Submission on Bill C-38

Financial Consumer Agency of Canada Act

NATIONAL BUSINESS LAW SECTION
CANADIAN BAR ASSOCIATION

August 2000

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PREFACE

The Canadian Bar Association is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the Financial Institutions Committee of the National Business Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved by the Executive Officers as a public statement by the National Business Law Section of the Canadian Bar Association.

Submission on Bill C-38
Financial Consumer Agency of Canada Act

A. Introduction

The Financial Institutions Committee of the National Business Law Section of the Canadian Bar Association welcomes the opportunity to comment on Bill C-38, *Financial Consumer Agency of Canada Act* (the Bill). The Bill is intended to implement the federal government's policy paper *Reforming Canada's Financial Services Sector □ a Framework For the Future* dated June 25, 1999 (the Policy Paper). In this submission, we identify technical issues with the Bill and point to areas where the federal government's policy objectives, as outlined in the Policy Paper, may not be fully addressed.

The issues in this submission are addressed in the order in which they arise in the Bill. Some of our concerns under the *Bank Act* (the BA or sometimes the *Act*) are mirrored under the corresponding provision in the *Insurance Companies Act* (the ICA) or the *Trust and Loan Companies Act* (the TLCA). In these cases, we have included cross-references to those statutes but have not repeated our discussion or included these cross-references in the recommendations.

We have some general concerns about the Bill. Portions are unclear or inconsistent and require re-drafting to avoid creating administrative problems for institutions and other parties and to avoid difficulty in clear legal interpretation. The Financial Institutions Committee does not usually address "public policy" issues, except to the extent they affect "law". We have therefore not commented on policy positions in the Bill. However, we are

concerned that parts of the legislative scheme provide unnecessarily broad and undefined discretion to the Minister of Finance and the Superintendent of Financial Institutions. This creates uncertainty in interpretation and application of the legislation and renders compliance costly and difficult to monitor. Our comments are restricted to issues specific to the wording of the Bill, in the context of the understood policy position. Because of time constraints in the response process and an indication that submissions should be limited in scope, we have limited our discussion to the technical issues which are raised as presenting legal interpretation issues.

We note that the lengthy provisions governing bank holding companies are virtually identical to those governing banks. We question this approach, as it is cumbersome and substantially lengthens the Bill for no apparently good reason. A better approach would generally be to adopt the bank regime for bank holding companies and limit the holding company section to provisions which differ from the bank regime. Similar comments apply to the insurance company and insurance company holding regime. We understand the initial drafting attempted to adopt this approach, but the drafters found this approach did not effectively capture the needed changes. These difficulties are not apparent in a review of the results. We believe it is desirable to consider the former approach to reduce duplication and the likelihood of unintended inconsistency in the statute.

B. Definition of Subsidiaries — BA Section 5, ICA Section 5, TLCA Section 5

We question the amendment to section 5 of the BA to expand the definition of "subsidiary" to include the *de facto* control test contained in section 3(1)(d). There is no mention of this proposed change in the Policy Paper. Further, it is not in keeping with corporate law principles, under the *Canada Business Corporations Act* and similar statutes. These define subsidiaries as those where a person holds more than 50% of the voting shares which can be cast to elect directors. Under the BA, ICA and TLCA, where the intention

is that control is required under investment regulations, the word "control" is used. "Subsidiary" is used to express the generally understood corporate relationship. Requiring financial institutions to analyze whether they *de facto* control an entity seems unnecessary where the expression "subsidiary" is used and will create confusion. This is at least in part because a *de facto* test is used for "control" and the expression "control" is used where that seems merited by the expressed policy concerns. We are uncertain of the purpose for this expansion and are concerned that it may have unintended consequences.

RECOMMENDATION:

1. **The National Business Law Section of the Canadian Bar Association recommends that the definition of "subsidiary" be amended to exclude circumstances when control exists as a result of section 3(1)(d).**

C. Appropriation — Section 13(1)

In a similar provision to ones found in the *Office of the Superintendent of Financial Institutions Act* (*OSFI Act*) and the *Canada Deposit Insurance Corporation Act* (*CDIC Act*), section 13(1) of the Bill allows the Minister to transfer funds from the Consolidated Revenue Fund to the Agency. Implicit in the wording is that the funds are to be lent to the Agency, to be repaid with interest. This is not expressly stated, as it is in the *CDIC Act*. This should be contrasted with the *OSFI Act*, where funds are simply appropriated to pay the Agency's costs of operation not covered by assessments. The proposed role of the Financial Consumer Agency of Canada (the Agency) currently comes under the Superintendent. We therefore believe that its funding arrangements should parallel those under section 17 of the *OSFI Act*.

RECOMMENDATION:

2. **The National Business Law Section of the Canadian Bar Association recommends section 13(1) of the Bill be amended to parallel section 17 of the *Office of the Superintendent of Financial Institutions Act*.**

D. Disclosure Permitted — Section 17(2)

Section 17(2) of the Bill allows for the disclosure of information, which the Agency is otherwise obliged to keep confidential, to certain listed persons and bodies.[1] Included in that list under section 17(2)(c) is the Canada Deposit Insurance Corporation (CDIC) or any other compensation association. The other bodies listed in section 17(2) directly regulate and supervise financial institutions. The *CDIC Act* contains no "consumer provisions" as defined in this Part of the Bill, nor is it either a financial institution (as defined) or a supervisory or regulatory body. It is difficult to see how the information to be disclosed would relate to CDIC's purposes. It is therefore inappropriate to include CDIC and similar associations in the list of bodies to which confidential information should be revealed.

RECOMMENDATION:

3. **The National Business Law Section of the Canadian Bar Association recommends section 17(2)(b) of the Bill be deleted.**

E. Assessments — Section 18

Section 18 provides first for the Commissioner of the Agency to ascertain the total expenses incurred during the preceding fiscal year in connection with the administration of the *Act*. This includes detailed calculations of prescribed categories of expenses in relation to any prescribed group of financial institutions. The section then provides that the

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1 This section may be simply a copy of section 22(2) of the *OSFI Act*.

Commissioner is to assess a portion of the total expenses against each financial institution, as prescribed by regulation. It seems more appropriate that those costs be assessed proportionately to the role played by each institution and by each category of institution in causing those expenses to be incurred, such that the categories of institutions (and individual institutions within that category) would bear the expense based on the cost of regulation.

RECOMMENDATION:

4. **The National Business Law Section of the Canadian Bar Association recommends section 18 of the Bill be amended to clarify that expenses will be assessed against financial institutions, both as a category of financial institutions and individually, in direct proportion to the total expenses incurred by the Commission in carrying out its duties under the Bill in relation to that category and the individual financial institutions within that category.**

F. Act or Omission — Section 21

Section 21 addresses penalties for contravention of a specified consumer provision or non-compliance with a compliance agreement. Where an act or omission is designated as a violation under section 19(1)(a), it can proceed either as a violation or an offence, but not both. This is unnecessary and in direct conflict with several other provisions of the Bill. For instance, section 19(1)(a) authorizes the Commissioner to designate certain acts or failures to act "as a violation", not as an offence. Section 22 provides that "[e]very contravention or non-compliance that is designated under section 19(1)(a) constitutes a violation…". Section 27 states that "[f]or greater certainty, a violation is not an offence…".

RECOMMENDATION:

5. **The National Business Law Section of the Canadian Bar Association recommends section 21 of the Bill be deleted.**

G. Declaration of Dividend — BA Section 79(5), ICA Section 83(5), TLCA Section 82(5)

Proposed section 79(5) of the BA provides that a dividend may not be declared or paid without the approval of the Superintendent if the total of all dividends declared by a bank *in any financial year* would exceed the aggregate of the bank's net income for that year and its retained net income for the previous two financial years. We have identified a number of concerns with this provision.

First, if a Bank were to reorganize to establish a holding company, as provided by the Bill, one of the techniques to achieve the most flexibility from the holding company's structure would be to dividend shares of certain of the operating subsidiaries under the bank to the holding company. If that were to occur, the impact on retained earnings (depending on the value of asset which is dividended) would be such that it would likely require approval for each subsequent dividend for the bank for the next three years. Moreover, even if a bank decides not to adopt the holding company structure, it may be advantageous to dividend out the shares of certain of its subsidiaries to its shareholders in order to focus on its core business. Again, in that situation, the special dividend could be so large as to require any dividend paid in the next three years to be specifically approved by the Superintendent.

Another concern would arise if, for example, a dividend was paid in the first quarter of a year and an extraordinary loss occurred in the third quarter which eliminated all the income for the year and the net income retained from the previous two financial years. In this case, it is arguable that the dividend declared and paid in the first quarter would require approval of the Superintendent. This is a concern because under section 207(2)(c) of the BA, the directors are personally liable for a dividend paid in contravention of section 79. Prudent

directors may request that management obtain prior approval of the Superintendent for any dividend if they believe there is even a remote chance that an extraordinary loss will occur later in the year. Obtaining such approvals results in unnecessary time and expense for no effective result.

Section 79(5) of the BA was not referred to in the Policy Paper. The 10-day prior notice to the Superintendent required under section 79(2), and the limitations in section 79(4) would seem to provide adequate protection and meet the prudential aims of the BA.

RECOMMENDATION:

6. **The National Business Law Section of the Canadian Bar Association recommends that section 79(5) be deleted from the Bill or, in the alternative, that section 79(5) be drafted to provide more clearly that the payment of a dividend would not contravene the provision if the Board of Directors had reasonable grounds for believing that the section would not be violated at the time the dividend was declared.**

H. Conduct Review Approval — BA Sections 195(3) and 495.3, ICA Sections 204 and 528, TLCA Sections 199 and 483

The duty of the Conduct Review Committee to approve related party transactions was removed from the *Act* in 1997. Proposed section 495.3 requires the Conduct Review Committee to approve transactions in certain circumstances. Accordingly, we believe that it is necessary for the duties of the Conduct Review Committee to be expanded under proposed section 195(3) to include approval of transactions under section 495.3.

RECOMMENDATION:

7. **The National Business Law Section of the Canadian Bar Association recommends that the duties of the Conduct Review Committee be expanded under proposed section 195(3) to include approval of transactions under section 495.3.**

I. Amendments to Letters Patent — BA Section 215, ICA Section 224, TLCA Section 220

Under section 28(1) of the *Act*, the letters patent incorporating a bank set out:

- the name of the bank;
- the place in Canada where the head office of the bank is to be situated;
- the date that the bank came, or is to come, into existence; and
- any provision not contrary to the *Act* that the Minister considers advisable.

Section 217 of the *Act* has been expanded to permit a bank: to change its name through a by-law approved by special resolution of the shareholders and by the Superintendent; and to change the location of its head office through by-law approved by special resolution of the shareholders. However, under section 215, the Minister's approval is necessary for a bank to change "any provision that is permitted by this *Act* to be set out in the bank's incorporating instrument". It should be clarified that the Minister's approval under section 215 is not required when a change is made in accordance with section 217.

RECOMMENDATION:

8. **The National Business Law Section of the Canadian Bar Association recommends that the Bill be amended to clarify that the Minister's approval under section 215 does not apply to a proposal to change the name or location of the bank pursuant to section 217.**

J. Major Shareholder — Transition — BA Sections 374 and 378

Section 374 of the *Act* states that no person may be a major shareholder of a bank with equity of $5 billion or more. Section 378 of the *Act* provides a transitional rule for certain banks with less than $5 billion in equity on the day the Bill comes into force. Neither of these sections address the situation of banks with greater than $5 billion in equity when the *Act* comes into force which subsequently fall below that threshold through losses or extraordinary dividends.

RECOMMENDATION:

9. **The National Business Law Section of the Canadian Bar Association recommends that the Bill be amended to clarify the ownership regime which would apply in the event that a bank with greater than $5 billion in equity falls below that threshold.**

K. Major Shareholder — Holding Company — BA Section 376, ICA Section 407.01

Section 376 prevents a widely held bank from having a major shareholder in a banking subsidiary of the bank. The policy objectives of this restriction are unclear. If the intention is to prohibit the major shareholder in the banking subsidiary from controlling the upstream bank, the provision is not necessary. The prohibition on *de facto* control of the widely held bank in section 377 of the *Act* would be operative even if the person did not own any shares in the upstream bank.

If the restriction was intended to limit joint ventures in the future it is unlikely to be effective. This is because it only applies to the Canadian banking subsidiary of the widely held bank and not to any trust, loan, insurance, foreign bank, or new financial services entity

subsidiaries. Moreover, such a restriction may inhibit joint venturing opportunities, which we had understood was one of the goals of the structural flexibility provided by the new holding company regime.

In addition, any transaction which would result in a person becoming a prohibited major shareholder in a Canadian bank would need to be specifically approved by the Minister. Under section 396, the Minister must take into account all matters considered relevant including a non-exhaustive list set out in that provision.

RECOMMENDATION:

10. The National Business Law Section of the Canadian Bar Association recommends that the Bill be amended to delete section 376 of the *Act*.

L. Investment Procedures — BA Section 419(2), TLCA Section 450, ICA Section 470(2)

Sections 419(2) of the BA and 470(2) of the ICA provide that the Superintendent may order a bank or insurance company to amend the policies required for investment procedures. Section 450 of the TLCA does not have a similar provision. The sections provide no guidance as to the circumstances in which the Superintendent may issue such an order. We recognize the Superintendent needs some flexibility to properly monitor prudential standards. However, there should be some standards against which the exercise of this power can be assessed. Right now, there are no statutory criteria for such an order.

RECOMMENDATION:

11. The National Business Law Section of the Canadian Bar Association recommends that the circumstances in which the Superintendent may issue an order under section 419(2) BA and 470(2) ICA be specified.

The order should be issued only for the purpose of ensuring that the investment procedures appropriately reflect the provisions of the *Act*.

M. Definition of Mutual Fund Entity — BA Section 464, ICA Section 490, TLCA Section 449

The requirement in the definition of a mutual fund entity that it must provide "professional investment management" does not seem to further any enunciated policy goal. This requirement may hamper effective management of the entity. For example, fund managers have recently started to outsource management to lower management expense ratios, as demanded by mutual fund investors. Internal professional investment management is not necessarily required for effective investment by the mutual fund. Mutual funds are heavily regulated under securities law, particularly as to investments and disclosure, and this type of regulation has been increasing.

RECOMMENDATION:

12. **The National Business Law Section of the Canadian Bar Association recommends that the requirement for professional investment management be removed from the definition of mutual fund entity.**

N. Control Holding Company — BA Section 468(4)(b), ICA Section 495(6)(b), TLCA Section 453(4)(b)

BA section 468(4)(b) requires the bank to control an entity that is primarily engaged in acquiring or holding shares that a bank is permitted to hold under the *Act* or that is otherwise permitted under the minority investment regulations. We do not understand the policy rationale for requiring a bank to control a holding company if the legislation would not otherwise require the bank to control the downstream substantial investments of the holding company. If the bank was required to control the downstream entity then it would

be appropriate to require the bank to control an investment which is made indirectly in such an entity through a holding company.

RECOMMENDATION:

13. **The National Business Law Section of the Canadian Bar Association recommends that BA section 468(4)(b) be amended to apply only to holding companies which hold substantial investments in entities which the bank is otherwise required to control.**

O. Definition of Related Party — BA Section 488.1, ICA Section 520.1, TLCA Section 476.1

These sections significantly expand the meaning of related party transactions by adding a "benefit" test. Transactions are deemed to be related party transactions where they "benefit" a related party of the bank. This test is so broad as to be largely incapable of clear interpretation. It will potentially fail to identify transactions of concern while capturing those not intended – including those which are otherwise on arm's length terms.

The true test of whether there has been an inappropriate related party transaction should be whether the consideration to the entity is at market terms – in other words, whether the consideration is the same as the party would receive from a third party. The "benefit" test fails to recognize the nature of the consideration. The proposed test makes it virtually impossible for an institution to establish any compliance system to reliably determine whether a transaction should be deemed to be a related party transaction. It will be ineffective to determine transactions of real concern and has the potential to be extremely burdensome and costly, even to attempt to implement compliance procedures. In many cases, it will be virtually impossible for parties to know whether indeed they have entered into such a transaction, which may be criticized as such in hindsight.

RECOMMENDATION:

14. The National Business Law Section of the Canadian Bar Association recommends that section 488.1 be deleted.

P. Undertakings — BA Section 470, TLCA Section 455, ICA Section 497

If a financial institution acquires control of specified entities, subsection (2) of these sections requires that institution to provide the Superintendent with any undertakings concerning the entities that the Superintendent may require. However, the legislation provides no criteria for the exercise of this discretion. This contrasts with subsection (1) in each section, which specifically set out that undertakings are limited to the activities of the entity and access to information about the entity. Subsection (2) grants an undue level of discretion and authority to the Superintendent without giving guidance as to its application. Presumably the lack of limitations in subsection (2) allows the Superintendent to require undertakings for other purposes. This is not consistent with the scheme of the *Act*, and results in the discretion being wholly undefined.

RECOMMENDATION:

15. The National Business Law Section of the Canadian Bar Association recommends that the Bill specify criteria for requiring undertakings under BA section 470(2). The criteria should carry out the purpose and intent of the *Act*. Preferably the criteria should set out the specific scope and purpose of the undertaking, tying into the provisions of subsection (1) in each instance. Subsection (2) should also specify the basic terms which may be included in undertakings.

Q. Exemption Related Party — BA Section 499, ICA Section 532, TLCA Section 487

Section 499 of the current *Act* grants what appears to be a broad exemption power to the Superintendent with respect to related party transactions. However, the exercise of this power requires that the transaction has not been entered into as a consequence of, and is not likely to be, influenced in any significant way by the related party. It also can not involve in any significant way the interest of a related party at the bank. This section is virtually never used because there are almost no circumstances where the precondition is capable of being satisfied. Accordingly, the Bill should either amend this section to provide for an attainable standard for the exemption or repeal it.

RECOMMENDATION:

16. The National Business Law Section of the Canadian Bar Association recommends that section 499 be either amended to provide for an attainable standard for the exemption, or repealed.

R. Fair Value — BA Section 501(2)(b), ICA Section 534(2)(b), TLCA Section 489(2)(b)

Section 501(2)(b)(ii) replaces the traditional test of "fair market value" with a new concept of "fair value" for transactions which would not reasonably be expected to occur in an open market. It is unclear how a court would interpret fair value when it has to consider "all of the circumstances of the transaction". A more appropriate standard – and one more likely to be consistently interpreted by the courts – is that the transaction must be in the "best interest of the corporation". This is consistent with the duties of the directors generally under section 158 of the BA, and would seem to address the policy issue.

RECOMMENDATION:

17. The National Business Law Section of the Canadian Bar Association recommends that section 501(2)(b)(ii) be amended to remove the

concept of fair value and replace it with the test that the transaction must be in the "best interest" of the institution.

S. Share Exchange — BA Sections 677-678, ICA Sections 714-715

These portions of the Bill address the exchange of shares of a bank or insurance company for shares of a new holding company. They also deal with the alternative of creating a holding company through another fundamental change to the bank or insurance company. The Bill only permits a direct share-for-share exchange. For these provisions to be effective, some tax structuring may be required to ensure no adverse material tax consequences in connection with the creation of a holding company. As well, a number of Canadian banks and insurance companies have securities listed and traded in the United States. Accordingly, these provisions should afford banks and insurance companies, to the extent possible, a basis for relying on statutory exemptions from the application of the *United States Securities Act of 1933* and the *United States Securities Exchange Act of 1934*. These goals require some flexibility in the process of the share exchange and in the attributes of the shares of the holding company to be issued.

RECOMMENDATION:

18. **The National Business Law Section of the Canadian Bar Association recommends that the nature of issued shares under BA section 677(2) be changed from the "same" to "the same or substantially similar" where a bank or insurance holding company is created through an exchange of bank or insurance company shares or by means of another fundamental change to a bank or insurance company. BA section 677(1) should permit the share exchange to occur directly or through a series of steps, provided the end result is a share for share exchange.**

T. Holding Company Regulations — BA Sections 922(1)(c), 929-930(2)-(6) and 949(2), ICA Sections 963(1)(c), 970-971(2)-(6) and 992(2)

In introducing the Bill, the federal government stated that regulated, non-operating holding companies were intended to offer financial institutions the potential for greater operational efficiency and lighter regulation. It is difficult to assess whether these objectives will be achieved without first reviewing draft regulations under this regime. A number of critical areas remain subject to further refinement through the regulation-making process. We highlight this issue to focus attention on the crucial role of regulations in this area.

U. Letters Patent — BA Sections 676 and 705-706, ICA Sections 713 and 744-745

With respect to the organization of a bank or insurance holding company including the creation of share capital, the Bill contemplates the use of letters patent and by-laws. BA section 676 permits the Minister broad, undefined discretion in imposing provisions in the letters patent. For approximately 25 years, many major federal and provincial corporate statutes, such as the *Canada Business Corporations Act*, *Business Corporations Act* (Ontario) and *Business Corporations Act* (Alberta) have employed a regime using articles of incorporation to organize corporations, including the creation of share capital. Letters patent are used where incorporation is a matter of approval and not of right.

As noted earlier, the government's objectives in creating a bank or insurance holding company include more flexibility, greater operational efficiency and lighter regulation. The holding company is not a financial institution subject to full regulation. It is, however, subject to approvals, authorizations or consents required in the context of, among other things, ownership and activities of a bank or insurance holding company.

RECOMMENDATION:

19. **The National Business Law Section of the Canadian Bar Association recommends that a bank or insurance holding company be organized under an articles regime. Alternatively, the Bill should set out the criteria for issuing letters patent to an entity which is not a financial institution but which is heavily regulated (for example, as to ownership). This should include guidance on the company specific provisions which can be required in the letters patent.**

V. Share Issuance — BA Section 709(1), ICA Section 748

A share of a bank or insurance holding company may only be issued if it is fully paid in money or, with the approval of the Superintendent, in property. Many corporate statutes also permit the issuance of shares where the consideration for the share is fully paid in money or in property or past services. This consideration can not have less value than the fair equivalent of the money that the issuer would have received had the share been issued for money. A similar provision in the Bill would provide flexibility and permit a bank or insurance holding company to offer appropriate compensation arrangements including equity entitlements. The provision should also clarify that the directors may take into account reasonable charges and expenses of organization and reorganization and payments for property and past services reasonably expected to benefit the holding company.

RECOMMENDATION:

20. **The National Business Law Section of the Canadian Bar Association recommends that the issuance of a share in a bank or insurance holding company require the consideration for the share to be fully paid in money or in property or past services that are not less in value than the fair equivalent of the money that the holding company would have received if the share had been issued for money. The provision should clarify that the directors may take into account**

reasonable charges and expenses of organization and reorganization and payments for property and past services reasonably expected to benefit the holding company.

W. Deemed Related Party — BA Sections 211, 488.1 and 506(1), ICA Sections 220, 520.1 and 539(1), TLCA Sections 216, 476.1 and 494(1)

Section 506 and its counterparts provide significant personal liabilities for directors and senior officers. The proposed deemed related party transactions in BA section 488.1 (discussed earlier) expand these liabilities. Directors already have significant general duties and standards. In most cases, these transactions are initially approved by management and, where required, by the Conduct Review Committee pursuant to the 1997 amendments. The 1997 amendments essentially delegated the approval of related party transactions to management. It is unduly onerous to impose personal liability on the directors and senior officers when there is already an involved statutory scheme to review and approve related party transactions. Even in arm's length transactions, it may be difficult for directors and officers to know until a transaction is well over whether it was, in fact, prudent, strategic and in the best interests of the corporation.

The reference to BA section 506.1 in BA section 211, with respect to the ability of the directors to rely on financial statements and reports, is of no real assistance. Financial statements and reports generally do not deal with the issues of concern in reviews of related party transactions.

RECOMMENDATION:

21. **The National Business Law Section of the Canadian Bar Association recommends that the addition of personal liability to directors and officers in BA section 506.1 and its counterparts be deleted.**

X. Removal of Director — BA Section 647.1(1)(a), ICA Section 678.1(4) and (5), TLCA Section 509.2(1)(a)

BA section 647.1(1)(a) provides the Superintendent extremely broad and virtually undefined discretion to remove a director or senior officer on the basis of the "competence, business record, experience, conduct or character of the person". This contrasts with section 647(1)(a), which is based on removing a director or senior officer under measures designed to maintain or improve the safety and soundness of the company. Other sections – for example, section 647.1(1)(b) – provide specific reasons for removal, such as contravening the *Act*; certain directions and orders; conditions in orders approving the commencement of carrying on the company's business; and prudential agreements and undertakings.

RECOMMENDATION:

22. The National Business Law Section of the Canadian Bar Association recommends that section 647.1(1)(a) and its counterparts be amended to provide more specific criteria for the grounds for removal. These would reflect the policy concern of protecting prudential standards.

Y. Major Owner — Foreign — BA Sections 507(2), (7) and (8)

Sections 507(2),(7) and (8) establish threshold levels beyond which a foreign bank would be a "major owner" of such an entity. These thresholds are 35% of ownership interests of an unincorporated entity, 20% of voting shares or 30% of non-voting shares of an

incorporated entity. It is not clear why these thresholds differ from those established for "control" or "substantial investment" elsewhere in the *Act*.

Further, the overlap of definitions may lead to some confusion. For example, section 518(1) permits a designated foreign bank to acquire or hold "control" of certain Canadian entities, or to become a "major owner" of such entities. These terms appear to overlap.

RECOMMENDATION:

23. The National Business Law Section of the Canadian Bar Association recommends the definition and use of the term "major owner" in the foreign banks part of the Bill be consistent with terms such as "control" and "substantial investment" used elsewhere in the *Act* to refer to the same concept.

Z. Foreign Banks, Business Powers — BA Section 508

Section 508(1)(a) is essentially a blanket restriction on a foreign bank engaging in any activity in Canada, subject to an elaborate series of exceptions. This is a broader restriction than in the current *Act*, and arguably impinges on the "natural person powers" of a Bank in section 15. In restricting a foreign bank's powers, the Bill arguably needs to go only so far as the list of business powers in section 409 for Schedule I banks. This results in a lack of parallelism, which is otherwise a desirable objective and a consistent theme throughout the Bill.

RECOMMENDATION:

24. The National Business Law Section of the Canadian Bar Association recommends that the Bill maintain the current language of section 508(1)(a), which only restricts the ability to carry on "any banking business." In the alternative, the Bill should only restrict the foreign

bank's ability to engage in any activity in which a Schedule I bank is permitted to engage.

AA. Approval for Investment — BA Section 518.2

Section 518.2(1) establishes a list of investments which a foreign bank may only make with approval of the Minister. Section 518.2(1)(b) requires approval for a foreign bank to acquire control in a Canadian entity engaging in certain activities. The provision will be difficult to apply because it is hard to determine in advance whether the financial intermediary activities of a target investment involve "material market or credit risk", if the target does not fall under the enumerated list of entities. Thus, it will frequently be unclear whether the Minister's consent is required. One problem is the word "material", which is largely incapable of determination without clarification of the standard of materiality. Another problem is what constitutes "market risk".

RECOMMENDATION:

25. **The National Business Law Section of the Canadian Bar Association recommends the Bill clarify what is intended to constitute "market risk" and provide a standard for "material".**

BB. Prudential Agreement — BA Section 644.1

BA section 644.1 gives the Superintendent the power to enter into a "prudential agreement" with a bank. The agreement's purpose is to implement any measure designed to maintain or improve the bank's safety and soundness. This power is quite open-ended and vague. The Bill should clarify when such an agreement would be sought and should provide some guidance on what the content of the agreement would be.

RECOMMENDATION:

26. The National Business Law Section of the Canadian Bar Association recommends that this section specify the circumstances in which such an agreement can be requested, provide that such an agreement is solely for the purpose of carrying out prudential regulation under the statute and set out some principles concerning the content of an agreement.

CC. ICA Section 250(5)

This section prohibits the Minister from issuing letters patent amalgamating a converted (demutualized) company before January 1, 2002. This seems to inadvertently prohibit an amalgamation between a demutualized insurance company and any other corporation, including a wholly owned subsidiary, where we understand the policy concern was to prevent a take over prior to that date. We do not believe that the above prohibition was intended, nor is it necessary to implement the proposal regarding amalgamation and insurance companies set out in the Policy Paper. Frequently, amalgamation is used for tax or other reasons in a manner which would not impede the rationale in the Policy Paper.

RECOMMENDATION:

27. The National Business Law Section of the Canadian Bar Association recommends that section 250(5) be amended not to prohibit amalgamations between a demutualized insurance company and a subsidiary or other entity which does not result in a "take over" of that company.

DD. Notice of Meeting ICA Section 143(1.5), (1.6)

Sections 143(1.5) and (1.6) provide that policyholders must return a form indicating that they wish to receive notices of meetings. This has not been amended by the Bill. However, in practice, it sometimes leads to unintended consequences for the policyholder and the company. For example, policyholders sometimes misplace this form and then ask to be placed on the mailing list by telephoning the company or sending an e-mail. If the company demands that the form be returned, policyholders may feel the company is being too bureaucratic. If the company accepts the oral or electronic request, the company may technically violate the ICA and bring in to question the validity of the meeting.

RECOMMENDATION:

28. **The National Business Law Section of the Canadian Bar Association recommends that the Bill be amended to allow the policyholder to either return the form or to indicate in any other manner acceptable to the company that the policyholder wishes to receive notice of the meeting.**

EE. Conclusion

We appreciate the opportunity to provide input into this important Bill. We emphasize the importance of financial institutions to our economy and urge that the legislation be carefully considered in both its technical and policy aspects prior to being passed. We are concerned that the drafting in many parts of this Bill will lead to uncertainty and increased administrative and compliance costs.

FF. Summary Of Recommendations

The National Business Law Section of the Canadian Bar Association recommends:

1. **that the definition of "subsidiary" be amended to exclude circumstances when control exists as a result of section 3(1)(d).**

2. **section 13(1) of the Bill be amended to parallel section 17 of the *Office of the Superintendent of Financial Institutions Act*.**

3. **section 17(2)(b) of the Bill be deleted.**

4. **section 18 of the Bill be amended to clarify that expenses will be assessed against financial institutions, both as a category of financial institutions and individually, in direct proportion to the total expenses incurred by the Commission in carrying out its duties under the Bill in relation to that category and the individual financial institutions within that category.**

5. **section 21 of the Bill be deleted.**

6. **that section 79(5) be deleted from the Bill or, in the alternative, that section 79(5) be drafted to provide more clearly that the payment of a dividend would not contravene the provision if the Board of Directors had reasonable grounds for believing that the section would not be violated at the time the dividend was declared.**

7. that the duties of the Conduct Review Committee be expanded under proposed section 195(3) to include approval of transactions under section 495.3.

8. that the Bill be amended to clarify that the Minister's approval under section 215 does not apply to a proposal to change the name or location of the bank pursuant to section 217.

9. that the Bill be amended to clarify the ownership regime which would apply in the event that a bank with greater than $5 billion in equity falls below that threshold.

10. that the Bill be amended to delete section 376 of the *Act*.

11. that the circumstances in which the Superintendent may issue an order under section 419(2) BA and 470(2) ICA be specified. The order should be issued only for the purpose of ensuring that the investment procedures appropriately reflect the provisions of the *Act*.

12. that the requirement for professional investment management be removed from the definition of mutual fund entity.

13. that BA section 468(4)(b) be amended to apply only to holding companies which hold substantial investments in entities which the bank is otherwise required to control.

14. that section 488.1 be deleted.

15. that the Bill specify criteria for requiring undertakings under BA section 470(2). The criteria should carry out the purpose and intent of the *Act*. Preferably the criteria should set out the specific scope and purpose of the undertaking, tying into the provisions of subsection (1) in each instance. Subsection (2) should also specify the basic terms which may be included in undertakings.

16. that section 499 be either amended to provide for an attainable standard for the exemption, or repealed.

17. that section 501(2)(b)(ii) be amended to remove the concept of fair value and replace it with the test that the transaction must be in the "best interest" of the institution.

18. that the nature of issued shares under BA section 677(2) be changed from the "same" to "the same or substantially similar" where a bank or insurance holding company is created through an exchange of bank or insurance company shares or by means of another fundamental change to a bank or insurance company. BA section 677(1) should permit the share exchange to occur directly or through a series of steps, provided the end result is a share for share exchange.

19. that a bank or insurance holding company be organized under an articles regime. Alternatively, the Bill should set out the criteria for issuing letters patent to an entity which is not a financial institution but which is heavily regulated (for example, as to ownership). This should include guidance on the company specific provisions which can be required in the letters patent.

20. that the issuance of a share in a bank or insurance holding company require the consideration for the share to be fully paid in money or in property or past services that are not less in value than the fair equivalent of the money that the holding company would have received if the share had been issued for money. The provision should clarify that the directors may take into account reasonable charges and expenses of organization and reorganization and payments for property and past services reasonably expected to benefit the holding company.

21. that the addition of personal liability to directors and officers in BA section 506.1 and its counterparts be deleted.

22. that section 647.1(1)(a) and its counterparts be amended to provide more specific criteria for the grounds for removal. These would reflect the policy concern of protecting prudential standards.

23. the definition and use of the term "major owner" in the foreign banks part of the Bill be consistent with terms such as "control" and "substantial investment" used elsewhere in the *Act* to refer to the same concept.

24. that the Bill maintain the current language of section 508(1)(a), which only restricts the ability to carry on "any banking business." In the alternative, the Bill should only restrict the foreign bank's ability to engage in any activity in which a Schedule I bank is permitted to engage.

25. the Bill clarify what is intended to constitute "market risk" and provide a standard for "material".

26. that this section specify the circumstances in which such an agreement can be requested, provide that such an agreement is solely for the purpose of carrying out prudential regulation under the statute and set out some principles concerning the content of an agreement.

27. that section 250(5) be amended not to prohibit amalgamations between a demutualized insurance company and a subsidiary or other entity which does not result in a "take over" of that company.

28. that the Bill be amended to allow the policyholder to either return the form or to indicate in any other manner acceptable to the company that the policyholder wishes to receive notice of the meeting.