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BILL C-8: AN ACT TO ESTABLISH THE FINANCIAL CONSUMER AGENCY OF CANADA, AND TO AMEND CERTAIN ACTS IN RELATION TO FINANCIAL INSTITUTIONS

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LEGISLATIVE HISTORY OF BILL C-8

HOUSE OF COMMONS		SENATE	
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Royal Assent:
Statutes of Canada

N.B. Any substantive changes in this Legislative Summary which have been made since the preceding issue are indicated in **bold print.**

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BILL C-8: AN ACT TO ESTABLISH THE FINANCIAL CONSUMER AGENCY OF CANADA, AND TO AMEND CERTAIN ACTS IN RELATION TO FINANCIAL INSTITUTIONS

On 1 June 1992, the federal government proclaimed its new legislative framework for federally regulated financial institutions: banks, trust and loan companies, insurance companies, and the national organization of the credit union movement. The new legislation changed the landscape within which federally regulated financial institutions operate by introducing new powers, making changes to the ownership regimes, and instituting new prudential safeguards.

On 18 December 1996, the Minister of Finance announced the mandate and composition of the Task Force on the Future of the Canadian Financial Services Sector. The Task Force was asked to advise the government on what needed to be done to ensure that the Canadian financial system remains strong and dynamic. It examined a number of substantial policy issues not dealt with by the 1996 White Paper on Financial Institutions.

In September 1998, the Task Force released its final report, which contained 124 recommendations dealing with four major themes: enhancing competition and competitiveness; improving the regulatory framework; meeting Canadians' expectations; and empowering consumers.

Two parliamentary committees – the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce – scrutinized the Task Force's report. Both committees conducted extensive public hearings and, in December 1998, issued their respective reports.

Following these reports, in late June 1999, the Minister of Finance released the federal government White Paper, *Reforming Canada's Financial Services Sector: A Framework for the Future*, outlining the government's vision for the future of the financial services sector.

Bill C-8 is the culmination of this lengthy process.(1)

The predecessor to this Bill, Bill C-38, was given first reading on 13 June 2000. It died on the *Order Paper* when the November 2000 general election was called. The Act was reintroduced on 7 February 2001 with some minor, mostly technical changes. This legislative summary updates the LS for C-38.

Overall, Bill C-8 proposes significant changes to the structure of the financial services sector. It expands access to the payments system and significantly blurs the distinctions between the different kinds of financial institutions.

On the consumer side, Bill C-8 institutes a variety of consumer-protection measures, most notably the creation of the Financial Consumer Agency of Canada.

Bill C-8 also changes the ownership structure of financial institutions by allowing the creation of bank holding companies, and by instituting a new size-based ownership regime for banks and converted life insurance companies. This Bill is accompanied by policy guidelines that set out the conditions under which mergers would be allowed as well as the conditions under which existing Schedule I banks could be recategorized according to the new size-based ownership rules.

This legislative summary, which provides an analysis of Bill C-8, is organized according to the following themes:

- Ownership Structure
- Bank Holding Companies
- Foreign Banks
- Merger Review
- Co-operative Financial Institutions
- Regulatory Changes
- Consumer Provisions
- Canadian Payments Association

OWNERSHIP STRUCTURE

A. Banks

1. The Current System

Under the current rules (*Bank Act*, Part VII, s. 372-408), no individual may own more than 10% of any class of shares in a Schedule I bank, regardless of its size. Accordingly, Schedule I banks are always widely held. No such limits apply to Schedule II banks, provided the owner has the prior approval of the Minister of Finance to acquire shares exceeding this limit. However, a shareholder of a domestic bank may have holdings in excess of the 10% limit for the first ten years of the bank's existence; after that time the bank becomes a Schedule I bank, subject to the widely held regime. The purpose of this rule is to encourage the formation of new domestic banks. The rule does not apply to foreign banks, which may establish Canadian subsidiaries and hold them indefinitely. Originally, these Canadian subsidiaries were limited in the amount of Canadian assets they could hold; however, as a result of Canada's participation in various international trade agreements, these restrictions have been progressively eliminated. Despite the elimination of these restrictions, Canadian subsidiaries of foreign banks continue to account for only a small portion of all Canadian bank assets.

Mutual insurance companies also have been allowed to wholly own Canadian banks, on the grounds that these insurance companies are themselves widely held because of their mutual status.

2. Policy Considerations

There are two main policy reasons for the "widely held" requirement. First, the absence of a controlling shareholder facilitates the continued Canadian control of banks, regardless of ownership. Previously, foreigners could hold no more than 25% of the share issue of federally regulated financial institutions; however, successive international trade agreements have led to the elimination of this restriction. Canadian control of strong domestic financial institutions is considered important because it:

- provides benefits to communities through philanthropic contributions and community leadership;
- establishes the foundation for domestic financial centres, which provide high-skilled employment opportunities to Canadians, and are an important source of taxation revenue for Canadian governments; and
- is considered to be more sensitive than foreign-controlled institutions might be to domestic market situations – particularly in an economic downturn.

Second, the widely held requirement is believed to facilitate the separation of financial and commercial activity; without this separation, dominant shareholders with commercial interests could influence a bank to make lending decisions that were not in the best interests of depositors or other shareholders. Of particular concern in a system of deposit insurance, this view was given some credence by the failure of many trust and loan companies owned by dominant shareholders in the 1980s and early 1990s. This concern led to the introduction of much more restrictive related-party transaction rules in the 1992 legislation; it was also a factor in the 35% public float requirement for larger trust and loan companies and shareholder-owned insurance companies, introduced at that time.

The changes proposed by the new ownership rules aim to balance the desire for increased competition in the banking and insurance sector and the promotion of international competitiveness, while at the same time maintaining the financial system's safety and soundness. The current 10% restriction may preclude the use of stock as acquisition currency for potential transactions requiring the granting of a position in excess of 10% to a major shareholder in the target company. In an industry increasingly dominated by consolidated institutions, and in which many transactions are made through share exchanges, this inflexibility is thought to seriously constrain the range of potential strategies available to domestic banks.

3. Proposed Changes

Under the proposed changes, most of Part VII of the *Bank Act* would be replaced. The current "Schedule I" and "Schedule II" classifications would be eliminated. The new ownership regime for banks would be based on equity:

- "small" banks – less than $1 billion equity;
- "medium" banks – $1 billion to $5 billion; and
- "large" banks – greater than $5 billion.

Large banks would still be required to be widely held (s. 374). However, to provide additional flexibility for large banks to enter into alliances or joint ventures, the definition of "widely held" would be expanded: a widely held bank would be one in which no person owns more than 20% of any class of voting shares or 30% of any class of non-voting shares(2) (clause 36, s. 2.2 and 2.3). Medium-sized banks would be allowed to be closely held, although a "public float"(3) of 35% of voting shares would be required (s. 385). Small banks would not be subject to any ownership restrictions other than the "fit and proper"(4) test.

Commercial entities would be permitted to own banks with less than $5 billion of equity. Subject to the fit and proper test, large banks would be permitted to have strategic investors owning up to 20% of voting shares or 30% of non-voting shares. Ownership would be permitted based primarily on the size of a particular bank: banks with equity of $5 billion or more would be required to be widely held,(5) banks with less than $5 billion of equity could be closely held.(6) A widely held bank that controls a bank which passes the $5 billion threshold only after the new law comes into force would be allowed to retain its shares in the bank (s. 374; see below for similar exemptions applying to widely held insurance holding companies governed by the *Insurance Companies Act*). This would permit a large bank or other eligible institution that establishes a bank subsidiary to retain its interest in the bank despite the fact that the bank has grown through the $5 billion threshold.

The new law would permit banks to own other banks. This is designed to introduce greater organizational flexibility; for example, a bank could be restructured into a number of smaller banks, each held by a widely held bank, with some or all of the subsidiary banks having outside strategic investors.

Banks with equity of $5 billion or more would not be permitted to have any major shareholder (s. 374). (7) For banks with equity under $5 billion, some restrictions would continue to exist (s. 382); however, a single shareholder could entirely own such a bank with the prior approval of the Minister (s. 377.1).

Although the National Bank of Canada, Laurentian Bank of Canada and Canadian Western Bank all have equity of less than $5 billion, the new legislation would treat these banks as entities with equity of more than $5 billion (s. 378(1)). Under the new *Act*, as long as these banks' equity remains below $5 billion, the Minister could revoke this treatment, in which case the bank could be closely held (s. 378 (2)). The Government's current policy is that the widely held requirement would not be revoked unless the Minister received an application from a bank in question along with indications that the interests of the particular region served by the bank would be enhanced by changing the bank's status.

The current rule requiring certain Schedule II banks to publicly trade a portion of their shares would continue to apply. Under the proposed system, once a bank exceeded $1 billion in equity, at least 35% of the bank's shares would have to be listed on a stock exchange in Canada and held by persons who are not major shareholders of the bank. The Minister could make exceptions to this public float requirement. This requirement would not apply to large banks because, being widely held, they would not be permitted to have major shareholders.

This proposed more liberal ownership regime gives rise to new supervisory issues, such as what to do if a bank is owned by a conglomerate. The Minister would continue to have broad discretion in deciding who would be a suitable owner for a bank, and the new law would set out a number of factors that the Minister could consider when making a decision. This list (s. 396) of factors is substantially the same as that set out in the current *Act*; however, two new elements would be added to the Minister's authority. First, the Minister would be authorized to consider the Superintendent of Financial Institution's opinion as to whether the corporate structure of a particular applicant would impede the proper supervision and regulation of the bank. Second, the Minister would be authorized to order the assets of any closely held bank to be frozen should the Superintendent voice concerns about the institution. The order could be lifted upon the conglomerate organizing its affairs to comply with the holding requirements of the law. This provision's apparent objective is to warn potential applicants that, in the case of a conglomerate, an applicant might not be permitted to acquire an interest in a bank unless it was prepared to bring its financial services into line with the requirements of the *Act*, i.e, under a regulated holding company. The Minister also would be entitled to consider the impact of any proposed integration of the operations and businesses of the applicant with those of the bank.

For large banks, the new *Act* would instruct the Minister to consider the character and integrity of an applicant wishing to acquire an interest at the 20% or 30% limit, **although the Minister would not be precluded from considering control issues**. In addition to prohibitions against holding in excess of 20% of voting shares or 30% of non-voting shares, the new *Act* would specifically prohibit anyone from having a controlling interest in a large bank.

The new law proposes two new anti-avoidance rules aimed at ensuring that no one shareholder is able to exert influence over a large bank. The "tainting rule" would prohibit anyone from being a major shareholder of any bank in Canada that is a subsidiary of a large bank. If a shareholder insists on remaining the major shareholding in the subsidiary bank, then the large bank would be required to divest itself of the subsidiary. To provide large banks with some flexibility to establish joint ventures, this rule would not apply to bank subsidiaries with equity of less than $250 million.

The second rule, known as the "cumulative voting rule," would provide that a person could only have a significant interest (ownership of more than 10% of a class of shares) at one level in any group of banks related to a large bank. If a person received approval to exceed the 10% limit with respect to the parent large bank, the person could not exceed that level in any subsidiary bank of the large bank. Similarly, if a person exceeded the 10% limit with respect to any subsidiary bank, the person could not apply for approval to acquire more than 10% interest in the large bank.

Under the current law, the Superintendent of Financial Institutions can exempt a class of non-voting shares of a Schedule II bank from the ownership regime if the class amounts to not more than 10% of the bank's equity. As such, a person can acquire more than 10% of the shares of that class without first obtaining the Minister's approval. Further, the holder is deemed not to be a related party of the bank for the purposes of the self-dealing rules(8) in the *Act*, despite the fact that the shareholder would hold more than 10% of a class of shares of the bank. Under the new law, the Superintendent would be able to exempt a class of shares in a bank with equity of less than $5 billion provided that the class accounted for not more than 30% of the aggregate book value of all the outstanding shares of the bank.

Under the current law, banks face restrictions in terms of what they may invest in or hold as a subsidiary. For example, certain financial services – such as credit card issuing and consumer lending – must take place within the bank itself. The new law would expand the permitted types of subsidiaries so that both a holding company and a parent-subsidiary structure would be permitted a broader range of investments than is currently available to banks. The purpose of expanding permitted investment activities is to give banks greater choice and flexibility with respect to structuring in order to carry out their activities in-house, under a holding company, or through a parent-subsidiary structure, without facing significantly different permitted investment constraints. Permitted investments for trust and loan companies and insurance companies would be similarly expanded.

The ability to have additional subsidiaries would also permit the creation of new special-purpose entities as well as facilitate alliances and joint ventures through these entities, thereby enhancing the banks' flexibility to meet the increasing technological and competitive challenges from sources such as unregulated and "monoline" firms specializing in a single line of business. The new rules would be based on defined categories of eligible investments and a number of key parameters. Permitted investments would be composed of five broad categories:

- regulated financial institutions (e.g., banks, trusts);
- firms primarily engaged in providing financial services (e.g., credit cards, small business loans, consumer loans);
- entities acting in the capacity of a financial agent, advisor or administrator (e.g., investment counselling, payroll administration);
- entities undertaking ancillary, complementary or incidental activities (e.g., Interac service corporation activities, armoured car transportation); and
- certain other activities not primarily related to financial services, but specifically enumerated (e.g., certain information services, real property brokerage corporations).

Control requirements, approvals and other rules would be based on the category of investment.

4. Holding Companies

The widely held rule for banks could also be met by having the bank held by a holding company(9) (s. 374), providing the holding company was itself widely held. The same ownership regime that applied to banks would apply to bank holding companies. Similarly, permitted investment rules would be similar for both banks and bank holding companies. Rules relating to insolvency, related-party transactions, governance, use of name, and regulatory intervention powers would be different for bank holding companies, reflecting the fact that the bank holding company would be required to be non-operating, and that the Office of the Superintendent of Financial Institutions (OSFI) would not be responsible for its creditors.

Only the holding company created to hold the shares of the bank would be entitled to the exception, i.e., another widely held bank holding company would not qualify to own that bank. The holding company option is designed to provide financial services providers with greater choice and flexibility in structuring their operations, and would allow them to compete more effectively in the global market by giving them new latitude for raising capital and forming strategic alliances. The holding company regime would enhance domestic competition by providing a structure for institutions to come together under a common ownership structure without having to enter into a parent-subsidiary relationship. This would allow them to maintain their separate identities to an extent not possible under an acquisition or merger. For example, a bank, an insurance company and a mutual fund company might find they could realize economies of scale and scope if they were to work together within a corporate group.

A bank holding company structure would be an incorporated entity under the *Bank Act*. Banks would have the choice of moving certain activities that are currently conducted in-house, or in a subsidiary of the bank, to an affiliate outside the bank. Depending on the risk that the affiliate poses for the holding company's bank, the affiliate could be subject to lighter regulation than that of the bank. However, the entire group would be overseen in order to safeguard regulated affiliates. The supervision of the holding company parent and its downstream holdings would be "risk-based," i.e., supervision would focus on those group activities that may pose material risks to the bank and other affiliated federally regulated financial institutions. The OSFI:

- would use its supervisory authorities over the holding company and its subsidiaries on a discretionary basis as events warrant;

- would have the authority to issue compliance orders, require special audits, and require the holding company to increase its capital where circumstances warrant; and

- could require the holding company to divest a subsidiary or other investments, if warranted.

As well, the Bill would permit other corporations to be interposed between the bank and the holding company, provided that the holding company controlled all of the corporations above the bank in the chain of ownership. Accordingly, up to 49% of the voting shares of the bank or of the intermediate corporation might be held by an entity other than the holding company.

B. Insurance Companies

In contrast to the banks' ownership regime, there is currently no widely held rule for federally regulated trust and loan companies or insurance companies owned by shareholders. For these companies, as with the Schedule II banks, the Minister of Finance must approve any shareholding in excess of 10%; currently, there are no legislative restrictions or directions on the exercise of this authority. The one exception to the global 10% restriction relates to the four former mutual life companies that demutualized(10) during 1999 and 2000. For these companies (like the current Schedule I banks), the current *Insurance Companies Act* and regulations do not permit anyone to acquire more than 10% of any class of shares of the company. Under the new rules, demutualized companies would have a two-year transition period from the time of demutualization, during which they would be required to remain widely held; no mergers or acquisitions of demutualized firms would be permitted. Following the transition period, the requirement that large demutualized insurers be widely held would continue. Medium-sized demutualized companies would automatically be subject to the new size-based ownership rules after the transition period. Unlike banks, they would not need to apply to the Minister for recategorization.

Three of the demutualized companies established holding companies under the *Act* at the time they demutualized; as such, the ownership restriction applies at the holding company level. No one other than the holding company is permitted to own any voting shares of the demutualized company. The new rules clarify the transitional nature of the widely held requirements: for companies with equity of less than $5 billion at the time they demutualized (i.e., Canada Life Assurance Company and Clarica Life Insurance Company), the widely held requirement would continue to apply, but only until 31 December 2001, after which time the two companies could be closely held. The two companies with equity of more than $5 billion at the time they demutualized (Manufacturers Life Insurance Company and Sun Life Assurance Company of Canada) would have to remain widely held until the Minister withdraws the requirement.

The widely held rule applying during the transition period to the two larger companies would differ from that applying to the two smaller companies. The two larger companies would be subject to the same rule as the large banks (i.e., no major shareholders); moreover, as with the large banks, holding more than 10% of any class of shares would require the Minister's prior approval. For the two smaller companies, during the transition period, no one could own more than 10% of any class of shares of each company.

For the three companies that have established holding companies, the widely held requirement would continue to apply at the level of the holding company. Again, though, only the holding company that was created for the purpose of holding the shares of the particular demutualized company would qualify, i.e., the demutualized company could not be acquired by another widely held holding company.

The rules for holding companies would be somewhat relaxed from the current rule in that the holding company would only need to control the demutualized company in fact. A person has "control in fact" where the person has direct or indirect influence that, if exercised, would result in the person controlling the company. The *Act* does not draw a direct correlation between control in fact and ownership of shares.

In addition, as with banks, it would be possible under the new rules to interpose other corporations between the ultimate widely held holding company and the demutualized company, again provided that the holding company controlled all of the corporations above the demutualized company in the chain of ownership.

As is the case under the current *Bank Act*, a new insurance holding company regime would be incorporated into the *Insurance Companies Act*. Consequently, exceptions from the widely held requirements would also be made to permit demutualized insurers to establish insurance holding companies, subject to the same ownership requirements that would apply to the three existing holding companies. A provision has also been included to allow the one company that did not establish a non-operating life insurance company holding company at the time it demutualized (Clarica Life Insurance Company) to establish a holding company as a non-operating life insurance company under the *Act* after the new ownership regime comes into force.

Under the new rules, the Minister could decide to suspend the widely held requirement for the demutualized companies. In so doing, the Minister would be authorized to consider the opinion of the Superintendent of Financial Institutions as to whether the corporate structure of a particular applicant would impede the company's proper supervision and regulation. Again, as with banks, the Minister would have the authority to order that the assets of a demutualized company be frozen if the Superintendent expressed concern about the conglomerate to which the company would be affiliated. The order could be lifted if the corporate structure of the conglomerate were suitably reorganized.

The Minister would also be permitted to consider, in respect of the acquisition of any company, the effects of any possible integration of the operations and businesses of an applicant with those of the company that the applicant seeks to acquire. This would permit the Minister to consider the impact of the acquisition on Canadian jobs.

As with large banks, if a purchaser were to seek to acquire an interest up to the 20% or 30% limit for the large demutualized companies, the new *Act* would instruct the Minister to consider only the character and integrity of an applicant wishing to acquire the interest.

The new system would also contain two anti-avoidance rules, similar to the banking rules, aimed at ensuring that no one shareholder could exert influence over a demutualized company. The "tainting rule" – as it would apply to the two large demutualized companies – would prohibit anyone from becoming a major shareholder in a life insurance company that is a subsidiary of the demutualized company. If a shareholder wished to remain the major shareholder in the subsidiary, the company would be required to divest the subsidiary. In the case of the two smaller demutualized companies, the rule would apply to anyone acquiring more than 10% of any class of shares of the subsidiary. The rule would not apply to life insurance company subsidiaries having equity of less than $250 million. As with the banks, the apparent intent of this provision is to provide the companies with flexibility to establish strategic investments.

The "cumulative voting rule" would allow a person to have a significant interest only at one level in any group of federal life insurance companies related to a large demutualized company. A person receiving approval to exceed the 10% limit in a demutualized company could not exceed that level in any subsidiary federal life insurance company. Similarly, if a person exceeded the 10% limit for any subsidiary, the shareholder could not acquire an interest in excess of 10% in the demutualized company itself. Because it would not be permitted to acquire more than 10% of any class of shares of the two smaller demutualized companies prior to 1 January 2002, applying the cumulative voting rule to these companies or their subsidiaries would not be necessary.

Apart from the demutualized companies, the new ownership rules for insurance companies would not be based on size. Unlike banks under the *Bank Act*, an insurance company with equity above $5 billion (or one that passed that threshold after the legislation came into force) would not be required to be widely held.

The current rule requires that companies with equity of more than $750 million publicly trade a portion of their shares. This "public float" rule would still apply; however, under the new rules, this requirement would apply only after the company's equity exceeded $1 billion. At that point, at least 35% of the company's shares would have to be listed on a stock exchange in Canada and held by persons who were not major shareholders of the company. Unlike the *Bank Act* (under which the Minister has broad discretion to grant exceptions), the Minister could only exempt a company from the public float requirement under the *Act* if the company were controlled by one of the listed eligible shareholders. For the most part, these shareholders are other financial institutions that have similar public float requirements. Also, unlike the large banks (to which the rule does not apply), the four widely held demutualized companies would be subject to the public float requirements.

Under the current rules, the Superintendent of Financial Institutions may exempt a class of non-voting shares from the ownership regime if the class amounts to not more than 10% of the company's equity. In the case of a mutual company, both the equity and the surplus of the company would be taken into account. Based on this exemption, a person could acquire more than 10% of the shares of the exempted class without seeking the Minister's approval. The holder would be deemed not to be a related party of the company for the purposes of the self-dealing rules of the *Act*. The new rules would permit the Superintendent to exempt a class of shares (other than those of a demutualized company that is required to be widely held or one of its holding companies), provided that the class accounted for not more than 30% of the aggregate book value of all the company's outstanding shares.

BANK HOLDING COMPANIES

A. Context

Banks are heavily regulated because of their retail deposit-taking activities, which are typically subject to deposit insurance. Regulations are designed to help protect the integrity of that system of deposit insurance as well as maintain the safety and soundness of the financial system. Other financial institutions which do not take deposits are less regulated, and sometimes not regulated at all. This has competitive implications when a non-bank subsidiary of a bank competes in a market segment with unregulated or less regulated financial services providers. Indeed, the subsidiaries of a bank are affected by the capital and other requirements of bank regulation, even though they are not directly involved in deposit-taking activities.

For example, trust and loan companies, which also take deposits, have the additional structural flexibility to organize via an unregulated holding company. These companies do not face the same structural restrictions as banks, as they are permitted to disaggregate functions between regulated and unregulated affiliates. This was considered by the Task Force on the Future of the Canadian Financial Services Sector:

> There is a growing dichotomy between activities that are not regulated or less regulated when carried on in some institutions, and more regulated when carried on in others. As markets become more competitive, the cost burden of regulation on the same activities in some institutions and not in competing institutions can affect competition in the marketplace. (Background paper #2, p. 45)

The Task Force felt that two institutions performing the same functions should be regulated in the same way with respect to these functions.

Canada has a constitutional division of powers between the federal and provincial governments over financial services. The federal government has exclusive jurisdiction over banking and the incorporation of banks. Provincial governments have exclusive jurisdiction over property and civil rights in the provinces and the incorporation of companies with provincial objects. This suggests that the activities of trust and loan companies, insurance companies, securities dealers, and co-operative financial institutions that are "provincial" in scope do not fall within federal banking jurisdiction. Therefore, a truly "functional approach" to regulation is, in practice, hard to implement.

Although regulation must continue to be based on institutions, it is possible to move closer to a "functional approach" by allowing more flexible organizational structures for regulated financial institutions. Allowing for the creation of financial holding companies would accomplish this by helping banks to better compete with unregulated financial institutions, form joint ventures, and reorganize their activities to better tackle and take advantage of innovations in financial markets.

B. Incorporation and Continuance of a Bank Holding Company

The *Bank Act* is being amended to allow for the creation of bank holding companies. Before issuing letters patent incorporating a bank holding company, the Minister would assess the suitability of the business plan and the prospective applicants. The Minister would consider:

- the capacity of the applicant to be a source of financial strength for the bank that is proposed to be its subsidiary;
- the soundness and feasibility of future operations of the bank projected to be a subsidiary;
- the character, integrity, competency and experience of the applicants;
- the impact of the integration of the bank's activities with those of other affiliates; and
- the best interests of the financial system.

However, if a proposed bank holding company was a subsidiary of a foreign bank, letters patent could not be issued unless the Minister was satisfied that, if the application was made by a non-member of the World Trade Organization (WTO), a domestic bank holding company would obtain an equivalent treatment in the jurisdiction in which the foreign bank principally carries on business (s. 673).

Existing banks could convert to a bank holding company structure. On the bank's request,(11) subject to the approval of the Minister, shares of the bank holding company could be issued, on a share-for-share basis, to all shareholders of the bank in exchange for all the issued and outstanding shares of the bank (s. 677(1)). The shares exchanged would be subject to the same designation and restrictions and carry on the same rights, privileges and liability as the shares of the bank for which they are exchanged (s. 677(2) and (3)). The ownership structure of the bank would automatically become the ownership structure of the bank holding company.

Existing corporations could also form a bank holding company(12) (s. 682). Where a corporation would be continued as a bank holding company, its existing property, obligation, liability, prosecution, conviction, ruling and by-laws would continue as the responsibilities and rights of the holding company (s. 687). Moreover, the holder of a security issued by the corporation would not be deprived of any right or privilege in respect of the security, nor be relieved of any liability (s. 687(f) and s. 703 (4)).

C. Capital Structure

Shares of a bank holding company would be in registered form and would be without nominal or par value (s. 703(2)). Moreover, where a corporation (including a bank) was continued as a bank holding company, shares with nominal or par value issued by the corporation before it was so continued would be deemed to be shares without nominal or par value (s. 703(3)). Where voting rights were attached to any series of a class of shares, the shares of every other series of that class would have the same voting rights – either one vote per share or no vote per share (s. 706(3) and s. 707).

Unless permitted by the regulations, or with the consent of the Superintendent, a bank holding company would not hold its own shares or the shares of a controlling body. Moreover, the bank holding company would have to preclude any of its subsidiaries from holding any of its shares or the shares of a controlling entity (s. 714).

The bank holding company would maintain a separate stated capital account for each class and series of shares it issues (s. 710). It also would maintain adequate capital and liquidity, subject to the regulations of the Governor in Council and the Superintendent's guidelines (s. 949).

D. Name

A bank holding company would not be permitted to adopt a name that is substantially similar to that of a bank unless the name contains words that, in the opinion of the Superintendent, indicate to the public that the bank holding company is distinct from any bank that is its subsidiary (s. 695). Moreover, every bank holding company would have as part of its name the abbreviation "bhc" or "spb"(13) (s. 696(2)).

E. Business, Powers and Investments

The bank holding company would be required to be non-operating. Its permitted activities would include acquiring, holding and administering permitted investments as well as providing management, advisory, financing, accounting and information processing services to entities in which it has a substantial investment(14) (s. 922(1)(a) and (b)). The bank holding company could also conduct any other prescribed business (s. 922(1)(b) and (c)). It would not be permitted to undertake any core banking or financial services functions such as credit assessments.

No bank holding company would acquire control of, or increase a substantial investment in, any entity other than a permitted entity (s. 928(1)). Permitted entities, which would require the Minister's prior written approval (s. 930(5)), would be defined as:

- financial services providers formed and regulated under federal or provincial legislatures – which would include a bank, a bank or insurance holding company, a trust corporation, a loan company, an insurance company, a co-operative credit society and an investment dealer; or,

- a foreign entity primarily engaged outside Canada in a business that, if carried on in Canada, would be the same business as the activity of a permitted Canadian entity (s. 930(1)).

The bank holding company also would be required to own a majority of the shares of its bank subsidiary (or a bank holding company subsidiary), which would result in both *de jure* control and control "in fact" of the bank subsidiary (paragraph 930(4)(a)). Other regulated affiliates would be subject to control "in fact," where a minority of shares could be held, but control could nevertheless be exercised by direct or indirect influence (paragraph 930(4)(b)). The same control restrictions would apply to affiliates that engage, as part of their business, in any financial activity that exposes the entities to material or credit risk (e.g., credit cards, small business loans, consumer loans) (paragraph 930(4)(c)).

Furthermore, a bank holding company could control:

- any entity whose business is limited to providing financial services that a bank is permitted to engage in;
- any entity providing services exclusively to another financial services entity, as long as the entity is also providing those services to the bank holding company or any of its members;
- a mutual fund entity or a real property brokerage entity (s. 930(2));

unless the entity was engaged in the business of accepting deposit liabilities, or any activity that a bank was not permitted to engage in (s. 930(3)).

Finally, a bank holding company and its subsidiaries could only acquire shares or ownership interests of an entity, other than permitted investments, up to a point that the aggregate value of those ownership interests, plus the value of its interests in or improvement to real property, did not exceed the prescribed percentage of its regulatory capital (s. 938, 939 and 940).

F. Ownership

Bank holding companies would be divided into three main classes: ones with equity of $5 billion or more; ones with equity of between $5 billion and $1 billion; and ones with equity of less than $1 billion.

A bank holding company with equity of $5 billion or more would have to be widely held, i.e., no shareholder could hold more than 20% of any class of voting shares, and no more than 30% of any class of non-voting shares (s. 876 and 2.2). Shareholders wishing to hold more than 10% ownership would have to obtain the approval of the Minister. In determining whether to approve a transaction, the Minister would review the applicant's character and integrity as a businessperson (s. 906).

Moreover, the widely held requirement would apply to the total direct and indirect ownership of a bank subsidiary that is itself controlled by a widely held bank holding company with equity of $5 billion or more. Other than the controlling bank holding company, no other shareholder could hold more than 20% of any class of voting shares of the bank subsidiary, and no more than 30% of any class of non-voting shares (s. 879). No shareholder who held more than 10% ownership of the bank holding company could also hold more than 10% of the bank subsidiary (s. 880). This would mean that no single investor would be able to use the holding company to exceed bank ownership restrictions for widely held banks.

A bank holding company with equity of between $1 billion and $5 billion could be closely held,(15) with the approval of the Minister (s. 883). However, the bank holding company would be required to maintain a 35% public float of voting shares, i.e., 35% of voting shares traded on a recognized stock exchange in Canada and not owned by any major shareholder(16) (s. 893). Finally, bank holding companies with equity of under $1 billion would have unrestricted choice in ownership structure, but the Minister's approval would still be required for control and substantial ownership. Therefore, bank holding companies with equity under $5 billion could be owned and controlled by a commercial enterprise.

G. Directors and Officers

The minimum number of directors would be seven, and at least half of the directors of a bank holding company that was a subsidiary of a foreign bank and at least two-thirds of the directors of any other bank holding company would have to be resident Canadians (s. 749).

At least one unaffiliated member would have to be present at all Board meetings.

When a contract was being considered by a bank holding company, any director or officer in a conflict-of-interest situation would have to disclose in writing or, request to have entered in the minutes of the meetings, the nature and extent of that personal interest (s. 789). Moreover, the director would have to be absent from any meetings of directors while the contract was being considered – some exceptions would apply (s. 790). Finally, the Superintendent of Financial Institutions could, by order, remove from office a director or senior officer of a bank holding company if the Superintendent believed that this person was not suitable to hold that office (s. 964).

H. Supervision and Capital Adequacy

The bank holding company would be subject to consolidated supervision. The Superintendent could request, by order, information and documents from the bank holding company or any of its affiliates, to review both financial and non-financial activities conducted under the holding company (s. 954). From time to time, the Superintendent could examine and inquire into the business and affairs of each holding company (s. 957). If necessary, the Superintendent could order the bank holding company to take necessary actions to comply with regulations, or to remedy a situation that was believed to be prejudicial to the interest of depositors, policyholders or creditors (s. 960).

The holding company group would be subject to consolidated capital adequacy requirements (s. 949 (1)), and the Superintendent could require the holding company to increase its capital and liquidity where circumstances warranted. When warranted, the Superintendent could, also by order, direct a bank holding company to divest a subsidiary or other investments (s. 942).

I. Insurance Holding Companies

Demutualized life insurers could convert into insurance holding companies. The rules that applied to demutualized insurance holding companies would be broadly similar to the ones applicable to bank holding companies.

Insurance holding companies that controlled a converted widely held insurance company with equity of $5 billion or more at the time of the conversion would be required to be widely held. However, they could be allowed, by order of the Minister after the day that is two years past December 31, 1999, to change their ownership status to become closely held, with a 35% public float (clause 449, s. 927(4) and (5)).

Insurance holding companies with equity of less than $5 billion that controlled a demutualized insurance company would be allowed to be closely held (with a 35% public float if equity exceeded $1 billion) after the transition period, with the approval of the Minister. They would also be allowed to grow beyond $5 billion in equity without any ownership restrictions, other than the 35% public float requirement (s. 927 and 938).

Finally, insurance holding companies that controlled a stock insurance company (non-demutualized, e.g., Great West Life), with equity of $1 billion or more, would have to comply with the 35% public float requirement, with no other ownership restrictions (s. 938).

FOREIGN BANKS

The aim of these amendments is to clarify the rules with respect to the activities of foreign banks in Canada. To date, the relevant sections of the *Bank Act* have been unclear, necessitating clarification through policy pronouncements and interpretations from the Superintendent and the Department of Finance. In addition, the proposed changes aim to ensure access for Canadian firms to international markets on the same terms as their international counterparts, as well as fostering greater domestic competition by giving foreign firms fuller access to Canadian markets.

Part XII contains some recent changes regarding the manner in which foreign banks may operate in Canada. A foreign bank may establish either a full-service branch or a lending branch. Full-service branches are permitted to take deposits greater then $150,000. A foreign bank wishing to take retail deposits (i.e., deposits under $150,000) may do so only through a subsidiary. Lending branches may not take deposits, they are restricted to borrowing only from other financial institutions. Because this puts no individual Canadian's funds at risk, lending branches face fewer regulatory requirements then do full-service branches.

Part XII of the *Act* would be replaced in its entirety. **This Part has undergone substantial re-drafting since Bill C-38. Most notably, it has been split into eight *divisions*, each dealing with a different subject matter. Foreign banks wishing to carry on business in Canada must comply with Part XII. Although the policy remains unchanged, section numbers have changed, and a new definition has been added. The part is still complex and substantial, comprising almost 50 pages in Bill C-8.**

In broad terms, Bill C-8 creates three categories of foreign banks. The first of these is what is commonly known as a *near bank*.(17) A near bank is an entity that falls within the definition of a foreign bank for the purposes of the *Bank Act* but that would not otherwise be considered a true regulated bank. The second type is a regulated foreign bank that wishes only to carry on commercial activities in Canada. The third is a regulated foreign bank that wishes to offer financial services in Canada. Part XII provides different rules for each type.

The definition of "foreign bank" would remain unchanged, with the result that the foreign financial institutions to which the *Act* would apply would still be quite broad. Section 510 states that a foreign bank could not (except in certain instances): undertake any business; maintain a branch in Canada; establish bank machines; or acquire or hold a substantial investment in a Canadian entity. As well, a foreign bank could not (again, except in certain prescribed instances): guarantee securities; or accept bills of exchange or depository bills issued by a person in Canada for sale or trade in Canada. A foreign bank could apply to the Minister for an order permitting it to establish a branch in Canada to carry on business in Canada under Part XII.

A foreign bank also could apply to the Minister for an authorization order, the effect of which would be to remove the bank from the application of Part XII and bring it under Part XII.1. The amendments to Part XII.1 (clauses 133-137) aim to ensure that authorized foreign banks would have similar business powers to those of Canadian banks. As well, they would ensure that new consumer provisions and new supervisory measures, including the authority for the Superintendent to remove the bank's principal officer in Canada, applied to authorized foreign banks.

As noted, Part XII is now broken into *eight divisions*, each of which deals with a distinct subject matter.

Division 1 is the most involved, setting out definitions, including the criteria that distinguish near banks from true banks. A true bank (i.e., one that meets the criteria set out in section 508) may be designated by the Minister for the purposes of Part XII. Under section 509, the Minister may exempt a bank from most of the requirements of Part XII; however, the Minister may not designate the bank if it has already been designated under section 508. This means that a bank that does not meet the designation criteria under section 508 is not a true bank, and may not be designated; it may, however, be exempted from some or all of the requirements of Part XII.

A bank may be designated a true bank if:

- it is regulated as a bank outside of Canada; or
- it is part of a conglomerate that contains one or more regulated banks, and a material portion of the assets or revenues(18) of the conglomerate are derived from the conglomerate's regulated banks.

Foreign banks that previously received a consent order from the Minister under what is now section 521 of the *Bank Act* (and that have not been designated under subsection 521(1.06)) are deemed automatically to have an exemption order under new section 509. By contrast, foreign banks that are currently designated under subsection 521(1.06) are considered to be designated banks under the new Part XII.

Division 2 begins with a general prohibition on foreign banks carrying on business or making investments in Canada except as authorized by Part XII. Accordingly, a true bank seeking to carry on business or make investments in Canada must have that business or those investments specifically authorized under Part XII.

Division 3 sets out the rules for banks that do not have financial establishments in Canada, but which seek to carry on business and make investments in Canada which will not result in the bank having a financial establishment in Canada. Essentially, the foreign bank would be permitted to engage only in commercial activities, including entities listed in section 468(1)(a) to (i).(19)

Division 4 deals with foreign banks seeking to carry on financial services activities in Canada. Generally, these banks will be permitted to carry on the same businesses and undertake the same investments permitted to a Canadian bank under the Act. As re-drafted, this Division parallels Part IX of the *Bank Act*, which establishes investment rules for Canadian banks. The Part also allows the Minister to permit a true foreign bank to carry on certain limited commercial business in Canada; the activities must be the same as, or similar to, related or incidental to the business outside of Canada of the foreign bank or an entity associated with it.

Division 5, like Division 3, also deals with foreign banks. It requires that a foreign bank without a financial institution in Canada must be either designated – or be associated with a designated foreign bank – in order to be permitted to acquire, control or be a major owner of:

- an entity referred to in section 468(1)(g) to (i);

- **a permitted Canadian entity that is a financial services entity; or**
- **a Canadian entity that is a financial services entity, by way of temporary investment.**

The foreign bank would also have to be designated to engage in securities dealing or cooperative credit society business. The same conditions would apply to an entity associated with a foreign bank. Similar conditions would apply to foreign banks having a financial establishment in Canada (and entities associated with them). Division 5 would not apply to investments acquired, or branches or businesses addressed under Division 3.

Section 522.22 would require the Minister's prior approval for certain acquisitions which would give the foreign bank controlling interest in certain Canadian entities.

Division 6 is brief and deals with Administrative matters, and includes the authority to make regulations, as well as other powers of the Minister to orders divestiture, to include terms and conditions, to revoke or vary decisions, etc.

Division 7 is also brief, and serves to exempt certain select transactions from the application of the *Investment Canada Act.*

Division 8 contains transitional rules for foreign banks already operating in Canada with respect to businesses or investments that are no longer authorized under Part XII. Some activities and investments are grandfathered; in other cases, however, the rules require that the Minister be notified with respect to the business activities of the grandfathered business or investment, and also that the business or investment will not be altered in the future.

For foreign bank subsidiaries operating in Canada that have opted out of the deposit-taking regime, amendments have been proposed that would prohibit an opting-out bank from operating from premises open to the public that are shared with or adjacent to those of a non-opted-out bank affiliate. In the case of adjacent premises, the prohibition would not apply if the premises were clearly distinguished to the banks' customers. A designated foreign bank could invest in any entity in which a bank might invest, including the new categories of permitted investments available to Canadian banks. Where an investment was such that a Canadian bank making it would require prior approval from the Minister, the foreign bank would also be required to obtain – in addition to the designation order – the Minister's approval.

Foreign banks would be permitted to operate in Canada a branch of the bank, an insurance company, a securities dealer, or a credit union, or to have an investment in a Canadian entity that carries on the business of one of these entities. Similarly, a foreign bank would be permitted to acquire indirect investments as a result of these activities. For example, a foreign bank could be permitted to make a temporary investment, or acquire and hold investments, as a result of a loan work-out or realization of security by its Canadian bank subsidiary.

MERGER REVIEW

Merger activity in the financial services sector accelerated steadily throughout the 1990s. As well, mergers are getting larger with values now exceeding U.S.$500 billion. A number of factors are contributing to the trend. In the United States, the elimination of regulatory restrictions on interstate branching has resulted in the construction of a national banking system for the first time in that country's history. In Europe, the introduction of the euro marks a new stage in European integration, leading to increases in consolidation in order to exploit the capacity to deliver cross-border financial services in a single currency regime. Moreover, most countries have been experiencing increased consolidation aimed at reducing costs and increasing efficiency in preparation for what is seen by all participants as an increasingly competitive global marketplace. In Canada, 185 mergers and acquisitions occurred in the financial sector from 1993 to 1996, up from 125 in the previous four years. Total merger activity in all sectors in Canada in the first half of 1998 set a record high, without counting the two proposed Schedule I bank mergers.

A. Banks

The aim of this set of amendments is to allow domestically based financial institutions to become large enough to compete internationally while maintaining an acceptable degree of domestic competition.

Both the *Bank Act* (in s. 223-231, Part VI) and the *Insurance Companies Act* (in s. 246-252, Part VI) treat mergers ("amalgamations") as distinct transactions from acquisitions. The new legislation would expressly permit bank mergers; however, banks with equity of $5 billion or more would be required to be widely held. In this context, "widely held" means that the bank has no major shareholder, i.e., one who beneficially owns – either directly or through entities controlled by that shareholder – more than 20% of the bank's outstanding voting shares or more than 30% of any class of the bank's non-voting shares.

Currently, banks are permitted to merge with any other federally incorporated bank and continue as one bank. Under the new *Act*, mergers would also be permitted between a bank and: a) a trust and loan company; b) a non-regulated lending institution; and c) an insurance company (except demutualized insurance companies). Some of these mergers – particularly that of a bank with an insurance company – raise transitional issues necessitating exemptions from the Minister. The current *Act* contains no provision prescribing how provincially incorporated foreign financial institutions which are not Schedule II banks can be amalgamated to form a bank.(20)

The $5 billion threshold would also apply to mergers: If a bank with equity of $5 billion merged with another bank or corporation, the merged bank would be required to be widely held (s. 223(3)). Some exceptions have been built into the regime applying to large banks held by a qualifying shareholder (i.e., a widely held bank or bank holding company):

- Where two banks merged, the resulting merged bank would have to be controlled by the holding company that controlled the large bank prior to the merger.

- If the parties to the merger were both large banks, each controlled by a widely held holding company, the resulting merged bank would have to be controlled by one of the holding companies that controlled those merger partners.

- If the merger would result in the creation of a bank with equity of $5 billion or more, the merged bank would have to be widely held or owned by a qualifying shareholder (i.e., a widely held bank holding company or an eligible Canadian or foreign institution).

Section 228 sets out a list of factors the Minister would be required to consider before issuing letters patent. The Minister would be authorized to consider the Superintendent's opinion (s. 228(4(g))) as to whether the newly merged bank would present any supervisory or regulatory concerns based on: **i) the**

nature and extent of the proposed financial activity; or ii) the nature and degree of supervision and regulation applying to the proposed financial activity.

The integration plan would be a significant part of the new approach to merger review. As recommended by the Task Force, the parties would be required to prepare a Public Interest Impact Assessment (PIIA) of both the micro- and macro-economic impact of the merger.(21) The PIIA would be required to indicate the costs and benefits of the proposed merger. For example, it would have to include an estimate of the impact of the merger on sources of financing for individual consumers and small- and medium-sized enterprises. It would also be required to address regional impacts including branch closures and changes to service delivery, as well as the impact on international competitiveness, employment and technology.

In addition, the PIIA would be required to set out the impact of the merger on the structure of the financial sector overall, proposals to address any negative results such as job losses or branch closures, and any other matter the Minister of Finance might specify. The matter would then be referred to the House of Commons Standing Committee on Finance **and the Senate Standing Committee on Banking, Trade and Commerce** for their consideration of the assessment, and for public hearings. The PIIA would be made public. More detailed requirements of the PIIA would be set out in regulation.

Concurrent with the Committee hearings, the Minister would receive reports from both the Office of the Superintendent of Financial Institutions (OSFI) as well as the Commissioner of the Competition Bureau with respect to issues falling within their respective authority. The OSFI would report to the Minister on prudential issues. The Competition Bureau would provide the Minister and the parties with the Bureau's view on the competitive aspects of the proposed merger. These reports would be made public, and would be available to the Committee for its scrutiny.

Based on these reports, the Minister of Finance would decide whether the proposed merger should proceed in light of the prudential, competition and public-interest concerns. The three criteria on which the government based its rejection of the 1998 bank merger proposals would continue to apply: merger proposals would have to demonstrate that they would not unduly concentrate economic power, significantly reduce competition, or restrict flexibility to reduce prudential concerns. The Minister could allow the proposed merger to proceed subject to certain conditions. Should the Minister find the concerns too great to be remedied, the proposal would be rejected. The Competition Bureau and OSFI would negotiate competition and prudential remedies with the parties. These two agencies would work with the Department of Finance to co-ordinate an overall set of prudential, competition and other public-interest remedies. It would then be left to the merging parties to decide whether they wished to proceed in light of the conditions imposed upon the transaction. If they decided to proceed, final approval of the merger would be sought from the Minister. Further legislative changes would be introduced to permit a breach of a term or condition to be remedied upon application to the court (s. 229.1). **The Government's Merger Review Guidelines are attached as Appendix II.**

B. Insurance Companies

As with banks, the Minister could issue letters patent amalgamating and continuing the applicants as one company. Amended s. 250(3) sets out a list of criteria the Minister would be required to consider.

Provisions of the new *Act* would restrict the ability of demutualized(22) insurance companies to merge. No mergers would be permitted involving any one of the four recently demutualized companies until 1 January 2002. After that date, restrictions applying to the two smaller companies –

Canada Life Assurance Company and Clarica Life Insurance Company – would be lifted. Restrictions similar to those applying to the large banks would continue to apply to the two larger companies, Manufacturers Life Insurance Company and Sun Life Assurance Company of Canada. The following rules would apply to mergers involving demutualized insurance companies:

- If one of the large demutualized companies merged, the resulting merged company would have to be widely held.

- Only the holding company that controlled the large demutualized company prior to the merger would qualify to control the new company.

- If the two merger parties were both large demutualized companies controlled by holding companies, the resulting merged company would have to be controlled by one of the widely held companies or insurance holding companies that controlled the merger partners. No other corporation, regardless of whether it was widely held, could become the holding company of one of the large demutualized companies.

The Minister would be able to order that the widely held requirement did not apply to a large demutualized company. In that event, the merger restrictions applying to the large demutualized companies would also cease to apply.

In any merger involving demutualized companies, the Minister would be authorized to consider the Superintendent's opinion as to whether the newly merged company would present supervisory or regulatory concerns based on the overall corporate structure applying to the company. The Minister would also be authorized to consider the integration plans of the merger applicants.

Unlike banks, mergers involving companies with equity of $5 billion or more would not be subject to the merger review policy.

CO-OPERATIVE FINANCIAL INSTITUTIONS

A. Overview

Consisting of both credit unions and caisses populaires, the credit union movement is an important component of the Canadian financial services sector. Although the movement plays a role in most parts of the country, it is particularly active in British Columbia, Saskatchewan and Quebec. In the latter two provinces, for example, it comprises approximately 40% of the market share while in British Columbia the market share is about 20%. More than 10 million Canadians belong to a credit union or caisse populaire, and the movement manages more than $120 billion in assets.

The credit union/caisse populaire system is characterized by a three-tiered structure:

- first tier – individual credit unions and caisses populaires;

- second tier – provincial centrals or regional federations in Quebec;

- third tier – the Credit Union Central of Canada (CUCC) (outside Quebec); inside Quebec, the Confédération des caisses populaires d'économie Desjardins du Québec (Desjardins).

Credit unions and caisses populaires are co-operatives owned and controlled by their members. In Quebec, each caisse belongs to one of a number of regional federations, which in turn are members of the provincial federation, the Confédération des caisses populaires d'économie Desjardins du Québec. (23) Desjardins provides liquidity support for individual caisses through the regional federations and provides access to the payments system. **By 1 July 2001, a new structure will be in place. The caisses will be divided into 16 regional councils and will elect their own representatives to the board of directors of the Confederation.**

Elsewhere in Canada, a significant number of credit unions are members of a provincial central credit union. These provincial centrals in turn belong to the national central, the Credit Union Central of Canada. Provincial centrals provide a number of services in support of local credit unions. Typically, these services include research, marketing, product development and public relations, member education and professional development programs, electronic data processing, government relations, capital for loans and investment, management services, co-ordination of access to the payments system, and the management of the liquidity pool for member credit unions. The CUCC oversees the national liquidity pool for the Canadian credit union system.

Both the provincial and federal governments participate in the regulation of the credit union movement. Individual caisses and credit unions are incorporated and regulated at the provincial level. In addition, the provinces provide deposit insurance for members of credit unions or caisses populaires. The CUCC is incorporated under federal law and regulated under federal legislation; a number of provincial centrals (British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Nova Scotia) have chosen to register under both federal and provincial legislation.

B. Task Force and Parliamentary Reports

The Task Force on the Future of the Canadian Financial Services Sector noted that Canada does not have strong second-tier financial institutions to compete with the major banks. Pointing to the success of the Mouvement Desjardins, the Task Force felt that the co-operative sector had an opportunity to build a system in the rest of Canada that could achieve the level of success gained by the caisse populaire system in Quebec.

The Task Force felt that public policy should not constrain the ability of credit unions and caisses populaires to compete and become more effective players in the financial services market. Concluding that the current policy framework is too rigid, and that the structural fragmentation of the system outside Quebec is a barrier to the growth of the credit union sector, it made a number of recommendations designed to increase the flexibility of credit union centrals to engage in joint ventures and provide services to assist local credit unions in offering more financial services products to customers. These included proposing changes to the *Cooperative Credit Associations Act* that would: allow credit union centrals to provide wholesale services to other financial entities or retail services directly to members of local credit unions; and remove the restrictions on the ability of credit union centrals to enter into financial joint ventures among themselves and with credit unions. The Task Force further called for the creation of co-operative banks. This proposal would allow a credit union or a group of credit unions to apply to become a federally chartered co-operative bank. Credit union centrals could also become co-operative banks whose sole business would be to provide services to local credit unions.

Both the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce supported the Task Force recommendations concerning the co-operative financial sector.

The White Paper issued by the Department of Finance in June 1999 proposed legislative changes that would permit the co-operative financial sector to restructure its operations into a two-tier system consisting of local credit unions and the federal credit union central. The upper tier would be a national service entity. The government also stated that it would work closely with credit unions wishing to form a national co-operative bank.

C. Analysis

Bill C-8 would make several changes to the *Cooperative Credit Associations Act (CCAA)* to provide the credit union system with increased structural flexibility as well as expanded business and investment powers. The credit union movement identified a number of challenges that it hoped would be addressed by the Bill: the inability of credit unions to provide services to members who move to another province; constraints on the ability of credit unions to pool resources and skills in different parts of the country; duplication of backroom activities and administrative costs; and lack of co-ordination of products and services.(24)

1. Structural Changes

The Bill contains several proposed amendments that would enable the credit union system, if it wished to do so, to move from the current three-tier structure – local credit unions, provincial credit union centrals, and the national credit union central – to a two-tier structure consisting of local credit unions and a national services entity.

The Bill would ease the constraints on the ability of an association to control another association. Under clause 256, an association could be created by another association or at least two credit union centrals, ten local credit unions, or two or more leagues. However, not all of the centrals, credit unions or leagues could come from one province (s. 24). Before approving the incorporation of an association, the Minister of Finance would have to consider a number of factors, including the character and integrity of the applicants, whether the association would be operated responsibly by persons with the competence and experience suitable for operating a financial institution, **whether the association is to be operated in accordance with cooperative principles,** and the impact of the integration of the business and operations of the applicant with those of the association on the conduct of those businesses and operations (s. 27). This last factor would allow the Minister to consider the impact of an association's creation on jobs.

The Bill provides for a new type of entity – a league – which clause 248 defines as a provincially incorporated co-operative created by local credit unions for providing administrative, technical, research and consultative services and goods related to those services to credit unions. By establishing a framework for leagues from more than one province to form an association, the Bill would accommodate the creation of a national services entity.

Clause 258 would allow for the continuance of a corporation incorporated under provincial or other federal laws as an association under the *CCAA*. Continuances could also be granted for the purposes of amalgamating with another corporation.

Under clause 259, an association could apply for a continuance as a trust and loan company, a bank or a bank holding company, or for amalgamating and continuing the association as any of the foregoing. With the approval of the Minister, an association could also apply for a continuance under the *Canada Business Corporations Act* or the *Canada Cooperatives Act*. **Likewise, under the amendments to the**

***Trust and Loan Companies Act* (clause 487, s. 38), a cooperative-owned trust company would be allowed to continue as an association under the CCAA.(25)**

Clause 285 (s. 226) would provide for the amalgamation of associations under the *CCAA* as one association if the proposed capital and corporate structure of the amalgamated association met the requirements for an association under the *Act*. A horizontal short-form amalgamation regime would be available under clause 286 where at least one of the applicants was an association and all the applicants were wholly owned subsidiaries of the same holding company.

Clause 287 sets out the matters that the Minister would have to take into account before approving an amalgamation that would create one association. These include:

- the source of continuing support for the amalgamated association;
- the soundness and feasibility of the plans for the future conduct and development of the business of the association;
- the business record and experience of the applicants;
- the reputation of the applicants for operating in a manner consistent with the standards of good character and integrity;
- whether the amalgamated association would be operated responsibly by persons with the competence and experience suitable for the operation of a financial institution;
- the impact of any integration of the operations and businesses of the applicants on the conduct of these operations and businesses;
- **whether the association is to be operated in accordance with cooperative principles; and**
- the best interests of the financial system in Canada.

Clause 270 would introduce new provisions to facilitate the transfer of assets from a member of an association to the association. With the approval of the Superintendent of Financial Institutions, an association's by-laws could contain a formula for valuing a member or its assets or liabilities when the association proposed to acquire the member or such assets or liabilities in exchange for shares. In addition, clause 289 would add new provisions to the *CCAA* that would allow an association to sell all or substantially all of its assets to a federally incorporated financial institution, a bank holding company or an authorized foreign bank. Such a sale would have to be approved by a special resolution of the association's members and shareholders and by the Minister of Finance (s. 233.1- 233.5).

2. Ownership Rules

Bill C-8 would expand the association ownership rules. The *CCAA* currently provides that at least two credit union centrals or at least ten local credit unions can form an association. In both cases, not all of the centrals or credit unions can be located in one province. Clause 256 (s. 24) would amend this provision by providing that an association could be incorporated by an association, or applicants that include at least two credit union centrals, ten local credit unions, or two or more leagues. Again, the centrals, credit unions and leagues would have to come from more than one province.

Under clause 263, membership in an association would be limited to associations, credit union centrals, credit unions, co-operatives, deposit protection agencies, leagues or unincorporated organizations consisting of any of the foregoing entities. Clause 265 provides that an association's membership would have to include at least an association, two credit union centrals, ten local credit unions, or two or more leagues. The centrals, local credit unions and leagues could all be from one province.

Clause 266 would amend the *CCAA* provision that deals with control of an association. Section 52 of the *Act*, which currently states that no individual can control an association, would be amended to allow an association to control another association. The Bill would lower the minimum capital requirement to form an association from $10 million to $5 million.

Section 354 of the *CCAA* would prevent a person from acquiring a significant interest in (defined as more than 10% of shares) or increasing a significant interest in an association without the approval of the Minister of Finance. It would also allow the Superintendent of Financial Institutions to exempt any class of shares from the ministerial approval requirement if the class was not more than 10% of the association's equity. Clause 297 would raise the exemption limit to 30%. Clause 298 (s. 354.1), however, provides that the Minister's approval would be required before a person could acquire control as a result of having a direct or indirect influence on an association that would amount to control in fact of the association.

Before approving an application to acquire a significant interest in an association, the Minister would be required to consider a number of factors, including:

- the nature and sufficiency of the applicant's financial resources as a source of continuing support for the association;
- the soundness and feasibility of the plans for the future conduct and development of the business of the association;
- the business record and experience of the applicants;
- the character and integrity of the applicant;
- whether the association would be operated responsibly by persons with the competence and experience suitable for the operation of a financial institution;
- the impact of any integration of the operations and businesses of the applicant on the conduct of the operations and businesses of the association;
- **whether the association is to be operated in accordance with cooperative principles; and**
- the best interests of the financial system **– in particular, the cooperative financial system –** in Canada (s. 358.1).

Where a person had applied to the Minister for approval to acquire control of an association, the person would have the right to make representations to the Minister if the Minister were not satisfied that the application should be approved (s. 361(2)).

3. Business and Investment Powers

Clause 306 would amend s. 375 of the *CCAA* to broaden an association's general business powers. Under s. 375, associations are currently limited to providing financial services to:

(a) a member of the association;

(b) an entity in which an association has a substantial investment;

(c) another association;

(d) a credit union;

(e) a co-operative corporation; or

(f) an entity **or group of entities** controlled by an entity described above.

Bill C-8 would expand the general business power by allowing an association to be engaged in "such business as generally appertains to the business of providing financial services" to the entities listed above and to an entity controlled by an entity or group of entities described above. This would allow an association to engage in activities relating to or generally supporting the provision of financial services.

Section 376 of the *CCAA* sets out a number of additional business powers, such as:

(a) holding real property;

(b) acting as a custodian of property on behalf of its members or credit unions;

(c) receiving money on deposit from the federal, provincial or municipal government and a deposit protection agency;

(d) making loans to and investments in entities that are not members of the association;

(e) making loans to officers and employees of the association;

(f) providing management, investment, administrative, advisory, educational, promotional, technical, research and consultative services to members of the credit union system; and

(g) with the Minister's approval, providing information services and products to any of the members.

Clause 307 would expand an association's business powers to include providing financial services to persons outside the credit union system or providing clearing, settlement and payment services to members of the Canadian Payments Association, or ancillary services related to the clearing, settlement and payment services.

It would also add to the roster of permissible activities for an association. For example, s. 376 would provide that, with the Minister's approval, an association could provide the following services to other members of the credit union system or, in the case of a retail association, to any person:

- collecting, transmitting and manipulating financial or economic data;
- providing advisory services related to the design, development or implementation of information advisory services;
- designing, developing or marketing computer software; and
- designing, developing, manufacturing or selling computer equipment integral to the provision of information systems.

Furthermore, an association could offer data transmission services. This would include developing, designing, holding and managing data transmission systems, information sites, communication devices, and information platforms or portals. However, these services would have to be related to processing financial or economic information.

Under the existing *Act*, an association cannot acquire more than 10% of the voting shares or more than 25% of the total equity in another entity (a substantial investment) unless the investment is permitted by the *Act*. The list of allowed substantial investments includes entities such as financial institutions, factoring corporations, financial leasing corporations and mutual fund corporations whose activities relate to the services offered by credit unions.

Under the Bill (s. 390), an association would be able to acquire control of or make substantial investments in other financial institutions including banks, or bank holding companies, insurance holding companies, credit unions, other associations, securities dealers, and trust and loan companies. This would allow an association to create separate entities for different types of services.

In addition to being able to invest in other financial institutions, an association could invest in any entity that provided a service that a retail association would be permitted to provide under certain provisions of the *Act* (s. 390(2)(a)) and in holding companies with investments that an association would otherwise be able to invest in directly (s. 390(2)(b)). Investments would also be permitted in service corporations. An association, for example, could invest in an entity that provided services to financial service providers and their affiliates (s. 390(2)(c)).

Under s. 390(2)(d), investments would be permitted in entities that engage in activities related to the promotion, sale, delivery or distribution of a financial product. As long as the financial services to which a significant portion of the entity's business related were those offered by the association or another member of the association's group, the entity would be able to provide services to customers outside the association's group.

The various categories of investments would be subject to limitations. Under s. 390(3)(a), the entity could not act as a trustee, deal in securities **(subject to some exceptions, such as dealing in mutual funds)**, engage in automobile leasing, or make non-guaranteed high ratio mortgages.

Proposed paragraph 390(4)(a) provides that an association would not be permitted to acquire or increase a substantial investment in an entity such as a bank, trust company, insurance company, credit union or securities dealer unless:

- **the association acquired control "in fact" of the entity; or**

* **certain regulations permitted the association to acquire or increase a substantial investment in the entity.**

Control in fact means that the association would not have to own more than 50% of the shares if it could establish that it controlled the entity though other means.

Clause 342 would ensure that the provisions of paragraph 390(4)(a) pertaining to substantial investments would not apply to the acquisition or increase of a substantial investment by a provincial credit union central registered under the *CCAA* in an association to which the *CCAA* applies.

Under s. 390(5), an association would be required to obtain the approval of the Minister of Finance to acquire control of a securities dealer or a provincially incorporated financial institution such as a trust, loan or insurance company, or a credit union. Ministerial approval would generally not be required, however, if ownership were being transferred within the same corporate group. Approval also would be generally required for investments in foreign financial institutions or in most of the entities that constitute the new types of investments permitted under the Bill, including investments in entities engaged in the promotion, sale, delivery or distribution of financial products, or in data management and transmission.

Under s. 390(6)(7), the Superintendent of Financial Institutions would be required to approve investments in a securities dealer or provincial financial institution, among others, if the investment were not approved by the Minister because it had been acquired from an entity within the association's group or from a federally regulated financial institution within the association's group; **or if the association is acquiring control of a factoring or financial-leasing entity, or a holding company that is not a specialized financing entity.**

The Bill (s. 393) would make some changes to the existing temporary investment power that allows an association to make a short-term investment in any entity. The provision of the *CCAA* stipulating that an association's interest in a temporary investment cannot exceed 50% of the voting rights in an entity would be eliminated. However, temporary investments would continue to be subject to a two-year holding period unless otherwise allowed by the Superintendent. An association would not be able to use the temporary investment power to circumvent a requirement to obtain ministerial approval for an investment.

4. Retail Associations

Bill C-8 would allow an association to apply to the Minister of Finance for permission to become a retail association (s. 375.1(1)-(3)). If approved, a retail association would be permitted to act as a deposit-taking institution, subject to the same restrictions and safeguards as other deposit-taking institutions, such as banks and trust and loan companies. One of the most important changes would allow a retail association to provide services and take deposits from non-members. A retail association would have to be a member of the Canada Deposit Insurance Corporation (CDIC) before it could accept deposits.

Among other things, a retail association could act as a financial agent, provide investment counselling and portfolio management services, issue debit and credit cards, sell lottery and transit tickets, and act as a receiver or liquidator (s. 376(1)(i)). It could also provide specialized business management and advisory services (s. 376(2)).

Retail associations would be subject to the same rules as other deposit-taking institutions with respect to unclaimed account balances, disclosure of interest rates, disclosure requirements on opening accounts, disclosure of borrowing costs, and disclosure of credit-card charges.

A retail association could open deposit accounts for existing account holders over the telephone by providing oral disclosure of prescribed information and full written disclosure within a maximum of seven business days after the account had been opened (s. 385.1(3)-(4)).

A retail association would be required to establish procedures for dealing with customer complaints. These procedures would have to be filed with the Commissioner of the Financial Consumer Agency of Canada (FCAC). The association would also be required to be a member of an independent complaints-handling body either at the provincial level or, if it wished to do so, at the federal level with the Canadian Financial Services Ombudsman (s. 385.22 and 385.23).

The provisions of the Bill pertaining to advance notice of a branch closure or a branch ceasing to carry on certain activities would also apply to associations taking retail deposit accounts (s. 385.27).

Clause 313 (s. 385.32) would permit **enforcement notices in respect of** child and family support orders to be served at a designated office of an association rather than at the particular branch where the debtor maintains an account.

Retail associations would be required to provide the FCAC Commissioner with the information required for administering the consumer provisions of the Bill applicable to such associations (s. 452.1). The Commissioner's regulatory powers in relation to a retail association would be the same as the Commissioner's powers with respect to a bank (s. 452.1-452.5) and would include the power to: conduct examinations or inquiries into whether the consumer provisions had been complied with; and enter into compliance agreements with the association.

5. Corporate Governance

Bill C-8 would change a number of the corporate governance provisions of the *CCAA*.

a. Directors and Officers

Under the existing *CCAA*, three-quarters of the members of an association's board of directors must be resident Canadians. Bill C-38 would reduce this residency requirement from three-quarters resident Canadians to two-thirds resident Canadians.

The Bill would give the Superintendent authority to disqualify a person from being elected or appointed as a director or senior officer of an association if the Superintendent was of the opinion that the individual was unsuitable to hold office on the basis of the person's competence, business record, experience, conduct or character. In addition to the disqualification power, the Superintendent would have authority to remove a director or senior officer of an association. Grounds for removal would include lack of suitability to hold office on the basis of competence, business record, experience, conduct or character, or because the person had contravened or contributed to the contravention of the *Act*, the regulations, a direction, an order, a condition or limitation relating to the association's business, or a prudential agreement (s. 441.2). The Superintendent would be required to consider whether the interests of the association's depositors and creditors would likely be prejudiced if the individual were to hold office. The individual would have the opportunity to make representations to the Superintendent about the decision and to appeal a removal order to the Federal Court.

b. Dividend Cap

The Bill would also introduce a cap on the amount of a dividend that could be paid in any year. Unless the Superintendent had approved, the dividend payment could not exceed the aggregate of the association's net income for the year and its retained net income for the preceding two financial years.

c. Disclosure of Information

A retail association would be required to establish procedures to provide for the disclosure of information to customers and for dealing with complaints, and designate a committee of the board of directors to monitor the procedures.

d. By-laws

Under the existing *Act*, an association must amend its incorporating documents if it wants to change its name. This process requires the consent of the Minister of Finance and can be quite cumbersome. Under the Bill, an association could change its name by amending its by-laws. This change would have to be approved by a special resolution and would not take effect until approved by the Superintendent.

e. Related-party Transactions

Under the existing provisions of the *CCAA*, related-party transactions must be on terms at least as favourable as market terms and conditions. Bill C-8 would provide that where there was no active market, a related-party transaction must provide the parties with "fair value having regard to all the circumstances of the transaction and that would be consistent with the parties to the transaction acting prudently, knowledgeably and willingly" (s. 425(2)).

In addition to other remedies available against directors who approve a transaction contrary to the related-party rules, the Superintendent could apply to the court for a compensation order to be made against the directors who authorized the transaction (s. 430). The directors would not be liable under this provision, however, if they relied in good faith on financial statements prepared by management or the association's auditors or on a statement made by a professional advisor (s. 215).

6. Security Interests

The existing *CCAA* prohibits associations from creating security interests to secure their obligations unless the security interest is of a specified type or is approved by the Superintendent. Bill C-8 would allow an association to create security interests without the approval of the Superintendent. The association's board of directors, however, would be required to establish a policy in relation to the creation of security interests; as well, the Superintendent could direct a change to the policy if he or she were not satisfied with the policy (s. 383). The Governor in Council would have the authority to make regulations, and the Superintendent could make guidelines with respect to the creation of security interests by an association (s. 383.1).

7. Prudential Agreements

Bill C-8 would authorize the Superintendent to enter into a prudential agreement with an association for the purpose of implementing measures designed to maintain or improve the association's safety and soundness (s. 438.1). This would allow the Superintendent to agree with the association's management on measures to deal with weaknesses before they developed into a serious problem. In addition, the Bill would give the Superintendent the authority to apply to a court for an order requiring the association to comply with the terms of a prudential agreement (s. 441) and to remove an association's directors or senior officers from office if they contravened or contributed to the contravention of a prudential agreement (s. 441.2).

REGULATORY CHANGES

The Task Force spent a considerable amount of time focusing on the regulatory environment within which financial institutions operate. Canada's financial system is noted not only for its high degree of safety and soundness but also for the relative difficulty of entering the financial services sector.

The Task Force made a number of recommendations on various aspects of the financial services sector regulatory environment in order to streamline the regulation of financial institutions, avoid overlap and duplication of regulation, and lighten the regulatory compliance burden.

A. *Canada Deposit Insurance Corporation Act*

The Canada Deposit Insurance Corporation (CDIC) operates a government-established compensation program which applies to regulated deposit-taking institutions. The CDIC provides deposit insurance and promotes standards of sound business and financial practice that contribute to the stability of the Canadian financial system and reduce depositors' exposure to loss.

In its June 1999 White Paper, the Department of Finance announced that it would put in place a number of changes to streamline the CDIC's administrative processes. Some of these changes would be effected through amendments to the *Canada Deposit Insurance Corporation Act (CDIC Act)*, and others would be implemented through revisions to administrative mechanisms.

1. Analysis

Bill C-8 would amend the definition of member institution for the purposes of the *CDIC Act*. Under the existing *Act*, a member institution is one that holds insurable deposits. This definition presents problems in applying the *Act* to newly incorporated institutions that have not yet taken an insured deposit. The proposed amendment would define a member institution as a corporation that has deposit insurance with the CDIC, thereby eliminating the requirement that a member institution hold insurable deposits.

Proposed amendments to s. 8 of the *CDIC Act* would make the *Act* applicable to an association incorporated under the *Cooperative Credit Associations Act*, allowing newly formed retail associations that accept consumer deposits to be CDIC members.

The Bill would change the composition of the CDIC board of directors by adding the Commissioner of the Financial Consumer Agency of Canada as a member, **allowing an officer of the Office of the Superintendent of Financial Institutions to replace a Deputy Superintendent of Financial Institutions,** and allowing another private sector director to be appointed to the board.

An amendment to s. 10 of the *CDIC Act* would clarify the CDIC's power to settle claims by and against it. A related amendment to s. 24.1 would ensure that a CDIC member could not, without the prior consent of the CDIC, reduce or eliminate a payment to the CDIC because it had a set-off or claim against the CDIC.

Under s. 26.03(1)(a) of the *CDIC Act*, a bank can be authorized to accept deposits without being a CDIC member if it is not affiliated with a member institution such as another bank. Clause 209 would delete the non-affiliation condition found in s. 26.03. This would accommodate proposed changes to the *Bank Act* that would allow domestic banks to have wholesale and retail operations.

Amendments to s. 29, 29.1, 29.2 and 45.2 would implement changes in the examination process for CDIC members agreed to by the OSFI and the CDIC in response to the White Paper proposals to reduce the reporting burden on financial institutions.

The CDIC requires its members to attest that they comply with the Standards of Sound Business and Financial Practices in the CDIC's by-laws. The White Paper noted that the CDIC's opinion on whether an institution was following the standards should take into account the significance of any deficiencies and that non-material deficiencies should not necessarily be viewed as non-compliance. The statutory requirement imposed on OSFI examiners to provide the CDIC with compliance standard reports under s. 29 of the *CDIC Act* would be amended to require the examiner to inform the CDIC of any change in the circumstances of a CDIC member that might materially affect the CDIC's position as an insurer (s. 29(5)).

Amendments to s. 47 of the *CDIC Act* would clarify the penalty provisions of the *Act.*

B. Office of the Superintendent of Financial Institutions

The White Paper acknowledged that greater competition in the financial services sector increases the potential for risk. As a result, the government proposed to give the Superintendent of Financial Institutions additional supervisory powers that would include:

- the authority for the Superintendent to remove directors and senior officers from office in certain circumstances, such as instances of misconduct;
- a system of administrative money penalties for financial institutions and individuals that failed to comply with undertakings and cease and desist orders, or violated financial institution legislation and regulations; and
- measures to enhance the Superintendent's power to deal with related-party transactions.(26)

These proposals have been included in Bill C-8.

1. Analysis

Bill C-8 would make a number of consequential amendments to the *Office of the Superintendent of Financial Institutions Act (OSFI Act*) to take into account amendments to the *Bank Act* that would allow for the creation of bank holding companies as well as amendments to the *Insurance Companies Act* that would allow for insurance holding companies. The *OSFI Act* would also apply to associations under the *Cooperative Credit Associations Act*.

The Bill would also make consequential amendments to the *OSFI Act* that reflect the introduction of new consumer protection provisions and the creation of the Financial Consumer Agency of Canada. The Bill would clarify that the Superintendent would be responsible for all matters connected with administering the provisions of the various financial institution laws except for the consumer provisions, which would be the responsibility of the FCAC (s. 6(1)).

a. Administrative Monetary Penalties

Clause 476 would create an administrative monetary penalty regime that would give the Superintendent the authority to impose monetary penalties for violations of various financial institution laws as well as safety and soundness instruments issued under those laws. This regime would be in addition to the Superintendent's authority to initiate criminal proceedings for violations of financial institution legislation.

Among other things, proposed s. 25 of the *OSFI Act* would give the Governor in Council the authority to make regulations:

(a) designating violations of financial institution laws and regulations that would be subject to the administrative monetary regime including contraventions of:

- orders made by the Superintendent under such laws;
- directions to cease from engaging in unsafe or unsound practices;
- terms and conditions imposed by the Superintendent or an undertaking to the Superintendent; or
- a prudential agreement entered into by the Superintendent and a financial institution;

(b) classifying violations as minor, serious or very serious; and

(c) fixing a penalty or a range of penalties for violations.

Based on the seriousness of the violation, penalties would be set at three levels:

- minor violations by an individual would carry a maximum penalty of $10,000, and $25,000 if committed by an entity;
- serious violations would be subject to a maximum penalty of $50,000 if committed by an individual, and $100,000 if committed by an entity;
- very serious violations by an individual would carry a maximum penalty of $100,000, and $500,000 in the case of an entity.

Under proposed s. 26, the amount of the penalty would be determined taking into account:

- the degree of intention or negligence of the person who committed the violation;
- the harm done by the violation;

- violations or convictions under a financial institution law in the preceding five years; and

- other prescribed criteria.

The Bill would give a person served with a notice of violation the right to make representations to the Superintendent (s. 28). A person who did not make a representation would be deemed to have committed the violation. If a person chose to make a representation, however, the Superintendent would decide on the balance of probabilities whether a violation had been committed. Persons found to have committed a serious or a very serious violation would have a right to appeal the Superintendent's decision to the Federal Court (s. 29 and 30). The Bill also provides that due diligence as well as common law rules and principles would be a defence to a violation (s. 34). The time limit within which the Superintendent could begin a proceeding for a violation would be six months after the Superintendent knew about the matter in the case of a minor violation and two years for a serious or very serious violation (s. 37).

b. Prudential Agreements

Bill C-8 would amend:

- the *Bank Act* (s. 614.1; s. 644.1; s. 959);

- the *Cooperative Credit Associations Act* (s. 438.1);

- the *Insurance Companies Act* (s. 675.1; s. 1002); and

- the *Trust and Loan Companies Act* (s. 506.1);

to give the Superintendent of Financial Institutions the authority to enter into prudential agreements with a bank, a foreign bank, a bank holding company, an association, an insurance company, an insurance holding company, or a trust and loan company.

Under clause 177, for example, the Superintendent would have the authority to enter into a prudential agreement with a bank for the purpose of implementing measures designed to maintain or improve the bank's safety and soundness. This would allow the Superintendent to agree with the bank's management on measures to deal with weaknesses before they developed into a serious problem. In addition, the Bill would give the Superintendent the authority to apply to a court for an order requiring the bank to comply with the terms of a prudential agreement (s. 646) and to remove a bank's directors or senior officers from office if they contravened or contributed to the contravention of a prudential agreement (s. 647.1). The Superintendent would also be given authority to enter into a prudential agreement with a bank holding company to protect "the interests of depositors, policyholders and creditors of any federal financial institution affiliated with it."

As noted above, the Superintendent would be given similar authority to enter into prudential agreements with an association, an insurance company, an insurance holding company, and a trust and loan company.

c. Removal of Directors and Senior Officers

Bill C-8 would give the Superintendent power to remove a director or senior officer of a bank

(s. 647.1), a bank holding company (s. 964), an association (s. 441.2), an insurance company (s. 678.2), an insurance holding company (s. 1007), or a trust and loan company (s. 509.2). Grounds for removal would include: lack of suitability to hold office on the basis of competence, business record, experience, conduct or character; and contravening or contributing to the contravention of the relevant act or regulations, a direction, an order, a condition or limitation relating to the entity's business or a prudential agreement. In forming his or her opinion, the Superintendent would be required to consider whether the interests of the depositors, policyholders and creditors of the entity, as the case might be, would likely be prejudiced if the individual were to hold office. The individual would have the opportunity to make representations to the Superintendent about the decision and to appeal a removal order to the Federal Court.

d. Measures Pertaining to Related-party Transactions

Directors of financial institutions who authorize a transaction contrary to the related-party rules set out in the relevant laws are personally liable to compensate the institution for any amounts distributed or losses incurred. In addition to the remedies currently available against directors, the Superintendent would be given the authority to apply to the court for a compensation order to be made against the directors who authorized the transaction (s. 506 of the *Bank Act*; s. 430 of the *CCAA*; s. 539 of the *Insurance Companies Act*; s. 494 of the *Trust and Loan Companies Act*).

C. Regulatory Streamlining

Currently, federal financial institutions must obtain the approval of the Minister of Finance or the Superintendent of Financial Institutions before they can complete certain transactions and business undertakings.

The Task Force recommended that the Superintendent be given authority to provide necessary approvals without the need for referral to the Minister of Finance, except where policy matters were involved. It also recommended measures to streamline regulatory approvals such as a system of notice filings, blanket approvals, fast-track approvals and advance rulings.

The Finance Committee and the Senate Banking Committee supported the introduction of such measures.

The White Paper endorses a streamlined regulatory process. A new notice-based approval process would be introduced for many of the transactions currently requiring the Superintendent's approval. Under this process, institutions would file a standard notice with the OSFI that would be automatically approved within 30 days unless the OSFI raised concerns or required further information. The White Paper also proposed blanket approvals for certain types of transactions.

1. Analysis

Bill C-8 would introduce a number of measures to streamline the regulatory process. In some situations, approval by the Minister of Finance would be transferred to the Superintendent. For example, under proposed amendments to the *Bank Act* and the *Insurance Companies Act*, the Minister's approval would no longer be required for certain investments. In many cases, approval by the Superintendent would be substituted for Ministerial approval.

For many of the applications requiring the Superintendent's approval, a new approval process would be instituted. Under this process, the Superintendent would be deemed to have approved an application if he or she failed to notify the applicant of a decision within 30 days after having received the application. The Superintendent would have the authority to extend the 30-day period by notifying the applicant of an extension before the expiration of the initial 30 days.

The Bill would add a new provision to the *Bank Act*, the *Cooperative Credit Associations Act*, the *Insurance Companies Act*, and the *Trust and Loan Companies Act* that sets out the approvals that would be subject to the streamlined process. In each case, a significant number of approvals (more than 20 under the *CCAA* and the *Trust and Loan Companies Act* and more than 30 in the case of the other statutes) would fall under the new process (s. 976 of the *Bank Act*; s. 461.1 of the *CCAA*; s. 1019 of the *Insurance Companies Act*; s. 529.1 of the *Trust and Loan Companies Act*).

Important approvals, however, would not fall under the streamlined process; as well, the Minister would continue to exercise a significant degree of authority in relation to the ownership and structure of financial institutions.

CONSUMER PROVISIONS

One of the goals of the Government's financial services sector reform is to acknowledge the convergence occurring among previously strongly differentiated institutions. Consequently, many of the consumer-related amendments to the various Acts relating to financial services would subject financial institutions to the same (or fundamentally the same) requirements. This section, therefore, is divided into three parts:

- an analysis of the proposed Financial Consumer Agency of Canada;

- an overview of the main consumer-protection provisions in the legislation, namely, the Canadian Financial Services Ombudsman as well as regulations covering branch closures, public accountability statements, disclosure requirements, low-fee bank accounts, and tied selling;

- as the proposed consumer amendments to other initiatives are reflected in the *Bank Act*, the section concludes with tables comparing the *Bank Act* to proposed amendments to the *Insurance Companies Act (ICA)*, the *Cooperative Credit Associations Act (CCAA)*, and the *Trust and Loan Companies Act (TLCA)*. The *Green Shield Canada Act* is also mentioned.

A. Bill C-8: Financial Consumer Agency of Canada (FCAC)

Bill C-8 would create the Financial Consumer Agency of Canada (FCAC), an organization responsible to the Minister of Finance (clause 3). This part of Bill C-38 generally follows the proposals set out by the Government in its 1999 White Paper.

Funding for the Agency would be set by the Minister and provided out of the Consolidated Revenue Fund. This, and "other revenues," could be spent in two consecutive fiscal years (clause 13). Each year, the FCAC would determine its costs and divide this among financial institutions in a way to be prescribed by the Governor in Council. This charge would be binding; no appeals would be allowed (clause 18).

The FCAC and its Commissioner would also take their powers from specific provisions in the *Bank Act*, the *Cooperative Credit Associations Act*, the *Green Shield Canada Act*, the *Insurance Companies*

Act, and the *Trust and Loan Companies Act* (Schedule I).

1. Objectives

Under the amended legislation, the FCAC would take over the consumer-issue-monitoring responsibilities of the OSFI for all financial institutions (banks, insurance companies, trust and loan companies, and retail associations).

This new agency's objectives, as stated in the proposed legislation (clause 3(2)), would be to:

> (a) supervise financial institutions to determine whether they are in compliance with the consumer provisions applicable to them;
>
> (b) promote the adoption by financial institutions of policies and procedures designed to implement consumer provisions applicable to them;
>
> (c) monitor the implementation of voluntary codes of conduct that are designed to protect the interests of customers of financial institutions, that have been adopted by financial institutions and that are publicly available, **and to monitor any public commitments made by financial institutions that are designed to protect the interests of their consumers**;
>
> (d) promote consumer awareness about the obligations of financial institutions under consumer provisions applicable to them; and
>
> (e) foster, in co-operation with any department, agency or agent corporation of the Government of Canada or of a province, financial institutions and consumer and other organizations, an understanding of financial services and issues relating to financial services.

2. FCAC Staff and Responsibilities

Responsibility for appointing the Commissioner of the FCAC would belong to the Governor in Council. The Commissioner would serve for five years (renewable), but could be removed by the Governor in Council "for cause." The Commissioner would be entitled to "reasonable travel and living expenses" incurred during the course of his or her duties. The position would be covered by the *Public Service Superannuation Act*, the *Government Employees Compensation Act*, and any regulations made under s. 9 of the *Aeronautics Act*. The Commissioner would be precluded from holding another job, although he or she could hold a non-paying governmental position. The Minister could appoint a Commissioner for 90 days in the case of absence, incapacity or vacancy. For a term longer than 90 days, Governor in Council approval would be needed.

The Commissioner's powers would include reviewing financial institutions' voluntary codes of conduct **and institutions' commitment to consumer protection.** In collecting information, he/she would have due regard for any other governmental agent, agency or department working in the same area. Otherwise, he/she would be given the latitude to do what he/she deems necessary to promote and foster consumer awareness. The Commissioner could appoint one or more deputy commissioners to work under him/her (clauses 4-6, 8).

FCAC employees would not be liable for any activities committed in good faith (clause 33).

The proposed legislation includes a conflict-of-interest provision against a Commissioner, his/her replacement or Deputy Commissioner owning, directly or indirectly, "any shares of any financial institution" or corporation similar to a financial institution. Written permission of the Finance Minister would be required to borrow money from a financial institution or CDIC member institution. They also would not be permitted to receive a grant or gratuity from financial institutions; fines and imprisonment are threatened (clauses 14-16).

Further, the FCAC would be permitted to enter into an agreement, with the Governor in Council's approval, to work with any body to meet its objectives (clause 7).

3. Powers, Duties and Functions

The proposed FCAC appears to have two reporting requirements. First, clause 5 would direct the Commissioner to report on the implementation of this and the Schedule 1 Acts "from time to time." As well, each fiscal year (by the fifth sitting day following September 30), the Finance Minister would have to submit before the House of Commons and the Senate an annual report "describing in aggregate form its conclusions on the compliance of financial institutions with the consumer provisions applicable to them in that year" (clause 34). It would also have to include a report on the "procedures for dealing with complaints established by banks [other amended Acts substitute the name of the appropriate financial institution], and the number and nature of complaints that have been brought to the attention of the Agency…" (*BA*, s. 456, 574).

The amended legislation for banks, insurance companies, co-operative credit associations, and trust and loan companies sets out the powers of the FCAC over these financial institutions. Each financial institution would be required to file a copy of its complaints procedure with the Commissioner (*BA*, s. 455(2), 573(2) – foreign banks; *CCAA*, s. 385.22(2); *Insurance Companies Act*, s. 486(2); *Cooperative Credit Associations Act*, s. 385.22(2)). It would mandate the FCAC Commissioner to examine these institutions at least once a year, and give him/her access to whatever information would be needed to administer the FCAC's duties, including information and explanations under oath from financial institutions' directors and officers. This information would be treated confidentially. The Commissioner would be required to report the findings of these examinations to the Finance Minister.

Business information submitted to the FCAC would be treated as confidential, and would be shared only with other agencies that share this confidentiality, namely, other supervisory bodies "for purposes, related to that regulation or supervision." These agencies would include the Canada Deposit Insurance Corporation, the Deputy Minister of Finance, and the Governor of the Bank of Canada.

Part XIV of the *Bank Act (BA)*, which deals with the regulation of the banks by the Commissioner, would compel foreign and domestic banks to give the Commissioner information that he/she may require for the purposes of administering the consumer provisions. Further, the Commissioner would be allowed access to any records of a bank and may require the directors or officers of a bank to provide information and explanations to him or her, and also would be able to obtain evidence under oath. Further, the Commissioner could enter into a compliance agreement with a bank to promote compliance with the consumer provisions (*BA*, s. 661). The same power would be granted the Commissioner under Part XIII.1 of the *Cooperative Credit Associations Act*, Part XII.1 of the *Trust and Loan Companies Act*, and Part XVI of the *Insurance Companies Act*. The only difference, in the case of the *ICA*, is that, instead of being given the power to turn over information to the CDIC (in the case of banks), the Commissioner could turn it over "to any compensation association designated by order of the Minister under s. 449(1) or 591(1), for purposes relating to its operation" (s. 695(2)(c)). The Minister already has this power under the current legislation.

4. Violations and Penalties

Violations of consumer provisions are not set out in Bill C-38; instead, the proposed legislation would give the Governor in Council the following powers: to designate what is a violation and what the attached fines will be; to regulate the service of documents; and generally to support the legislation (clauses 19, 32).

A violation could either be treated as a violation or offence, although a violation would not be an offence as set out in the *Criminal Code*. Due diligence would be a defence, and there would be a two-year limit to the commencement of proceedings once the subject matter became known to the Commissioner (clauses 17, 21, 28, 30, 31). Further, the Commissioner would be allowed to make public the nature of the violation, who committed it, and the amount of the fine.

Penalties would be set at maximums of $50,000 (violation by a natural person) and $100,000 (financial institution) (clause 20). Unless fixed by regulation, fees would be determined by the degree of intention or negligence, the harm done, and a five-year history of the person fined. The Governor in Council could also set factors to be considered (clause 25). Fines would be remitted to the Receiver General.

The Commissioner would issue a notice of violation, which would set out the proposed penalty and the right of the person to either pay the penalty or to make representations (the Commissioner can set a longer period) in the manner proposed. If the fined person did not pay or make representations, he/she would be treated as guilty. If representations were made, the Commissioner would decide whether a violation had been committed, and, if so, could maintain, reduce or eliminate the penalty. If nothing was done within the allotted time, the Commissioner could impose, reduce or eliminate the original penalty. Notice of decisions and of the right to appeal would be related to the person fined. The fined person could appeal to the Federal Court, which could confirm, set aside or vary the decision (clauses 22-24).

5. FCAC-related Amendments in Other Acts

Proposed amendments to the *Bank Act (BA)* and the four Acts relating to financial institutions would also transfer responsibility for dealing with consumer complaints from the OSFI to the FCAC. Institutions would have to provide prospective and actual clients with information on how to contact the FCAC.

B. Other Consumer-related Amendments

Many of the proposed changes seem designed to cover as wide a variety of services as possible. The definition of "cost of borrowing" would be expanded. The "audience" of financial institutions would no longer include simply "customers," but also "persons having requested or received products or services" in Canada from a bank (or appropriate financial institution, depending on the legislation) (e.g., *BA*, s. 455.1).

1. Canadian Financial Services Ombudsman

The Government's 1999 White Paper states the government's intention to "work with financial institutions" to create "an independent Canadian Financial Services Ombudsman" (CFSO) that would be modeled after the existing Canadian Banking Ombudsman. Its goal would be "to ensure fair and impartial complaints resolution for consumers."(27)

Regarding independence, the White Paper states that the Ombudsman organization's board of directors would consist of eight independent directors and four directors appointed by member financial institutions, each appointed for three-year terms. It also states that after the Finance Minister's initial appointment of the independent directors, "a process will be established for the Minister of Finance and the incumbent independent directors to select new independent directors." Further, the Paper states that the Minister would play "an ongoing role in insuring the independent operation of the organization," although not on a day-to-day basis.

In contrast to the establishment of the FCAC, the CFSO organization is briefly set up in the proposed amendments to the *Bank Act* (s. 455.1). The legislation does not establish the CFSO. Rather, it gives the Finance Minister the power to set up such an office and appoint a majority of its directors. Its relationship to the FCAC is unclear, as it would be the second stop in dealing with complaints; banks and other financial services organizations would have to file a copy of their complaints procedures with the FCAC Commissioner. As well, the FCAC would have to submit a yearly report detailing "the number and nature of complaints that have been brought to the attention of the Agency by persons who have requested or received a product or service from a (financial institution)." How this would fit in with an ombudsman office is unclear.

Regarding directions, as the legislation would give the Finance Minister the power to appoint a majority of the organization's directors, it would be independent of the financial services sector, but not of the Ministry of Finance.

The CFSO's stated mandate involves "dealing with complaints, made by persons having requested or received products or services from its member financial institutions" that were not resolved satisfactorily at the financial-institution level. What exactly would be involved in its mandate to "deal with complaints" – enforcement, investigative or hearing powers – is unclear. The White Paper states that the CFSO would have the power to recommend non-binding awards to aggrieved customers, publicizing non-compliant institutions.

Banks (foreign and domestic) would have to belong to this organization, were it to be created. Co-operative credit associations (s. 385.23, *CCAA*), trust and loan companies (s. 441.1, *TLCA*), and insurance companies (s. 486.1, *ICA*) must belong to a provincial scheme if the province in which they operate has legislation that requires participation in such a scheme. In the absence of a provincial law, these financial institutions must be a member of an organization that is not controlled by it and that deals with complaints that have not been resolved at the company level. This could be either the federal CFSO scheme, or a voluntary scheme in the province, provided the company does not control it and deals with unresolved complaints.

2. Branch Closures

Subject to any regulations made by the Governor in Council, banks, federal trust and loan companies, and co-operative credit associations would be required to give notice of a branch closure. After notice was given but before the branch closed, the Commissioner could, in prescribed situations, require a bank to meet with the Commissioner and interested parties "in order to exchange views about the closing or cessation of activities" (*BA*, s. 459.2, *CCAA* 385.27, *TLCA* 444.1). However, the

Commissioner's powers in this area would end here. The Commissioner would have no power to enforce or prohibit any closures, or change a closure schedule.

Although the legislation does not mention a specific timeline, the Government's White Paper states the government's intention that federal deposit-taking institutions "be required to provide at least four months' notice of a branch closure, except in rural communities with only one branch in a 10-km radius, where six months' notice will be required."

3. Public Accountability Statements

Banks, trust and loan companies, and domestic insurance companies with $1 billion or greater in equity would have to publish annual statements "describing the contribution of the (financial institution) and its prescribed affiliates to the Canadian economy and society." This statement would have to be filed with the Commissioner; the financial institution also would have to disclose the statements to their customers and the public (in the manner and at the time prescribed).

The Governor in Council would regulate the when and how, to whom, and the what of the notice, the when of the meeting, and when notice is not necessary or could be given in a different manner than would be usual.

The Governor in Council would also give itself the power to regulate the disclosure of information related to consumer protection.

4. Disclosure Requirements (*BA* 445, *CCAA* 385.07, *TLCA* 431)

Banks, trust and loan companies, and co-operative credit associations would be required to provide information in writing about the account opened. Under the current section, information can be provided either in writing "or in such manner as may be prescribed." Currently, institutions are required to inform individuals that the information can be made available in writing, and that individuals can request that this information be provided in written form. The information that the bank would have to provide to a customer would not change.

If a customer opens another account over the telephone, the Bill would allow for the oral provision of information as long as the information is provided in writing by a maximum of seven business days after the account has been opened. However, the Governor in Council would be able to regulate how and when the information is deemed to be given to the customer.

The Bill would also allow an account to be closed within 14 days without incurring any charges, other than interest charges.

These changes are mirrored in the amendments covering foreign banks (s. 564).

5. Low-fee Bank Accounts Made Mandatory

Section 448.1 of the *BA* would require banks to allow individuals to open a retail account without requiring a minimum deposit or the maintenance of a minimum balance. The Governor in Council would have the power to define and prescribe "points of service" (e.g., branches), and to limit and restrict the conditions in which this section applies and who qualifies for it. Continuing this, s. 448.2 would give the Governor in Council the power to require banks to open a low-fee account, as well as to define again "point of service," and to limit and restrict the conditions in which this section applies and who qualifies for it. In addition, it would give the Governor in Council the power to prescribe "the characteristics, including the name, of a low-fee deposit account."

The government's current approach is to give the banks an opportunity to take a self-regulatory approach toward low-cost accounts. It has signed memoranda of understanding with eight banks outlining each bank's conception of a low-cost account to be enacted by the end of March 2001. Fees range from $2.95 to $4.00 per month for a number of transactions (approximately 12 for each bank) and other services. The Memorandum of Understanding is attached as Appendix III. The FCAC will monitor compliance with these targets, and the government has committed to making regulations in this area should problems arise.

The government's 1999 White Paper suggests that regulation in this area would be partly to assure that such an account is not linked to fraudulent activity. In addition to the no-balance and no-minimum-deposit rules, the Paper also states that a person opening such an account would not have to be employed, although the legislation is silent in this matter. (Foreign banks would be exempted from this requirement.)

In addition to not charging for a government cheque (already in the *Bank Act*), banks would be required to cash government cheques as long as the individual cashing the cheque does so in person and meets the prescribed conditions, and the cheque is not more than the prescribed amount. As well, the Governor in Council could make regulations detailing when this does not apply, and when a person otherwise eligible "is considered not to be a customer of the bank."

6. Tied Selling Prohibited

In the existing *Bank Act*, tied selling refers to the practice of linking the purchase of a product or service to a bank loan. The proposed amendments would expand the definition of tied selling to include linking any product or service to any other.

Under the proposed amendment, banks would have to display and make available a plain-language statement describing the prohibition on coercive tied selling. This prohibition would apply only to banks (s. 459.1).

C. Amendments (Act by Act)

1. *Cooperative Credit Associations Act*

These changes effectively mirror the *Bank Act* as well as the proposed amendments, and would bring the *CCAA* into line with the *Bank Act*. Because of this large overlap, this section merely states the equivalent section in the *Bank Act* (*BA*) or the proposed amendments to the *BA* (ABA). Any differences are also noted. Throughout, where the *BA* refers to "bank," these amendments refer to "retail association."

CCAA Amendments	Title	BA	ABA	Differences/Notes
385.05		439.1		No definition of "low-fee retail deposit account"; "member

				association," not "member bank"
385.06	Account Charges	440		
385.07 (1,2)	Disclosure on opening account	441 (1)	441 (2)	
385.08	Disclosure in advertisements	442		
385.09 (a,c)	Disclosure regulations	443 (a, b)		
385.09 (b)				The Governor in Council can make regulations about how and when disclosure to customers regarding the keeping of an account is to be made.
385.1	Disclosure required on opening a deposit account	445 (1) (a-e)	445	
385.11	Disclosure of charges	446		
385.12	No increase in new charges without disclosure	447		
385.13	Application		448	Applies to s. 385.1-385.12.
385.14	Definition of "cost of borrowing"		449	
385.15	Rebate of borrowing costs	449.1*		
385.16	Disclosing borrowing costs	450*		
385.17	Calculating borrowing costs	451		
385.18	Additional disclosure	451*		
385.19	Renewal statement	452.1*		
385.2	Disclosure in advertising	453*		
385.21	Regulations re borrowing costs	454*		Slight wording difference: "…may make regulations (a) respecting the manner in which … a retail association is to (*BA*: shall) disclose to a borrower…"
385.22	Procedures for dealing with complaints	455 (1), (1)(b), (c)	455(1)(a), (2)	
385.23	Obligation to be a member		455.1	A retail association must be a member of a third-party complaints body similar to that proposed under *BA*, s. 455.1(1). The federal requirement comes into play if there is no provincial requirement. This section says that a retail association must belong to an independent complaints organization if, in any province, there is no law subjecting it to the jurisdiction of an organization that deals with complaints.
385.24	Information on contacting Agency		456	
385.25	Prepayment protected, etc.	458*		

385.26	Regulations re customer information	459		
385.27	Notice of branch closure		459.2	
395.28	Regulations re disclosure		459.4	

* 1997 Amendments

Part XIII.1 Regulation of Retail Associations – Commissioner

These provisions would give the FCAC Commissioner the same powers over retail associations as over banks (Part XIV, *BA* proposed amendments).

Differences from *BA* and amendments:

- No requirement for public accountability statements (as in *BA*, s. 459.3)
- No prohibition of tied selling (as in *BA*, s. 459.1)
- No requirement to provide low-fee retail deposit accounts (as in *BA*, s. 448.2)
- No requirement to cash Government of Canada cheques of a non-member (as in *BA*, s. 458.1)

2. *Green Shield Canada Act*

The *Act* would give the FCAC Commissioner the same access to supervisory information from Green Shield and the same supervisory tools necessary to regulate Green Shield's compliance with the consumer-related provisions as the Commissioner has in relation to insurance companies under the *Insurance Companies Act*.

3. *Insurance Companies Act*

Changes to consumer protection regulations are found in proposed s. 479-489.2 (domestic); s. 598-607.1 (foreign); s. 693-698 (Part XVI Regulation of Companies and Foreign Companies – Commissioner). Many of the suggested amendments mirror those of the *Bank Act*. As with the *Cooperative Credit Associations Act* amendments, this section refers to the changes in the *Bank Act*, noting any differences.

ICA Amendments	ABA	Differences/Notes
Definition of "cost of borrowing"		
479	449	As this is for an insurance company, the definition covers "a loan or an advance on the security or against the cash surrender value of a policy made by a company."
Complaints		
486	455	See notes on *BA* amendments.
486.1	455.1 (2)	As with retail associations, an insurance company must be a member of a third-party complaints body similar to that proposed under *BA*, s. 455.1(1). The federal requirement comes into play if there is no provincial requirement. This section says that an insurance company must belong to an independent complaints organization if, in any province, there is no law subjecting it to the jurisdiction of

		an organization that deals with complaints.
Information on contacting the FCAC		
487	456	Similar to *BA*, s. 456: the firm must provide information on how to contact the FCAC to individuals requesting or receiving a product or service from it. Again, moves OSFI consumer-protection responsibilities to the FCAC. As with the banks, the Commissioner's Annual Report must include a report on the "procedures for dealing with complaints established by companies, and the number and nature of complaints that have been brought to the attention of the Agency… ."
Public Accountability Statement		
489.1	459.3	As with banks, insurance companies with equity greater than or equal to $1 billion must also file public accountability statements.
Regulations re disclosure		
489.2	459.4	Exactly similar regarding what can be regulated in this area.

The changes to the domestic part of the *Insurance Companies Act* are mirrored in the changes to the regulations governing the activities of foreign insurance companies (s. 598-607.1). However, unlike domestic insurance companies, foreign companies with equity greater than or equal to $1 billion would not be required to file a public accountability statement.

Part XVI Regulation of Companies and Foreign Companies – Commissioner

This would give the Commissioner of the FCAC the same powers to investigate domestic and foreign insurance companies as he/she would have to investigate domestic and foreign banks (Part XIV, *BA* proposed amendments). The only difference is that, instead of being given the power to turn over information to the CDIC (in the case of banks), the Commissioner could turn it over "to any compensation association designated by order of the Minister under s. 449(1) or 591(1), for purposes relating to its operation" (s. 695(2)(c)). The Minister already has this power under the current legislation.

4. *Trust and Loan Companies Act (TLCA)*

Changes to consumer protection regulations are found in proposed s. 301, 385.05-385.28; Part XII.1 Regulation of Companies – Commissioner, s. 520.1-520.5.

These changes effectively mirror the amendments to the *Bank Act* (ABA) discussed above. This section therefore refers to the relevant changes in the *Bank Act*, noting any differences.

TLCA Amendments	ABA	Differences/Notes
Definitions and Disclosure		
425.1	439.1	Defines "member company," "personal deposit account," "retail deposit account." No definition for "low-fee retail deposit account," as it is not mentioned in this section.
427 (2)	441 (2)	Exception for telling a customer the rate of interest of an account and how it is to be paid.
430	444	Repealed: definition of personal deposit account.
431	445	Disclosure required on opening an account: information to be provided in writing, closure of an account without charge within 14 days.

434	448	Application.
435	449	Expands definition of "cost of borrowing."
Complaints		
441	455	See notes on *BA* amendments.
441.1	455.1 (2)	As with retail associations, a trust and loan company must be a member of a third-party complaints body similar to that proposed under *BA*, s. 455.1(1). The federal requirement comes into play if there is no provincial requirement. This section says that a trust and loan company must belong to an independent complaints organization if, in any province, there is no law subjecting it to the jurisdiction of an organization that deals with complaints.
Information on Contacting FCAC		
442	456	Similar to *BA*, s. 456: the firm must provide information on how to contact the FCAC to individuals requesting or receiving a product or service from it. Again, moves OSFI consumer-protection responsibilities to the FCAC. As with the banks, the Commissioner's Annual Report must include a report on the "procedures for dealing with complaints established by companies, and the number and nature of complaints that have been brought to the attention of the Agency… ."
Notice re Branch Closure		
444.1	459.2	The same.
Public Accountability Statement		
444.2	459.3	As with banks, trust and loan companies with equity greater than or equal to $1 billion must also file public accountability statements.
Regulations re Disclosure		
444.3	459.4	Exactly similar regarding what can be regulated in this area.

Differences from *BA* and amendments:

- No prohibition of tied selling (as in *BA*, s. 459.1)
- No requirement to provide low-fee retail deposit accounts (as in *BA*, s. 448.2)
- No requirement to cash Government of Canada cheques (as in *BA*, s. 458.1)

Part XII.1 Regulation of Companies – Commissioner

This would give the Commissioner of the FCAC the same powers to investigate domestic foreign trust and loan companies as he/she would have to investigate domestic and foreign banks (Part XIV, *BA* proposed amendments).

CANADIAN PAYMENTS ASSOCIATION

A. Creation and Expansion

The amendments to this *Act* (which include changing its name to the *Canadian Payments Association Act*) are designed to expand membership in the Canadian Payments Association (CPA), making it more open to innovation and change, while assuring the continued stability of the system. Thus, it would open the CPA to life insurance companies, money market mutual funds and securities dealers (s. 4). Further, the Minister would be given powers to designate new payments systems (see below).

The goals of the CPA (s. 5(1)) would be to:

(a) establish and operate national systems for the clearing and settlement of payments and other arrangements for the making or exchange of payments;

(b) facilitate the interaction of its clearing and settlement systems and related arrangements with other systems or arrangements involved in the exchange, clearing or settlement of payments; and

(c) facilitate the development of new payment methods and technologies.

As s. 5(1) establishes, there would be multiple systems of payments as well as other arrangements for the making or exchange of payments.

Information collected by the CPA would be confidential, and would only be disclosed to relevant government and regulatory agencies, the Bank of Canada, and the CDIC if the Minister were satisfied that the information would be treated as confidential (s. 43). Sections 45-47 would establish penalties for non-compliance (could go to the court); they also state that the Minister could apply to a superior court to achieve compliance with directives, provisions or requests.

B. Board of Directors

In support of these changes, the proposed amendments would change the composition of the CPA's board of directors. Section 8 would increase the number of directors from 11 to 16. Previously, the members elected ten directors; the Bank of Canada appointed a senior officer to chair the board.

Under the proposed amendments, members would elect 12 directors, the Bank of Canada would elect one director, and the Finance Minister would appoint three directors. The Minister would not be permitted to appoint members of the following groups: public-sector workers (provincial or federal); MPs; Senators; MLAs; or Association members or affiliates.(28) In keeping with the increased scope of the CPA's membership, the number of classes of members would be increased. Remuneration of directors would be dealt with in the by-laws.

The board of directors would be given the power to make rules regarding: remuneration of directors; fees for services performed by or on behalf of the Association and how they are to be determined; the authenticity and integrity of payment items and messages; and the identification and authentication of members (s. 18.1).

Further, s. 19 and 19.1 more explicitly states that the Board could make such rules as it deems necessary to meet the goals of the Association. These would include: payment items acceptable for exchange, clearing or settlement; standards and procedures regarding these; settlements and related matters; authenticity and integrity of payment items and messages; **and the identification and authentication of members and other persons.**

Under changes to s. 19, the Association – not the General Manager – would be responsible for making rules available to members. Rules would no longer have to be sent to members (s. 19(4)). The Minister would receive copies of each rule within ten days of a rule being set.

Section 19.1 would allow the board to make a statement of principles and standards.

Currently, s. 21 allows the Executive Committee to undertake any activity not specifically reserved to the Chairperson or the Board, and the Executive Committee must report to the Board at each board meeting. According to s. 18(1)(a), the Board could tell the Committee what to do. The Executive Committee (whose terms are set by the Board) would have no other job description. Section 21.1 would allow the Board to delegate to other committees.

C. Ministerial Powers

Sections 19.2-19.4 would give sweeping new powers to the Finance Minister. Under s. 19.2, CPA rules would come into force 30 days after a copy is sent to the Minister, although the Minister could decide to put it into effect before then, or extend the period by up to 30 days. Further, the Minister could also "disallow the whole or a part of a rule." The Minister could also issue directives to the Board to make, amend or repeal a by-law, rule or standard; these would have to be followed. The Board would have to be consulted before a directive is given, and outside parties could be consulted.

D. Stakeholder Advisory Council

This new section (21.2) would legislate the Stakeholder Advisory Council (SAC), formed in 1996, "to provide counsel and advice to the board on payment and clearing and settlement matters," etc. The SAC would consist of up to 20 people: up to two would be directors from the Board. The rest "must be broadly representative of users and service providers to payment systems." The CPA Board would appoint members in consultation with the Minister for three-year terms, except **that as far as possible, one-third of the first members would be appointed for three years, one-third for two years, and one-third for one year.** These would be unpaid positions, except for travel and living expenses incurred on the job.

E. Regulatory Powers (s. 35)

Under the amendments, the Governor in Council's regulation-making power would be expanded to include: **the number of members of committees of the Board; the eligibility of persons to be elected as directors, including the number of directors from each class and when two or more classes are to be collapsed into one;** requirements for membership; the conditions a money market mutual fund must satisfy; and other regulations for carrying out the purposes and provisions of this Part.

F. Supervisory Powers Repealed

The elimination of current section 28 and replacement with a note on electronic meetings would eliminate the role of the Superintendent of Financial Institutions, leaving the Association with no oversight mechanism outside the Minister. Currently, the Superintendent is responsible for examining the workings of the Association and reporting to the Minister (s. 28). Section 30 of the current *Act*, which states that every member must belong to the CDIC, or have some assurance of financial stability, would be repealed.

G. Designated Payment Systems (s. 37)

Under the proposed amendments, the Minister would be responsible, subject to several criteria, for designating payment systems in the public interest. Payment systems would have to be at least substantially national, or play a major role in supporting transactions in Canadian financial markets or the Canadian economy.

In designating a payment system, the Minister would have to consider:

- the level of financial safety provided by the payment system to the participants and users;
- the efficiency and competitiveness of payment systems in Canada; and
- the best interests of the Canadian financial system.

The Minister would have to consult the manager **and participants** of the payment system **before it would be designated.**

Again, the Minister would get copies of the rules governing a designated payment system (s. 38). Again, he or she would have the discretion to waive or increase the time, disallow whole or parts of the rules, or exempt a payment system from the 30-day rule (s. 39).

The Minister could issue guidelines regarding Part 2 to be available to the public, with notice given in a way that "the Minister considers appropriate."

Through directives, the Minister could decide (s. 40):

- the conditions for a participant to become a member of a designated payment system;
- how a designated payment system should operate;
- how payment systems would interact; and
- their relationship with users.

The Minister would have to consult with the manager **and/or participants** of a designated payment system before a directive is given, and could consult with any other interested parties. Directives would be published in the *Canada Gazette*.

If a designated payment system did not have a Canadian manager, its Canadian participants would have to comply with the obligations imposed on managers as if they themselves were the manager. In that case, however, any action which the Minister would take with respect to a manager of the payment system would apply only to the Canadian participants. A manager or participant would be "Canadian" if the manager or participant were incorporated or formed under an enactment of Canada or a province.

Information collected under the *CPA* is to be treated as confidential, although the Minister is allowed to disclose any information to financial-institution regulatory bodies, and to authorized agents of the Bank of Canada and the Canada Deposit Insurance Corporation (s. 43). There is no liability for acting in good faith under the Act (s. 44). If a person fails to comply with a provision or directive issued under this Act, the Minister can apply to a superior court to enforce compliance (s. 45). A contravention of the Act carries a maximum penalty of $100,000 and/or 12 months imprisonment for a natural person; for other entities, a maximum fine of $500,000 applies (s. 47).

APPENDIX I

DEMUTUALIZATION

In 1992, the Government introduced a legislative framework to allow mutual insurance companies to demutualize. Demutualization is a process that occurs when mutual companies convert to stock companies. A mutual company is owned by its participating policyholders; they not only vote, they also share in the risk of a company and would receive the remaining assets of the company upon liquidation. For this reason, they receive most of the demutualization benefits. Most non-participating policyholders do not have ownership or voting rights in their companies, and so do not participate in demutualization benefits. Only those who are voting policyholders at the time of the company's announcement of its intention to demutualize are entitled to participate in the demutualization process.

A company would choose to demutualize for three main reasons:

- to give companies the opportunity to restructure, subject to the approval of their policyholders, in order to improve efficiency and competitiveness. As stock companies, they can issue common shares, an important source of financing for corporations that want to grow and expand. Increased ability to raise capital enables demutualized insurance companies to seize growth opportunities both at home and abroad, especially those outside of traditional insurance products;

- to allow companies greater opportunities to strengthen their capacity to invest in new technologies with the aim of providing a wider range of products and services to their customers; and

- to give companies incentive to enhance efficiency and competitiveness.

The allocation of benefits does not cause a cash drain on the company. The company generally distributes shares in the company to eligible policyholders. Policyholders may then either keep the shares or sell them in the market. For those wanting cash in lieu of shares, the company may sell shares to investors and use the proceeds to pay cash to policyholders. Most of the cash distributed by the company directly to policyholders as part of demutualization will be raised through the stock market.

The OSFI continues to regulate demutualized companies. As a result, the full range of prudential rules, including the requirement of maintaining adequate capital and of conforming to accepted standards of sound business and financial practices, continue to apply. The OSFI will continue to monitor companies to ensure standards are met.

All mutual companies must remain widely held for at least a two-year period after a demutualization, (29) preventing the mutual company from being taken over by another company, including by a Canadian bank. After that period, a size-based ownership regime is put in place.

Although the federal government is not promoting demutualization, it has put in place a set of rules that companies must follow in order to demutualize. The objective of these rules is to ensure that the allocation of value is fair, and that eligible policyholders have complete, accurate and clear information before voting on demutualization. In the course of any specific demutualization, the OSFI is responsible for ensuring that the companies comply with the legislation and the regulations. Every individual demutualization proposal must also receive the approval of the Minister of Finance after having been approved by eligible policyholders. The OSFI's role in a demutualization is to ensure that companies meet all of the requirements in the proposed demutualization regulatory framework, which contains key provisions for the fair and equitable treatment of policyholders. In reviewing the information it receives on company conversion plans, the OSFI has the authority to engage outside experts and to require additional information from the companies, if it deems this necessary, in order to evaluate the demutualization plan.

To date, four large mutual life insurance companies have demutualized.(30) In the process of demutualization, eligible policyholders are asked by their company to vote on a conversion proposal. If policyholders approve (and if regulatory approval is obtained), eligible policyholders become shareholders of their life insurance company. Policyholders' rights as customers remain unchanged – insurance coverage, policy values, premiums and policy dividends are not affected by demutualization. What changes is the nature of the policyholders' ownership rights in the company. In exchange for their ownership rights and interests, the company distributes benefits to eligible policyholders, generally in the form of shares in the company, although policyholders can choose to receive demutualization benefits as either shares or dividends. As shareholders in the company, they are entitled to:

- shareholder dividends, receiving share dividends as declared by the directors of the company;
- the right to vote at company meetings – shareholders elect up to two-thirds of the board; and
- the right to sell shares at any time for cash.

In a mutual life insurance company, eligible policyholders are the only ones permitted to vote at company meetings. After demutualization, stockholders in the company have that right, although policyholders are still entitled to vote at the meetings. Canadian law ensures that, even after a mutual life insurance company converts to a stock company, policyholders still elect at least one-third of the company's board of directors.

When a company demutualizes, its total value is allocated to eligible policyholders in exchange for their ownership rights and interests in the mutual company. The benefit received by an individual policyholder is based on a number of factors, such as: the length of the policyholder's relationship with the company; the amount of insurance coverage; the policy cash value; and the annual premium. The allocation formula proposed by each company is reviewed by both the company's actuary and an independent actuary, who must provide an opinion that it is fair and equitable to policyholders. Individual allocation information for eligible policyholders is contained in the package mailed out by each company.

Demutualization occurs in seven steps:

- A company develops a detailed demutualization plan identifying eligible policyholders.
- The plan is submitted to the company's Board of Directors for approval.
- The plan (and supporting material) is forwarded to the Superintendent of Financial Institutions for review. The plan is also examined by insurance and securities regulators in any other jurisdiction in which the company operates.
- If the material submitted to the Superintendent is acceptable and conforms to the regulations,

then a package of the details is mailed to all eligible policyholders, at least 45 days before a special meeting called to vote on demutualization.

- Eligible policyholders will be asked to vote at a special meeting held for demutualization.
- If eligible policyholders vote for demutualization, the Minister of Finance would then be asked to approve the plan.
- With the Minister's approval, the demutualization may proceed; the company becomes a stock company, and the company distributes benefits to policyholders.

Eligible policyholders are:

- policyholders that held, on the day that the company announced its intention to develop a demutualization plan, or at a later date chosen by the company, policies entitling them to vote at a meeting of the company;
- those who applied for a voting policy before the eligibility day of the company and were subsequently issued such a policy;
- those whose policy lapsed before the eligibility day but was reinstated at least 90 days before the special meeting called to vote on demutualization; and
- when a company's eligibility day is after the announcement date, those whose voting policies terminated involuntarily (by maturity, by death, but not by surrender) during that period.

APPENDIX II

APPENDIX III

(1) For ease of comparison, all changes from the legislative summary of Bill C-38 are in bold in this document.

(2) Currently, “widely held” in respect of a Canadian financial institution means (a) a Canadian financial institution in which no person holds shares (i) carrying more than 10% of the voting rights attached to all the outstanding shares of the Canadian financial institution, or (ii) having an aggregate book value exceeding 10% of the shareholders’ equity of the Canadian financial institution.

(3) The public holding requirement (sometimes known as the “public float”) of a company’s stock is those shares that are listed and posted for trading on a recognized stock exchange in Canada and that are not owned or controlled by persons who have a significant interest in any class of voting shares. Public float requirements for Schedule II banks, trust and loan companies and insurance companies were instituted in 1992.

(4) The “fit and proper” test is used to assess the suitability of prospective owners. The test includes an examination of the applicant’s past business record, the soundness of the applicant’s business plan, and the reasons why the applicant wishes to get into the business. The test also seeks to assess whether an applicant has the necessary integrity and fitness of character.

(5) A widely held bank is owned by many shareholders, with no individual owner holding sufficient shares to exercise control over the bank. The current widely held rule for banks applies to Schedule I banks as set out in the *Bank Act*. Schedule I banks must be widely held, which is defined to mean that no more than 10% of any class of shares of a bank may be owned by a single shareholder, or by shareholders acting in concert. The banking sector has argued that the current definition of widely held is too restrictive, precluding a widely held Canadian bank from entering into a joint venture or alliance that results in any shareholder having more than 10% of any class of the bank’s shares. Banks argue that they should be able to enter into joint ventures and strategic alliances that make good business sense and bring about innovation for the consumer. The government agrees with this position; the new widely held rule would apply to all banks and demutualized insurers with equity over $5 billion.

(6) In a closely held bank, a single shareholder can own more than 10% of outstanding shares. Typically, a closely held bank is controlled (but not necessarily 100% owned) by a single shareholder. A common example would be a domestically incorporated subsidiary of a foreign bank, controlled by the parent institution. The new *Act* would amend the definition of closely held so that it would apply to any institution that is not required to be widely held.

(7) A major shareholder is one who beneficially owns, either directly or through entities controlled by that shareholder, more than 20% of the outstanding voting shares of the bank or more than 30% of any class of non-voting shares of the bank.

(8) The term “self-dealing” refers to transactions between a financial institution and persons who are in positions of influence over, or in control of, the institution. A key part of the 1992 financial sector reform was the implementation of comprehensive controls on such transactions.

(9) A holding company is generally a non-operating company that holds interests in other, generally operating, companies. A holding company structure is currently permitted for financial services providers in the United States, the United Kingdom and many other industrialized countries. In Canada, closely held financial institutions (for example, stock life insurance companies) have always had the option of organizing under an unregulated holding company.

(10) For a more detailed explanation of demutualization, please refer to Appendix I.

(11) The bank's request would have to be approved by a special resolution of the shareholders of the bank at a shareholders' meeting called to consider the application (s. 677(5)).

(12) The application would have to be duly authorized by a special resolution (s. 683(3)).

(13) BHC is the acronym for Bank Holding Company and SPB is the French acronym for Société de Portefeuille Banquaire.

(14) A substantial investment would be defined as owning more than 10% of total voting rights of the entity, or more than 25% of total shareholders' equity (s. 10(1)).

(15) However, a bank holding company that would control a current Schedule I bank with equity of less than $5 billion would be deemed, for the purpose of the *Act*, to be a bank holding company with equity of more than $5 billion, and therefore would have to remain widely held (s. 884).

(16) Being a major shareholder would be defined as owning more than 20% of voting shares (s. 2.2).

(17) Although the terms *near bank* and *true bank* do not actually appear in the legislation, they are understood commonly in the industry to describe what is, in fact, a collection of legal attributes.

(18) The bill does not specify what constitutes a material portion of a conglomerate's assets or revenues; this will be set out in regulation.

(19) (*a*) a bank; (*b*) a bank holding company; (*c*) a body corporate to which the *Trust and Loan Companies Act* applies; (*d*) an association to which the *Cooperative Credit Associations Act* applies; (*e*) an insurance company or a fraternal benefit society incorporated or formed by or under the *Insurance Companies Act*; (*f*) an insurance holding company; (*g*) a trust, loan or insurance corporation incorporated or formed by or under an Act of the legislature of a province; (*h*) a cooperative credit society incorporated or formed, and regulated, by or under an Act of the legislature of a province; (*i*) an entity that is incorporated or formed by or under an Act of Parliament or of the legislature of a province and that is primarily engaged in dealing in securities.

(20) Although this would suggest that mergers with non-Canadian corporations are not anticipated by the *Act*, Ogilvie (*Canadian Banking Law*, 2nd ed., 1998, Carswell, p. 238) suggests that the institution might do so by first becoming a federally incorporated financial institution or body corporated and then executing an amalgamation agreement prior to receiving letters of patent as a new bank.

(21) The Minister announced the PIIA requirement at the time of the Bill's introduction. It is not reflected in the legislation.

(22) For more information on insurance company demutualization, see Appendix I.

(23) This structure will be changed in 2001 when the individual federations and the Confédération amalgamate into one new federation of which each individual caisse would be a member.

(24) Department of Finance, *Reforming Canada's Financial Services Sector*, 25 June 1999, p. 37.

(25) This is a substantive change from Bill C-38 and comes as a result of stakeholder representations.

(26) Department of Finance, *Reforming Canada's Financial Services Sector*, *A Framework for the Future*, 25 June 1999, p. 74.

(27) Department of Finance, *Reforming Canada's Financial Services Sector*, pp. 45-46.

(28) In Bill C-38, members of the Stakeholder Advisory Council were barred from the Board. This restriction was deemed too onerous, and has been lifted.

(29) No shareholder can own more than 10% of any class of shares of a widely held company.

(30) Clarica Life Insurance Company (formerly Mutual Life Assurance Company of Canada) (announced 8 December 1997); Manufacturers Life Insurance Company (announced 20 January 1998); Sun Life Assurance Company of Canada (announced 27 January 1998); Canada Life Assurance Company (announced 2 April 1998).