



Ruling

Category: Foreign Banks

NOTICE*

Subject: Small denomination notes

No: 2003 – 05

Issue: The issue was whether an authorized foreign bank that is a full-service branch (FSB)¹ could issue a debt obligation in a denomination of greater than \$150,000 (large denomination note), which would subsequently be subdivided into notes of less than \$150,000 that would confer a beneficial interest in the large denomination note (small denomination notes).

Background: The FSB proposed to issue large denomination notes to agents or intermediaries, such as securities dealers or mutual fund trusts, on the understanding that the agents or intermediaries would subdivide the large denomination notes into small denomination notes (in amounts as small as ten dollars) to be sold to the public. The small denomination notes would be tradable on a secondary market. For example, the FSB could issue a large denomination note to a securities dealer, to be held through the Canadian Depository for Securities Limited. The securities dealer would sell beneficial ownership interests in the note to retail investors. As another example, the FSB could issue a large denomination note to a mutual fund trust, whose main asset would be the note. The mutual fund trust would distribute trust units to retail investors.

The FSB submitted that section 545 of the *Bank Act* (BA) did not preclude it from issuing large denomination notes that would be subdivided into small denomination notes. It argued that the small denomination notes would not be “deposits” as that term is defined in subsection 545(3) for the purpose of subsection 545(1). The meaning of “deposit” in subsection 545(3) is linked to the definition set out in the schedule to the *Canada Deposit Insurance Corporation Act* (CDIC Act). Its main arguments were that the small denomination notes would not be “deposits” as defined under the schedule to the CDIC Act because the money received in consideration of these notes would not be received in the usual course of the FSB’s deposit-taking business. The small denomination notes were more similar to a security than a deposit (i.e., unlike deposits, they would be issued by an agent or intermediary that is not a deposit-taking institution and would be tradable).

¹ A foreign bank in respect of which an order has been made under subsection 524(1) of the *Bank Act*, permitting the foreign bank to operate in Canada through a branch without being subject to the restrictions and requirements referred to in subsections 540(1) and (2) of the *Bank Act*.

Considerations: Subsection 545(1) of the BA prohibits FSBs from accepting retail deposits (i.e., deposits of less than \$150,000 and payable in Canada) in respect of their business in Canada, subject to a *de minimus* exception. Foreign banks that wish to engage in the retail deposit-taking business in Canada must establish a Canadian bank, trust or loan subsidiary and be a member of CDIC.

Although an argument could be made that the small denomination notes are not deposits for the purposes of deposit insurance as defined in the schedule to the CDIC Act, and therefore would not be deposits for the purpose of section 545 of the BA, the issuance of such notes by FSBs would not be consistent with the publicly enunciated government policy to preclude foreign banks from engaging in retail operations in Canada through a branch, nor would it be compatible with the regulatory regime developed for foreign bank branches.

Conclusion: OSFI advised the FSB that the issuance of large denomination notes to agents or intermediaries in Canada on the understanding that the notes would subsequently be subdivided into small denomination notes is not consistent with the government's foreign bank entry policy. In addition, OSFI indicated that if the FSB were to issue such notes, the Superintendent could use remedial powers set out in the BA to restrict the issuance of such notes or could restrain the FSB from engaging in such deposit-taking activity. For example, the Superintendent may make one or more of the following orders:

- place conditions or limitations in the FSB's Order to Commence and Carry On Business or revoke it (section 534 of the BA); or
- direct the FSB to maintain assets in Canada in an amount greater than the minimum requirement set out in paragraph 582(1)(b) of the BA; i.e., the greater of five million dollars or five per cent of the liabilities of the FSB in respect of its business in Canada (section 617 of the BA).

Legislative References:

Subsection 545(1) of the BA states that a FSB must ensure that, on average for any 30-day period, the sum of all its retail deposits does not exceed more than one per cent of its total deposit liabilities.

Subsection 545(3) of the BA states that for the purpose of subsection (1), "deposit" has the meaning that would be given to it by the schedule to the CDIC Act for the purposes of deposit insurance if that schedule were read without reference to subsections 2(2), (5) and (6) of that schedule, but does not include prescribed deposits.

Table of Concordance:

Other federal financial institution legislation does not contain similar provisions that may be of relevance to the reader.

* Rulings describe how OSFI has applied or interpreted provisions of the federal financial institutions legislation, regulations or guidelines to specific circumstances. They do not negate the need to obtain any necessary approval of the transaction under the relevant federal financial institutions legislation. Rulings are not necessarily binding on OSFI's consideration of subsequent transactions as these transactions may raise additional or different considerations. Legislative references in a Ruling are not meant to substitute provisions of the law; readers should refer to the relevant provisions of the legislation, regulation or guideline, including any amendments that came into effect subsequent to the Ruling's publication.