



**Notes for a speech by the Minister of Finance
to the International Finance Club of Montréal
Montréal
September 17, 2007**

CHECK AGAINST DELIVERY

Hello.

I was happy to accept the invitation to speak to you, members and guests of the International Finance Club of Montréal.

I want to discuss two subjects with you today.

First, I will give you a brief round-up of the economic situation and the progress made by our government since 2003.

Second, I will deal with the issue of securities regulation in the context of the Canadian securities passport that will become effective shortly.

A more prosperous economy

Since 2003, our government has taken many steps to stimulate job creation and the creation of wealth.

- We cut personal income tax.
- We reduced taxes on businesses.
- We have revived major hydro-electricity projects.
- We have made significant increases in public infrastructure investments.
- We have restored order to public finances.

The government's actions have produced results.

- The unemployment rate has fallen from 9.3% to 7%, the lowest it has been in 33 years.
- The employment rate has hit an all-time record of 61.1%. There have never been so many Quebecers at work.
- There are 57 000 fewer people on social assistance.

Robert Bourassa was right when he said that “an economically poor people can always have a history but will never have a future”. An essential condition for ensuring sustained long-term growth is healthy public finances. That has been my priority since I was named Chair of the Conseil du trésor in 2003 and it remains my priority.

Last May, I tabled a budget that put discipline and transparency front and centre. I did so thinking of those Quebecers who work every day and enable us to afford quality public services.

The budget focused on six points. The first four give practical effect to our fiscal policy.

- First, the budget recognizes work. I announced that taxes will be cut by almost \$1 billion as of next January 1, chiefly for the middle class. Quebecers will no longer be the most heavily taxed citizens in North America.
- Second, I am taking firm measures to tackle the debt. Exports of electricity will soon allow us to increase our deposits to the Generations Fund to \$1 billion per year.
- Third, I am fostering private investment to create jobs in every region. I have announced an accelerated reduction of the capital tax that will be completely eliminated after December 31, 2010. We are moving away from a tax system that penalizes investment to one that rewards it.
- Fourth, I am making our administration a model of transparency. I have agreed with the Auditor General of Québec to review the government’s accounting practices.

The two other points seek to re-focus the role of the state on its primary missions and modernize our management approaches.

Accordingly, and this is my fifth point, the government's actions are re-focused on the top two priorities of Quebecers, health and education. I have announced that five government services will be handed back to the private sector and that 3 800 additional public service positions will be eliminated over three years. That brings the number of public service positions to be eliminated since 2003 to over 7 000.

Sixth, I have earmarked more than \$30 billion of investment in our infrastructures over five years. We will renovate our schools and hospitals and repair our roads. We will leave our children with public infrastructures in good condition.

A major part of these investments will be carried out through public-private partnerships, which will be of interest to the financial sector.

Concerning PPPs, I am proud to note that:

- The partnership agreement for autoroute 25, including the financing, will be announced in the next few days.
- Nine consortiums submitted their candidacy last week to build the CHSLD Saint-Lambert.
- Calls for qualification to build the new CHUM hospital, the Centre de recherche du CHUM and the Glen Campus of the MUHC have been published. Candidacies will be tabled next October 10 and 12.

The momentum is there. Many other projects will follow. Carrying out these projects will require skills in financing engineering and risk management. I encourage the financial industry in Québec to become an active participant in this leading sector and to expand elsewhere, in Canada and throughout the world.

The interdependence of capital markets

Now I want to turn to the main subject of my speech: regulation of the Canadian securities industry.

The liquidity crisis of the asset-backed commercial paper market provides a stark illustration of the interdependence of capital markets.

The source of this liquidity crisis lies in the United States, in particular in the sub-prime market, i.e. securities backed by high-risk mortgages. The phenomenon has rapidly spread throughout the world.

Canada has obviously not been spared. In Canada, the asset-backed commercial paper market is valued at \$120 billion. Of this amount, \$85 billion lies with bank conduits and \$35 billion in non-bank conduits.

The Montréal Proposal of August 16, 2007 stipulating a 60-day stand-still period should give the market time to reach equilibrium and thus allow an orderly solution to the commercial paper liquidity problem. In this regard, I believe it is appropriate to single out the leadership of the Caisse de dépôt et placement du Québec that allowed the proposal to take shape.

In this context, you will readily understand my surprise when I read the headline of the Globe & Mail Report on Business of September 10, 2007 and Canada's Finance Minister Jim Flaherty assertion that "we'd be better equipped going forward to respond and act in response to these types of events with one common securities regulator in Canada".

My problem with this statement is not the fact that Mr Flaherty said it (he represents the Toronto area). My real problem is that the statement is misleading. There is no link between a single securities regulator in Canada and the commercial paper liquidity crisis.

The idea that a single Canadian securities regulator would significantly improve the efficiency and competitiveness of Canadian capital markets is an enduring myth. The recent impetus to push for its adoption stems in large part, in my opinion, to the competitive pressure US stock exchanges put on the Toronto Stock Exchange and the financial industry in Ontario. The data tells the story:

- In 1990, 18 of the 60 largely capitalized Canadian stock were interlisted with a US exchange. This had increased to 70% in 2003 and is still growing since then.
- The proportion of transactions on Canadian interlisted stocks for which more than 50% of the volume is done in the United States has increased from 28% in 1990 to 55% in 2006.

Clearly, the Toronto Stock Exchange and the financial industry in Ontario are under pressure. But in my opinion, a single regulator is not the answer to the challenges that lie ahead.

Several proposals have been made in recent years to overhaul the Canadian securities regulatory system. They embody either one of two competing views of the preferable securities regime. The first model is a single regulator, which is espoused by Ontario, Jim Flaherty and his federal government officials and several leaders of the Canadian securities industry. The second model is the "passport" or "principal regulator" system that makes best use of the existing provincial regulatory institutions as the cornerstone of a pan-Canadian harmonized regulatory system. All provinces, except Ontario, support the passport model as well as many leaders of the industry.

I am quite aware the many leaders of Québec's financial sector have signed reports supporting the concept of a centralized Canadian regulatory organization and that many of you see this as an inevitable outcome, the political pressure from certain influential quarters being very strong. That is exactly why this debate must emerge from specialist circles to escape from group-think. The consequences are too important to ignore the empirical data and facts.

The structure of the regulatory system in Canada and the United States

Many supporters of a centralized regulatory system compare the image of a Canadian system from the distant past with a totally idealized and truncated vision of a perfect American system. But reality will have its due, so let's look at a few facts:

- The Canadian system:

A number of measures have been taken in recent years to improve the efficiency of the regulatory system in Canada. Information technology and an adapted regulatory framework have made it possible to implement systems and practices that are truly pan-Canadian and have eliminated many of the functions that were filled locally by each securities commission in the past. Today we have:

- SEDAR, the System for electronic Document Analysis and Retrieval.
- SEDI, the electronic system for insider reports.
- NRS, the National registration system.
- NRD, the National Registration Database.
- MRRS, the mutual reliance review system.
- Adoption and implementation of 25 national general instructions and 24 national instruments concerning key aspects such as prospectus requirements, mutual fund regulation, issues of rights, regulation of takeover offers, prospectus and registration exemptions, continuous information requirements, etc...

Québec has been a leader in adopting these rules that are harmonized across Canada as a result of which, for issuers, brokers and other registered persons, there has been a significant decline in regulatory complexity. The legislation amending the Securities Act, passed in December 2006, has given us the flexibility to complete implementation of the Canadian passport system and the harmonization of regulation.

Every province, except Ontario, has undertaken to implement phase II of the passport system by the end of 2008. The pan-Canadian passport will provide each issuer, broker and registered person with a single access point to the Canadian market. This reform, which will become effective imminently, is by no means trivial.

- The passport system will enable an issuer to access capital markets across Canada by dealing solely with the securities regulator of his principal jurisdiction and complying only with its access rules.
- Similarly, a broker or representative wanting to do business throughout Canada will only have to register with the authority of his principal jurisdiction; only the registration rules of that jurisdiction will apply.

Let's be clear, under this system, a receipt issued by the Autorité des marchés financiers will enable a Québec issuer to distribute its securities across Canada, without having to obtain another receipt, except for in Ontario for the moment.

Looking ahead, it is obvious to practitioners and observers that the passport system initiative is causing a profound transformation of our securities regulatory system. The benefits accruing from implementation of the first phase are recognized by industry participants. The Crawford Panel Report is eloquent on the subject.

"Participants at every roundtable commented that while the passport system will not achieve all of the benefits of a single regulator, it is nevertheless an important initiative and should be permitted to reach its full potential... For the passport system to reach its full potential they said, Ontario's participation is mandatory. Most roundtable participants remarked that they do not view the passport system and our proposed CSC as diametrically opposed alternatives."

This momentum and the experience gained with phase one are sustaining the drive to implement the second phase. Beginning in early 2008, phase two of the passport system will enhance the single-window concept of securities regulation by allowing participants to access capital markets across Canada by dealing only with the regulator in one jurisdiction. Participants will be able to clear a prospectus, register as a dealer or adviser, or obtain a discretionary exemption from the regulator in their home province or territory and have it apply in all other jurisdictions. The second phase also ensures public companies are subject to only one set of harmonized continuous disclosures requirements.

The Crawford Panel recommends that Ontario become a Signatory to the MOU. This simple action would deliver additional economies to issuers across Canada in a very short time without closing the door on further improvements. One would hope that the Minister of Finance of Canada would use his influence to encourage Ontario to heed to this sound advice. It is unfortunate that Ottawa's energy is now geared to disrupt a process which is already yielding considerable benefits to Canadians and our economy.

Let's be clear: the passport system builds on what already works. It will eliminate the remaining duplication of administrative tasks just as effectively as a single regulator. It will do it faster, at a lower cost, and all without the kind of constitutional dispute we can all do away with.

I can already hear some saying, sure but a single securities commission would be so much more rational, more coherent, like.....in the United States. Ignorance or bad faith, I'm not sure which. But the reality is:

- In the United States, contrary to a well-maintained myth, most states have their own securities regulator. The American system is much less centralized than it appears.
- On many occasions, state authorities have acted faster and more effectively than the central agency, the Securities and Exchange Commission (SEC), for instance, to correct abuses among financial analysts or put an end to questionable practices by mutual funds. One of the major scandals of the 1980s, the fraudulent actions of the officers of Prudential-Bache, were brought to light thanks to the tenacity of securities commissions of certain American states, and so on.
- The SEC did not protect Americans and other investors from the Enron, Global Crossing and Tyco debacles, and more recently from the sub-prime crisis.

In fact, a detailed comparison of the Canadian and American securities regulatory systems brings the following paradox to light: the existing Canadian system, without a federal or national commission, is more consistent and better harmonized than the American system.

Investor protection

The main objective of securities regulation is to protect investors. It is significant that the proposals to replace the existing system are not supported by rigorous comparative analyses of the performance of the Canadian system in relation to other jurisdictions. We live in an imperfect world, so the pipe dream of a perfect system cannot be used as the standard of comparison. The question is, where do we rank globally.

And indeed, it so happens that such comparisons are very favourable to Canada.

- In 2006, a study by the World Bank and Lex Mundi ranked Canada 3rd in the world in terms of investor protection. The United States placed 7th and the United Kingdom 9th.
- In its 2006 report, the OECD ranked Canada 2nd in terms of quality of securities regulation, ahead of the United States (4th), the United Kingdom (5th) and Australia (7th).

What is wrong here! It is surprising that with such results, the federal and Ontario governments continue to denigrate the Canadian regulatory system both within our borders and abroad. That's what I call shooting yourself in the foot.

Three myths concerning the competitiveness of the Canadian market in corporate equities

I want to deal with three myths concerning the competitiveness of the Canadian capital market that are spread by the promoters of a single securities commission.

The three myths are:

- 1) Our regulatory system is more cumbersome and more costly.
- 2) Our regulatory system implies higher financing costs for companies.
- 3) A single commission would reduce transaction costs on the secondary market.

I will deal with each of these myths in turn.

Myth one, the higher cost of our regulatory system

In a recent speech, the federal Minister of Finance said: "that the benefits of moving to a Common Securities Regulator will save money and give all regions a real say". He added:

"A Common Securities Regulator would better serve our common interest by having a structure that would allow all regions of the country to participate in market regulation in a more meaningful and constructive way. By having a structure that would ensure broad and equal participation by all provinces and territories (13 commissions), with a strong on-the-ground presence in all regions with local expertise that would respond to regional needs."

What are the facts? In 2002, the direct costs of regulation per million dollars of capitalization were \$145.80 in Canada compared with \$141.90 for federal regulatory organizations in the United States alone. Add to that the costs of the regulatory organizations of each state and the situation favours Canada by a wide margin.

How can it be seriously maintained that a structure with a strong organization in each province, in addition to a head office in Toronto or Ottawa responsible for directing and coordinating 13 regional offices will result in a less onerous cost structure than the existing decentralized system?

Myth two: higher financing costs in Canada

The main factors that determine financing costs are of three types. First, broker remuneration; second, costs relating to legal expenses, fees and prospectus preparation; and third, the initial under-valuation of the share price.

The results of empirical studies speak volumes. They show that the average total direct cost of a small issue in Canada (one to US\$10 million) is less (15.98%) than that of an issue in the United States (17.99%). The direct cost for larger issues (more than US\$100 million) is similar in both countries.

Once again, the facts contradict the promoters of a single securities commission.

Myth three: a single commission would reduce transaction costs on the secondary market

The liquidity of the secondary market for corporate equities is a key factor in the cost of capital stock. This dimension is extremely important because investment decisions depend on the cost of capital.

The empirical data paint a worrisome picture for anyone interested in the competitiveness of the Canadian capital market. For instance, a recent study compared transaction costs for shares of a corporation listed on the TSX and an American exchange. The results show that transaction costs in Canada were 52.4 basis points compared with 38.1 in the United States.

This disadvantage for the Canadian market does not stem from the existing regulatory system. It is quite likely that a centralized agency would tend to exacerbate the problem with a more cumbersome bureaucracy.

The real problem is the low level of competition on the Canadian market. Bear in mind that the large Canadian banks alone control roughly 85% of the mutual fund market.

In passing, I note with interest that it took the threat of alternative competitive markets (Pure Trading, Instinet and Alpha) in Canada for the TSX to announce the development of Quantum, a faster transaction system. Here as elsewhere, the answer to many shortcomings of the Canadian capital market is not to overturn the architecture of the securities regulatory system but to increase competition in the industry.

An action plan

No one is more determined than I am to foster the development and the efficiency of our capital markets and of the financial sector in Québec and Canada. A single Canadian securities commission is not the panacea it is made out to be, and it is not what we need. We must focus all our efforts on resolving real problems.

I propose a three-part action plan:

1. Resolutely pursue and implement phase II of the Canadian passport system.
2. Strengthen enforcement of the securities laws.
3. Bolster Montréal's position in the derivatives sector.

Phase II of the passport system will be complete in 2008. I will bring various harmonization measures to the National Assembly in the coming months. However, I hope that Ontario will listen to reason and follow in the footsteps of all the other provinces in the interests of everyone.

The second point of this action plan, namely strengthening enforcement, is very important. Many stakeholders and observers consider that Canada's regulatory organizations have failed in this area. They are right.

Since economic crimes are criminal in nature, the federal government has the constitutional responsibility in the matter and it is not necessarily meeting its responsibility with the required care.

However, I note with satisfaction that concrete steps have been taken recently. At the end of 2003, Integrated Market Enforcement Teams (IMET) were set up in Toronto, Vancouver and Montréal. Unlike the situation that prevailed in the United States and the United Kingdom, Canada was slow to create such an entity, its resources seem limited and the operational bugs are still being worked out of the system.

In October 2006, the federal and provincial Justice Ministers formed a task force to recommend measures to bolster resources to prosecute fraud in the securities field. Louis Dionne of Québec is co-chair of this major task force whose final report will be tabled next November.

In Québec, the CINAR and Norbourg cases, to name only two, have left marks and adjustments are needed. In Ontario, many were disappointed by the recent outcome of the Bre-X case.

At the Canadian level, I proposed to my colleagues that we look at the merits of creating a single tribunal in Canada in the securities sector. This would separate the regulatory functions from the quasi-judicial functions of securities regulators.

The objective of this initiative is to strengthen the quasi-judicial functions by establishing a common tribunal system that would help improve efforts to combat fraud in Canada.

The third point of the action plan seeks to strengthen Montréal's position in the derivatives sector.

As you certainly know, the exclusivity agreement for transactions on derivatives granted to the Montréal Exchange will end in March 2009. For many months, the Toronto Stock Exchange has on many occasions signalled its intent to re-enter derivatives trading. This has given rise to many rumours concerning the future of Canadian exchanges. A possible merger between the Montréal and Toronto exchange has been widely evoked.

Let's be clear: Montréal must retain its exchange and its expertise in the derivatives sector. I firmly believe that we must bank on the enormous potential of the derivatives market to continue the development of Montréal as a financial centre. With compound annual growth of some 26% over the last five years, it is easy to see why its influence extends beyond Canada's borders.

I want to congratulate the authorities of the Montréal Exchange, namely Luc Bertrand and his team, for their extraordinary work in making Montréal a place recognized throughout the world for derivatives trading.

Conclusion

In conclusion, I issue an invitation to the federal Minister of Finance, Jim Flaherty, for whom I have deep respect.

First, I invite him to work with us to improve the Canadian regulatory system. His contribution is essential to convince Ontario to join the passport system. All of Canada stands to gain. Indeed, the passport system has been adopted by Europe.

Next, I invite Mr. Flaherty to accept my proposal of a single securities tribunal in Canada. My colleagues in the other provinces participating in the passport have endorsed this proposal. Investor protection demands that we work closely together to punish those who violate the law.

Lastly, I invite Mr. Flaherty to act so that the spirit of the 1999 agreement among securities exchanges in Canada is respected. Montréal is and must remain the Canadian derivatives exchange.

Thank you for your attention.