

Globalization, Federalism and Intergovernmental Policy Harmonization: Insurance
Regulation in the Canadian Financial Services Sector

B. Timothy Heinmiller (University of Western Ontario) &
Brian Woodrow (University of Guelph)

While globalization is the defining characteristic of the current political era, and federalism remains one of the defining characteristics of both the Canadian state and the Canadian political community, the nexus between globalization and Canadian federalism is still not completely understood. Some of the best work in this area has been done by political economist Thomas Courchene who has argued that liberalized international trade, mobile investment capital and instantaneous global communications have prompted the provinces to reorient their economic development strategies “outward” toward participation in the global economy rather than “inward” toward regional development assistance from Ottawa. In the process, the political and economic space of Canada is being transformed so that the provinces are becoming increasingly “self-reliant” from each other and from Ottawa, suggesting a trend toward further decentralization in Canadian federalism

Without challenging the essence of Courchene’s argument, we suggest that there is more to the globalization-federalism story than this. Our empirical findings suggest that the federal division of powers in Canada creates a number of intergovernmental interdependencies that the provinces can not ignore in their pursuit of “outward-looking” economic policies. To manage these interdependencies, intergovernmental policy harmonization is usually necessary, and, consequently, increased efforts toward harmonization are an additional effect of globalization on Canadian federalism. These findings are derived from an empirical investigation of recent regulatory policies in the insurance sector, supplemented with observations from the other financial services and other economic sectors. In the sections that follow, the phenomenon of globalization is explored as are the rationales for intergovernmental policy harmonization in the face of globalization and the various modes through which harmonization may be achieved.

Globalization, Financial Services and Canadian Federalism

Globalization has become a meta-discourse of the late 20th and early 21st century. According to David Held and his colleagues, globalization refers to the “widening, deepening and speeding up of worldwide interconnectedness in all aspects of contemporary social life.” Its wide-ranging transformative processes – economic, cultural and political – have been driven by sustained technological change and prosecuted primarily through transnational capitalism. Its primary impact on governments is to challenge contemporary nation-states, whether they be federal or unitary, through “pressures from above,” in the form of supranational constraints or internal coordination problems, as well as “pressures from below,” in the form of local

and transnational resistance to globalization.¹ Globalization should be conceived primarily as a private-sector phenomenon, then, driven by the competitive processes of international business and finance and facilitated by contemporary information technology, which over the past 20 years has brought about a virtual “financial services revolution” in the way nation-states and financial services firms organize, operate and regulate their domestic financial systems.

Following the analysis of Grace Skogstad, it is useful also to distinguish two elements associate with globalization that have particular impact in the financial sector: internationalization and regionalization. Financial sector *internationalization* refers specifically to the cooperative arrangements among nation-states, and often involving private-sector actors, which have come to operate in the areas of finance and trade through fora such as the IMF, the WTO, and especially the Bank for International Settlements. These intergovernmental bodies in general, particularly the latter body, responding to the logic of interdependence and functionalism, continue to establish rules and standards at the international level which bear directly or indirectly on domestic regulatory activities through capital adequacy requirements, core regulatory principles, and monitoring activities. *Regionalization*, on the other hand, refers to the emergence of new “territorial” forms of organization beyond the traditional nation-state through various levels and types of regional integration whether these be full-blown supranational entities like the EU or as yet more modest free trade agreements such as NAFTA.² Such “territorial” expressions of the dynamic of globalization, in particular, lead to pressures for convergence and harmonization as nation-states and financial sector actors seek to adapt domestic policy and regulation to the new regionalism. Both internationalization and regionalization serve as “pressures from above” which have particular implications within federal states where there is a pre-existing and often delicately balanced division of powers among levels of government across financial sectors.

As many observers have demonstrated, the “four pillars” of the traditional Canadian financial services system – banks, trusts, insurance and securities – no longer exist as separate financial sectors, whether in terms of domestic policy and regulation or the activities of major financial services firms. Traditionally, federalism and the division of powers served to delineate and hold those “four pillars” in place. Under the impact of globalization over the past 20 years, federalism and intergovernmental relations have been transformed and the four pillars have been significantly eroded. In much oversimplified form, the federally-regulated national banks have largely subsumed the provincially-regulated trust and loan business while the securities sector remains entangled in sub-national regulation, though operating in a thoroughly globalized business environment. Only in the insurance sector does the classic federal division of powers still hold and here, as we will see, ongoing pressures for policy convergence and regulatory harmonization are paramount.

¹ David Held and et al., *Global Transformations: Politics, Economics and Culture* (Cambridge: Polity Press, 1999).

² Grace Skogstad, "Globalization and Public Policy: Situating Canadian Analyses," *Canadian Journal of Political Science* 33.4 (December 2000): 805-28.

In banking, the division of powers has traditionally been most clear-cut and determinative of policy and regulation in the sector. The federal government holds legislative authority under Section 91(15) of the *Constitution Act, 1867* in relation to banking, incorporation of banks and the issue of paper money.” Primarily, it has utilized this power to create “chartered banks,” which became the major players in the banking system, and to regulate the entry of foreign banks into Canada. At the same time, the provincial governments limited themselves to the so-called ‘near-banks’ – provincially chartered trust and loan companies and financial cooperatives – which came eventually to engage in many of the same functions as the chartered banks. Since Confederation, the Department of Finance has always held central responsibility for all the major aspects of fiscal and financial policy, including their federal-provincial and international aspects. In addition, during the 1930s, the federal government established the Bank of Canada as the autonomous authority in the area of monetary policy and specific responsibilities with regard to the ‘lender of last resort’ and payments system. To complete the picture, the Office of Superintendent of Financial Institutions was created in 1987 as the consolidated supervisor for federally- regulated financial activities in banking, insurance, and, now, pensions.³ Overall, the reality is that the federal government dominates banking policy and regulation in Canada, with at best modest attention to the need for provincial ‘consultation’ and very little need to pursue policy convergence or harmonization initiatives with provincial governments in the banking sector.

In securities, the jurisdictional and regulatory situation has been dramatically different, with separate policy and regulatory regimes predominating across the Canadian provinces and the dynamic of policy convergence and regulatory harmonization very much in play. Section 92(13) which gives legislative authority over “property and civil rights” to provincial governments has been interpreted consistently to uphold provincial control over securities regulation within their boundaries. Historically, any substantive federal role in securities regulation utilizing its “trade and commerce” power, or other powers, was denied, although recent jurisprudence and regulatory reform initiatives may be reducing that limitation to some extent.⁴ Over the years, individual provincial governments authorized stock exchanges and established their own regulatory bodies to oversee securities regulatory matters, both in terms of solvency and market conduct. Moreover, whenever appropriate, and exclusive of any federal involvement, they coordinated among themselves through bodies such as the Canadian Securities Administrators so as to limit conflicts of law and administration among them.⁵ However, it has only been since the 1980s that pressures have mounted for stronger and more efficient securities regulation in Canada, whether achieved through mutual recognition and heightened regulatory cooperation among provincial securities regulators or through more direct federal involvement with provincial governments in a national securities regulator.

³ William D. Coleman, *Financial Services, Globalization and Domestic Policy Change* (Toronto: Macmillan, 1996) Chapter 9.

⁴ Jean Leclair, "The Supreme Court of Canada's Understanding of Federalism: Efficiency at the Expense of Diversity," *Queen's Law Journal* 28 (2003): 411-53.

⁵ Stephen L. Harris, "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry," *Changing the Rules - Canadian Regulatory Regimes and Institutions*, ed. G. Bruce Doern, et al. (Toronto: University of Toronto Press, 1999) 361-88.

Insurance is the often neglected financial sector in Canada and differs markedly both from banking and securities, having long been the classic case of divided jurisdiction and regulation in Canada. From the series of cases leading to *Citizen's Insurance v. Parsons*[1881] through the *Insurance Reference*[1932], successive courts established that insurance contracts were to be treated as provincial matters under “property and civil rights” and not as transactions subject to federal authority under “trade and commerce.” After one further abortive episode to establish its jurisdiction during the early 1940s, the federal government retreated from attempts to engage in market conduct regulation in insurance and hove squarely to its more limited role in regulating insurer solvency. This is an area where the failure of high-profile insurance companies like Confederation Life, as well as increasing internationalization of insurance regulation, has enhanced the leadership role of OSFI. For their part, provincial governments have utilized their wide latitude to legislate and regulate in the area of market conduct as they have seen fit, to harmonize insurance law and regulation among themselves, with or without the involvement of the federal government.⁶ Thus, insurance regulation in Canada remains a classic case of divided jurisdiction and an ideal testing ground for efforts at intergovernmental policy harmonization under conditions of globalization.

Adaptation to Globalization in Federal States

In a recent article, legal scholars Mark Luz and Marc Miller have argued that “[g]lobalization is a theory blind to federalism”.⁷ They explain this by asserting that the globalization literature “usually focuses on two sets of actors: the nation-state, as if it were an undivided entity, and non-state actors, such as corporations, non-governmental organizations and individuals. The *internal* political structure of a state and its relevance for that society... is rarely discussed...”.⁸ Though this is probably a fair assessment of much of the globalization literature, there are notable exceptions in Canadian scholarship, particularly in the work of Thomas Courchene.

Courchene has approached the federalism-globalization nexus from a political economy perspective and his work forms the basis for much of the current understanding of the relationship between globalization and Canadian federalism. Underlying Courchene’s analysis is a general assumption that increasingly mobile capital and increasingly powerful transnational actors are effecting a transformation in provincial governments from a welfare state mentality to a competitive state mentality. As Grace Skogstad explains, “[t]he competitive state mentality triggers a search for the public policies that will situate states [or provinces] most favourably vis-à-vis transnational

⁶ Marvin G. Baer, "Harmonization of Canadian Insurance Law," *Harmonization of Business Law in Canada*, ed. Ronald Cumming (Toronto: University of Toronto Press, 1986).

⁷ Mark A Luz and C. Mark Miller, "Globalization and Canadian Federalism: Implications of the NAFTA's Investment Rules," *McGill Law Journal* 47 (2002): 951.

⁸ Luz and Miller, "Globalization and Canadian Federalism" 960.

economic actors and external competitors”.⁹ In other words, the assumption in this line of analysis is that globalization is changing the way that governments approach their economic policies, but governments retain considerable agency in their efforts to adapt to the new global economy.

In his studies of Canadian federalism, Courchene has found that globalization is prompting the adoption of a competitive state mentality amongst the provincial governments and, as a result, is gradually and inevitably altering the traditional roles of the provinces and their relations with the federal level.

...globalization and the knowledge/information revolution are transforming the political, economic and geographical space of Canada, one result of which is a shift away from the traditional national-national relationship and toward a regional-international relationship. Another is a shift away from the inward-looking, Ottawa-centered transfer dependency toward a fiscal and globalization triggered, outward-looking regional self reliance.¹⁰

In other words, provincial governments, in recent years, have become increasingly attuned to the global economy and increasingly preoccupied with their competitiveness in relation to other jurisdictions, both national and international. Accordingly, provincial governments actively pursue strategies to enhance their competitiveness and this reorientation has fundamentally changed Canadian federalism. Many provinces now effectively act as “region-states” in their close linkages with foreign jurisdictions, and competitive deregulation between provinces is increasingly likely as they seek to attract/retain investment. Overall, Courchene has argued that the provincial governments are trying to become more self-sufficient by tapping into the benefits of the global economy and, in the process, are growing more distant from each other and from Ottawa.¹¹

Though most provinces seem to have adopted the competitive state mentality and have become increasingly active players in the global economy, there has yet to be a widespread disengagement of the provinces within the Canadian federation, even in economic policy areas where competitive pressures are most urgent. Rather than invalidating Courchene’s argument, however, it is suggested here that the lack of provincial disengagement is merely reflective of provincial efforts toward the competitive state that are unaccounted for in Courchene’s analysis. The federal division of powers in Canada creates intergovernmental interdependencies in many different economic policy areas and many of these interdependencies need to be addressed by provincial governments in their quest for the competitive state. To overcome these interdependencies, policy harmonization between Canadian governments is often necessary. Harmonization ensures that the policies of governments on a given policy issue are comparable and compatible, so that an interdependency is effectively managed. In this regard, globalization has highlighted at least three different types of

⁹ Skogstad, "Globalization and Public Policy" 814.

¹⁰ Thomas J. Courchene, "Glocalization: The Regional/International Interface," *Canadian Journal of Regional Science* 18.1 (Spring 1995): 19.

¹¹ Courchene, "Glocalization" 8-9.

intergovernmental interdependencies in which policy harmonization is an effective and rational response by provincial governments pursuing the competitive state:

1. *Efficiency Harmonization* – A key part of most governments’ strategies in the global economy is to realize cost reductions for themselves and businesses in the regulation of economic activities; this makes any jurisdiction a more attractive place in which to do business. In many policy areas, particularly those areas of provincial jurisdiction, cost reductions in economic regulation can not be realized without some sort of intergovernmental policy harmonization because the inefficiencies are rooted in regulatory overlap and duplication with other jurisdictions. Reducing overlap and duplication allows governments to draw on each other’s regulatory activities and achieve greater economies of scale in the provision of regulation, both resulting in cost saving to governments. At the same time, businesses realize cost-savings from reduced overlap and duplication because their regulatory compliance burdens are reduced.¹² Given the fiscal restraint imperative facing both governments and businesses in the global economy, efficiency harmonization can be a strong motivation for policy harmonization in federal states.
2. *Policy Floor Harmonization* – As rational actors of considerable agency, it is quite conceivable that politicians and administrators can recognize when private investors are using their mobile capital to play governments against each other for their benefit. Experience and analysis may also tell governmental actors how unrestrained inter-jurisdictional competition is bound to end: a situation of competitive deregulation in which all jurisdictions are collectively worse-off in terms of environmental protection and/or social justice. Governments embroiled in a situation of competitive deregulation are faced with an interdependency between themselves and the competing jurisdiction(s): any move toward deregulation by one government is likely to trigger a response in kind. To resolve this interdependency, governments may decide to harmonize their policies in the establishment of a policy floor, beneath which all governments pledge not to tread. This preempts the possibility of spiraling deregulation, which is usually in the collective interest.
3. *Risk Management Harmonization* – One of the hallmarks of the global economy is not only increased mobility of capital but also increased interdependence of capital. Transnational and multinational corporations operate in a plethora of jurisdictions worldwide, investors routinely diversify their portfolios by scattering their investments around the world, and new financial products have emerged that link previously separate financial activities. As business and investment activities become increasingly interdependent, governmental regulators are challenged to keep pace. A persistent danger, in this regard, is the existence of regulatory gaps and loopholes that put businesses, investors and the general financial system at unacceptable risk.¹³ One perennial source of regulatory gaps and loopholes is the federal division of powers, and governments can devote considerable time and energy toward policy

¹² Stephen Handfield-Jones, *Harmonization of Financial Regulation in Canada*, Conference Board of Canada no. 42-89 (June 1989), 5.

¹³ Handfield-Jones, *Harmonization of Financial Regulation in Canada* 6-7.

harmonization in an effort to close-off the regulatory gaps and loopholes made apparent by new business and investor activities. In this way, managing the risks of participating in the global economy is quite often an exercise in intergovernmental policy harmonization.

In essence, what is proposed in this paper is an extension of Courchene's argument concerning the globalization-federalism nexus in Canada. While the provincial governments may have become "outward looking" in the pursuit of "self reliance" in the global economy, they have not been able to disengage from Canadian federalism. The exigencies of globalization, and many of the new policies pursued by Canadian governments in the transition to the competitive state, have underlined a number of persistent interdependencies related to the federal division of powers. To deal with these interdependencies, intergovernmental policy harmonization in many economic sectors has become increasingly necessary, and efforts have increased towards this end. Thus, while many traditional inter-provincial economic linkages in Canada may have been weakened by globalization, the need for inter-provincial economic policy harmonization seems to have been strengthened.

The Multiple Dimensions of Policy Harmonization

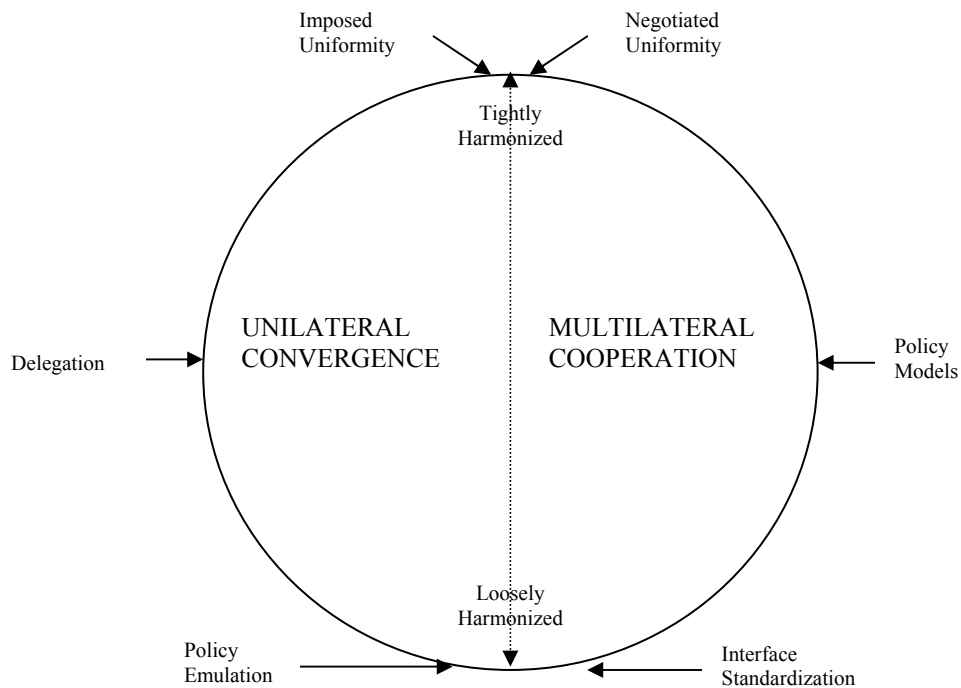
The idea of policy harmonization has been around for quite some time, but it has yet to be fully conceptualized and operationalized. Fritz Scharpf, a German political scientist, has provided a seminal treatment of policy harmonization by identifying two distinct modes of harmonization among cooperating governments: policy uniformity and policy interface standardization.¹⁴ Heinmiller, however, has subsequently shown that harmonization need not necessarily be cooperative and can occur through processes of intergovernmental policy emulation, a finding that is also reinforced by the considerable literature in comparative politics on international policy convergence.¹⁵ Overall, policy harmonization has received a fair degree of attention from political scientists, but the concept remains somewhat ill-defined.

What seems evident from the existing literature, however, is that intergovernmental policy harmonization has both multilateral and unilateral dimensions. The multilateral dimension refers to negotiated efforts among governments to achieve some degree of harmonization, while the unilateral dimension refers to harmonization that is the result of non-negotiated convergence to common policy model. Thus, policy harmonization is an outcome that can result from a number of different intergovernmental processes, some of which involve cooperation and some of which do not. These various processes (or 'modes') of harmonization are illustrated in Figure 1 and described in greater detail, below.

¹⁴ Fritz W. Scharpf, "Community and Autonomy: Multi-Level Policy-Making in the European Union," *Journal of European Public Policy* 1.2 (June 1994): 219-42.

¹⁵ B. Timothy Heinmiller, "Harmonization Through Emulation: Canadian Federalism and Water Export Policy," *Canadian Public Administration* 46.4 (Winter 2003): 495-513.

Figure 1 – Modes of Intergovernmental Policy Harmonization



On the right half of Figure 1 are those modes of policy harmonization that involve negotiated, multilateral cooperation between governments. Of these modes, the mode that involves the highest degree of harmonization is *negotiated uniformity*, in which all of the participating governments agree on an identical policy for their collective jurisdictions.¹⁶ This degree of harmonization is often difficult to achieve, however, because of the very high threshold of agreement required to attain it. Consequently, governments may choose to harmonize their policies through less demanding means, such as the development of *policy models*. In this mode, governments negotiate the creation of a mutually acceptable policy model and agree to implement it in their respective jurisdictions, with slight modifications accepted in light of local circumstances and conditions. If a single policy model somehow proves unattainable for governments, though, they may still resort to an even looser form of multilateral policy harmonization known as *interface standardization*.¹⁷ In this mode, governments negotiate agreement on a set of general policy principles and agree to conform their policies to these principles, but are otherwise allowed to go their separate ways in terms of policy design. This mode of harmonization is particularly useful in policy issues where governments have long-established policies that are resistant to significant change because of path dependency or the power of vested interests.

¹⁶ Scharpf (1994) identifies this mode simply as ‘uniformity.’ The term ‘negotiated uniformity’ is used here to distinguish this mode from ‘imposed uniformity,’ discussed below.

¹⁷ Scharpf, "Community and Autonomy."

Moving to the left half of Figure 1, we encounter those modes of policy harmonization that involve unilateral convergence rather than multilateral negotiation. At the top of the diagram, where policies are mostly tightly harmonized, is imposed uniformity. As the term implies, *imposed uniformity* occurs when governments adopt identical policies because they are forced to do so by another government. This mode of harmonization involves either a usurpation of sub-national jurisdiction by a national government or a considerable degree of extra-territoriality by a single sub-national government, so it occurs on shaky legal grounds and is somewhat exceptional. While imposed uniformity involves a coerced centralization of policy authority in a given policy issue, delegation involves a voluntary centralization. In this mode, governments transfer their respective policy authority to a single government who then implements policy on their behalf. This has the potential to create a considerable degree of policy harmonization, but, because delegation is voluntary, it is also likely that some governments will choose not to transfer their policy authority and some policy divergence will remain, as a result. Finally, governments may unilaterally harmonize their policies without any transfer of policy authority through a process of *policy emulation*. In this mode, a single government develops a particularly effective or popular policy model and other governments copy it for themselves, making modifications to accommodate local circumstances. The incidental effect of this intergovernmental emulation is policy harmonization, though this harmonization may be relatively loose in many cases.¹⁸

In sum, the preceding discussion suggests that there are at least six different modes of policy harmonization possible among governments in a policy issue of shared jurisdiction. However, these modes must be regarded and treated as ideal types because it is quite likely that ‘real-world’ policy harmonization will involve various hybrids of these modes, or even entirely new modes that have not been identified here. Nevertheless, Figure 1 provides a good conceptual reference point for identifying evidence of policy harmonization among Canadian governments in the insurance sector and beyond. Now, we can not only identify the motivations that Canadian governments have had for harmonizing their economic regulations (discussed in the previous section) we can also more precisely identify how this harmonization has been achieved.

Policy Harmonization in the Canadian Insurance Sector

Regulation of the insurance industry has a long history in Canada, dating back to pre-Confederation in most of the Canadian colonies.¹⁹ Since that time, participants and analysts of the industry have generally regarded insurance regulation as serving two distinct but interrelated purposes: regulation of insurers’ market conduct and regulation of insurers’ solvency. Market conduct regulation is usually justified with reference to the inherent complexity of the insurance business. Because of their contractual nature, insurance products can seem quite complex to average insurance customers, who have only a superficial knowledge of the insurance business, and opportunities for self-dealing

¹⁸ Heinmiller, "Harmonization Through Emulation."

¹⁹ Baer, "Harmonization of Canadian Insurance Law" 239.

by insurers are ripe in an unregulated market. Consequently, market conduct regulation usually involves governmental oversight of "...the marketing practices of insurers, the wordings of policies, the approval of premium rates for automobile insurance, the licensing of insurance adjusters, the prescribing of various insurance company forms and other related areas" in an effort to ensure fair relations between insurers and the public.²⁰ Governments also have a keen interest in regulating the solvency of the insurance companies in their domestic markets because these companies are both major employers and major contributors to the public welfare. As a result, regulations have been developed to shape the business structures and investment practices of insurers, and guaranty funds have been established to protect the investments of insurance customers in case of insurer insolvencies.²¹ Though the market conduct of insurers is clearly linked with their solvency, and regulators are readily aware of this linkage, these two aspects of insurance regulation are generally treated separately by governments, in practice.

For many years, Canadian governments undertook market conduct and solvency regulation in insurance markets that were distinct and well-bounded: the other financial services (banking, trusts and securities) were not permitted to underwrite insurance products and the marketplace was dominated by a plethora of relatively small domestic insurers, exposed to limited foreign competition. Even while changes took place in the other financial services, the insurance industry remained relatively staid, insulated by governmental regulation, mostly at the provincial level. Starting in the early 1980s, however, this began to change significantly. Innovations within the financial services sector resulted in new financial products, such as annuities, that began to breakdown the traditional walls between the financial services, and insurance companies pressed for revised regulations that would allow them to expand their investment activities in securities and real estate. At the same time, insurance developed into a truly global business with the advent of new communications technologies and the emergence of transnational financial conglomerates that seemed to transcend political borders. Overall, the speed and complexity of the financial services increased manifold, and governments struggled to keep pace with these remarkable marketplace changes.²²

As Courchene might predict, some provinces responded to the accelerated globalization of the financial services sector by undertaking new regulatory policies in line with the competitive state mentality and intended to take advantage of the potential benefits of the global economy. In particular, Quebec, spurred by nationalist sentiment for economic self-reliance, "...registered its objective to favour financial services as an economic sector of potential growth" and enacted new policies toward this end beginning in 1984.²³ The substance of Quebec's new regulatory strategy was to erode the barriers

²⁰ Lawrie Savage and Associates, *The Case for Change - A Report to the Insurance Bureau of Canada Regarding the Regulation of the Canadian Property/Casualty Insurance Industry* (2003), 8.

²¹ There are two separate guaranty funds in the Canadian insurance industry and both are privately funded and operated by their member companies. The guaranty fund for the life insurance sector is known as CompCorp and the guaranty fund for the property/casualty sector is known as PACCIC. In the case of a member's insolvency, these guaranty funds cover losses to insureds with the insolvent company, up to specified levels.

²² Rod McQueen, *Who Killed Confederation Life?* (Toronto: McClelland & Stewart Inc., 1996).

²³ Coleman, *Financial Services, Globalization and Domestic Policy Change* 215.

between the various financial services in order to encourage the development of larger and stronger Quebec-based financial institutions, and to lure investment from other jurisdictions, particularly Ontario. Aiming to retain its preeminent place as the centre of the Canadian financial services industry, the Ontario government responded with its own program of regulatory reform to match Quebec's deregulation. By the time this spate of competitive deregulation came to end in 1988-89, the regulatory barriers between banking, trusts and securities were considerably diminished and the chartered banks would eventually come to dominate all of these sectors.²⁴

Though the insurance industry also experienced some regulatory reform during this time, the regulatory barriers between insurance and the other financial services remained largely intact and continue so today. This is not to say, however, that the competitive deregulation did not threaten in this policy area. One of the early regulatory reforms passed by Quebec in 1984 was, in fact, a reform to its insurance regulations, and this reform did not go unnoticed by the Ontario government or the Ontario Task Force on Financial Institutions that reported in 1985.

The passage of Bill 75 in the Province of Quebec gives Quebec chartered insurers, a number of whom are also licensed to conduct business in Ontario, the power to engage in a number of non-insurance activities and varied financial intermediation functions. While the full impact of these legislative changes is as yet undetermined, clearly the enlarged sphere of permitted activities and greater latitude in investment powers granted to these companies have the potential to expose the Government of Ontario to certain economic and political costs.²⁵

The exclusion of insurance, as yet, from extensive deregulation is mostly explained by the well-organized and stubborn resistance of insurers and insurance agents to any significant erosion of the regulatory barriers between insurance and the other financial services. For instance, in 1996, the chartered banks lobbied Ottawa to revise the *Bank Act* to allow them to market life insurance products directly from their branches. However, insurance agents, in particular, mounted a very effective lobbying effort that succeeded in persuading Ottawa to leave this regulatory barrier intact.²⁶ In general, the insurance industry has even more policy influence at the provincial level, where their contributions to local economies are more acutely felt.

The situation in Canadian insurance regulation, then, is one in which the insurance industry remains largely separated from the other financial services by regulatory barriers, but the pressures and challenges of the global economy are felt by both insurers and regulators. Thus, instead of adapting to these competitive pressures through cross-pillar integration and the creation of universal banks, insurers have sought to realize cost-savings from reduced regulatory burdens in both market conduct and solvency regulation. Responding to concerted pressure from insurers, and seeking new

²⁴ William D. Coleman and Tony Porter, "Banking and Securities Policy," *Border Crossings - The Internationalization of Canadian Public Policy*, ed. G. Bruce Doern, Leslie A. Pal and Brian W. Tomlin (Toronto: University of Toronto Press, 1996) 55-81.

²⁵ J. Stefan Dupre, A. Rendall Dick, and Alexander J. MacIntosh, *The Ontario Task Force on Financial Institutions - Final Report* (Her Majesty the Queen in Right of Ontario, December 1985), 96.

²⁶ McQueen, *Who Killed Confederation Life?* 248.

and improved ways to protect the public interest, Canadian governments have responded with unprecedented efforts in insurance regulatory harmonization over the past two decades.

Market Conduct Regulation

In the market conduct regulation of the insurance industry, intergovernmental policy harmonization has been primarily multilateral and cooperative, with national efforts coordinated through the Canadian Council of Insurance Regulators (CCIR). The CCIR is an intergovernmental organization comprised of the top insurance regulators from each of the provinces as well as a representative from the Office for the Superintendent of Financial Institutions (OSFI), the federal regulator of financial services in Ottawa. With a history dating back to 1917, when it was known as the Association of Superintendents of Insurance, the CCIR has long been a forum for data exchange, discussion, and coordination of provincial strategies to resist federal incursions into the insurance policy area.²⁷ In recent years, however, intergovernmental harmonization has become a major preoccupation of the CCIR, particularly in the market conduct area.

In the insurance market, the core product is a legal contract: insurers agree to cover a defined risk in exchange for a schedule of premium payments from the insured. As remarked above, Canadian governments, over the course of more than a century of accumulated regulation, have come to regulate insurance products to the point that the wording of many insurance policies (i.e., the contracts) are actually written into governmental regulations, as are the premiums that can be charged, the inducements that insurers can use to entice new clients and many other aspects of the insurer-insured relationship. To ensure a fair marketplace, regulation is generally accepted as necessary, but insurers that operate in multiple provinces are faced with regulatory regimes that can vary substantially between jurisdictions. Complying with these various sets of regulations is cost-incurring for insurers because they have to offer different products in each province and retain the administrative personnel necessary to ensure compliance with the diverging regulations of each province. Thus, even if insurance products remain tightly regulated, there are significant cost-savings to be found for insurers just in the intergovernmental harmonization of these regulations, and the insurance industry has put increasing pressure on Canadian governments to realize these savings over the past ten years. This is where the CCIR comes in.

The CCIR meets twice annually and these meetings are very well attended by insurance industry representatives, who play a considerable role in the proceedings.²⁸ A number of harmonization initiatives have been undertaken of late, but one is probably most representative of the kind of efficiency harmonization that is taking place within the CCIR: the harmonization of insurance classes. Insurance classes are important to insurers because they serve as the basis for what kinds of insurance products insurers can offer in any given province. When insurance classes vary from province to province,

²⁷ Baer, "Harmonization of Canadian Insurance Law" 221.

²⁸ Baer, "Harmonization of Canadian Insurance Law" 221-22.

insurers have to tailor their products to meet the specifications of each province and incur considerable costs in doing so. In conjunction with the Insurance Bureau of Canada, the umbrella organization representing most property and casualty insurers in Canada, the CCIR has negotiated a harmonization initiative that reduces the number of insurance classes across Canada from over 50 to just 16 (15 in Quebec). The initiative was created in the policy model mode of harmonization as a 16 category model classification system was negotiated through the CCIR, but the provinces are allowed some leeway in defining these classes for themselves.²⁹ For insurers, this represents a significant change in the way they do business and a considerable reduction in their regulatory compliance costs.

Having achieved a number of successes in the harmonization of market conduct regulations, the CCIR has more recently approached the goal of intergovernmental policy harmonization in a broader fashion. In early 2002, the CCIR established a Streamlining and Harmonization Committee with an open mandate to survey the insurance industry to receive feedback on potential harmonization issues.³⁰ The response was overwhelming and the committee had to establish three new working groups to deal with the abundance of issues raised.³¹ The work of these groups is still ongoing, but most of these harmonization initiatives have been inspired by the efficiency concerns of insurers, a common feature of regulatory harmonization in the market conduct area.

Outside of the CCIR, there is also an ongoing effort to achieve greater regulatory harmonization in insurance on a regional basis. This is the Atlantic Insurance Harmonization Project, a comprehensive harmonization initiative that seeks "...to provide insurance companies with a single environment throughout Atlantic Canada, thereby allowing the delivery of equivalent products and services in each province".³² The idea for the harmonization project was first put forward by the Insurance Bureau of Canada in 1995 and was first discussed in the Council of Atlantic Premiers in October 1996.³³ For the economically small and struggling Atlantic provinces, harmonization seemed like an attractive option because it would result in cost savings for both insurers and regulators. The Insurance Bureau of Canada estimated that harmonization would save the Atlantic insurance industry about \$3.8 million per year, or 2 percent of its annual operating costs.³⁴ Though the premiers rejected the creation of a single Atlantic insurance regulator, insurance harmonization would allow them to draw on each others' regulatory activities, helping to reduce their costs, as well. At the same time, harmonized insurance legislation would create a de facto policy floor among the Atlantic provinces, preempting the possibility of mutually destructive competitive deregulation, the other avenue to finding cost-savings for the Atlantic insurance industry.

²⁹ Winston Morris, "Re: Classes of Insurance Project," March 20, 2002.

³⁰ Canadian Council of Insurance Regulators, *CCIR Newsletter*. Summer (2002), http://www.ccir-ccrra.org/about_ccir/index_en.htm (Nov. 2, 2003).

³¹ Canadian Council of Insurance Regulators, *CCIR Newsletter*. Summer (2003), http://www.ccir-ccrra.org/about_ccir/index_en.htm (Nov. 2, 2003).

³² Council of Atlantic Premiers, "Atlantic Insurance Harmonization Project," 2003, <http://www.cap-cpma.ca> (3 Dec. 2003).

³³ J. Brian Reeve, "Harmonization: Real Change Begins," *Canadian Underwriter* 64.7 (July 1997): 22-23.

³⁴ Lowell Conn, "Harmonization, Drive Sputters, But It's Alive," *Canadian Underwriter* 65.12 (December 1998): 16.

Since 1996, the Atlantic Insurance Harmonization Project has proceeded in a halting fashion. Several rounds of public consultations have been held and a number of provincial governments have come and gone, but the initiative now appears to be nearing completion. Harmonization is being attempted through the policy model mode in which model legislation is being negotiated and the provinces are then left to adapt this legislation to their local circumstances. The model legislation is in its third draft and the negotiations have proven difficult for a number of reasons. The first is the sheer scope of the Harmonization Project which encompasses almost every aspect of insurance regulation. A second factor is a simultaneous push towards insurance reform, which, at various times, has confounded efforts toward harmonization. Finally, insurance is an issue that is usually of little public salience and, so, it has been difficult to garner political attention long enough to see the project to fruition.³⁵ Recent public controversy over skyrocketing auto insurance rates, however, has realigned the Harmonization Project as a political priority and new model legislation was approved by the Atlantic Superintendents of Insurance in September, 2003.³⁶

Solvency Regulation

In the area of solvency regulation, a significant degree of policy harmonization has also been evident, but this harmonization has mostly occurred through unilateral convergence. Unlike market conduct regulation, solvency regulation features a significant federal presence. Jurisdictionally, the federal government is responsible for the solvency regulation of all insurance companies that are federally incorporated. This group includes many of the largest insurance companies in Canada, particularly among life insurers, and it is one of the few areas of the insurance industry where federal regulatory power is unquestioned. More importantly, the federal government, through the creation of OSFI in 1987, has developed a considerable degree of expertise in this area and has shown a willingness to take the lead in solvency issues pertaining to insurers. Solvency regulation involves the annual (or semi-annual) monitoring and examination of data from the corporate portfolios of insurance companies to ensure that they have taken on a reasonable dispersion of risk and have retained sufficient capital to payout claims. These tasks can be very complex and labour intensive, so the provinces have lately begun to delegate them to OSFI.

The impetus towards policy harmonization in solvency regulation is a combination of efficiency and risk management harmonization. For some provincial governments, delegating solvency regulation to the federal government is a viable way of reducing budgetary spending in an era of fiscal austerity. Furthermore, many insurance industry representatives, the Insurance Bureau of Canada in particular, have been pushing

³⁵ Craig Harris, "Off Track?" *Canadian Underwriter* 105.13 (December 2000): 22-25.

³⁶ Janet H. Cameron, "Re: Transmittal of Harmonized Model Insurance Act for Atlantic Canada," Sept. 22, 2003.

for this sort of harmonization for years, because it reduces the regulatory compliance burdens of insurers. With solvency standards harmonized, provincially incorporated insurers can file one set of annual reports rather than multiple sets. In addition, on the risk management side, there has been a growing concern in many provinces over the past two decades that provincial regulators simply do not have the capacity to undertake effective solvency regulation in an era when so many of the activities of financial companies transcend provincial (and national) borders. This concern is primarily related to provincial experiences during the insolvency of a number of trust companies in the early 1980s and a number of insurance companies in the early 1990s. Harmonized solvency regulations ensure that many ‘cracks’ in the national regulatory system are effectively patched.³⁷

As indicated above, harmonization in insurance solvency regulation has mostly taken place through the delegation mode. Some provinces, such as Ontario, Manitoba and New Brunswick, have arrangements with OSFI to conduct their solvency regulation on a “fee for service basis”.³⁸ Other provinces, such as Nova Scotia, have simply ‘piggybacked’ onto OSFI’s regulatory activities by requiring federal endorsement of a company’s of safety and soundness before an insurer is allowed to do business in their jurisdiction.³⁹ In either case, the provinces accede to OSFI’s solvency regulations and a considerable degree of harmonization is the result. Of course, there are notable outliers such as Quebec, which maintains a self-sufficient financial services regulator and undertakes its own solvency regulation, but the degree of harmonization in solvency regulation over the past two decades is remarkable considering the historical context of this issue.⁴⁰ Over the first seventy years of Confederation, there was a series of acrimonious jurisdictional conflicts over the solvency regulation of insurers and the provinces went to great lengths to preserve their autonomy in this area.⁴¹ However, in the face of the new global economy, many provinces, including the largest one, have bowed to efficiency and risk management pressures, delegating this area to achieve harmonization.

Policy Harmonization in the Other Financial Services and Beyond

To demonstrate the generalizability of our argument beyond the somewhat narrow confines of insurance regulation, it is constructive to explore briefly some of the intergovernmental harmonization efforts that have taken place in the regulation of other financial services and other economic activities over the past two decades. Just like insurance regulation, all of the examples discussed below involve policy areas of provincial jurisdiction.

³⁷ , December 2003, Ministry of Finance, Canada, to Anonymous.

³⁸ , December 2003, Office for the Superintendent of Financial Institutions, Canada, to Anonymous.

³⁹ Baer, "Harmonization of Canadian Insurance Law" 219.

⁴⁰ Interview.

⁴¹ Vincent C. MacDonald, "The Regulation of Insurance in Canada," *The Canadian Bar Review* 24.4 (April 1946).

In financial services regulation, one of the earliest examples of the movement toward policy harmonization occurred in the regulation of trust companies.⁴² The motivation for this harmonization can be traced directly to the failure of several Canadian trust companies in the early 1980s, mentioned above, and the feeling of vulnerability this created for regulators in Ontario. Ontario felt that trust companies had been allowed to engage in risky investment activities in other Canadian jurisdictions, creating problems for Ontarians when these companies became insolvent. So, to manage this risk, the Government of Ontario introduced the “equals approach” which required all trust companies doing business in Ontario, regardless of their jurisdiction of incorporation, to follow Ontario regulations and procedures in all their operations, including those in other provinces.⁴³ In essence, this was a unilateral effort by Ontario to achieve harmonization in the regulation of trusts through imposed uniformity. This approach was quite controversial and achieved only moderate success, but the movement toward intergovernmental policy harmonization as a means of risk management is unmistakable.

Another area of the financial services where intergovernmental policy harmonization has become a pressing concern is in securities. This is an area where provincial regulation has long been prevalent, but globalization has created intense pressure for inter-provincial regulatory harmonization, mostly out of risk management and efficiency concerns. This was a major theme of the recent “Wise Persons Committee” report on the structure of securities regulation in Canada:

As capital markets have become more integrated, the need for harmonization of regulatory content and standards has increased. As capital markets and financial instruments have grown in complexity, so too have the demands on regulators.... If foreign investors lack confidence in Canada’s system of securities regulation, they will be less likely to invest in Canadian firms, depriving Canadian issuers of an important source of capital.⁴⁴

The provinces have become well aware of these harmonization pressures in recent years and have worked through the Canadian Securities Administrators (CSA) to undertake a number of harmonization initiatives. Most of these initiatives, such as the existing Mutual Reliance Review System and the proposed Passport System, have approached harmonization in the interface standardization mode, though the more recent Uniform Securities Legislation Project seeks a much tighter harmonization through negotiated uniformity.⁴⁵ ⁴⁶ For its part, the Wise Persons Committee sees the need for harmonization

⁴² This was, of course, before the regulatory barriers between trusts and chartered banks were removed in the late 1980s. After this deregulation, most trust companies were subsumed by the banks.

⁴³ William D. Coleman, “Federalism and Financial Services,” *Canadian Federalism - Performance, Effectiveness, and Legitimacy*, ed. Herman Bakvis and Grace Skogstad (Don Mills: Oxford University Press, 2002) 178-96.

⁴⁴ Wise Persons Committee, *It's Time*, Committee to Review the Structure of Securities Regulation in Canada (December 2003), 3.

⁴⁵ The Mutual Reliance Review System was introduced by the CSA in 1999 and it creates interface standardization through “...a system in which a decision maker in one jurisdiction is prepared to rely primarily on the analysis and review of regulatory staff in another jurisdiction.” The proposed Passport System would simply expand this type of interface standardization. In contrast, the objective of the Uniform Securities Legislation Project is to create a uniform securities act that would be adopted “word-for word” in every province.

⁴⁶ Wise Persons Committee, *It's Time* 11-17.

as particularly urgent and the multilateral cooperative efforts of the provinces to be altogether too slow and too cumbersome. As a result, it has recommended that the federal government intervene in the securities area to achieve harmonization through imposed uniformity.⁴⁷ Whether the federal government has the constitutional grounds and the political will to do this, however, remains to be seen.

Outside of the financial services, it is also possible to discern a number of economic sectors in Canada where regulatory harmonization has become a priority with the onset of globalization. One such area is water exports. As freshwater has become recognized as a potential growth area in international trade, the provinces, as the main regulators of Canada's freshwater resources, have recognized this emerging risk and taken regulatory measures to preempt the possibility of bulk water exports from Canada. A significant degree of policy harmonization now exists in the provinces' water export policies, one of the relatively few areas where harmonization has occurred in the policy emulation mode.⁴⁸ Another example may be the negotiation of the Agreement on Internal Trade (AIT) in 1995. The AIT covers a broad range of economic sectors and was designed to lower non-tariff trade barriers between the provinces through a process of policy harmonization in the interface standardization mode. Non-tariff trade barriers between the provinces had been a recurring political issue for decades, but it was not until Canada embraced the liberalization of international trade that domestic efficiency concerns created enough momentum for the creation of the AIT.⁴⁹

Conclusion

Overall, this paper has shown that, although globalization has prompted Canadian provinces to become more "outward looking" and more concerned with their individual competitiveness in the global economy, there are clear limits to the extent that the provinces can "go it alone" in their new development strategies. These limits are related to the constitutional division of powers in Canadian federalism and the interdependencies created by this jurisdictional fragmentation, particularly in areas of provincial jurisdiction. Accordingly, in order for governments and businesses to realize efficiency gains, in order for governments to manage the risks involved in new economic activities, and in order for governments to establish policy floors to prevent destructive competitive deregulation, intergovernmental policy harmonization of some sort is necessary. The various examples outlined above, in insurance regulation and elsewhere, suggest the prevalence of intergovernmental harmonization efforts in Canada and indicate the policy harmonization is being pursued in many different modes. Notwithstanding the fact that some of these harmonization efforts have proven somewhat disappointing, it seems abundantly clear that the various pressures for harmonization have continued to push Canadian governments together even as Ottawa's influence in provincial economic development strategies has diminished.

⁴⁷ Wise Persons Committee, *It's Time*.

⁴⁸ Heinmiller, "Harmonization Through Emulation."

⁴⁹ Douglas M. Brown, *Market Rules - Economic Union Reform and Intergovernmental Policy-Making in Australia and Canada* (Montreal & Kingston: McGill-Queen's University Press, 2002).

Works Cited

- Baer, Marvin G. "Harmonization of Canadian Insurance Law." *Harmonization of Business Law in Canada*. Ed. Ronald Cumming. Toronto: University of Toronto Press, 1986.
- Brown, Douglas M. *Market Rules - Economic Union Reform and Intergovernmental Policy-Making in Australia and Canada*. Montreal & Kingston: McGill-Queen's University Press, 2002.
- Cameron, Janet H. "Re: Transmittal of Harmonized Model Insurance Act for Atlantic Canada." Sept. 22, 2003.
- Canadian Council of Insurance Regulators. *CCIR Newsletter*. Summer (2002). http://www.ccir-ccra.org/about_ccir/index_en.htm (Nov. 2, 2003).
- . *CCIR Newsletter*. Summer (2003). http://www.ccir-ccra.org/about_ccir/index_en.htm (Nov. 2, 2003).
- Coleman, William D. "Federalism and Financial Services." *Canadian Federalism - Performance, Effectiveness, and Legitimacy*. Ed. Herman Bakvis and Grace Skogstad. Don Mills: Oxford University Press, 2002. 178-96.
- . *Financial Services, Globalization and Domestic Policy Change*. Toronto: Macmillan, 1996.
- Coleman, William D., and Tony Porter. "Banking and Securities Policy." *Border Crossings - The Internationalization of Canadian Public Policy*. Ed. G. Bruce Doern, Leslie A. Pal and Brian W. Tomlin. Toronto: University of Toronto Press, 1996. 55-81.
- Conn, Lowell. "Harmonization, Drive Sputters, But It's Alive." *Canadian Underwriter* 65.12 (December 1998): 16&18.
- Council of Atlantic Premiers. "Atlantic Insurance Harmonization Project." 2003. <http://www.cap-cpma.ca> (3 Dec. 2003).
- Courchene, Thomas J. "Glocalization: The Regional/International Interface." *Canadian Journal of Regional Science* 18.1 (Spring 1995): 1-20.
- Dupre, J. Stefan, A. Rendall Dick, and Alexander J. MacIntosh. *The Ontario Task Force on Financial Institutions - Final Report*. Her Majesty the Queen in Right of Ontario, December 1985.
- Handfield-Jones, Stephen. *Harmonization of Financial Regulation in Canada*. Conference Board of Canada no. 42-89. June 1989.
- Harris, Craig. "Off Track?" *Canadian Underwriter* 105.13 (December 2000): 22-25.
- Harris, Stephen L. "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry." *Changing the Rules - Canadian Regulatory Regimes and Institutions*. Ed. G. Bruce Doern, et al. Toronto: University of Toronto Press, 1999. 361-88.
- Heinmiller, B. Timothy. "Harmonization Through Emulation: Canadian Federalism and Water Export Policy." *Canadian Public Administration* 46.4 (Winter 2003): 495-513.
- Held, David, and et al. *Global Transformations: Politics, Economics and Culture*. Cambridge: Polity Press, 1999.
- . December 2003. Office for the Superintendent of Financial Institutions, Canada, to Anonymous.

- . December 2003. Ministry of Finance, Canada, to Anonymous.
- Lawrie Savage and Associates. *The Case for Change - A Report to the Insurance Bureau of Canada Regarding the Regulation of the Canadian Property/Casualty Insurance Industry*. 2003.
- Leclair, Jean. "The Supreme Court of Canada's Understanding of Federalism: Efficiency at the Expense of Diversity." *Queen's Law Journal* 28 (2003): 411-53.
- Luz, Mark A, and C. Mark Miller. "Globalization and Canadian Federalism: Implications of the NAFTA's Investment Rules." *McGill Law Journal* 47 (2002): 951-97.
- MacDonald, Vincent C. "The Regulation of Insurance in Canada." *The Canadian Bar Review* 24.4 (April 1946).
- McQueen, Rod. *Who Killed Confederation Life?* Toronto: McClelland & Stewart Inc., 1996.
- Morris, Winston. "Re: Classes of Insurance Project." March 20, 2002.
- Reeve, J. Brian. "Harmonization: Real Change Begins." *Canadian Underwriter* 64.7 (July 1997): 22-23.
- Scharpf, Fritz W. "Community and Autonomy: Multi-Level Policy-Making in the European Union." *Journal of European Public Policy* 1.2 (June 1994): 219-42.
- Skogstad, Grace. "Globalization and Public Policy: Situating Canadian Analyses." *Canadian Journal of Political Science* 33.4 (December 2000): 805-28.
- Wise Persons Committee. *It's Time*. Committee to Review the Structure of Securities Regulation in Canada. December 2003.