

Too Big to Challenge?



Has Canada's 'Big- Bank' Model Killed the Geese that Lay the Golden Eggs?

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A. INTRODUCTION

Canadian business and economic policy leaders don't state it in a boastful manner, but corporate Canada, like that Canada's biggest banks, as Financial Institution Groups (hereafter referred to as FIGs in this paper) have been continuously credited over the last two decades with providing Canada its bedrock of economic stability. What if there is too much of a good thing? Has the bet size on stability exceeded the payoffs, creating risks around inflexibility? Has acting in concert with the expanding statist role in the economy acted to further crowd out private enterprise and free market in productivity? Is it possible Canada's financial services market structure created a self-reinforcing and reflexive feedback loop limiting risk taking appetite, capability and capacity to the detriment of inherently higher risk but critical financial activities?

Equity capital formation is the trophy business in capital markets. Without "equity" formation, the bedrock capital of free enterprise, all other forms of financing (debt, derivatives, foreign exchange) have a much harder existence. Equity, in all its forms, is the pollen that all other forms of financial life depend on. Without it, the concept of free enterprise itself dies. The development of an equity capital risk transference mechanism is more than a business; it is a public good which has taken over 150 years to develop and allows future generations to flourish. Someone has to underwrite the next national champion in technology, medicine and space, just as in the past they did in rails, communications and energy, while they are small enterprises. Participants in the ecosystem need to serve this part of the market, for the entire ecosystem's benefit.

Privately, senior leaders working in equities at FIGs recognize that Canada must start looking at its market ecosystem from the perspective of symbiosis as well as competitiveness and think about what is good for the markets as an ecosystem. It is time for these conversations to occur in the public domain.

What impact have FIGs had on the ability of Canadian capital markets to catalyze equity formation? This paper explores the subject matter, including consequences of 'too much of a good thing'. Financial intermediation, behavioral impacts and potential alternatives, through changing macro-economic incentives, are considered in order to kickstart equity capital formation, while remaining vested in FIGs' success.

While much of this paper may or may not be disagreeable, the sincere hope and goal is to catalyze a needed conversation. Canada needs equity capital formation, and its market failure needs to be addressed with positive solutions for Canada and its FIGs.

B. EXECUTIVE SUMMARY

i) The Landscape at a Glance.

Canada in the late 1980s and early 1990s engaged in a deliberate policy to create 'national champions' through FIGs. They have afforded everyday Canadians a panoply of financial services and have allowed Canada as an economy to continue to scale and compete; as both FIGs and the country punched above its weight of a nation of similar size from the mid-80s to the mid-2010s. The concentration of financial force also created constraints to Canada's economy. FIG concentration has introduced market inefficiencies including:

- The removal of consumer surplus in platform business, affecting issuers and investors in primary markets, via the move toward perfect price discrimination.
- The shift to annuity like businesses through a panoply of products.
- A fixed cost model, to achieve greater heights of scale.

These moves away from idiosyncratic sequence risk of underwriting have created a market inefficiency in equity capital formation to the point of what economists may describe as a "deadweight loss" that has been devastating for Canada's equity capital markets. Perversely, it is now both "too expensive", from a fixed and friction cost perspective, to take on the merchandising risk as a small underwriter, "but not rewarding enough" for the FIGs to take on the risk of an industry whose cost structure they themselves have changed.

Given the scale of the remaining participants on the overall economy, the negative externality has been evidenced, as a whole class of firms, the small and medium-sized enterprises ("SME") and emerging companies, which are now mostly exclusively served by FIGs are a shadow of their past presence because the sector is so under-competed for by the FIGs. This economic evolution is an entirely natural consequence to the fall of the Four Pillars, described further in this paper.

FIGs have leveraged their lower cost of capital to expand their business and market share at continually reduced risk levels. But ironically, in the long run, as with all negative externalities, the very largest organizations, the FIGs, who serve the largest clients will have the most to lose if the ecosystem continues to degrade. By over-grazing capital formation through indirect substitute offerings as a collective, they eventually shrink the broader available market for themselves. That is, by over-diversifying client risks, with an intermediation cost, and removing surplus for the investor and issuer, they reduce the size of the potential marketplace, and therefore their own potential revenues. FIGs have the most capital and cost structure at risk in serving clients and consequently the greatest need for Canadian industry to continually renew itself.

In the meantime, the greatest cost to Canada's economy, and therefore Canadians, has been the opportunity cost of the transactions which have not happened, the businesses that have not been funded, the jobs not created, and the opportunities lost.

ii) The Solutions at a Glance

Change can only occur through government, regulatory and, preferably, extraneous market forces. Through positive market-based, aligned incentives, a new form of national champions, globally relevant equity markets organizations in turn creating new Canadian companies and breathing new life into Canada's economy can be formed to turbo-charge competition and enhance the manufacturing of

Canadian equity for the benefit of Canadians. This involves the carve-out by one or more FIGs of their equity capital trade desk and investment banking businesses, while maintaining a significant equity interest, without balance sheet consolidation, in the new entity. The new entity is funded via institutional private equity investors for a period of time, who would resell a portion of their holdings, at a profit, to long-term institutional investors. Then a portion would be floated in the market for the benefit of retail investors and to provide proper employee/partner incentives. The structure, which enhances FIGs' operational effectiveness to the benefit of their current portfolio, is open to global funding. It allows Canada to once again take the lead in equity capital formation through 'Canadian champions' defending the public good of intermediating single stock equity risk, owned by higher risk/return appetite investors, as a critical function to the future of corporate Canada.

C. THE ORIGINS AND INTENTIONS OF FIG CONCENTRATION

In the late 1980s and early 1990s, the "four pillars", the chartered banks, trust and loan companies, insurance companies and securities dealers, were toppled by reforms to federal and provincial legislation that enabled financial services firms the opportunity to stray out of their traditional silos and into each other's business segments. The "Little Bang" of 1987 allowed chartered banks to venture into securities dealing.¹ Meanwhile the Big Bang in 1992, with the rewrite of the Bank Act, allowed for cross-ownership across all pillars.²

Some of the reasons for allowing for the fall of the pillars was the expectation that financial "supermarkets" would develop, as the various pillars would merge into each other offering:

- Better global competitiveness, as a deep concern to an economy looking forward to dealing with free trade with the United States and Mexico along with more global trade liberalization.
- Consumer convenience, as much like a supermarket consolidated the butcher, baker and vegetable stand, consumers could access all their financial needs under one roof.
- Consumers benefit from new product development.
- Increased diversification of business models to implicitly diversify FIG non-systemic risks. As relationships deepened, their revenue streams would have more certainty.
- Shareholder benefit from the value realized via a lower cost of capital as they diversified non-systemic risks³. This was reflected in additional premium on share valuations.

¹ Charles Freedman, "The Canadian Banking System" (Paper delivered at the Conference on Developments in the Financial System: National and International Perspectives, The Jerome Levy Economics Institute of Bard College, Annandale-on-Hudson, 10 April 1997) at 9, Bank of Canada (March 1998), online:

<https://publications.gc.ca/collections/collection_2008/bank-banque-canada/FB3-1-81E.pdf>

² Charles Freedman, "The Canadian Banking System" (Paper delivered at the Conference on Developments in the Financial System: National and International Perspectives, The Jerome Levy Economics Institute of Bard College, Annandale-on-Hudson, 10 April 1997) at 12, Bank of Canada (March 1998), online:

<https://publications.gc.ca/collections/collection_2008/bank-banque-canada/FB3-1-81E.pdf>

³ For a refresher on the cost of capital, the economic basis of its inputs – see Justin Pettit, 1999. "Corporate Capital Costs: A Practitioner's Guide," Journal of Applied Corporate Finance, Morgan Stanley, vol. 12(1), pages 113-120, March.

Negative consequences were also considered:

- The decline of independent firms, as nearly all major trust companies and securities dealers were absorbed. The removal of the independent dealers, and their differing risk profile, is one of the core challenges in allocating equity capital at a national level discussed in this paper.
- The trade-off of stability over innovation. ⁴The long-term shift in lending from productive business investment toward housing finance, also discussed in this paper, exemplifies this tradeoff.

John Turner, former Prime Minister, was one of the most vocal opponents and specifically argued against the “implicit government guarantee” created by consolidating riskier sectors in the banking system, ⁵ highlighting the costs of moral hazard, 20 years before the 2008 crisis. Several warned that the reforms could leave the financial-services market dominated by the major banks. ⁶ Policymakers also proposed “Chinese walls” to separate fiduciary functions from other financial activities and supported explicit prohibitions on tied selling. ⁷ Smaller institutions and innovation-policy advocates criticized a “one-size-fits-all” regulatory framework, arguing that rules designed for large financial institutions could inhibit smaller firms and financial innovation. ⁸ Interestingly, it was south of the border where the real consequence of eliminating the pillars – the removal of specialization in Canada, was highlighted ⁹ the strongest.

In hindsight, FIGs acquired the trusts and the securities dealers and were the main beneficiaries of the integrative benefits. None of the other “pillars” in the consolidation stepped in to fill the gap as various financial or strategic challenges discouraged them from being acquirers. Reasons include:

- Their own time horizons and cost of capital (insurance companies have long-lived assets and liabilities and cost structures).

⁴ Lawrence L. Schembri & Andrew Spence, *Increasing Competition and Efficiency in Canadian Banking Services* (Vancouver: Fraser Institute, 2025), online: <https://www.fraserinstitute.org/sites/default/files/2025-11/increasing-competition-and-efficiency-in-canadian-banking-services_0.pdf>.

⁵ Time, “Facing Failure: Canadian banks in trouble”, *Time* (21 October 1985), online: <<https://time.com/archive/6704996/facing-failure-canadian-banks-in-trouble/>>

⁶ House of Commons, Standing Committee on Finance and Economic Affairs, *Evidence*, June 15, 1995, testimony concerning the Canadian “four pillars” system, https://www.ourcommons.ca/Archives/committee/351/fine/evidence/149_95-06-15/fine149_blk-e.

⁷ Department of Finance, *The Regulation of Financial Institutions: Proposals for Discussion*, 1985, 34–36, https://publications.gc.ca/collections/collection_2017/fin/F2-67-1985-1-eng.pdf. The document proposed a “Chinese Wall” between fiduciary operations and other financial operations and stated that tied selling would be explicitly prohibited in the legislation governing the relevant financial institutions. https://publications.gc.ca/collections/collection_2017/fin/F2-67-1985-1-eng.pdf

⁸ David E. Bond, “And Never the Twain Shall Meet,” *Investment Executive*, October 30, 2019, https://www.investmentexecutive.com/newspaper/_news-57179/. The article describes the “Chinese wall” separating banks from their insurance subsidiaries and discusses restrictions on the promotion of insurance through bank websites.

⁹ Garry J Schinasi, “Canadian Financial Markets: The Government’s Proposal for Reform” (1985), Federal Reserve Board, International Finance Discussion Papers No 269, online: <<https://www.federalreserve.gov/pubs/ifdp/1985/269/ifdp269.pdf>>

// While financial sector growth initially promotes GDP growth as a necessary intermediation of sources and uses of capital, an oversized or overly concentrated financial sector may eventually hamper economic expansion.

- Conflicting incentives (the view that asset managers, such as trust companies, as the main pools of wealth management at that time, could not credibly be primarily on the “buy-side” and be “own” capital markets organizations), the “sell-side”, or vice versa.
- Diseconomies of small scale (trusts) did not afford any natural edge to participate in equity markets.

On a relative basis, chartered banks, already being lenders to these other institutions, were the more natural buyers. The fall of the Four Pillars led to the rapid entry of FIGs into the securities business. Most importantly over time, the cost of capital, the hurdle rate, and management’s appetite to meet these hurdles, converged to the lower rate of the acquirers, with broader and larger shareholder basis, than higher risk and higher reward independent securities firms. As further explained in this paper, as management teams were integrated and a couple of generations of executives passed through the ranks, securities divisions were subject to behaviors and incentives fundamental to FIGs’ strategies, changing the risk appetites for equity capital formation.

Ultimately, the objective of creating national champions and protecting Canada’s financial industry in the upcoming eras of free trade and globalization; were achieved. The question is at what cost?

D. THE GENERAL IMPACTS OF FIG CONCENTRATION

A significant body of academic evidence suggests¹⁰ that while financial sector growth initially promotes GDP growth as a necessary intermediation of sources and uses of capital, an oversized or overly concentrated financial sector may eventually hamper economic expansion. This is primarily due to resource misallocation and the crowding out of other productive sectors:

i) Threshold Effect

Numerous studies find a non-linear, inverted U-shaped relationship between financial depth (size) and economic growth. Financial development boosts growth up to a certain point, after which the correlation becomes negative as credit is misallocated.¹¹

¹⁰ See: Jean-Louis Arcand, Enrico Berkes & Ugo Panizza, “Too Much Finance?” (2015) 20:2 Journal of Economic Growth 105; Stephen G Cecchetti & Enisse Kharroubi, “Reassessing the Impact of Finance on Growth” (2012), Bank for International Settlements, Working Papers No 381, online: <<https://www.bis.org/publ/work381.pdf>>; Ratna Sahay et al, “Rethinking Financial Deepening: Stability and Growth in Emerging Markets” (2015), International Monetary Fund Staff Discussion Note No SDN/15/08, online: <https://www.imf.org/-/media/websites/imf/imported/external/pubs/ft/sdn/2015/_sdn1508pdf.pdf>; Siong Hook Law & Nirvikar Singh, “Does Too Much Finance Harm Economic Growth?” (2014) 41 Journal of Banking & Finance 36; Stephen G Cecchetti & Enisse Kharroubi, “Why Does Financial Sector Growth Crowd Out Real Economic Growth?” (2015), Bank for International Settlements, Working Paper No 490, online: <<https://www.bis.org/publ/work490.pdf>>; Joshua Aizenman, Yothin Jinjark & Donghyun Park, “Financial Development and Output Growth in Developing Asia and Latin America: A Comparative Sectoral Analysis” (2015), National Bureau of Economic Research, Working Paper No 20917, online: <<https://www.nber.org/papers/w20917>>.

¹¹ Philippe Aghion et al, “Financial Constraints and Productivity Growth: An Inverted-U Relationship” *VoxEU* (13 September 2019), online: <<https://cepr.org/voxeu/columns/financial-constraints-and-productivity-growth-inverted-u-relationship>>; Siong Hook Law & Nirvikar Singh, “Does Too Much Finance Harm Economic Growth?” (2014) 41 Journal of Banking & Finance 36; Sok Heng Lay, “Bank Credit and Economic Growth: Short-Run Evidence from a Dynamic Threshold Panel Model” (2020) 192 *Economics Letters* 109231; Cecchetti & Enisse Kharroubi,

When private sector credit exceeds a certain threshold, typically around 80%-100% of GDP, or when the financial sector makes up more than 3.5% of total employment in OECD countries, further expansion of the financial services sector begins to reduce the GDP growth rate.¹² In Canada's case, there are 857,000¹³ out of 21mm¹⁴ or about 4-5% of employment in the financial sector. Private sector credit (non-financial) is well over 200%, above the threshold¹⁵ Arguably Canada's financial sector is, likely at, nearing or surpassed the threshold level of diminishing returns.

ii) Institutional Factors:

The impact of financial sector size often depends on the quality of institutions and regulations. In countries with weak governance and regulation, an expanding financial sector is more likely to be detrimental to growth, as a lack of oversight can lead to credit misallocation and financial crimes. Without getting into an apologia for Canada's regulatory environment, it is sufficient to say that Canada has good institutional factors including:

Stability may remove or mask risk, but it does not develop capabilities needed to meet the risk requirements, as necessary tools, in an increasingly global marketplace

- The Office of the Superintendent of Financial Institutions (OSFI), a federal prudential regulator responsible to ensure the resilience of federally regulated financial institutions.
- The Bank of Canada, a central bank responsible for maintaining stable monetary policy.
- Consumer protection laws¹⁶ and agencies.¹⁷
- Deposit insurance mixed with bail in provisions.¹⁸
- Capital buffers, including additional buffers for the largest FIGs.¹⁹
- Systemic risk oversight.²⁰
- Strong national credit.²¹

"Why Does Financial Sector Growth Crowd Out Real Economic Growth?" (2015), Bank for International Settlements, Working Paper No 490, online: <<https://www.bis.org/publ/work490.pdf>>.

¹² Jean-Louis Arcand, Enrico Berkes & Ugo Panizza, "Too Much Finance?" (2015) 20:2 Journal of Economic Growth 105.

¹³ Statistics Canada, "Employment by Industry, Annual" (26 March 2026), online: <<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1410020201>>

¹⁴ Statistics Canada, "Labour Statistics" (June 2026), online: <https://www.statcan.gc.ca/en/subjects-start/labour_>

¹⁵ Bank for International Settlements, "Total Credit to Private Non-Financial Sector, Adjusted for Breaks, for Canada" (15 June 2026), online: <<https://fred.stlouisfed.org/series/QCAPAM770A>> <https://fred.stlouisfed.org/series/QCAPAM770A>

¹⁶ Financial Consumer Agency of Canada Act, S.C. 2001, c. 9, ss. 2.1, 3(2), 5, Bank Act, S.C. 1991, c. 46, ss. 627.01-627.998.

¹⁷ For example: the Financial Consumer Agency of Canada

¹⁸ Canada Deposit Insurance Corporation Act, R.S.C. 1985, c. C-3 (CDIC Act) establishes CDIC and its mandate to insure eligible deposits at member institutions (e.g., chequing, savings, GICs) up to prescribed limits, providing the core safety net for retail depositors. CDIC Act amendments (2016) add "bail-in power" for Domestic Systemically Important Banks.

¹⁹ Bank Act ss. 485(1) and 949(1) require banks and bank holding companies to maintain adequate capital/ OSFI's Capital Adequacy Requirement Guideline sets the framework the Superintendent uses to assess adequacy.

²⁰ Financial Institutions Supervisory Committee (FISC): formal coordination among OSFI, Bank of Canada, Department of Finance, CDIC, and FCAC to share information on supervisory matters and systemic risks.

²¹ Department of Finance Canada, *Spring Economic Update 2026*, Annex 3, "Debt Management Strategy" (Ottawa: Government of Canada, 2026), online: Government of Canada.

The primary focus of all these institutions/institutional factors, has been on financial stability, rather than broader productivity gains for the economy as a whole. Stability may remove or mask risk, but it does not develop the capabilities needed to meet risk requirements, as necessary tools to embrace, in an increasingly global marketplace because of:

a) Resource Crowding Out

A large and concentrated financial sector can drain resources in both capital and skilled labor from the real economy, particularly from research and development (R&D) intensive, knowledge capital or manufacturing industries. This harms productivity growth in those sectors.²²

b) Inefficient Capital Allocation

Concentrated financial systems, such as stock markets dominated by a few large firms, are associated with less efficient capital allocation, sluggish innovation, and slower economic growth. The concentration can lead to a misdirection of credit towards risky or unproductive investments, such as real estate bubbles, rather than broad-based productive investments.²³

c) Increased Volatility and Crisis Risk

Excessive credit growth associated with a large financial sector can lead to higher economic volatility and an increased probability of financial crises, which have long-term negative economic consequences²⁴

These findings challenge the view that "more finance is always better," highlighting the importance of a balanced and well-regulated financial system managing for sustainable economic growth which factors in real economy productivity gains as well as the need for stability.

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- S&P Global Ratings: AAA (stable outlook).
 - Moody's Investors Service: Aaa (stable outlook).
 - DBRS Morningstar: AAA (stable outlook).
 - Fitch Ratings: AA+ (stable outlook).

²²Cecchetti & Enisse Kharroubi, "Why Does Financial Sector Growth Crowd Out Real Economic Growth?" (2015), Bank for International Settlements, Working Paper No 490, online: <<https://www.bis.org/publ/work490.pdf>>

²³ Daniel Neuhann & Michael Sockin, "Financial Market Concentration and Misallocation" (2024) 159:103875 Journal of Financial Economics, https://danielneuhann.com/files/ns_concentration_JFE.pdf

²⁴ Thorsten Beck, Asli Demirgüç-Kunt & Ross Levine, "Bank Concentration and Fragility: Impact and Mechanics" (2005), National Bureau of Economic Research, Working Paper No 11500, online: <https://www.nber.org/system/files/working_papers/w11500/w11500.pdf>

E. APPLICATION TO CANADA

i) Generally

Canada has the intellectual capability - Canada is a country that aside from making its own planes²⁵, trains²⁶, and automobiles²⁷ from World War II up until the 1980s, had also split the atom²⁸, broke the sound barrier²⁹, put 16 bits on a microprocessor³⁰, led the world in biotechnology³¹ and had its own satellites in space.³² A true leader global leader in all spheres of applied sciences and technology, Canada was poised to lead in the 21st century. Equity is the tool which unlocks and organizes this intellect, capital, and labor.

It has been argued that Canada is more stable as a result of FIG concentration. On the other hand, by influencing the broader economy in a manner which makes Canada's economy less productive to reflect the risk profile of its sector such as investing in real estate, as opposed to R&D collateralized working capital loans and risk capital, FIG concentration has sown the seeds of inevitable future instability. Eventually, inordinately increasing bet sizes in these "same way" investments reach their marginal limits. There are some warning indicators that Canada's financial sector has been impacted by resource crowding out, inefficient capital allocation, increased volatility, and crisis risk. These are explained below:

ii) Real Estate

Alpha producing investments are those which generate a return greater than their cost of capital³³; effectively economically productive investments. Real estate, by definition, is not an alpha producing

²⁵ Christian Riel, *The Walkway of Time: Highlights in the History of Canadian Aviation*, ed by Rénaud Fortier (Ottawa: National Aviation Museum, 1998), online: <https://publications.gc.ca/collections/collection_2017/maec-casm/NM97-12-2-10-1998-eng.pdf>

²⁶ Via Rail Canada, "An All-Canadian Rail Innovation from Roof to Wheels" (Spring 2009), online: <https://www.viarail.ca/sites/all/files/media/pdfs/About_VIA/our-company/capital-investment-plan/BK090501E%20-%20VIA%20LRC.pdf>

²⁷ Richard White, *Making Cars in Canada: A Brief History of the Canadian Automobile Industry 1900-1980*, (Ottawa: Canada Science and Technology Museum, 2007) at 71, online: <https://publications.gc.ca/collections/collection_2018/mstc-cstm/NM33-1-15-eng.pdf>

²⁸ Jeremy Whitlock, ""Okay Let's Go": 80 Years Ago Canada Became the Second Nation to Harness the Atom" (2025) 81:1 *Physics in Canada* 14

²⁹ Austin Hancock, "Today in Aviation History: First Flight Past the Sound Barrier in Canada" (9 August 2025), *Vintage Aviation News*, online: <<https://vintageaviationnews.com/warbirds-news/today-in-aviation-history-first-flight-past-the-sound-barrier-in-canada>>

³⁰ Zbigniew Stachniak & Scott M Campbell, *Computing in Canada: Building a Digital Future*, Transformation Series No 17 (Ottawa: Canada Science and Technology Museum, 2009) at 50, online: <https://publications.gc.ca/collections/collection_2018/mstc-cstm/NM33-1-17-eng.pdf>

³¹ BiotechCanada, "Building a global biotechnology powerhouse in Canada" (24 January 2025), online: <<https://www.biotech.ca/news/building-a-global-biotechnology-powerhouse-in-canada/>>

³² Canadian Space Agency, "Alouette I and II" (28 September 2018), online: <<https://www.asc-csa.gc.ca/eng/satellites/alouette.asp>>

³³ For a refresher on how economic profit requires the opportunity cost of capital - Marwaan Karame, "Prepare for This Pay-for-Performance Measure," CFO.com, December 4, 2018, <https://www.cfo.com/news/prepare-for-this-pay-for-performance-measure/658375/>

investment³⁴. Real estate in the long run is an input to, and not an output of, broad industrial productivity. Long-run returns in real estate meet, rather than exceed the cost of capital. By weighting our Canadian economy to real estate, we do not seek more productive uses in manufacturing, industry, technology, health care, and space.

Canadian data demonstrates symptoms of resource crowding. Canadian capital has diverted into the housing market, including renovations as well as new homes, from lows of around 10% of GDP in the turn of the century to 13%³⁵, which is a 30% lift. While three points might not sound like a lot, considering that government spending is roughly 45 % of GDP³⁶, this means an almost a 6% shift of private sector spending was directed to real estate. The result is that 38% of Canada's gross fixed capital formation was directed toward housing, the highest share in the OECD.³⁷

This is materially large crowding out when considering that the level of spending on productive capital (machinery, equipment and intellectual property investment) has declined³⁸, along with the R&D spending required to make productive capital even more productive. Canadian R&D spending is 1.8% of GDP, while the OECD averages are around 2.7%.³⁹ Canada's R&D intensity has remained below the OECD average for over two decades.⁴⁰ Weak investment in information and communications and technology is as a primary reason for the pronounced divergence from U.S. productivity growth this century. Put differently, if only 1/10th of the capital directed to housing the last couple of decades, were directed to Research and Development, Canada would reach and even exceed global leadership levels. If 2/10 of the capital diverted to housing was additionally diverted to R&D, Canada would become a global leader on par with Taiwan, Korea and Israel – all recognized as technology powerhouses for their scale.

Translating esoteric economic data into practical daily terms: holding all else equal, a doubling of prices per sq. feet in housing does not make the average Canadian wealthier necessarily (even if some of this

³⁴ Òscar Jordà, Katharina Knoll, Dmitry Kuvshinov, Moritz Schularick, and Alan M. Taylor, "The Rate of Return on Everything, 1870–2015," NBER Working Paper no. 24112 (Cambridge, MA: National Bureau of Economic Research, December 2017), https://www.stern.nyu.edu/sites/default/files/assets/documents/RORE_NBER.pdf. Using an economic profit perspective, this is to mean that Unlevered real estate does not generate returns in excess of its opportunity cost of equity over the complete business cycle.

³⁵ Statistics Canada, "Gross Domestic Product (GDP) at Basic Prices, by Industry, Annual Average (x 1,000,000)" (30 June 2026), online: <<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610043403>>

³⁶ Across all levels of government. OECD, *Government at a Glance 2025: Canada*, (Paris: OECD, 2025), online: <https://www.oecd.org/content/dam/oecd/en/publications/reports/2025/06/government-at-a-glance-2025-country-notes_9de36e82/canada_f2ef6224/2cf4d84b-en.pdf>

³⁷ Hanif Bayat, "Canada's Capital Is Flowing to the Wrong Places", *The Globe and Mail* (24 February 2026), online: <<https://www.theglobeandmail.com/investing/personal-finance/article-canada-capital-wrong-places-investment-real-estate/>>

³⁸ OECD, *OECD Economic Surveys: Canada 2025*, Government at a Glance, Report, (Paris: OECD, 2025) at figure 4.5, Business investment dynamics have been weak, and total investment has fallen since 2014, driven by a decline in the extraction industry." https://www.oecd.org/en/publications/oecd-economic-surveys-canada-2025_28f9e02c-en/full-report/raising-business-sector-productivity_443bcd88

³⁹ OECD, *OECD overall R&D growth stable; government R&D budgets decline and reorient towards defence*, Statistical Release, (Paris: OECD, 2026), online: <<https://www.oecd.org/en/data/insights/statistical-releases/2026/03/oecd-overall-rd-growth-stable-government-rd-budgets-decline-and-reorient-towards-defence>>

⁴⁰ Innovation, Science and Economic Development Canada, *Indicators and Targets: Growing Business Investment in Research and Development, Innovation and Skills Plan*, online: <https://ised-isde.canada.ca/site/innovation-better-canada/en/tracking-progress-and-results-innovation-and-skills-plan/indicators-and-targets-growing-business-investment-research-and-development>

pricing would be found in “increased GDP” but rather forces a reduced square footage (or utility) on the citizen buying the marginal property. As citizens in major Canadian cities experience specifically, increased “economic activity” or GDP gains, do not always lead to better outcomes, where they are not based on productivity gains.

Government has played a role in this resource crowding by promoting and subsidizing the consumption of housing in GDP and relatively reducing resources for non-residential investment. Government has effectively backstopped insurance programs through the Canada Mortgage and Housing Corporation (CMHC) and by promoting rapid population expansion, while also acting as an the effective put option on the market for Canadian Mortgage-Backed Securities (CMBS) through monetary and regulatory policy. More specifically, intermediated capital flows through the lens of government requirements and policy goals lending is favored to collateral rich property vs. the “riskier” and increasingly un-collateralized business sector.

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iii) Small and Medium Sized Enterprises (SMEs) Struggling for Loans

Allocating capital by size of firm, as a key lending risk metric, rather than the merits of productivity of capital, ultimately leads to poor productivity growth. Within the business sector, SMEs are struggling for loans as capital allocation has favored larger firms over smaller firms. Collateralization requirements have increased from 33-45% to 66% and funding costs which had an 80bps premium over large firms, expanded to 210 bps⁴¹

Collateral and Personal Risk: In 1995, financing was largely based on business assets. By 2025, a massive 66% of small businesses were required to pledge collateral jump from 46% just one year prior.⁴² Today, over 1 in 2 micro-businesses must provide a personal guarantee⁴³, and 29% must pledge their primary residence to secure a loan in 2025. They face a steep rejection rate, with only 53% of debt requests approved.

⁴¹ Innovation, Science and Economic Development Canada, “Small Business Credit Condition Trends, 2014-2024” (17 November 2025), online: <<https://ised-isde.canada.ca/site/sme-research-statistics/en/small-business-credit-condition-trends-2014-2024#>>

⁴² Innovation, Science and Economic Development Canada, “Small Business Credit Condition Trends, 2014-2024” (17 November 2025), online: <<https://ised-isde.canada.ca/site/sme-research-statistics/en/small-business-credit-condition-trends-2014-2024#>>

⁴³ Competition Bureau Canada, “Consultation on proposed terms of reference for a market study on competition for financing to small and medium-sized enterprises (SMEs)” (4 September 2025), online: <<https://competition-bureau.canada.ca/en/how-we-foster-competition/consultations/consultation-proposed-terms-reference-market-study-competition-financing-small-and-medium-sized#>>

Financially Unhealthy SMEs: As of late 2025, the number of "financially unhealthy" Canadian small businesses has risen to 60%, leading to a multi-year decline in satisfaction with their primary credit providers.⁴⁴

Government Dependency: The Canada Small Business Financing Program (CSBFP) remains a critical crutch. In 2025, it was estimated that over 75% of the loans it backed would have been denied by traditional institutions entirely in the absence of loss-sharing guarantees.⁴⁵ In the mid-1990s, the Small Business Loans Act (the CSBFP predecessor) saw much higher relative start-up participation without the current level of "payment shock" risk.; with estimates ranging as high as 70% in 1995⁴⁶

iv) Growing Profits but Less "Real Economy" Capital

Capital allocation geared toward intermediation is evident in the operating results of corporate performance and the capital employed in the non-financial economy. In 1995, total annual corporate operating profits were 95.2 billion, while non-financial sectors were roughly 75 billion, such that the balance 20-21% of profit was in financial sectors.⁴⁷ In 2025 the profitability of the Canadian financial sector reached \$200 billion, of total corporate profit of 677 billion, or almost 29% of the total.⁴⁸ Put another way, financial services profit grew by 8% a year, while the non-financial sector grew profit by roughly 6%. Yet less capital flows to the real economy⁴⁹, showing in reduced productivity:

⁴⁴ JD Power, "Economic Headwinds Erode Small Business Satisfaction with Banks in Canada, JD Power Finds", *JD Power Press Release*, (21 October 2025), online: <<https://canada.jdpower.com/press-releases/2025-canada-small-business-banking-satisfaction-study>>

⁴⁵ Canada Small Business Financing Program, "Canada Small Business Financing Act Comprehensive Review Report 2019-2024" (10 February 2025), online: <<https://ised-isde.canada.ca/site/canada-small-business-financing-program/en/documentation-centre/canada-small-business-financing-act-comprehensive-review-report-2019-2024>>

⁴⁶ *Ibid.*

⁴⁷ David Caldwell, Gary Sawchuk and Jack Wilson, "Do Small Firms Face Higher Financing Costs?" *Quarterly Financial Statistics for Enterprises*, Statistics Canada, Catalogue No. 61-008, vol. 5, no. 4 (Fourth Quarter 1994), online: Government of Canada Publications.; <https://publications.gc.ca/site/eng/9.808801/publication>

⁴⁸ Steve Randall, "Financial sector profits drive corporate Canada's third quarter rebound", *Wealth Professional* (25 November 2025), online: <<https://www.wealthprofessional.ca/news/industry-news/financial-sector-profits-drive-corporate-canadas-third-quarter-rebound/390940>> Statistics Canada, "The Daily: Quarterly financial statistics for enterprises, fourth quarter 2025" (25 February 2026), online: <https://www150.statcan.gc.ca/n1/daily-quotidien/260225/dq260225a-eng>

⁴⁹ This includes food production, manufacturing, healthcare, stores, restaurants, and transportation.

- **Declining Growth Rates:** Average annual growth in Canadian labor productivity fell from approximately 3% in the 1960s and 1970s to just 1% between 2000 and 2019.⁵⁰ By early 2025, annual growth averaged a meager 0.6%, roughly one-third of the pace seen between 1981 and 2001.⁵¹
- **Widening U.S.-Canada Gap:** In the mid-1990s, Canadian productivity was approximately 85% of U.S. levels. By 2022, this had fallen to 72%. Between 1981 and 2024, labor productivity increased by 127% in the United States compared to only 61% in Canada. In 2025, Canadian workers are projected to receive only 55 cents of new capital for every dollar received by their U.S. counterparts.⁵²
- **G7 and OECD Lag:** By 2023, Canada's workforce generated USD 74.70 in goods and services per hour worked, significantly trailing the U.S. (USD 97.00) and France (USD 89.30).⁵³

v) Signs of Increased Concentration Risk and Crisis

An inflexible structure is in itself riskier where there is significant concentration risk. Such a structure can be considered to be less anti-fragile. If one believes that risks that can conceivably go wrong, at some point in time eventually do; then those risks threaten the whole system. The 2008 crisis should have been a warning to the Canadian system, not a “pat on the back”.⁵⁴

The 2008 crisis should have been a warning to the Canadian system, not a “pat on the back”.

A continually increasing scale, but reduced breadth of FIGs economic activity, by definition is an increasing bet size as a share of the economy. This increases contagion risks should such “bets” fail to pay off and credits are not repaid. There are a number of ways in which

concentration risk, or our economy’s bet-size on outsized FIGs, and their outsized bets on housing may get them and the economy into trouble. The bet size may be too high in their current business model. FIGs effectively intermediate capital and therefore compete for and on their primary input and output cost – the cost of capital. Effective risk management is critical to the levering of their equity base to ensure

⁵⁰ Nicolas Vincent, Address (delivered to the Association des économistes québécois (ASDEQ) and CFA Québec, 19 November 2025) published Bank of Canada, “Towards a virtuous circle for productivity” at Chart 1, online: <https://www.bankofcanada.ca/2025/11/toward-a-virtuous-circle-for-productivity/>

⁵¹ Statistics Canada, “The Daily: Quarterly financial statistics for enterprises, fourth quarter 2024” (5 March 2025), online: < <https://www150.statcan.gc.ca/n1/daily-quotidien/250305/dq250305b-eng> >

⁵² Statistics Canada, “Productivity Performance in Canada, 1961 to 2008: An Update on Long-term Trends: Executive Summary,” *The Canadian Productivity Review*, no. 25, December 19, 2012, www150.statcan.gc.ca; Statistics Canada, “Relative Productivity Levels in Canada and the United States,” *The Daily*, July 21, 2008, www150.statcan.gc.ca; Weimin Wang, “Unit Labour Cost Growth, Inflation and Productivity Growth in Canada and the United States,” *Economic and Social Reports* 5, no. 4, April 2025, Statistics Canada, April 23, 2025, publications.gc.ca; Government of Canada, “Chapter 1: Building a Stronger Canadian Economy,” *Budget 2025*, November 4, 2025, budget.canada.ca

⁵³ OECD, OECD Economic Surveys: Canada 2025 (Paris: OECD Publishing, 2025) Figure 4.1 “Canada’s level of labour productivity lags most other advanced economies”. Online: https://www.oecd.org/en/publications/oecd-economic-surveys-canada-2025_28f9e02c-en/full-report/raising-business-sector-productivity_443bcd88

⁵⁴ David Macdonald, *the Big Banks’ Big Secret*, (Ottawa: Canadian Centre for Policy Alternatives, 2012), online: <<https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2012/04/Big%20Banks%20Big%20Secret.pdf>>;

that they generate an economic spread. They continually scale in order to drive down unit and incremental costs.

But as large as they are, they may not be equipped to face new business models and future growth vectors of the industry. After dividends and share buybacks, they have a relatively smaller capital base to amortize development costs compared to global peers, including investments in artificial intelligence, which will attack the heart of existing behaviors of differentiating clients. The development of true omni-channel platforms with one integrated back-office across all forms of financial access, from manual to automated, physical to online and compute to mobile. They are competing against fully digital platforms across product types unburdened by physical “presence” and associated costs, specialized platforms who cherry pick at profit centers (such as payments or foreign exchange) and potential massive scale entrants⁵⁵ with lower cost of capital⁵⁶ than FIGs. This competition for credit may generate an impetus to take risks, or price risk less effectively, in a manner FIGs otherwise would not take in order to maintain market position.

Currently, there is evidence of negative impacts of concentration in the broader economy.

Currently, there is evidence of negative impacts of concentration in the broader economy. The Bank of Canada and OSFI have cited elevated household debts⁵⁷. Pre impact of Big-Bang debt to income ratios in Canada were \$1.03 and are at \$1.77 as of Q3 2025.⁵⁸ Delinquency rates have increased. Albeit still at low levels, they reached 0.24%, the highest level since 2015, with 1.45MM Canadians missing at least one payment in Q4 2023 alone⁵⁹ The non-mortgage delinquency rates in the cohort of ages 18-35, is up to 2.35%, up 20% year over year. ⁶⁰ Commercial Real Estate (CRE) growth is not independent of real estate driven policy, as vacancy rates remain elevated, with recovery uneven.⁶¹ While the market has not found a clearing price as seller, and buyers will not cross “the spread” between bid and offer, sales volumes dropped from 2023 to 2025 ⁶²

⁵⁵ For example, through the purchase of particular business units.

⁵⁶ While Canadian FIGs have amongst the lowest cost of capital on a domestic basis due to their diversified basis; and some access to US Capital markets; they do not benefit from a truly Global cost of capital. American multi-nationals have been benefitting from diversification benefits of global assets and funding for over 30 years, while Canadian firms still suffer from many of the impediments to these benefits outlined by: Justin Pettit, Mack Ferguson & Robert Gluck “A Method for Estimating Global Corporate Capital Costs: the Case of Bestfoods” (1999) 12:3 Journal of Applied Corporate Finance 80.

⁵⁷ Office of the Superintendent of Financial Institutions, “Infosheet: Residential Mortgage Underwriting Practices and Procedures—Guideline B-20,” August 23, 2023, <https://www.osfi-bsif.gc.ca/en/guidance/guidance-library/infosheet-residential-mortgage-underwriting-practices-procedures-guideline-b-20>; Bank of Canada, *Financial Stability Report—2026* (Ottawa: Bank of Canada, May 28, 2026), “Households,” <https://www.bankofcanada.ca/publications/financial-stability-report/financial-stability-report-2026/households/>.

⁵⁸ The Canadian Press, “Canadians’ debt-to-income ratio climbed to 176.7% last quarter” *The Globe and Mail* (11 December 2025), online: <<https://www.theglobeandmail.com/business/article-canadians-debt-to-income-ratio-ticked-higher-last-quarter/>>

⁵⁹ Equifax, “Credit Card Balances Expected to Peak in December with the Holiday Season” *Equifax Newsroom* (26 November 2025), online: < <https://www.equifax.ca/about-equifax/newsroom/-/intlpress/credit-card-balances-expected-to-peak-in-december-with-the-holiday-season>>

⁶⁰ Equifax Canada. (2025, August 18). *Delinquency levels show signs of stabilizing, but the financial gap continues to widen for some Canadians*. Equifax Canada Newsroom

⁶¹ CBRE, “Canada Office Figures Q2 2026,” July 6, 2026, accessed August 7, 2026, <https://www.cbre.com/insights/figures/canada-office-figures-q2-2026>

⁶² Altus Group, “Canadian Commercial Real Estate Market Update-Q4 2025”

Concentration risk makes Canada’s economic system less adaptable to exogenous “real” economy shocks to the sector itself, and the sectors in which the system is investing., such as trade policy, technology disruption, and business model innovation. Managing for stability is sometimes contrary for managing for adaptability. Focusing our national policy on the former, brings harm the latter.

Naturally, FIG-owned capital market businesses should pursue their economic self-interest and needs of their shareholders.

F. AN EXAMINATION OF THE FIG BUSINESS MODEL AND ITS WIDER IMPACT

Naturally, FIG-owned capital market businesses should pursue their economic self-interest and needs of their shareholders. Their goal is to gain an “increasing share of wallet”, using the “cross-sell”, and pricing differentiation at the point of their clients’ maximum utility to generate low risk, annuity like revenue streams. There is absolutely nothing wrong, in and of itself, with all this natural economic turn of circumstance for individual participants. The challenge is that there has been a void in protecting the equity capital formation in Canada as a system as follows:

i) Shifting Consumer Surplus to Producer Surplus

The Canadian FIGs are hyper – efficient at extracting maximum marginal utility from their customer base. They are very good at getting paid in many small ways. This is evidenced by their continual move toward first-degree or perfect price discrimination, which in a strict economic sense, is charging each individual client the maximum that individual client would be willing to pay.

A step beyond charging different “types of fees” (interest, account fees, transaction fees) is charging by various segment, as they move from third degree differentiation on demographic or lifecycle characteristics (student, seniors, newcomer risk buckets) to second degree (tiering, volume discounts, product versioning), to first degree fully negotiated pricing as the ultimate goal, allowing for more self-selection of risk profiles.

The challenge is that there has been a void in protecting the equity capital formation in Canada as a system.

A hyper efficient supermarket – is motivated to move to first degree price differentiation.⁶³ →

The multi-product focus of a supermarket offering across every product from borrowing to lending, equity to debt; discretionary to self-directed activities, and everything in between, allows for more and more pricing of a client’s overall financial services to be blended toward the first degree. This pricing allows FIGs to extract closer to the maximum financial intermediation fee from a specific client for that specific client’s needs. FIGs leverage extensive individual data on credit risks, and transactional utilization rates,

(23 March 2026) at figure 1, online: <<https://www.altusgroup.com/insights/canadian-commercial-real-estate-market-update/>>; Altus Group, “Canadian CRE investment trends-Q4 2024” (30 January 2025), online <<https://www.altusgroup.com/insights/canadian-cre-investment-trends-q4-2024/>>

⁶³ Alexandra Twin, “What is Price Discrimination and How Does it Work?”, *Investopedia* (7 April 2026), online: <[https://www.investopedia.com/terms/p/price_discrimination.asp#:~:text=Price%20discrimination%20is%20practiced%20based,1](https://www.investopedia.com/terms/p/price_discrimination.asp#:~:text=Price%20discrimination%20is%20practiced%20based,1>)>

for example in negotiated markets such as mortgages which are >50% of their balance sheet.⁶⁴ As further data mining techniques leveraging advanced statistical analytics and artificial intelligence are perpetuated, a greater and greater share of their balance sheet is based on negotiation, and eventually the majority of prices move toward the first degree.

While “tied selling”, or the overt statement that unwanted, or inferior products, must be purchased as a condition for getting another product, such as a mortgage, is expressly prohibited., FIGs can, and often do offer, bundled deals to the point where optimal economic utility is reached. As FIGs must still offer standard prices that are unbundled, the bundled offerings are attractive enough where it is rational for individual consumers to consume them as a low-cost utility transfer relative to peer competitors who do not have the same bundling opportunity. As the marginal overhead cost of offering additional products to existing customers approaches zero, it suits FIGs to bundle as aggressively as possible. A relationship focused strategy, coupled with intensive data mining on risks and artificial intelligence, becomes the optimal strategy to maximize marginal utility per client.

Offering the suite of supermarket services, in service mixes specifically suited to the client (various full-service, self-directed equity investment, cash or chequeing, and asset management accounts in each product) in atypically priced transactions, in economic terms, effectively captures the bulk of the aggregate consumer surplus from a transaction or series of transaction and transfers it to the producer surplus. If the entire surplus is shifted to the FIGs, consumers as a whole do not reinvest that surplus into their own savings pools. This is demonstrated in the consistent excess returns, defined as economic profit in excess of their cost of equity, that FIG’ return on equity (ROE) demonstrates. This has broad societal impacts which have raised questions of fairness⁶⁵. Certain key impacts are as follows:

If the entire surplus is shifted to the FIGs, consumers as a whole do not reinvest that surplus into their savings pools.

- **Income Inequality:** No value is created from the entire economic welfare created from the net new economic transactions they receive. They have simply changed the form of utility to an equal utility of different form. The entire total net new utility created by the suite of services is transferred from a large group of individual consumers to a small group of producers, the FIGs.

- **Cross-Subsidization:** As a positive, higher profits in one segment may allow firms to maintain loss-making services that have social benefits, such as rural transport or night-time services. On the other hand, they may subsidize other capital intensive, loss marking services which provide the data for which they can execute on these strategies.

⁶⁴Bank of Canada, *Chartered Bank Selected Assets: Month-End (Formerly C1)*, accessed August 5, 2026, <https://www.bankofcanada.ca/rates/banking-and-financial-statistics/chartered-bank-selected-assets-month-end-formerly-c1/>; Statistics Canada, *Table 10-10-0134-01: Balance Sheet of Chartered Banks, Monthly*, accessed August 5, 2026, <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1010013401>; Canada Mortgage and Housing Corporation, *Residential Mortgage Industry Report*, accessed August 5, 2026, <https://www.cmhc-schl.gc.ca/professionals/housing-markets-data-and-research/housing-research/research-reports/housing-finance/residential-mortgage-industry-report?ap=a1-p1&>

⁶⁵ Mary Starks et al., *Price discrimination in financial services: How should we deal with questions of fairness?* Research Note (London: Financial Conduct Authority, 2018), online: https://www.fca.org.uk/publication/research/price_discrimination_in_financial_services.pdf

- **Decline in Equity Financings:** This capture of consumer surplus is most problematic in securities dealers. In brokerage, as in any “two-sided” or “multi-sided” market, the service provider or platform in the middle (the securities dealer), needs to satisfy both sides of the transaction in order for the transaction to occur.

If FIGs owned brokerages effectively first-degree price differentiate both the issuer, through blended pricing of underwriting fees, loans, credit and F/X facilities, and consumers (investors providing capital), over time there is less reason to come back for more trade, as neither outside party consuming the transaction, issuer or investor, captures enough economic surplus from the transaction. This is the core rational economic explanation for the decline in equity financings in Canada (and globally) as securities dealers, exchanges and data providers have moved to removing this surplus.

ii) Shifting to Predictable Cash Flow Streams

Through a shift of revenue models into fee based “wealth managers” vs. commission based “stockbrokers”, and leveraging their scale into service offerings, FIGs naturally embraced consolidation and were able to be the “winners” in the shift. They embraced structured products, funds and ETFs, spreading their own risk, and their client’s risk, into more annuity like, and diversified, revenue streams.

As organizations scale annuity like revenue streams, they develop an incentive to shift to more predictable cash flow streams. Fixed costs are then matched to fixed-like revenue streams, creating a mismatch with the sequence risk of capital market formation. In the process of leveraging their scale and most importantly, scope, via the price differentiation strategies described, and transitioning the securities dealer’s business model into more annuity like revenue, they seek fixed cost streams as opposed to a historical variable cost structure. This requires more permanent capital; with larger and more complex capital markets transactions to sustain businesses. This is the most direct mismatch with the risk capital underwriting component of the securities industry.

Equity underwritings declined precipitously over the last two decades, especially in IPO activity.

Equity underwritings declined precipitously over the last two decades, especially in IPO activity⁶⁶. While FIGs continue to underwrite sustaining capital for clients of long-standing relationships, they do not underwrite risk capital at the venture stage. From 1993 to 2024, FIGs led approximately 60% of TSX public equity underwriting on average, including IPOs and follow-on offerings, with their share peaking near 80%. This shift coincided with a decline in the independent, regionally focused dealer ecosystem that historically supplied specialized underwriting capacity and risk capital to smaller and growth-stage issuers.⁶⁷ At the same time, smaller issuers have increasingly relied on prospectus-exempt financing channels, including private placements. Canadian exempt-market data show substantial growth in private capital raising, though much of the dollar volume is institutional, debt-related, foreign-issuer, investment-fund,

⁶⁶ J. Ari Pandes, *Testimony of J. Ari Pandes*, submission to the Senate Standing Committee on Banking, Commerce and the Economy, March 12, 2026, sencanada.ca

⁶⁷ Deacon, C. (2026, February 19). *The Big Six banks are to blame for the lifeless Toronto Stock Exchange*. online: Senate of Canada. <https://sencanada.ca/en/sencaplus/opinion/the-big-six-banks-are-to-blame-for-lifeless-tsx-senator-colin-deacon/>

or financial-vehicle activity rather than pure venture-stage operating-company equity.⁶⁸ The result is a more bifurcated capital-raising environment: FIG-owned dealers continue to provide underwriting and corporate-finance capacity for established issuers and long-standing clients, while earlier-stage and higher-risk issuers more often rely on exempt-market financing, non-bank intermediaries, smaller dealers, or issuer-direct private placements. Unfortunately, these market-oriented responses to the gaps in the marketplace can't raise the sums necessary for AI, space, and the industries of the future for the lack of depth. This is another symptom of market failure.

Secondary trading support for smaller Canadian public companies has also weakened. Traditional market making requires dealers to commit capital and hold inventory, which is riskier, more volatile, and less attractive when trading volumes are thin. As further discussed in this paper, Canadian equity trading has also become more fragmented across venues, with more dark trading and internalization, making displayed market making less profitable.⁶⁹

iii) Structured Product

Price differentiation coupled the capability to arbitrage between opaque (over-the-counter markets) and visibly transparent markets, also motivates annuity like revenue streams via structured products.

The consequences of perfect price discrimination are further amplified by providing, where possible, “near substitutes” to traditional products for investors, via structured products, which considerably reduce risks to the FIGs. This risk reduction is achieved by bundling risks into institutionally managed or “wholesale” offerings to retail. Fees are ongoing rather than transactional. Some examples include, segmented between retail and institutional, equity linked notes, with embedded fees, ETFs / funds and Canadian depository receipts with embedded foreign exchange costs; rather than the maintenance of equivalent USD accounts.

Price differentiation coupled with the capacity to arbitrage between opaque (over-the-counter markets) and visibly transparent markets, also motivates annuity like revenue streams via structured products.

The confluence of the efficient market hypothesis, index investing, and ETF packaging suits the marketability of “stay invested, at all times in the entire market”, as the harder work of actively selecting securities, timing exposures, and risk management, in particular effective bet sizing against edge, are done away with, along with the associated costs. While these products are “pitched” as low, explicit cost, costs are still borne out of the total opportunity cost or potential market returns. With almost 700 ETFs and countless other structured products in Canada repackaging 1500 senior listings, questions arise regarding combinatorial math or truly lower cost. To a certain degree, a number of these products can provide over-diversification, or negative risk reduction, at an unreasonable cost.

⁶⁸ Borden Ladner Gervais LLP, “Canada’s Exempt Market - Growing, Growing, Growing” (19 December 2022), online: <https://www.blg.com/insights/2022/12/canada's-exemption-market-growing-growing-growing>

⁶⁹ TSX Venture’s launch of an issuer-sponsored market-making program for public venture companies is good evidence that smaller issuers were not getting enough natural liquidity support from the market: <https://www.tsx.com/ebooks/en/market-making/>

With a low risk driven cost of capital self-reinforcing a lower risk appetite, FIGs will reduce and compete away their inherent risks toward the level of risk implied from their own cost of capital into the products they offer. These products may develop near perfect investment substitutes which work for them in terms of fees and generic market exposures, but it does not work for issuers, primary investors and therefore the country. This is specifically where one can visualize the extraction of economic transaction surplus from the issuers. A dealer intermediates capital between providers of capital and users of capital. If the users of capital are further disintermediated by the additional step of structured products (who own the issuers' shares), they simultaneously compete with/and serve their competition for investor capital because FIG-owned dealers own the relationships with clients. At the extreme, issuers, may lose their broad relationships with retail and other direct institutional investors.

Some of the FIGs try to address economic challenges with specialized lending programs, units or merchant banks, but unfortunately, these are sized so as not to be material to the overall economy. What is required is an increased risk appetite, by participants in the equity capital formation space, and a rejuvenation of that ecosystem.

iv) Shifting to Higher Fixed Costs

Likewise, in an effort to match predictability, the securities industry shifted to a higher fixed cost basis. This has been the main economic driver of consolidation. How has the market structure of the securities industry seen an increase in fixed costs?

- **Regulation** - Firstly, the cost of regulation and its explicit burden have increased with its scale⁷⁰ Regulatory authorities, as their own independent economic enterprises, more naturally seek fixed revenue streams which are more predictable to build and fund their own fixed cost base. Each and every decision they make, therefore, becomes tinged with this economic incentive to shift from "variable to fixed"⁷¹.
- **Market Data** - While labor costs were the primary cost driver in the industry, over time, market structure forces have driven an increase in non-labor costs such that they can now be greater than fixed labor costs, creating coincident negative consequences. Specifically, the cost of market data on the profit/loss of equity trading desks in many cases rather than being a fraction of total costs, now exceeds total compensation costs.

v) The Mismatch in the Underwriting of Risk Capital

⁷⁰ See, for example, The Good, the Bad and the Unnecessary: A Scorecard for Financial Regulations in Canada | C.D. Howe Institute | Canada Economy News | Canadian Government Policy (cdhowe.org).

⁷¹ *Ibid.*

The underwriting of risk capital is, by its nature, better suited to a variable cost versus fixed cost business model. Aside from the fact that the bulk of fees generated from underwriting are on a variable basis, the process of underwriting itself is punctuated by a series of sequence risks which make it very challenging to cover fixed cost burdens.

An underwriter must search, perhaps hundreds of companies, to evaluate the right projects/firms to be financed, bear the costs to compete for originating economic transactions versus their peers, bear the cost of due diligence, and ultimately take the risk that their timing for these endeavors matches the markets appetite for marketing a transaction when it is ready and ultimately executing on the transaction. Each of these steps, in the “merchandising of securities”, has a binary outcome. Multiplicativity of the sequence of probabilities creates a low total probability of any single issuer getting funded by public markets at one point in time relative to the total number of possible issuers in the economy.

Within FIGs, the clout of these equities businesses has been significantly reduced, as the incentive for taking on single stock risk in primary and secondary stock markets has declined.

Therefore, to manage the negative consequence of sequence risk failure at any point along the process, the underwriter of risk capital reduces their own “bet size” by compensating their staff with a lower “fixed” compensation versus variable compensation based on success. It is not uncommon for the leaders of these businesses at US peers to generate variable compensation of five to fifteen times “base salary”.

The shift in Canada to a higher relative fixed cost structure has created negative consequences that have:

- Decreased room for the variable compensation which drives the risk seeking behavior to engage in the sequence risk by competent personnel, and
- Increased the risk borne by any single transaction, such that only larger and larger players can compete in the process described above. This applies to issuer size. Small and mid-cap companies do not move the needle. The corporate finance and syndicate desks at the FIGs have relatively extremely

How has the market structure of the securities industry seen an increase in fixed costs?

high fixed cost basis and naturally sell deals they “know” can at least be partially “pre-marketed” to a select group of clients they cover and those clients’ cost basis themselves have a growing fixed cost to cover.

Over time, FIG-owned dealers naturally bundle sales of their lower cost of capital in credit, and lower foreign exchange spreads when pricing equity transactions⁷². The largest players, with the most breadth of offerings, and the largest clients, can and do diversify away some element of sequence risk or subsidize the cost of maintaining platforms. As they serve larger “upmarket” issuers, they have opportunities for a panoply of ancillary revenues – lending, debt syndication, f/x, trade finance among money.

⁷² Foreign exchange spreads are a key source of profitability in the Canadian based Interlisted trade; which constitutes 1/3-50% of Canadian equity markets on any given day.

// Not serving the formation of smaller issuers; which in the very long run becomes a self - defeating cycle. The overall system is not creating the future companies to carry Canada forward. Equity underwriting is a hard fit for modern FIGs risk / return profiles and the FIGs risk/return profile, in this important space, is a hard fit for Canada's future.

Secondary equity underwriting therefore becomes one of many products utilized to create first degree price differentiation to issuers, with consequent impacts on their consumer surplus as well. This has blurred the lines between credit and equity to the point where equities are increasingly viewed as a “product” rather than a “core business”. Within FIGs, the clout of these equities businesses has been significantly reduced, as the incentive for taking on single stock risk in primary and secondary markets has declined.

In contrast, smaller firms may succeed in managing sequence risk, but any one major miscalculation or misfortune may remove those firms entirely from the industry, consequently reducing industry capacity overall. Likewise, if smaller securities firms serve only smaller issuers, those smaller issuers cannot be cross-sold many products.

Over time, slowly, but surely, the relentless competitive forces which increase the minimum scale required to participate in the business have driven out the independent firms. The net result is that the FIGs dominance has both had the effect of competing away independents from the “cream of the business”, upmarket issuers, who can’t bundle services, while also reducing overall risk taking at the bottom tier. It is the combination of eliminating Issuer surplus at the upmarket tier and not serving the formation of smaller issuers; which in the very long run becomes a self – defeating cycle. The overall system is not creating the future companies to carry Canada forward. Equity underwriting is a hard fit for modern FIGs risk / return profiles and the FIGs risk/return profile, in this important space, is a hard fit for Canada’s future.

G. AN EXAMINATION OF MARKET INCENTIVES

Adam Smith might suggest where the "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." ⁷³In this case, there is a change in the economics of an entire industry.

Market forces, driven by natural and unnatural (subsidized) positive and negative incentives drive the economic behavior of the financial industry. Understanding the incentives, and how they could be changed, may generate new behaviors.

The incentive answer lies in three fundamental premises which have been at the heart of a revolution, which has driven over the last 40 years the greatest accumulation of shareholder wealth in human history: the objective of a corporation is to maximize shareholder value, the value of the company is determined by its ability to generate future cash flows, discounted for risk and capital markets are generally efficient mechanisms for measuring risk and allocating capital as compared to any alternatives.⁷⁴

Don Chew⁷⁵ highlights in his excellent modern economic history of how the revolution in modern corporate finance, as a practice, acted as a form of software technology which transformed and

⁷³ Smith, Adam. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Book I, Chapter X, Part II. London: W. Strahan and T. Cadell, 1776.

⁷⁴ Donald H. Chew, Jr., *The Making of Modern Corporate Finance*, (New York: Columbia Business School Publishing, 2025).

⁷⁵*Ibid.*

rejuvenated American business, capital and economic productivity to its great current heights. That is, ‘advances in the principles and methods of finance played a critical role in enhancing the productivity of the U.S. private sector’ and ‘American corporate finance has embraced shareholder as opposed to stakeholder theory to a greater extent than any other part of their world. It is not co-incidence that the market capitalization of U.S. public equity markets now dwarfs the remainder of the developed world.

These principles include three core concepts around incentives which are not unique to Canadian financial services as general concepts and which Canadian FIGs have demonstrated exceptional challenges managing:

i) Agency Costs - Stakeholder vs Shareholder Theory

The American revolution in modern corporate finance was to a large degree kickstarted with the publication of “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,” by Michael Jensen and William Meckling.⁷⁶ Prior to this paper, the field of corporate finance, generally took a rational economics approach to the managers of stockholder owned corporations and assumed that they were effectively “agents” focused on maximizing long-run shareholder value. The authors successfully pointed out the presence of additional “agency costs” including conflicts of interest and conflicts of incentives that reduce the value of all public companies. These ranged from the direct observable costs of prerequisite consumption to the opportunity costs presented by corporate managers’ higher value placed on growth, size and diversification, versus the shareholders who could exercise those options on their own, as drivers of their own compensation. Shareholders have a greater tolerance for risk than corporate managers for corporate risk taking so long as expected returns exceed the required rate of return because they can, and do, diversify themselves.

Michael Jensen further made the case that managers in mature industries tend to hoard capital and reinvest in low-return business or diversifying acquisitions rather than return it to shareholders who may seek higher returns. All else equal, managers generally prefer to hold on to cash or redeploy capital more gingerly. This management risk aversion to an extreme, and also off the back of the Great Depression and World War II, led to sub-par capital allocation in the 1950s and 1960s, as returns on incremental capital did not exceed their cost.⁷⁷ This failure to take on value-creating risks, is further exacerbated by any market failures in the market for corporate control. That is, to the extent it is difficult for shareholders to remove obstinate boards and failing executive teams, value destruction is perpetuated.

The converse is also true: a robust market for corporate control, as seen in the U.S. with a robust and continually renewing M&A, spin out, privatization and go public market, creates the accountability that misaligned management can be changed. Leveraged buyouts, leveraged recapitalizations, and other going private transactions, such as management buy-outs, created value in the U.S. by forcing out excess capital; as discretionary payments (dividends and buybacks) were replaced into larger contractual payments of interest and principal. The cost of capital to corporations became more explicit, narrowing the gap of

⁷⁶ Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.

⁷⁷ Alfred D Chandler Jr, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass: Harvard University Press, 1977) at 484–504.

agency costs as a friction on shareholder value. On an agency level, this was done by aligning executives with shareholders by either changing their compensation or removing and replacing the executives.

Corporate America, working off its excesses, reversed a 30-year decline in capital productivity, doubled manufacturing productivity and expanded research and development⁷⁸ The focus for that period was to ensure that deployed capital was expanded or contracted to value accretive levels by lowering the cost of capital, and ensuring their invested capital met the hurdle.

ii) The Costs Shareholders Care Most About: Their Cost of Capital and Strategy

On the issue of management agency point above, for illustration assume:

- Two business with the exact same operating capabilities, “A” vs. “B”.
- Firm “A” is financed with a lower cost of capital (8%) than “B” (9%) through a slightly greater use of leverage, consequent tax shield benefits, and its choice to take on less risky clients and activities, reducing its inherent risk.
- The average market risk cost of capital is 8.5%.
- The firms are evaluating two equal scale strategies expected to generate at 8.25% and 9.5% respectively.

Management of “A”, on a practical basis will tend to prefer a lower risk (at 8.25% still hurdle rate exceeding) than a higher risk strategy, even if the latter (at 9.5%) is expected to create greater value on its own merits. “A” knows it can capture the entire market between 8 and 9% rates of return before firm B begins to efficiently compete with it and deploy capital. That is, management “A” has more strategic choice than “B”. It can generate and reinforce the operating benefits of scale accordingly. Compensating itself based on this increased scale, the agency cost to shareholders is the foregone economic benefit of having taken on the higher returning strategy.

Even though in theory, firm “A” and “B” should both approach activities at 9.5% as value creating in the same manner, practical agency costs can motivate the lower risk strategic behavior. Firm “A” is also careful not to engage in incremental return profile strategies which may be perceived to increase its perceived firm risk “above the market average” of 8.5% and raising its overall cost of capital. This feedback loop occurs in a reflexive⁷⁹ mechanism—the agents of the lower than market risk corporation believe their investors continually and dynamically seek less risk than market average. Therefore, over time, they engage in activities which drive down firm risk, by shedding higher risk activities or adding new lower risk activities, continually shaping a lower perceived cost of capital through this achieved lower risk profile. This attracts even more lower risk hurdle priced capital, consequently motivating the agents to drive out even more risk and so on and so forth.

On the other hand, a high cost of capital is not “bad” or “good”, but rather simply reflects overall business risk relative to the market. Management “B” with a higher cost of capital than market average would demand entry into higher return areas in order to meet their own higher hurdle. Likewise, for “higher than market risk” businesses, reflexivity also exists. Where a higher than market average cost of capital

⁷⁸ Chew, *The Making of Modern Corporate Finance* p. 60

⁷⁹ George Soros, “Fallibility, Reflexivity, and the Human Uncertainty Principle” (13 January 2014), online: George Soros <https://www.georgesoros.com/2014/01/13/fallibility-reflexivity-and-the-human-uncertainty-principle-2/>.

exists, due to the need to take greater risks to potentially achieve those returns, those businesses embrace those risks where available. They attract investors who have allocations to riskier forms of capital. As those uncertainties “pay off”, they attract even more capital to the greater than market average risk projects, and so on and so forth.

At the extreme, recent booming markets in crypto, gaming, meme stocks and prediction markets are examples of activities which attract extremely higher “risk capital”. These exist where the providers of that capital may have a low marginal utility of incremental capital. By definition, the formation of new enterprise or embracing of new and disruptive technology is higher than the average market risk, requiring a match to higher risk appetite and cost capital. As an actual economic activity is, Silicon Valley is the greatest example of financial intermediation succeeding with a much higher cost of capital; but still tremendously accretive wealth creating results.

If the first 40 years or so of the American revolution in corporate finance, value was created by focusing on lower costs of capital and meeting those hurdles with more certainty on existing economic activity and demand utilizing the explicit governance tools of debt finance. The evolution of the last 10 years in corporate America has been to embrace, in a parallel system, a higher cost of capital and managing the risks of new economic activities to meet those hurdles using equity.

More specifically, Silicon Valley and the innovation economy prove that investors do have an appetite for greater than market risk and competing on the basis of a higher cost of capital can be achieved. Those with a higher-risk appetite will seek ways to achieve higher returns as well, so long as the activities are believed to be value creating when funded, or funding stopped when information indicates the opposite is true. In this construct, agency costs are still managed, but via equity based governance tools and controls (such as stage gating funding, the use of multiple classes of securities, and preference rights on governance and liquidation). In the Silicon Valley, venture capitalists, which set themselves a higher hurdle rate, demand exposure to opportunity sets which achieve them. Over time, those opportunity sets have expanded as they reinvest their capital at higher hurdle rates in ecosystems that generate them.

In the illustration, as business is an uncertainty, firm “B” may not succeed in actualizing their hurdle rate, as on average, those higher return opportunities will likely also be riskier, if not linear. Management group A is guaranteed not to generate these greater returns by not even trying. In Canadian hockey parlance “one always misses the shots they don’t make” – that, in a nutshell, is the economic cost to Canada of mismatching low risk capital with high-risk equity capital formation. It leaves us holding the puck rather than shooting at the net.

iii) Compensation Alignment

Chew explains that, from the beginnings of Corporate America up until the late 1950s to early 1960s, US corporate pay was guided by “fixed sharing”, or a proportion of the company’s profits went to management, and the rest went to investors. Over time America’s largest companies began to implement “competitive pay policies”, with annually recalibrated packages. These plans were divorced from aligning managers to the needs of their owners and introduced agency costs in the 1970s and 1980s. To a large degree, a core contributor to the success of US private equity in transforming the US economy, has been its focus on addressing agency costs, through appropriate accountability and incentives. Reintroducing fixed sharing, in the form of management equity ownership, is front and center of private equities.

Capital Markets business compensation practices were once almost entirely defined by fixed sharing, or a variety of “direct drive” models until their absorption into FIGs. While FIGs maintained to a large degree competitive, ‘high’ levels of compensation in those divisions, by effectively adjusting them to the compensation systems of their acquirors, namely focus on cash bonuses and incentives tied to market pay, acting as a form of semi-variable fixed compensation, the core factors that drive incentives that drive performance have been lost. Indeed, they have been counter-productive by removing “at-risk” pay which links and drives operating performance through:

- Appropriate levels of alignment between the interests of managers and their shareholders in the sense that bonus and stock compensation for any given year are typically tied to operating, and market measures of shareholder value for that year.
- Pay leverage so that a large proportion of pay is dependent on current performance and “at risk”.
- Fair wealth sharing percentage/cost, or the total cost of executive compensation, that is not outsized as compared to competitive labor markets.

H. THE APPLICATION OF MARKET INCENTIVES TO FIGs

i) The Incentive Loop of the Cost of Capital and Agency Costs

FIGs are interesting entities because by the nature of their business models present multiple aspects of incentive loops:

They are already highly levered entities and are well aware of the explicit costs of capital. Indeed, across corporate Canada, perhaps no other industry explicitly factors in its costs of capital to the same degree by business line. As levered entities, the incentives to “hoard cash” and diversify into or reinvest into “lower risk” businesses, rather than higher risk businesses, is a constant pressure. Their “core” deposit and lending business both provides continual liquidity, via depositors’ payroll and borrowers’ interest payments, and also creates liquidity crunches through short term demands.

Furthermore, as regulated entities, they are given the regulatory “cover” to do so. This regulatory cover is manifested in management performance measurement models that “balance” shareholder, employee, supplier, customer, and public interest rather than taking the approach of “enlightened value maximization” which would ensure that sufficient resources are allocated to all these stakeholder groups (including the environment) which affect the productivity and long-term value of the firm⁸⁰, while focusing on that maximization as the core goal.⁸¹ This is a subtle but important distinction to shareholders and the risk appetites of FIGs as firms. It is not a coincidence that Canadian FIGs have more wholeheartedly embraced non-shareholder driven strategies, or stakeholder “purpose driven” strategies; as their delivery further insulates them from the market for corporate control.

Finally, as regulated entities, with ownership caps, they are insulated from the market for corporate control and have a form of codified lack of accountability to shareholders relative to other industries’ corporate management.⁸²

⁸⁰ Michael C. Jensen, “Value Maximization, Stakeholder Theory, and the Corporate Objective Function,” *Journal of Applied Corporate Finance* 14, no. 3 (Fall 2001): 8–21.

⁸¹ Meeting at least the minimal requirements of all these stakeholder groups may be the only means to satisfy shareholders”, keeping in mind this includes the minimum cost of capital.

⁸² Randall Morck and Masao Nakamura, “Banks and Corporate Governance in Canada,” in *Corporate Decision-Making in Canada*, ed. Ronald J. Daniels and Randall Morck (Calgary: University of Calgary Press, 1995); *Bank Act*, SC 1991, c. 46, ss. 372–374, Justice Laws Website.

ii) Shareholder Theory and the Clientele Effect – How Shareholder Type Influences Strategy

The clientele effect states the obvious, which is that shareholders are not a homogenous uniform group. With different tax exposures and goals, they can be broadly viewed in two groups:

- **High – payout clientele** who seek steady predictable income. This can include retail investors, retirees, and institutional investors like pension funds. They gravitate toward mature companies with high dividend yields.
- **Low-payout clientele** who prefer companies that retain earnings to reinvest in growth, which drives capital gains and different tax treatment which compounds deferral for taxation. This group consists of wealthy individual investors in high tax brackets and growth-oriented funds.

Canadian FIGs naturally cater to a high-payout clientele. FIGs have a blended cost of capital, debt and equity, in the 5-7% range, not including low-cost deposits or insurance float, and payout of their cash flows in dividends. Also, various government subsidies in terms of how mortgage markets, their primary business line, operate effectively as a floor or barrier option to their cost of capital.⁸³

But the consequence of a high payout clientele, including buybacks, can mean a combined payout ratio of 50-70%. This constrains investment of fresh funds or reinvestment of cash flows into higher risk capital markets activities in Canada. At their scale, low cost of capital and high payout ratio targeted to dividend hungry investors, provide extremely limited appetite to engage in activities with a great idiosyncratic risk. Volatility of returns is generally not something FIGs want to introduce to their businesses to the extent high payout rates are at risk.

While FIGs will pool some higher risk capital markets activities into diversifiable flow businesses (f/x, fixed income market making, OTC derivatives) and execute capital markets services which tie to their structured product asset and wealth sales, they have less incentive for the non-systemic undiversifiable high risk, high reward singular “merchandising” activities, such as underwriting equities. Single stock risk, which requires greater investments, incentives and potentially higher relative payoffs, are much lumpier for the appetite of the pensioner.

The combination of these factors, including the leveraging of various cross-subsidies of scale, have developed FIGs which are focused on high payout ratios, particularly when factoring in share buybacks.

Put simply, the risk of underwriting small and mid-cap companies does not suit FIGs’ shareholder/clientele profile.

⁸³ Peter P. Mora, “The ‘Too Big to Fail’ Subsidy in Canada: Some Estimates,” *Bank of Canada Staff Working Paper* no. 2018-9 (Ottawa: Bank of Canada, 2018), https://publications.gc.ca/collections/collection_2018/banque-bank-canada/FB3-5-2018-9-eng.pdf; Allan Crawford, Césaire Meh, and Jie Zhou, “The Residential Mortgage Market in Canada: A Primer,” *Bank of Canada Financial System Review* (December 2013), <https://www.bankofcanada.ca/wp-content/uploads/2013/12/fsr-december13-crawford.pdf>

iii) Performance Management: What Doesn't Get Measured Doesn't Get Managed

In the case of alignment, the efforts and value created in a high sequence risk activity are lost in the totality of the profitability of a FIG. The risks that would need to be taken to drive outsized performance would be lost in the noise. That is, FIGs overall profitability has almost no bearing on divisional equity activity. FIGs compensation plans are not levered to the revenue of the deals in the division. FIG capital markets compensation plans have very little leverage, with a downside of perhaps 30% and upside of 50% -any lower, and personnel are targeted for reduction. Outsized gains are tied to increases in scope and scale of responsibility rather than performance. Finally, wealth leverage is also lost. While the total cost to the organization is managed, this is done by managing a compensation “pyramid” with competitive pay bands, such that no level is too out of line from the others, and effectively total cost is reduced. But this reduction of total cost, reduces the wealth sharing and fairness to executives outside perhaps the top-named officers.

Arguably, in comparison to the “perfect pay plan” promoted by American corporate finance leaders,⁸⁴ Canadian equity compensation plans fail on every measure. Put simply, executives, in particular those managing equity securities businesses, are no longer paid to think and act like “owners” of businesses which merchandise single stock underwriting risk.⁸⁵ While parent FIGs may not want all their executives to think like owners, as large parts of their capital base comes from non -shareholders such as customer deposits and policy holder premiums, by divorcing the ownership mentality from equity markets, the incentive to take on ‘merchandising risk’ for those also trying to manage their corporate careers has been broken.

Executive compensation itself is tied to scale. For an industry so closely tied to the US, it is too tempting to scale via US markets to drive executive compensation upwards. This suits our largest issuers who are interlisted and the largest of our FIG-owned dealers, who may over time find it perfectly suitable to have one trading desk out of New York or Chicago rather than Toronto or Montreal, but does nothing for Canada’s junior and venture-oriented issuers.

In addition, the benefit of convenience to internal human resources compensation practices of harmonizing high inherent risk business with those of the lower risk tolerant parent banks, is overwhelmed by the opportunity cost of poor, sub-par performance.

Over time, “investments” in the talent such as bonus pools, employee development, marketing costs, support of research divisions, and management attention naturally shifts to where there is a fit. Most importantly, top talent seeks opportunity elsewhere within these FIGs, aside from underwriting equities. The incentive, or pressure, is one where a self-reinforcing reflexive feedback loop exists where talent is attracted to the requisite lower risk profile, which attracts lower risk talent and so on and so forth.

⁸⁴ Michael C. Jensen, Kevin J. Murphy, and Eric G. Wruck, *Remuneration: Where We've Been, How We Got to Here, What Are the Problems, and How to Fix Them*, ECGI Finance Working Paper No. 44/2004 and Harvard NOM Research Paper No. 04-28 (Brussels: European Corporate Governance Institute, July 2004). <https://doi.org/10.2139/ssrn.561305>.

⁸⁵ Gregory Milano, “Prepare for This Pay-for-Performance Measure,” *CFO*, 2018, accessed August 5, 2026, <https://fortuna-advisors.com/wp-content/uploads/2018/12/Prepare-for-This-Pay-for-Performance-Measure-CFO-3.pdf>. Milano explains in less academic but no less hard-hitting terms the contrast between at risk pay that drivers ownership behavior, and those with high agency costs.

// Incentives must drive solutions. While incentives have driven economic behavior with potential negative externalities, they can also be introduced or adjusted to begin to remove them. Solving for the rejuvenation of higher risk business activities such as the underwriting of equity capital formation requires new incentives aligned with their risks.

iv) Collective Impact of Incentives

Coupling the powerful incentive forces of agency costs on developing strategy, exacerbated by a lack of pressure for corporate control, high payout clientele effects, misaligned compensation plans, and a drive to scale via North American markets has created extremely low risk, and payout variation tolerance at FIGs, and environments reinforcing this appetite. The “invisible hand” driven by these incentives for the economic capital and requisite business decision making support and strategy to be allocated to higher risk businesses, such as equities’ underwriting, within the internal corporate market for capital face misaligned strategy, shareholders, talent and regulatory environment. Higher risk businesses, and equity capital markets formation, do not meet FIGs’ needs.

In the words of a past mentor, “there is no such thing as a ‘mature’ business, but rather ‘mature’ management”. That is “maturity” being the point at which a businesses’ strategic portfolio places itself in the low growth/low risk bucket, with equity markets capital formation being some of the first higher risk businesses “to go”.

I. THE INCENTIVE-BASED SOLUTIONS

FIGs immense scale and scope coupled with their low-risk cost of capital crowds out risk capital formation in equity capital markets. Coupling the agency problem, incentive misalignments and the clientele effect with a lack of pressure from the market for corporate control, the status quo is continually reinforced.

Therefore, change requires an exogenous force to be introduced into this market structure; specifically targeting the incentive issue to correct risk taking in Canadian equity formation. In particular, the development, scaling and maturation of new and growth enterprises in private and eventually public equity markets requires new equity markets leadership to embrace greater quantum of risk specific to this field. This needs to be addressed by creating more capacity and capability. Solving the issue of equity markets formation and allocating capital better at a national level, while not easy, does have a clear path, creating the incentives which match shareholder needs (capital costs), talent (compensation alignment), strategy (growth vs. high payout) and the regulatory environment.

Solutions to expanding equity capital formation must recognize the economic consequences of agency costs, the impact of misaligned cost of capital on corporate strategy, and the emphasis that a robust market for corporate control places on corporate governance and management to maximize its productivity. A recognition of clientele effects which is funded by low-payout investors will be necessary.

i) A Review of Legislative and Regulatory Solutions – Non-Market-Based, Negative Incentives

The following legislative and regulatory solutions would increase the overall cost basis by deliberate intention, with the expectation that FIGs would maintain ownership of securities dealers, to their continued financial benefit.

At a governmental level:

1. The reintroduction of “Glass-Steagall” type actual separation of pillars to a “virtual” separation of pillars.⁸⁶
2. The use of tax code to reduce the ability of FIGs to cross-subsidize other fixed cost burdens and risk transference⁸⁷
3. The creation of new government incentives which require equity capital market businesses to be reinvested at certain levels, rather than maintain high payout rates. This may be a tax on money removed from underwriting activities. Conversely this may be a subsidy on money deployed to these activities. Subsidies in follow-on markets such as housing can be also dependent on risks taken in the primary equity market.

At a regulatory level:

4. The imposition of a moratorium on FIG acquisition of ‘smaller participants.’
5. The elimination of structural risks to regulatory arbitrage so that similar activities face similar regulation regardless of where they sit within FIGs and products are not selected to be sold on ‘less regulated’ sides.

In particular, at a regulatory level, this would also include the elimination of any preferential regulations, exceptions or exemptions that have been introduced over the years to reduce the cost-burden of FIGs to manage the total and variable cost of ownership of a securities dealer which cannot be equally benefited by independent dealers. Individually, every exemption or “synergy” generated by FIGs in regulation appears de minimis, but collectively they add up to a material, consistent margin advantage. This includes the cross-subsidization of operational and compliance costs, cost sharing of key executives and regulated persons across divisions and legal entities, so that dealer staff are working on broader FIG activities, and ease of senior management exemptions from otherwise mandatory courses. To participate in the securities dealer space, FIGs in a virtual separation are required to embrace the notion that the whole of their markets-facing organization is regulated by securities regulators and synergies be entirely relegated to the funding side of the balance sheet.

Over the last decade, almost every market structure change, or proposed change, from quote sizes, dark rules, complexity of order types, marketplace access (pricing, normal course issuer bids, at-the-market offerings, securities lending links), and carveouts for OTC trading (issuance standards, accounting regulation) has been driven towards the orientation of making Canada’s marketplace appear more American or to harmonize with American interests. These regulatory changes have helped make Canadian capital markets more interoperable with the U.S. market, while other features of the Canadian system

⁸⁶ Ingo Walter, “The New Case for Functional Separation in Wholesale Financial Services” (NYU Stern School of Business, 30 July 2009), PDF. https://www.stern.nyu.edu/sites/default/files/assets/documents/con_039542.pdf; Nova Scotia Senator Colin Deacon proposed a “de-consolidation” of the Canadian financial sector — a return to the days of the “four pillars” before banks were allowed to acquire large investment dealers, insurers, and trust companies. “Bring back the four pillars,” *Advisor.ca* (reporting on comments by Senator Colin Deacon), 1 May 2026, *Advisor.ca*

⁸⁷ For example, Department of Finance Canada, “Excessive interest and financing expenses limitation (EIFEL) regime” (2022), and related explanatory materials showing the fixed-ratio rule, group ratio election, and limitations for certain financial institutions. <https://fin.canada.ca/drlég-apl/2022/ita-lir-1122-n-1-eng.pdf>

such as small domestic pools of growth capital, weak IPO markets, valuation discounts, proximity to U.S. buyers, and relatively permissive foreign-investment thresholds—can make Canadian firms natural acquisition targets.⁸⁸

US market structure is driven by the needs of super liquid corporations (AAPL, Nvidia etc.), which trade at high prices, but may have average spreads at a sub-penny or so close to zero, such that market maker liquidity isn't likely even necessary in normal trading circumstances. The US challenge for these names is managing information flows smoothly, or the capacity for trade demand, rather than the opportunity cost of trade not happening.

The needs of a small thinly traded venture issuer are less about convenience rather than getting a fair price. Rules such as trade through, continuous trading, de minimis quotes sizes and fractional shares, make it uneconomic to allow secondary trading desks to contribute to the economic process of size discovery/price of corporate control for such issuers in co-operation with primary investment bankers and syndicate desks. Indeed, an alarming indicator co-incident with the reduced number of IPOs is the sheer number of private equity sales of Canadian corporate interests to the United States as an exit as opposed to public Canadian markets.⁸⁹

A recognition that the regulatory environment needs to also serve Canada's scale and not always align itself to that of the U.S., or globally, is necessary. An overt alignment with US practices harms primary Canadian formation of capital, and public equities, as the focus of the US public securities' market has been to promote the price of convenience over the price of corporate control. There are virtually no new public equities created in the United States at the scale of Canadian SMEs, called micro-cap – this is not the regulatory environment Canada should want.

A recognition that the regulatory environment needs to also serve Canada's scale and not always align itself to that of the U.S., or globally, is necessary.

Over time to recoup additional cost, FIGs would either reduce or constrain the size of their securities dealers in the capital markets space, leaving more room for independent participants to gain market share, or be forced to increase participation by going “down-market” to the middle and smaller markets, raising their risk profile. On a total notional dollar basis, these increased costs would be a rounding error contrasting with their holdco costs. In the meantime, a more level playing field, and more vibrant ecosystem.

As the aforementioned can be characterized as negative incentives; to be clear, these should not be the preferred, as they are not market-based. We prefer that the industry seek positive incentives via market-based solutions.

⁸⁸ Torys LLP, “U.S. Cross-Border M&A: Key Trends and Considerations,” *Torys Quarterly*, 2026, <https://www.torys.com/our-latest-thinking/torys-quarterly/q3-2026/us-cross-border-ma>

⁸⁹ Chambers and Partners, “Canada: Private Equity 2025 - Trends and Developments,” *Chambers Global Practice Guides*, September 11, 2025, [practiceguides.chambers.com](https://www.practiceguides.chambers.com)

J. PREFERRED MARKET BASED SOLUTIONS – POSITIVE INCENTIVES

Market-based solutions should primarily focus on addressing more underwriting of risks, by encouraging private forces to coalesce through positive incentives. These positive incentives would recognize that participants should only engage in an economic activity where they believe they have an “edge” or alpha and appreciate there is no such thing as mature business, but rather mature management. This mindset should be coupled with incentives which:

- Necessitate a higher cost of capital (or hurdle rate) and therefore motivate risk taking as a necessary tool by removing capital associated with equity underwriting activities from entities not seeking this type of return and putting it in the hands of those who do;
- Match with a high payout clientele or shareholders, who would also demand such a return;
- Tie management compensation to underwriting activity in capital markets business;
- Promote and invest in a regulatory focus which also drives Canada’s domestic needs.

This can be done by the creation of at least one national champion in the capital markets space in a very targeted, deliberate, time -limited manner, with the least intrusiveness to FIGs objectives. It is an opportunity to intervene for a one-time buyout of low-cost of capital shareholders and support the

Market-based solutions should also focus on addressing more underwriting of risks, by encouraging private forces to coalesce through positive incentives.

changing payout structure of a subset of Canadian FIGs by those who have the scale to finance such changes in corporate control. This includes, but is not limited to, the private equity divisions, with higher cost of capital, of government sponsored pension funds and other alternative, private institutional capital.⁹⁰ The result is a partial “private equity” like transformation of FIGs’ strategic orientation toward growth in capital markets and away from managing these businesses critiqued as “cash cows with high payouts”. This would proceed in the following steps:

- a. One or more FIGs would carve out the equity capital markets and investment banking activities of the business. The profit dilutions should be immaterial to their financial statements, but material to the activities in Canada’s economy.
- b. These entities, if smaller could be merged into each other, or if larger, set up independently, with the former parent FIGs holding between 20% to under 50% of equity in order to continue to record profit from the activity, while avoiding full consolidation of the entity’s balance sheet, risks and independent dividend policy (NewCo). The goal is to maintain some critical linkage between securities manufacturing and distribution⁹¹, without fully absorbing the entity into the FIGs.

⁹⁰ This may require a time gated relaxation of ownership limitations and controls *Bank Act*, S.C. 1991, c. 46, s. 2.2, ss. 373-374. - <https://laws-lois.justice.gc.ca/eng/acts/b-1.01/page-103>;

⁹¹ The distribution of securities (sales) through retail as well as wholesale channels is a critical linkage in the industry, which this plan recognizes. Continued material investment in these new champions by FIGs would ensure the incentive to continue to distribute manufactured product where suitable to their investor needs.

- c. The remaining portion would be funded via a private equity investment for a period of time. This would be to orient them to growth by supporting stock ownership while operational and strategic changes are made. This would likely include changes to:
 - i) Dividend (and planned buyback) payout ratios / reinvestment plans through dramatic reduction to steer cash flows to investments in attracting and retaining high-quality personnel and technologies.
 - ii) Portfolio composition.
 - iii) Funding composition to higher hurdle and equity-based capital stack.
 - iv) Compensation plans with better alignment, wealth leverage and cost, to prudently orient necessary risk tools.
- d. Once such a sequence is complete, private equity investors would resell some or all of that holding in NewCo using a structure that appeals to growth-oriented shareholders and long-term institutional investors who do not pressure the company for cash payouts, allowing it to reinvest earnings and grow. This is intended to generate considerable profitability and create new 'national champions', poised for growth. A balance of up to 25% of shares would be floated in the public markets for retail investors. This public listing would establish an ongoing market price for the company's shares, which would then be used for proper equity-based incentive compensation (rather than the currently prevalent equity linked but highly cash taxed synthetic units).

This would create one or more shareholder focused capital markets organizations and then allow natural incentives to play out. These organizations would retain ties to parent FIGs and materiality through equity accounting, synergies in areas such as treasury functions, F/X, larger credit-based transactions, have growth-oriented shareholders, a public print and a better incentive alignment for executive staff. The benefits in improved corporate performance of these capital markets focused entities, tied to better incentives, would outweigh the negative value impact of a higher cost of capital and lessen leverage on their balance sheet as well as some operating dis-synergies. In such a scenario, one might see a national champion, taking on all comers, addressing any foreign introduced competition, with a Canadian headquartered equity market focused organization⁹², with global funding, multiple international listings from a global shareholder base, multiple currency debt avails, global cost of capital benefits and a payout policy focused on reinvestment and growth rather than dividends and buybacks.

The FIGs would enhance their operational effectiveness and still have traditional supermarket-like portfolios, with an even lower risk net portfolio, with partially spun-out equity capital markets subsidiaries at scale seeking more risk/return, consolidated as an investment only. They would be able to consolidate a growing share of income, and to use that income for their higher payout clientele equity holders, manufacturing product for their large wealth management arms at a greater rate.⁹³

Put another way, the 'bet' is that what a FIG might lose in equity dilution of this business division (which is increasingly smaller and less relevant to them), they would gain in an increase over time in greater manufacturing capacity and capability and business levels from a higher functioning division with a

⁹² Private, public, primary distribution, secondary trading; and advisory.

⁹³ Equity market formation activities including secondary equities trading, equities securities lending, margin lending, equity clearing, equity capital markets, and investment banking (excluding debt markets and equity derivatives specifically), and research combined, are immaterial to the overall profit/loss of FIGs. Therefore, a spinoff would not impact their near-term dividend levels.

measure of independence. Canada needs this greater capacity and capability specifically in equity capital formation.

The FIGs would enhance their operational effectiveness and still have traditional supermarket-like portfolios, with an even lower risk net portfolio, with partially spun-out equity capital markets subsidiaries at scale seeking more risk/return, consolidated as an investment only.

CONCLUSION

Managing for the stability of the deposit banking system is incongruent with managing for the risk taking necessary in single stock risk underwriting. Change will not come from within as the forces maintaining the status quo are reinforcing, from agency costs to the immunity from the market for corporate control, and from performance measurement to incentive compensation.

Change can only come first with a recognition of a need for change. Continued travel along the road Canada is on will only lead us farther and farther from a more desirable destination – home-grown capital formation, funding home-grown productivity gains, for the benefit of domestic investors.



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