Explanatory Notes to an Act to Amend the Cooperative Credit Associations Act

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

October 1991

Canada

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Department of Finance Canada
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PREFACE

These explanatory notes are intended as a reader's guide to the Cooperative Credit Associations Bill. They are not meant as a substitute for a careful reading of the Bill itself, but as a road map to identify the aspects of the Bill that are likely to be of interest to those in the financial services industry and the legal profession with an interest in financial sector reform.

The notes identify significant deviations of the Bill from corresponding provisions in the current *Bank Act* (the most up-to-date of the federal statutes governing financial institutions) and the *Canada Business Corporations Act*. In addition, they indicate the general nature of the key regulations for which the Bill provides.

The majority of the provisions in the Bill are the same as those in the proposed trust and loan companies, bank and insurance companies legislation.

Short title

Section 1

This Act is to be cited as the *Cooperative Credit Associations Act* and will replace the current Act of the same name.

PART I - INTERPRETATION

Definitions

Definitions

Section 2

This section provides specific definitions for some of the key words and expressions that are used in the Act. Most are identical to the corresponding definitions in the current *Bank Act* and the *Canada Business Corporations Act (CBCA)*. Among these unchanged definitions, the most significant are:

"body corporate" This term describes a corporation, regardless of where or how it is incorporated.

"Minister" The Minister responsible for this Act is the Minister of Finance, although section 464 authorizes the Minister to delegate any Ministerial powers, duties and functions under the Act to a Minister of State.

"Superintendent" The Superintendent of Financial Institutions.

New Definitions

The more significant of the new definitions set out in this section are:

"association" This term applies to associations governed by the Act (see section 14).

"delegate" This term refers to the natural persons who are elected or appointed to represent members at annual or other meetings of an association.

"deposit protection agency" This term refers to the entities organized under provincial law whose purpose is to insure deposits in local cooperative credit societies or provide liquidity support. Deposits in local cooperative credit societies are not insured under the *Canada Deposit Insurance Corporation Act.*

"entity" This term has been explicitly defined because many of the expressions used in the Act, (including "affiliate", "control", "debt obligation", "officer" and "security") refer to both corporations and unincorporated entities (such as partnerships, trusts and funds). In contrast, both the current *Bank Act* and the *CBCA* as a general rule

apply only to corporations. Accordingly, many of the provisions in this Act (especially those in Parts VIII to XII) have a different scope than they would if current *CBCA* or *Bank Act* definitions had been used.

"financial institution" The definition of this term lists the various entities considered to be financial institutions under the Act. It includes banks to which the *Bank Act* applies; trust, loan and insurance companies, securities dealers and cooperative credit societies, whether federally or provincially incorporated; and foreign institutions.

"foreign institution" This term refers to an entity created otherwise than under Canadian law that is primarily engaged in the business of providing financial services, including the business of banking or dealing in securities and the business of trust, loan or insurance companies or cooperative credit societies.

"former-Act association" This term refers to the *Canadian Cooperative Credit Society.*

"incorporated" References to associations "incorporated" under this Act also apply to associations amalgamated under this Act.

"membership shares" This term is used throughout the Act to refer to the shares which only the members of the Association can hold.

"officer" In a corporation, an officer is an individual holding any of a number of listed offices, and anyone designated as an officer by by-law or a resolution of its board of directors. In an unincorporated entity, an officer is an individual designated as an officer by by-law or a resolution of its members.

"patronage allocation" This term encompasses the various ways in which a cooperative can distribute to its members returns calculated on the basis of the business done by that member.

"personal representative" This term replaces a lengthy and recurring term found in the current *Bank Act* and *CBCA* that lists "trustees, executors, administrators, committees, guardians" and a number of other functions.

"real property" In this Act, interests in real property include leasehold as well as equity interests.

"regulatory capital" This term — which is to be defined in the regulations — is used in the portfolio investment limits of sections 397 to 403 and in the limit on certain classes of related party transactions in section 411. The term does *not* refer to the minimum capital requirements for the purpose of the capital adequacy requirements in section 410 or to the minimum start-up capital requirement of subsection 60(1)(*b*).

"subordinated indebtedness" This term is drawn from the terms "bank debenture" in the current *Bank Act* and "subordinated note" in the current *Trust Companies Act* and *Loan Companies Act* (see section 83).

Modified Definitions

In addition to the new definitions noted above, a number of definitions drawn from the *CBCA* and the current *Bank Act* have been adapted for this Act. The more significant are described in the explanatory note on the new definition of "entity" above and in the following:

"Central Cooperative Credit Society" This definition has been modified to delete the reference to centrals incorporated under a federal statute and to add a requirement that one of its principal purposes is to provide liquidity support to local cooperative credit societies.

"complainant" This Act makes explicit the Superintendent's role in the remedial measures provisions of sections 318 to 322 and 469 and does not include the Superintendent in the definition of "complainant". This departs from the *CBCA*, in which "complainant" includes the primary regulator (the Director appointed under that Act).

"director" The plural — directors — is used to refer to the board of directors as a body.

"Local Cooperative Credit Society" This definition has been modified to delete the reference to incorporation pursuant to a federal statute.

"security" In addition to modifying the scope of this term to cover securities issued by unincorporated entities (see "entity" above), the new definition makes clear that deposit instruments issued by a financial institution and membership shares are not considered to be securities.

"security interest" Unlike the *CBCA*, where this term only applies to security pledged by *CBCA* corporations, this Act defines the term more generally as property pledged as security for the performance of an obligation by any person.

"share" is defined to exclude membership shares.

Definition of "control"

Section 3

The definition of "control" in this Act differs from the one used in the current *Bank Act* and *Canada Business Corporations Act* in that this Act defines control of unincorporated entities and employs the concept of *de facto* control, or "control in fact".

Paragraph 3(1)(*a*) corresponds to the traditional test for determining control (known as *de jure* or "legal" control) of a corporation, namely that a person beneficially own shares carrying more than 50 per cent of the votes that may be cast to elect directors, provided they are sufficient to elect a majority of the board. Paragraph 3(1)(*b*) sets out a corresponding test that applies to unincorporated entities, other than limited partnerships, namely that a person beneficially own more than 50 per cent of the ownership interests in the entity and be able to direct its business and affairs. Paragraph 3(1)(*c*) establishes that the general partner controls a limited partnership even if the person's ownership interest is less than 50 per cent.

Paragraph 3(1)(*d*) is a modification of the traditional test for determining control set out in paragraph (*a*). This modification was necessary because in an association, the voting rights of members do not correspond exactly to the equity interest of that member in the association.

Paragraph 3(1)(*e*) recognizes that control of an entity can be exercised in circumstances not captured by the specific tests described above. It permits a determination of control — known as "*de facto* control" or "control in fact" — based on the facts of the relationship between a person and the entity. Throughout the Act, an unqualified reference to "control" means either *de jure* or *de facto* control. Where the Act means only *de jure* control, as in the definition of "subsidiary" in section 5, it refers to "control, determined without regard to paragraph 3(1)(*e*)".

Subsection 3(2) addresses the situation where control of a particular entity is exercised indirectly through control of another entity. It provides that, if a person controls entity "A", and entity "A" controls entity "B", the person is deemed to control entity "B". Control therefore extends through a chain of owners where there is control at every link of the chain.

Subsection 3(3) deals with the more complicated situation where control of a corporation or an unincorporated entity is achieved through the holding of its shares or ownership interests by several entities controlled by the same person. The person is deemed to control the corporation or unincorporated entity if the aggregate of shares or ownership interests beneficially owned by the person and entities controlled by the person would constitute control within the meaning of subsection 3(1).

Definitions of "holding body corporate" and "subsidiary"

Sections 4 and 5

In this Act, the expressions "holding body corporate" and "subsidiary" apply only to corporations linked by *de jure* control. "Entity controlled by" is used in those instances where "subsidiary" would be too narrow.

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Definition of "affiliate"

Section 6

Two entities are affiliated if either controls the other or if both are controlled by the same third party. Since the general definition of "affiliate" in subsection 6(1) is based on the definition of control in section 3 — which includes both *de facto* and *de jure* tests — and applies to both corporations and unincorporated entities, it has a different meaning than in the current *Bank Act* or *Canada Business Corporations Act*. Subsection 6(2) sets out a second definition of "affiliate", based on *de jure* control, which is used in a few instances in this Act.

Meaning of "holder"

Sections 7 and 8

The Act treats a person as the holder of a membership share or a share if the person either is, or is entitled to become, its registered holder.

Definition of "significant interest"

Section 9

The concept of a "significant interest" is defined in reference to a class of shares of an association and is used primarily in Part VIII to determine the transfers of share ownership that require approval by the Minister.

A person is considered to have a significant interest in a class of shares of an association if the aggregate number beneficially owned by the person and entities controlled by the person exceeds 10 per cent of the outstanding shares of that class.

Subsection 9(2) makes clear that an increase in a significant interest in a class of shares of an association means an increase in the *percentage* of shares of that class beneficially owned by a person and the entities controlled by that person. Acquisition of additional shares of that class *pro rata* with other shareholders does not constitute an increase of a significant interest.

"Acting in concert"

Section 10

The concept of members "acting in concern" is used in connection with section 52 which prohibits any person obtaining control of an association. By virtue of this concept, where two or more members who individually may not have infringed the prohibitions in section 52, but who have jointly in respect of their interests in the association, would contravene these prohibitions if their combined interests would constitute control.

Idem

Section 11

Subsection 11(1) is used in connection with the requirements in Part VIII. The concept of persons "acting in concert" is used in connection with the requirements in Part VIII for ministerial approval of acquisitions or increases of significant interests in classes of shares of an association. Where two or more persons who individually may not have a significant interest, but who act jointly in respect of their interests in an association, they would require ministerial approval if their combined interests would constitute a significant interest. This concept replaces those aspects of the "associated shareholder" definition in the current *Bank Act* that deal with "associations" of a type other than affiliations of corporations through *de jure* control links. [The latter type of affiliation is already taken into account by the definition of "significant interest".]

Subsection 11(2) specifies that an agreement giving each party to the agreement a veto over proposals put to the board of directors or resolutions of the board is an agreement to "act in concert".

Subsection 11(3) makes clear that shareholders and their proxyholders are not considered to be acting in concert if that is the only relation between them, and that shareholders are not considered to be acting in concert with other shareholders solely because they happen to vote the same way.

Subsection 11(4) allows the Superintendent to deem persons to be acting in concert where it is reasonable for the Superintendent to conclude that such an arrangement exists.

Definition of "substantial investment"

Section 12

The "substantial investment" concept is used for two principal purposes in this Act:

- In the investment rules (Part X), associations are restricted from having investments in entities that exceed the thresholds described below, unless the substantial investment is one that is held on a temporary basis (as a temporary investment, following a realization on security, or otherwise) or one that is authorized for an indeterminate period (for example, investments in permitted subsidiaries of an association).

- The concept is also used in section 420 to identify which downstream interests of certain related parties of an association are themselves considered to be related parties of the association.

Under subsection 12(1), a person has a substantial investment in a **corporation** if the person and the entities controlled by the person beneficially own shares that, in the aggregate,

- carry more than 10 per cent of the voting rights attached to all of the outstanding shares of the corporation,

- in the case of a cooperative corporation, the person has the right to exercise more than 10% of the votes that may be cast at an annual meeting of the cooperative, or

- represent ownership of more than 25 per cent of its equity.

For the purpose of the latter test, different classes of shares may represent different claims on equity. For example, a share of a particular class of preferred shares might represent ownership of only a prorated portion of the stated capital (including any contributed surplus) recorded for that class of shares, whereas a fully participating share, such as a common share, would represent ownership of a prorated portion of both the stated capital (including contributed surplus) for that class of shares and retained earnings.

Under subsection 12(5), a person has a substantial investment in an **unincorporated entity** if the person and any entities controlled by the person beneficially own more than 25 per cent of its ownership interests.

Subsections 12(2), (5) and (6) make clear that a person who already has a substantial investment in a corporation or unincorporated entity increases it if the person or entities the person controls either acquire more shares or ownership interests or acquire control of another entity that holds such shares or ownership interests, provided the acquisition increases the proportion of voting rights or equity in the corporation, or of ownership interests in the unincorporated entity, that are held in the aggregate by the person and the entities controlled by the person.

Subsection 12(4) makes clear that a person also acquires a *new* substantial investment in a corporation if the person already has a substantial investment in it, by virtue of either the "10 per cent of voting rights" test or the "25 per cent of shareholders' equity" test, and then exceeds the threshold of the other test by making further acquisitions.

Definition of "distribution to the public"

Section 13

The concept of a "distribution to the public" is used in a number of places in the Bill and is substantially the same as the corresponding provision in the *Canada Business Corporations Act.*

Application

Application

Sections 14 and 15

This Act will apply to the *Canadian Cooperative Credit Society* and to new associations incorporated under it, unless discontinued under sections 32 to 34. The provisions of this Act take precedence if they present any conflict or inconsistency with the special Act of the Canadian Cooperative Credit Society.

PART II - STATUS AND POWERS

Summary. This Part provides associations with the usual status and powers accorded to corporations. Its provisions are substantially the same as the corresponding provisions in the current *Bank Act* and *Canada Business Corporations Act.*

Associations have powers of a natural person

Sections 16 to 22

Unlike the current *Cooperative Credit Associations Act*, which limit associations to powers expressly conferred on them by their special Act or letters patent of incorporation, this Act confers on associations the rights, powers and capacities of a natural person. As a result of sections 16 and 17:

- An association has the power to do anything the Act does not expressly prohibit or restrict.
- An association may contravene the Act or its incorporating instrument without the action being void — as it would be under the current legislation owing to the absence of the natural-person power — but the association may incur sanctions and other consequences under the Act.
- An association can carry on business throughout Canada.
- An association has the capacity to carry on business abroad, subject to the laws of foreign jurisdictions.

Sections 18 to 20 set out standard corporate law provisions, the most important of which are:

- An association may exercise its powers even in the absence of by-laws.

- Shareholders are not, as a general rule, liable for liabilities of the association.

Requirement for regular review of this Act

Section 22

This section is similar to a long-standing provision in the *Bank Act*; its effect is to require Parliament to review the new Act by setting a time limit on the carrying on of business by the associations it governs. Unlike the current *Bank Act*, which requires a review after 10 years, this Act provides for a review after only five years. It is expected that subsequent versions of this Act will provide for decennial reviews.

PART III - INCORPORATION, AND DISCONTINUANCE

Summary. Sections 23 to 34 set out how associations are incorporated, and how associations incorporated under this Act can be continued under the *Canada Cooperative Associations Act*. Sections 35 to 40 set out rules governing the corporate names of associations.

Restrictions on incorporation

Sections 23 and 24

Unlike the *Canada Business Corporations Act*, which confers a right to incorporation, this Act provides that incorporations are at the discretion of the Minister and subject to the requirement that the applicants included:

- At least two central cooperative credit societies incorporated in different provinces, or

- At least ten local cooperative credit societies not all incorporated in the same province.

Application procedures and public inquiry

Sections 25 and 26

Applicants must publish a notice of their intention to apply for the incorporation of an association. The application itself must contain the names of the first directors of the association and be filed together with any other information required by the Superintendent. As in the current *Bank Act*, interested parties are given an opportunity to raise objections to an application for incorporation.

Factors to be considered by Minister in deciding on proposed incorporations

Section 27

The Act requires the Minister to take into account all factors the Minister considers relevant to the application for incorporation and specifies several for which the Minister should have particular regard.

These include several indicators of whether the business is likely to be run successfully, in particular

- the financial resources of the applicants (to ensure that the new association can be successfully financed on an ongoing basis);
- the soundness of the applicants' business plans;
- the applicants' business record and experience; and
- the character, competence and experience of the persons who will be running the association.

The Minister must also consider whether the incorporation would be in the best interests of Canada's financial system and the cooperative movement.

Provisions contained in letters patent of incorporation

Section 28

Unlike the incorporating instruments of former-Act associations, the letters patent incorporating new associations will generally contain only basic information: association name, location of head office, and date of incorporation. All other matters formerly dealt with in incorporating instruments — in particular the capital structure of an association — will normally be set out in the association's by-laws. This permits changes to an association's capital structure to be made through the "fundamental by-law" provisions of sections 221 to 226 and avoids the need to apply to the Minister for supplementary letters patent under sections 219 and 220.

Subsections (2) and (3) provide flexibility, however, by allowing the Minister to insert additional provisions in the letters patent. In addition, the Minister may impose terms and conditions for issuing the letters patent.

Effect of issue of letters patent

Sections 29 to 31

The proposed association comes into existence on the date set out in its letters patent of incorporation, which may be different from the date they were issued. Notice of the issue of the letters patent must be published.

Discontinuance

Discontinuance into other jurisdictions

Sections 32 to 34

Discontinuance is the process by which legislative responsibility for a corporation and its activities is transferred to a different public body or agency or to a different jurisdiction. Subsection 32(1) permits an association, with the permission of the Minister, to discontinue under

this Act only if the association is applying to be continued under the *Canada Cooperative Associations Act.*

Since discontinuance changes the fundamental corporate nature of the association, a special resolution of the shareholders must first be obtained. Subsection 32(2) requires the Minister to be satisfied that this resolution has been obtained.

Corporate Name

Restrictions governing corporate names

Sections 35 to 40

These sections set out a number of restrictions on association names:

- Section 35 prohibits associations from having names forbidden by another federal statute, names reserved for another association under section 39, or names that in the opinion of the Minister are potentially misleading: for example, because they are deceptive or similar to an existing trademark, trade name, or name of any other entity carrying on business.

- Section 36 requires an association to include "cooperative" or "coopérative" in its name along with a word indicating its financial nature or the words "central credit union" or "credit union central".

Section 37 provides limited exemptions for associations and their affiliates from these restrictions. To allow affiliates of associations to be recognized as such, the Minister may permit associations to have names similar to those of their affiliates.

If an association is for any reason incorporated with a prohibited name, section 40 enables the Minister to direct it to change its name and, if it fails to do so within 60 days, to revoke the name and assign another.

PART IV - MEMBERSHIP

<u>Summary</u>. **This Part deals with the rights and obligations of members of the association and authorizes the association to pass by-laws dealing with terms and conditions of membership.**

Members

Section 41

Only cooperative corporations and other entities listed in subsection (1) are eligible to become members of an association. Individuals cannot be members.

Delegates

Sections 42 and 43

An association can adopt a system for the appointment or election of delegates to represent the members at all meetings of the association.

An association can also divide its members into classes based on criteria in a by-law and provide for the election or appointment of delegates by classes of members.

Transfer of membership shares

Section 44

The board of director must approve any transfer of membership shares.

By-laws Binding

Section 45

The by-laws of an association are binding on the members as if the by-law was a contract under seal.

Withdrawal and Expulsion

Sections 46 to 48

A member may resign from membership in an association after giving the required amount of notice.

A member may also be expelled from the association by the board of directors if the directors pass a special resolution to that effect.

In either case, the member may withdraw its deposits with the association and the association shall redeem the membership shares of the departing member unless the redemption would leave the association with inadequate capital.

Members Register

Section 49

An association is required to maintain a members' register which is similar to the central securities register required under section 245.

Minimum membership

Section 50

In order to continue operating under this Act, an association must maintain a minimum number of members, which is the same as the minimum number of applicants required for incorporation under section 24. If the minimum membership is not maintained, the association will be required to discontinue pursuant to sections 32 to 34 or liquidate and dissolve under Part VII.

Lien on membership shares

Section 51

An association can have a lien on the members' membership shares and deposits to the extent of any debts owed by a member to the association.

No control

Section 52

This section prohibits a person from exercising control of an association. Section 3 sets out the test for determining control.

PART V - ORGANIZATION AND COMMENCEMENT

Summary. This Part of the Act deals with what is required of associations to organize themselves and commence business. The requirements apply to both newly incorporated associations and associations amalgamated under the Act.

Organization meetings

Sections 53 to 55

At its first meeting following incorporation, the board of directors may deal with matters necessary to organize the association. These may include appointing officers, admitting members, and authorizing the issue of membership shares or shares. The first members' meeting is required to make by-laws, formally elect directors, and appoint an auditor.

Permission to commence and carry on business

Sections 56 and 57

An association may not carry on any business until the Superintendent issues a commencement order. This requirement does not apply to the Canadian Cooperative Credit Society. Commencement orders are valid indefinitely.

Restrictions on use of start-up capital before commencement order

Sections 58 and 59

These sections govern the use of association funds during the period after an association has come into existence but before the issue of a commencement order.

Conditions to be met before commencement order

Section 60

Before issuing a commencement order, the Superintendent must be satisfied that a number of requirements have been complied with — in particular that the first members' meeting has been held, the minimum $10 million start-up capital has been raised, and the expenses paid out of start-up capital have been reasonable. Subsection 60(2) prohibits the issue of a commencement order if the association is unable to satisfy the issuance requirements within a year of its incorporation. Section 64 provides that the incorporation of the association lapses in such cases.

Commencement order may contain additional authorities, conditions and restrictions

Sections 61 and 62

Section 61 permits the Superintendent to include in the commencement order conditions and limitations concerning the business of an association, provided they are consistent with the Act. The practice of attaching conditions and limitations to commencement orders parallels the licensing system under the current trust and loan associations legislation.

Although the commencement order is essentially a once-only event, subsequent changes in circumstance may make it appropriate to alter it. Section 62 authorizes the Superintendent to make such alterations for the purposes of

- making an existing commencement order subject to conditions and limitations the Superintendent considers necessary; or
- amending or revoking conditions and limitations to which the order is subject.

The power to amend or revoke any authorization and to impose or vary conditions and limitations can only be exercised if the Superintendent has given the association a reasonable opportunity to make representations on the matter.

Publication of notice of commencement order

Section 63

Both the association and the Superintendent are required to publish a notice of the issue of a commencement order.

Association to be wound-up if no commencement order is issued

Sections 64 and 65

As noted above (section 60), if an association fails to obtain a commencement order within its first year, the association ceases to exist, except for the purpose of distributing its assets to the shareholders or incorporators and otherwise winding up its affairs.

PART VI - CAPITAL STRUCTURE

Summary. This Part of the Act sets out rules governing an association's capital, including the characteristics of its shares and subordinated indebtedness and the transfer of security certificates it issues. Most of its provisions are modelled on Parts V and VII of the *Canada Business Corporations Act* and Divisions C and D of Part IV of the current *Bank Act*.

Power to issue shares

Subsection 66(1)

Subsection 66(1) confers on the board of directors of an association the general power to authorize the issue of membership shares and shares at any time to any person for any consideration. This general power is subject to the other provisions of the Act (notably section 74 and the ownership restrictions of Part VIII) and the by-laws of the association.

Concept of "par value" shares to be phased out

Subsections 66(2) and 69

Subsection 66(2) requires that membership shares and shares of an association must be without nominal or par value. At one time, corporations commonly issued shares with a nominal or par value. Since the par value did not necessarily bear any relationship to the real value of the share, modern corporate statutes such as the *Canada Business Corporations Act* require shares to be without nominal or par value.

To accommodate former-Act associations that may have outstanding par value shares when they come under the jurisdiction of this Act, subsection 69(1) deems such shares to be shares without par value. In addition, subsection 69(2) preserves any existing rights that are expressed in terms of the par value of such shares. For example, the right of a share to dividend payments expressed as a percentage of its par value would be unaffected by the fact that the share is deemed to be a share without par value.

Restriction on use of term "membership share"

Sections 67 and 68

Subsection 67(2) requires membership shares to carry the right to

- receive dividends; and
- receive the remaining property of the association on dissolution.

Subsection 67(3) prohibits the use of the term "membership shares" or any variation of that term for a class of shares.

Subsection 67(4) allows the by-laws of the association to set out the terms and conditions for redeeming membership shares.

Subsections 67(5) and (6) deal with the issuance of certificates for membership shares.

Section 68 prohibits the issuance of shares under section 70 that have full voting rights; subsection 68(2) limits the right to vote for directors. Section 173 limits shareholders to voting for no more than one third of directors.

Restrictions on issue of classes of shares

Sections 70 and 71

These sections allow associations to issue classes of shares if authorized by by-law adopted by special resolution of members and approved in writing by the Superintendent. The by-laws may also provide for a class of shares to be divided into separate series. Series within a particular class must rank equally with each other in voting rights and the right to receive dividends or participate in the repayment of capital. This differs from the current *Bank Act* and *Canada Business Corporations Act*, which do not require the same voting rights for series within a class.

One share, one vote

Section 72

Section 72 establishes the general rule that all voting shares of an association carry one vote.

Shares to be paid for in money

Sections 73 and 74

Like the current *Bank Act* — but unlike the *Canada Business Corporation Act* and the current trust and loan legislation — subsection 74(1) allows membership shares and shares of an association to be issued only if they are fully paid for in money. Allowance is made for shares paid for in property. Section 73 is a standard corporate law provision: once a share is fully paid, its holder has no other obligation to the company that it issued.

Transitional rules regarding capital structure

Section 75

This section sets out the standard corporate law rules governing the establishment of a stated capital account for membership shares and each class and series of shares (subsections 75(1) and (2)) as well as transitional rules governing modifications to the stated capital account on the coming into force of this Act (subsections 75(3) to (5)).

Pre-emptive rights

Section 76

Section 76 deals with pre-emptive rights: the right of shareholders to take up their proportionate share of new share issues on the same terms offered to others. Usually, such a right is conferred by law, subject to any restrictions set out in the incorporating instrument or by-laws. This Bill, however, only allows for pre-emptive rights if the by-laws explicitly provide for them. Furthermore, such rights may not be exercised when

- shares are issued for a consideration other than money; or
- the issue of the shares to a particular shareholder would be prohibited by the Act or — if the shareholder is a non-resident — the board of directors is aware of a requirement in the non-resident's country that appropriate authorities should first be notified.

Convertible shares and share options

Section 77

Associations may issue conversion privileges, options and other rights to acquire shares. These may be transferable and may also be made separable from any other security to which they may be attached.

Prohibition against holding of membership shares and shares

Sections 78 to 81

In modern corporate law statutes, corporations are usually not permitted to own their own shares. Section 78 incorporates this prohibition, applies it to membership shares, and extends it to subsidiaries of the association (with the exception of membership shares require to be held by a member). Exceptions to these restrictions are set out in sections 79 and 80:

- Section 79 allows associations to accept donations of their shares, acquire them through issuer bids, and redeem their redeemable shares in accordance with the terms of the issue. Such transactions require the consent of the Superintendent and may not be entered into if they would result in a violation of the capital adequacy requirements of section 409.

- To allow members to withdraw, an association may redeem up to 1% of its outstanding membership shares in any calendar year.

- Subsection 80(1) allows associations and their subsidiaries to hold membership shares and shares as personal representatives, provided they do not beneficially own them.

- Subsection 80(2) allows associations and their subsidiaries to have security interests in membership shares and shares or ownership interests, provided the amounts are nominal or immaterial.

- An association is not prohibited from holding or realizing on the lien it has on membership shares (see section 51).

The regulations will set out additional exceptions to this rule. One will enable the securities subsidiary of an association to participate in a distribution of the shares of the association.

Section 81 set out the requirements for disposition of membership shares and shares in an association:

- Associations and their subsidiaries must dispose of such membership shares and shares within six months after acquiring them through the realization of a security interest.

- The subsidiaries of a former-Act association that hold such membership shares and shares on the coming into force of this Act must dispose of them within six months.

- Associations are required to cancel all their membership shares and shares acquired through issuer bids, redemptions and donations.

Reductions in stated capital

Sections 82 and 83

These are standard corporate law provisions that allow an association to reduce its stated capital and reimburse members if authorized by special resolution and approved in writing by the Superintendent. As with redemptions and issuer bids (section 79) and dividend payments (section 86), a reduction in stated capital must not result in a violation of the capital adequacy requirements of section 409.

Adjustments to stated capital accounts

Sections 84 and 85

These sections are modelled on *Bank Act* and *Canada Business Corporations Act* provisions that set rules for making adjustments to stated capital accounts when an association acquires or redeems its membership shares and shares, when shares are converted from one class or series to another or when debt obligations are converted into shares.

Declaration of dividends

Section 86

The board of directors of an association is authorized to declare a dividend payable in money, property, fully paid membership shares and shares, or rights to acquire fully paid membership shares and shares. The declaration of dividends is subject to certain notice requirements and must not result in a violation of the capital adequacy requirements of section 409.

Subordinated Indebtedness

Subordinated indebtedness

Section 87

This section sets out rules governing the issue of subordinated indebtedness by associations. These rules are less restrictive than those governing bank debentures — the equivalent concept in the current *Bank Act* — and those governing subordinated notes — the equivalent concept in the current trust and loan companies legislation. The only restrictions imposed on its issue by this section are the following:

- Since it is considered an element of an association's capital, subordinated indebtedness — like shares — may only be issued if it is fully paid for in money.

- Subordinated indebtedness is deemed not to be a deposit and — in order to avoid the possibility that it might be mistaken for a deposit — associations are required to specifically refer to it as subordinated indebtedness in public documents.

Procedures for transfer of ownership of security certificates

Sections 88 to 142

Sections 88 to 142 are standard corporate law provisions governing the transfer of security certificates issued by associations. They are substantially the same as Part VII of the *Canada Business Corporations Act* and sections 75 to 108 of the current *Bank Act*. These sections do not apply to membership shares.

PART VII - CORPORATE GOVERNANCE

Members and Shareholders

Summary. Sections 143 to 166 set out the rules governing members' or shareholders' meetings. They are modelled on sections 132 to 146 of the *Canada Business Corporations Act* and sections 60 to 74 of the current *Bank Act*. They deal with such matters as the rules governing the calling and holding of members' or shareholders' meetings, the creation and use of lists of members or shareholders, and the resolution of disputes by the courts. Unlike the *Canada Business Corporations Act*, this Act does not permit the members to relieve the directors of their responsibility to manage the business and affairs of the association by a unanimous agreement.

Procedures for calling shareholders' meeting

Sections 143 to 156

These sections include a provision that annual meetings of members must be held within six months of the end of each financial year (subsection 144(1)). They also govern

- the calling and holding of members' or shareholders' meetings (sections 143 and 156 and subsection 144(1));
- the fixing of record dates for various purposes, including the payment of dividends and notice of meetings (subsections 145(2) to (4));
- the giving of notice of members' or shareholders' meetings (sections 146 to 151);
- the presentation and consideration of member proposals (sections 152 and 153);
- the preparation and use of member or shareholder lists (section 154); and
- the determination of a quorum for members' or shareholders' meetings (section 155).

Exercise of voting rights at meetings

Section 157

Section 157 allows shareholders only one vote per voting share. It complements section 72, which prohibits the issue of new shares that carry multiple or fractional voting rights.

Procedures for holding meetings

Sections 158 to 166

These sections govern the following matters:

- representation at members' or shareholders' meetings of entities that are not natural persons (section 158);
- treatment of joint shareholders (section 159);
- voting procedures at meetings (section 160);
- adoption of written unanimous resolutions in place of meetings (section 161);
- requisitioning of members' meeting by members and shareholders' meetings by shareholders (section 162);
- intervention by the courts when the requirement for members' and shareholders' meetings cannot be met, or when disputes about the election or appointment of directors or auditors must be resolved (sections 163 to 165); and
- establishment of agreements among shareholders to exercise their voting rights in concert (section 166).

Directors and Officers

Summary. **Sections 167 to 218 deal with the roles, responsibilities and qualifications of officers and directors. Most are standard corporate law provisions modelled on the current *Bank Act* and *Canada Business Corporations Act*, though some changes have been made to reflect the policy set out in the *New Directions* policy paper.**

Duties

Duties of directors

Section 167

Subsection 167(1) sets out the general duties of the board of directors, charging it with the management — or supervising the management — of the business and affairs of the association. In addition, subsection 167(2) charges the board with a number of specific duties, requiring it to:

- establish an audit committee and a conduct review committee;

- establish procedures to resolve conflict of interest problems, and designate a committee to monitor these efforts;

- establish appropriate investment and lending policies and procedures.

Standards of conduct

Section 168

This section sets general standards of conduct for directors and officers, including a requirement to act prudently and to comply with this Act, the regulations, and the incorporating instrument and by-laws of the association.

Qualification and Number – Directors

Summary. Sections 169 to 171 are mostly new provisions that reflect changes to the rules governing directors set out in the *New Directions* policy paper. Most of those that have *Bank Act* and *CBCA* precedents have also been modified.

Minimum size of board of directors and residency requirements

Section 169

The board of directors must consist of at least seven members. At least three-quarters of the directors must be resident Canadians.

Certain persons disqualified from being directors

Section 170

As in other corporate statutes, only natural persons who are not minors, bankrupts or persons determined by a court to be of unsound mind may be directors of an association. Section 170 extends the prohibition to the following persons:

- shareholders who are prohibited by the ownership provisions (section 367) from voting their shares, as well as the directors, officers and employees of such shareholders;

- ministers or agents of the federal or provincial governments; or

- employees of a foreign government.

Restrictions on number of "inside directors"

Section 171

No more than 15 per cent of the directors of an association may be employees of the association or its subsidiaries.

Rules governing appointment or election and tenure of directors

Sections 172 to 175

These sections set out the general rules for the appointment or election and tenure of directors. They cover fixing the number of directors, and their terms of office. Directors may be elected at an annual meeting or the by-laws may provide for the appointment of directors by members or classes of members and set out a procedure for such appointments.

Where shareholders have a right to vote for the election of directors, they are limiting to voting for no more than one third of the directors.

Re-election of directors

Section 176

This section makes clear that directors may be re-elected any number of times.

Incomplete Elections and Director Vacancies

Faulty election of directors

Sections 177 and 178

These sections set out rules governing the faulty election or appointment of directors:

- An election or appointment of directors is **void** if the board fails to meet the composition requirements of subsection 169(2), or if a quorum of directors is not elected at a meeting.

- The election of directors at a meeting is valid but incomplete if, after the election, a quorum is in place but the number of directors is less than the minimum number required by this Act or the by-laws.

In both cases, the Act designates interim directors and requires them to call a special meeting to conduct a proper election or fill the remaining vacancies.

Creation of director vacancies

Sections 179 to 180

These sections are standard corporate law provisions governing vacancies on the board of directors created through resignation, removal, disqualification, or death.

Statements submitted by directors on resignation or replacement

Sections 181 to 182

As in the *Canada Business Corporations Act* and the current *Bank Act,* a director who resigns or learns that he or she will be removed as a director or replaced at the end of a term is entitled to submit a written statement to the association giving reasons for the resignation or

setting out objections to the removal or replacement. The association is required to send a copy of the statement to members and all holders of its voting shares and to the Superintendent.

In addition, subsection 181(2) is a new provision that *requires* a director who resigns as a result of a disagreement with the other directors or management of an association to submit a written statement to the Superintendent describing the disagreement.

Filling of director vacancies

Sections 183 to 186

These sections provide for the filling of vacancies resulting from events other than void or incomplete elections (see sections 177 and 178):

- Except when vacancies cause an association to be in violation of the "minimum number" and composition requirements in section 169(2) vacancies may be filled only by a vote of members or shareholders, or members or shareholders of the class or series that has the exclusive right to elect the directors among whom a vacancy exists.

- When the "minimum number" and composition requirements are not met as the result of a vacancy, they must be filled by a quorum of directors without delay.

Meetings of the Board

Directors' meetings

Sections 185 to 190

These sections are modelled on standard corporate law provisions in the *Canada Business Corporations Act* and the current *Bank Act* that govern the holding of meetings of the board or of its committees, including the requirement for giving notice of such meetings, their adjournment, the determination of a quorum, the requirement for the presence of a majority of resident Canadian directors, the recognition of the validity of meetings held by means of telephone or other electronic communications media, the recording of directors' dissent, and the recording of director attendance.

The principal differences in this Act from the others are:

- The rules are extended to apply to meetings of committees of the board as well as the board itself;

- Section 187 fixes the quorum at a majority of the minimum number of directors or committee members required by the Act. Also, the quorum can be varied by by-law.

- The "Canadian majority" requirement in section 188 is expressed in terms of the number of directors who are "resident Canadians" (as

defined in section 2) rather than the number who are Canadian citizens.

- References to the validity of meetings by telephone and other methods have been extended to cover a broader range of electronic media that enable participants to communicate.

Superintendent may require board meetings to be held

Section 191

This is a new provision that allows the Superintendent to call a meeting of the board of directors when the Superintendent considers it necessary.

By-laws

By-laws

Sections 192 to 195

Unlike a business corporation, in an association the members have the general authority to make, amend or repeal by-laws regulating the business or affairs of the association by special resolution; directors may also make or amend a by-law but only if the by-law or amendment is not contrary to a by-law passed by the members.

By-laws or amendments passed by directors are subject to confirmation by members at the next meeting of members.

Sections 195 and 196 provide that by-laws of former-Act associations not inconsistent with this Act continue in effect. They do, however, require by-laws for the remuneration of directors to be reconfirmed at the first annual meeting after the Act comes into force.

Provisions in incorporating instrument deemed to be by-laws

Section 197

This Act consigns to by-laws many matters set out in the incorporating instruments of former-Act associations. Section 197 deems such provisions to be set out in the by-laws of former-Act associations and provides that they may be modified or repealed in the same way as other by-laws.

Committees of the Board

Committees of the board

Sections 198 to 200

These sections set out the general power of the board to establish committees of directors and assign them duties, as well as a statutory requirement to establish an audit committee and a conduct review committee. They also set out the Act's requirements for the composition of the audit and conduct review committees, their powers and duties, and certain requirements for the reporting of their activities:

- None of the members of the two committees may be an officer or employee of the association or its subsidiaries.

- The audit committee must review the financial statements and returns of an association, meet with auditors to discuss the financial statements, ensure that the association maintains appropriate internal controls, and review transactions brought to its attention that could adversely affect the well-being of the association. The audit committee may also call a meeting of the full board to consider any matter of concern to it.

- The conduct review committee must review related party transactions as required by Part XII and ensure that any that might materially affect the stability or solvency of the association are identified.

Directors and Officers - Authority

Summary. **Sections 201 to 205 deal with the appointment of officers and the authority that the board of directors may delegate to them.**

Appointment of officers and delegation of powers

Sections 201 and 202

The board is required to appoint the chief executive officer of the association and may appoint other officers of the association. Subject to certain restrictions, the board may also delegate its powers to management or to committees of the board.

Remuneration, validity of acts, and participation of directors at members' and shareholders' meetings

Sections 203 to 205

These sections govern:

- the authorization given by the board of directors for the remuneration of directors, officers and employees;

- the validity of actions of directors and officers despite defects in their qualifications or irregularities in their election or appointment; and

- the right of directors to participate at meetings of shareholders.

Conflicts of Interest

Rules governing conflicts of interest of members of the board

Sections 206 to 210

These sections set out rules requiring officers and directors to make timely disclosure to the association of contracts between themselves and the association and between the association and entities in which they may have an interest, other than members of the association.

Liability, Exculpation and Indemnification

Rules governing liability, indemnification and insurance of directors and officers

Sections 211 to 218

These sections set out rules governing

- the liability of directors to the association and its employees;
- the indemnification by the association of its directors and officers, and other persons acting on its behalf, for the expenses of legal actions against them in their official capacity; and
- the obtaining of insurance to cover the liability of its directors and officers, and other persons acting on its behalf.

Fundamental Changes

Amendments

Summary. **Sections 219 to 225 govern the amendment of the incorporating instrument and fundamental by-laws of associations. They are loosely modelled on current *Bank Act* and *Canada Business Corporations Act* provisions.**

Amendment of incorporating instrument

Sections 219 and 220

These sections enable an association to apply to the Minister for an amendment to its incorporating instrument for the purposes of changing its name or adding, changing or removing any other provision permitted by the Act. Proposals to this effect are subject to certain notice requirements and must be authorized by a special resolution.

In order for the amendment to take effect, the Minister must approve the application and issue supplementary letters patent.

Amendment of fundamental by-laws

Sections 221 to 225

Many of the basic provisions currently set out in the incorporating instrument of corporations are, under this Act, consigned to the by-laws (see the explanatory notes to sections 28 and 197). Unlike ordinary by-laws, but like amendments to the incorporating instrument, the making, amendment or repeal of these "fundamental" by-laws — those governing capital structure, the number of directors and changes in the location of the association's head office — requires a special resolution of members and shareholders, including (in some cases) the holders of shares that ordinarily do not carry the right to vote. In most cases, the Superintendent must also approve the changes in order for them to take effect.

Amalgamation

Rules governing amalgamation

Sections 226 to 233

These sections are modelled on the *Bank Act* and *Canada Business Corporations Act* and govern the creation of new associations by the amalgamation of two associations or an association and federally incorporated subsidiary of the association.

The applicants must set out the terms of their proposed amalgamation in a draft amalgamation agreement, which must be approved by the Minister before being submitted to their members and/or shareholders. All shareholders — including those who normally do not have voting rights — are eligible to vote on the amalgamation agreement. Holders of different classes or series of shares are entitled to vote separately if their rights under the amalgamation would differ from those of other shareholders. The amalgamation agreement is approved when the members and/or shareholders of all the applicants have approved it by separate special resolutions.

The applicants must then meet certain notice requirements and send the approved amalgamation agreement to the Minister within three months. Before issuing letters patent to give effect to the amalgamation agreement, the Minister must be satisfied that all the requirements of the Act relating to amalgamations have been met.

Section 230 provides for "short-form amalgamations": streamlined amalgamation procedures to facilitate the amalgamation of wholly-owned subsidiaries of the same person. Section 233 provides a limited transition period during which newly-amalgamated associations may continue to engage in certain practices that would otherwise be prohibited by the Act.

Corporate Records

Head Office and Corporate Records

Summary. Sections 234 to 244 describe the records associations are required to keep and the rules governing their maintenance and retention. Some records are unique to deposit-taking institutions, others are general corporate records. The rules governing them are modelled on similar rules in the *Canada Business Corporations Act* and the current *Bank Act*.

Location of head office and records to be kept

Sections 234 and 235

These sections require an association to maintain its head office at an address in the place specified in its incorporating instrument or by-laws. They also specify the records an association must keep and maintain. These include corporate records, such as its incorporating instrument, by-laws, and minutes of members', shareholders' and directors' meetings, as well as records of deposit-taking.

Keeping of association records and access

Sections 236 to 239

These sections set out the rules governing the keeping of association records and access by members, shareholders, creditors and other persons to association records such as by-laws and member and shareholder lists.

Form and protection of records

Sections 240 and 241

These sections set out rules governing the form in which records may be kept and a requirement that associations take reasonable precautions to protect their records from loss or falsification, to detect and correct any errors they contain, and to prevent unauthorized access to them.

Processing of records in Canada

Section 242

This section requires associations to maintain and process information and data relating to their records in Canada. Associations may, however, keep copies of such records outside Canada unless expressly prohibited from doing so by the Minister or the Superintendent. These rules do not apply to records of the activities of an association outside Canada.

Regulations governing retention of records

Sections 243 and 244

Associations are required to retain their records for a period that may vary with the type of record. Subsection 243(1) and the regulations under section 244 govern all the period of retention of records. This approach is more flexible than the approach in the current *Bank Act*, which sets a fixed 10-year retention period for most records.

Securities Registers

Rules on establishment and maintenance of securities registers

Sections 245 to 249

These sections establish rules for keeping registers recording the securities issued by the association in registered form. They are modelled on corresponding provisions in the *Bank Act* and *Canada Business Corporations Act.*

Corporate Name and Seal

Use of corporate name in legal documents

Sections 250 and 251

These sections require an association to set out its name in contracts and other documents. However, they also provide that a document is not invalid merely because it does not bear the association's corporate seal.

Proxies

Rules governing proxies

Sections 252 to 259

These sections are standard corporate law rules dealing with proxies. They are substantially the same as those in the corresponding provisions of the *Canada Business Corporations Act* and the current *Bank Act*. These rules do not apply to members exercising their voting rights, which are governed by Part IV.

Insiders

Rules governing insider reports and insider trading

Sections 260 to 267

These sections are substantially the same as the current *Canada Business Corporations Act* and *Bank Act* provisions that set out reporting requirements for association insiders, prohibit insider trading, and provide for civil remedies.

Prospectus

Prospectus requirements

Sections 268 to 277

These sections are modelled on sections 145 to 154 of the current *Bank Act* and require the filing of a prospectus before any distribution of the securities of an association. Regulations made under section 270 will provide exemptions for private placements and other classes of securities issues that are not part of a distribution to the public. In addition, since provincial securities laws also impose prospectus requirements on the distribution of associations' securities, section 271 permits the Superintendent to exempt an issue from the prospectus requirements if satisfied that the association has filed a prospectus substantially complying with these rules in another jurisdiction.

Trust Indentures

Rules governing issue of subordinated indebtedness under

Sections 278 to 290

These sections are modelled on sections 82 to 93 of the *Canada Business Corporations Act (CBCA)* and sections 133 to 144 of the current *Bank Act*. They set out procedures governing the issue of debt obligations under a trust indenture. Like the *Bank Act*, but unlike the *CBCA*, they permit only subordinated indebtedness to be issued in this way.

Summary. Sections 291 to 317 set out the requirements for financial disclosure by associations and the rules governing the appointment and duties of auditors. Most are standard corporate law provisions modelled on the current *Bank Act* and *Canada Business Corporations Act*, though some changes have been made to reflect the policy set out in the *New Directions* policy paper.

Annual Financial Statement

Financial year

Section 291

Associations must have December 31 as their financial year end.

Annual financial statements and accounting principles

Section 292

The board of directors must submit a comparative annual financial statement and auditor's report to every annual meeting of members. The annual financial statement must contain:

- a balance sheet, income statement, statement of change in financial position, and statement of change in equity for the most recently completed financial year;
- a list of entities in which the association has a substantial investment, other than those acquired through realizations or loan workouts;
- any other information necessary to fairly present the association's financial condition; and
- any other information required by the regulations.

Subsection 292(4) requires associations to prepare financial statements in accordance with generally accepted accounting principles unless the Superintendent specifies otherwise. As with auditing standards (section 307(2)), generally accepted accounting principles are those described in the Handbook of the Canadian Institute of Chartered Accountants.

Approval of annual statement by the board of directors

Section 293

Annual statements must be approved by the board of directors before they are published and submitted to the annual meeting of shareholders.

Retention of financial statements of downstream interests

Section 294

An association is required to keep copies of current financial statements of entities in which it has a substantial investment.

Members and shareholders of an association and their representatives may examine such statements unless the association obtains a court order barring access to them.

Distribution of annual statements

Sections 295 and 296

Associations must send a copy of the annual statement to each member and shareholder at least 21 days before the annual meeting, unless the requirement is waived. If an association fails to do so, the annual meeting must be adjourned until the requirement is met. A copy of the annual statement must also be sent to the Superintendent within 45 days after each annual meeting.

Auditor

Appointment of auditor

Sections 297 and 298

The members are required to appoint an auditor at each annual meeting. This Act differs from the *Bank Act* in that:

- associations under this Act are required to appoint only one auditor, rather than two;
- the auditor may be a natural person and need not be a firm of accountants; and
- regular rotation in the office of auditor is not required.

Qualifications for association auditor

Section 299

If a natural person is appointed auditor of an association, that person must

- be a member in good standing of a provincial association of accountants;
- have five years' experience at a senior level in auditing financial institutions; and
- ordinarily reside in Canada.

In addition, the auditor must be independent of the association. Independence is a question of fact to be determined with regard to the particular circumstances of a proposed appointment. However, a person is deemed *not* to be independent if the person, another member of the person's accounting firm, or any other business partner of the person

- is a director, officer, employee of the association, any of its subsidiaries, or certain members of the association;

- is a business partner of a director, officer or employee of the association or any of its affiliates;
- has a material interest in equity securities of the association or any of its subsidiaries; or
- has been involved in the receivership, bankruptcy or liquidation of any provincial central or subsidiary of the association within the preceding two years.

A firm appointed auditor must designate one of its members who meets the requirements noted above to conduct the audit of the association.

Resignation and removal of auditor

Sections 300 to 303

An auditor who ceases to be qualified under section 299 is required to resign. A court order removing the auditor may be obtained if the disqualified auditor does not resign. The Superintendent may revoke the appointment of an auditor by sending a written notice to the auditor and the association. An auditor may also be replaced by ordinary resolution of the members. The board of directors is authorized to fill any vacancy occurring in the office of auditor. If it does not, the Superintendent may fill the vacancy.

Attendance of auditor and Superintendent at meetings

Section 304

As in the *Canada Business Corporations Act* and the current *Bank Act*, an association's auditor is entitled to attend members' meetings and may be required to do so by any director or member.
Subsections 304(3) and (4) are new provisions that require the Superintendent to be notified when a director or member requires the auditor to be in attendance at a members' meeting. They enable the Superintendent to attend the meeting and provide an opportunity for the Superintendent to participate in the discussion of the matters that the auditor may be required to address.

Statement made by auditor on resignation

Sections 305 and 306

Section 305 makes mandatory the current *Bank Act* and *Canada Business Corporations Act* provisions that allow an auditor who is removed or resigns to submit a statement to the association and the Superintendent regarding the reasons for the resignation or the factors that led to the removal. A person or firm appointed to replace such an auditor may not take office until the former auditor provides them with such a statement.

Audits

Sections 307 to 313

These sections set out rules governing the auditing of associations. In general, auditors must conduct any examinations they consider necessary to enable them to make the report to members on an

association's annual statement required by section 310. To that end, auditors may require directors, officers and employees of an association to give them access to both its own records and those of entities in which it has a substantial investment, provided the directors or other persons are reasonably able to do so (section 308).

Section 307 provides that — as with accounting principles (subsection 292(4)) — audits are to be conducted according to generally accepted auditing standards unless the Superintendent specifies otherwise. These standards are those described in the Handbook of the Canadian Institute of Chartered Accountants.

In addition to these requirements:

- The Superintendent may require the auditor of an association to make special examinations and report on the auditing procedures used in examining the association's annual statement and on the internal control procedures used by the association (section 309).

- The shareholders of an association may require the auditor to audit any financial statement prepared for them by the directors and report on whether it fairly presents the information required by members (section 311).

- The auditor of an association must report to the chairperson of the board of directors, its chief executive officer and chief financial officer, and to the Superintendent, on transactions entered into that are not within the association's powers, expected losses on loans in excess of one-half of 1 per cent of regulatory capital, and any other unsatisfactory situation requiring rectification (section 312).

- Associations must ensure that their own auditors are also appointed to audit their subsidiaries, except in the case of foreign subsidiaries where the laws of the jurisdiction concerned do not permit it (section 313).

Auditor's relationship with audit committee and internal auditors

Sections 314 and 315

As in corresponding provisions of the *Canada Business Corporations Act* and the current *Bank Act*, section 314 and subsection 315(1) provide that the auditor of an association

- is entitled to participate in meetings of the association's audit committee and must attend every such meeting if requested to do so by a member of the committee; and

- has the power to call a meeting of the committee.

Subsection 315(2) is a new provision that requires the chief internal auditor of an association to meet with the auditor at the auditor's request.

Detection of errors in financial statements

Sections 317 and 318

Directors and officers are required to notify the auditor and the audit committee if they become aware of any error in a financial statement. Conversely, if auditors or former auditors discover a material error in a financial statement on which they reported, they must inform the board of directors, which is then required to prepare and issue a revised statement and inform the shareholders and Superintendent of the error.

Remedial Actions

Derivative actions and actions to rectify records

Sections 318 to 322

These sections are modelled on corresponding provisions in Part XX of the *Canada Business Corporations Act.* Sections 318 to 321 permit the Superintendent or a complainant to bring a derivative action: legal action taken in the name of an association or any of its subsidiaries if the association or subsidiary refuses to take the action itself and a court agrees that the action should be taken. Section 322 permits persons adversely affected by errors or omissions in an association's records or members' or securities register to apply to a court for an order rectifying the error or omission.

Liquidation and Dissolution

Rules governing voluntary liquidation of associations

Sections 323 to 353

These sections deal with procedures to be followed in the voluntary liquidation of an association that is not insolvent. They are standard corporate law provisions modelled on Part XVIII of the *Canada Business Corporations Act* and Part XI of the *Bank Act* and govern

- the liquidation of associations with no assets or liabilities, such as those whose incorporation lapses under section 64 (section 326);
- the liquidation process for other associations and the issuing of letters patent of dissolution by the Minister (sections 317 to 330);
- applications by the Superintendent or any other person for supervision of the liquidation process by a court (sections 331 and 332);
- the powers of the court to supervise a dissolution, including the appointment of a liquidator (sections 333 to 336);
- the duties, powers and privileges of a liquidator (sections 337 to 341);

- the making of a final order of liquidation by the court, the right of members to be paid in money, and the issue of letters patent of dissolution (sections 342 to 344);

- the continuation of legal liability of an association after its dissolution (sections 345 to 347); and

- the transfer to the Bank of Canada of amounts remaining unclaimed by members, creditors, or shareholders after dissolution and the retention of a dissolved association's records (sections 348 to 352).

Priority on insolvency

Section 353

This section governs the priorities of various classes of creditors when an association is found to be insolvent and is forced into liquidation under the *Winding-Up Act*. Modelled on section 277 of the *Bank Act*, its effect is as follows:

- Secured creditors enjoy priority over all other creditors to the extent of the value of their security.

- With regard to unsecured and unsubordinated liabilities, the Crown enjoys priority over all other creditors with otherwise equivalent claims. As in the current *Bank Act*, however, this Act waives Crown priority in respect of fines and penalties for which associations are liable and explicitly gives them the lowest ranking among creditor claims: after deposits, other unsecured creditors and subordinated indebtedness, but before shareholder claims.

- Deposit liabilities and other unsubordinated liabilities rank ahead of subordinated indebtedness.

Subsection (3) makes clear that the relative ranking of claims within each of these classes is to be determined in accordance with applicable laws governing priorities.

PART VIII - OWNERSHIP

DIVISION I

CONSTRAINTS ON OWNERSHIP

Summary. **The ownership rules contained in this Part do not apply to the ownership of membership shares. The rules apply instead to preference shares issued by an association, and are substantially similar to the ownership rules for trust and loan company shares. Provisions dealing with membership shares in associations are found in Part IV of this Act.**

This Division sets out the general restrictions on the ownership of shares in an association.

Section 354

This section requires written Ministerial approval before a person, or an entity controlled by the person, may acquire shares of an association — either directly or through the acquisition of control of an entity that holds such shares — if the acquisition would cause the person to acquire or increase a significant interest in a class of shares of the association. Membership shares in an association are excluded from the definition of "shares" and are therefore not subject to the constraints in this Division.

Sections 358 to 364 set out the procedures governing approval. Where more than one person would acquire or increase a significant interest as the result of a transaction, each of them must obtain the approval of the Minister. For example, if a corporation were to acquire a significant interest in a class of shares of an association, its controlling shareholder would also acquire a significant interest by virtue of the way "significant interest" is defined (see section 9). Section 387(2) allows any person requiring approval to apply on behalf of all such persons.

Subsection 354(2) makes clear that an amalgamation, merger or other reorganization of entities that have interests in shares of a company also requires prior approval in writing of the Minister if the resulting entity would have a significant interest in a class of shares of the association.

Ministerial approval required for registration of acquisition or increase of significant interests

Section 355

This provision complements section 354 — which prohibits direct or indirect acquisitions of shares that would cause a person to acquire or increase a significant interest without prior Ministerial approval — by also prohibiting the association from registering any direct acquisition of shares in its securities register without such approval.

Exceptions for small fluctuations in share holdings

Section 356

This section provides flexibility by waiving the requirement for Ministerial approval in the case of small fluctuations in the level of a person's significant interest.

Subsection (1) provides a general exemption from the requirements of sections 354 and 355 for small fluctuations in a person's existing significant interest in a class of shares of an association. The "smallness" test is set out in subsections (2) and (3). It provides exceptions for fluctuations in existing significant interests (through direct acquisitions of shares, acquisitions made by entities controlled by the person, and acquisition of control of entities that hold such shares) within a band of plus or minus 5 percentage points from

- the latest benchmark level reached with the approval of the Minister, or

- the level of the person's significant interest on the date of tabling of this Bill, if the person has made no subsequent acquisition requiring approval.

If a person's significant interest drops below the lower bound of this range, the exemption applies only to subsequent rebounds totalling 10 percentage points or less. That is, if a person's significant interest declined by as much as 10 percentage points, the person could still get back to the original benchmark level; larger rebounds — for example, back to the former upper bound of the range — would require Ministerial approval.

Because the exemption for small fluctuations applies only to persons with an *existing* significant interest, it does not allow a person who ceases to have a significant interest by virtue of a small decline in the percentage of shares held to reacquire a significant interest without Ministerial approval.

Exception for infusions of capital ordered by the Superintendent

Subsection 356(1)

The requirement for Ministerial approval of share acquisitions does not apply when an association issues shares in accordance with an order of the Superintendent to increase its capital.

Approval in advance

Subsection 356(2)

The Minister may approve in advance the acquisition of a particular number or percentage of shares over a specified period.

Approval Process

Procedures for share transfer approval

Section 358

Persons requiring approval for the acquisition or increase of a significant interest in a class of shares must file applications with the Superintendent. The application must contain information — to be set out in published guidelines — required by the Superintendent. Where the requirement applies to more than one person — for example, where an entity acquiring a significant interest is controlled by another person — the application may be made by any one of them on behalf of all of them.

Terms and conditions

Section 359

The Minister may set out terms and conditions for the approval of acquisitions or increases of significant interests.

Superintendent to certify receipt of application

Section 360

When an application under section 358 contains all the information required by the Superintendent, the Superintendent must refer it to the

Minister and send a receipt to the applicant certifying the date on which the complete application was received. If the Superintendent receives an incomplete application, notice must be sent to the applicant specifying the missing information.

Notice of decision to applicant

Section 361

The Minister must send a notice to the applicant within 30 days, measured from the certified date of receipt of a complete application referred to in subsection 360(1), indicating whether the Minister has approved the transaction. The Minister must also advise the applicant of the right to make representations if the Minister gives notice of not being satisfied that the application should be approved.

If unable to complete consideration of the application in the initial 30-day period, the Minister may extend it for a further 30 days (or longer if the applicant agrees).

Representations and final decision

Sections 362 to 364

When the Minister has notified the applicant of not being satisfied that the application should be approved, the applicant must be given an opportunity to make representations within 30 days of the date of the notice or some other period that may be mutually agreed upon.

After the period for making representations has expired, the Minister must reach a decision and notify the applicant within a further 30-day period. The Minister is deemed to have approved the application if any of the notifications required by sections 361 to 363 is not given.

DIVISION II

OTHER CONSTRAINTS ON OWNERSHIP

Summary. This division contains rules governing ownership of (non-membership) shares of associations by non-residents and governments. The provisions are modelled on the current *Bank Act*, *Trust Companies Act* and *Loan Companies Act* and incorporate the provisions of the Free Trade Agreement governing ownership of financial institutions.

Definitions and interpretation

Section 365

Definitions in this division are generally modelled on the corresponding definitions in the current *Bank Act*. The principal exception is the definition of "non-resident", the scope of which has been modified by virtue of the definition of "control" used in this Act. In particular, while both this Act and the *Bank Act* treat entities controlled by a non-resident as non-residents, the applicable definition of "control" in this Act is the section 3 definition rather than the *de jure* definition used in the current *Bank Act*. The definitions of

"United States resident" and "corporation" and the special definition of "control" used to determine U.S. residents are the same as those in the legislation implementing the Free Trade Agreement.

Restrictions on share ownership by non-residents

Section 366

Associations are prohibited from registering acquisitions of their shares by non-residents (including shares jointly held by residents and non-residents) if, after the acquisition,

- the voting rights attached to the aggregate of the shares beneficially owned by any single non-resident and the non-resident entities the person controls exceeds — or would exceed — 10 per cent of the total; or

- the voting rights attached to all shares beneficially owned by non-residents would exceed 25 per cent of the total.

The "10/25" rule noted above differs in a number of ways from the corresponding rule in the current *Cooperative Credit Associations Act*:

- In the current legislation, the "10/25" threshold is based on the percentage of shares held, not on the percentage of voting rights held. The old approach dates from a time when associations did not issue non-voting shares. It has been replaced by the new approach to maintain the intent of the rules in changed circumstances. The "10/25" threshold in this Part applies only to the contingent voting rights which may be attached to preference shares issued by an association.

- In the current *Bank Act*, the "10/25" thresholds are based on the holding of a percentage of shares of classes or series of shares, rather than on voting shares or voting rights.

A further difference between the proposed "10/25" rule and the corresponding rules in current legislation is in the calculation of the direct and indirect share holdings of a particular person. Current legislation uses the concept of shares held by persons and their "associates". This Act expresses a similar concept through "a person and any entities controlled by that person" and the operation of the "acting in concert" provision (see section 11).

Sanctions: suspension of voting rights

Section 367

Subsection 367(1) is modelled on a provision in the current *Bank Act* and trust and loan companies legislation. It prohibits a non-resident and the entities controlled by the non-resident — excluding trusts (such as pension fund trusts) in which residents have a majority of the beneficial interest — from exercising voting rights attached to shares of a company they beneficially own if the aggregate of their voting rights exceeds the 10 per cent threshold in subsection 367(1).

DIVISION III

DIRECTIONS

Summary. **Sections 368 and 369 set out the sanctions the Minister may impose for violations of the ownership restrictions.**

Disposition of shareholdings

Subsection 368(1)

The Minister may order a person and any entity the person controls to dispose of a specified number of shares of an association, and suspend voting rights attached to the shares, if

- the person fails to obtain the Minister's approval required by section 354 before acquiring or increasing a significant interest in a class of shares of the association;
- the person fails to comply with any terms and conditions the Minister imposes under section 359 in respect of an approval under this Part.

Representations, appeals and court enforcement

Subsections 368(2) to (4) and Section 369

The Minister must give persons subject to an order under subsection 368(1) a reasonable opportunity to make representations before making the order. The person may also appeal to the courts within 30 days of the date of the order, but an order that suspends voting rights may not be stayed on appeal. If a person fails to comply with a Ministerial order, the Minister may seek enforcement through the courts.

General Provisions

Summary. **The following are miscellaneous provisions, including an exemption for certain classes of share transactions from the ownership restrictions in this Part, and provisions to facilitate the gathering of information that may be necessary to enable associations to meet their requirements.**

Part does not apply to interests held by securities underwriter

Section 370

The ownership restrictions in this Part do not apply to shares acquired by a securities underwriter for distribution to the public, provided the shares are held for no longer than six months.

Arrangements to effect compliance

Sections 371 to 373

These sections authorize the board of directors of an association to make arrangements necessary to carry out the requirements of this Part. In particular, an association's board may require registered shareholders, or persons seeking to become registered shareholders, to disclose

relevant facts about the beneficial ownership of the shares and other matters the board considers relevant, such as the names of entities controlled by the registered shareholder that are themselves shareholders of the association. If a person required to make such a disclosure fails to do so, the association may refuse to record the share acquisition. In addition, the association and other persons acting in good faith on such a disclosure enjoy legal immunity for those actions.

Section 373 sets out a *de minimis* exemption from the requirement that associations ensure that proposed share transfers do not violate this Part before registering them. Associations are entitled to assume that small share transfers — those involving fewer than 5,000 shares and less than one-tenth of 1 per cent of the shares of a class — comply with the Act.

Subsections 371(2) and (3) also allow the Superintendent to require an association to obtain information from its registered shareholders about the beneficial ownership of shares and other matters relevant to the administration of this Part.

Exemptions from the ownership restrictions for estate planning purposes

Section 374

The regulations may exempt from ownership restrictions the transfer of shares from an individual's estate to heirs or a trust on their behalf.

PART IX - BUSINESS AND POWERS

GENERAL BUSINESS

Summary. Sections 375 to 385 correspond to section 10 of the current *Cooperative Credit Associations Act* but have been extensively restructured in light of the changes to institutional powers announced in the *New Directions* policy paper. These changes eliminate, or consign to regulations, many of the restrictions in the current *Cooperative Credit Associations Act.*

Main business and powers

Sections 375 and 376

Unlike the current legislation governing non-bank financial institutions, which sets out a long list of authorized businesses and powers, this Act provides associations with the powers of a natural person (see section 16) but confines their business activities to those that appertain to the business of providing financial services to members of the association, entities in which the association has a substantial investment and certain other cooperative entities.

"Financial services" is left undefined because the term is still evolving. However, since it may be unclear whether "financial services" include certain activities currently carried on by financial institutions, subsection 375(2) and section 376 specifically authorize associations to engage in a number of these activities. The regulations may set out

restrictions on some of these — in particular acting as a custodian of property; holding or dealing with real property; and investment counselling and portfolio management services.

Networking

Section 377

This section makes clear that associations may enter into networking arrangements to sell any financial service to persons to whom an association may provide financial services directly or a member of a cooperative credit society, subject to the regulations governing the retailing of insurance (see section 381). Such arrangements may include both

- the association acting as agent for persons who provide services that can be provided by a financial institution, or by any other entity in which an association could have a substantial investment pursuant to section 390, and
- the association leasing its premises for use by those persons.

Restriction on guarantees

Section 379

This section is modelled on provisions in the current *Bank Act* and its regulations. It allows an association to make a guarantee on behalf of a third party only if

- the amount of the guarantee is stated as a fixed sum;
- the third party undertakes to unconditionally reimburse the association for the full amount of the guarantee; and
- the guarantee complies in all other respects with the regulations.

The stated amount of such guarantees may be taken into account in the portfolio limit on commercial loans in sections 398 and 399 and the restrictions on certain classes of related party transactions in section 421.

Restriction on securities activities

Section 380

Associations may deal in securities except as prohibited or restricted by the regulations. The principal prohibitions to be set out in regulations are:

- Associations will be prohibited from participating in the primary distribution of corporate debt and equity securities and other classes of equity securities, such as mutual funds.
- Associations will be prohibited from acting as brokers in secondary market trading of equity securities.

Associations will be permitted to carry on other securities activities, including all money market activities, activities relating to government or government-guaranteed securities, and secondary market trading in corporate debt securities.

Restrictions on insurance activities

Section 381

This section contains a number of restrictions on the insurance activities of associations; other restrictions will be set out in regulations. The principal restrictions are:

- Regulations under subsection (1) will prohibit associations from underwriting insurance.
- Subsection (2) prohibits associations from acting as agents for insurance companies and providing space — for example, through networking arrangements — in associations offices to insurance companies, agents or brokers.
- Subsection (5) prohibits associations from exerting pressure on clients to place insurance for the security of the association with a particular insurance agency.

Regulations under subsection (3) will specify the extent of the prohibition against associations "acting as agents" for insurance companies, agents and brokers. Subsections (4) and (5) make clear that none of the restrictions prohibits an association from obtaining group insurance for its own employees, employees of its members or employees of its downstream interests, from requiring insurance to be taken out for its own security, or from requiring that such insurance be taken out with an insurance company it has approved.

Restriction on leasing

Section 382

Associations may engage in financial leasing but must comply with the same restrictions as financial leasing corporations. In particular, restrictions on the leasing of motor vehicles and personal household property will be the same as in the current *Bank Act* and its regulations.

Restrictions on security interests and receivers

Sections 383 and 384

Associations are prohibited from pledging their assets as security, except to secure obligations to the Canada Deposit Insurance Corporation or the Bank of Canada, or in cases approved by the Superintendent. Associations are also required to notify the Superintendent after acquiring any asset subject to an existing security interest.

An association is also prohibited from granting any person the right to appoint a receiver or receiver-manager for the association.

Restrictions on partnerships

Section 385

Associations are prohibited from entering into partnerships with other persons except as a limited partner in a limited partnership or in cases approved by the Superintendent.

PART X - INVESTMENTS

Summary. This Part sets out investment rules based on a "prudent portfolio approach". It essentially replaces sections 11 through 14 of the current *Cooperative Credit Associations Act.*

Definitions and Application

Definitions

Section 386(1)

This subsection defines a number of key concepts used in this Part, including the different types of corporations and unincorporated entities in which an association is permitted to have a substantial investment under section 390. The definitions of "factoring corporation", "financial leasing corporation", "investment counselling and portfolio management corporation", "mutual fund distribution corporation", "real property brokerage corporation", "real property corporation" and "service corporation" are modelled on the current *Bank Act* and trust and loan legislation. The new types of entities in which associations are permitted to have substantial investments are:

"information service corporation" A corporation whose activities are limited to: data processing; providing services relating to information management systems; and designing, developing and marketing computer software and special purpose computer hardware. These activities are subject to restrictions that may be set out in the regulations.

"real property holding vehicle" The unincorporated equivalent of a real property corporation.

"specialized financing corporation" A corporation providing specialized business management, investment, financing and advisory services. These activities subsume those that may be engaged in by venture capital corporation subsidiaries allowed under the current *Bank Act*; they are also intended to cover a wider range of merchant banking activities than is allowed under the current *Bank Act* and trust and loan companies legislation. As in the current provisions governing banks' venture capital subsidiaries, the activities of specialized financing corporations will be subject to terms and conditions set out in the regulations.

The section also contains several other new definitions, the more significant of which are:

"commercial loan" This term is defined to include not only loans in the conventional sense but also certain loan substitutes (see the definition of "loan" below) and investments in debt and equity securities of corporations and unincorporated entities. The definition does, however, exclude several classes of "loans" and investments that are not to be considered commercial loans. These include:

- loans to a central cooperative credit society registered under this Act;
- mortgage loans that are insured or meet certain requirements regarding loan-to-value ratios;
- certain deposits by an association with another financial institution other than an association designated by the Superintendent;
- "loans" and investments in debt obligations directly or indirectly backed by the guarantee of a government or prescribed international agency, such as the World Bank and other international development banks;
- "loans" and investments in debt obligations either directly or indirectly backed by the guarantee of another financial institution or secured by deposits with any financial institution, including the association;
- investments in debt or equity securities that are widely distributed within the meaning of the regulations; and
- investments in participating shares.

"loan" The definition of "loan" used in defining "commercial loan" has a modified meaning that incorporates close substitutes for loans, such as acceptances and other guarantees, financial leases, conditional sales contracts, repurchase agreements, and similar arrangements.

"participating share" This term embraces both voting and non-voting common shares; it excludes preferred shares that have characteristics that make them close loan substitutes.

"prescribed subsidiary" The regulations will set out which classes of entities controlled by an association are to be consolidated with the association in applying the portfolio limits in sections 398 to 403. In particular, the regulations are expected to set out the following rules:

- For any portfolio limits that differ between federally incorporated deposit-taking institutions on the one hand, and insurance companies and securities dealers on the other, the insurance company and securities subsidiaries of an association will not be consolidated.
- Where joint ventures to invest in real property are structured as real property corporations, these will not normally be consolidated for

the purposes of the real property limits. [The method of calculating the value of such interests would instead be set out in the real property valuation regulations under section 392.]

- Other subsidiaries listed in subsection 390(1) will normally be consolidated.

- In all other cases — notably where control of an entity is acquired through realization of security interests or loan workouts referred to in sections 394 or 395 — such entities will not be consolidated. The same inclusions and exclusions will apply in consolidating a parent association's regulatory capital for the purposes of sections 398 to 403.

Non-application of Part

Subsection 386(3)

An association is considered *not* to have made an investment in real property or in securities of an entity solely because it has a security interest in those assets.

General Constraints on Investments

Summary. Sections 387 to 389 set out a general requirement that associations maintain a prudent portfolio of investments and a general rule governing substantial investments of an association. They also provide for regulations determining the amount or value of various classes of loans, investments and other interests that are subject to this Part, and regulations limiting the exposure of a company to a single person or group of connected persons.

Investment standards

Section 387

This section requires the board of directors of an association to establish standards and procedures governing its lending and investment activities with a view to maintaining a portfolio of loans and investments that is "reasonable and prudent" when viewed as a whole. In addition to adhering to such standards and procedures, associations must also comply with the portfolio limits on certain classes of loans and investments set out in sections 397 to 403.

General rule governing substantial investments by associations and principal exceptions

Section 388

This section sets out the general rule that associations are not permitted to have or increase a substantial investment in any entity. The principal exceptions to this rule are:

- substantial investments acquired indirectly through subsidiaries of a financial institution or specialized financing corporations;

- substantial investments in other entities engaged in providing financial or other related services, as permitted by sections 390 and 391; and

- substantial investments acquired through realizations or loan workouts, or as temporary investments (see sections 393 to 395).

Regulations setting single exposure limits and valuation rules

Section 389

This section provides for two different classes of regulations:

- Paragraph (*a*) provides for regulations determining the value of assets for the purposes of the portfolio limits in sections 397 to 403 and the limit on asset transactions in section 406. In particular, for the purpose of the portfolio limits, they will make clear that the assets of an association include not only those appearing on its own books, but also those of its "prescribed subsidiaries" (see section 386).

- Paragraphs (*b*) and (*c*) provide for regulations limiting the exposure of an association to a single person or group of connected persons.

Subsidiaries and Equity Investments

Summary. **Sections 390 to 396 set out detailed rules governing acquisitions and increases of substantial investments by associations.**

Permitted substantial investments and undertakings

Sections 390 to 392

These sections describe the entities in which an association may acquire permanent substantial investments and the conditions under which it may do so. Subsections 390(1) and (2) contain the list of entities in which an association is permitted to have a permanent substantial investment; these include other financial institutions, various corporations that provide financial services or engage in activities ancillary to the business of financial institutions, real property corporations, and unincorporated real property holding vehicles. Section 391 also allows the Minister to deem certain corporations to be corporations described in section 390 if their activities are substantially similar.

Subsection 390(3) prohibits an association from acquiring a substantial investment in certain corporations unless it also acquires *de jure* control (see section 3). The restriction applies if the corporation is a financial institution or carries on the business of one or more of the following corporations listed in subsection 390(1):

- factoring corporation,

- financial leasing corporation,

- specialized financing corporation, or

- financial holding corporation.

The restriction does not apply to information service corporations, mutual fund corporations, mutual fund distribution corporations, investment counselling and portfolio management corporations, mutual fund corporations, service corporations, real property brokerage corporations, real property corporations, real property holding vehicles, and specialized financing corporations. The requirement for *de jure* control is also waived for foreign corporations in which an association has a substantial investment if it would be illegal or contrary to normal business customs in the foreign jurisdiction for the association to have *de jure* control of the corporation.

Subsection 390(3) also requires Ministerial approval for the acquisition of substantial investments in financial institutions, other than other associations, information service corporations, and specialized financing corporations.

Subsection 390(3)(c) requires that where an association has a substantial investment in a body corporate that carries on the business of one or more of a factoring corporation, a financial leasing corporation or a specialized financing corporation, the body corporate may only provide its services to members of the association and other members of the cooperative movement specified in this section.

When an association acquires control of an entity in which it is permitted to have a substantial investment under section 390, subsections 392(1) to (3) require certain undertakings from the association. Except for subsidiaries that are financial institutions regulated by provincial or foreign jurisdictions, the undertakings required by the Superintendent would involve the activities of the subsidiary, notably its transactions with related parties of the association (see section 413), and access to information about it. For provincial and foreign-incorporated financial institutions, the undertakings would be broadly similar, though a provision for agreements between the Superintendent and regulatory agencies in those jurisdictions permits additional flexibility.

In addition, subsection 392(4) requires an association to obtain an undertaking from all entities it controls to provide the Superintendent reasonable access to their records.

Temporary investments

Section 393

Associations may acquire or increase substantial investments on a temporary basis if they undertake to do all that is necessary to dispose of them within two years, or such longer period as the Superintendent considers necessary. A temporary substantial investment in a body corporate is subject to the additional restriction that an association and the bodies corporate listed in section 390 that are its subsidiaries may not, without the prior approval of the Superintendent, hold shares of the body corporate carrying more than 50 per cent of voting rights.

Subsection (3) is a transitional exemption that will apply to associations that, on the date of introduction of the Bill, have substantial investments acquired under the investment rules in the current cooperative Credit Associations Act Associations will be allowed to temporarily increase such substantial investments, and will only be required to reduce them to their initial level — rather than dispose of them completely — within two years or such longer period as the Superintendent considers necessary.

Loan workouts

Section 394

This section allows an association to acquire any number of shares or ownership interests in entities as part of the working out of loans made by the association that are in default. As with the provision allowing acquisitions through realization of security (section 395), this provision overrides the restriction on acquiring or increasing substantial investments.

The entity whose shares or ownership interests may be acquired may be the debtor in default, any of its affiliates, or any other entity that holds securities of the debtor or its affiliates, or assets acquired from them. As with temporary investments, however, if the acquisition of such shares or ownership interests results in the acquisition of a substantial investment, associations are required to take all steps necessary to dispose of that substantial investment within two years or such longer period as the Superintendent considers necessary.

Subsection (2) is a transitional exemption that applies to associations that, on the date of introduction of the Bill, have substantial investments acquired under the current investment rules. It operates in the same way as subsection 393(3).

Realization of security

Section 395

This section allows associations to acquire any number of shares or ownership interests in entities through the realization of a security interest held by the association. As with loan workouts (section 394), it overrides the restriction on acquiring or increasing substantial investments. In addition, it overrides all other restrictions on share acquisitions under the Act, including the prohibitions in Part XII on related party transactions.

As with loan workouts, if the acquisition of such shares or ownership interests results in the acquisition of a substantial investment, associations are required to take all steps necessary to dispose of it within two years or such longer period as the Superintendent considers necessary. Subsection (3) is a transitional exemption modelled on subsection 393(3) that applies to associations with substantial investments when the Bill is introduced.

The Minister may waive the disposition requirement entirely in cases where the entity in which the substantial investment was acquired is one that the association could acquire under section 390.

Regulations restricting ownership

Section 396

This section is modelled on subsection 193(7) of the current *Bank Act* and provides for regulations imposing restrictions, terms and conditions on the ownership of shares or ownership interests by an association under sections 390 to 395. These will include regulations modelled on existing *Bank Act* regulations governing the activities of an association's financial leasing, specialized financing and real property subsidiaries.

Portfolio Limits

Treatment of realizations and loan workouts for the purposes of the portfolio limits

Section 397

This section makes clear how investments acquired through realizations and loan workouts are to be treated in determining the total of various classes of investments subject to the portfolio limits in sections 398 to 403. The general rule is that investments acquired in this way do not count for 12 years, in the case of the portfolio limits on interests in real property, and for two years, in the case of all other portfolio limits.

Commercial Loans

Limits on commercial lending

Sections 398 to 400

Where an association has less than $25 million in regulatory capital, the total value of commercial loans held by the association and its prescribed subsidiaries is limited to 5 per cent of the total assets of the association. The regulations will define "total assets" to incorporate the assets of an association's prescribed subsidiaries.

Section 399 permits an association with more than $25 million in capital to exceed the 5 per cent of capital limit on commercial loans with the approval of the Superintendent and in accordance with such terms and conditions as may be specified by the Superintendent.

Real Property

Portfolio limits on real property

Sections 401 and 402

An association and its prescribed subsidiaries are not permitted to acquire an interest in real property or make an improvement to real property in which they have an interest if, after the acquisition or improvement, the total value of such real property holdings would exceed 35 per cent of the association's regulatory capital. The

regulations under section 402 will set out rules for calculating the value of interests in real property. The purpose of the regulations will be to make clear the distinction between

- the types of exposure to real property that are subject to the real property portfolio limits: equity investments by associations and their prescribed subsidiaries in real property and commitments that are the equivalent of such investments, and

- the types of exposure to real property that are not subject to the limits: debt financing provided by associations to real property ventures in which they have an interest, where the financing is on the same terms as their other commercial lending.

Equities

Portfolio limits on investments in equity securities

Section 403

An association and its prescribed subsidiaries may not acquire portfolio investments in participating shares (see the definition in section 386) or ownership interests in unincorporated entities if, after the acquisition, the total value of such securities would exceed 35 per cent of the association's regulatory capital. This test does not include shares of corporations mentioned in section 390 or 391 in which the association has a substantial investment.

Miscellaneous

Superintendent may order divestment of illegal investments

Section 404

The Superintendent may order an association to dispose of any investment acquired in contravention of this Part. In addition, the Superintendent may order an association to

- dispose of any investment in equity securities of an entity — other than one in which it is permitted to have a substantial investment — if the investment enables it to control the entity;

- take the necessary steps to terminate any arrangement allowing it to exercise a veto over any proposal put before the board of directors or other governing body of an entity, other than a permitted substantial investment; or

- dispose of any substantial investment in an entity in respect of which the association has failed to provide, obtain or ensure compliance with the undertakings referred to in section 445.

Deemed temporary investment

Section 405

When an association has a substantial investment in an entity and becomes aware of a change in the entity's business or affairs that would have precluded it from acquiring the substantial investment, the association is deemed to have acquired a temporary investment in the entity (see section 393) on the day it became aware of the change. This requires the association to dispose of the substantial investment within two years or such longer period as the Superintendent considers necessary.

Assets transactions

Section 406

An association must obtain the approval of the Superintendent before entering into a single large transaction — one with a value in excess of 10 per cent of the total assets of the association — or a series of direct or indirect transactions with a single person over any 12-month period that together would amount to a large transaction. As in the portfolio limit on commercial lending (sections 398 to 400), "total assets" are to be defined to incorporate the assets of an association's prescribed subsidiaries.

This restriction does not apply to transactions involving members' assets that are frequently traded and easily valued, such as government securities, money market instruments and other widely-distributed debt securities.

Transitional rules

Sections 407 and 408

These sections grandfather existing loans, loan commitments, and investments allowed under the current *Cooperative Credit Associations Act* but prohibit any increases in them if they would be prohibited by this Act.

PART XI - ADEQUACY OF CAPITAL AND LIQUIDITY

Adequacy of capital and liquidity

Section 409

Associations are required to maintain adequate capital and liquidity and comply with any regulations concerning them. In addition, even though an association may be complying with the regulations, the Superintendent may direct it to increase its capital or provide additional liquidity to ensure it meets the requirements for adequate capital and liquidity.

PART XII - SELF-DEALING

Summary. This Part sets out a general ban on self-dealing and a number of exceptions.

Interpretation and Application

Definition of related party

Section 410

Subsection (1) lists the classes of persons who are related parties of an association for the purposes of this Part. These include:

- persons other than members who have a significant interest in any class of shares of an association;
- directors and officers of the association;
- spouses and minor children of natural persons listed above;
- entities in which the association's directors or officers, or any of their spouses or minor children have a substantial investment; and
- entities controlled by any of the above.

In addition, the Superintendent may designate any other specific persons or classes of persons as related parties if they have an interest or relationship that might reasonably be expected to affect the behaviour of the association in any transaction involving those persons.

Finally, a person is deemed to be a related party in any transaction entered into in the expectation that the person will subsequently become a related party.

General exemptions from the application of this Part

Section 411

This section exempts from the restrictions and requirements of this Part:

- transactions entered into before the coming into force of this Part (though renewals or subsequent changes to their terms *would* be subject to its provisions);
- the issuing of shares of the association to related parties or the payment of dividends on such shares; and
- the payment of salaries, fees and other fringe benefits normally included in the remuneration packages of directors, officers and employees of the association, except when the remuneration is for duties outside the ordinary course of business of the association, or for the purchase of services referred to in paragraph 419(1)(*a*).

Definition of "transaction" and "loan"

Section 412

This section defines the term "transaction" to include, for the purposes of this Part, not only transactions with related parties, such as loans made by an association to its related parties, but also:

- guarantees given to third parties on behalf of related parties,
- investments in related party securities, including those acquired from unrelated third parties,
- the acquisition by an association of loans originally made to related parties by third parties, and
- the taking of a security interest in related party securities for a loan or other obligation of a third party.

As in Part X (Investments), the definition of "loan" in this Part includes close loan substitutes such as financial leases, conditional sales contracts, repurchase agreements, and other similar arrangements.

Prohibited Related Party Transactions

General prohibition on transactions with related parties and application of self-dealing rules to entities controlled by an association

Section 413

Subsection (1) sets out a blanket prohibition against entering into related party transactions. The exceptions to this rule are set out in sections 414 to 424.

Subsections (2) to (4) require associations to ensure that the entities they control comply with the restrictions of this Part: transactions entered into by such entities are treated as if they were entered into by the association itself. Subsection (3) provides an exemption to make clear that this requirement does not apply to subsidiaries that are provincially incorporated financial institutions, provided the Minister is satisfied that the provincial subsidiary is subject to essentially equivalent rules regarding its transactions with the related parties of the parent.

Permitted Related Party Transactions

Exemption for nominal or immaterial transactions

Section 414

This section permits all transactions of nominal or immaterial value. The conduct review committee of every association must set out the criteria for materiality, which must be approved in writing by the Superintendent.

Exceptions: lending to and borrowing from related parties

Sections 415 to 417

A limited range of exceptions from the general ban on related party transactions applies to borrowing transactions among related parties. In particular, associations may

- make loans to related parties that are fully secured by federal or provincial government securities;
- make mortgage loans to related parties that are secured by the principal residence of the related party;
- deposit funds for cheque-clearing purposes with a related party financial institution that is a direct clearer or a member of a clearing group under Canadian Payments Association by-laws; and
- borrow funds from related parties, notably by taking deposits from them or issuing them subordinated indebtedness.

Exceptions: sale, purchase and leasing of assets

Section 418

This section sets out a number of exceptions from the general ban on related party transactions. These exceptions cover a number of different classes of transactions involving the sale, purchase or leasing of assets to or from related parties in general, or to or from a particular class of related parties.

Asset transactions involving related parties generally:

Associations may enter into transactions with any related party to

- acquire federal or provincial government securities, securities guaranteed by those governments, or assets — such as loans — fully secured by such securities;
- lease space in buildings for use by the association in the ordinary course of business; or
- acquire or lease goods — excluding real property, securities, loans and other financial assets — used by the association in the ordinary course of business.

Associations may also sell or lease any assets to any related party provided an active market exists for the sale or leasing of the assets and the sale or lease payments are in money.

Asset transactions involving particular classes of related parties:

Associations may also enter into transactions with other related financial institutions to acquire and dispose of any asset, other than real property, in the ordinary course of business if the Superintendent has

approved the arrangement. The principal purpose of this provision is to accommodate recurring asset transfers between parent financial institutions and their subsidiaries, such as regular transfers of mortgage loans between a mortgage loan company and its parent.

Exceptions: provision and purchase of services

Section 419

This section provides exceptions from the general ban for transactions involving the provision or purchase of certain services by an association. Specifically, an association may

- purchase from related parties services that it normally uses in the ordinary course of business;
- enter into networking arrangements for the sale of services with related parties that are either a financial institution or an entity in which the association is permitted to have a substantial investment pursuant to section 390;
- enter into arrangements with related parties for the establishment, management or administration of pension or benefit plans for the benefit of officers and employees of the association or its subsidiaries; and
- provide management, advisory, accounting, information, processing or other services in relation to the business of the related party.

Where an association has entered into a contract involving the purchase of services from related parties and the combined effect of all such contracts is that substantially all of the management functions of the association are exercised by persons who are not its employees, the Superintendent may order the association to ensure that its own employees resume the exercise of its essential management functions.

Exceptions: transactions with directors, officers and their interests

Sections 420 to 422

These sections set out the rules governing transactions with the following classes of related parties:

- natural persons who are directors or officers of an association or of an entity that controls it (or their spouses or minor children), but who are not otherwise related parties;
- entities in which the directors or officers of an association (or their spouses or minor children) have a substantial investment; and
- entities controlled by the directors or officers of an entity that controls the association, or their spouses and minor children.

In particular, subsection 420(1) allows an association to enter into any type of transaction with these related parties, subject to a number of restrictions in the case of certain classes of transactions.

Subsections 420(2) to (4) govern the making or acquisition — by an association — of loans to its full-time officers:

- The aggregate of all such loans to any full-time officer of an association may not exceed the greater of $50,000 and the officer's annual salary.

- For the purposes of the $50,000 limit, the term "loan" is used in the modified sense of section 412. The limit does not, however, apply to margin loans to an officer or to loans secured by a mortgage on the officer's principal residence.

- Both mortgage loans secured by an officer's principal residence and the class of "loans" that is subject to the $50,000 limit are considered part of officers' compensation packages: they are the only permitted related party transactions that need not be entered into on market terms and conditions (see section 425).

Section 421 governs the following classes of transactions with any related party referred to above (including associations' full-time officers):

- making any "loan" (as defined in section 412) to the related party;

- acquiring any "loan" made to the related party by a third party;

- making guarantees on behalf of the related party; and

- investing in securities of the related party.

Subsection 421(1) is not a restriction in itself, but shifts the responsibility for approving such transactions to the board of directors of an association in cases where, after the proposed transaction, the aggregate value of

- all loans to any single related party held by the association and its subsidiaries,

- all guarantees on behalf of that related party made by an association and its subsidiaries, and

- all investments in securities of that related party that are held by the association and its subsidiaries

would exceed 2 per cent of the regulatory capital of the association. Two-thirds of the directors in office at the time of the proposed transaction must approve the transaction in advance.

Subsection 421(2), on the other hand, is a portfolio limit similar to those in Part X and limits total exposure to all such related parties — in the form of loans to them, guarantees on their behalf, and investments in their securities — to 50 per cent of an association's regulatory capital.

The following valuation rules apply in determining the aggregate value of loans, guarantees and investments under subsections 421(1) and (2):

- Nominal or immaterial transactions (see section 414) are not counted.
- Neither mortgage loans on the principal residence of a related party nor preferential loans subject to the $50,000 limit (in the case of full-time officers of an association) are counted.
- Loans secured by government securities are not counted toward the 50 per cent limit, but are counted toward the 2 per cent threshold.

Section 422 makes clear that the making of margin loans to an association's directors or officers may be made subject to additional terms and conditions set by the Superintendent.

Other exceptions

Sections 423 and 424

Regulations under these sections may provide additional flexibility to accommodate other classes of related party transactions found not to raise prudential concerns. In addition, the Minister, on the recommendation of the Superintendent, may approve proposed related party transactions on a case-by-case basis if the Minister is satisfied they do not result from any undue influence on an association and would not significantly affect the interests of a related party of the association.

Restrictions on Permitted Transactions

Permitted related party transactions to be on market terms and conditions

Section 425

Except for preferential loans to full-time officers under section 420, all permitted related party transactions — including restructuring transactions approved by the Superintendent and special-case transactions approved by the Minister — are required to be under terms and conditions at least as favourable to the association as market terms and conditions. Market terms and conditions are defined as

- the terms and conditions that would ordinarily be expected to apply in a similar transaction conducted in an open market under conditions requisite to a fair transaction between arm's length parties acting prudently, knowledgeably and willingly.

Related party transactions require prior approval of conduct review committee

Sections 426 and 427

These sections set out the general rule that all proposed transactions of an association with related parties be reviewed and approved by the association's conduct review committee. In addition, when a person ceases to be a related party of an association, transactions with that person continue to be subject to review for twelve months. The conduct review committee must be satisfied the transaction is on terms at least as favourable to the association as market terms and conditions.

The requirement for approval by the conduct review committee does not apply, however, to transactions that

- are nominal or immaterial in value (see section 414);
- consist of preferential loans to full-time officers under section 420;
- must be approved by two-thirds of the directors under subsection 421(1); or
- are exempted from this requirement by regulation.

For additional flexibility, subsections 426(2) and (3) make clear that the conduct review committee may approve general arrangements covering a series of similar transactions. It must review the arrangements at least once a year.

Disclosure

Associations must seek disclosure of interests of possible related parties

Section 428

In considering transactions with a person who it has reason to believe is a related party, an association must take the measures necessary to obtain full disclosure from that person of any interest and relationship that would make the person a related party. The association, its directors, officers, employees and agents enjoy legal immunity for actions taken or omitted to be taken in reliance on any such disclosure.

Associations to notify Superintendent of the discovery of inadvertent violations

Section 429

Where an association inadvertently enters into a prohibited related party transaction or one requiring approval under subsection 421(1) or section 426 or 427, it must immediately notify the Superintendent upon discovering the violation.

Remedial Actions

Sanctions: illegal transactions may be overturned

Section 430

Where a prohibited related party transaction takes place, either the association or the Superintendent may apply for a court order setting it aside and ordering the related party to pay compensation to the association.

PART XIII - REGULATION OF ASSOCIATIONS

Supervision

Summary. Sections 431 to 438 contain reporting requirements and provisions for the inspection of associations and the valuation of association assets. Their goal is to ensure that the Superintendent can accurately assess the true financial condition of associations governed by the Act. The provisions correspond to the "Annual Statement", "Auditor", and "Superintendent" provision found in Part II of the current *Cooperative Credit Associations Act.*

Superintendent may require associations to provide information

Section 431

This section is designed to harmonize the publication requirements under the various federal statutes governing financial institutions. The Superintendent will issue guidelines describing periodic returns that will be required and may also from time to time seek specific information about the business and financial condition of any association governed by the Act.

Returns and principal corporate records

Sections 432 to 434

Sections 432 to 434 are modelled on the current *Bank Act* and require associations to provide the Superintendent with copies of the associations by-laws, an annual report on the directors and auditor of the association, and notification of certain changes in the information contained in the report. They also require the Superintendent to establish a public register containing copies of those documents as well as the incorporating instrument of the association.

Confidentiality of information received by the Superintendent

Section 435

This section complements the provision governing confidentiality of information contained in the *Office of the Superintendent of Financial Institutions Act.* As in that Act, all information on the business and affairs of an association obtained by the Superintendent is confidential and must be treated accordingly.

The section also makes clear that the Superintendent may disclose such information to other agencies with responsibilities for regulating

financial institutions if satisfied they will also treat the information as confidential.

Publication of information

Section 436

This section is modelled on a provision in the current *Bank Act* and requires the Superintendent to publish any information obtained pursuant to the Act as the Minister may determine.

Inspection of Associations

Examination of associations

Sections 437 and 438

These sections provide for examination of every association by or on behalf of the Superintendent at least once a year. The Superintendent, or the person acting on behalf of the Superintendent, has a right of access to the records of an association and may require its directors, officers and auditor to provide any information or explanation that may be required regarding the condition and affairs of the association, its subsidiaries, or any entities in which it has a substantial investment. The Superintendent has the powers of a commissioner appointed under Part II of the *Inquiries Act* and may delegate those powers.

Remedial Powers

Summary. Sections 439 to 452 provide the Superintendent with the power to issue directions of compliance (sections 439 and 440), to obtain court enforcement of the Act (section 441), and to take control of associations or their assets under certain conditions (section 442 to 452). They correspond to sections 71 through 75 of the current *Cooperative Credit Associations Act.*

Directions of compliance

Sections 439 and 440

The Superintendent may issue directions to an association or persons involved in its operations requiring them to:

- cease any action or conduct the Superintendent believes to be an unsafe or unsound business practice, or
- take measures the Superintendent considers necessary to remedy the situation.

The Superintendent must give the association or person a reasonable opportunity to make representations before issuing a direction of compliance but may issue a temporary direction if the length of time required to allow an association or person to make representations would be prejudicial to the public interest. Both types of direction may be appealed: first to the Minister, then to the Federal Court-Trial

Division. A decision of the Minister cannot be stayed by an appeal to the court without the consent of the Superintendent.

Court enforcement of the Act

Section 441

This section allows the Superintendent to apply for a court order if an association or person contravenes the Act or fails to comply with a direction of compliance. Orders of the court may be appealed in the usual manner.

"Temporary" control of assets by the Superintendent

Section 442

This section allows the Superintendent to take temporary control of the assets of an association, as well as the assets held under the administration of the association, if the Superintendent is of the opinion that

- the assets are not satisfactorily accounted for;
- it has failed to pay its obligations as they come due, or is likely to fail to do so;
- its assets are inadequate to protect the interests of its creditors; or
- some other practice or state of affairs exists that is materially prejudicial to the interests of its creditors.

Report to Minister regarding grounds for taking "temporary" control

Section 443(1)

The Superintendent must report to the Minister when

- the Superintendent takes temporary control of an association's assets under section 442,
- the requisite conditions for taking temporary control under section 442 exist; or
- the membership of an association has fallen below the minimum required for incorporation as set out in section 24 of the Act.

Notice of report to provincial minister

Section 443(4)

Where a report required under subsection 443(1) is in respect of a provincial central, the Superintendent must notify the appropriate provincial minister.

Further action by the Minister leading to assumption of control over an association's business and affairs

Section 443(2) to Section 452

The Minister, after receiving a report under subsection 443(1) and giving the association a reasonable opportunity to be heard, may give the association additional time to rectify the situation. Alternatively — or subsequently, if the association fails to rectify the situation — the

Minister may direct the Superintendent to take full control over the business and affairs of the association. The powers of its directors and management are suspended and the Superintendent is authorized to manage the association and assume all of their duties and functions.

The Minister may also at any time seek a winding-up order under the *Winding-up Act*. Alternatively, if the Minister believes that the association has ben restored to a state that meets the requirements of the Act and that control can properly be restored to its directors and officers, the Minister may direct the Superintendent to relinquish control.

PART XIV - ADMINISTRATION

Legal rules governing notices, documents and declarations required under the Act

Sections 453 to 459

These sections set out a number of legal rules and requirements, including:

- provisions for sending notices, including notices to directors or shareholders, or to the association (sections 453 and 456);
- a legal presumption that the list of directors sent by an association to the Superintendent is accurate and that certain notices or documents are received within a certain period after they are sent (sections 454 and 456 and subsection 455(1));
- an exemption from the requirement that a notice or document be sent to a shareholder after the third unsuccessful attempt to do so (subsection 455(2));
- rules of evidence governing certified statements of certain facts issued by an association, the validity of entries in an association's securities register, and the verification of documents or facts required by the Act or by the Superintendent (sections 457 to 459).

Certain orders exempt from publication requirements

Section 460

To ensure confidentiality of the business and affairs of associations and other persons subject to the Act, this section provides an exemption from the requirement in the *Statutory Instruments Act* that all statutory instruments — including regulations, guidelines, orders, and directions — be made public. The exemption applies to all instruments issued and directed toward a single association or person except for case-by-case Ministerial approvals of self-dealing transactions under section 423.

Required form of applications

Section 461

This section replaces provisions in the current legislation that set out detailed forms to be used in making applications to the Minister or

Superintendent. It provides greater flexibility by allowing the Superintendent to specify the form that such applications should take.

Decisions of Minister appealable to the Federal Court

Section 462

This section provides that directions and decisions of the Minister may be appealed to the Federal Court—Trial Division in the following cases:

- a decision of the Minister to dismiss an appeal of the Superintendent's decision to revoke or amend an authorization or to add conditions and limitations to an association's commencement order (see section 62);
- a decision of the Minister to dismiss the appeal by an association or person of a direction of compliance issued by the Superintendent (see section 440);
- an order of the Minister that a person not vote shares acquired in contravention of the ownership provisions, or that the person dispose of such shares (see section 368); and
- an order of the Minister to the Superintendent to take control of the business and affairs of an association under section 443.

Any person launching an appeal may require the Minister to provide a certified copy of the order or decision, along with the reason for it. The court has the power to set aside any such direction or decision and/or refer the matter back to the Minister or Superintendent.

Authority to make regulations

Section 463

This section provides the regulation-making authority for all regulations referred to in this Act for which such authority has not been provided elsewhere in the Act.

Delegation of Minister's authority to Minister of State (Finance)

Section 464

Any of the powers, duties and functions of the Minister of Finance under this Act may be delegated to a Minister of State.

PART XV - SANCTIONS

Summary. **This Part sets out the offenses and sanctions under the Act. It differs from the current legislation governing federal financial institutions, in which the various provisions governing offenses and sanctions are widely separated.**

Offenses

Section 465

A person is guilty of an offence when the person contravenes any of the provisions of the Act or its regulations without reasonable cause. In addition, the following persons are also guilty of an offence:

- a director, officer or employee of an association who gives a fraudulent preference to any creditor of the association;
- a director, officer or auditor of an association who fails to provide the Superintendent with any information required under section subsection 437(2); and
- any person who uses the name of an association in any document relating to a securities transaction in contravention of the rules set out in the regulations.

Sanctions and other enforcement

Sections 466 to 471

Offenders under the Act may be prosecuted and punished on summary conviction by fines of up to $100,000 and/or a prison term of up to a year, in the case of a natural person, and by fines of up to $500,000, in the case of an entity. In addition:

- The court may order the person to comply with the provision of the Act that was violated.
- If a violation results in a financial gain to the person or a close relative of the person, the court may impose an additional fine in the amount of the gain.
- Where a violation is committed by an entity, the officers, directors or agents of the entity who participated in the offence are also guilty and may be prosecuted even if the entity itself is not prosecuted.

In addition to being prosecuted, offenders may be made subject to compliance or restraining orders granted by a court on application by the Superintendent or any complainant or creditor.

The above-noted provisions do not, however, invalidate any contract entered into in contravention of any provision of the Act.

All orders of a court under this Act may be appealed to the relevant appeals court in the usual manner. Fines are payable to Her Majesty in right of Canada.

PART XVI - CENTRAL COOPERATIVE CREDIT SOCIETIES

Summary. Sections 472 to 480 contain provisions whereby a Provincial Central Cooperative Credit Society may, by order of the Superintendent, make itself subject to certain provisions of the federal Act.

Superintendent may issue an order applying this Part to centrals

Section 473

This section details the information to be submitted by a central to allow the Superintendent to issue an order applying this Part to a central.

Sections of the Act that apply to centrals

Section 474

This section sets out those sections of the Act which apply to centrals which have obtained an order. It further provides that a central can only accept the powers of the federal Act if authorized by the laws of its province, but it may exercise all the powers conferred on it by the province except for certain prudential restrictions and the investment limitations.

Additional Powers

Section 475

- A central may make loans to and invest in the shares of a cooperative credit society or cooperative corporation that is its member, or in an association of which it is a member, without the loans or investments being considered a commercial loan.
- A central may create a security interest to secure an obligation to an association of which it is a member.
- A central may issue an unlimited guarantee of payment items in accordance with the by-laws and rules of the Canadian Payments Association.

An order under this Part may contain additional authorities, conditions and restrictions

Section 476

The Superintendent may impose such terms and conditions in an order issued under section 473 as is deemed necessary. In addition, the Superintendent may vary any such order, providing any conditions or limitations are consistent with the Act.

Publication of notice of issuance of an order

Section 477

Both the central and the Superintendent are required to publish a notice of the issuance of an order under this Part.

Revocation of an order

Sections 478 and 479

The Superintendent may revoke an order issued under section 473 if the central ceases to be a member of an association or if the central applies to have the order revoked.

The section provides that the Superintendent may not revoke an order unless he is satisfied that the provincial authorities have been notified and that the central is in sound financial condition.

Transitional

Section 480

A central to which section 92 of the former Act applied is deemed to be a central for which an order has been issued under section 473.

PART XVII - LOANS TO ASSOCIATIONS AND DEPOSIT PROTECTION AGENCIES

This Part authorizes the Canada Deposit Insurance Corporation to act as a lender of last resort to associations, central cooperative credit societies, and deposit protection agencies which provide deposit insurance for credit union members and emergency liquidity funds to credit unions. The provision corresponds to Part V of the current *Cooperative Credit Associations Act.*

For the most part, the liquidity reserves of local credit unions are in the form of demand deposits with the centrals. The centrals, therefore, play a key role in maintaining liquidity in the movement, and the liquidity of the centrals is vital to this role. The *Cooperative Credit Associations Act* provides a regulation-making authority to impose minimum requirements concerning liquidity, but there is no facility whereby emergency liquidity can be provided to the centrals, should that be required.

The *Canada Deposit Insurance Corporation Act* provides for insurance of deposits with banks, trust companies and loan companies, but not deposits with credit unions. It also permits the C.D.I.C. to make loans to member institutions, thus filling the role, in part, of a lender of last resort.

Loans made by the C.D.I.C. as lender of last resort are funded by monies advanced to the C.D.I.C. out of the Consolidated Revenue Fund.

The total of loans outstanding cannot exceed the difference between $200 million and the aggregate of reimbursements for losses made to the C.D.I.C.

Loans may not exceed six months in term, but may be renewed for succeeding terms not in excess of six months each. The rate of interest will be determined by the Corporation at a rate higher than that which an association could obtain if its sources of funds were not substantially exhausted. Both requirements are intended to emphasize the short-term nature of the loan. The Corporation may set such other conditions as it deems advisable.