and Report Analysis Centre (FINTRAC). Outside of Quebec, the federal government plays a limited role regulating credit unions that have elected to register under federal legislation adopted in 2012 in addition to being regulated at the provincial level.

Moreover, in the case of insurance, even if the company is under OSFI supervision for prudential regulation, the provinces are in charge of licensing insurers operating within their jurisdictions and responsible for dealing with business conduct and consumer concerns matters. Similarly, the promotion of insurance products by chartered banks is subject to a province's legislation and associated regulation governing insurance business (SCC 2007). Securities and derivative markets regulation are provincial responsibilities. Each province and territory has its own securities and derivatives regulator.

In October 2017, the Quebec government introduced an omnibus bill (Bill 141) that brought about the most significant changes to the regulation of the Quebec financial sector in decades, with key pieces of legislation being amended or replaced entirely. Notable legislative changes include provisions: (i) allowing the sale of insurance and financial products and services online; (ii) centralizing all financial services regulatory and enforcement activities under the Autorité by expanding its mandate to include the regulation and supervision of mortgage brokerage and the SRO covering real estate agents and, (iii) absorbing the responsibility for controlling the activities of representatives in the group insurance, life and health insurance, general insurance and financial planning industries, including ethics, training and discipline, which until then had been performed by the Chambre de la sécurité financière and the Chambre de l'assurance de dommages, which were abolished. An important aspect of Bill 141 is the addition of a chapter concerning the Groupe Coopératif Desjardins to the *Act Respecting Financial Services Cooperatives* to replace the *Act Respecting the Mouvement Desjardins*, which dates from 2000. The new legislation includes, among others, measures reinforcing the powers of intervention of the security fund intended to protect creditors, the conditions of control of a financial services co-operative and provides rules regarding capital shares and investment shares of financial services co-operatives. From Mouvement Desjardins' point of view, "Quebec's legislative framework is one of the most modern in the world." The law implementing this broad reform was adopted in June 2018 (Quebec National Assembly 2018).

It is noteworthy that despite its wide ambit, no issues were raised by the financial sectors already under the supervision of the Autorité concerning its unified regulatory mandate during the consultations that preceded adoption of Bill 141. This reflects a broad consensus that the unified regulatory system is aligned with the objectives of creating and assisting the growth, diversification and development of Quebec's financial organizations in Canada and abroad and is best positioned to meet the challenge of regulating the province's few but large financial conglomerates to international standards.

CONCLUSION

What lessons can we learn from this brief overview of Quebec's financial legislative and regulatory policies over the past decades and how can we assess their impact?

A first observation is the consistent effort to ensure that the financial regulatory regime kept pace with the rapid evolution of financial business and services and regulatory practices and standards in Canada and internationally. The continuity of Quebec's financial regulation policies over the whole 1960–2022 period, regardless of the political party in power, is noteworthy. This has been achieved in close consultation with financial institutions, financial intermediaries and their self-regulatory organizations, as well as with financial regulators' counterparts in other Canadian jurisdictions and abroad.

The Autorité plays an active role in the work of Canadian and international securities and financial regulatory organizations, which helps ensure that the best oversight practices are incorporated into its operations and that new regulatory developments and standards are implemented in a timely manner throughout the relevant industry segments. Noting that the Autorité "has the most extensive prudential supervision responsibilities among Canadian provinces," the IMF's recent Financial System Stability Assessment Report unequivocally states that "the AMF is able to maintain high standards of regulation and supervision" and that "insurance supervision at OSFI and the AMF is of high quality, consistent with the Insurance Core Principles" (IMF 2019).[29] These findings show that the mandate given to the Autorité that it must ensure that its actions "promote financial sector development" in the pursuit of made-in-Quebec financial institutions and efficient markets is not incompatible with the rigorous conduct of prudential regulation.

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[29] In its report, the IMF noted approvingly the recent creation of the Financial Services Regulatory Authority of Ontario (FSRA) in 2016. It also noted that the Financial Institutions Commission of British Columbia (FICOM) lacked operational independence and resources and had not yet introduced the formal requirements of Basel III. FICOM, established in 1989, was replaced by a new independent state agency, the British Columbia Financial Services Authority (BCFSA), in April 2019. The IMF assessment did not cover the operations and regulatory practices of the Alberta Office of the Superintendent of Financial Institutions (OSFI). In Quebec, the creation of a single integrated financial regulator like those mentioned above, except for pensions, dates back to April 1983.

As noted above, the most consequential regulatory initiatives Quebec has taken to unshackle financial institutions from growth-limiting statures and regulations have been achieved through private bills which were adopted at the instigation of the companies' senior executives with the full support of the Quebec National Assembly, not through the Autorité's initiatives. This accelerated and customized legislative process has proven to be key in facilitating corporate initiatives, giving them the flexibility to cope with some of the challenges their executives expected to face in the coming years and assisting financial industry change. The development and growth of IA Financial Group and Mouvement Desjardins illustrate the singular achievements of the Quebec approach to the regulation of financial organizations. The broad support for the legislative measures adopted over the years to enable their growth and to become leading financial institutions in Canada capture the prevailing zeitgeist. The rapid adoption of these special laws must also be attributed in part to the confidence of government (and National Assembly members) that the Autorité has the wherewithal to supervise the restructured financial institutions as they pursue their growth and diversification strategies.

What's past will not be prologue. Provincial policy-makers and financial regulators mindful of the importance of promoting their financial sector's competitiveness and growth must consider the rapid evolution and innovations that are transforming technology-based industries, financial markets and services. Spurred by technological advances, exponential increases in computer power and changing investor and consumer preferences, the convergence of financial services and their widening perimeter, and the disintermediation of financial markets through digital payment systems, mobile banking and online financing and investment platforms is accelerating. This gives rise to three major challenges for provincial governments and financial regulators.

The first is that the significant investments required to keep up with technological advances, the development of application programming interfaces (APIs) and the implementation of artificial intelligence capabilities are beyond the reach of smaller established financial institutions, while the markets within their geographic boundaries are small and very mature. Therefore, to achieve solid growth in the future, they must expand into other Canadian or international markets to reach a size that allows them to make the necessary investments to keep up with the accelerating pace of technology deployment in financial services.

This can be done in several ways. Borrowing from the experience of the European Union, one option is the adoption of a passport system between participating provinces, as was recently suggested for credit unions (Losier 2021). Quebec's Bill 141 provides that the minister of finance may, subject to certain conditions, "enter into agreements allowing a cooperative outside Québec having a mission similar to that of a financial services cooperative to obtain an authorization to carry on deposit institution activities in Québec."

The second challenge is the need to establish and manage a flexible regulatory process that can cope with the changing market dynamics of fintechs and regtechs, while ensuring the safe and efficient deployment of these new technologies without inhibiting positive innovation. Failure to do so will result in a regulatory framework that fails to achieve its objectives and reduces the competitiveness of local economies.

A third and pressing challenge is the need to make legislative and regulatory changes, primarily with respect to market conduct and consumer protection, and to build the technological infrastructure required to implement open banking in a way that benefits financial services consumers. Developing a secure digital ID system that gives individuals and businesses control over access to their data is a necessary component, a task that the Alberta and Quebec governments have already begun to address, but there is still a long way to go. The adjustments needed to overcome the challenges of regulatory fragmentation in the financial services sector should not be underestimated.

The relatively small size of the financial sector under their jurisdiction argues for the adoption of the unified model of financial regulation to address the key challenges facing provincial authorities. Not being constrained by the traditional segregation of financial institutions and intermediaries, the model is particularly well suited to facilitating the pooling of skilled personnel and the mobilization of resources needed to address the disruptive elements of the new technological landscape.

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APPENDIX 1 – AUTORITÉ DES MARCHÉS FINANCIERS' MISSION

Under the *Act Respecting the Regulation of the Financial Sector*, Autorité des marchés financiers' mission[1] is to:

1. Provide assistance to consumers of financial products and services, in particular by setting up consumer-oriented educational programs on financial products and services, processing complaints filed by consumers and giving consumers access to dispute resolution services;

2. Ensure that the financial institutions and other regulated entities of the financial sector comply with the solvency standards applicable to them as well as with the obligations imposed on them by law with a view to protecting the interests of consumers of financial products and services, and take any measure provided by law for those purposes;

3. Supervise the activities connected with the distribution of financial products and services, administer the rules governing eligibility for and the carrying on of those activities, and take any measure provided by law for those purposes;

4. Supervise stock market and clearing house activities and monitor the securities market, in particular, by administering the controls provided by law as regards access to the public capital market, ensuring that the issuers and other practitioners involved in the financial sector comply with the obligations imposed on them by law and taking any measure provided by law for those purposes;

5. Supervise derivatives markets, including derivatives exchanges and clearing houses and ensure that regulated entities and other derivatives market practitioners comply with the obligations imposed by law;

6. See to the implementation of protection and compensation programs for consumers of financial products and services and administer the compensation funds set up by law.

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[1] Autorité des marché financiers, 2021–2025 Strategic Plan.

ABOUT THE AUTHOR

Pierre Lortie is Senior Business Advisor at Dentons Canada LLP. He is also Chairman of the Board of SCIREQ Scientific Respiratory Equipment and Director of Flyscan Inc.; Eski inc.; Groupe Touchette and ECN Capital Corp.

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A former President and COO of Bombardier Capital, Bombardier Aerospace Regional Aircraft, Bombardier International and Bombardier Transportation. He is also a former Chairman, President and CEO of Provigo Inc., President and CEO of the Montreal Stock Exchange and Senior Partner of SECOR Inc.

Pierre served as Chairman of Canada's Royal Commission on Electoral Reform and Party Financing, as representative of the Prime Minister of Canada on the APEC Business Advisory Council as well as Vice Chairman of Canada's National Advisory Board on Science and Technology Chairman of the Centre for Information Technology Innovation and member of the Panel of Senior Advisors of the Auditor General of the Government of Canada.

Pierre also served as Chairman of the Montreal Demerger Transition Committee and he directed, as the Representative of the public authorities, the PPP procurement of the new McGill University Health Center (MUHC), the Centre hospitalier universitaire de l'Université de Montréal (CHUM) and the Research Centre of the CHUM.

Mr. Lortie received an MBA with honours from the University of Chicago, a license in applied economics from the Université de Louvain in Belgium, and a Bachelor's degree in applied sciences (engineering physics) from Université Laval. He was awarded a Doctorate Honoris Cause in civil law from Bishop's University. He was elected Fellow of the Canadian Academy of Engineering in 1988, appointed Member of the Order of Canada in 2001 and Senior Fellow of the C.D. Howe Institute in 2019.

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