On September 23, 2018, the Bank Recapitalization (Bail-in) Conversion Regulations under the Canada Deposit Insurance Corporation Act, the Bank Recapitalization (Bail-in) Issuance Regulations under the Bank Act (collectively the Bail-In Regulations) and the Office of the Superintendent of Financial Institution’s Total Loss Absorbing Capacity (TLAC) Guideline will come into effect. These represent the final step in the implementation of the bail-in regime that will allow for the expedient conversion of certain bank liabilities into regulatory capital in the highly unlikely event that a domestic systemically important bank (D-SIB) becomes non-viable. For a more detailed discussion about the substance of the Bail-In Regulations, please refer to our bulletins entitled “Government of Canada Publishes Bail-In Regulations” and “Final Bail-In Regulations and Related Guidelines Published”, which can be found on our website at torys.com.
WHAT YOU NEED TO KNOW

- The Superintendent issued orders to each D-SIB, setting the minimum risk-based TLAC ratio at 21.5% of risk-weighted assets and the minimum TLAC leverage ratio at 6.75%.
- The CSA published (i) CSA Staff Notice 46-309 Bail-in Debt, which addresses the distribution or trade of bail-in debt to investors, and (ii) CSA Staff Notice 81-331 Investment Funds Investing in Bail-in Debt.
- A question raised by marketplace participants is whether a liability of a D-SIB outstanding prior to September 23, 2018 under a bond indenture, deposit note or similar instrument could be made subject to the bail-in regime by a D-SIB without the consent of the holder of that liability as a result of the D-SIB issuing additional debt under that same instrument on or after September 23, 2018. In our view, that existing liability could not be made subject to the bail-in regime without the consent of the holder.

D-SIB FORMAL DESIGNATION AND TLAC MINIMUM

On August 21, 2018, the Superintendent of Financial Institutions issued orders to Canada’s six largest banks, Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, The Bank of Nova Scotia and The Toronto-Dominion Bank, formalizing OSFI’s identification as these banks as D-SIBs in March 2013. In addition, the Superintendent issued orders to each D-SIB, setting the minimum risk-based TLAC ratio at 21.5% of risk-weighted assets and the minimum TLAC leverage ratio at 6.75%.

CSA STAFF NOTICES

On August 23, 2018, the Canadian Securities Administrators (CSA) published two notices outlining CSA staff’s views regarding the implementation of the bail-in regime. The first notice (CSA Staff Notice 46-309 Bail-in Debt) addresses the distribution or...
trade of bail-in debt to investors located in Canada and the second notice (CSA Staff Notice 81-331 Investment Funds Investing in Bail-in Debt) provides guidance for investment fund issuers that may invest in bail-in debt. CSA staff will continue to monitor developments regarding the implementation of the bail-in debt regime and will consider whether additional guidance is needed.

CSA Staff Notice 46-309 Bail-in Debt

This notice sets out the CSA’s view that there are different investment risks between bail-in debt and other types of unsubordinated debt. The notice also conveys the regulatory expectation that distributions or trades of bail-in debt by persons or companies in the business of trading in securities to investors located in Canada be done (i) by or through a registered dealer in accordance with relevant investor protection requirements under National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registration Requirements (NI 31-103), or (ii) in compliance with the international dealer registration exemption in NI 31-103.

CSA Staff Notice 81-331 Investment Funds Investing in Bail-in Debt

This notice sets out the CSA’s view that bail-in debt is an eligible investment for a money market fund (so long as the bail-in debt continues to meet the prescribed eligibility requirements applicable to money market funds as set out in National Instrument 81-102 Investment Funds). This is consistent with Torys’ view set forth in the bulletin “Final Bail-In Regulations and Related Guidelines Published.” The notice also reminds investment fund managers who will or may hold bail-in debt, that (i) they must fully understand and take into consideration key features and risks of bail-in debt and take into consideration any risks to their funds as a result of such investment (e.g., the risk the CDIC may convert all or a portion of the bail-in debt into common shares), (ii) any such holdings must be consistent with the fund’s investment objectives and strategies, and (iii) such funds must consider their disclosure obligations to their security holders (e.g., appropriate risk disclosure about bail-in debt and distinctions between bail-in debt and non-bail-in debt).

RE-OPENINGS

Under the Bail-in Regulations, a liability will be subject to the bail-in regime only if it is issued on or after September 23, 2018 or, in the case of a liability issued before that date, its terms are amended on or after that day to increase its principal amount or to extend its term to maturity.

A question raised by marketplace participants is whether a liability of a D-SIB outstanding prior to September 23, 2018 under a bond indenture, deposit note or similar instrument could be made subject to the bail-in regime by a D-SIB without the consent of the holder of that liability, as a result of the D-SIB issuing additional debt under that same instrument on or after September 23, 2018. In our view, that existing liability could not be made subject to the bail-in regime without consent of the holder for the following reasons.

It is a well-established principle of Canadian contract law that an agreement between parties cannot be amended by one party to provide for new terms (i.e., a bail-in conversion right) unless the other party consents to that amendment. This basic principle arises out of the same legal requirements that must be satisfied in order to create an enforceable agreement, including a mutual intention of the parties to be legally bound. Accordingly, a D-SIB could not unilaterally amend the terms of an outstanding liability such that it becomes subject to the bail-in regime.

We understand that according to the terms of certain instruments under which liabilities were issued by D-SIBs prior to September 23, 2018, amendments may be made without the consent of the holder in specified circumstances (i.e., under an amendment provision that permits amendments to be made that do not adversely affect the rights of a holder in a material respect). The specific terms of those instruments would need to be examined to determine
if those provisions would permit amendments such that existing liabilities could become subject to the bail-in regime without consent of the holders.

In our view, however, except for amendment provisions that specifically contemplate the bail-in regime, a court would conclude that an interpretation of amendment provisions permitting existing liabilities of a D-SIB to become subject to the bail-in regime without the holder’s consent would not accord with the intentions or reasonable expectations of the parties and therefore would not be given effect.

[Blair Keefe is co-head of the Torys’ Financial Services, Bank Regulatory and Insurance Regulatory practices, and is co-head of the Payments and Cards Practice. His practice focuses on corporate and regulatory issues relating to financial institutions, including mergers and acquisitions and corporate finance.

David Seville is a partner in Torys’ Toronto office and is co-head of the Capital Markets Practice. David has extensive experience advising issuers and underwriters on domestic and cross-border equity and debt public offerings and private placements. He also advises on continuous disclosure, corporate governance and financial institution regulatory matters. David also advises clients, including private equity and pension funds, on acquisitions, dispositions, shareholder arrangements and reorganizations.

Aaron Emes is the Head of Opinions and Research at Torys. Aaron has been with Torys his entire legal career and practised corporate and commercial law, mergers and acquisitions and securities law until 2017, when he assumed his current role. Aaron advises on a wide range of legal issues in a broad variety of areas, and is consulted about the most difficult legal questions faced by the firm in connection with the structuring and implementation of complex corporate and commercial transactions, where research alone cannot provide the answers. Aaron’s practice also involves conducting legal research, writing and reviewing legal opinions and memoranda, and reviewing and supervising complex research projects.

Eli Monas’ practice focuses on corporate law and regulatory issues relating to financial institutions. He has been involved in a number of significant transactions involving Canadian and foreign financial institutions. Eli recently returned to Torys after a 6-month secondment to the Legislation and Approvals Division at the Office of the Superintendent of Financial Institutions.

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• OPEN BANKING UPDATE: CANADA 2020 ISSUES
OPEN BANKING REPORT •

Ana Badour, Shauvik Shah and Tyler Hawley
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On July 5, 2018, Canada 2020, a Canadian think-tank, published its report on open banking following a Policy Lab which brought together various stakeholders to discuss open banking in Canada.
While still a relatively new concept in Canada, open banking has the potential to transform the financial services sector. The federal government is currently undergoing a review of open banking to assess whether it could have a positive impact on consumers while considering the risks to consumer privacy, data security, and financial stability.

WHAT IS OPEN BANKING?

“Open Banking” refers to an emerging financial services business model that focuses on the portability and open availability of customer data, including transactional information. The core aim of open banking is to enable consumers to share their financial data between their financial institution and third party providers (and between financial institutions), typically through the use of application programming interfaces (APIs).

INTERNATIONAL CONTEXT

A number of jurisdictions have either mandated or encouraged open banking. In the European Union, PSD2 (Revised Payment Service Directive) enables bank customers to allow third-party providers access to their account data, which, for example, could enable third-party providers to manage a customer’s finances. Recently, the European Banking Authority (EBA) released an Opinion and draft Guidelines Opinion and draft Guidelines to provide clarity to market participants on the implementation of the technical standards on strong customer authentication and common and secure communication under PSD2.

The United Kingdom has also been actively mandating open banking, pursuant to an order from the Competition and Markets Authority requiring the UK’s largest banks to share customer data with third parties. The Financial Conduct Authority (FCA) has recently stated that they plan to consult on changes to their guidance and rules to reflect the recently issued EBA Opinion and draft Guidelines.

Australia is also implementing open banking, following its review into open banking, but in this case as part of a broader move to implement a Consumer Data Right “to give Australians greater control over their data, empowering customers to choose to share their data with trusted recipients only for the purposes that they have authorised”. The Consumer Data Right will be implemented first in the banking industry followed by the energy and telecommunications industries, and thereafter followed by other industries.

In Hong Kong, the Hong Kong Monetary Authority has issued an Open API framework for public consultation. Japan has also introduced legislation on open banking. In Singapore, instead of mandating open banking, the Monetary Authority of Singapore (MAS) has been encouraging financial institutions to develop APIs openly so they can work with service providers to enhance customer experience. MAS also plans to issue guidelines on the ethical use of data.

THE CANADA 2020 POLICY LAB

The purpose of the Policy Lab was to encourage stakeholders to share information and to discuss the future of open banking in Canada.
The policy lab identified nine broad areas of consensus:

1. Consumers must provide informed consent before any data is shared and must have the ability to retract consent at any time.
2. An evolving financial services market may create new or enhanced risks; understanding that some of the risks are unknown, governments, the private sector and consumer advocates should collaboratively develop mechanisms to mitigate and reduce risks.
3. Rules around the sharing of data should ensure that the data shared is proportionate to the stated use.
4. Common standards, including API standards, must be created to ensure interoperability, avoid fragmentation and drive safe adoption. Those standards should be developed by the public and private sector collaboratively.
5. Technical standards around authentication and data sharing should comply with ISO and global standards as closely as possible to match rules in other jurisdictions since the issues are universal.
6. Before rules and standards are put in place, regulators must consider the impact they will have on inclusive innovation.
7. When designing rules and standards, ethical considerations need to be taken into account on how data can be used.
8. A well-designed system of open banking puts the consumer at the centre of their information through increased transparency and the introduction of new products that lower costs, give consumers more options, enhance global competitiveness and accelerate innovation.
9. The national retail payments oversight framework should reflect the realities of open banking.

A few themes flowed from the nine resolutions that received broad support. First, in the federal budget and the resolutions, it is clear that consumers must be at the center of the open banking discussion. Open banking should enable innovation that provides consumers with new products and services on a more competitive basis.

Second, the expansion of open banking will not come without risks and these risks need to be managed. Consumers must provide informed consent before their data is shared and ethical considerations need to be taken into account on how the data can be used. All interested parties will need to act together to identify and mitigate these risks.

Finally, in regulating open banking, rules and standards will need to be put in place. Canada should consider international standards when implementing open banking rules and regulators must consider the impact that rules may have on inclusive innovation.

While some of the resolutions were agreed upon by all, there remained some points that remain to be resolved, including (i) how to ensure that consumers are providing informed consent, (ii) how standardized the consent process should be among applications, (iii) whether a white list of authorized players should be created, and (iv) whether or not open banking should be the beginning of a broader open data regime in Canada.

CONCLUSION

The open banking movement is gaining momentum around the world. While open banking has the potential to create many new opportunities for consumers and financial services providers, implementation in this area is complex and requires thoughtful consideration of various risks. Stay tuned for further developments in this complex and developing area in Canada, following the federal government consultation.

[Ana Badour leads McCarthy Tétrault LLP’s national Fintech Group. She is a partner in their Financial Services Group and a Certified Anti-Money Laundering Specialist. She advises financial services entities, including financial institutions and Fintech entities, on regulatory compliance matters, including with respect to consumer protection, anti-money laundering and other regulatory requirements. She holds a LLM in Banking and Financial Law from Boston University, a LLB from Osgoode Hall Law School, and a BMath (Operations Research) from the University of Waterloo.]
Shauvik Shah is a business law associate with the law firm McCarthy Tétrault LLP. He focuses on securities law, private equity, mergers and acquisitions and is actively involved with the firm's leading Fintech practice.

Tyler Hawley was a summer student at McCarthy Tétrault and is currently completing his JD program at Western Law. He earned his Bachelor of Business Administration (with High Distinction) from the University of Toronto.

OSFI UPDATES ITS TRANSACTION INSTRUCTIONS FOR FRFIS’ PURCHASE OR REDEMPTION OF SHARES AND REDUCTION OF STATED CAPITAL

By Carol Lyons, Darcy Ammerman and Christopher Tworzyanski (Student-at-Law)
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On August 17, 2018, the Office of the Superintendent of Financial Institutions (“OSFI”) revised its transaction instructions relating to the consent and reporting obligations of Federally Regulated Financial Institutions (“FRFIs”) entering into transactions to purchase (for cancellation) shares,
redeem shares or to reduce stated capital, all of which are subject to OSFI’s deemed approval process. The revisions expand on previously published transaction guidance and require FRFIs to provide OSFI with more in-depth disclosure before a share purchase for cancellation, redemption or stated capital reduction is approved.

SHARE PURCHASE OR REDEMPTION TRANSACTIONS

Pursuant to the applicable governing legislation (i.e., the Bank Act, Trust and Loan Companies Act, Insurance Companies Act or Cooperative Credit Associations Act) (the “Acts”), an FRFI can purchase for the purpose of cancellation any shares issued by it, or redeem any redeemable shares issued by it, if certain conditions are met, including the prior consent of the Superintendent (subject to a few discrete exceptions).

In its application for consent, an FRFI is generally expected to provide OSFI with the following information and documentation:

- a description of and rationale for the transaction including the number and type of shares to be purchased or redeemed, the rationale supporting the purchase or redemption price and the proposed timing;
- a certified copy of the board resolution authorizing the transaction;
- a copy of any proposed disclosure prepared in connection with the transaction and required by another regulatory authority, such as a stock exchange or securities commission;
- an analysis of the effect of the transaction on the applicant’s financial position and risk profile including details of the projected changes to the applicant’s balance sheet, capital position and, in the case of deposit-taking institutions, liquidity position (if material, the projected changes are to be provided by way of comparative pro forma balance sheet, capital position and liquidity position that confirms compliance with applicable targets), together with all relevant assumptions and a breakdown of the calculation of all relevant tests and ratios;
- confirmation that following the transaction the applicant FRFI will be in compliance with all relevant policies; and
- for the redemption of shares, confirmation that the redemption price is consistent with the formula set out in the applicant’s bylaws or conditions attaching to the shares.

STATED CAPITAL REDUCTION TRANSACTIONS

Pursuant to the Acts, the stated capital of an FRFI may be reduced by special resolution (the “Special Resolution”) so long as certain conditions are complied with. A Special Resolution is a resolution passed by a majority of not less than 2/3rds of the votes cast by the shareholders, policyholders or members (as the case may be) of the FRFI who voted in respect of that resolution, or signed by all the shareholders, policyholders or members (as the case may be) entitled to vote. Subject to a few specific exceptions, the Special Resolution has no effect until it is approved in writing by the Superintendent. An application for approval must be made within three months after the time of the passing of the Special Resolution and a copy of the Special Resolution, together with a notice of intention to apply for approval (the “Notice”), must have been published in the Canada Gazette prior to submission of the application. If the Notice is published prior to the passing of the Special Resolution, additional requirements may apply.

In the application, FRFIs are generally expected to provide OSFI with the following:

- the rationale for the transaction, statements showing the number of shares of each class of shares of the FRFI that are issued and outstanding, the proposed timing and the amount of the proposed reduction;
- proof of publication of the Notice;
- confirmation that the applicant has not, since publication of the Notice, received any objections related to the Notice, or has addressed any objection
received (together with a description of the manner in which each objection was addressed);  
• an executed copy of the Special Resolution which authorizes the transaction and specifies the stated capital account or accounts from which the reduction will be taken;  
• results of voting by class of shares in respect of the Special Resolution;  
• an analysis of the effect of the reduction of stated capital on the financial position and risk profile of the applicant, including a comparative pro forma balance sheet, capital position and, in the case of deposit-taking institutions, liquidity position, together with relevant assumptions and a breakdown of the calculation of all relevant tests and ratios; and  
• confirmation that, following the transaction, the applicant will be in compliance with all relevant policies.

The required supporting documentation can be submitted by email to approvalsandprecedents@osfi-bsif.gc.ca. Under this approval regime, OSFI generally will make a decision to grant or deny approval within 30 days of receiving the prescribed information.

COMMENT

The enhanced information requirements associated with these approvals are consistent with OSFI’s focus on FRFI disclosure and transparency and are designed to provide OSFI with an increased ability to monitor FRFIs’ compliance with financial and governance obligations when entering these types of transactions. Note, however, that the requirements set out in the transaction instructions may not be exhaustive. The instructions provide that OSFI may request additional information, take into account other matters, impose terms and conditions on providing the Superintendent’s consent or require certain undertakings. Applicants should therefore be prepared for the approval process to be more of an iterative progression which may evolve based on the information provided.

[Carol Lyons is a corporate/commercial lawyer and the emphasis of her practice is on transactional work. She advises clients on establishing businesses in Canada, mergers and acquisitions, corporate reorganizations, formation of strategic alliances (including divestment/outsourcing of business functions) and contract procurement, including requests for proposals (RFPs). Carol specializes in working with clients in the insurance, health care and other regulated industries. Her practice includes assisting insurers and reinsurers with the regulatory approval process in the context of transactions and other corporate changes as well as advising on regulatory compliance generally. She also advises on corporate governance and pension law matters.  
Darcy Ammerman is a partner in the firm’s Ottawa office advising on all aspects of domestic and cross-border debt financing transactions, financial institution regulation, regulation of service contracts/warranties and insurance matters. In the insurance area, Darcy advises on regulatory approvals, reorganizations, direct marketing and coverage issues (including with respect to cybersecurity coverage). Darcy’s transactional experience includes syndicated lending, asset-based lending, DIP financing, mezzanine financing and project finance. Darcy is named as a rising star in the IFLR1000 Financial and Corporate Guide.]

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