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BUILDING ALBERTA'S FINANCIAL SECTOR

Jack Mintz, L. Daniel Wilson and Bryce Tingle, QC*

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ALBERTA FUTURES PROJECT PRE-PUBLICATION SERIES

Alberta has a long history of facing serious challenges to its economy, including shocks in the form of resource price instability, market access constraints, and federal energy policies. However, the recent and current challenges seem more threatening. It seems that this time is truly different.

The collapse of oil and gas prices in 2014 combined with the rapid growth of U.S. oil production, difficulties in obtaining approval for infrastructure to reach new markets and uncertainty regarding the impacts of climate change policies world-wide have proven to be strong headwinds for the province's key energy sector. Together, the negative effects on employment, incomes and provincial government revenues have been substantial. To make matters worse, in early 2020 the Covid-19 pandemic struck a major blow to the lives and health of segments of the population and to livelihoods in many sectors. The result has been further employment and income losses, more reductions in government revenues and huge increases in government expenditures and debt. These events, combined with lagging productivity, rapid technological shifts, significant climate policy impacts and demographic trends, call for great wisdom, innovation, collective action and leadership to put the province on the path of sustainable prosperity.

It is in this context that we commissioned a series of papers from a wide range of authors to discuss Alberta's economic future, its fiscal future and the future of health care. The plan is that these papers will ultimately be chapters in three e-books published by the School of Public Policy. However, in the interest of timeliness and encouraging discussion, we are releasing selected chapters as pre-publications.

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After the 2020 pandemic-induced recession, Alberta has turned its attention to its economic recovery agenda (Alberta 2020). Part of this agenda is a focus on sectoral strategies, including building a stronger financial sector. Pursuing broad-scale economic diversification to minimize the province's historical dependency on resource extraction is viewed by many as a critical economic issue facing Alberta. Development of a larger financial sector is a specific priority because of its relatively good labour compensation levels and the ability to draw businesses to co-locate near deep capital pools.

It is not obvious that a larger financial sector translates into higher economic growth (Prochnia and Wasiak, 2017). The "supply leading view" suggests that the growth of financial services helps grow the economy as borrowers and lenders are matched at lower transaction, risk and information costs. The alternative is the "demand-driven view" whereby the financial sector itself is not a determinant of economic growth, but a result of economic demands for advanced financial services.

Many of the world's major financial sector hubs have developed within populous cities, with long histories as prosperous trading ports servicing large inland geographic areas such as New York City, London, Tokyo, Shanghai, Sydney and Toronto. However, other significant financial-sector hubs have developed around the world in locations that did not have the geographic advantage of being located in areas with large population bases and pre-existing deep pools of wealth. Singapore, Switzerland, Luxembourg, Hong Kong and Delaware are all examples of such jurisdictions. This second group of financial sector hubs have succeeded in developing significant local financial-sector industries through effective regulatory and tax policy, inducing market actors to set up shop based on the comparative advantages for financial sector operations in those particular jurisdictions.

This paper focuses on two key issues. The first is to examine those supply-driven factors that enable financial markets to expand, as seen in various jurisdictions. In this section, we compare Alberta's financial sector depth to other provinces. We also look at OECD and non-OECD countries with the largest financial and insurance sectors as a share of GDP. We observe that jurisdictions with larger financial and insurance sectors have favourable conditions, including a strong rule of law, low political risk, low withholding and corporate income taxes, and financial soundness resulting from regulation. The second is to discuss how those factors could apply to Alberta and the policy choices that would result in a growing financial sector. We provide several ideas that could be considered to enhance and deepen the financial sector in Alberta, specifically focusing on ways to provide earlier-stage access for entrepreneurial companies to access larger, and more diverse, pools of capital through various mechanisms including the development of an Alberta "captive" stock exchange for junior issuers.

I. LESSONS FROM ABROAD FOR FINANCIAL SECTOR SIGNIFICANCE

To start, it is useful to understand how important the financial sector is in Alberta, and how that compares to other provinces in Canada. The financial sector includes banks, credit unions, brokerages and investment banks, trust and mortgage companies,

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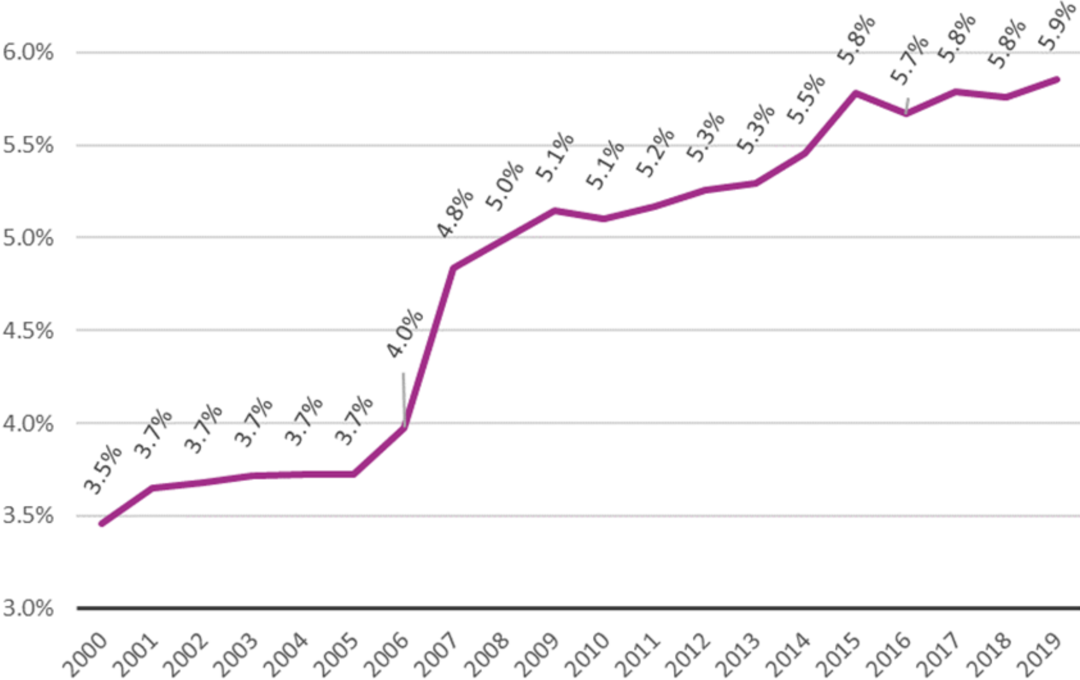
insurance, leasing and investment funds. To measure the size of the financial sector, we use value-added analysis of the finance, insurance and leasing sectors as a proportion of provincial GDP.[1]

As shown in Figure 1, Alberta's financial sector has grown substantially as share of its GDP from 3.5 per cent in 2000 to 5.9 per cent in 2014. Not shown, Alberta's share of Canada's financial sector value-added also increased from 9.1 per cent of GDP in 2000 to 12.1 per cent by 2019 (it peaked in 2014 at 13.7 per cent). Given the ebbs and flows largely reflect the economic boom in the resource markets, one could argue that Alberta's financial sector growth has been largely driven by demand factors.

Figure 1: Finance, Insurance and Leasing Value-Added as a Share of Alberta's GDP



Source: Statistics Canada, Table 36-10-0402-01.

While the financial sector has grown in importance in the past two decades, it accounts for a smaller share of Alberta's economy compared to Ontario. As shown in Figure 2, Alberta's financial sector accounts for 12.1 per cent of Canada's financial sector in 2019 while Alberta's share of Canada's GDP is 17.0 per cent. In contrast, Ontario's share of Canada's financial sector is 51.6 per cent while its share of Canada's GDP is 37.9 per cent. None of this is surprising – financial services in Canada have largely concentrated in the Toronto region. Quebec accounts for the second highest share of Canada's financial sector (17.1 per cent), although this is less than its share of Canada's GDP (19.1 per cent). British Columbia follows Alberta with a financial sector share of 10.8 per cent, also below its share of GDP (12.8 per cent).

[1] The real estate sector is excluded including real estate investment trusts since it reflects value-added related to residential and commercial real estate. This sector is not part of "finance".

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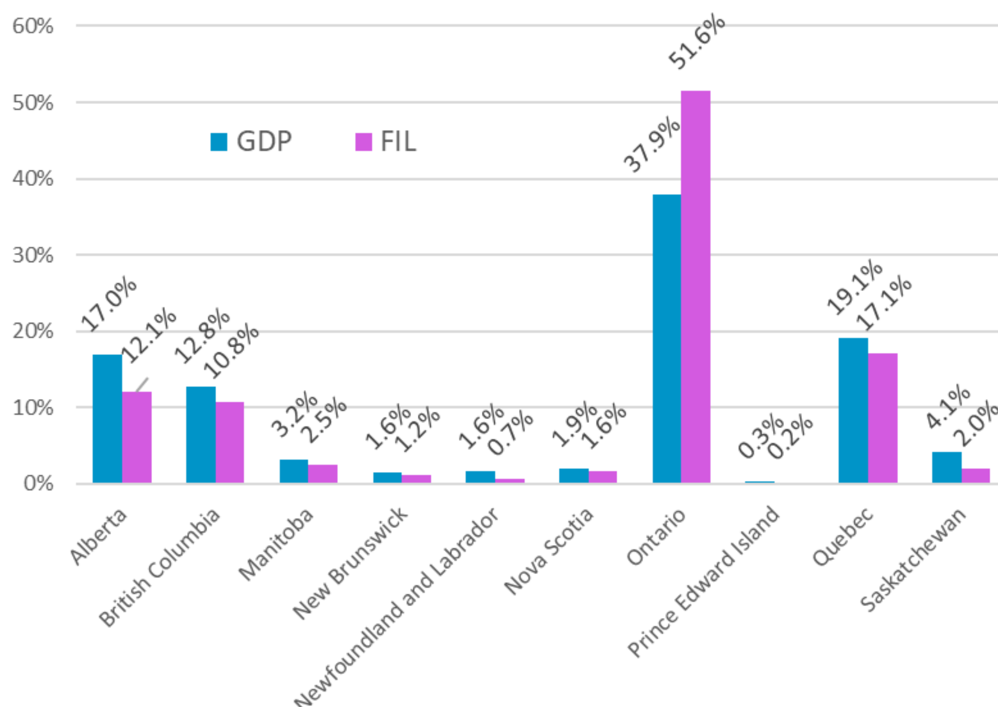
Figure 2: Provincial Shares of Canada's Financial Sector and GDP 2019



Source: Statistics Canada, Table 36-10-0402-01.

So, if the financial sector were to be a driver of growth rather than driven by growth, what would be required to do so? The World Bank considers four major factors influencing financial sector development: access, depth, efficiency and stability. In ranking 114 global financial centres, key factors include the business environment (political stability, tax and cost competitiveness, macroeconomic environment and regulatory environment), human capital (education and skills), communication and transportation infrastructure, financial sector development (depth and breadth of industrial sectors, liquidity and availability of credit) and reputation.[2]

In Tables 1a and 1b below, we provide the top ten OECD and top 10 non-OECD countries, ranked according to importance of their finance and insurance sectors.[3] To provide some analysis, we look at several factors related to the strength of the financial sector: rule of law (corruption), efficiency (non-interest expenses as a share of gross income), financial stability (capital adequacy) and tax variables (corporate income tax and withholding tax rates). Some OECD jurisdictions have quite large financial sectors relative to the size of their economy – Luxembourg having the largest financial sector given its size, followed by Australia and the United States. Among non-OECD countries, jurisdictions with quite sizable financial sectors include Caribbean countries, Cyprus, Mauritius, Hong Kong and Singapore.

2 A *Global Financial Centres* survey solicits about 11,000 responses since 2007 (City of London, Z/Yen and the China Development Institute, 2021). Calgary is included in the ratings – it scores at 593, well below Vancouver (719), Montreal (696) and Toronto (695), losing 56 points since the previous year. This undoubtedly reflects the state of Alberta's economy.

3 Note that leasing is not included here. The United Nations data provide an alternative measure of output as a share of GDP that provides somewhat different rankings.

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We note that several important factors influence the size of the financial sector. The first is rule of law (which is relatively strong in the OECD compared to non-OECD countries, except Hong Kong which is similar to OECD countries at least until recently). The Belgian, Hong Kong, Singapore and Mauritius financial sectors seem to operate efficiently with respect to cost, with non-operating expenses at less than one half of gross income (differences among other countries is slight). Capital adequacy is especially strong in Ireland, a turn of events since the 2008 financial crisis when several Irish banks faced bankruptcy. Almost all jurisdictions except Lesotho have no withholding taxes on portfolio interest (especially with treaty partners). Some countries attract financial companies with low corporate income tax rates (Ireland, Switzerland and most non-OECD countries). The financial centre ratings are particularly strong for the Singapore, Switzerland, United States (New York City), Luxembourg and Hong Kong[4] (all above 700), reflecting a wide number of factors described above including the availability of skilled workers, good infrastructure and reputation.

Canada has been recognized as offering a strong regulatory system that enabled it to avoid financial instability during the 2008 financial crisis (Lynch, 2010). This included strong capital adequacy requirements, an integrated approach to regulating banking, finance and insurance companies through the Office of Superintendent of Financial Institutions, and rules that limited risky mortgage lending. On the other hand, Canada has a relatively highly concentrated financial sector – the top three banks account for 58 per cent of assets, slightly lower than OECD average.[5] Foreign-controlled banks enter the Canadian financial services market, but are either limited in size or scope (wholesale only rather than retail). With economies of scale, large banks can reduce financial intermediary costs, although a lack of competition can result in higher loan rates or lower deposit rates to captured markets. As for taxation, Canada exempts non-arm's length interest from withholding tax, as well as interest paid to related non-residents. Its federal-provincial corporate income tax rate – on average 26.2 per cent – tends to be on the higher side compared to other significant centres.

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4 Recent political stress in Hong Kong could impact on its ratings in the future.

5 The United States, Japan, Luxembourg and Poland have the least concentrated banking sectors with top three accounting roughly 40 per cent of assets. The most concentrated banking sectors are in Israel, Estonia, Finland and Norway with a concentration ratio equal to 100 per cent or somewhat less. See World Bank data base.

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Table 1a: Top OECD Countries with largest financial sectors (value-added basis)[6]

	Financial Sector Share of GDP (1)	Rule of Law (2019) (2)	Financial Efficiency (3)	Financial Stability (4)	Corporate Income Tax Rate (5)	Withholding Tax Rate on Interest (6)	Financial Centre Rating (7)
Luxembourg	22.7%	80	78.4%	22.8%	24.9%	0%	712
Australia	9.3%	77	74.3%	15.7%	30%	0/10%	711 (Sydney)
United States	7.6%	67	61.2%	16.2%	25.7%	0/30%	764 (NYC)
Switzerland	7.6%	85	68.4%	19.3%	18%	0/35%	720 (Zurich)
Ireland	5.8%	72	75.1%	25.2%	12.5%	0/20/33%	650 (Dublin)
Chile	5.1%	67	46.8%	12.8%	27%	4/35%	597 (Santiago)
Belgium	5.0%	76	39.4%	18.8%	25.5%	0/15/30%	676 (Brussels)
Israel	4.9%	60	66.4%	14.6%	23%	0/23%	666 (Tel Aviv)
Netherlands	4.7%	82	73.8%	22.8%	21.7%	0%	695 (Amsterdam)
Denmark	4.7%	88	64.8%	22.5%	22%	0/22%	680 (Copenhagen)

Note: New Zealand (6.2% share) would be ranked 5th, but is excluded due to missing data in certain other categories. Canada's financial sector value-added share is 2.9 per cent and therefore not ranked in top 10.

Table 1b: Top Non-OECD Countries with largest financial sectors (value-added basis)

	Financial Sector Share of GDP (1)	Rule of Law (2019 Corruption Score) (2)	Financial Efficiency (3)	Financial Stability (4)	Corporate Income Tax Rate (5)	Withholding Tax Rate on Interest (6)	Financial Centre Rating (7)
Cayman Islands	33.8%	--	--	--	0%	0%	592
British Virgin Islands	21.5%	--	--	--	0%	0%	614
Hong Kong	18.1%	77	46.8%	20.3%	16.5%	0%	741
Bermuda	15.9%	--	--	--	0%	0%	580
Curaçao	14.9%	--	--	--	22%	0%	--
Singapore	12.9%	85	44.3%	17.0%	17%	15%	740
Mauritius	11.7%	53	40.9%	20.5%	15%	0/15%	573
Cyprus	10.1%	57	68.5%	19.8%	12.5%	0%	561
Lesotho	9.1%	41	58.5%	19.4%	20%	15/25%	--
Bahamas	9.0%	63	--	--	0%	0%	591

Sources:
(1) United Nations – finance and insurance sectors measured by gross output as a share of GDP
(2) Corruption Perception Index: https://www.transparency.org/en/cpi/2020/index/usa. Higher values indicate less corruption.
(3) IMF, Non-interest expense to income, 2019, https://data.imf.org/regular.aspx?key=61404589.
(4) IMF, Regulatory Capital to Risk-Weighted Assets 2019.
(5) Bazel and Mintz, University of Calgary
(6) EY
(7) Global Financial Centres Index, March 2021.

6 New Zealand (6.2% share) would be ranked 5th, but is excluded due to missing data in certain other categories. Canada's financial sector value-added as a share of GDP is 2.9 per cent and therefore not ranked in top 10.

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For the financial sector to take off in Alberta, a large number of factors would need to come into play. Given that Alberta collects its own corporate income tax, it could use tax as a lever to attract mobile financial service companies. To this end, Alberta's corporate income tax rate, now at 8 per cent (for a combined federal-provincial rate of 23 per cent), is the lowest in Canada and likely soon to be the lowest in North America if the US raises its corporate income tax rate in the near future. However, even if there was no Alberta corporate tax, the federal tax would apply at 15 per cent. Withholding tax is determined by the federal government, and therefore reflects a policy that cannot be controlled by the Province. Alberta could also make itself more attractive for financial companies by having a regulatory structure that is of a higher standard and greater efficiency than elsewhere – which is the primary focus of the next section.

II. AREAS OF FINANCIAL SECTOR REGULATORY REFORM AND INNOVATION

Financial regulation involves three objectives: (i) efficiency, (ii) financial stability and (iii) investor protection. Efficient regulation supports competitive financial markets that enable borrowers to have the lowest possible capital cost and for lenders to have the highest possible returns on their investment (commensurate with risk). Financial intermediaries reduce risk costs through the diversification of their portfolio of assets widely held by investors. They also enable borrowers and lenders to be matched at the lowest transaction and information costs. Therefore, innovation in financial markets can also achieve efficiency by reducing the cost of financial intermediation. Regulation also supports financial stability (avoiding financial stress when investors lose confidence in financial institutions) and investor protection (ensuring investors are protected from fraud and lack of disclosure etc.). The trick to financial regulation to make sure that, over time, efficiency considerations are appropriately traded off with financial stability and investor protection objectives.

Given capital is highly mobile, it is sensitive to regulatory efficiency considerations. The stress on regulatory efficiency is especially related to the availability of alternative sources of finance for markets that are less well served due to excessive financial intermediary costs. A broader capital market can result in lower risk costs, as investors have a larger pool of investments and companies can have a wider investor base to share risks. Informational costs are especially important in financial markets, so the availability of institutions going beyond bank lending is critical to financial development in Alberta. Thus, efficiency considerations to correct for underlying market failures are particularly important in certain segments of capital markets.

Moreover, with respect to competition from American states that have evidenced a recent willingness to adopt aggressive pro-efficiency regulations, Alberta enjoys broader constitutional authority as a sub-national jurisdiction with exclusive jurisdiction in the key areas of property and commercial law, as well as the administration of justice. This constitutional authority opens up a plethora of regulatory tools in Alberta's toolkit that are not available at the state level in the U.S.

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Admittedly, not all of the proposed reforms below will be popular with entrenched financial market interests across Canada, particularly at a time when many voices elsewhere in Canada are taking business development for granted and urging additional expensive regulation. However, we believe that Alberta currently enjoys an important advantage in this regard. While the economy of the other populous Canadian provinces thrived in recent years up until COVID, the Albertan economy has comparatively stagnated since 2014. As a result, Albertans are keen to see economic growth prioritized in public policy initiatives, providing a useful context and momentum for innovative and efficient regulatory reform.

In this section, we identify a number of the most promising initiatives for regulatory reform and innovation, briefly outlining ideas with the greatest potential to create a competitive advantage for the Alberta financial sector. One principal focus is on initiatives to improve entrepreneurial and growth-stage capital markets, particularly with reforms to corporate law and securities regulation. We then turn to other potential areas of reform that would enable Alberta to create dynamic markets in open banking, fintech and insurance and reinsurance.

A Made-in-Alberta Precedent for Innovative Financial Market Policy Initiatives

The idea of being an innovator in utilizing regulatory policy to stimulate financial markets is not new in Alberta. In fact, Alberta led the world in developing and refining publicly-traded blind capital pools in the late 1980's. The capital pool program originated as a joint regulatory initiative of the Alberta Securities Commission (the "ASC") and the Alberta Stock Exchange (the "ASE") in 1986. Although the capital pool initiative was widely criticized by many out-of-province industry observers at the time as being too radical, this innovative financing structure has become a staple of capital markets throughout Canada and beyond. More than 2600 capital pool companies have been created to date in Canada. Companies that originated as capital pools in Canada have raised over $75 billion in equity through follow-on financings on the TSX, and comprise 32% of the TSXV grads now listed on the TSX. Similar capital pool structures have also gained increasing prominence in the U.S., with US$64 billion in equity raised in 2020 alone through initial public offerings of Special Purpose Acquisition Companies.

From its inception and through the 1990's, the capital pool program offered a distinct competitive advantage to Alberta financial sector, stimulating a robust junior securities market and bringing many entrepreneurs from outside the province to access this unique financing vehicle. Eventually, however, other Canadian jurisdictions adopted their own versions of the capital pool program, and any competitive advantage to Alberta of being the originator of the concept was lost in the late 1990's when the ASE merged with out-of-province exchanges to ultimately form the TSXV. The capital pool program, therefore, serves as both an inspirational precedent, and a cautionary tale, for those seeking to stimulate financial sector growth in Alberta through innovative regulatory policy.

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EXPANDING ENTREPRENEURIAL AND GROWTH-STAGE CAPITAL MARKETS

Our overarching theme is to create an expanded opportunity for entrepreneurial and growth-stage companies to access more diverse pools of capital at earlier stages, at lower financing costs, and with reduced compliance obligations. Securities regulators in Canada execute a dual mandate in terms of being both protectors and promoters of capital markets. In executing the capital markets protection function, securities regulators are tasked with protecting individual investors, who place their faith in the reliability and trustworthiness of the system, as well as capital markets as a whole, by providing stability to the markets. However, we believe that the pendulum of securities regulation across Canada has often swung too far in favour of protecting individual investors, at the expense of striking an appropriate balance with the competing mandate of fostering public and private capital markets.[7] This tilt towards investor protection ultimately has led to an unintended consequence in which retail investors are prevented from accessing the higher-return market segments, as start-up and growth-stage companies have increasingly avoided public markets and gravitated towards private financing options. With restrictive accredited investor requirements and high minimum subscription levels for participation in private equity and venture capital funds, only a small percentage of individual investors have access to many of the faster growing firms.

A major opportunity for Alberta, therefore, is to foster an alternative capital market segment, giving entrepreneurial companies access to an increased number of equity financing sources currently reserved for public issuers (without simultaneously foisting on them the full range of public company compliance obligations), while also giving a broader group of individual investors increased access to the entrepreneurial and growth-stage market segment. This could be achieved by several securities and corporate law reforms.

(a) Announce to the world that Alberta is charting its own distinctive efficiency-focused regulatory path for the financial sector

Alberta must make it clear that it is committed to charting its own distinctive path forward in aggressively pursuing financial-sector growth, particularly for start-up and growth-stage companies. This commitment must be internally directed and take advantage of Alberta's unique business environment and community expectations of government. It is not consistent with joining the national securities regulatory initiative. Creating the preconditions for supply-driven growth will require significantly differentiating Alberta's regulatory environment from those around it. The past twenty years of increasing capital markets harmonization across Canada provide ample evidence that harmonization leads to continuing concentration of financial sector job creation elsewhere in Canada.

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7 Two major factors contributing to the significant increase in capital markets regulation were the devolution of rule-making power from provincial legislatures to the local securities commissions in the 1990's and the regulatory initiatives that resulted from the global financial crisis of 2008.

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Alberta may continue working towards harmonization and reciprocity for securities policies that impact senior issuers listed on the TSX or American exchanges, but must pursue distinctive made-in-Alberta securities initiatives to create a strong pro-issuer jurisdictional advantage for entrepreneurial, growth-stage and junior public companies.

(b) *Build or acquire a "captive" stock exchange to serve Albertan ambitions, and leverage the Alberta captive exchange to create alternative trading boards that significantly enhance access to capital for issuers and higher-growth investment opportunities for individual investors.*

Crucially, many possible strategies depend on the presence of a secondary market for junior issuers based in Alberta, and subject mainly to Alberta-based oversight and regulation. Local control of the ASE in the 1980's was foundational to the collaboration that created the capital pool company program, notwithstanding the skepticism and objections from central-Canadian regulators. Now, only 19 out of 105 currently listed employees of the TSXV are based in Alberta, none in senior executive positions.

Effective collaboration between the provincial government, the ASC and a captive stock exchange is an essential pre-condition to pursuing some of the more innovative financial markets expansion ideas, including the creation of the alternative trading boards discussed hereafter.

Options to be considered for re-acquiring an Alberta-dominated exchange include making an offer to purchase the existing TSXV or CSE exchanges by parties in Alberta (public and/or private) or developing a new exchange.

Leveraging an Alberta-based captive exchange, three alternative trading boards can be envisioned that could be significantly accretive to the Alberta capital markets landscape, giving start-up and growth companies increased access to capital and individual investors increased access to high-growth investment opportunities.

The first alternative trading board would give private companies access to an IPO-lite offering, in which companies have access to a primary market for treasury issuances and investors have a secondary market for trading.[8] Treasury offerings on this board would require only a limited disclosure document similar to an offering memorandum. Continuous disclosure could be limited to *only* the disclosure required by ABCA along with a simplified annual disclosure document. Regulations could place significant re-sale restrictions, or outright prohibitions, on all company insiders, recognizing that that this alternative trading board is designed for use as a financing vehicle to fund company growth and development, not for insider liquidity.

All investors eligible to participate in this alternative market (primary and secondary trading) would be certified as accredited investors, specifically registered with the ASC. However, the accredited investor definition should be significantly expanded to allow certification based on knowledge and experience, which can include completion of self-

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8 This idea borrows from the Regulation D initiative in the United States, but would extend beyond the American precedent in its scope. Implementation of this alternative trading board would require bespoke regulatory exemptions designed and implemented by the ASC.

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study modules in various core topics published by ASC. Consider limiting maximum investment by an individual investor in any one company listed on this alternative board to a safety threshold.

Secondary market trading in companies on this first alternative board could also be limited to seasonal “trading windows” within a specified period after release of the annual filing form, or similar disclosure document (such as an offering memorandum or voluntarily updated disclosure form), to ensure trading only occurs in the presence of current publicly available information.

Distinguishing it from the first alternative trading board, a second alternative trading board could be open to all individual investors. Listed companies would be reporting issuers, but with materially streamlined initial public offering processes and continuous disclosure requirements (e.g. 6-month financial statements, instead of quarterly statements, with simplified business disclosure document formats).[9] Possibly, regulations could permit at-the-market treasury issuances by participants based on a simplified form of annually updated shelf prospectus, which would double as the annual business disclosure document for each issuer. This second alternative board would allow insiders to sell, providing liquidity options for company founders. Essentially, this second alternative board would serve as an alternative market to the existing TSXV and CSE, but would offer easier access to capital for issuers, along with simplified and less expensive continuous disclosure requirements.

The third alternative trading board would be designed to give Alberta retail investors access to the higher-growth prospects currently concentrated in the venture capital and private equity markets. This board would allow the listing of actively-managed mutual fund companies that invest solely in private start-up and growth-stage companies. Companies listed on this board would have the benefit of a streamlined disclosure template for reporting on portfolio companies. Ensuring effective governance within the private portfolio companies would primarily be the purview of the mutual fund managers, not the regulators. While providing public investors with access to higher-return investment opportunities, risk reduction for individual investors would be attained through diversification of investment portfolios within individual funds. Further diversification could be obtained through fund-of-funds structures such as electronically-traded funds. To align the interests of public investors with mutual fund managers traded on this board, cash management fees payable to the fund managers should be limited, with compensation for fund managers principally determined by fund performance above hurdle rates and calculated only on realized gains at time of portfolio company dispositions (as opposed to mark-to-market carrying values of investments).

[9] This idea borrows from the Regulation A+ initiative in the United States, but again would extend beyond the scope of the American precedent.

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(c) *Allow companies and market forces to be the principal determinants of CSR and DEI mandates, not regulators*

Securities commissions and stock exchanges in recent years have been continually increasing corporate governance, CSR (corporate social responsibility), and DEI (diversity, equity, inclusion) mandates on companies. However, market forces have also evolved rapidly during this period, and sources of capital have become clear in advising companies that they will demand specific CSR and DEI elements as preconditions of investment. We believe that the market is nimble and effective in addressing constantly evolving CSR and DEI best practices, and therefore should be the principal determinants of CSR and DEI mandates. Taking this approach is a prospective competitive advantage for Alberta, particularly as other jurisdictions move towards increasingly complex CSR and DEI requirements. Preserving a market-driven approach would allow more freedom for junior companies to adopt governance, CSR and DEI initiatives at appropriate stages of corporate development.

(d) *Initiatives to re-orient the Alberta alternative capital markets from short-termism to long-termism*

This set of policy initiative proposals reflect the belief that the Alberta alternative capital market system should be focused on long-term business growth and job creation, and not short-term trading profits. Among the specific initiatives that would support long-termism are the following:

- Reduce the frequency of financial reporting to six months or annually, depending on the particular trading board.
- Adopt a shareholder voting structure (similar to the one piloted in France) whereby shareholder voting rights lag investments, gradually accumulating base on the length of ownership by the shareholder. For example, 1/3 voting rights might vest immediately, 2/3 after one year of holding, and full voting rights after the second anniversary of acquisition.
- Eliminate or severely restrict short-selling for smaller issuers (where market manipulation by short sellers is quite easy), and reinstate the up-tick rule for all other issuers.
- Provide incentives for market-making activities by designated intermediaries.
- Permit (with shareholder approval) the adoption by issuers of classified boards with multi-year terms.

(e) *Protect companies from special interest interference by establishing minimum holding requirements for advancement of shareholder proposals*

Abundant empirical evidence has shown that shareholder proposals have virtually no utility, but instead represent deadweight losses to companies and their shareholders.[10] Nearly all proposals in Canada fail to even attract majority shareholder support. Set a minimum ownership threshold for the advancement of shareholder proposals at a level of

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[10] A review of the relevant empirical studies is contained in Tingle, 2021.

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significance (e.g. 10% of a share class). However, allow individual shareholders to combine their votes to reach the minimum significance level by submitting joint resolutions.

(f) *Fundamentally re-work the system of shareholder communication to align with the current realities of modern communication*

The existing system of shareholder communication is obsolete and fails to take advantage of the technical developments of the past 30 years. Alberta should adopt systems that simplify and streamline shareholder communication, including the following ideas:

- Provide issuers with the ability to know who beneficially owns their shares so they may directly communicate with them.
- Require every beneficial shareholder to have a valid email address through an individual trading ID, which would be the address for all shareholder communications and continuous disclosure via electronic delivery.
- Allow for fully online annual general meetings and special shareholder meetings.
- Significantly abridge the advance notice requirements for all corporate meetings to reflect the realities of instant communication.
- Allow electronic proxy appointment.
- Create a statutory cause of action against publishers of corporate disinformation online for personal gain.

(g) *Update the ABCA to reflect best practices from Canada and abroad*

The ABCA needs a major revision to adopt many of the best innovations in corporate statutes from across Canada and abroad. The ultimate goal should be to make Alberta the preferred statute for incorporation for business leaders across Canada, similar to the ways Delaware has used its legal system to become dominant in the United States. Among the proposed ABCA amendments to be considered are the following:

- The object of the duty of care must be clarified, similar to reforms made by Ontario.
- The sections relating to the indemnification of directors and officers should be amended to reflect reforms made federally in Ontario.
- Proportional liability of directors and officers should be considered, along with increased clarity on the requirements for exercising due diligence defences.
- Corporate opportunity waivers should be permitted generally along the lines permitted in Delaware
- The rules around unanimous shareholders agreements (“USA”) need to be updated to permit fettering of directors’ discretion, allow shareholders to choose the thresholds for amendment or termination, permit shareholders to avoid liability by disclaiming powers granted by a USA, etc.
- Follow Ontario in allowing written resolutions to be effective with less than every shareholder’s signature
- Permit the adoption of classified boards with shareholder approval.

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(k) *Administration of Justice- Create a specialist court for corporate law and reduce incentives for litigation opportunism*

Following the Delaware example, Alberta should consider creating a separate Court of Chancery, with exclusive original jurisdiction in all corporate law matters, and serving as the appeal court from decisions made by the Alberta Securities Commission. All judges on this court would be subject matter experts in corporate law. The Court of Chancery would provide swift, expert, cost-effective rulings on complex matters of corporate law.

Allow the Chancery Court to be designated as a neutral arbitration site for international corporate dispute resolution, providing low-cost professional dispute resolution for international companies on a for-fee basis.

Also, consideration should be given to placing maximums on contingency-based legal fees payable to class action litigators. Corporate litigation should serve the interests of injured stakeholders, not serve as lottery tickets for the class action bar who troll public filings for perceived deficiencies.

BANKING, FINTECH AND INSURANCE

Pockets of Alberta financial markets could be served by new and innovative institutions. Compared to other countries, open banking and fintech are less developed in Canada. Insurance markets are well developed, but Alberta could strengthen its role especially in captive insurance and reinsurance. Below, we provide several areas of potential growth.

(a) *Responding to the challenges and opportunities associated with the intersection of rapidly evolving technologies and financial sector regulation.*

To become a new economy financial center, Alberta's strategy must successfully anticipate where regulation and technological innovation will intersect. Successfully competing in this space will necessitate an integrated technology-based strategy that successfully anticipates the opportunities and challenges associated with rapidly evolving issues such as personal privacy, adoption of digital assets technologies, disintermediation, decentralized autonomous organizations and security of digital transactional interaction.

Consolidating regulators across banking, credit unions, pensions, insurance is a place to start. The resulting regulatory body should be properly resourced and charged with working with regulators elsewhere in Canada, such as OFSI, to level the playing field when Alberta-based financial firms experience obstacles. It should also be tasked with driving innovation and "fast following" global best standards of efficiency in promoting financial stability and investor protection.

(b) *Open banking initiatives*

Research should evaluate the opportunities for the creation of an Alberta-specific open banking initiative for locally-based financial institutions. Open banking enables more efficient sharing of personal banking data in secure environments, with the prior consent of individuals, through the use of application programming interfaces ("APIs).

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Open banking initiatives define the parameters for the development and deployment of APIs to maximize efficient financial information sharing, while preserving confidentiality and security of individual financial data. Open banking initiatives offer the prospect of significantly enhanced banking experiences for individuals by increasing the integration of third-party financial applications with existing online banking platforms.

(c) *Become a jurisdiction of choice for international banking services based on Canada's existing reputation for stability and tax-treaty structure*

Many banks in tax-advantaged jurisdictions abroad are now struggling with the impact of managing international standards for know-your-client ("KYC") and anti-money laundering ("AML") compliance. Companies incorporated in these same jurisdictions are facing challenges in opening bank accounts abroad and transferring funds due to complex and inefficient KYC and AML compliance programs.

Alberta should aspire to become a jurisdiction-of-choice for the international banking industry, leveraging its reputation for political stability and Canada's tax-treaty structure by focusing on using technological solutions for streamlining KYC and AML verification to reduce processing delays and improve verifiability. In particular, the provincial government's combined legislative and regulatory role could allow Alberta to become the originator of a global standard for certifying digital identity for business transactions, greatly reducing compliance costs for local financial institutions servicing the international market.

(d) *Focus on Creating an Ecosphere for Successful Fintech Development*

Alberta currently lags other jurisdictions in Canada on fintech development and needs to be aggressive in catching up. We should consider supporting innovation hubs with streamlined access to seed funds for fintech start-ups, encourage collaboration with university finance faculty to support talent pipelines and reskilling of existing talent, and streamline the process for transferring jointly developed intellectual property in the fintech space to private start-ups.

Further, Alberta should offer dedicated governmental contacts for fintech firms where they can seek instruction on specific issues and obtain non-binding guidance in relation to licensing or registration requirements, as well as regulatory and supervisory expectations.

(e) *Insurance and Reinsurance*

The opportunities and challenges associated with increasing Alberta's attractiveness as an insurance and reinsurance hub are similar to Alberta's ability to attract increased banking services, including the need to adopt specific captive insurance and reinsurance regulations that leverage new technologies and processes to streamline the regulatory and reporting requirements. Also, creating strong segregated portfolio legislation and facilitating private acts of the legislature to restrict access to certain insurance assets may be required to gain significant traction in this space.

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(f) *Support Regional Banks*

Alberta has two medium-sized financial institutions: Alberta Treasury Branch ("ATB") and Canadian Western Bank ("CWB"). The province should carefully investigate what conditions are preventing these institutions from growing. In particular, if there is not a level playing field between Canada's largest banks and mid-tier banks (such as might arise from differing fractional reserve models) the province should take the lead in insisting on reforms of federal banking regulation.

Within the province, Alberta should ensure that a level playing field exists between credit unions and finance cooperatives. A concept of regulatory personality could help promote new entry of market participants and expansion to strengthen competition, but this must also be balanced with escalating requirements as firms become larger.

(g) *Evaluate the Alberta Enterprise Corporation*

The Alberta Enterprise Corporation ("AEC") has a mandate to create a venture capital ecosystem in Alberta and to facilitate the delivery of capital to early-stage companies in the province. The performance of AEC against these objectives should be carefully scrutinized. If AEC investments are not creating local venture capital management teams, or if AEC investments are mostly being made in businesses located outside of the province, reforms need to be made.

CONCLUSION

Admittedly, none of the specific reforms or innovations outlined above singularly offer the prospect of putting Alberta in a position to out-compete other jurisdictions in the financial sector for an extended period of time. In order to achieve that ambitious goal, it will be essential for a broad range of reforms and innovations to be adopted in Alberta in the upcoming years, thereby making it clear to the financial markets domestically and abroad that Alberta is firmly committed to delivering the most aggressive pro-business environment for financial sector operations. To sustain this credible commitment, strong institutions and political support for steady and continuous improvement will be critical.

As evidenced by the capital pool company program, we must also anticipate that the best innovations that Alberta adopts will ultimately be copied by other jurisdictions, and any comparative advantages associated with specific initiatives will erode over time. It is, therefore, critical to reinforce Alberta's continuing commitment to ongoing financial sector innovation to attract the necessary volume of new financial start-ups and existing financial sector participants.

The ideas set forth are not intended to be exhaustive, but rather to indicate the types of initiatives that can be put forward for evaluation. The space limitations of this paper restrict this analysis to only a fraction of the reform and development ideas that we have identified as warranting further consideration. Additional ideas, such as focusing on creating a local hub for trading carbon (and other environmental) credits, development of cryptocurrency initiatives, and establishment of geographically-based

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centres-of-excellence in specific cities for certain financial sector niches, may also be worthy of further development and evaluation. Many prospects discussed in this paper have not yet been sufficiently researched to conclusively recommend their adoption in Alberta. Completing the analysis necessary to prioritize and evaluate possible reforms, and to recommend the specific reforms and innovations that should be pursued as priorities in Alberta, will be the focus for future research.

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About the Authors

Dr. Jack M. Mintz is the President's Fellow of the School of Public Policy at the University of Calgary after serving as the Palmer Chair and founding Director from January 1, 2008 to June 30, 2015. He also serves on the board of Imperial Oil Limited and is the National Policy Advisor for Ernst & Young. He is also a regular contributor to the *Financial Post* and is a member of the editorial board of *International Tax and Public Finance*. He currently serves as Chair of the Alberta Premier's Economic Recovery Council. Dr. Mintz became a member of the Order of Canada in 2015 as well as receiving the Queen Elizabeth Diamond Jubilee Medal in 2012 for service to the Canadian tax policy community.

L. Daniel Wilson has recently returned to academia after a career spanning more than 25 years as a corporate lawyer, senior business executive and serial entrepreneur. He is currently an Assistant Professor in the School of Business at MacEwan University in Edmonton, teaching a variety of courses related to business law and corporate finance. His research focus is in the area of financial markets regulation, and his 2020 PhD dissertation involved an extensive empirical analysis of the factors contributing to the decline of the number of operating public companies in the Canadian public markets. He is also the author of the *Alberta Annotated Securities Legislation* reference tool published annually by Lexis/Nexis.

Bryce C. Tingle, QC is the Director of the Financial Markets Regulation Programme, School of Public Policy, and holds the N. Murray Edwards Chair in Business Law, at the University of Calgary. He has degrees in law from the University of Alberta, Duke, and Osgoode. He was a member of the Ontario Securities Commission's Exempt Markets Committee and he is a member of the Alberta Securities Commission's Securities Advisory Committee.

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