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Reform of Federal Financial Institutions Legislation

Overview of Legislative Proposals

Issued by
The Honourable Gilles Loiselle
Minister of State (Finance)

Fall 1990

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Department of Finance Canada
Ministère des Finances Canada

Foreword

This overview outlines the main elements of the government's policy on the new legislative framework for federal financial institutions. It provides details about the Trust and Loan Companies bill, the first bill being introduced, as well as details about the other bills that will follow. These include the Bank Act, Insurance Companies Act and Cooperative Credit Associations Act and related statutes. All pieces of legislation would come into force at the same time.

The Explanatory Notes of the Trust and Loan Companies bill contain more detailed information.

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I. Introduction

Every day, billions of dollars are exchanged internationally among financial institutions. Every day Canadian financial institutions oversee billions of dollars in transactions. Some involve flows to or from other countries, others are within the national pool of wealth and investment.

Financial institutions must be able to handle these huge sums efficiently, safely and quickly. In Canada, more than 3,000 Canadian financial institutions, with assets of over $900 billion, operate some 14,000 branches, employ close to 500,000 people, and serve every individual and business in the country. Their success is essential to our economic success, as well as to our security as savers and investors.

These financial institutions fund the mortgages of Canadians, finance our automobile purchases, hold and invest our savings and make available the investment for new or expanded industries and businesses. Because they channel savings to finance economic growth, they must be sound, innovative, dynamic and internationally competitive.

The regulation of financial institutions is shared by federal and provincial governments. Since most of the financial system's assets are held by federally incorporated institutions, the federal government's proposals affect the vast majority of Canadians. The challenge has been to develop a regulatory approach that protects the savings of the public while it encourages, rather than inhibits, innovation and efficiency.

A. Objectives

The objectives of the reform of federal financial institution legislation are to:

- benefit consumers by increasing competition and the variety of services offered by financial institutions;
- enhance protection for depositors and policyholders;
- strengthen the ability of Canadian financial institutions to compete at home and abroad; and
- lay the groundwork for discussions with the provinces on harmonization.

These goals will be achieved under the proposed new legislation and regulations.

The government has consulted at length with financial institutions, their associations and the provinces. It has combined these views with its continuing analysis of the needs of a dynamic, evolving market, both nationally and

internationally, and has decided on the pragmatic policies now being put before Parliament.

The reform balances individual, national, international, federal-provincial, commercial and prudential concerns in a package that will serve the public interest well and encourage Canadian financial institutions to be innovative and competitive.

B. Implications for Consumers

Consumers will find shopping for financial services more convenient. They will benefit from a wider choice of financial products, since banks, trust and loan companies and insurance companies will be allowed to compete more directly with each other.

C. Enhanced Protection for Customers

The federal government has already acted to strengthen the supervisory system. To underpin the new regime now being proposed, there will be further measures to enhance prudential rules. They will include tougher self-dealing rules as well as new networking regulations.

D. Promotion of Strong Canadian Institutions

The proposals create a framework for strong national institutions serving the Canadian interest. By opening new avenues of growth for Canada's financial institutions, the policy will strengthen their ability to meet the new challenges that have evolved in the global marketplace.

The proposed ownership regime maintains the principle of wide ownership by the public of major domestic banks, which represent the core of the Canadian financial system. It prevents shares of these banks from being controlled by a resident or non-resident. The policy also proposes an approval system for ownership transfers that will take into account whether transfers are in the best interests of the Canadian financial system.

E. Harmonization

Regulation of financial institutions is shared with the provinces. There is a need for greater consistency between federal and provincial rules to avoid balkanization of regulatory regimes and to permit Canadian financial institutions to compete more effectively at home and abroad. This entails reasonable compatibility of rules. The proposed legislation provides a basis for the necessary further discussions with provincial governments.

Co-operation between federal and provincial authorities is the most responsible way of ensuring the stability and growth of our national and regional financial institutions by reducing the possibility of regulatory and supervisory duplication. The goal is to avoid, in practical terms and to the degree possible, the multiple

regulation of federal and provincial institutions operating in several jurisdictions. The approach is designed to have financial institutions regulated where appropriate by their jurisdiction of incorporation.

Extensive consultation after a draft Trust and Loan Companies bill was released in December 1987 has resulted in changes to the details of the policy. The changes take into account a number of concerns that have been expressed regarding matters such as commercial links, the in-house trust powers of banks and provisions allowing for improved sharing of information among federal and provincial supervisors of financial institutions.

F. Summary of the Policy

The government is tabling the Trust and Loan Companies bill as the first piece of the legislative reform package. This paper summarizes the policy set out in that bill, and in the bills that are to follow.

The policy will:

- establish rules for an ownership policy that allow for both closely-held and widely-held financial institutions;
- establish a new framework for competition in the financial sector by removing many of the remaining restrictions on financial institutions fully competing with one another;
- update prudential safeguards to reflect the changing environment in which financial institutions operate; and
- modernize the existing statutes by adopting rules and procedures modelled on the Canada Business Corporations Act.

A review of the statutes will take place five years after proclamation and every 10 years thereafter.

Regulations will set out details about the operation of the new rules. This approach provides flexibility for the framework to evolve over time as the sector changes.

II. New Framework for Competition

To enhance competition and thereby strengthen institutions, it is proposed that banks and federally incorporated trust, loan and insurance companies generally have the opportunity to offer a similar range of services and compete in markets that were previously not open to them. This will enhance choices available to consumers. The expansion of powers will take place directly or through financial institution subsidiaries.

A. Financial Institution Subsidiaries

With approval, financial institutions could diversify into new financial businesses through financial institution subsidiaries. A first step has already been taken in this regard with the passage of legislation in June 1987 that permitted federal financial institutions to own securities dealers. To complete the process, the new legislation would:

- permit institutions without trust powers, such as the banks, to own trust companies;
- permit institutions without insurance underwriting powers, such as banks and trust and loan companies, to own insurance companies, although rules will restrict the retailing of insurance by deposit-taking institutions;
- permit institutions without deposit-taking powers, such as life insurance companies, to explicitly own trust and loan companies; and
- permit widely-held institutions, such as mutual insurance companies, to own Schedule II banks.

Because of concerns about potential concentration in financial services markets, in considering whether to approve the purchase of a deposit-taking financial institution (a bank, a trust or loan company) by another deposit-taking institution where permitted under the legislation, the Minister of Finance would take into consideration the size of the target institution and the size of the acquiring institution. Similarly, the Minister would review relative sizes when considering whether to approve the purchase of a federal insurance company by another insurance company. In considering size, worldwide operations will be included.

When a financial institution considers making a purchase of another financial institution engaged in a different business, transactions involving large companies would not be automatically excluded.

As currently, the Competition Act will also apply to all takeovers and mergers of federal financial institutions.

B. In-House Powers

The policy provides trust, loan and insurance companies with full consumer lending powers. These companies will also receive full commercial lending powers as long as they satisfy certain conditions, namely a capital base of at least $25 million and supervisory approval, to ensure that they have the necessary staff and controls in place to manage a commercial loan portfolio. Trust, loan and insurance companies that do not meet these conditions would be required to ensure that commercial loans do not exceed 5 per cent of their assets.

Banks and loan companies will be permitted to offer portfolio management and investment advice services in-house, just as trust companies, life insurance companies and securities dealers do.

Although banks will not be given in-house trust powers, they could own trust companies. Trust companies will continue to accept deposits on a guaranteed trust basis.

C. Networking

As a result of having broad financial services powers, all institutions will be permitted to network financial services offered by affiliates or independent financial institutions (though banks, trust and loan companies will be restricted from offering most insurance services on behalf of insurance companies). It is proposed that discussions take place with the provinces on networking disclosure rules for non-bank financial institutions.

Tied-selling that impedes competition will continue to be addressed by the Competition Act. It is proposed that discussions take place with the provinces on the question of whether additional tied-selling rules in financial institution statutes would be useful.

Banks, trust and loan companies would be given the legislative power to promote goods and services, including insurance, to their credit card holders.

D. Restrictions on Powers: Car Leasing and Insurance Retailing

The federal government does not propose to allow federally incorporated financial institutions to engage in car leasing or to own car leasing companies.

The retailing of insurance through the branches of deposit-taking institutions will also be prohibited. This policy will ensure that, on the whole, insurance would continue to be sold by qualified, licensed insurance brokers and agents working independently of any deposit-taking financial institution. Accordingly, the proposed legislation will not permit a bank, trust or loan company to act as an agent in the placing of insurance, or to provide space in a branch to an insurance agent or broker. Regulations are also being developed as follows:

- Institutions would be prevented from distributing insurance applications through their branches, with the exception of credit-related life and term insurance products for which there is no assessment of the risk of insuring a person at the time of purchase (for example, travel insurance). Applications for property and casualty insurance, such as fire and theft insurance, would not be distributed.

- Institutions would be required to take whatever steps are necessary to ensure that insurance offices are separate and distinct, and therefore not part of the branches of a deposit-taking institution.

- Such branches would be restricted from servicing insurance policies, such as taking directions to change a beneficiary or to alter any term of a policy.

- Such branches would also be restricted from providing direct links to insurance companies or agents through telephone or computer links.

- The flow of information from a deposit-taking institution to an insurance company or to an agent or broker, would be restricted. Information such as the age of a customer, marital status, whether the customer has children or owns a house or a car, type and amount of any loans outstanding and the amount of money held on deposit with an institution, will all be subject to the prohibition on disclosure.

Banks, trust and loan companies will be permitted to mail applications to customers provided the mailings are not targeted on the basis of the type of confidential information noted above.

E. Investments in Other Companies

As noted, financial institutions will receive new powers to own other financial institutions as subsidiaries. In addition, they will receive new powers to hold other types of corporations that are specifically set out in legislation. Investment powers will be generally identical for all types of financial institutions.

Full flexibility to invest in downstream commercial corporations is not appropriate for financial institutions entrusted with the savings of Canadians. Accordingly, substantial share investments in corporations that are not explicitly mentioned in the legislation will be more strictly controlled than at present. Specifically, all institutions will be limited to owning shares representing no more than 10 per cent of the votes of a business or 25 per cent of the shareholders' equity of the business. As currently, exceptions would be allowed on a temporary basis, so as to enable an institution to realize on security backing a loan, for example. Existing investments in corporations that are in excess of the new 10 per cent of votes or 25 per cent of shareholders' equity limitation would be grandfathered.

The list of corporations in which a financial institution could invest without limit will include the following:

- a factoring corporation: a company that buys accounts receivable from an entity and collects amounts owed;

- a financial leasing corporation, excluding car leasing;

- an information services corporation: a company that has broad powers in the information management and data processing fields, reflecting the fact that information technology is becoming more significant in the evolution of the financial services sector;

- an investment counselling and portfolio management corporation;

- a mutual fund distribution corporation;

- a real property brokerage corporation: a company that acts as an agent for vendors and purchasers of real estate, and provides consulting or appraisal services;

- a real property corporation: a corporation that holds and deals with real property;
- a service corporation: a corporation that generally provides administrative and other services to the financial institution;
- an ancillary business corporation;
- a financial holding corporation;
- a specialized financing corporation: a company that would, subject to size and exposure regulations, provide "merchant banking" type services, through medium-term investment in Canadian corporations and financing and advisory services to Canadian corporations, both in a more flexible manner than currently provided under the venture capital provision of the Bank Act;
- a corporation that engages in more than one business noted above.

F. Portfolio Investments

Portfolio investments would generally be made in accordance with the prudent portfolio approach, which would replace the current legal for life rules. In some cases, however, explicit limits will be set out in the legislation. For example, real estate investments held by a financial institution and its prescribed subsidiaries will be limited to 70 per cent of a financial institution's regulatory capital. Similarly, total common share investments will be limited to 70 per cent of an institution's regulatory capital. An overall cap of 100 per cent of the regulatory capital of a company would apply to the aggregate holdings of real estate and common shares. Some additional flexibility will be provided to life insurance companies.

III. Major Elements of the Ownership Policy

A. General

In Canada, financial institutions have a variety of ownership structures. The Schedule I banks are widely-held: no person or group of associated persons may own more than 10 per cent of any class of shares. The trust and loan companies are generally closely-held. Stock insurance companies are also generally closely-held, while mutual insurance companies are, by definition, widely-held.

The federal government does not propose that a single ownership structure be imposed on all federally regulated financial institutions, or that a total ban on commercial enterprises acquiring any financial institution be enacted. The issue has been debated at length by Parliamentary Committees, industry associations, financial institutions and their owners. Arguments have been made in favour of both widely-held ownership and closely-held ownership, and it is apparent that no ownership model is correct to the exclusion of all others. The proposed legislation

thus puts forward a pragmatic approach, by allowing both forms of ownership to continue to exist within a strengthened regulatory environment.

B. Ownership Approval Process

An ownership approval process is an important element of the proposed ownership regime.

At present, the Minister of Finance has the authority to approve all start-ups of federal financial institutions, but subsequent changes in ownership do not always require approval. It is proposed that this deficiency be corrected by requiring that significant changes in ownership of federal financial institutions be subject to the approval of the Minister of Finance. This will ensure that a takeover is in the best interests of the financial system and that new owners have the expertise necessary to run a financial institution, adequate financial resources and sound and feasible plans for the future conduct and development of the business.

An investor will be required to obtain the approval of the Minister of Finance in order to buy shares of a financial institution that would result in the investor owning in excess of 10 per cent of any class of shares. Similarly, if an investor already owns more than 10 per cent of a class of shares and wishes to purchase additional shares, approval will be required. Finally, an investor will be required to seek Ministerial approval if that investor acquires control of a company that is linked to a financial institution and, as a result, there is a change in the significant ownership interest in the institution. For the ownership approval process, and generally throughout the legislation, control will be defined to include control in fact.

The proposed legislation will permit minor fluctuations in ownership to occur without requiring approval. As well, it will provide prospective owners with the opportunity to obtain pre-approvals so that they can make business decisions with certainty.

As announced on August 11, 1989, the new legislation would make the approval process for trust and loan companies effective as of that date.

C. Bank Ownership

The proposed revisions to the Bank Act would permit chartered banks to be either widely-held, on a path to wide-ownership, or directly owned by widely-held regulated financial institutions.

Schedule I Banks

For Schedule I banks, which include the six largest domestic banks, the revised Bank Act would maintain the current regime of wide public ownership. Wide ownership of banks prevails in one form or another in all Western countries and Japan. The policy would ensure that the "big six" domestic banks would remain widely-held, with no one person or group of associated persons owning more than 10 per cent of any class of shares.

Schedule II Banks

The existing Bank Act permits a Canadian or group of Canadians to start a Schedule II bank and own it on a closely-held basis for the first 10 years after receiving a bank charter. After that time, it must become widely-held. This provision would be maintained in the new Bank Act.

As well, the new Bank Act would continue to permit a foreign bank to apply for permission to establish a foreign bank subsidiary in Canada, designated as a Schedule II bank.

In a new measure, the proposed Bank Act would expand the Schedule II bank designation to include banks that are directly owned by, and continue to be owned by, widely-held regulated financial institutions that are not themselves banks, whether they be Canadian or foreign. Owners of such a bank could be widely-held trust, loan or stock life insurance companies, as well as mutual insurance companies or widely-held securities dealers. As is currently the case for foreign banks that wish to establish banks in Canada, one of the factors that would be considered prior to giving approval for a widely-held financial institution to own a bank would be the presence and nature of non-bank activities operated by the parent of the proposed bank.

If the ownership of a Schedule II bank subsequently changes as a result of a takeover of the parent of the bank by an unregulated entity, for example, the Schedule II bank would be required to be widely-held within 10 years. If it wishes to remain closely-held, it could convert to become a federally incorporated trust company.

D. Non-Bank Ownership

The Trust and Loan Company bill and the Insurance Companies bill will permit federal trust, loan and stock insurance companies to continue to be closely-held and, if sold, to be sold on a closely-held basis.

E. 35-Per-Cent Rule

A federal trust, loan or stock insurance company with $750 million or more in consolidated capital would be required, within five years, to take the necessary steps to ensure that at least 35 per cent of the total voting rights in the company are attached to shares that are widely-held and listed for public trading on a Canadian stock exchange. A Canadian financial holding company or Canadian regulated financial institution could be eligible to meet the rule on behalf of its trust, loan or insurance company subsidiary.

Schedule I banks would automatically meet the 35-per-cent rule by virtue of their 10 per cent ownership limit. The 35-per-cent rule would not be relevant for Schedule II banks that are required by legislation to meet the 10-per-cent wide ownership requirement within a 10-year time period.

For other Schedule II banks, the 35-per-cent rule would apply where a capital size of $750 million is reached because of the acquisition of a large domestic institution that, prior to the acquisition, was itself subject to the 35-per-cent public shareholding requirement. A ministerial exemption from having to meet the 35-per-cent requirement will be available for institutions that reach $750 million in capital through internal growth. Other situations, such as reaching the $750 million capital threshold through successive acquisition of a number of small Canadian financial institutions, would be examined on a case-by-case basis.

An extension to the five-year time limit would be possible where general market conditions warrant and the Minister is satisfied that a company has used its best efforts to satisfy the rule.

The 35-per-cent rule will ensure a significant public shareholding to provide a counterbalance to the influence of the majority shareholder. An element of broad public ownership can bring benefits in terms of ensuring market scrutiny and establishing the basis for sound corporate governance.

F. Foreign Ownership

The existing foreign bank regime will be maintained. However, the foreign bank guidelines will be modified to cover entry by non-resident widely-held regulated financial institutions that are not banks, such as life insurance companies and securities dealers. In addition, the so-called 10/25 foreign ownership rules now found in federal legislation, which limit acquisitions of Canadian-controlled financial institutions by non-residents, will be based on a broader definition of control. As part of the Canada-U.S. Free Trade Agreement, U.S. residents are not subject to the 10/25 rules. As noted previously, all significant changes in ownership of federal financial institutions will also be subject to the approval of the Minister of Finance, who will consider a number of factors, including the best interests of the financial system.

IV. Key New Prudential Safeguards

A. Self-Dealing

A key part of the reforms is the implementation of comprehensive controls on transactions between a financial institution and persons who are in positions of influence over, or control of, the institution. This is commonly known as self-dealing.

The new self-dealing rules will cover the purchase of services and the purchase of assets, including real estate, from related parties, as well as loans and investments. The related parties to a financial institution will be those persons who are considered to be in a position of influence over the institution. The definition of who is a related party of a financial institution is as described in the Explanatory Notes.

The proposed legislation is based on a three-tiered approach:

- a general ban on non-arm's-length transactions, with some exceptions;
- internal controls and screening of permitted transactions;
- certain special transactions would be allowed with the pre-clearance of the Superintendent of Financial Institutions.

Most transactions permitted under exceptions to the general ban would have to be cleared by a special committee of the board of directors required under the new legislation, called the Conduct Review Committee. A majority of the members of the Committee would have to be independent of the institution. The Committee would have to review permitted transactions to ensure that they are at market terms and conditions. The legislation would provide the flexibility for the Committee to approve, for example, a general arrangement covering a series or number of similar transactions.

Transactions would be permitted in special cases provided they had the approval of the Superintendent of Financial Institutions. For example, a restructuring that resulted in a movement of assets within a group of companies would be exempted under the rules, provided supervisory approval had been obtained. Transfers of assets among financial institutions, other than real property transfers, would also be permitted in the normal course of business, provided the Superintendent of Financial Institutions agreed.

To ensure that the rules are forward-looking and that financial institutions are not hamstrung when reasonable business opportunities arise, the Minister has authority to exempt transactions from the self-dealing ban on a case-by-case basis, if the Minister is satisfied that the transaction is not influenced by a related party. As well, certain classes of exemptions will be prescribed through regulation. For example, the participation by an institution in a syndicated loan arrangement with related party financial institutions would be exempted by regulation. The regulations would also ensure that a securities dealer subsidiary would not be prevented from underwriting an issue for a related party of its financial institution parent.

The proposed self-dealing provisions include rules on the extent to which financial institutions may lend money to directors, or make investments in, or loans to, companies owned by directors and officers. A limit of 50 per cent of an institution's capital will be placed on the amount of such loans and investments that could be made by the institution, excluding items such as mortgage loans. As well, large loans will have to be approved by two-thirds of the board.

The new legislation would not force non-arm's-length transactions that are permitted under existing law to be unwound. However, existing transactions with related parties could not be modified or renewed once the legislation was passed, unless such modifications or renewals were consistent with the legislation.

B. Additional Prudential Safeguards

The supervisory system, which was strengthened by legislative amendments enacted in 1987, will be improved further. A new power will be provided to the Superintendent of Financial Institutions to require an owner of a federal financial institution, or an affiliate, to provide information. This request would cover such information as may be necessary for the Superintendent to be satisfied that the provisions of the legislation are being observed and that the institution is in a sound financial condition.

As well, there is a provision to require any director of a financial institution who resigns as a result of a disagreement with other directors or officers of the company to submit a written statement to the Superintendent of Financial Institutions setting out the nature of the disagreement. This will help to ensure that the Superintendent of Financial Institutions is aware, at an early stage, of internal developments in a financial institution that might threaten its solvency.

Similarly, the proposed legislation will require an auditor who resigns or who is being replaced at the institution's request, to submit a written statement to the Superintendent of Financial Institutions setting out the reasons for such action.

C. Strengthening the Role of Directors

The proposed legislation would contain measures to strengthen the role of directors of federally regulated financial institutions and to mandate increased reliance on the self-supervision of financial institutions.

It is proposed that a minimum of one-third of the board be composed of directors who are not affiliated with the institution. Unaffiliated directors would be persons who do not have significant business associations with the institution. Federal financial institutions that are wholly-owned subsidiaries of other federal financial institutions will not be subject to the one-third rule.

The audit committee and the Conduct Review Committee will also have to be composed of a majority of unaffiliated directors. The remainder of the directors of such committees could not be officers or employees of the institution.

A person would be considered to be affiliated with a financial institution if:

- the person is an officer or employee of the institution, or has a substantial investment in the institution or any affiliate of the institution;

- the person is a significant borrower from the institution, or is a director, officer or controlling owner of a corporation that is a significant borrower from the institution;

    - Significant borrowers from an institution would be persons who have loans from an institution, excluding mortgage loans, greater than $100,000, or corporations who have loans from an institution exceeding the greater of $500,000 and 25 per cent of their indebtedness for borrowed money plus equity.

- the person has a loan that is not in good standing from the institution or an affiliate of the institution, or is an officer, director or controlling owner of a corporation that has a loan that is not in good standing from the institution;

- the person provides goods and services to the institution that exceed 10 per cent of the person's total annual billing, or the person is a director, officer or controlling owner of a company that provides goods and services to the institution in an amount that exceeds 10 per cent of the company's total annual billing; or

- the spouse of any person described above.

Cumulative voting, another new measure, is designed to help ensure that minority shareholders are adequately represented on the board. Under cumulative voting, the votes attached to the shares held by a shareholder are multiplied by the number of directors' seats being filled, with the shareholder being permitted to cast all the votes in favour of one director, if desired. It is proposed that financial institutions having a shareholder owning more than 10 per cent of any class of voting shares be required to introduce mandatory cumulative voting procedures for the election of directors. The latter rule would not apply when a financial institution is wholly-owned.

D. Conflicts of Interest

When financial institutions offer a wide variety of services, either in-house or through a subsidiary, a greater potential exists for abuses of conflict of interest situations that can financially damage a customer. Accordingly, the policy requires federal financial institutions to put into place procedures to manage conflicts of interest, including the identification of potential conflict situations and techniques for restricting the flow of sensitive information.

Some concern has been expressed about the incentives that a financial institution may have to share customer information with affiliates or third parties for the purpose of soliciting clients to purchase services. The proposed legislation includes a regulation-making power to deal with an institution's handling of private customer information.

V. Proposals for Specific Types of Financial Institutions

The policies described in this document are generally applicable to all federally incorporated financial institutions. There would, however, be some differences in the legislation covering banks, insurance companies and cooperatives that have not already been described. These are necessitated by the unique nature of some of these institutions.

A. Banks

Like non-bank financial institutions, banks will be able to network financial services in the future, with the general exception of insurance. For banks, new regulations would contain disclosure requirements to ensure that consumers know which company is actually providing a product that is being networked by the bank, and whether a commission is being earned by the bank when selling such a product.

The new Bank Act would also include the service charge disclosure provisions, now contained in Bill C-9, which is before Parliament.

Due to reserve requirements, banks face higher costs than other financial institutions when competing for the same business. Thus the new Bank Act would remove, within two years of the date of proclamation, the requirement that banks hold non-interest bearing deposits at the Bank of Canada.

B. Insurance Companies

Main Business Powers

The insurance legislation would be modernized. It would give insurance companies natural-person powers in financial service activities, subject to restrictions on commercial activities and core business powers of other pillars - banking, trust activities, underwriting and brokerage. This approach would be consistent with the proposed Trust and Loan Companies legislation. Key elements of the proposals include:

- Life insurance business and property and casualty (P&C) insurance business will continue to have to be carried on in separate companies.
- Insurance companies will be permitted to network products of other financial institutions, including other insurers.
- Life insurance companies will continue to have segregated funds and the power to issue all kinds of annuities. However, the proposed insurance legislation will not extend deposit-taking or trust powers to insurance companies.

As is the case now, property and casualty insurance companies will have more limited powers than life companies.

Access to Capital

The proposed insurance companies legislation will give insurance companies enhanced access to capital. Insurance companies, including mutual companies, will be permitted to issue preferred shares, to the extent they count towards Tier II capital in the formula for calculating capital adequacy.

Borrowing Powers

Life insurance companies will also be permitted to issue debt instruments to the extent they count toward Tier II capital in the capital adequacy formula. Furthermore, life and P&C companies will be permitted to borrow for short-term liquidity purposes.

Investment Rules

As for other financial institutions, insurance company investment rules will be governed by prudent portfolio principles. The use of participating fund assets for investment in financial subsidiaries would not be subject to legislative limit. However, appropriation of surplus in participating funds for investment in a subsidiary's shares would have to be subject to the company's policyholder dividend policy.

Real estate and common share investments will be subject to numerical limits applying to other financial institutions. In addition, some matching of real estate and common equity investments against life insurance liabilities, including longer-term annuities, would be permitted.

Segregated fund investment rules will be governed by prudent portfolio principles.

Shareholder and Policyholder Rights

As part of the modernisation of the legislation, the proposed insurance company legislation will enhance the corporate governance rights of shareholders, to be generally consistent with those available to shareholders under the Canada Business Corporations Act.

The corporate governance rights of participating policyholders will be enhanced along the lines of the provisions applying to shareholders. However, the rules will recognize that the position of participating policyholders is not the same as that of shareholders and that there are practical constraints on the ability of insurance companies to provide participating policyholders all the information that would normally go to shareholders.

Under the proposed legislation, policyholders will be permitted to submit a proposal to be discussed at meetings of the company on any matter, provided there is support from 100 policyholders. A proposal could not be submitted regarding the nomination of directors or regarding a list of special business matters, unless the support of the lesser of 500 or one per cent of policyholders is obtained.

The details of the various options regarding proxy solicitation and notification rules are being developed.

Actuaries

The proposed insurance companies legislation will recognize the evolution of the strengthened professional role and responsibilities of actuaries in insurance companies.

Related-party Reinsurance

Under the proposed legislation, the related-party reinsurance rules will involve less reliance on pre-approval by the Superintendent of Financial Institutions relative to requirements under existing regulations.

CompCorp

The Canadian Life and Health Insurance Association recently implemented a consumer protection plan, known as CompCorp, for policyholders of life and health insurance. The plan, which protects policyholders up to specified limits in the event of a failure of a member company, has been developed in consultation with federal and provincial regulators. As was announced in a press release dated January 29, 1990, the new insurance legislation will require that all federally incorporated insurance companies transacting life, accident and sickness insurance participate in the plan.

Other Provisions

Branching by foreign insurance companies will continue to be permitted. Canadian policyholders will continue to be protected by requiring assets to be vested in trusts.

Current discrepancies in the treatment of foreign currency exposure will be removed.

C. Fraternal Benefit Societies

The unique features of fraternal benefit societies will be recognized by the proposed legislation. For example, corporate governance provisions will allow a four-year cycle for directorships and meetings of the company. As well, the proposed legislation will provide the Minister with flexibility to incorporate a new fraternal benefit society with less than the $10-million capital required for other financial institutions.

D. Cooperative Credit Associations Act (CCAA)

Membership

Recognizing the evolution and growth of the cooperative credit system in Canada, the proposed CCAA legislation will broaden the membership of federal associations. However, liquidity loans will be limited to the credit union movement.

Since the main role of federal associations is to provide services to the cooperative sector, the proposed CCAA will not permit individuals to become members of federal associations, and the minimum membership requirement would be at least two centrals or ten credit unions, from more than one province.

Access to Capital

The proposed legislation will permit federal associations to issue preferred shares to non-members subject to restrictions on voting rights, to ensure that control remains within the credit union system.

Business Powers and Investments

Business powers and investment rules in the CCAA will be generally modelled after the Trust and Loan Companies bill. They will have a general orientation towards providing services to members and will take account of the important liquidity function of federal associations. Investments would be subject to the prudent portfolio approach with some limits.

By-laws Affecting Control Structure

Federal associations will not be subject to the same ownership approval rules and unaffiliated director requirements as are other financial institutions because of the cooperative principle upon which the voting rights are accorded. The Superintendent of Financial Institution's approval would be required for changes to by-laws that would modify the basis upon which voting rights and board appointments are allocated.

Application to Registered Provincial Centrals

Recognizing that current provincial legislation governing credit union centrals permits them to enjoy powers conferred on federal associations by the existing CCAA, consultations with the provinces regarding any extension of powers to centrals under the CCAA are proposed.