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Highlights

**the White Paper
on Canadian Banking
Legislation**

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Finance Finances



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The federal government's White Paper on banking issued today proposes significant legislative changes designed to encourage more competition in Canada's financial system.

The White Paper proposes to establish a new national framework for Canada's chequing system. It would permit foreign bank subsidiaries to operate within Canadian banking legislation, as a new dimension in competition. * * *

Steps outlined in the White Paper will help facilitate the establishment of new Canadian domestic banks. A number of changes are also proposed in the powers of the chartered banks, in order to promote stronger competition within a framework of Canadian regulatory control and predominantly Canadian ownership.

The White Paper follows an extended period of study by federal authorities, during which financial institutions and other groups made representations to the government. The Paper provides a further opportunity for public discussion before conclusion of the current decennial review of the Bank Act and other banking legislation. Comments on the White Paper proposals are requested by October 15.

The review is occasioned by the fact that the Bank Act confers powers on Canada's ten chartered banks for a ten-year period only. The last review was concluded in 1967; Parliament will be required to act before the next scheduled expiry of these powers on June 30, 1977.

A Canadian Payments Association

The White Paper points to growing inequities and fragmentation within the payments function, which lies at the heart of our financial system. This function is exercised principally by the chequing system, under which deposits are transferred by cheque or similar orders to settle financial obligations. Near-banks, which include trust and mortgage loan companies, caisses populaires and credit unions largely outside federal regulation, play an important role in effecting payments. But they have only indirect access to the clearing system for cheques, and do not enjoy a full voice or full rights in its operations, with the result that they are not fully subject to all its obligations.

The White Paper proposes to bring all institutions offering chequing facilities into a new Canadian Payments Association to replace the present clearing system operated by the chartered banks. Members will share the same rights and obligations. They will obtain credit facilities from the Bank of Canada and will be required to maintain minimum reserves with the central bank.

The reserve requirements:

On Canadian dollar notice deposits, and term deposits with an original term to maturity of one year or less, or longer if encashable (includes most reservable deposits of near-banks) -

2 per cent on the first \$500 million,

4 per cent on the remainder.

On Canadian dollar demand deposits (mainly banks) -

12 per cent as at present.

On foreign currency deposits used domestically -

4 per cent.

Foreign Banks

Canadian law does not permit foreign banks to operate as banks in Canada, but they have established many affiliated corporations here as active lenders to business and as borrowers in the money market. Many of their operations are not subject to regulation. They enjoy some special advantages and have captured a significant share of commercial lending activities, including some areas where direct participation by Canadian banks is prohibited under the Bank Act.

Foreign banks can bring additional competition and innovation to bear in Canadian banking. With their worldwide connections, they can help develop Canadian resources, industries and trade. However, there should be a legislative basis for regulating their operations in Canada to ensure equitable and effective competition and that Canada's banking system remains predominantly in Canadian hands.

The paper therefore proposes to allow foreign bank subsidiaries to operate in Canada as banks, incorporated with full powers under the Bank Act. However, government policy will be to limit their growth and size individually and their combined operations to 15 per cent of commercial lending in Canada, these limits being subject to review. They will be permitted a maximum of five branches; a minimum of one-half of their directors will have to be Canadian citizens. Limits on the size of any foreign bank subsidiary will be removed if it opts to "Canadianize" by selling shareholdings in excess of 10 per cent to Canadians.

Canada will expect reciprocal recognition for its banks in the jurisdiction of the parent bank. The government does not propose to permit the establishment in Canada of branches or agencies of foreign banks. Foreign bank representative offices will be registered.

Non-bank subsidiaries of foreign banks in Canada will be required to file reports on their activities. Unless specifically authorized, such affiliates will be denied the right to borrow in the Canadian market with the guarantee of their foreign parents.

Entry into Banking

The growth of the financial system has been accompanied by a gradual reduction in the proportion of total banking business done by the five largest Canadian banks. They held 61 per cent of total Canadian dollar deposits of all Canadian deposit-accepting institutions in 1975, compared with 69 per cent in 1967 and 75 per cent in 1960. One aspect of change in the system has been a recent acceleration in the establishment of new banks.

However, a substantial degree of concentration remains in Canadian banking, and to encourage greater competition the government proposes to further facilitate the entry and growth of new Canadian banks. The key proposals:

- Incorporation of banks by letters patent as an alternative to the present unique requirement of incorporation by special Act of Parliament.
- Provisions allowing Canadian institutions with financial experience and expertise to establish a new bank with

an interest of 25 per cent (or more if approved by Governor in Council) for a period of 10 years. Trust companies and others which accept deposits from the public are excluded from the proposal because of potential conflict of interest.

- Provincial governments will be permitted to hold and vote up to 25 per cent of the shares of a new bank, reducing to 10 per cent within 10 years.
- Incorporation provisions will facilitate conversion of an existing financial institution to a chartered bank.
- Reserve requirements will bear lightly on new banks until liabilities exceed \$500 million.

Business Powers

Three principles are reflected in the government's review of the powers conferred by the Bank Act.

1. To avoid potential conflicts of interest. For example, business decisions could be affected if an institution is in a position to exercise both trustee powers and lending powers with respect to the same client.
2. To extend the availability of specialized financing services where possible. Where conflicts of interest do not arise, it is desirable to broaden competition in services closely related to other banking services; factoring and leasing are examples.

3. To encourage provision of services directly, rather than through affiliated corporations, to improve regulatory control, to avoid conflicts of interest, and to discourage non-financial activities.

Financial Leasing

Financial leasing is a form of financing which can benefit small and medium-sized businesses in particular.

Banks will be permitted to engage in financial leasing of equipment, subject to certain regulations.

Factoring

In factoring, a seller of goods or services contracts with another party to finance and collect his accounts receivable and to assume the credit risks involved.

The White Paper proposes to permit banks to engage in factoring in order to increase competition and the Canadian presence in this activity.

Residential Mortgages

The Bank Act now places arbitrary limits on bank holdings of residential mortgages. The limits have so far constrained only new banks, but in future they could also curb mortgage lending by larger banks. The limits will be removed in recognition of the need for residential mortgage funds.

Data Processing

The extension of data processing services to bank clients poses concerns about concentration of power and conflict of interest. There is also a need to permit room for the independent computer services industry to grow and develop.

Regulations, similar to the guidelines in effect since January, 1975, will be introduced limiting banks' data processing services to those directly related to the making of payments and to banking-related services provided to other financial institutions.

Securities

The role of banks in dealing in corporate securities will be defined more precisely. Most importantly, the power of banks to underwrite corporate securities or to act as agent in the private placement of corporate securities will be withdrawn, but the name of a bank will be permitted to appear in a prospectus or advertisement listing the selling group to enable the banks to distribute corporate securities.

Trust and Quasi-Trust Activities

Banks will not be given trustee powers. However, the Bank Act will clarify powers of the banks with respect to a number of activities related in some degree to trustee business.

Banks will be permitted to sell but not manage mutual funds. They will be restricted to offering registered retirement savings plans and registered home ownership savings plans in the form of deposit plans only; they will be able to offer for sale but not manage bond and equity RRSP and RHOSP funds.

Banks would generally not be permitted to engage in portfolio management or investment counselling. Exceptions would be provided under certain conditions in respect of real estate investment trusts and mortgage investment companies. Small clients or infrequent investors could continue to request advice on particular securities and certain administrative services in the course of normal banking activities.

Investments in Canadian Corporations

The White Paper outlines a limited number of exceptions to the principle that the business of a bank should be provided directly through its own corporate structure.

The exceptions arise in such areas as residential mortgage lending, certain mortgage-based funds, venture capital and joint venture activities.

Bank Corporate Powers

The broad reforms recently enacted or now underway in legislation dealing with corporations, competition and bankruptcy will be applied to banks, either directly or through revisions in the Bank Act.

Banks will be given additional flexibility in the forms and methods of raising capital. Requirements for financial disclosure will be strengthened.

The Minister of Finance will retain responsibility to approve agreements among banks that are desirable for reasons of monetary or financial policy, and to approve mergers between banks

which he regards to be in the interest of the stability of the financial system. In other respects, banks will be directly subject to the Combines Investigation Act.