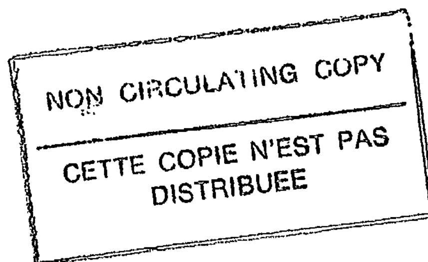
Bank Act
Explanatory Notes

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

Winter 1990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PREFACE

These explanatory notes are intended as a reader's guide to the proposed new Bank Act legislation. 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 banking 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 proposed legislation are the same as those in the Trust and Loan Companies Bill and those to be included in the forthcoming insurance company and cooperative credit association legislation. Accordingly, when these latter Bills are tabled in Parliament, their explanatory notes will discuss only provisions specific to them. Most of the comments in these notes should therefore be interpreted as applying to insurance companies, and cooperative credit associations and trust and loan companies, as well as banks.

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Section 1

This Act is to be cited as the *Bank Act* and will replace the current *Bank Act*.

PART I - INTERPRETATION

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 559 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:

"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 VII to XI) 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 dealing in securities and the business of trust, loan or insurance companies or coöperative credit societies.

"incorporated" References to companies "incorporated" under this Act also apply to companies continued or amalgamated under this Act.

"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.

"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 473 to 477 and in the limit on certain classes of related party transactions in section 495. The term does *not* refer to the minimum capital requirements for the purpose of the capital adequacy requirements in section 483 or to the minimum start-up capital requirement of subsection 46(1).

"subordinated indebtedness" This term replaces the terms "bank debenture" in the current *Bank Act* and "subordinated note" in the current *Trust Companies Act* and *Loan Companies Act* (see section 80).

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:

"complainant" This Act makes explicit the Superintendent's role in the remedial measures provisions of sections 335 to 339 and 568 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.

"foreign bank" The definition of "foreign bank" has been enlarged to include a foreign institution that would not be a foreign bank according to the definition of the current *Bank Act* but that controls a Schedule II bank.

"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 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.

Interpretation

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*) 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)(*d*)".

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.

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 "shareholder"

Section 7

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

Definition of "significant interest"

Section 8

The concept of a "significant interest" is defined in reference to a class of shares of a bank and is used primarily in Part VII 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 a bank 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 8(2) makes clear that an **increase** in a significant interest in a class of shares of a bank 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" constitutes deemed acquisition of shares, etc.

Section 9

The concept of persons "acting in concert" is used in connection with the requirements in Part VII for ministerial approval of acquisitions or increases of significant interests in classes of shares of a bank. By virtue of this concept, two or more persons who individually may not have a significant interest, but who act jointly in respect of their interests in a bank, 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".]

Persons who have a significant interest in a bank by reason of an agreement to act in concert may also be designated as related parties of a bank for the purposes of Part XI (see section 484).

Subsection 9(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 9(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 9(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 10

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

- In the investment rules (Part IX), banks 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 a bank).

- The concept is also used in section 484 to identify which downstream interests of certain related parties of a bank are themselves considered to be related parties of the bank.

Under subsection 10(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 or
- represent ownership of more than 25 per cent of its shareholders' equity.

For the purpose of the latter test, different classes of shares may represent different claims on shareholders' 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 10(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 10(2), (3) 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 shareholders' 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 10(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 11

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 to banks

Sections 12 and 14

This Act like the current Bank Act empowers the Minister to exempt an entity from the status of foreign bank. In addition, the order granting the exemption may be revoked or varied. This Act will apply to banks named in Schedule I or Schedule II. Sections 505 to 511 and subsections 563(1) to (3) apply to foreign banks and sections 2, 16, 560, and 565 to 570 apply in respect of foreign banks. Widely-held banks (in which no one has a significant interest) will have their names set out in Schedule I. Closely-held banks will have their names set out in Schedule II. Together with the names of the bank will be set out the address of the head office, the classes of shares of the bank and the number of shares of each class.

PART II - STATUS AND POWERS

Summary. This Part provides banks 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*.

Corporate powers

Sections 15 to 20

This Act confers on banks the rights, powers and capacities of a natural person. As a result of sections 15 and 16:

- A bank has the power to do anything the Act does not expressly prohibit or restrict.
- A bank may contravene the Act or its incorporating instrument without the action being void, but the bank may incur sanctions and other consequences under the Act.
- A bank can carry on business throughout Canada.
- A bank has the capacity to carry on business abroad, subject to the laws of foreign jurisdictions.

Sections 17 to 19 set out standard corporate law provisions, the most important of which are:

- A bank may exercise its powers even in the absence of by-laws.
- Shareholders are not, as a general rule, liable for liabilities of the bank.

Requirement for regular review of this Act

Section 21

This section is similar to a long-standing provision in the current *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 banks 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, CONTINUANCE AND DISCONTINUANCE

Summary. Sections 22 to 41 set out how banks are incorporated, how corporations incorporated under other Acts can be continued under this Act. Sections 40 to 44 set out rules governing the corporate names of banks and their affiliates.

Formalities of Incorporation

Restrictions on incorporation

Sections 22 to 23

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 following restrictions:

- A bank may not be incorporated if the applicant for letters patent is a domestic or foreign government, an agency of such a government, or an entity controlled by such a government. A limited exemption is provided for an applicant controlled by a government if the applicant is a foreign institution or the subsidiary of a foreign institution.
- If a proposed bank would be controlled by a foreign bank with the traditional meaning, the Minister must be satisfied that the bank is capable of making a contribution to the Canadian financial system and that the home jurisdiction of the foreign bank provides or will provide treatment as favourable to Canadian banks as that provided to foreign institutions under this Bill.

Application procedures and public inquiry

Sections 25 and 26

Applicants must publish a notice of their intention to apply for the incorporation of a bank. The application itself must contain the names of the first directors of the bank 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 bank 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 bank.

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

All these factors are also cited in section 391 as matters that must be taken into consideration when the Minister considers an application for significant transfers of share ownership or control of a bank.

Provisions contained in letters patent of incorporation

Section 28

The letters patent incorporating new banks will generally contain only basic information: bank name, location of head office, and date of incorporation. All other matters formerly dealt with in incorporating instruments — in particular the capital structure of a bank — will normally be set out in the bank's by-laws. This permits changes to a bank's capital structure to be made through the "fundamental by-law" provisions of sections 218 to 223 and avoids the need to apply to the Minister for supplementary letters patent under sections 216 and 217.

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.

Letters patent of incorporation on application of certain companies

Section 29

This section corresponds, in a modified form, to section 9 of the current Bank Act and authorizes a financial institution to

incorporate a bank for the purposes of permitting the shareholders of a trust company or other financial institutions to become the shareholders of the bank that holds the shares of the trust company.

Effect of issue of letters patent

Sections 30 to 32

The proposed bank 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.

Continuance

Summary. Sections 33 to 39 deal with continuance, the process whereby a corporation incorporated under one statute or jurisdiction transfers to another.

Application for continuance

Sections 33 to 35

As with new incorporations (section 22), the continuance of a corporation as a bank under this Act is at the Minister's discretion. Corporations may apply for continuance only if they are authorized to do so under their governing statute. Such applications are subject to all the requirements in sections 23 to 28 that apply to new incorporations.

Effect of issue of letters patent

Sections 36 to 38

A corporation is continued as a bank on the date set out in its letters patent of continuance, which may be different from the date of issue. Notice of the issue of the letters patent must immediately be sent to the appropriate government official or body responsible for the corporation, such as the Director under the *Canada Business Corporations Act*; a notice must also be published.

Transitional provisions for continued banks

Section 39

This section is modelled on section 269 of the current *Bank Act*; it recognizes that some corporations continued as banks under this Act may have outstanding business commitments, or hold assets acquired before its continuance, that are not permitted under this Act. It authorizes the Governor in Council to grant continued banks a transition period to comply with this Act in respect of

- their business activities;
- their debt obligations outstanding on the date of the application for continuance;
- the continued issue of voting shares to non-residents on the conversion of outstanding convertible securities of a bank;
- the type of assets they hold; and

- the maintenance of records, or the processing of information arising from such records, outside Canada.

The transition period for the issue of voting shares to non-residents is a temporary exemption from the restrictions in section 400 that prohibit a bank from registering the acquisition by non-residents of shares of the bank in cases where particular non-residents and the entities they control beneficially own more than 10 per cent of the shares of any class, or where non-residents in total beneficially own more than 25 per cent of its voting shares.

Subsection 39(2) limits the period for which the Governor in Council can give permission to carry on a non-conforming practice. For a business activity, the permission can only be given for a period of 30 days after continuance. If the activity is carried on as a result of an existing contractual obligation, the permission expires on the expiry of the obligation. For non-conforming debt obligations, the period may not exceed 10 years. In all other cases, it may not exceed two years.

Subsection 39(3) permits the Governor in Council to renew any permission other than permission relating to business activities or record keeping for as long as the Governor in Council considers necessary. This subsection must be read in conjunction with subsection 39(4), which limits the Governor in Council's ability to extend these periods. The period for non-conforming debt obligations may only be extended if the Governor in Council is satisfied, on proper evidence supplied by the bank, that the bank is not able at law to redeem those obligations at the end of the 10-year period. The initial two-year period for owning non-conforming assets cannot be extended beyond 10 years from the date the bank received its commencement order (see sections 48 and 49).

Corporate Name

Restrictions governing corporate names

Sections 40 to 44

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

- Section 40 prohibits banks from having names forbidden by another federal statute, names reserved for another bank under section 43, 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 41 provides limited exemptions for banks and their affiliates from these restrictions. To allow affiliates of banks to be recognized as such, the Minister may permit banks to have names similar to those of their affiliates. "Affiliate" in these instances is used in the *de jure* sense of subsection 6(2).

If a bank is for any reason incorporated with a prohibited name, section 44 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 - ORGANIZATION AND COMMENCEMENT

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

Organization Meetings

Organization meetings

Sections 45 to 47

At its first meeting following incorporation, the board of directors may deal with matters necessary to organize the bank. These may include making by-laws, appointing officers and two auditors, and authorizing the issue of shares. The first meeting of shareholders may only take place after the bank has raised a minimum start-up capital of $10 million from the issue of shares. The first shareholders' meeting is required to approve, reject or amend the by-laws made by the board of directors and formally elect directors and appoint two auditors.

Commencement and Carrying on of Business

Permission to commence and carry on business

Sections 48 and 49

A bank may not carry on any business until the Superintendent issues a commencement order. Existing licences issued to Schedule II banks under the Current *Bank Act* are deemed to be commencement orders. Unlike licences, which needed to be renewed annually, commencement orders are valid indefinitely.

Restrictions on use of start-up capital before commencement order

Sections 50 and 51

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

Conditions to be met before commencement order

Section 52

Before issuing a commencement order, the Superintendent must be satisfied that a number of requirements have been complied with —

in particular that the first shareholders' 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 52(2) prohibits the issue of a commencement order if the bank is unable to satisfy the issuance requirements within a year of its incorporation. Section 57 provides that the incorporation of the bank lapses in such cases.

Commencement order may contain additional authorities, conditions and restrictions

Sections 53 and 54

Section 53 permits the Superintendent to include in the commencement order conditions and limitations concerning the business of a bank, provided they are consistent with the Act.

Although the commencement order is essentially a once-only event, subsequent changes in circumstance may make it appropriate to alter it. Section 54 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 the authorizations contained in the order and to impose or vary conditions and limitations can only be exercised if the Superintendent has given the bank a reasonable opportunity to make representations on the matter.

Permission to foreign bank subsidiary

Section 55

The Governor in Council may, by order, grant a foreign bank subsidiary permission to hold assets not otherwise permitted by this Act, for a period of two years. The period can be extended for a total of 10 years.

Publication of notice of commencement order

Section 56

Both the bank and the Superintendent are required to publish a notice of the issue of a commencement order. This requirement does not apply to existing banks deemed to have been issued a commencement order under section 48.

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

Sections 57 and 58

As noted above (section 52), if a bank fails to obtain a commencement order within its first year, the bank ceases to exist, except for the purpose of distributing its assets to the shareholders or incorporators and otherwise winding up its affairs.

PART V - CAPITAL STRUCTURE

Summary. This Part of the Act sets out rules governing a bank'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*.

Share Capital

Power to issue shares

Subsection 59(1)

Subsection 59(1) confers on the board of directors of a bank the general power to authorize the issue of shares at any time to any person for any consideration. This general power is subject to the other provisions of the Act (notably section 65 and the ownership restrictions of Part VII) and the by-laws of the bank.

Concept of "par value" shares to be phased out

Subsections 59(2) to (5)

Subsection 59(2) requires that shares of a bank must be in registered form and 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 existing banks and continued banks that may have outstanding par value shares when they come under the jurisdiction of this Act, subsections 59(3) and (4) deem such shares to be shares without par value. In addition, subsection 59(5) 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 "common share" to designate shares

Section 60

Subsection 60(1) requires banks to have one class of shares designated as "common shares" that must carry the right to

- vote at shareholders' meetings;
- receive dividends; and
- receive the remaining property of the bank on dissolution.

Subsection 60(2) prohibits the use of the term "common shares" or any variation of that term for more than one class of shares. Accordingly, a bank may not have one class designated as "common shares" and another class designated as "non-voting common shares". Subsections 60(3) and (4) provide a twelve-month grace period to enable existing banks and continued banks with more than one class of shares designated as "common shares" to redesignate their shares in compliance with the Act.

Restrictions on issue of other classes of shares

Sections 61 and 62

These sections allow banks to issue classes of shares in addition to the common shares described in section 61 if authorized by by-law adopted by special resolution of their shareholders 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 63

Subsection 62(1) establishes the general rule that all voting shares of a bank carry one vote.

Shares to be paid for in money

Sections 64 and 65

Like the current *Bank Act* — but unlike the *Canada Business Corporation Act* — subsection 65(1) allows shares of a bank to be issued only if they are fully paid for in money. Exceptions are made for shares issued

- in exchange for outstanding securities of the bank;
- in the form of a share dividend;
- in exchange for shares of a continued bank;
- in exchange for shares of a trust and loan company or an insurance company for the purposes of section 29
- under an amalgamation or similar agreement; or
- in exchange for shares of another corporation — with the approval of the Superintendent.

Section 64 is a standard corporate law provision: once a share is fully paid, its holder has no other obligation to the bank that issued it.

Transitional rules regarding capital structure

Sections 66 and 67

These sections set out the standard corporate law rules governing the establishment of a stated capital account for each class and series of shares.

Pre-emptive rights

Section 68

Section 68 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 in the circumstances cited as exemptions to the requirement in subsection 65(1) that shares be issued only when fully paid for in 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 69

Banks 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 own shares and equity securities of upstream entities

Sections 70 to 74

In modern corporate law statutes, corporations are usually not permitted to own their own shares or the shares of any corporations that control them *de jure*. Section 70 modifies this prohibition to apply to equity investments in any entity, including an unincorporated entity, that controls the bank within the meaning of section 3. It also requires the bank to prevent its subsidiaries from holding shares of the bank or shares or ownership interests in any entity that controls the bank. Exceptions to these restrictions are set out in sections 71 and 72:

- Section 71 allows banks 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 483.
- Subsection 72(1) allows banks and their subsidiaries to hold such shares or ownership interests as personal representatives, provided they do not beneficially own them.
- Subsection 72(2) allows banks and their subsidiaries to have security interests in such shares or ownership interests, provided the amounts are nominal or immaterial.

The regulations will set out additional exceptions to this rule. One will enable the securities subsidiary of a bank to participate in a distribution of the shares or ownership interests of the bank or its parent entities.

Sections 73 and 74 set out the requirements for disposition of shares and ownership interests in a bank and its parent entities:

- Banks and their subsidiaries must dispose of such shares or ownership interests without delay after acquiring them through the realization of a security interest.
- The subsidiaries of an existing bank that hold such shares or ownership interests on the coming into force of this Act must dispose of them within six months.
- Banks are required to cancel all their shares acquired through issuer bids, redemptions and donations.

Reductions in stated capital

Sections 75 and 76

These are standard corporate law provisions that allow a bank to reduce its stated capital and reimburse shareholders if authorized by special resolution and approved in writing by the Superintendent. As with redemptions and issuer bids (section 71) and dividend payments (section 79), a reduction in stated capital must not result in a violation of the capital adequacy requirements of section 483.

Adjustments to stated capital accounts

Sections 77 and 78

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

Declaration of dividends

Section 79

The board of directors of a bank is authorized to declare a dividend payable in money, property, fully paid shares, or rights to acquire fully paid 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 483.

Subordinated Indebtedness

Subordinated indebtedness

Section 80

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

- Since it is considered an element of a bank 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 — banks are required to specifically refer to it as subordinated indebtedness in public documents.

Security Certificates and Transfers

Procedures for transfer of ownership of security certificates

Sections 81 to 135

Sections 81 to 135 are standard corporate law provisions governing the transfer of security certificates issued by banks. They are substantially the same as Part VII of the *Canada Business Corporations Act* and sections 75 to 108 of the current *Bank Act.*

PART VI - CORPORATE GOVERNANCE

Shareholders

Summary. Sections 136 to 157 set out the basic rights of shareholders and the rules governing shareholders' meetings. They are modelled on sections 137 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 shareholders' meetings, the creation and use of lists of shareholders, and the resolution of disputes by the courts. Unlike the *Canada Business Corporations Act,* this Act does not permit the shareholders to relieve the directors of their responsibility to manage the business and affairs of the bank by a unanimous shareholders' agreement.

Procedures for calling shareholders' meeting

Sections 136 to 147

These sections include a provision that annual meetings of shareholders must be held within six months of the end of each financial year (subsection 137(1)). They also govern

- the calling and holding of shareholders' meetings (sections 136 and 147 and subsection 137(1));
- the fixing of record dates for various purposes, including the payment of dividends and notice of meetings (subsections 137(2) to (5));
- the giving of notice of shareholders' meetings (sections 138 to 142);
- the presentation and consideration of shareholder proposals (sections 143 and 144);

- the preparation and use of shareholder lists (section 145); and
- the determination of a quorum for shareholders' meetings (section 146).

Exercise of voting rights at shareholders' meetings

Section 148

Section 148 allows shareholders only one vote per voting share. It complements section 63, which prohibits the issue of new shares that carry multiple or fractional voting rights.

Procedures for holding shareholders' meetings

Sections 149 to 157

These sections govern the following matters:

- representation at shareholders' meetings of shareholders that are not natural persons (section 149);
- treatment of joint shareholders (section 150);
- voting procedures at shareholders' meetings (section 151);
- adoption of written unanimous resolutions of shareholders in place of shareholders' meetings (section 152);
- requisitioning of shareholders' meetings by groups of shareholders (section 153);
- intervention by the courts when the requirement for shareholders' meetings cannot be met, or when disputes about the election or appointment of directors or auditors must be resolved (sections 154 to 156); and
- establishment of agreements among shareholders to exercise their voting rights in concert (section 157).

Directors and Officers

Summary. Sections 158 to 215 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 158

Subsection 158(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 bank. In addition, subsection 158(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;
- set up procedures to disclose prescribed information to customers; and
- establish appropriate investment and lending policies and procedures.

Subsection 158(3) permits a bank that is a wholly-owned subsidiary of another federally incorporated financial institution to dispense with an audit committee and conduct review committee, if their functions are performed on its behalf by those of the parent financial institution.

Standards of conduct

Section 159

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 bank.

Qualification and Number — Directors

<u>Summary</u>. Sections 160 to 165 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 160

The board of directors must consist of at least seven members. If the bank is a subsidiary of a foreign institution, at least half of the directors must be resident Canadians. In all other cases, at least three-quarters must be resident Canadians.

Certain persons disqualified from being directors

Sections 161 and 162

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 a bank. Section 161 extends the prohibition to the following persons:

- shareholders who are prohibited by the ownership provisions (sections 389, 401 and 402) from voting their shares, as well as the directors, officers and employees of such shareholders;
- ministers, agents or employees of the federal or provincial governments; or
- employees of a foreign government.

Section 162 makes clear that there is no statutory requirement for a director to be a shareholder. Banks may, however, have by-laws requiring directors to hold at least some shares. Such shares — which are referred to in this Act as "directors' qualifying shares" — are not counted in determining whether a bank is a wholly-owned subsidiary for the purposes of subsections 158(3) and 164(2).

Restriction on number of affiliated directors

Sections 163 and 164

No more than two-thirds of the directors of a bank may be affiliated with it. The section 163 definition of an affiliated *person* is different from the section 6 definition of "affiliate" — which applies only to entities — and includes:

- officers and employees of the bank or its affiliates;
- persons with a significant interest in a class of shares of the bank or with a substantial investment in any of its affiliates;
- significant borrowers from the bank, persons who control a significant borrower, and officers, directors and employees of a significant borrower;
- significant suppliers of goods or services to the bank;
- persons who have a loan not in good standing from the bank or any of its affiliates, persons who control an entity that has such a loan not in good standing, and directors, officers and employees of such entities; and
- the spouse of any person referred to above.

Subsection 164(2) provides an exemption from this requirement for banks that are wholly-owned subsidiaries of another federally incorporated financial institution.

Restrictions on number of "inside directors"

Section 165

In addition to the restriction on the number of affiliated directors, no more than 15 per cent of the directors of a bank may be employees of the bank or its subsidiaries. To accommodate banks with small boards, an exception is made to allow up to four employee directors, provided they do not constitute a majority of the board.

Election and Tenure — Directors

Rules governing election and tenure of directors

Sections 166 to 168

These sections set out the general rules for the election and tenure of directors. They are modelled on standard corporate law provisions governing the fixing of the number of directors by by-law, the election of directors at the annual meetings of shareholders, and their terms of office.

Cumulative voting

Section 169

As in the current *Bank Act, Canada Business Corporations Act* and other corporate statutes, this Act gives banks the option of electing their directors by cumulative voting. Unlike those other statutes, however, this Act also *requires* a bank that has more than one shareholder to elect its directors by cumulative voting if any person, whether directly or through entities the person controls, can exercise more than 10 per cent of the voting rights attached to its shares.

Subsection 169(1) is the standard corporate law provision that sets out the procedures for cumulative voting. Under cumulative voting rules:

- The exact number of directors to be elected must be fixed by by-law.
- The total number of votes eligible to be cast is determined by multiplying the number of directors to be elected by the total number of votes attached to all voting shares of the bank.
- Shareholders may cast all of their votes for a particular candidate or may distribute them among more than one candidate.
- A person is elected director if the person is among those receiving the highest number of votes.

These features facilitate the election of directors representing minority shareholders by giving them a better opportunity to influence the vote for a particular candidate than they would have under the standard plurality voting system. In particular, minority shareholders (or groups of such shareholders) can always ensure the election of such a director if they hold a certain minimum fraction (equal to the reciprocal of the number of directors to be elected) of a bank's total voting rights: for example, where the by-laws provide for 20 directors, a minority shareholder who has over 5 per cent of the voting rights is able to elect at least one director.

Re-election of directors

Section 170

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

Incomplete Elections and Director Vacancies

Faulty election of directors

Sections 171 and 172

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 160(2)

or 164(1) or section 165, or if the shareholders fail to elect a quorum of directors at a shareholders' meeting.

- The election of directors at a meeting of shareholders 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 of shareholders to conduct a proper election or fill the remaining vacancies.

Creation of director vacancies

Sections 173 to 174

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

Statements submitted by directors on resignation or replacement

Sections 175 to 176

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 bank giving reasons for the resignation or setting out objections to the removal or replacement. The bank is required to send a copy of the statement to all holders of its voting shares and to the Superintendent.

In addition, subsection 175(2) is a new provision that *requires* a director who resigns as a result of a disagreement with the other directors or management of a bank to submit a written statement to the Superintendent describing the disagreement.

Filling of director vacancies

Sections 177 to 180

These sections provide for the filling of vacancies resulting from events other than void or incomplete elections (see sections 171 and 172):

- Except when vacancies cause a bank to be in violation of the "minimum number" and composition requirements in sections 160, 164 and 165, the by-laws may require that vacancies be filled only by a vote of all shareholders, or of the 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 181 to 187

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 are:

- The rules are extended to apply to meetings of committees of the board as well as the board itself;
- Section 183 fixes the quorum at a majority of the actual number of directors or committee members, rather than a majority of the minimum number of directors provided for in the by-laws. Also, the quorum rule cannot be varied by by-law.
- The "Canadian majority" requirement in section 184 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 188

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 189 to 192

Sections 189 and 190 are standard corporate law provisions governing the making, amendment and repeal of ordinary by-laws by the board of directors, subject to confirmation by shareholders; shareholders may also make by-laws by way of proposals approved at shareholders' meetings. [Section 218 sets out additional provisions governing the making, amendment and repeal of "fundamental" by-laws.]

Sections 191 and 192 provide that by-laws of existing banks 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 193

This Act consigns to by-laws many matters set out in the incorporating instruments of existing banks and corporations continued as banks (see section 28). Section 193 deems such provisions to be set out in the by-laws of existing banks and corporations continued as banks 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 194 to 196

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:

- The majority of members of the two committees must be unaffiliated directors. None may be an officer or employee of the bank or its subsidiaries.
- The audit committee must review the financial statements and returns of a bank, meet with auditors to discuss the financial statements, ensure that the bank maintains appropriate internal controls, and review transactions brought to its attention that could adversely affect the well-being of the bank. 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 XI and ensure that any that might materially affect the stability or solvency of the bank are identified.

Directors and Officers — Authority

Summary. Sections 197 to 202 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 197 to 199

The board is required to appoint one of its members, who must ordinarily reside in Canada, to be the chief executive officer of the bank and may appoint other officers of the bank. 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 shareholders' meetings

Sections 200 to 202

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 203 to 207

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

Liability, Exculpation and Indemnification

Rules governing liability, indemnification and insurance of directors and officers

Sections 208 to 215

These sections set out rules governing

- the liability of directors to the bank and its employees;
- the indemnification by the bank 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.

Amendments

Summary. Sections 216 to 223 govern the amendment of the incorporating instrument and fundamental by-laws of banks. They are loosely modelled on current *Bank Act* and *Canada Business Corporations Act* provisions.

Amendment of incorporating instrument

Sections 216 and 217

These sections enable a bank 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 of shareholders. 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 218 to 223

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 193). 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 bank's head office — requires a special resolution of all 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 the amalgamation of corporations and their continuance as a bank

Sections 224 to 232

These sections are modelled on the *Bank Act* and *Canada Business Corporations Act* and govern the creation of new banks by the amalgamation of existing banks and/or other federally incorporated corporations (including other financial institutions) that are authorized to apply for an amalgamation under this Act. Other corporations seeking amalgamation under this Act must first be continued as banks under the Act (see sections 33 to 39). When a Schedule I bank is part of an amalgamation, the resulting bank must be a Schedule I bank too.

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 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 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. In addition, as with new incorporations and continuances, the issue of letters patent of amalgamation is subject to sections 23 to 28.

Section 228 provides for "short-form amalgamations": streamlined amalgamation procedures to facilitate the amalgamation of wholly-owned subsidiaries of the same person. Section 232 is a provision similar to the one that applies to continuances (section 39) and provides a limited transition period during which newly-amalgamated banks may continue to engage in certain practices that would otherwise be prohibited by the Act.

Transfer of Business

Rules governing the sale of all of a bank's business

Sections 233 to 237

These sections govern the sale of all or substantially all of the assets of a bank to another federally-incorporated financial institution. Most of them closely parallel provisions in sections 224 to 232 governing amalgamations — in particular the requirement for approval of a draft sale agreement by the Minister, the procedures for subsequently obtaining the approval of shareholders, and the three-month time limit for submitting the approved agreement to the Minister.

Ministerial approval is also required before the sale agreement can take effect. Before giving final approval, the Minister must be satisfied that the bank has met all relevant requirements.

Head Office and Corporate Records

Summary. Sections 238 to 248 describe the records banks are required to keep and the rules governing their maintenance and retention. The rules governing them are modelled on similar rules in the *Canada Business Corporations Act* and the current *Bank Act*.

Sections 238 and 239

Location of head office and records to be kept

These sections require a bank to maintain its head office at an address in the place specified in its incorporating instrument or by-laws. They also specify the records a bank must keep and maintain. These include corporate records, such as its incorporating instrument, particulars of any restrictions and conditions or particulars from Schedule I or Schedule II that apply to the bank, by-laws, and minutes of shareholders' and directors' meetings, records of deposit-taking activities.

Sections 240 to 243

Keeping of bank records and access of shareholders and creditors

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

Sections 244 and 245

Form and protection of records

These sections set out rules governing the form in which records may be kept and a requirement that banks 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.

Section 246

Processing of records in Canada

This section requires banks to maintain and process information and data relating to their records in Canada. Banks 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 a bank outside Canada.

Sections 247 and 248

Regulations governing retention of records

Banks are required to retain their records for a period that may vary with the type of record. While the period of retention of certain deposit records is governed by section 439, subsection 247(1) and the regulations under section 248 govern all other 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 249 to 255

These sections establish rules for keeping registers recording the securities issued by the bank 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 256 and 257

These sections require a bank 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 bank's corporate seal.

Proxies

Rules governing proxies

Sections 258 to 266

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.*

Insiders

Rules governing insider reports and insider trading

Sections 266 to 273

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

Prospectus

Prospectus requirements

Sections 274 to 283

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 a bank. Regulations made under section 276 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 banks' securities, section 277 permits the Superintendent to exempt an issue from the prospectus requirements if satisfied that the bank has filed a prospectus substantially complying with these rules in another jurisdiction.

Compulsory Acquisitions

Squeeze-out of minority shareholders after successful takeover bid

Sections 284 to 294

These sections correspond to section 206 of the *Canada Business Corporations Act (CBCA)*. Commonly known as "squeeze-out" provisions, they enable a person who has acquired 90 per cent or more of a class of shares of a bank through a takeover bid to acquire the remaining shares of that class by paying fair compensation to their owners.

Trust Indentures

Rules governing issue of subordinated indebtedness under trust indentures

Sections 295 to 307

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.

Financial Statements and Auditors

<u>Summary</u>. Sections 308 to 334 set out the requirements for financial disclosure by banks 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.

Financial year

Section 308

As in the current *Bank Act*, October 31 is the financial year end for banks.

Annual financial statements and accounting principles

Section 309

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

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

Subsection 309(4) requires banks to prepare financial statements in accordance with generally accepted accounting principles unless the Superintendent specifies otherwise.

Approval of annual statement by the board of directors

Section 310

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 311

A bank is required to keep copies of current financial statements of entities in which it has a substantial investment. Shareholders of a bank and their representatives may examine such statements unless the bank obtains a court order barring access to them.

Distribution of annual statements

Sections 312 and 313

Banks must send a copy of the annual statement to each shareholder at least 21 days before the annual meeting, unless the shareholder waives the requirement. If a bank 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.

Appointment of auditors

Sections 314 and 315

The shareholders are required to appoint two auditors at each annual meeting each of which must be a firm of accountants. This Act differs from the *Bank Act* in that regular rotation in the offices of auditors is not required.

Qualifications for bank auditor

Section 316

At least two members of any firm of accountants appointed auditor of a bank must

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

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

- is a director, officer, employee of the bank or any of its affiliates;
- is a business partner of a director, officer or employee of the bank or any of its affiliates;
- has a material interest in equity securities of the bank or any of its affiliates; or
- has been involved in the receivership, bankruptcy or liquidation of any affiliate of the bank 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 bank.

Resignation and removal of auditor

Sections 317 to 320

An auditor who ceases to be qualified under section 316 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 bank. An auditor may also be replaced by ordinary resolution of the shareholders. The board of directors is authorized to fill any vacancy occurring in the offices of auditors. If it does not, the Superintendent may fill the vacancy.

Attendance of auditor and Superintendent at meetings

Section 321

As in the *Canada Business Corporations Act* and the current *Bank Act*, a bank's auditor is entitled to attend shareholders' meetings and may be required to do so by any director or shareholder. Subsections 321(3) and (4) are new provisions that require the Superintendent to be notified when a director or shareholder requires the auditors to be in attendance at a shareholders' 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 auditors may be required to address.

Statement made by auditor on resignation

Sections 322 and 323

Section 322 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 bank 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 324 to 330

These sections set out rules governing the auditing of banks. In general, auditors must conduct any examinations they consider necessary to enable them to make the report to shareholders on a bank's annual statement required by section 331. To that end, auditors may require directors, officers and employees of a bank 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 325).

Section 324 provides that — as with accounting principles (subsection 309(4)) — audits are to be conducted according to generally accepted auditing standards unless the Superintendent specifies otherwise.

In addition to these requirements:

- The Superintendent may require the auditors of a bank to make special examinations and report on the auditing procedures used in examining the company's annual statement and on the internal control procedures used by the bank (section 326).
- The shareholders of a bank may require the auditors to audit any financial statement prepared for them by the directors and report on whether it fairly presents the information required by shareholders (section 328).
- The auditors of a bank must report to its chief executive officer and chief financial officer, and to the Superintendent, on transactions entered into that are not within the bank'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 329).
- Banks must ensure that one of their own auditors is 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 330).

Auditors' relationship with audit committee and internal auditors

Sections 331 and 332

As in corresponding provisions of the *Canada Business Corporations Act* and the current *Bank Act*, section 331 and subsection 332(1) provide that the auditors of a bank

- are entitled to participate in meetings of the bank's audit committee and must attend every such meeting if requested to do so by a member of the committee; and
- have the power to call a meeting of the committee.

Subsection 332(2) is a new provision that requires the chief internal auditor of a bank to meet with the auditors at the auditors' request.

Detection of errors in financial statements

Sections 333 and 334

Directors and officers are required to notify the auditors 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 335 to 339

These sections are modelled on corresponding provisions in Part XX of the *Canada Business Corporations Act*. Sections 335 to 338 permit the Superintendent or a complainant to bring a derivative action: legal action taken in the name of a bank or any of its subsidiaries if the bank or subsidiary refuses to take the action itself and a court agrees that the action should be taken. Section 339 permits persons adversely affected by errors or omissions in a bank's securities register to apply to a court for an order rectifying the error or omission.

Rules governing voluntary liquidation of banks

Sections 340 to 369

These sections deal with procedures to be followed in the voluntary liquidation of a bank 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 current *Bank Act* and govern

- the liquidation of banks with no assets or liabilities, such as those whose incorporation lapses under section 57 (section 343);
- the liquidation process for other banks and the issuing of letters patent of dissolution by the Minister (sections 344 to 347);
- applications by the Superintendent or any other person for supervision of the liquidation process by a court (sections 348 and 349);
- the powers of the court to supervise a dissolution, including the appointment of a liquidator (sections 350 to 353);
- the duties, powers and privileges of a liquidator (sections 354 to 358);
- the making of a final order of liquidation by the court, the right of shareholders to be paid in money, and the issue of letters patent of dissolution (sections 359 to 361);
- the continuation of legal liability of a bank after its dissolution (sections 362 to 364); and
- the transfer to the Bank of Canada of amounts remaining unclaimed by shareholders after dissolution and the retention of a dissolved bank's records (sections 365 to 369).

Priority on insolvency

Section 370

This section governs the priorities of various classes of creditors when a bank 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 banks 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 VII - OWNERSHIP

DIVISION I

DEFINITIONS AND INTERPRETATION

Summary. This part sets out some definitions and interpretation rules which are special to the Bank Act and in particular special to the ownership rules for banks.

Definitions

Section 371

"agent" This definition is similar to the definition of "agent" in subsection 109(1) of the current Bank Act.

"eligible Canadian financial institution" This refers to a Canadian financial institution (see definition in section 2), other than a bank, that is widely held as described in subsection (2), and therefore "eligible" to own a Schedule II bank.

"eligible financial institution" This term refers to an eligible Canadian financial institution or an eligible foreign institution (see below).

"eligible foreign institution" This expression refers to a foreign bank within the meaning of the traditional definition of foreign bank, and to a foreign institution which would not normally be considered a foreign bank. The foreign bank guidelines will continue to apply to foreign banks, and other foreign institutions must be widely held in the opinion of the Minister. If they meet these criteria both are "eligible" to own a Schedule II bank.

Subsection (2) sets out the criteria for a Canadian financial institution that is widely held for the purposes of making it "eligible" to control a Schedule II bank indefinitely. No person may hold shares to which are attached more than 10% of the voting rights or having an aggregate book value in excess of 10% of the shareholders' equity.

Subsection (3) clarifies that in calculating the shares held by a person for the purposes of the widely held test in subsection (2), the shares held by any entities controlled by that person are to be included.

Associates

Section 372

This section loosely duplicates the concept of "associated shareholder" in subsection 109(2) of the current Bank Act. Subsection (1) states that where two persons are associated and each owns shares of a bank, they are deemed to be one person who owns the aggregate number of shares of the bank owned by the two of them.

Subsection (2) sets out the various situations in which one person who owns shares of a bank is associated with another person who owns shares of the bank, and these rules are similar to those set out in section 109(2) of the current Bank Act.

DIVISION II

OWNERSHIP OF BANKS

Summary: **This division replaces sections 110 to 114 of the current Bank Act and sets out the general framework for the ownership of banks.**

Significant interests

Section 373

This section is the linchpin of the ownership regime for banks; it sets out the basic rule to which everything that follows is an exception: no one may have a significant interest in any class of shares of a Canadian bank unless expressly permitted. This section should therefore be continually borne in mind when reading the rest of Division II. The rule is a restatement of the existing Bank Act rule which prohibits any person from owning more than 10% of any class of shares of a bank.

Resident

Section 374

The first exception to the rule set forth in section 374 is a restatement of the existing rule governing "domestic" Schedule II banks. Any Canadian resident (and, as a result of the Free Trade Agreement, any U.S. resident) may have a significant interest in a Schedule II bank (and may own up to 100% of its shares) for the first ten years of its existence. Thereafter the rule of section 373 applies, and no person may have a significant interest in any class of shares of such a bank. The penalty for failing to dilute down to less than 10% of any class of shares will be the loss of voting rights and possible divestiture (see section 403). As an alternative, section 578 (which is part of the transitional provisions becoming effective when Bill C-83 comes into force), provides that the Schedule II bank in question may apply to continue as a company under the Trust and Loan Companies Act, and so remain closely held.

Eligible Canadian financial institutions

Section 375

Subsection (1) contains a further exception to the rule stated in section 373 and is also an exception to the rule concerning "domestic" Schedule II banks contained in section 374: an eligible Canadian financial institution [see definition in subsection 371(1)] may continue to have a significant interest in a Schedule II bank beyond the initial 10-year period providing that it is the immediate holding company of the bank and controls it de jure.

Subsection (2) provides for a financial institution holding company of a Schedule II bank which is provincially incorporated to enter into an agreement with the Minister with respect to its future investments in entities other than those that the Schedule II bank itself is permitted to make pursuant to sections 466 and 467. In the case of a federally incorporated financial institution holding company, such institution would already be complying with such investment rules under its own particular legislation.

Eligible foreign institutions

Section 376

A further exception to the rule of section 373 applies to eligible foreign institutions [see definition in section 371(1)]. A foreign bank, or a foreign institution that does not fall within the traditional definition of foreign bank, may have a Schedule II bank as its subsidiary. While the eligible foreign institution is also required to control the Schedule II bank de jure, there is no requirement for it to be the immediate parent of the bank as there is for its Canadian counterpart. The section makes the ability of an eligible foreign institution to own a Schedule II bank conditional on an agreement with the Minister imposing terms and conditions with respect to the ownership of the eligible foreign institution.

Agreement

Section 377

This section deals with the situation where an eligible financial institution (i.e. Canadian or foreign) has a Schedule II bank as its subsidiary pursuant to section 375 or 376 and subsequently wishes to relinquish *de jure* control. It may do so providing it has entered into an agreement with the Minister to undertake the necessary steps to dilute down its shareholdings in the bank so that within 10 years of the date on which it first ceased to control the bank *de jure* (or such other lesser period as the Minister may direct) no person has a significant interest in any class of shares of the bank.

DIVISION III

CONSTRAINTS ON OWNERSHIP

Summary. This Division sets out the general restrictions on the ownership of Schedule II bank shares. The key element of the ownership rules in the Bill is a requirement for Ministerial approval of all acquisitions and increases of significant interests in classes of Schedule II bank shares. The detailed rules governing Ministerial review of such transactions are similar to those set out in the 1987 discussion draft of the trust and loan companies legislation, though a number of changes have been made to provide greater flexibility. In particular, the Bill provides exemptions from the approval requirement for *de minimis* fluctuations in shareholdings and certain other cases. In addition to the provisions requiring Ministerial approval, this Division contains a "35 per cent widely-held" rule for the ownership of voting shares of large Schedule II banks as well as sanctions for violations of its provisions.

Ministerial approval required for acquisition or increase of significant interests

Section 378

This section requires written Ministerial approval before a person, or an entity controlled by the person, may acquire shares of a Schedule II bank — 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 Schedule II bank. By extension, this requirement also applies to situations where a person acquires *control* of a Schedule II bank: changes in control of a Schedule II bank would invariably involve the acquisition or increase of a significant interest by the person acquiring control.

Sections 390 to 397 set out the criteria and 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 a Schedule II bank, its controlling shareholder would also acquire a significant interest by virtue of the way "significant interest" is defined (see section 8). Section 390(2) allows any person requiring approval to apply on behalf of all such persons.

Subsection 378(2) makes clear that an amalgamation, merger or other reorganization of entities that have interests in shares of a Schedule II bank 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 Schedule II bank.

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

Section 379

This provision complements section 375 — 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 bank from registering any direct acquisition of shares in its securities register without such approval.

Exceptions for small fluctuations in share holdings

Section 380

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 378 and 379 for small fluctuations in a person's existing significant interest in a class of shares of a bank. 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.

Subsection (4) provides that the above exceptions do not apply to a fluctuation resulting in the acquisition of control of a bank. They also do not apply where a person already has *de facto* control of an entity and the fluctuation would cause the person and the entities controlled by the person to have beneficial ownership of more than 50 per cent of the voting rights in the bank.

Exception for infusions of capital ordered by the Superintendent

Subsection 381(1)

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

Approval in advance

Subsection 381(2)

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

Requirement for 35% of voting shares to be widely held

Section 382

This section requires a Schedule II bank with equity, including minority interests in its subsidiaries, of $750 million or more to take the steps necessary to ensure that at least 35 per cent of total voting rights of the bank are attached to shares both widely held and belonging to classes listed for public trading on a recognized stock exchange.

Banks exceeding the $750 million equity threshold have five years to comply, measured from the day of the first annual general meeting after the threshold is reached or, for banks already above the threshold, from the day this Part comes into force. Subsection (4) enables the Minister to extend the period if general market conditions make it unduly onerous for a bank to meet the requirement within the initial five years.

Failure to meet the "35% widely-held" rule: sanctions

Section 383

A Schedule II bank that fails to comply with the "35 per cent widely-held" rule in section 382 within the required period is prohibited from having average total assets in any period of three calendar months that are greater than its average total assets in the last three complete calendar months before its failure to comply. The test must be met at the end of each month, beginning with the first complete calendar month after the failure to comply.

For this restriction, "total assets" will be defined in the regulations to mean the consolidated assets of the bank and its subsidiaries at the end of each month. "Average total assets" are to be calculated as a three-month moving average of total assets, measured at the end of each calendar month in the period.

These restrictions cease to apply once the bank resumes compliance with section 382 or if an exemption order is granted under section 385.

Exception where infusion of capital ordered by the Superintendent

Section 384

Section 384 provides for an exception from section 382 if a Schedule II issues shares in accordance with an order of the Superintendent to increase its capital. This exception parallels the

exception from the requirement for Ministerial approval of share acquisitions in subsection 381(1). The Superintendent may, however, set a time limit after which the bank would once again be required to comply with section 382.

Exemption by order of the Minister

Section 385

The Minister may exempt a Schedule II bank from the "35% widely-held" requirement if the Minister considers it appropriate. This exemption may be subject to any terms and conditions as the Minister considers appropriate.

Such banks are required to comply with any terms and conditions the Minister may set.

The Minister may terminate an exemption order if the bank ceases to comply with any of the conditions described above; the bank is then required to comply with the "35 per cent widely-held" rule on the day the exemption expires. If it is not in compliance, the sanctions are the same as in section 383: the moving average of the bank's total assets in any three-month period may not increase after the exemption expires, unless the Minister grants an extension.

Temporary exemptions from the "35% widely-held" rule

Section 386

This section grants Schedule II banks a six-month period to remedy temporary breaches of the "35 per cent widely-held" rule that arise

- in the course of a distribution of shares to the public — for example, because of an uneven take-up of shares;
- because of the redemption of shares — for example, if the purpose of the redemption is to issue new shares to the same shareholders;
- because the holder of an option or conversion privilege exercises the right to acquire shares; or
- because non-voting shares that are not widely held acquire voting rights — for example, because preferred dividends are in arrears.

The restrictions on the growth of average total assets only begin to apply if the bank fails to comply with the test before the end of the grace period. The Minister may, however, extend the grace period if the temporary failure to comply is due to the acquisition of voting rights by non-voting shares.

"35% widely-held" rule does not preclude acquisition of control of company

Sections 387 and 388

These sections provide an additional temporary exception to the "35 per cent widely-held" rule to allow takeover bids for a Schedule II bank. Since securities laws require certain takeover bids to be made to all shareholders on the same terms, the "widely-held float" — the percentage of voting rights attached to shares that are widely held and publicly traded — could not be maintained throughout the period of the takeover.

Accordingly, the Act provides an exception if the person acquiring control of the bank undertakes to restore the widely-held float to the greater of 35 per cent or the level prevailing at the time of the takeover bid and agrees to do so within five years or such other period as the Minister may allow. At the end of this period, the bank resumes its responsibility for maintaining the widely-held float, and must maintain it at a level at least as high as the level of the undertaking given by the successful bidder at the time of the takeover bid.

Sanctions: suspension of voting rights

Section 389

If a person acquires shares of a bank in contravention of section 378 (the requirement for prior Ministerial approval) or fails to comply with an undertaking under subsection 387(2) to restore the widely-held float to its pre-takeover level, the voting rights attached to all shares of the bank held by the person and entities controlled by the person may not be exercised either in person or by proxy.

Approval Process

Procedures for share transfer approval

Section 390

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.

Factors to be considered by Minister

Section 391

This section requires the Minister to take into account all factors that are, in the Minister's opinion, relevant to the application. The following factors are specifically mentioned:

- the financial resources of the applicants;
- the soundness of their proposed business plan;
- their business record and experience;

- the character, competence and experience of the persons who would operate the bank;
- the size of the bank, and of any of the applicants or their affiliates that is another deposit-taking institution; and
- the best interests of Canada's financial system.

These factors parallel those in section 27 concerning approval of new incorporations, with the addition of the "size" factor. Generally, large deposit-taking institutions will not receive approval to acquire large deposit-taking institutions. Large foreign deposit-taking institutions will be considered large even though their Canadian operations may be small.

In addition, where the acquisition of the shares would result in the bank becoming a subsidiary of a foreign bank, the Minister must consider whether the jurisdiction in which the foreign bank is incorporated provides treatment as favourable to Canadian banks as that provided to foreign institutions under this Act.

Terms and conditions

Section 392

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 393

When an application under section 390 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 394

The Minister must send a notice to the applicant within 30 days (or 45 days, if the application involves the acquisition of control of a bank), measured from the certified date of receipt of a complete application referred to in subsection 393(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- or 45-day period, the Minister may extend it

- for a further 30 days (or longer if the applicant agrees), if the application does not involve acquisition of control of the bank; or
- for any number of additional 45-day periods, if the application does involve acquisition of control.

Representations and final decision

Sections 395 to 397

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 within 45 days, if the application involves the acquisition of control of a bank — 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 (or 45-day) period. In cases where the application does not involve the acquisition of control of a bank, the Minister is deemed to have approved the application if any of the notifications required by sections 394 to 396 is not given.

DIVISION IV

OTHER CONSTRAINTS ON OWNERSHIP

Summary. This division contains rules governing ownership of bank shares by non-residents and governments. The provisions are modelled on the current *Bank Act* and incorporate the provisions of the Free Trade Agreement governing ownership of financial institutions.

Definitions and interpretation

Section 398

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 current *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 governments

Section 399

Banks are prohibited from registering any acquisition of their shares by or on behalf of the federal government, a provincial or foreign government, or any of their agencies. This section is modelled on a prohibition in the current *Bank Act*. Subsection 399(2) provides an exception for acquisitions of shares by agencies of a foreign government that are foreign institutions. It is similar to the exception in section 23

that allows foreign institutions controlled by a foreign government to incorporate a bank subsidiary.

Restrictions on share ownership by non-residents

Section 400

Companies are also prohibited from registering acquisitions of their shares by non-residents (including shares jointly held by residents and non-residents) if,

- the voting rights attached to all shares beneficially owned by non-residents would exceed 25 per cent of the total after the acquisition; or
- the transfer or issue would cause the non-resident to have a significant interest in any class of shares of the bank.

Sanctions: suspension of voting rights

Sections 401 and 402

Subsection 401(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 bank in which they have a significant interest, unless the non-resident is an eligible foreign institution which is the holding body corporate of the bank (subsection 401(3)).

Section 402, also modelled on a provision in the current legislation, supplements the above by prohibiting the exercise of voting rights attached to shares that are beneficially owned by a non-resident but held by a resident nominee.

Subsection 401(2) is modelled on a provision in the current *Bank Act* that prohibits the exercise of all voting rights attached to shares of a bank held by or on behalf of the federal government, a provincial or foreign government, or any of their agencies. Existing voting rights attached to shares legally acquired by foreign governments or their agencies — pursuant to subsection 399(2) — are permitted by subsection 401(4).

DIVISION V

DIRECTIONS

<u>Summary</u>. Sections 403 and 404 set out the sanctions the Minister may impose for violations of the ownership restrictions.

Disposition of shareholdings

Subsection 403(1)

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

- the person fails to obtain the Minister's approval required by section 378 before acquiring or increasing a significant interest in a class of shares of the bank;
- the person fails, after a takeover, to comply with an undertaking to restore the "widely-held float" of voting rights to the level required by section 387; or
- the person fails to comply with any terms and conditions the Minister imposes under section 392 in respect of an approval under this Part.

Representations, appeals and court enforcement

Subsections 403(2) to (4) and Section 404

The Minister must give persons subject to an order under subsection 403(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

<u>Summary</u>. **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 banks to meet the requirements.**

Part does not apply to interests held by securities underwriter

Section 405

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 406 to 408

These sections authorize the board of directors of a bank to make arrangements necessary to carry out the requirements of this Part. In particular, a bank'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 bank. If

a person required to make such a disclosure fails to do so, the bank may refuse to record the share acquisition. In addition, the bank and other persons acting in good faith on such a disclosure enjoy legal immunity for those actions.

Section 408 sets out a *de minimis* exemption from the requirement that banks ensure that proposed share transfers do not violate this Part before registering them. Banks 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 406(2) and (3) also allow the Superintendent to require a bank to obtain information from its registered shareholders about the beneficial ownership of shares and other matters relevant to the administration of this Part.

Application of *Competition Act*

Section 409

This section makes clear that the ownership rules in this Act do not affect the operation of the *Competition Act*. However, consequential amendments designed to clarify the respective roles of the two Acts in regulating takeovers of financial institutions are set out in sections 591 and 592.

PART VIII - BUSINESS AND POWERS

GENERAL BUSINESS

<u>Summary</u>. Sections 410 to 422 correspond to Divisions A and C of Part V of the current *Bank 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 *Bank Act*.

Main business and powers

Sections 410 and 411

This Act provides banks with the powers of a natural person (see section 14) and confines their business activities to banking and business that appertains to banking.

"It is also stated that a bank may also engage in certain activities currently carried on by financial institutions. The regulations may set out restrictions on some of these — in particular real property brokerage services; data processing and other related activities that an information services corporation could engage in (see

subsection 462(1)); and investment counselling and portfolio management services.

Networking

Section 412

This section makes clear that banks may enter into networking arrangements to sell any financial service, subject to the regulations governing the retailing of insurance (see section 417). Such arrangements may include both

- the bank acting as agent for persons who provide services that can be provided by a financial institution, or by any other entity in which a bank could have a substantial investment pursuant to section 466, and
- the bank leasing its premises for use by those persons.

Restriction on fiduciary activities

Section 413

Banks may not act as trustees for a trust or serve as executors of wills or as administrators, guardians, etc. of minors and mentally incompetent persons. Banks will, however, be able to provide trust services to their customers through networking arrangements with trust companies, including their affiliates.

Restriction on deposit taking

Section 414

This section is modelled on provisions in the current *Bank Act* and trust and loan companies legislation that require federal deposit-taking institutions to be members of the Canada Deposit Insurance Corporation.

Restriction on guarantees

Section 415

This section is modelled on provisions in the current *Bank Act* and its regulations. It allows a bank 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 bank 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 restrictions on certain classes of related party transactions in section 495.

Subsection (2) makes clear that these requirements do not apply to indemnities given by any bank to its directors and officers under section 213.

Restriction on securities activities

Section 416

Banks may not engage in securities dealing as prohibited or restricted by the regulations. The principal prohibitions to be set out in regulations are:

- Banks 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.
- Banks will be prohibited from acting as brokers in secondary market trading of equity securities.

Banks 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 417

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

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

Regulations under subsection (3) will specify the extent of the prohibition against banks "acting as agents" for insurance companies, agents and brokers. Subsections (4) and (5) make clear that none of the restrictions prohibit a bank from obtaining group insurance for its own employees and 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 418

Banks may engage in financial leasing but must comply with the same restrictions as financial leasing corporations (see section 462). 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.

Restriction on residential mortgage lending

Section 419

This section is modelled on provisions found in all current federal financial institutions legislation and requires mortgage insurance to cover the amount of any mortgage loan made by a bank in excess of 75 per cent of the value of the mortgaged property. It has been modified to make clear that this requirement applies only to mortgage loans made for acquiring, renovating or improving a residential property, or refinancing such loans, and does not apply to other "lending" related to real property, such as the acquisition of bonds issued by real property development corporations on the security of residential buildings.

Restrictions on security interests and receivers

Sections 420 and 421

Banks 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. Banks are also required to notify the Superintendent after acquiring any asset subject to an existing security interest.

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

Restrictions on partnerships

Section 422

Banks are prohibited from entering into partnerships with other persons except as a limited partner in a limited partnership.

Limitation regarding branches

Section 423

This section replaces subsections 173 (2) and (2.1) of the existing *Bank Act*: All Schedule II banks need the approval of the Minister to open branches outside Canada, and foreign bank subsidiaries, other than those controlled by United States residents, require such approval for branches within Canada other than a head office and one branch.

Domestic assets foreign bank subsidiaries

Section 424

This section provides for a limit on the domstic assets of each foreign bank subsidiary, other than one controlled by a United States resident. It replaces paragraph 174(2)(e) and subsections 174(6) and (8) of the current *Bank Act* which based a similar limit on the concept of authorized capital which no longer exists. The new limit provides for an amount to be fixed by order of the Minister for each foreign bank subsidiary, and states more directly what the original provisions did through the concept of "deemed authorized capital".

12-per-cent ceiling

Section 425

This section fixes the limit for domestic assets of all foreign bank subsidiaries, other than U.S. controlled foreign bank subsidiaries,

at 12% of the total domestic assets of all Canadian banks. It replaces the similar restriction contained in existing section 302(8).

Special Security

Loans to certain borrowers and security

Sections 426 to 437

These sections incorporate almost verbatim sections 177 to 187 of the Bank Act. The definitions which are special to these sections are found in section 426 rather than at the beginning of the Bill. Section 428 is the equivalent of present section 178, and has been expanded to include loans to aqualculturists.

SPECIFIC BUSINESS

Deposit Acceptance

Summary: Sections 438 to 440 are modelled on the rules governing deposits in Part V of the current *Bank Act*.

Deposit acceptance

Section 438

Banks may accept deposits from any person, including minors and others not able to enter into contracts, without requiring the intervention of other persons, such as a minor's parents or legal guardian. Banks are not bound to execute any provisions of the trust to which a deposit is subject.

Notification and transfers of unclaimed balances and unpaid bills of exchange

Sections 439 and 440

These sections are modelled on the current *Bank Act* provisions governing notification of inactive accounts and unpaid cheques and other bills of exchange, and the transfer to the Bank of Canada of the value of unclaimed deposits and unpaid bills of exchange after 10 years. The Bank of Canada then becomes liable to pay out the amount of such deposits or bills of exchange to persons who had a right to them.

Summary. Sections 426 to 438 are modelled on Division F of Part V of the current *Bank Act*. They consist primarily of requirements for the disclosure of certain terms and conditions of deposit accounts and loans made by banks.

Accounts

Disclosure of interest and charges

Sections 441 to 443

These sections parallel the current *Bank Act* requirements governing notification of the method of calculating interest on interest-bearing accounts, disclosure of interest rates on such deposits in advertisements, disclosure of increased or new charges, and provide for regulations governing these matters.

Bill C-9

Sections 444 to 450

These sections set out the rules governing the disclosure a bank must make concerning charges applicable to deposit accounts with the bank in Canada and for services normally provided by the bank to its customers and to the public in Canada. The manner of disclosure, including the manner of disclosure of increased or new charges, will be established by regulations.

Section 448 requires banks to establish procedures for dealing with customer complaints concerning charges applicable to deposit accounts and to file a copy of these procedures with the Superintendent.

Under section 449 the bank must inform customers having complaints concerning their deposit accounts how the customer can contact the Office of the Superintendent.

Borrowing Costs

Disclosure of costs of borrowing

Sections 451 to 456

These sections are modelled on the current *Bank Act* provisions that set out rules governing the calculation of costs of borrowing and their disclosure to customers.

Primary Reserves

Sections 457

This section requires banks to continue to hold primary reserves for a two year period following proclamation of the Act. The required reserve applies only to banks in existence immediately prior to the proclamation of the Act and is based on an average of required reserves for the 12 months ending with the month in which the Act is brought into force.

The required reserve can be met by holding coins, notes and deposits at the Bank of Canada, as is currently the case.

Required reserves will be phased out over a two year period, with three per cent reductions in required reserves occurring in the first, seventh, thirteenth, and nineteenth months following proclamation. Required reserves will be nil after the two year period.

The current arrangements permitting certain banks to hold their reserve deposits with other banks will be continued. Banks which hold such deposits on behalf of other banks will have their required reserves increased by the amount of such deposits.

Regulation making power necessary for the carrying out of this section is provided; regulations will specify the period over which actual reserves on average must be equal to or greater than required reserves.

Secondary reserves which are currently required under the Bank Act will be eliminated.

Prepayment of loans

Subsections 458(1) and (2)

These subsections prohibit banks from making loans to natural persons on terms that prohibit prepayment. An exception is provided for mortgage loans and large loans over $100,000 or a prescribed larger amount.

Financial arrangements of banks with the federal government

Subsections 458(3) and (4)

These subsections set out rules governing the financial arrangements between the federal government and banks. Banks are not allowed to levy charges for cashing cheques issued by the federal government or deposited to its account. This restriction does not prohibit arrangements between the government and a bank for compensation for services, or prohibit the payment of interest on government deposits.

Regulations governing use of customer information

Section 459

This section provides for regulations governing the use of confidential customer information. The regulations will be prepared in consultation with industry and other interested persons.

Section 460

This section reiterates the prohibition of the second part of subsection 201(2) of the current Bank Act. It prohibits a bank from imposing on a customer a requirement to maintain a minimum credit balance with the bank as a condition for the making of a loan or advance, except by express agreement.

Section 461

This section corresponds to section 188 of the current Bank Act. For the purpose of this Act, a bank is deemed to lend money or make advances when it accepts a bill of exchange or pays or makes money available for the payment of such a bill of exchange.

PART IX - INVESTMENTS

<u>Summary</u>. This Part sets out investment rules based on a "prudent portfolio approach". It essentially replaces Divisions D and E of Part V of the current *Bank Act*.

Definitions and Application

Definitions

Section 462(1)

This subsection defines a number of key concepts used in this Part, including the different types of corporations and unincorporated entities in which a bank is permitted to have a substantial investment under section 443. 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 banks 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*. 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:

"loan" The definition of "loan" 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 a bank are to be consolidated with the bank in applying the portfolio limits in section 473 to 477. 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 a company 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 475.]
- Other subsidiaries listed in subsection 466(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 470 or 471 — such entities will not be consolidated.

The same inclusions and exclusions will apply in consolidating a parent bank's regulatory capital for the purposes of sections 473 to 477.

Non-application of Part

Subsection 462(2)

A bank 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 463 to 465 set out a general requirement that banks maintain a prudent portfolio of investments and a general rule governing substantial investments of a bank. 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 bank to a single person or group of connected persons.

Investment standards

Section 463

This section requires the board of directors of a bank 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, banks must also comply with the portfolio limits on certain classes of loans and investments set out in sections 473 to 477.

General rule governing substantial investments by banks and principal exceptions

Section 464

This section sets out the general rule that banks 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 bank that are either financial institutions or specialized financing corporations;
- substantial investments in other entities engaged in providing financial or other related services, as permitted by sections 466 and 467; and
- substantial investments acquired through realizations or loan workouts, or as temporary investments (see sections 469 to 471).

Regulations setting single exposure limits and valuation rules

Section 465

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 473 to 477 and the limit on asset transactions in section 480. In particular, for the purpose of the portfolio limits, they will make clear that the assets of a bank include not only those

appearing on its own books, but also those of its "prescribed subsidiaries" (see section 462).

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

Subsidiaries and Equity Investments

Summary. Sections 466 to 472 set out detailed rules governing acquisitions and increases of substantial investments by banks.

Permitted substantial investments and undertakings

Sections 466 to 468

These sections describe the entities in which a bank may acquire permanent substantial investments and the conditions under which it may do so. Subsections 466(1) and (2) contain the list of entities in which a bank 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. Subsection 466(6) prevents Schedule II banks from owning more than 10% of a foreign corporation's voting shares. Section 467 also allows the Minister to deem certain corporations to be corporations described in section 466 if their activities are substantially similar.

Subsection 466(3) prohibits a bank 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 466(1):

- factoring corporation,
- financial leasing corporation,
- investment counselling and portfolio management corporation,
- mutual fund distribution corporation,
- real property brokerage corporation,
- specialized financing corporation, or
- financial holding corporation.

The restriction does not apply to information service corporations, service corporations, real property corporations, real property holding vehicles, and ancillary business corporations. The requirement for *de jure* control is also waived for foreign corporations in which a bank has a substantial investment if it would be illegal or contrary to normal business customs in the foreign jurisdiction for the bank to have *de jure* control of the corporation.

Subsection 466(3) also requires Ministerial approval for the acquisition of substantial investments in financial institutions, information service corporations, and specialized financing corporations.

When a bank acquires control of an entity in which it is permitted to have a substantial investment under section 466, subsections 468(1) to (3) require certain undertakings from the bank. 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 bank (see section 487), 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 468(4) requires a bank to obtain an undertaking from all corporations it controls to provide the Superintendent reasonable access to their records.

Temporary investments

Section 469

Banks 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 corporation is subject to the additional restriction that a bank and the corporations listed in section 466 that are its subsidiaries may not hold shares of the corporation carrying more than 50 per cent of voting rights.

Subsection (3) is a transitional exemption that will apply to banks that, on the date of introduction of the Bill, have substantial investments acquired under the investment rules in the current bank Act. Banks 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 470

This section allows a bank to acquire any number of shares or ownership interests in entities as part of the working out of loans made by the bank that are in default. As with the provision allowing acquisitions through realization of security (section 448), 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, banks 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 banks 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 446(3).

Realization of security

Section 471

This section allows banks to acquire any number of shares or ownership interests in entities through the realization of a security interest held by the bank. As with loan workouts (section 470), 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 XI on related party transactions and the prohibition in Part V on banks acquiring shares or ownership interests in entities that control them.

As with loan workouts, if the acquisition of such shares or ownership interests results in the acquisition of a substantial investment, banks 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 469(3) that applies to banks 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 bank could acquire under section 466.

Regulations restricting ownership

Section 472

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 a bank under sections 466 to 471. These will include regulations modelled on existing *Bank Act* regulations governing the activities of a bank'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 473

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 474 to 477. 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.

Real Property

Portfolio limits on real property

Sections 474 and 475

A bank 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 70 per cent of the bank's regulatory capital. The regulations under section 475 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 banks 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 banks 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 476

A bank and its prescribed subsidiaries may not acquire portfolio investments in participating shares (see the definition in section 462) or ownership interests in unincorporated entities if, after the acquisition, the total value of such securities would exceed 70 per cent of the bank's regulatory capital. This test does not include shares of corporations mentioned in section 466 or 467 in which the bank has a substantial investment.

Aggregate Limits

Combined portfolio limit for investments in real property and equity securities

Section 477

A bank and its prescribed subsidiaries may not acquire interests in real property, make improvements to real property in which they have an interest, or acquire investments in equity securities referred to

in section 476 if, as a result, the total value of all such investments and interests would exceed 100 per cent of the bank's regulatory capital.

Miscellaneous

Superintendent may order divestment of illegal investments

Section 478

The Superintendent may order a bank to dispose of any investment acquired in contravention of this Part. In addition, the Superintendent may order a bank 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 bank has failed to provide, obtain or ensure compliance with the undertakings referred to in section 468.

Deemed temporary investment

Section 479

When a bank 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 bank is deemed to have acquired a temporary investment in the entity (see section 469) on the day it became aware of the change. This requires the bank to dispose of the substantial investment within two years or such longer period as the Superintendent considers necessary.

Assets transactions

Section 480

A bank 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 bank — 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. "Total assets" are to be defined to incorporate the assets of a bank's prescribed subsidiaries.

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

Transitional rules

Sections 481 and 482

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

PART X - ADEQUACY OF CAPITAL AND LIQUIDITY

Adequacy of capital and liquidity

Section 483

Banks are required to maintain adequate capital and liquidity and comply with any regulations concerning them. In addition, even though a bank 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 XI - 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 484

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

- persons who have a significant interest in any class of shares of a bank — including those who control the bank;
- directors and officers of the company and of entities that control the bank;
- spouses and minor children of natural persons listed above;
- entities in which the bank's directors or officers, a person who controls the bank, or any of their spouses or minor children have a substantial investment (see next paragraph, however); and
- entities controlled by any of the above.

Entities in which a bank has a substantial investment (including its subsidiaries) are not normally treated as related parties of the bank. Subsection (2) ensures that such entities are not treated as related parties solely because they are technically captured by the definition in

subsection (1) — since substantial investments of a bank are also substantial investments of a person who controls the bank (see section 10). However, such an entity *would* be considered a related party if the person who controls the bank had other interests in the entity that would result in its being captured under the related party definition even if the bank's own stake in the entity were not taken into account. Subsection (2) also does not prevent such entities from being considered related parties if they are captured by some other criterion in subsection (1) — for example, if a director of the bank had a substantial investment in one of its subsidiaries.

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 bank 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 485

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);
- transactions with the parent of a bank, if the bank is its wholly-owned subsidiary and the parent is another federally-incorporated financial institution;
- the issuing of shares of the bank 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 bank, except when the remuneration is for duties outside the ordinary course of business of the bank, or for the purchase of services referred to in paragraph 493(1)(*a*).

Definition of "transaction" and "loan"

Section 486

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 a bank 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 a bank 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 IX (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 a bank

Section 487

Subsection (1) sets out a blanket prohibition against entering into related party transactions. The exceptions to this rule are set out in sections 488 to 498.

Subsections (2) to (4) require banks 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 bank 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.

The regulations may provide additional exceptions, including exceptions for transactions entered into by insurance subsidiaries that involve the provision of certain classes of financial services that deposit-taking institutions do not have the power to provide and that are permitted under the self-dealing rules governing transactions of insurance companies with their related parties.

Permitted Related Party Transactions

Exemption for nominal or immaterial transactions

Section 488

This section permits all transactions of nominal or immaterial value. The conduct review committee of every bank 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 489 to 491

A limited range of exceptions from the general ban on related party transactions applies to borrowing transactions among related parties. In particular, banks 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, provided the loan either

is insured or meets the "75 per cent loan-to-value" rule in section 419;

- deposit funds for cheque-clearing purposes with a related party financial institution that is a direct clearer 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 492

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:

Banks 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 bank in the ordinary course of business; or
- acquire or lease goods — excluding real property, securities, loans and other financial assets — used by the bank in the ordinary course of business.

Banks 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:

Banks 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.

In addition, the Superintendent may authorize specific acquisitions and dispositions of assets for the purpose of restructuring a bank.

Exceptions: provision and purchase of services

Section 493

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

- purchase from related parties services that it normally uses in the ordinary course of business, provided the term of the contracts does not exceed five years;
- provide to related parties services that it normally offers to the public in the ordinary course of business (for example, investment counselling and other financial services, but not loans and other transactions explicitly covered by this Part);
- enter into networking arrangements with related parties for the sale of services on an agency basis, provided the term of the contract does not exceed five years; and
- 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 bank or its subsidiaries.

Banks may not, however, enter into contracts involving the purchase of services from related parties if the combined effect of all such contracts is that substantially all of the management functions of the bank are exercised by persons who are not its employees. The Superintendent may enforce this prohibition by ordering the bank to ensure that its own employees resume the exercise of its essential management functions.

Exceptions: transactions with directors, officers and their interests

Sections 494 to 496

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

- natural persons who are directors or officers of a bank 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 a bank (or their spouses or minor children) have a substantial investment; and
- entities controlled by the directors or officers of an entity that controls the bank, or their spouses and minor children.

In particular, subsection 494(1) allows a bank 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 494(2) to (4) govern the making or acquisition — by a bank — of loans to its full-time officers:

- The aggregate of all such loans to any full-time officer of a company 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 486. 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 499).

Section 495 governs the following classes of transactions with any related party referred to above (including a bank's full-time officers):

- making any "loan" (as defined in section 466) 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 495(1) is not a restriction in itself, but shifts the responsibility for approving such transactions to the board of directors of a bank in cases where, after the proposed transaction, the aggregate value of

- all loans to any single related party held by the bank and its subsidiaries,
- all guarantees on behalf of that related party made by a bank and its subsidiaries, and
- all investments in securities of that related party that are held by the bank and its subsidiaries

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

Subsection 495(2), on the other hand, is a portfolio limit similar to those in Part IX 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 a bank's regulatory capital.

The following valuation rules apply in determining the aggregate value of loans, guarantees and investments under subsections 495(1) and (2):

- Nominal or immaterial transactions (see section 488) 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 a bank) 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 496 makes clear that the making of margin loans to a bank's directors or officers may be made subject to additional terms and conditions set by the Superintendent.

Other exceptions

Sections 497 and 498

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 a bank and would not significantly affect the interests of a related party of the bank.

Restrictions on Permitted Transactions

Permitted related party transactions to be on market terms and conditions

Section 499

Except for preferential loans to full-time officers under section 494, 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 bank as market terms and conditions. Market terms and conditions are defined as

- the terms and conditions that the bank offers to the public in the ordinary course of business, in the case of financial and other services provided by a bank; and
- in the case of any other transaction, 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 500 and 501

These sections set out the general rule that all proposed transactions of a bank with related parties be reviewed and approved by the bank's conduct review committee. In addition, when a person ceases to be a related party of a bank, 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 bank 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 488);
- consist of preferential loans to full-time officers under section 494;
- must be approved by two-thirds of the directors under subsection 495(1); or
- are exempted from this requirement by regulation.

For additional flexibility, subsections 500(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

Banks must seek disclosure of interests of possible related parties

Section 502

In considering transactions with a person who it has reason to believe is a related party, a bank 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 bank, its directors, officers, employees and agents enjoy legal immunity for actions taken or omitted to be taken in reliance on any such disclosure.

Banks to notify Superintendent of the discovery of inadvertent violations

Section 503

Where a bank inadvertently enters into a prohibited related party transaction or one requiring approval under subsection 495(1) or section 500 or 501, it must immediately notify the Superintendent upon discovering the violation.

Remedial Actions

Sanctions: illegal transactions may be overturned

Section 504

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

PART XII - FOREIGN BANKS

Summary. This Part contains the rules set out in sections 302 to 307 of the current Bank Act. The drafting has been updated to reflect the new terminology such as "significant interest" and "substantial investment", and some of the rules have been made more flexible. Since paragraph (g) of the definition "foreign bank" in section 2 includes a foreign institution (other than a foreign bank in the traditional sense) that controls a Schedule II bank, those rules that apply when a foreign bank has a foreign bank subsidiary automatically apply to such non-bank foreign institutions.

Definitions

Section 505

Subsection (1) gathers together the various definitions used in Part XII.

"entity associated with a foreign bank" is the equivalent of the concept of a corporation associated with a foreign bank appearing in section 303(2) of the current Bank Act, expanded to include unincorporated entities in line with the rest of the Bill. The rules for association are set out in subsection (2).

"non-bank affiliate of a foreign bank": this expression now includes unincorporated entities

"representative office" remains the same as in the current Bank Act.

Subsection (2) contains the rules of association for determining when an entity is associated with a foreign bank, and are based on the existing criteria of section 303(2) of the Bank Act, but technically modified to use the term "substantial investment".

Subsection (3) deems a foreign bank to have a substantial investment in certain instances for the purposes of the definition "non-bank affiliate of a foreign bank", and for the purposes of sections 515 and 516 (see below).

Subsections (4) and (5) are new and give the Minister the power to exempt any entity from the status of being associated with a foreign bank for specified purposes, and the power to revoke or vary such an order.

Permitted and prohibited activities

Sections 506 to 511

Sections 506 to 511 are the equivalent of subsections 302 (1) to(3) and (5) to (7) and 307(2) and section 306 of the Bank Act with some modifications: The prohibition against foreign banks maintaining branches in Canada does not apply if such branches are authorized under other federal legislation, and an exception has been included to

the prohibition against maintaining automated teller machines in Canada to allow non-residents to access their accounts located outside Canada. A regulation making power has also been included for the purposes of exempting certain activities from the prohibition against foreign banks undertaking banking business in Canada.

Non-bank affiliates

Sections 512 and 513

Sections 512 and 513 are based on existing subsections 303(5),(8) and (9) of the current *Bank Act* and cover the prohibition against non-bank affiliates engaging in the business of both lending money and accepting deposits, and the prohibition against representations by a foreign bank on behalf of its non-bank affiliate that it has guaranteed the borrowings of such non-bank affiliate. Subsection 512(3) grandfathers non-bank affiliates which were exempted from the first of these rules under the existing *Bank Act*.

Statement and returns

Section 514

Section 514 is the equivalent of subsection 303(7) of the *Bank Act*, and requires non-bank affiliates to provide the Superitendent with certain statements and information. However, in a departure from the existing *Bank Act*, this section empowers the Superintendent to exempt particular entities from the requirement.

Prohibition against issue and registration of shares

Section 515

Section 515 contains the prohibitions currently found in subsection 303(6) against a Canadian entity which is in the business of both lending money and accepting deposits issuing or transfering any of its shares to a foreign bank or to an entity associated with a foreign bank if the foreign bank would thereby acquire or increase a substantial investment in the Canadian entity. This section must be read in conjunction with the deeming provisions in subsection 505(3) (see above).

Ownership of Canadian entities

Sections 516 amd 517

Sections 516 and 517 restate section 305 of the existing *Bank Act*. A foreign bank which owns a foreign bank subsidiary and entities associated with such foreign bank are prohibited from having a substantial investment in any bank or other Canadian entity. Certain exceptions to the latter rule with regard to entities engaged in "non-financial" activities contained in subsection 516(3) are based on those contained in existing subsections 305 (3) and (4). The rules have been relaxed to some extent in that both a foreign bank and an entity associated with a foreign bank holding shares in such a Canadian entity at the time of the application for incorporation of the foreign bank subsidiary may continue to hold such shares; either the foreign bank or associated entity may subsequently acquire such shares with the permission of the Minister given by an order which may be varied or revoked at a later date. The existing two-year limit that applies to a

foreign bank holding shares in a foreign bank subsidiary if it holds any shares in a Canadian entity in contravention of existing subsection 305(6) at the time of the incorporation of the foreign bank subsidiary, and the inability of a foreign bank to acquire any such shares at a later date have been deleted.

Divestiture

Section 518

Section 518 sets out the penalty for a contravention of the rules set out in section 516, namely the possible divestiture by the foreign bank of its foreign bank subsidiary.

Acquisitions in Canada

Sections 519 and 520

Sections 519 and 520 reiterate and clarify subsections 307(1), (3) and (4) of the existing Bank Act which require consent for acquisitions in Canada of shares or assets, on the establishment of a new business by a foreign bank, and the paramountcy of the Bank Act over the Investment Canada Act in this regard.

PART XIII - REGULATION OF BANKS

Supervision

<u>Summary</u>. Sections 521 to 533 contain reporting requirements and provisions for the inspection of banks and the valuation of bank assets. Their goal is to ensure that the Superintendent can accurately assess the true financial condition of banks governed by the Act. The provisions correspond to Parts VII and IX of the current *Bank Act*.

Returns

Superintendent may require banks to provide information

Section 521

This section is designed to harmonize the publication requirements under the various federal statutes governing financial institutions. Except for a few provisions (sections 522 to 527) taken from the current *Bank Act* and trust and loan company legislation, it replaces the detailed reporting provisions found in the current legislation — in particular those requiring monthly returns and returns covering reserves, foreign currency, and domestic assets — with more flexible provisions that allow the Superintendent to obtain such information as the Superintendent may require. 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 bank governed by the Act.

Returns, principal corporate records, and reports of unclaimed deposits and bills of exchange

Sections 522 to 527

These sections set out requirements for two different types of return. Sections 522 to 524 are closely modelled on the current *Bank Act* provisions requiring returns for deposit accounts that remain inactive and bills of exchange that remain unpaid for nine years or more.

Sections 525 to 527 are also modelled on the current *Bank Act* and require banks to provide the Superintendent with copies of the bank by-laws, an annual report on the directors and auditors of the bank, 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 bank.

Superintendent may require information from affiliates of banks

Section 528

This section allows the Superintendent to require the persons who control a bank and its other affiliates to provide any information additional to requirements under section 521 that may be needed to show that the provisions of this Act are being complied with and that the bank is in sound financial condition.

Subsection (3) provides an exemption from this provision for affiliates that are federally regulated financial institutions and — where the Superintendent has entered into an information-sharing agreement with the relevant provincial jurisdiction — affiliates that are provincially regulated financial institutions.

Confidentiality of information received by the Superintendent

Section 529

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 a bank 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 530

This section is modelled on a provision in the current *Bank Act* and requires the Superintendent to publish the information set out in the returns referred to in sections 522 and 523 on unclaimed deposits

and unpaid bills of exchange, and any other information obtained pursuant to the Act as the Minister may determine.

Inspection of Banks

Examination of banks

Sections 531 and 532

These sections provide for examination of every bank 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 a bank and may require its directors, officers and auditors to provide any information or explanation that may be required regarding the condition and affairs of the bank, 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.

Superintendent to notify banks and auditors of material differences in valuation of assets

Section 533

This section is modelled on the current *Bank Act* and requires the Superintendent to notify the bank, its auditors and its audit committee when the appropriate value of any asset, as determined by the Superintendent, varies materially from the value placed on it by the bank.

Remedial Powers

<u>Summary</u>. Sections 534 to 547 provide the Superintendent with the power to issue directions of compliance (sections 534 and 535), to obtain court enforcement of the Act (section 536), and to take control of banks or their assets under certain conditions (sections 537 to 547). They correspond to provisions added to the current financial institutions legislation by Bills C-42 and C-56 in July 1987.

Directions of compliance

Sections 534 and 535

The Superintendent may issue directions to a bank 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 bank 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 a bank 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 536

This section allows the Superintendent to apply for a court order if a bank 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 537

This section allows the Superintendent to take temporary control of the assets of a bank, as well as the assets it holds in trust, if the Superintendent is of the opinion that

- its 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 538(1)

The Superintendent must report to the Minister when

- the Superintendent takes temporary control of a bank's assets under section 537,
- the requisite conditions for taking temporary control under section 537 exist; or
- the requisite conditions exist for the cancellation of a bank's deposit insurance coverage under the *Canada Deposit Insurance Corporation Act*.

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

Subsection 538(2) to Section 547

The Minister, after receiving a report under subsection 538(1) and giving the bank a reasonable opportunity to be heard, may give the bank additional time to rectify the situation. Alternatively — or subsequently, if the bank fails to rectify the situation — the Minister may direct the Superintendent to take full control over the business and affairs of the bank. The powers of its directors and management are suspended and the Superintendent is authorized to manage the bank 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 bank has been 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 548 to 554

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 bank (sections 548 and 551);
- a legal presumption that the list of directors sent by a bank to the Superintendent is accurate and that certain notices or documents are received within a certain period after they are sent (sections 549 and 551 and subsection 550(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 550(2));
- rules of evidence governing certified statements of certain facts issued by a bank, the validity of entries in a bank's securities register, and the verification of documents or facts required by the Act or by the Superintendent (sections 552 to 554).

Certain orders exempt from publication requirements

Section 519

To ensure confidentiality of the business and affairs of banks 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 bank or person except for case-by-case Ministerial approvals of self-dealing transactions under section 497.

Required form of applications

Section 556

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 557

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 a bank's commencement order (see section 54);
- a decision of the Minister to dismiss the appeal by a bank or person of a direction of compliance issued by the Superintendent (see section 535);
- 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 403); and
- an order of the Minister to the Superintendent to take control of the business and affairs of a bank under section 502.

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 558

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 559

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 offence and sanctions under the Act. It differs from the current legislation governing federal financial institutions, in which the various provisions governing offence and sanctions are widely separated.

Offence

Sections 560 to 564

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 a bank who gives a fraudulent preference to any creditor of the company;
- a director, officer or auditor of a bank who fails to provide the Superintendent with any information required under section subsection 531(2);
- any person who uses the name of a bank in any document relating to a securities transaction in contravention of the rules set out in the regulations;
- any entity that uses "bank", in any form, in its name without being authorized to do so by this Act. Subsections 563(3) and 563(4) provide for exemptions.

Section 564 sets out certain offenses of a bank in connection with warehouse receipts or bills of lading, or security under section 427, which are presently contained in section 189 of the current *Bank Act.*

Sanctions and other enforcement

Sections 565 to 570

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 - GENERAL

Transitional amendments

Sections 571 to 580

These amendments enact certain technical amendments to the *Bank Act* if other Acts come into force during the same session of Parliament. In particular, sections 571 to 579 involve the replacement of references to "trust companies", "loan companies" and the current trust and loan companies legislation by references to the proposed Trust and Loan Companies Act and companies to which that Act would apply upon its coming into force.

Section 580 enacts certain technical changes if amendments to the *Federal Court Act* come into force.

Consequential amendments

Sections 581 to 604

Many of these amendments involve replacement of references to existing provisions of the *Bank Act* to the appropriate reference as established by this Act. The statutes so affected are:

- the Bankruptcy Act;
- the Canada-Newfoundland Atlantic Accord Implementation Act;
- the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act;
- the Canada Petroleum Resources Act;
- the Canadian Wheat Board Act;
- the Canada Business Corporations Act;
- the Farm Debt Review Act;
- the Federal Business Development Act;
- the Investment Canada Act; and
- the Office of the Superintendent of Financial Institutions Act.

As it cannot be presumed that the proposed *Trust and Loan Companies Act* will be passed by Parliament nor that it will come into force prior to or at the same time as the *Bank Act*, some of these consequential amendments also contain transitional provisions amending the consequential amendments as of the later date of the coming into force of the appropriate section of this Act or the proposed *Trust and Loan Companies Act.*

In addition, there are some substantive consequential amendments, the most significant of which are the following:

Bank of Canada Act:

- Subsection 581(1) repeals section 19 of the *Bank of Canada Act* since the requirement for banks to maintain secondary reserves has been eliminated.

- Section 582 amends section 22 of the *Bank of Canada Act* in order to implement the new unclaimed balances regime set out in sections 439 and 440 of the Act.

Competition Act:

- Sections 589 and 590 broaden the scope of the *Competition Act* provisions that currently govern agreements among banks regarding interest rates, charges and the amount or kind of services provided to customers. The rules are being generalized to apply to both banks and trust and loan companies.

- Section 591 broadens the scope of the current provision whereby the Minister of Finance may exempt an amalgamation or other merger of banks from the provision of the *Competition Act* that empowers the Competition Tribunal to prevent or overturn mergers.

- Section 593 also removes such exempted mergers from the category of "notifiable transactions" subject to Part VIII of that Act.

Repeal of Bank Act

Sections 605 and 606

These sections repeal the Bank Act and provide for the coming into force of this Act either as a whole or in parts.

Subsection 606(2) provides banks with six months to comply with the provision governing the maintenance and processing of bank records in Canada (section 246) after the provision identifying those records (section 239) comes into force.