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THE FINANCIAL CONSUMER AGENCY OF CANADA ACT

A Massive New Act Makes Significant Changes in the Structure of Canadian Bank Regulation. The Authors Provide an Overview of the Changes for Bank Ownership, Mergers, Holding Companies, Powers and Permitted Investments, and the Operation of Foreign Banks in Canada.

By Pat Forgione and Cheryl Stacey*

On October 24, 2001, the federal government of Canada proclaimed into force the *Financial Consumer Agency of Canada Act* (Canada) (the "FCA"), which makes significant amendments to the Bank Act (Canada)[1] (the "Bank Act") and other legislation relating to federally regulated financial institutions. The FCA is a very lengthy statute (over 900 pages) with more than one third devoted to amending the Bank Act. The Federal Government has also published four separate sets of regulations relating to the amendments contained in the FCA of which three have now been proclaimed into force. The remaining set of regulations is expected to be proclaimed into force shortly.

The FCA and the amendments to the Bank Act contained therein are the result of an extensive review of Canadian financial services legislation that began in December of 1996 with the establishment of The Task Force on the Future of the Canadian Financial Services Sector.[2] The mandate of the Task Force was to establish a policy framework that would enable both the Federal Government and participants in the financial services sector to respond to the ongoing rapid transformation of the financial services industry both domestically and globally.[3] On September 14, 1998, the Task Force released its report entitled *Change, Challenge, Opportunity: Report of the Task Force*[4] (the "MacKay Report") to

1. *Bank Act*, R.S.C. 1991, c. 46.

2. The members of the Task Force consisted of Harold MacKay (Chairman), Pierre Ducros (Vice-Chairman), Neil Baker, Norm Bromberger, Donald Brown, Moya Cahill, John McArthur and Lynn Toupin.

3. The Task Force noted that rapid technological change, the spread of market economies, the integration of Europe (including the adoption of a single currency), the broadening and deepening of freer trade and investment, and the ascendancy of global markets were rapidly transforming how commerce was being conducted and a new policy framework was required to allow the financial services sector to respond to the changes.

4. TASK FORCE ON THE FUTURE OF THE CANADIAN FINANCIAL SERVICES SECTOR, CHANGE, CHALLENGE, OPPORTUNITY: REPORT OF THE TASK FORCE, (Ottawa: Department of Finance, Sept. 14, 1998), available at <http://finservtaskforce.fin.gc.ca/rpt/pdf/Main_E.pdf> (last visited Feb. 27, 2002).

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the Federal Government. The MacKay Report contained 124 recommendations addressing four main principles: enhancing competition and competitiveness; empowering consumers; responding to Canadian expectations and corporate conduct; and improving the regulatory framework.

The MacKay Report was subsequently reviewed by two parliamentary committees which conducted extensive public consultations on its recommendations. This process culminated in the release by the Federal Government on June 25, 1999 of its policy paper entitled *Reforming Canada's Financial Services Sector: A Framework for the Future*[5] (the "White Paper"). The White Paper contained 57 recommendations based on four fundamental guiding principles: promoting efficiency and growth; fostering domestic competition; empowering and protecting consumers of financial services; and improving the regulatory environment. These four principles form the policy framework of the FCA, and many of the White Paper recommendations have, in one form or another, been adopted in the FCA.[6]

Given the breadth, complexity and technical nature of the amendments to the Bank Act contained in the FCA, a detailed analysis of the amendments is beyond the scope of this paper. However, we will provide a general overview of some of the more significant amendments to the Bank Act contained in the FCA relating to the following:

- bank ownership regime;
- merger review process;
- bank holding company regime;
- bank powers and permitted investments;
- operation of foreign banks in Canada; and
- consumer protection.

5. GOVERNMENT OF CANADA, DEPARTMENT OF FINANCE, REFORMING CANADA'S FINANCIAL SERVICES SECTOR: A FRAMEWORK FOR THE FUTURE (Ottawa: Department of Finance, June 25, 1999), available at <http://www.fin.gc.ca/finserv.docs/finservrept_e.pdf> (last visited Feb. 27, 2002).
6. In the press release accompanying the introduction of the FCA on February 7, 2001, the Federal Government made its policy

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objectives clear by stating that "[t]he legislation would provide Canada's financial services sector with a framework that promotes efficiency and growth, fosters international competitiveness and domestic competition, empowers and protects consumers of financial services, and improves the regulatory environment." See press release from Minister of Finance, Feb. 7, 2001 available at <http://www.fin.gc.ca/news01/01-014e.html> (last modified: Feb. 15, 2002).

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BANK OWNERSHIP REGIME

The FCA's amendments to the Bank Act have substantially changed the bank ownership regime. These changes, taken together with the expanded permitted investment rules and the introduction of a new bank holding company regime, have the potential to fundamentally change the landscape of the financial services sector in Canada.[7]

Under the previous ownership rules, Schedule I banks under the Bank Act were required to be "widely held" — *i.e.* no shareholder or group of shareholders acting in concert could own more than 10% of any class of shares of a Schedule I bank. On the other hand, Schedule II banks8 were not subject to this "widely held" rule (at least initially) and could be owned up to 100% by a single shareholder with the consent of the federal Minister of Finance (the "Minister"). However, a shareholder of a domestic Schedule II bank could only have shareholdings exceeding this 10% threshold for the first ten years of the Schedule II bank's existence, after which it would become a Schedule I bank and subject to the "widely held" requirement.[9] The exception to this "10 year rule" were Schedule II banks owned by foreign banks which could remain 100% owned by the foreign bank indefinitely with the prior consent of the Minister.[10]

There were two main policy reasons for this "widely held" requirement applicable to Schedule I banks. First, it made it easier to ensure continuing Canadian control of Schedule I banks.[11] Second, the "widely held" requirement made it easier to maintain the separation between financial and commercial activities and reduced the risk of a controlling shareholder with commercial interests influencing a bank to make imprudent lending and investment decisions.[12]

The new bank ownership regime attempts to find a balance between the principles of maintaining the safety and soundness of the financial system cultivated by the previous ownership regime and increasing domestic competition.[13] Under the new bank ownership regime, the traditional ownership rules based on the distinction between Schedule I and Schedule II banks have been replaced with ownership rules based on the size of a bank's equity. Under the new regime, banks are divided into the following three categories for the purposes of determining the applicable ownership rules:

1. "large banks" — banks that have equity of at least Cdn$5 billion,[14]

2. "medium banks" — banks that have equity of Cdn$1 billion or greater but less than Cdn$5 billion, and

3. "small banks" — banks that have equity of less than Cdn$1 billion.

Under the new ownership regime, "large banks" must continue to be "widely held". However the definition of

7. CANADIAN BANKERS ASSOCIATION, FINANCIAL SERVICES REFORM 2001: THE CANADIAN BANKERS ASSOCIATION RESPONSE TO BILL C-8 , (March 2001) at 11, available at <http://www.cba.ca/eng/CBA_on_the_Issues/Reports/billc8.cfm> (last visited Feb. 27, 2002).
8. Prior to the most recent amendments to the *Bank Act* contained in the FCA, the main difference between Schedule I and II banks was the 10% ownership restriction imposed on shareholders of Schedule I banks. Subject to obtaining the necessary approvals, Schedule II banks were not required to adhere to this 10% ownership restriction for the first 10 years after establishment. After the expiry of this initial 10 year period, a Schedule II bank would be re-characterized as a Schedule I bank and subject to the 10% ownership restriction. The one exception to this re-characterization were foreign bank subsidiaries which, after obtaining the necessary consent, could continue to be closely held and remain Schedule II banks beyond this initial 10 year period. Under the new ownership regime, all domestic banks are now listed in Schedule I and all foreign bank subsidiaries are now listed in Schedule II.
9. The policy reason behind this initial 10 year grace period to the application of the "widely held" requirement was to encourage the formation of new domestic banks.
10. Foreign bank subsidiaries were the most typical forms of Schedule II banks prior to the new bank ownership regime.
11. LIBRARY OF PARLIAMENT, LEGISLATIVE SUMMARY: BILL C-8 - LS387-E, (Ottawa: Library of Parliament, Feb. 14, 2001) at 7, available at <http://www.parl.gc.ca/common/Bills_ls.asp?lang=E&Parl=37&Ses=1&ls=C8&source=Bills_House_Government> (last visited Feb. 27, 2002).
12. Id.
13. Id.
14. "Large banks" include all banks referenced as Schedule I banks under the *Bank Act* prior to the amendments contained in the FCA including the following: Royal Bank of Canada, The Toronto-Dominion Bank, Bank of Montreal, The Bank of Nova Scotia, National Bank of Canada, Laurentian Bank of Canada and Canadian Western Bank. National Bank of Canada, Laurentian Bank of Canada and Canadian Western Bank do not technically meet this Cdn$5 billion threshold but are deemed to be "large banks". The Federal Government has released guidelines setting out the framework for review of an application for re-categorization any of these three banks.

"widely held" has been changed to permit a single shareholder to own up to 20% of any class of voting shares and 30% of any class of non-voting shares of a "large bank,"[15] provided that no shareholder or group of shareholders acting in concert may control the bank in accordance with the definition of "control" in the Bank Act.

One exception to this prohibition against a "large bank" having a "major shareholder" (*i.e.* a person owning more than 20% of a class of voting shares or 30% of a class of non-voting shares of a bank) is a bank holding company (discussed below). A bank holding company may be a "major shareholder" of a "large bank" provided that it (i) controls the bank, and (ii) satisfies the same "widely held" requirements and control prohibitions that the "large bank" would be subject to if it were not controlled by the bank holding company.

The expressed purpose of the new ownership rules applicable to "large banks" is to accommodate strategic investors and to provide these banks with greater flexibility to enter into strategic alliances and joint ventures with commercial and other entities through share exchange structures.

The Federal Government's policy objective of increasing competition in the domestic market is clearly evident in the ownership rules applicable to "medium banks" and "small banks." Under the new ownership regime, "medium banks" may have a "major shareholder" or be closely held provided that 35% of its voting shares must be publicly traded on a stock exchange and not owned by a "major shareholder." This is commonly referred to as the "public float requirement." "Small banks" on the other hand are not subject to this "public float requirement" and accordingly all the shares of a "small bank" may held by one shareholder. In addition, the minimum paid-up capital required to establish a bank has been reduced from Cdn$10 million to Cdn$5 million. These new ownership rules and the reduced capital requirements provide new opportunities for commercial and other entities (including, for example, grocery chains or other commercial entities that have a significant retail presence) to enter the banking sector by acquiring or establishing "medium banks" or "small banks." The Federal Government is also hopeful that these new ownership rules relating to "medium banks" and "small banks" will lead to the creation of community-based banks providing services that are tailored to the needs of specific clientele and that enable these banks to compete with "large banks" in local or regional markets.[16]

It is important to note that while the permitted ownership levels for banks have been liberalized, ownership by any shareholder of more than 10% of any class of shares of a bank continues to be subject to the approval by the Minister based on a "fitness test." This "fitness test" consists of eight factors that the Minister will take into account in the approval process. These factors are: (i) financial resources of the shareholder; (ii) soundness and feasibility of the business plan of the shareholder; (iii) business record of the shareholder; (iv) character and integrity of the shareholder; (v) competence and experience of management; (vi) impact on the integration of the business and operations of the shareholder with that of the bank; (vii) the view of the Office of the Superintendent of Financial Institutions ("OSFI") in respect of the extent to which the proposed structure will affect supervision and regulation; and (viii) the best interests of the Canadian financial system. However, the shareholder's character and integrity will be the only fitness factor that will be considered by the Minister if the approval sought is for ownership of more than 10% of a class of shares but less than that of a "major shareholder."

The approval process being based on fitness factors is important in two respects. First, it allows the Federal Government (through the Minister) to have significant control over who owns and controls "medium banks" and "small banks," thereby mitigating the risks associated with the establishment of such banks. There have been concerns raised that the liberalization of the ownership rules for "medium banks" and "small banks" will inevitably lead to an increased number of bank failures. The fitness factors provide the Minister with broad discretion to refuse any application if the Minister has concerns about the applicant. Second, the discretion involved in assessing the fitness factors will allow the

15. This new rule for "large banks" introduces into the *Bank Act* the concept of "major shareholder" which is defined as any person who owns in the aggregate more than 20% of a class of voting shares of a body corporate or more than 30% of a class of non-voting shares of a body corporate. This calculation will include all shares in the body corporate owned by an entity controlled by such person.

16. See press release from the Minister of Finance (Feb. 7, 2001) available at <http://www.fin.gc.ca/news01/data/01-014_1e.html> (last visited Mar. 7, 2002) at 3.

Minister to determine the impact these changes to the ownership regime will have on competition in the banking sector by applying these fitness factors either liberally or conservatively. In the end, the Minister will likely try to find an approach to evaluating applications that fosters increased competition in the banking sector and at the same time continues to provide the protection and stability that the Canadian public has come to expect from its banking sector.

MERGER REVIEW PROCESS

A review of the new ownership regime under the Bank Act would not be complete without also discussing the new merger review guidelines released by the Federal Government. Merger activity in the financial services sector has been rising steadily throughout the 1990s. In Canada, 185 mergers and acquisitions occurred in the financial services sector from 1993 to 1996, up from 125 in the previous four years.[17] In addition, the two failed merger attempts among Canada's largest Schedule I banks in the late 1990's brought the issue of bank mergers to the political forefront. Within this context, and in an effort to provide a transparent review process to banks interested in merging, the Federal Government released merger review guidelines (the "Guidelines") that will be applied to any proposed merger between "large banks" or bank holding companies. The Guidelines do not form part of the Bank Act but were released as an accompaniment to the press release issued by the Minister introducing the FCA.

There are three distinct phases to the merger review process outlined in the Guidelines: an examination stage; a decision stage; and if applicable, a negotiation of remedies stage. During the examination stage, the merging banks must submit a written application to the Competition Bureau, OSFI and the Minister requesting approval to merge and containing information necessary to properly assess the merger request. During the examination stage, the merging banks must also submit a Public Interest Impact Assessment ("PIIA"). The PIIA contains information relating to the rationale for the merger and the steps that the merging banks propose to take to mitigate any potential costs and concerns resulting from merger. The Guidelines provide a list of items that must be addressed by the merging banks within this context in the PIIA. During the examination stage, the Competition Bureau and OSFI will review the merger proposal from a competition and prudential perspective, respectively. Concurrently with these reviews by the Competition Bureau and OSFI, two separate government committees will conduct public hearings on the public interest issues raised by the merger proposal using the PIIA as a key input. Once they have completed their reviews of the proposed merger, the Competition Bureau and OSFI will provide to the Minister written reports outlining their views on the proposed merger. These reports will then be released to the government committees for public scrutiny. Upon completion of public hearings and deliberations, each of the government committees will submit a report to the Minister on the public interest issues raised by the proposed merger.

Once the Minister has received the reports prepared by the government committees, the merger review process will move to the decision stage. Upon reviewing all the reports submitted, the Minister will make a decision on whether the public interest, prudential and competition concerns raised by the proposed merger are capable of being satisfactorily addressed. The Federal Government has indicated that it will attempt to complete this second stage within five months after all reports have been submitted. If the Minister decides that these concerns cannot be adequately addressed, the merger application will be denied and the merger review process will end at this second stage. If the Minister decides that these concerns are capable of being addressed, the merger review process will proceed to the negotiation of remedies stage.

During this final negotiation of remedies stage, the Competition Bureau will negotiate the remedies necessary to deal with the competition concerns raised during the examination stage and OSFI will negotiate the remedies necessary to address the prudential concerns. In addition, both the Competition Bureau and OSFI will work with the Minster to co-ordinate an overall set of public interest remedies. If remedies are successfully negotiated to the satisfaction of the Minister, the Competition Bureau and OSFI, the Minister will approve the proposed merger subject to the terms and conditions reflected in the negotiated remedies.

The Canadian Bankers Association has stated that the introduction of the Guidelines confirms the Federal Government's acceptance of the position that "mergers can be a legitimate business strategy .... to build size, scale and scope to respond to forces driving change in the industry

17. Library of Parliament, *supra* note 11, at 22.

at home and abroad."[18] However, it is clear from the wide powers granted to the Minister in stage two of the merger review process that public opinion and political considerations will continue to play a large role in determining whether a merger application is accepted or rejected. Accordingly, the timing of the next proposed merger between Canada's largest banks will likely be dependent on the perceived level of public support for bank mergers and whether the banks believe that they can succeed in convincing the public that the proposed merger will be beneficial to the Canadian financial system and to Canadian consumers.

BANK HOLDING COMPANIES

For the first time in Canadian history, widely held Canadian banks are now permitted to organize their activities through a regulated non-operating holding company incorporated under the Bank Act. This represents a dramatic change from the previous regime which required banks to be "widely held" (as discussed in greater detail above) and provides significant added flexibility for Canadian banks in structuring their operations.

Canadian banks have traditionally been very heavily regulated due to their retail deposit-taking activities. However, the Federal Government recognized that regulating all activities of a bank and its subsidiaries in the same manner may negatively impact competition when the bank is attempting to compete with non-bank entities that do not face such regulation.[19] The bank holding company structure is therefore intended to create the opportunity for lighter regulation in various areas by permitting a bank holding company to carry on non-deposit-taking activities through subsidiaries that operate as non-regulated affiliates of a bank.[20] The holding company structure is also intended to facilitate joint venture arrangements between a bank and one or more financial or non-financial organizations.

Under the new amendments to the Bank Act, a bank holding company may be established in the following ways: (i) incorporation of a bank holding company; (ii) conversion of an existing bank to a bank holding company; or (iii) continuation of a corporation as a bank holding company. Each applicant seeking to establish a bank holding company must first meet a "fitness" test similar to that set out above for applicants seeking to hold greater than 10% of the shares of a bank. In addition, if a proposed bank holding company would be a subsidiary of a foreign bank from a non-WTO member country, the Minister may not issue letters patent incorporating such bank holding company unless he is satisfied that treatment as favourable for bank holding companies exists or will be provided in the jurisdiction in which the foreign bank principally carries on business.

A bank holding company is not permitted to use a name that is substantially similar to that of a bank unless the name contains words that, in the opinion of the Superintendent of Financial Institutions (the "Superintendent"), indicates to the public that the bank holding company is distinct from any bank that is a subsidiary of the bank holding company. Every bank holding company must have as part of its name the abbreviation "bhc" or "spb."[21]

Bank holding companies must be non-operating entities and may not engage in or carry on any business other than as permitted by the Bank Act. Under the new regime, the permitted activities of a bank holding company are limited to: (i) acquiring, holding and administering permitted investments; (ii) providing management, advisory, financing, accounting, information processing, and other services prescribed by regulations to entities in which the bank holding company has a substantial investment;[22] and (iii) other busi-

18. Canadian Bankers Association, *supra* note 7, at 15.
19. Library of Parliament, *supra* note 11, at 14. This policy follows from the MacKay Report which recognized that as markets become more competitive, the cost burden of regulating the same activities in some institutions and not in competing institutions may affect competition in the marketplace. In order to foster domestic competition, the MacKay Report recommended that two institutions performing the same functions should be regulated in the same manner with respect to those functions. *See also* GOVERNMENT OF CANADA, DEPARTMENT OF FINANCE, ORGANIZATIONAL FLEXIBILITY FOR FINANCIAL INSTITUTIONS (BACKGROUND PAPER #2) (Ottawa: Department of Finance, Sept. 1998) at 45, available at <http://finservtaskforce.fin.gc.ca/rpt/pdf/BG2_E.pdf> (last visited Feb. 27, 2002).
20. Canadian Bankers Association, *supra* note 7, at 9.
21. Bhc is an acronym for Bank Holding Company and spb is an acronym for Societe de Portefueille Banquaire.
22. A person holds a substantial investment in a body corporate for the purposes of the *Bank Act* if (1) such person (together with all entities controlled by the person) owns greater than 10% of the voting rights attached to all of the voting shares of the body corporate or (2) such person (together with all entities controlled by the person) owns greater than 25% of the shareholders' equity of the body corporate. This definition of substantial investment was not amended by the FCA.

ness activities prescribed by regulations. Considerable detail relating to these permitted activities of a bank holding company remains to be addressed by regulations, and the extent to which the bank holding company provisions of the Bank Act are successful in providing added flexibility for Canadian banks will be determined in large part by the content and interpretation by OSFI of such regulations.[23]

Many provisions in the Bank Act that apply to banks will apply equally to bank holding companies. For example, ownership rules for bank holding companies are based on the same equity thresholds as set out above for banks. These provisions are intended to ensure that investors cannot use the bank holding company structure to exceed the bank ownership restrictions applicable to banks.[24] Bank holding companies are also subject to many of the same investment rules that apply to banks (as discussed in more detail below). Given the expanded range of permitted investments set out in the FCA, the holding company structure should provide bank financial groups with the opportunity to develop their businesses and form strategic alliances in accordance with the growing needs of their customers.[25]

In recognition that lighter regulation is appropriate with respect to non-deposit taking activities, the FCA provides that certain provisions of the Bank Act applicable to banks will not apply to bank holding companies and certain affiliates not engaged in deposit-taking activities. For instance, bank holding companies and unregulated affiliates are not subject to certain governance, mandatory examination, and conduct review committee provisions that are applicable to banks. This reflects the fact that OSFI is not responsible for protecting creditors of a bank holding company or any unregulated affiliate of such bank holding company.[26]

OSFI does, however, have an obligation to protect depositors of any bank in the bank holding company structure and accordingly, the amendments to the Bank Act contained in the FCA provide that a bank holding company and its subsidiaries will be subject to supervision on a consolidated basis. The Superintendent may order any person who controls a bank holding company or any entity affiliated with a bank holding company to provide any information or documents requested by the Superintendent to determine whether the bank holding company is in compliance with the Bank Act and to ascertain the financial condition of the bank holding company.[27] In addition, the Superintendent will from time to time examine the business and affairs of each bank holding company in order to make any such determination. In this regard, the Superintendent may enter into a "prudential agreement" with a bank holding company for the purposes of implementing any measures designed to protect the interests of depositors, policyholders, and creditors of any federal financial institution affiliated with the bank holding company. If it is necessary, in the opinion of the Superintendent, a bank holding company may be ordered to cease or refrain from committing any act that may be prejudicial to the interests of such depositors, policyholders and creditors of any federal financial institution affiliated with the bank holding company.

Bank holding companies and their subsidiaries must also maintain adequate capital and adequate and appropriate forms of liquidity on a consolidated basis. The capital requirements will be prescribed by regulation and have yet to be determined. It is important to note that even if a bank holding company is complying with regulations or guidelines in respect of capital and liquidity, the Superintendent retains the discretion to order it to increase its capital or to provide additional liquidity in such forms and amounts as the Superintendent requires.

BANK POWERS AND PERMITTED INVESTMENTS

In keeping with the guiding principles of fostering domestic competition and promoting efficiency and growth, the FCA considerably broadens the scope of investments that Canadian banks are permitted to make. Under the new investment regime, banks may make substantial investments in various different entities (each of which is discussed below): (i) banks and other financial institutions; (ii) entities that are engaged in providing services to financial institutions, financial service providers or their affiliates; (iii) entities that are engaged in activities solely related to the promotion, sale, delivery or distribution of financial products; (iv) mutual fund entities, real property

23. Canadian Bankers Association, *supra* note 7, at 11.
24. Library of Parliament, *supra* note 11, at 18.
25. Canadian Bankers Association, *supra* note 7, at 9.
26. JOHN W. TEOLIS & C. DAWN JETTEN, BANK ACT: LEGISLATION AND COMMENTARY (Butterworths, 1998+) at 15.1.
27. All such information provided to the Superintendent with respect to the bank holding company shall be kept confidential.

brokerages and certain other specialized financing vehicles; and (v) entities engaging in any financial service or non-financial service activity that the bank is permitted to engage in.[28]

As with the previous legislation, banks continue to be permitted to make a substantial investment in non-bank financial institutions, such as trust companies, insurance companies and securities dealers. The amendments to the Bank Act contained in the FCA give banks the additional power to make a substantial investment in another bank or in a bank holding company, provided that any such investment is in compliance with the new ownership rules applicable to banks and bank holding companies (each as discussed above). With this new investment power, banks now have the added flexibility to offer varying services through separate legal entities. As an example, a bank may choose to offer retail banking services in-house and move its corporate banking services to a subsidiary or vice versa. Furthermore, a bank wishing to enter a new line of business will have the flexibility to create that business or invest in another bank that has already developed a customer base and/or expertise in that business. While there is no limit to the number of entities that a bank may control, as a practical matter each bank must have a business plan and the Superintendent may be concerned if there is no apparent business necessity for having separate entities.[29]

Under the new investment regime, banks are permitted to have a substantial investment in any entity that is engaged solely in the provision of any services (a "Service Entity") exclusively to banks and other entities engaged in the business of providing financial services. Prior to the FCA's amendments to the Bank Act, a bank was permitted to make an investment in a Service Entity only if the Service Entity was providing its services exclusively to the bank or to a member of the bank's group. The new regime expands this concept and permits a bank to have a substantial investment in a Service Entity that provides services exclusively to financial services providers, provided that the Service Entity is also providing those services to the bank or to any member of the bank group.[30]

Banks are now expressly permitted to invest in any entity that engages in activities limited to the promotion, sale, delivery or distribution of (i) a financial product or a financial service that the bank or any member of the bank group provides or (ii) a financial product or a financial service that is provided by any other entity that is primarily engaged in the business of providing financial services, provided that such financial product or financial service is also provided to the bank or a member of the bank group. These new amendments permit banks to now invest in marketing and service entities that have existing customer bases; accordingly, banks will be in a position to offer a wide range of services to customers who are not presently in the bank's customer group.

The amended Bank Act continues to permit banks to invest in mutual fund entities and in real property entities that act as real estate brokers for vendors, purchasers, mortgagors and mortgagees, and lessors and lessees.[31]

A bank may now invest in any entity that limits itself to providing financial services or non-financial services that the bank itself provides, other than deposit-taking. This provision represents a fundamental broadening of bank investment powers. Under the new legislation, for instance, banks are permitted to make substantial investments in entities that: (i) provide bank-related data processing services; (ii) provide advisory services relating to information management systems; (iii) design, develop and market computer software; and (iv) deal with data transmission systems and communication devices that are primarily financial or economic in nature.[32] The Canadian Bankers Association feels that the increased ability of banks to become involved in information services related activities will permit banks to assist small business customers and contribute to the development of e-commerce

28. It is important to note that certain permitted investments may require the prior approval of the Superintendent and/or the Minister.
29. Teolis, *supra* note 26 at 9.18.
30. Id. at 9.22.
31. A mutual fund entity is defined in the *Bank Act* as "an entity (a) whose activities are limited to the investing of the funds of the entity so as to provide investment diversification and professional investment management to the holders of its securities; and (b) whose securities entitle their holders to receive, on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in a part of its net assets, including a separate fund or trust account of the entity."
32. Prior to making a substantial investment in an entity that deals with data transmission systems and communication devices that are primarily financial or economic in nature, a bank must obtain the approval of the Minister.

in the broader economy through financing, management and advisory services and partnership.[33]

In structuring the legislation to allow investments in any entity that provides services that a bank may provide, the drafters have provided a more flexible regime. As we have witnessed in recent years, banks have been increasingly permitted to provide a wider array of services and the amendments to the Bank Act contained in the FCA will ensure that as banks are permitted to provide new services, banks will similarly be allowed to invest in entities that provide such services.

While the amendments in the FCA have expanded the business powers and permitted investments contained in the Bank Act, banks continue to be denied the ability (either directly or through a subsidiary) to offer retail insurance or life annuities through their branches or to engage in auto lease financing. This has been a major disappointment to banks, who believe that these restrictions deny Canadian consumers the benefits of competition and lower prices in these areas and conflict with the Federal Government's stated objectives of increasing competition and empowering consumers.

FOREIGN BANKS

Foreign banks operating in Canada have been subject to regulation under the Bank Act since 1980. The original policy objectives behind the regulation of foreign banks were taken primarily from the Federal Government's report entitled *Canadian Banking Legislation: Proposals* released in 1976 by then federal Minister of Finance Donald S. McDonald (the "McDonald White Paper").[34] One of the conclusions reached in the McDonald White Paper was that any regulation relating to the operation of foreign banks in Canada should balance various competing objectives. Specifically, any such regulation should be flexible enough to encourage foreign bank activity in Canada but at the same time should ensure that control of the Canadian financial system remains predominantly in Canadian hands.[35]

The provisions in the Bank Act relating to the operation of foreign banks in Canada have undergone significant changes since 1980. The FCA has completely rewritten the foreign bank provisions relating to the operation in Canada of foreign financial institutions and financial service providers contained in Part XII of the Bank Act. Notwithstanding the extensive nature of the rewrite, the policy objectives underlying the regulation of foreign banks operating in Canada continue to remain consistent with those originally enunciated in the McDonald White Paper.

By way of general background, foreign banks are able to operate in Canada under the Bank Act in four ways:

- through the establishment of a representative office whose activities are limited to promoting the services of the foreign bank or to acting as liaison between the foreign bank and its clients (*i.e.* a representative office may not engage in banking operations in Canada);
- through the establishment of a foreign bank subsidiary which may carry on almost all activities that a domestic bank may carry on;
- through the establishment of a "full service branch" or "lending branch" which generally have business powers similar to those of a foreign bank subsidiary except for significant restrictions on deposit taking activities;[36] and
- through the acquisition of control, or substantial investment in, shares of a Canadian entity under the provisions contained in Part XII of the Bank Act.

The provisions relating to this last mode of foreign bank operation in Canada have been completely rewritten by the FCA amendments to Part XII of the Bank Act. The main goal of these new provisions is to continue to pro-

33. Canadian Bankers Association, *supra* note 7, at 7.
34. GOVERNMENT OF CANADA, MINISTRY OF FINANCE, WHITE PAPER ON THE REVISION OF CANADIAN BANKING LEGISLATION: PROPOSALS ISSUED ON BEHALF OF THE GOVERNMENT OF CANADA BY THE HONOURABLE DONALD S. MCDONALD, MINISTER OF FINANCE, (Ottawa: Ministry of Supply and Services Canada, 1976).
35. *Id.* at 26.
36. A "full service branch" may not accept deposits of less than Cdn$150,000. A "lending branch" may not accept any deposits in Canada or otherwise borrow in Canada except for some very limited exceptions.

vide flexibility to foreign banks operating or wishing to operate in Canada to permit them to compete on equal footing with domestic banks. Another goal of the new provisions is to provide greater transparency and clarity in the application of these provisions.

In general terms, the definition of "foreign bank" has not been amended under the new foreign bank provisions and continues to be very broad. The definition includes any entity that provides financial services and is affiliated with a foreign bank, and any entity that controls a foreign bank. Accordingly, the definition captures entities that are non-bank financial service providers and in some cases entities that are strictly commercial entities.

The new foreign bank provisions contained in Part XII of the Bank Act distinguish between two categories of foreign banks. The first category consists of foreign banks that are called a bank or regulated as or like a bank. Though not defined as such in the Bank Act, these entities are commonly referred to as "true foreign banks." The second category consists of entities that fall within the broad definition of "foreign bank" but would not otherwise be considered a bank. Though not defined as such in the Bank Act, these entities are commonly referred to as "near foreign banks." They include, for example, many foreign owned consumer finance companies and companies that engage in securities related activities.

Part XII of the Bank Act also distinguishes between foreign banks that have or wish to have a financial establishment in Canada, and those that do not have a financial establishment in Canada and wish to carry on in Canada only commercial (*i.e.* non-financial) activities.

Part XII of the Bank Act is broken down into eight divisions with each division dealing with specific subject matter including rules pertaining to entities falling into either of these two categories of foreign banks described above.

Division I of Part XII sets out the criteria distinguishing "true foreign banks" and "near foreign banks." Specifically, section 508 of the Bank Act provides that the Minister may "designate" a foreign bank for purposes of Part XII if it meets any of the following criteria: (a) the foreign bank is a bank according to the laws of its jurisdiction of incorporation or any other jurisdiction in which it carries on business; (b) the foreign bank engages, directly or indirectly, in the business of providing financial services and it uses, to identify itself or its business, a name that includes the word "bank" or "banking" (or the equivalent thereto in any other language); (c) the foreign bank is regulated as or like a bank in any jurisdiction where it carries on businesses; or (d) the foreign bank is part of a conglomerate that contains one or more foreign bank(s) described in (a) to (c) above ("Regulated Foreign Banks"), and a material percentage (35% as prescribed by regulation) of the assets or revenues of the conglomerate are derived from the Regulated Foreign Banks in the conglomerate. A bank that meets any of the criteria set out in Section 508 is considered "true foreign bank."

Section 509 of the Bank Act, on the other hand, provides that the Minister may issue an exemption order to a foreign bank provided that it has not been designated under section 508 and does not meet the criteria for designation under section 508 (*i.e.* provided it is a "near foreign bank" rather than a "true foreign bank"). The result of such an order is to exempt the "near foreign bank" from the application of most of the remaining provisions of Part XII, including most of the restrictions on the types of activities in which a foreign bank may engage in Canada. In this connection, it is important to note that any foreign bank that has obtained an exemption order under section 509 has an obligation to advise OSFI if circumstances change which would make the near foreign bank a true foreign bank in accordance with the criteria set out in section 508.

Transitionally, a foreign bank that has received a consent order under section 521[37] of the former foreign bank provisions and was not subject to a "designation order"[38] under those provisions is deemed to have an exemption

37. Prior to the current amendments to Part XII of the *Bank Act*, foreign banks could only acquire control of, or a substantial investment in a Canadian entity engaging in financial services activity if it received a consent order from the Minister under the former section 521 of the *Bank Act* commonly referred to as a "section 521 order".

38. When considering a "section 521 order" application under the old Part XII of the *Bank Act*, the Minister would also consider whether as a condition of issuing the "section 521 order" the foreign bank should be "designated" under section 521(1.06). If a foreign bank was designated by the Minister, the foreign bank would be required to obtain further Ministerial approval if it wished to acquire a substantial investment in another Canadian entity. If a foreign bank obtained a "section 521 order" without being designated, no further Ministerial approval would generally be required to acquire a substantial investment in another Canadian entity.

order under section 509 of the new provisions. Conversely, a foreign bank that was previously subject to a designation order under the former foreign bank provisions is deemed to be designated under section 508 of the new provisions.

Division 2 of Part XII of the Bank Act contains a general prohibition against a foreign bank carrying on any business in Canada unless otherwise authorized by another provision under Part XII. This prohibition has been expanded from the former equivalent provision which prohibited a foreign bank from carrying on any banking business in Canada.

Division 3 of Part XII sets out the permitted activities in Canada that may be engaged in by a foreign bank that does not have a financial establishment in Canada (and that has not received an exemption order from the Minister under section 509). Specifically, such a foreign bank may acquire or hold control of, or make a substantial investment in, any Canadian entity provided that the investment would not result in the foreign bank having a financial establishment in Canada. In short, this allows a foreign bank to make investments in Canadian entities that are engaged solely in commercial activities. No consent is required from the Superintendent or the Minister in respect of this type of investment.

Divisions 4 and 5 of Part XII set out the authorities and restrictions applicable to a foreign bank that has a financial establishment in Canada or that wishes to carry on financial services activities in Canada (and that has not received an exemption order from the Minister under section 509). These provisions generally mirror the authorities and restrictions applicable to domestic banks described above including the various Superintendent and Ministerial consent requirements. This in part reflects the Federal Government's policy intention to allow foreign banks to carry on the same activities as and compete on an equal footing with Canadian domestic banks.

A foreign bank with a financial establishment in Canada may also invest in a Canadian entity carrying on primarily commercial activities provided that (i) the portion of the Canadian entity's business relating to financial services activities does not exceed 10% (or some other amount prescribed by regulation); (ii) the Canadian entity does not engage in leasing activities; and (iii) the Canadian entity, in the opinion of the Minister, engages or carries on a business that is the same as, or similar, related or incidental to, the business outside Canada of the foreign bank.

The remainder of Part XII contains provisions relating to administration, non-application of *Investment Canada Act* (Canada),[39] and transitional matters which are equally important but beyond the scope of this paper.

While the amendments to Part XII are intended to provide greater clarity and transparency to the rules applicable to foreign banks, these provisions continue to be one of the most complex and involved set of provisions contained in the Bank Act. Clarification from OSFI will therefore no doubt continue to be required not only on the interpretation and application of the new provisions but also on the transition process for foreign banks already operating in Canada prior to the coming into force of the new provisions. However, what is clear is that the ability or inability of a foreign bank to obtain an exemption order will be of paramount importance in ultimately determining the flexibility that such a bank will have in relation to its current or proposed future operations in Canada.

CONSUMER PROTECTION

One of the four guiding principles in the White Paper is empowering and protecting consumers of financial services.[40] Consistent with this principle, the FCA establishes the Financial Consumer Agency of Canada (the "FCAC"), which has the statutory mandate to (i) supervise financial institutions to determine compliance with the consumer provisions found in financial institutions legislation; (ii) promote the adoption by financial institutions of policies and procedures designed to implement applicable consumer provisions; (iii) monitor voluntary codes of conduct and public commitments made by financial institutions and designed to protect customers; (iv) promote consumer awareness about the obligations of financial institutions under consumer provisions applicable to them; and (v) foster an understanding among consumers of financial services and issues relating to financial services. To avoid unnecessary duplication, it is the intention of the Federal Government that OSFI will transfer all

39. *Investment Canada Act*, R.S.C., 1985 (1st Supp.) c. 28.
40. Government of Canada, *supra* note 5.

of its existing regulatory responsibilities with respect to monitoring consumer issues to the FCAC.[41]

Following from the recommendations set out in the White Paper, the FCA provides for the creation of an Office of the Canadian Financial Services Ombudsman (the "CFSO") intended to handle complaints of consumers and small businesses with respect to their dealings with financial institutions. Shortly after the release of the FCA, five of the major industries in the Canadian financial services sector announced the creation of a National Financial Services OmbudsService (the "NFSO") intended to provide similar services.[42] Under the NFSO, each industry will sponsor an Ombudsman that will operate independently of its industry association and will provide financial consumers with access to a single access point to address their complaints.[43] As a result of the NFSO initiative, the Federal Government has decided to suspend its plan to implement the CFSO and to work together with the NFSO to ensure that consumers have an adequate vehicle to address their financial concerns.[44]

The amendments to the Bank Act contained in the FCA set out a number of additional provisions intended to provide added protection to consumers. All federal financial institutions with equity in excess of $1 billion will be required to publish annual public accountability statements that describe their contributions to the Canadian economy and society. A bank is now required to provide prior notice of a branch closure, and in certain circumstances the bank must meet with interested parties to discuss differing views with respect to the closing of the branch. Banks must also provide customers with access to low-fee banks accounts with no requirement for a minimum initial deposit or a minimum balance.

CONCLUSION

The FCA is an extensive piece of legislation that has made significant amendments to the statutory framework governing banks and other participants in the Canadian financial services sector.

This new legislation will result in significant changes to the structure of the financial services industry. It will provide banks and other financial institutions with increased opportunities to compete for new business and new customers, and at the same time it will introduce new competitors into the marketplace. The legislation also contains extensive measures designed to protect interests of consumers of financial services.

Although the amendments contained in the FCA are quite complex and technical, much of the detail regarding the interpretation of these new provisions has been left to the regulations. By structuring the amendments in this way, the Federal Government has created a more flexible statutory framework that permits it to respond quickly to the rapidly changing financial services marketplace. ■

41. Library of Parliament, *supra* note 11, at 41. More information about the FCAC is available at <http://www.fcac-acfc.gc.ca/eng/default.asp> (last modified Sept. 20, 2001).
42. The industries participating in the NFSO include banks, life and health insurers, property and casualty insurers, investment dealers and mutual funds. See press release of the Canadian Bankers Association (Dec. 20, 2001), available at <http://www.cba.ca/cba/eng/media_centre/press/011220.htm> (last visited Feb. 27, 2002).
43. *Id.*
44. See press release from Secretary of State (International Financial Institutions), (Dec. 20, 2001) available at <http://www.fin.gc.ca/news01/01-124e.html> (last visited Feb. 27, 2002).