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Getting the Deal Through

Banking Regulation

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GETTING THE
DEAL THROUGH

Banking Regulation 2016

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

Canada has a centrally regulated banking system with a focus on macro-prudential regulation and stability of the financial system. The Bank Act, the principal federal statute governing all aspects of banking, indicates its main purposes as fostering a strong and efficient banking sector comprising competitive and resilient institutions, protecting the interests of depositors and consumers, and maintaining stability and public confidence in the financial system. The Bank of Canada (the central bank) exercises a monetary policy focusing on an inflation-control target of around 2 per cent and a policy of non-intervention in a flexible foreign exchange rate.

Canada is a strong supporter of the Financial Stability Board and has been a leading jurisdiction in the adoption of the Basel III international regulatory framework. The Office of the Superintendent of Financial Institutions (OSFI), Canada's primary bank regulator, introduced revised capital adequacy requirements in 2011, which came into effect in 2013. A further revised capital adequacy requirements guideline was released in 2014 and came into effect in the first fiscal quarter of 2015. The revised capital adequacy requirements are consistent with Basel III and have an aggressive schedule in lockstep with the Basel III timeline for the planned implementation.

The thrust of Canadian banking regulation is guided by principles-based regulation as opposed to bright-line rule making. OSFI has issued guidelines on capital adequacy, prudential limits, accounting and disclosure, and sound business and financial practices that are considered 'best' or 'prudent' practices for banks and set industry standards for the financial services sector as a whole.

To ensure the safety and protection of the Canadian banking system, Canada also imposes a public ownership requirement on banks, requiring large domestic banks to be 'widely held' by the public and listed on a prominent Canadian stock exchange and medium-sized domestic banks to be at least 35 per cent publicly owned and listed. Similarly, Canadian banks are prohibited from engaging in any business other than the 'business of banking' through various ownership restrictions resulting in a separation between banking, insurance, auto leasing and securities dealing sectors of the economy. The 'business of banking' includes providing financial service, acting as a financial agent, providing investment counselling services and portfolio management services and issuing and operating payment, credit or charge cards.

As of June 2015, there are 28 domestic banks, 24 foreign banks, and 29 foreign bank branches operating in Canada. There are also 23 foreign bank representative offices established to represent foreign banks in Canada. Canada's six largest banks, being Royal Bank of Canada, Toronto-Dominion Bank, Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and National Bank of Canada, have been identified by OSFI as domestic systemically important banks (D-SIBs).

2 Summarise the primary statutes and regulations that govern the banking industry.

Regulation of the banking industry falls under the exclusive jurisdiction of the federal government. Although provincial governments have jurisdiction to incorporate and regulate certain deposit-taking institutions, such as credit unions, only a financial institution incorporated under the Bank Act can conduct business as a 'bank' in Canada.

The Bank Act regulates domestic banks (listed on Schedule I of the Bank Act), foreign subsidiary banks that are controlled by eligible foreign institutions (Schedule II) and bank branches of foreign institutions (Schedule III). The Bank Act regulates, inter alia, the ownership, capital and corporate governance structures of banks, prohibits certain business undertakings and associations, prescribes capital and liquidity adequacy requirements, and regulates consumer disclosure, transparency and record-keeping.

The Bank Act also contains a sunset clause that provides for a statutory review and update of the Bank Act every five years. New legislation tabling the Bank Act together with any proposed amendments must be brought into force by March 2017.

The Bank Act is also supplemented by numerous regulations that set out various banking requirements, regarding, for example, the disclosure of charges and interest on banking services, the cost of borrowing for loans under a credit agreement and notice of uninsured deposits. OSFI publishes guidelines and advisories (discussed further below) to provide more guidance and clarity for participants.

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA) also forms an important part of the Canadian regulatory landscape for banks.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The federal government enacted the Office of the Superintendent of Financial Institutions Act, which established OSFI as the primary regulator of banks in Canada. OSFI administers the Bank Act and supervises banks in accordance with its published Supervisory Framework, which involves assessing the safety and soundness of banks, providing feedback, and intervening when necessary. Under the Supervisory Framework, OSFI's primary supervisory goal is to safeguard depositors against loss. As such, OSFI focuses on material risks to banks on a consolidated basis, which involves an assessment of all of a bank's material entities (including subsidiaries, branches and joint ventures), both in Canada and internationally.

Where OSFI identifies issues that may impact the stability of the financial system, it reports those issues to the Financial Institutions Supervisory Committee (FISC). The FISC comprises representatives from the federal Department of Finance, the Bank of Canada, OSFI, the Canada Deposit Insurance Corporation (CDIC) and the Financial Consumer Agency of Canada (FCAC). The FISC meets regularly to share information, coordinate actions and advise the federal government on financial system issues.

The FCAC is an independent agency of the government of Canada and is responsible for, inter alia:

- supervising and monitoring compliance with federal consumer protection measures;
- promoting the adoption by financial institutions of policies and procedures designed to implement voluntary codes of conduct designed to protect the interests of their customers;
- monitoring the implementation of voluntary codes of conduct that have been adopted by financial institutions;
- promoting consumer awareness about the obligations of financial institutions and of external complaints bodies under consumer provisions applicable to them;

- fostering, in cooperation with other government departments and participants, an understanding of issues relating to financial services;
- monitoring trends and issues that may affect consumers of financial products and services; and
- collaborating its activities with stakeholders to strengthen the financial literacy of Canadians.

The FCAC is also similarly responsible for supervising payment card network operators.

The CDIC, a Canadian federal Crown corporation, insures eligible deposits held at member financial institutions to protect consumers in the event of a bank failure.

Additionally, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), Canada's financial intelligence unit, oversees compliance with the PCMLTFA and its regulations. FINTRAC's mandate is to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities. As such, FINTRAC requires all banks and certain other entities to keep and retain prescribed records, to submit reports for certain types of transactions, to take specific steps to identify prescribed individuals or entities, and to implement a compliance programme.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

CDIC insures eligible deposits up to $100,000 (principal and interest combined) per depositor per institution. To qualify as an eligible deposit, the deposited funds must be in Canadian dollars and payable in Canadian currency. Eligible deposits include savings and chequing accounts, term deposits repayable no more than five years after the date of deposit, accounts holding funds to pay realty taxes on mortgaged properties, and money orders, bank drafts, certified cheques and travellers' cheques issued by a member institution. CDIC does not protect against fraud or theft and does not insure most debentures, treasury bills or investments in mortgages, stocks, bonds, or mutual funds.

As of January 2016, 78 financial institutions, including 38 banks, are CDIC members. CDIC members fund CDIC deposit insurance through premiums paid on the insured deposits they hold. CDIC members are required to display CDIC signage, file annual returns and comply with additional member requirements set out in the Canada Deposit Insurance Corporation Act (CDIC Act), the Financial Administration Act and the CDIC by-laws.

Neither the federal government nor any provincial government has taken any ownership interest in banks or other financial institutions.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Subject to certain limited exceptions under the Bank Act, a bank cannot enter into any transactions with a related party, including providing a guarantee on behalf of a related party, making an investment in the securities of a related party, assuming a loan owed by the related party or taking a security interest in the securities of a related party. A related party includes a person holding a 'significant interest' in the bank, an entity in which the person who controls the bank has a significant investment, directors or senior officers of the bank or a bank holding company, and the spouse, common-law partner or child under 18 years of age of any of the foregoing persons.

Federally regulated banks are prohibited from engaging in any business other than the business of banking and such business as generally appertains thereto, except as specifically permitted under the Bank Act. The business of banking includes the provision of financial services, investment counselling and portfolio management, acting as financial agent, and issuing of payment and credit cards. Also, a Canadian bank or a major shareholder or parent of a Canadian bank may not hold a substantial investment in entities engaging in fiduciary activities (unless such subsidiary is a federally registered trust company), certain restricted securities activities, restricted leasing activities (such as automobile leasing), restricted residential mortgage activities (such as high loan-to-value mortgages) or certain insurance activities. Foreign governments and agencies or entities controlled by them (other than foreign banks) cannot incorporate a bank in Canada or acquire a significant ownership interest in a Canadian bank.

6 What are the principal regulatory challenges facing the banking industry?

The primary regulatory challenge facing the Canadian banking industry is OSFI's implementation of the Basel III capital and liquidity requirements and the systems, administration and accounting changes that result from the imposition of these requirements.

Canadian banks are also affected by regulatory changes taking place in the United States, both as a result of conducting a considerable amount of business in the United States but also because of the potential extraterritorial reach of certain US laws. The Volcker Rule and the related set of US laws have meant that large Canadian banks with US subsidiaries have to deal with two very different regulatory environments on cross-border and transnational business lines.

Similarly, the recent adoption of the Foreign Account Tax Compliance Act (FATCA) in the US has been a cause for concern for the Canadian banks. On 5 February 2014, Canada and the US entered into the Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada–US Tax Convention to implement FATCA in Canada which came into force on 27 June 2014. Under this Intergovernmental Agreement, information related to US residents and citizens is reported to the Canada Revenue Agency rather than directly to the IRS in compliance with Canadian privacy laws. Furthermore, certain provisions of FATCA are not applicable to Canada, including the withholding tax, and certain accounts are exempt from reporting requirements.

The prolonged period of low interest rates in Canada paired with concerns over a stable and secure housing market have prompted OSFI to publish a letter advising banks and other financial institutions of upcoming changes to the capital requirements for loans secured by residential real property. Canada's Minister of Finance has also announced that the minimum down payment required for insured residential mortgages for house prices over $500,000 will be increased to 10 per cent, rather than the current 5 per cent.

Recently, OSFI has prioritised attention to cybersecurity and outsourcing risks, which in part are aimed at the rise of FinTech (the industry term for 'financial technology'). FinTech is likely one of the greatest regulatory challenges currently facing the banking industry as innovation in technology and its application to the financial industry can often outpace regulatory developments.

7 Are banks subject to consumer protection rules?

FCAC is a federal government agency responsible for ensuring financial entities comply with consumer protection provisions in various federal acts including the Bank Act, the Insurance Companies Act, the Trust and Loan Companies Act, the Cooperative Credit Associations Act, the Green Shield Canada Act, the Payment Card Networks Act and the Financial Consumer Agency of Canada Act.

FCAC addresses consumer protection issues that arise from time to time. In 2013–14, the FCAC opened a total of 891 cases against banks and other federally regulated financial entities for issues such as credit card statement disclosure, fees or debt collection practices. The FCAC issued a total of nine violations and imposed related penalties in the aggregate amount of C$775,000 (total for all financial services entities including insurance companies, payment card operators, etc).

In a 2014 landmark decision, *Bank of Montreal v Marcotte*, the Supreme Court of Canada held that consumer protection legislation applied to federally regulated bank credit card issuers. The decision indicates that in some circumstances provincial consumer protection law may apply to federally regulated financial institutions. The impact of the decision is that federally regulated financial institutions may need to consider both provincial and federal consumer protection laws.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The Canadian banking regulatory landscape will continue to evolve towards more principles-based regulation and oversight of individual banking institutions and the banking industry as a whole. Regulatory policy resulting from OSFI's ongoing implementation of Basel III and increased attention to corporate governance will continue to develop over the next few years. Financial institutions are adjusting to the increased regulatory burdens that have been imposed in recent years as a result of the implementation of Basel III. This includes more onerous liquidity requirements and leverage requirements and the implementation of the forward-looking accounting method, the International Financial Reporting Standard 9, for D-SIBs. Increased focus on anti-money laundering and terrorist financing will likely place greater assessment and mitigation responsibilities on individual banking institutions. OSFI has indicated that operational risk management will become part of its ongoing supervisory activities and has published draft operational risk management guidelines that will require certain financial institutions to establish and maintain an enterprise-wide framework of controls for operational risk management.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

OSFI requires disclosure from all federally regulated banks on a monthly, quarterly and annual basis. For example, banks must file consolidated balance sheets, deposit liabilities and interbank exposures as at the last day of each month; income statements, statements of mortgage loans and non-mortgage loans, and a statement of retail portfolio on a quarterly basis; and an impairment charge filing on an annual basis. Additionally, the Bank Act requires OSFI to conduct an examination of every bank on an annual basis to determine compliance with regulations and assess its financial condition.

10 How do the regulatory authorities enforce banking laws and regulations?

The Bank Act contains penalty and sanction provisions that can be exercised by OSFI. In practice, however, OSFI does not generally exercise these penal powers and instead relies on other mechanisms such as requiring binding compliance agreements or issuing compliance directives. In addition, the FCAC and CDIC also have limited enforcement powers. The FCAC's consumer protection powers are briefly discussed in response to question 7. CDIC has the authority to be appointed as a receiver over a troubled member bank with significant CDIC-insured deposits, but this power has not been exercised in the past decade.

OSFI has a four-stage intervention framework that enables OSFI – and, where appropriate, CDIC – to work collaboratively with a bank to develop a process to bring the bank into full compliance with regulations or improve the bank's financial viability. The first stage entails an early-warning system whereby senior management may be required to meet with OSFI (which may involve site visits by OSFI), and OSFI may issue public supervisory letters calling on the bank to undertake certain measures. In the second stage, OSFI can require mandatory implementation of corrective measures and increase its monitoring of the bank. OSFI may also engage an auditor to undertake an external audit of the procedures, processes and reporting mechanisms of the bank. The third stage anticipates a future failure of the bank and involves assessing asset quality, full-time on-site monitoring and enhanced planning for full regulatory administration of the bank. The fourth stage denotes that the bank is no longer viable. OSFI will take over the affairs of the bank and commence restructuring under the Winding-Up and Restructuring Act (WURA), which likely results in the sale of assets of the bank to another institution approved by federal government.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Based on the information released by OSFI, FINTRAC and the FCAC, there are no recurring regulatory compliance issues or common enforcement measures related to the banking industry in Canada. Supervisory and regulatory bodies rarely initiate enforcement action with the exception of consumer protection issues. FCAC's consumer protection enforcement is discussed in response to question 7. In 2014, OSFI released a Guideline on the regulation of the benchmarking of CDOR (the Canadian Dollar Offered Rate – the Canadian equivalent of LIBOR); however, this seems to be in response to international banking investigations related to LIBOR. There has been no commentary to suggest any manipulation of CDOR by Canadian banks. The Guideline states that it is in furtherance of OSFI's work with banks to meet international standards. The Guideline is intended to complement OSFI's Corporate Governance Guideline and Supervisory Framework as well as OSFI's general principles-based approach. OSFI requires adequate governance controls, annual reports by senior management to the board of directors of the bank, independence between oversight functions and operational management, and timely disclosure of material breaches in the submission process to senior management and the board. Banks are expected to include CDOR submission process compliance in their annual audit plans. OSFI will review banks' CDOR submission controls, may require copies of any related reports and may discuss findings with senior management, the board and the oversight functions.

Resolution

12 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

While the government is under no legal obligation to take over a failing bank, there is a widely held assumption that the government would not permit a large Canadian bank to fail because of the negative impact on the greater Canadian economy. Banks may be taken over by OSFI or the CDIC in cases of insolvency or regulatory non-compliance. OSFI's four-stage intervention process, described at question 10, and the establishment by CDIC of a 'bridge-bank' are tools that these regulatory authorities may use to take over a bank.

Bank failures are very rare in Canada and consequently, government or regulatory authority intervention by way of bank takeover is also very rare. The Bank of Canada and the Canadian Mortgage and Housing Corporation provided liquidity support during the recent financial crisis, including short-term loans, purchasing mortgage-backed securities and providing guarantees for Canadian banks. The government was not, however, required to intervene in the Canadian banking industry to the extent witnessed in other jurisdictions, nor did the government take an equity stake in any Canadian bank during the crisis.

Canadian banking regulation is strongly focused around the protection of depositors. This is demonstrated by CDIC's insuring of a depositor's first C$100,000 of eligible funds in a given bank. OSFI tightened its capital requirements after the financial crisis to better protect depositors by providing additional funds in a bank crisis scenario, including requiring the inclusion of non-viability contingent capital (NVCC) provisions in non-common share capital instruments.

13 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

If OSFI takes control of a bank pursuant to the four-stage intervention process (described at question 10), directors' legal roles are suspended until either the period of control expires or a winding-up is requested. Once a liquidator is appointed by the court pursuant to a bank's winding-up proceedings, the directors' powers are vested in the liquidator.

Currently, banks are not required to have a resolution or 'living will' plan that sets out the protocol for a failure or recovery following a failure, but OSFI and the CDIC have been working with financial institutions to implement such plans from a prudential standpoint. In March 2013, OSFI designated Canada's six largest banks as D-SIBs and requires each of these banks to establish a resolution plan. In addition, the CDIC's by-laws require deposit-taking CDIC-insured institutions to provide certain information on an annual and on-request basis to facilitate resolution planning.

14 Are managers or directors personally liable in the case of a bank failure?

Officers or directors are not personally liable in the case of a bank failure, but directors may be liable for certain actions that could result in a bank failure. Directors are liable for any breach of a duty imposed under the Bank Act or other applicable legislation or a duty under common law. For example, directors may be liable under the Bank Act if the directors authorised subordinate indebtedness or a reduction in stated capital when there were reasonable grounds for believing that the bank was, or the reduction would cause the bank to be, in contravention of capital adequacy provisions or liquidity provisions. There is a two-year limitation period from the date the resolution passed authorising the prohibited action after which directors would no longer be liable. There are several defences available to directors including the 'business judgement rule', whereby a director would not be found liable for properly informed business decisions made in good faith and in the absence of conflicts of interest, fraud or illegality.

Update and trends

FinTech will be one of the most interesting challenges facing the banking industry in 2016 as regulators try to keep pace with technological advances relating to the provision of financial services. Regulators have already introduced proposed changes to anti-money laundering laws to address some of the verification challenges raised by FinTech innovations. We anticipate additional regulatory changes as FinTech innovations become more prominent. The implications of the *Marcotte* decision discussed in question 7 will continue to be a focus of banks as they try to determine the scope of provincial laws that might apply to them. Finally, cybersecurity and cyber resiliency will continue to be of major concern to the banking industry as systems become more interconnected worldwide. Additional regulatory and legislative safeguards are anticipated over the next year as regulators and government seek to limit the banking industry's exposure to potentially disastrous cyberattacks.

In the event of a bank failure, directors are also jointly and severally liable for up to six months of unpaid wages for each employee. There is a six-month limitation period from the date wages are owed but go unpaid, a winding-up order is issued or liquidation proceedings have commenced, and a two-year limitation period after the director ceases to be in that role. Banks can purchase directors' and officers' insurance in order to ensure indemnification for such claims.

Capital requirements

15 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The Bank Act requires banks to maintain adequate capital and permits OSFI to establish guidelines setting out these requirements. The current Capital Adequacy Guidelines implement the Basel III Accord. The Capital Adequacy Guidelines require banks to have capital requirements that meet or exceed the Basel III minimums. Among those requirements, Canadian banks must have total capital ratios of 8 per cent, which will gradually increase to 10.5 per cent by 2019 through the phase-in of a capital conservation buffer starting in 2016. Banks that issue preferred shares or subordinated debt must contractually provide for the conversion of such instruments into common equity should the institution become non-viable, as discussed above. OSFI implemented a Leverage Requirements Guideline in 2014. Beginning in the first quarter of 2015, institutions must maintain a leverage ratio that meets or exceeds 3 per cent at all times. Individual institutions may be prescribed their own authorised leverage ratios by the Superintendent.

Banks are required to establish and maintain policies relating to liquidity consistent with OSFI's current liquidity guideline. These policies must be approved by the board of directors and reviewed annually. In 2014, OSFI revised the Liquidity Adequacy Requirements Guideline consistent with Basel III, including the liquidity coverage ratio and net stable funding ratio. The revised and reissued Liquidity Adequacy Requirements Guideline has been in effect as of January 2015.

Foreign banks carrying on business through a foreign subsidiary incorporated in Canada are subject to the same capital requirements and regulatory framework as domestic banks. Foreign banks operating through a foreign bank branch (whether through a full-service branch or a lending branch) are not subject to Canadian capital requirements. The rationale for this approach is that foreign banks operating through a foreign bank branch are subject to capital requirements and regulation in their home jurisdiction. Full-service branches are required to hold a capital equivalency deposit (CED) of C$5 million or 5 per cent of their branch liabilities, whichever is greater, with an approved Canadian financial institution. A lending branch is only required to hold a CED of $100,000.

16 How are the capital adequacy guidelines enforced?

Section 628 of the Bank Act obliges banks to provide OSFI with such information, at such times and in such form as OSFI may require. OSFI requires banks to submit quarterly reports detailing compliance with capital adequacy requirements. If issues are identified, OSFI will subject the bank to the four-stage intervention process described above.

17 What happens in the event that a bank becomes undercapitalised?

Undercapitalisation may result in OSFI requiring a bank to increase its capital. OSFI has the ability to intervene through its four-stage intervention process. Ultimately, OSFI has the ability to take control of a bank's assets or take control of a bank for an interim period. Also, the federal government is permitted to invest in the shares of a bank if it believes it will assist in stabilising the financial industry.

18 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Once OSFI controls a bank, it may request that the Attorney General apply to wind up the bank under WURA. A liquidator of a bank must be either CDIC itself or a trustee licensed under the Bankruptcy and Insolvency Act. The statutory duties of a liquidator are set out in WURA and include controlling all property of the bank, carrying on business that is beneficial during the winding-up, repaying indebtedness and distributing assets.

The CDIC Act permits CDIC to take certain measures if a CDIC-insured bank becomes insolvent. Such measures include requesting an order vesting the shares of the bank with CDIC so as to be sold to a third party and also the option to request the establishment of a 'bridge-bank' from the Minister of Finance such that the bank's viable assets could be sold to a third party.

19 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As described above, the Basel III capital adequacy requirements have been implemented for Canadian banks through the revised Capital Adequacy Requirements Guidelines. In addition, as previously noted, in March 2013, OSFI designated the six largest Canadian banks as D-SIBs and announced a 1 per cent common equity surcharge for all D-SIBs. As of 1 January 2016, D-SIBs are required to meet the target common equity Tier 1 (CET 1) ratio of 7 per cent of risk-weighted assets that all institutions are already required to meet, plus the additional 1 per cent owing to its D-SIB designation. The surcharge will be periodically reviewed in light of national and international developments. Such restrictions were implemented in recognition of the importance of D-SIBs to the Canadian economy, as the largest six banks account for more than 90 per cent of total banking assets. As discussed in question 15, OSFI introduced a number of regulatory guidelines in 2014 which are, for the most part, in effect.

In December 2015, OSFI announced its intention to update the regulatory capital requirements for loans secured by residential real estate properties by no later than 2017. The anticipated changes will impact the regulatory capital requirements for deposit-taking institutions using internal models for mortgage default risk.

Ownership restrictions and implications

20 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Limitations on the ownership or control of Canadian banks will vary depending on the size of a bank's equity. Banks are divided into three categories for the purposes of determining the applicable ownership rules:

- 'large banks', which have an equity capitalisation of C$12 billion or more;
- 'medium banks', which have an equity capitalisation of C$2 billion or more but less than C$12 billion; and
- 'small banks', which have an equity capitalisation of less than C$2 billion.

Large banks must be widely held, such that no single shareholder may own more than 20 per cent of any class of voting shares, or more than 30 per cent of any class of non-voting shares. A bank holding company may control a large bank, so long as the bank holding company is itself widely held.

Medium banks may be closely held, so long as at least 35 per cent of the voting shares of the bank are listed on a recognised stock exchange in Canada and are publicly held.

Small banks are not subject to ownership limits as long as the Minister of Finance is satisfied with the character and integrity of the applicant or, for a corporate applicant, its reputation for being operated in a manner that is consistent with the standards of good character and integrity.

In addition to these constraints on ownership, no person may acquire or increase a 'significant interest' in a bank without the consent of the Minister of Finance. A 'significant interest' is more than 10 per cent of any class of shares of a bank.

21 Are there any restrictions on foreign ownership of banks?

If a foreign bank that is not a resident of a World Trade Organization (WTO) member country wishes to acquire or increase a significant interest in a bank, prior to approving the transaction, OSFI (acting on behalf of the Minister of Finance) must be satisfied that banks are treated similarly in the jurisdiction in which the applicant principally carries on business, either directly or through a subsidiary. The government of a foreign country, or any political subdivision or agent thereof, cannot acquire shares of a Canadian bank.

22 What are the legal and regulatory implications for entities that control banks?

An entity that seeks approval from the Minister of Finance to acquire or increase a significant interest in a bank must provide a range of information that enables the regulator to investigate the applicant, including information that demonstrates that the applicant has sufficient resources to provide continuing financial support to the bank, and that the applicant's business record and experience is appropriate. The proposed ownership structure will be scrutinised.

An application for approval of a significant interest in a bank must also include an acknowledgement in writing of OSFI's expectation that the applicant will provide ongoing financial, managerial and operational support to the bank if such support becomes necessary (the 'Support Principle Letter'). Such ongoing support may take the form of additional capital, the provision of managerial expertise or the provision of support in such areas as risk management, internal control systems and training for bank employees. Importantly, the Support Principle Letter does not create a legally binding obligation on the applicant to provide such support.

23 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

See question 22.

24 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Under the Bank Act, shares issued by a bank are non-assessable, so a controlling entity is not liable to the bank or its creditors by virtue of holding such shares. OSFI will take over the affairs of an insolvent bank or commence restructuring under the WURA (or both), which will likely result in a sale of assets of the bank to another approved institution. In the event of liquidation, a controlling entity would be likely to lose the entire value of its investment since depositors and other creditors rank ahead of shareholders in a distribution of the proceeds from the liquidation.

As noted in question 22, although the controlling entity or individual will have provided a Support Principle Letter, the letter does not create a legally binding obligation on the applicant to provide such support in the event of, or to prevent, an insolvency.

Changes in control

25 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The Minister of Finance must approve the acquisition of control of a small or medium bank. With limited exceptions, no person may control a large bank. Under the relevant statutory provisions, 'control' means control in fact and not necessarily a legally defined concept of control. Many factors are relevant in determining whether an entity has 'control in fact' of another entity, and a specific analysis is required in each case to make a determination. OSFI will review an application and then make a recommendation to the Minister.

A closely related concept is that of a 'significant interest'. An acquisition or accumulation of more than 10 per cent of any class of shares of a bank (referred to as a 'significant interest') requires the approval of the Minister of Finance.

26 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

See question 21 regarding foreign ownership. In addition, the investment rules applicable to foreign banks, including their ability to acquire or hold control of, or a substantial investment in, Canadian banks, are comparable to the rules applicable to Canadian banks. Section 522.22 of the Bank Act requires ministerial approval for a foreign bank to acquire or hold control of, or a substantial investment in, a Canadian bank.

27 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

In determining whether or not to grant approval for the acquisition of control of a bank, the Minister of Finance will assess whether the applicant is suitable to control a bank. In this regard, the minister will consider various factors relevant to the application, including the financial resources of the applicant, the soundness and feasibility of the plans of the applicant, the business record and experience of the applicant, the character and integrity of the applicant and its reputation, whether the bank will be operated responsibly, the impact of any integration of the businesses and operations of the applicant with those of the bank, the extent to which the proposed corporate structure of the applicant and its affiliates may affect the supervision and regulation of the bank, and the best interests of the financial system in Canada.

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28 Describe the required filings for an acquisition of control of a bank.

The transaction instructions describe the information to be included with an application to OSFI, and provide administrative guidance about the application process. In addition to certain basic information about the applicant, the applicant is also expected to provide information that will help OSFI make a determination about whether the applicant is 'fit and proper' to control a bank, including a business plan and financial information. Background and security assessments must be conducted for certain key individuals of the applicant, and an OSFI security information form must be submitted for each such individual for this purpose. The applicant must submit a Support Principle Letter (see question 22).

29 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Applicants should always ensure that an application is complete, and that an OSFI security information form is submitted as early as possible in the application process, as OSFI does not control how long it takes to complete these background assessments. Although the application process usually takes a few months, the Minister is not subject to a specified time limit on the assessment of applications. Where an applicant is a WTO-member foreign bank, additional information may be requested and the process may take longer.

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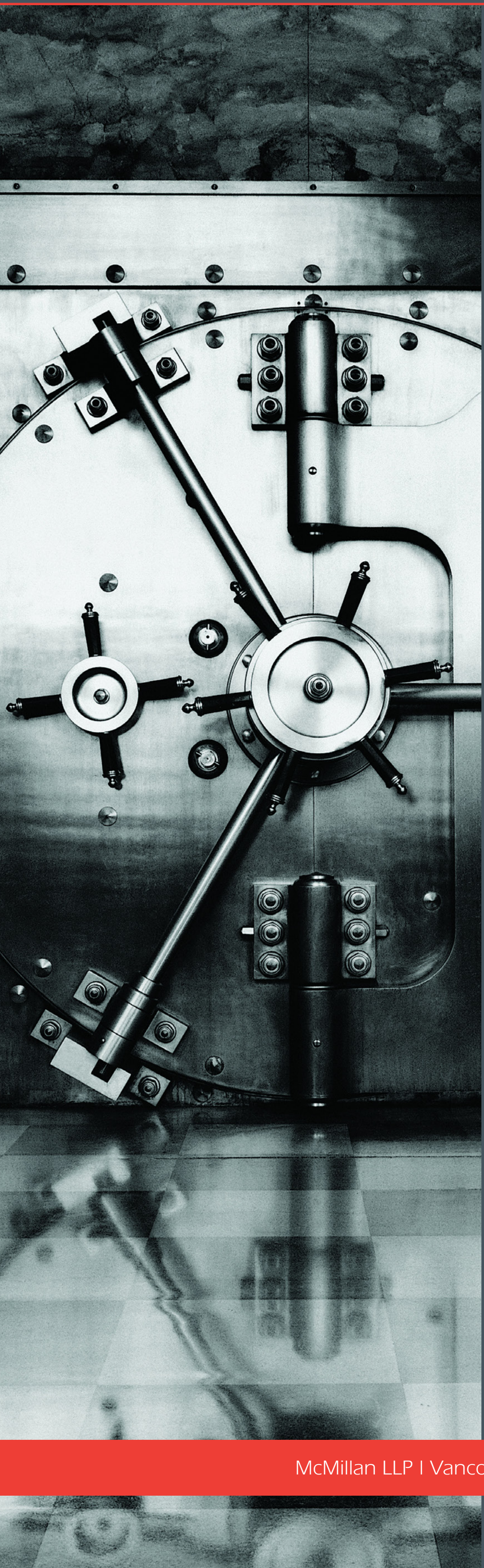

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