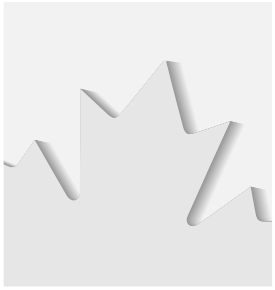
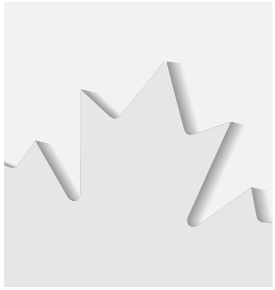


1997 Review of Financial Sector Legislation: Proposals for Changes

June 1996

Canada



1997 Review of Financial Sector Legislation: Proposals for Changes

June 1996

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PREFACE

In June, 1992, the federal government completed a comprehensive reform of the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act* and the *Cooperative Credit Associations Act*. Barriers between the various pillars of the financial sector were significantly reduced, creating a new framework for competition. Given the far-reaching scope of the changes, sunset clauses were introduced in the Acts requiring Parliament to enact new legislation by March 31, 1997.

The government began the 1997 legislative review process with two objectives in mind. First, we wanted to assess whether or not the legislation adopted in 1992 was functioning as intended. Second, we wanted to determine whether or not the framework set four years ago remained adequate in view of the significant developments affecting the financial sector. Over the last year, the government has consulted extensively on these issues with a wide range of stakeholders. The Standing Senate Committee on Banking, Trade and Commerce also held a series of hearings and issued an interim report on the 1992 legislation. The overall message emerging from these consultations is that the legislative framework adopted in 1992 is generally working well, but that certain provisions of the statutes require adjustment.

In this document, we are proposing a series of important amendments to the legislation that will serve to address the needs of consumers, and to simplify and update regulation. Consultations will be held with consumers, the financial community and other interested parties to discuss proposals set out in this document. It is my intention to have new legislation in place prior to the Acts' expiration.

At the same time, the government recognizes that there are broad trends at play, such as globalization of financial services markets, technological advances and a changing competitive landscape. These developments raise important questions relating to the structure of the Canadian financial services industry and the role played by financial institutions in serving the emerging needs of Canadian businesses and consumers and in Canada's international competitiveness. These issues are important and require thoughtful analysis. They must be addressed to ensure that Canadians continue to have a secure, efficient and competitive financial sector that offers real choice.

Given the complexity and importance of the task, the government will undertake a comprehensive review of the appropriate framework for the financial sector in the 21st century – one that will promote economic growth and job creation. A Task Force on the Future of the Canadian Financial Services Sector will be established to provide advice to the government on public policy issues related to the development of the framework. This review will shape the next revision of amendments to the financial sector legislation, which the government proposes take place no later than five years after the passage of the 1997 legislation.

The Honourable Doug Peters
Secretary of State (International Financial Institutions)

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EXECUTIVE SUMMARY

Canadians enjoy one of the strongest financial systems in the world – one that is efficient, effective and stable. For the most part, it offers a good balance between competition and the stability of financial institutions.

But the federal government continually monitors developments in the financial sector and looks for ways to improve the system. In 1992, significant changes were made to the legislative framework which supports the financial services sector. By most accounts, these changes have produced positive results.

It was agreed when the 1992 legislation was passed that the legislative framework should be revisited in five years. After extensive consultation and analysis, the government has concluded that the legislative framework established in 1992 should be kept largely intact, but that a number of important adjustments to the financial institutions legislation should be made. These adjustments would serve to:

- strengthen consumer protection,
- ease the regulatory burden on financial institutions, and
- keep the legislation current with evolving trends.

The government also believes that a comprehensive review of the payments system is warranted.

In this document, the government proposes a series of amendments to the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act*, the *Cooperative Credit Associations Act*, the *Bank of Canada Act*, the *Canadian Deposit Insurance Corporation Act*, the *Bills of Exchange Act*, the *Office of the Superintendent of Financial Institutions Act* and the *Interest Act*.

At the same time, the government recognizes that the financial sector is evolving rapidly and that fundamental questions which have been raised by stakeholders in consultations – mainly on the structure of the industry and the role played by financial institutions – must all be addressed to ensure that we have the most efficient, secure and competitive financial sector for the next century. These fundamental questions are complex and must be addressed in a broad context. The government will need to establish the appropriate framework for the financial sector in the 21st century – one that will promote economic growth and job creation. A Task Force on the Future of the Canadian Financial Services Sector will be established to provide advice to the government on public policy issues related to the development of the framework. This study will shape the next round of amendments to the legislation which the government proposes take place no later than five years after the passage of the 1997 legislation.

Strengthening Consumer Protection

In this document, the government proposes a number of initiatives to further protect the interests of consumers in their dealings with federal financial institutions.

1) Privacy Safeguards

The protection of personal information is of utmost importance to this government. The government acknowledges the efforts made by financial institutions to address privacy concerns over the past few years, and intends to build on these successes with further improvements. In this regard, the government proposes introducing regulations governing the collection, use, retention, and disclosure of customer information by federal financial institutions.

2) Cost of Financial Services

The government will work with the banks and trust and loan companies to simplify and improve the dissemination of information about their fees. Financial institutions will also be required to provide more detailed information about the cost of credit, as a result of the Internal Trade Initiative.

3) Availability of Basic Financial Services

The government will work with consumer and community groups, and financial institutions to develop and implement a strategy to improve access to financial services for low-income Canadians.

4) Tied Selling

The government will explore with consumer groups, financial institutions and other interested parties whether or not new measures are needed to protect consumers of financial services against abusive tied selling.

5) The Right to Prepay Mortgages

Consultations will be held with interested parties to determine whether or not prepayment rights and maximum mortgage prepayment penalties should be legislated for all new mortgages.

Easing the Regulatory Burden on Financial Institutions

Regulations are important for the financial sector. They protect consumers and set out rules of the game so that the sector can operate smoothly. Having said this, there are a number of areas where regulations are not functioning as well as intended and should be simplified to ease the regulatory burden on financial institutions. As stated in the February 27, 1996 Speech from the Throne, the government is committed to taking appropriate action to promote a proper climate for economic growth and jobs. In particular, the government wants to ensure that regulatory requirements are clearly defined, and that delays are minimized when regulatory approval is required. There are

five areas which the government is focusing on in this regard in the financial sector. These are: overlap and duplication between federal and provincial regulation; the self-dealing regime; the requirement to establish subsidiaries to carry on certain activities; the ability of opting out of Canada Deposit Insurance Corporation (CDIC) membership; and, the foreign bank entry regime. In addition, the government is conducting a review of the approval process which will deal with the number of approvals required and who must provide them.

1) Overlap and Duplication Between Federal and Provincial Regulation

The government supports reducing overlap and duplication in Canadian financial sector regulation. The government reaffirms its commitment to work with the provinces to make further progress in a number of areas.

2) Self-Dealing Regime

The government proposes a number of changes to streamline the self-dealing regime. These changes involve refocusing the role of the Conduct Review Committee that has to be established by the boards of directors of financial institutions, narrowing the range of related parties, and allowing subsidiaries of a federal financial institution to transact with each other.

3) Subsidiary Requirements

In order to reduce their operational costs, the government proposes to permit financial institutions to carry on both information processing and specialized financing activities in-house, rather than through subsidiary operations.

4) Deposit Insurance Opt-Out

The government proposes to allow deposit-taking institutions that do not take retail deposits to opt out of CDIC coverage. As a result, these institutions would no longer have to fulfil the reporting requirements associated with CDIC membership.

5) Foreign Bank Entry Regime

Modifications are proposed to the rules governing the operations of foreign banks in Canada. These changes would reduce the regulatory burden on many foreign entities while ensuring consistent treatment with domestic institutions.

Fine-Tuning the Legislation

The government plans to fine-tune some aspects of the 1992 legislation which are not operating as well as they should, and to make timely adjustments to other pieces of legislation.

1) Corporate Governance

Changes are proposed to encourage financial institutions to adopt appropriate corporate governance processes to manage risk, and to keep the legislation in tune with evolving standards. A "best practices" paper will be developed by the Office of the Superintendent of Financial Institutions (OSFI) in consultation with industry. Refinements to the rights of policyholders to receive information and participate in the affairs of their companies are proposed.

2) Joint Venture Arrangements

The government will amend regulations to provide more flexibility to financial institutions seeking to enter into joint venture arrangements.

3) Access to Capital for Mutual Insurance Companies

The government proposes a number of changes to enhance access to capital for mutual insurance companies. First, they would be permitted to issue participating shares. Second, the demutualization regime would be extended to apply to all mutual life companies, and added flexibility would be provided.

4) Amendments to the Bank of Canada Act

The government is considering a few technical amendments to the *Bank of Canada Act* to remove outdated impediments to functions and activities of the Bank of Canada.

Reviewing the Payments System

The government believes it important that the regulatory structure supporting the payments system be reviewed. Therefore, the Department of Finance will establish an advisory committee to study payments system issues. The work of this committee will be an important input into the broader review by the Task Force on the Future of the Canadian Financial Services Sector.

Next Steps

The government has consulted extensively on most of the areas covered in this paper. It is confident that the proposals to strengthen consumer protection and to simplify and update regulation are sound and will serve the best interests of the consumer and the financial sector.

Having said this, the government is prepared to engage in further discussions on proposals contained in this document before introducing legislation by the end of the year.

Written comments regarding any element of this paper are invited and should be directed to the Financial Sector Division, Department of Finance, by August 30, 1996. All written comments received will be made available upon request to interested parties.

CHAPTER 1

FRAMEWORK AND OBJECTIVES FOR THE 1997 REVIEW

Financial institutions are essential to our economic success as a nation. They fund the mortgages of Canadians, insure our homes and automobiles, attract and invest our savings, and provide loans to consumers and businesses across the country. Financial institutions employ over half-a-million Canadians. The strength of our institutions contributes to a world-class financial system in Canada.

This document sets out proposals to improve the legislation governing the operations of federally regulated financial institutions. These include banks, trust, loan and insurance companies as well as co-operative credit associations.

In June of 1992, new legislation came into effect governing the operations of federal financial institutions. The legislation resulted in amendments to the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act*, and the *Cooperative Credit Associations Act*.

This package of legislation was the most comprehensive reform of financial sector legislation ever undertaken by the federal government. It removed many of the restrictions preventing financial institutions from fully competing with each other. Financial institutions were allowed to diversify into new lines of financial business through broader in-house powers and subsidiary operations. They were also permitted to market financial services offered by affiliates or independent financial institutions (with exceptions in the area of insurance).

Previous revisions to the *Bank Act* had included a 10-year sunset clause to ensure regular review of the legislation. At the time the 1992 legislation was implemented, it was decided that the breadth and scope of the changes warranted an early review of their effectiveness. Thus, sunset clauses were included in all four Acts and set for March, 31, 1997.

Key Developments in the Financial Sector Since the 1992 Reform

The financial services industry has changed significantly over the past few years, both in Canada and abroad. Domestically, the most pronounced development has been the significant restructuring in the deposit-taking sector, with banks acquiring a number of trust and loan companies, many of which were in financial difficulty. Consolidation has also taken place in the insurance sector.

The pace of consolidation has been spurred by several factors. One is slower growth of the demand for financial products. Another is the entry of financial institutions into new lines of business, either directly or through subsidiaries. As a result, different types of financial institutions now compete with each other for the market share on a wider range of products. In this environment,

many financial institutions have restructured their operations to facilitate expansion into new markets, take advantage of complementary product lines, and build the size and strength which they believe is necessary to compete effectively.

The failure of a few financial institutions has focused attention on the federal supervisory system. In February 1995, the government released a discussion paper entitled *Enhancing the Safety and Soundness of the Canadian Financial System*. The paper proposed refinements to strengthen the supervisory and regulatory framework for federal financial institutions, the federal deposit insurance system, and federal oversight of clearing and settlement arrangements. Legislative proposals flowing from the 1995 discussion paper have been introduced under the recently passed *An Act to amend, enact, and repeal certain laws relating to financial institutions*.

The financial sector has also seen a continuing trend towards globalization of financial services markets. Major international trade agreements, such as the North American Free Trade Agreement and the General Agreement on Trade in Services under the World Trade Organization, have been signed since 1992. These agreements have enhanced the ability of Canadian financial institutions to compete abroad, by establishing principles for trade in financial services and by providing for dispute settlement mechanisms.

Scope and Objectives of the 1997 Review

The government began the 1997 legislative review process with two objectives. The first was to assess whether or not the legislation adopted in 1992 was functioning as intended. The second objective was to determine whether or not the legislative framework remained adequate in view of the significant developments occurring in the sector.

The government has consulted extensively on both of these questions. In September 1994, the Department of Finance provided a background report to the Standing Senate Committee on Banking, Trade and Commerce.[1] This report supported Committee hearings on the functioning of the 1992 legislation. An interim report was issued by the Committee in August 1995.

The Department of Finance has also held wide-ranging consultations with a variety of stakeholders. In March 1995, interested parties were invited to provide written comments on any aspects of the four financial institutions statutes. The department received over 30 written briefs. Discussions were held with most submitting parties, including consumer groups, industry and trade associations, professional societies, and individual firms.

[1] Developments in the Financial Services Industry Since Financial Sector Legislative Reform.

The primary conclusion of these consultations is that the legislative framework established in 1992 is generally working well. Most observers continue to support the broad objectives of the 1992 reform and believe that the legislative framework remains appropriate.

That being said, one of the important issues discussed in the course of these consultations is the state of competition in the Canadian financial sector, with some stakeholders suggesting that concentration in the hands of a few large institutions has reduced competitive forces. While the level of concentration may have increased over the past 10 years, there is no concrete evidence suggesting that this increase has had a negative impact on the state of competition.

Nonetheless, there have been representations raising this possibility. For example, a number of independent securities dealers have suggested that preferential treatment given to bank-owned dealers in the provision of standby and subordinated loans has reduced competition. Consideration will be given to the nature and the extent of these alleged problems and, if warranted, to their solutions. However, the government believes that a major overhaul to address concentration is not needed. The government is of the view that the legislative framework established in 1992 is generally working well and should be kept largely intact.

Another issue which has dominated the consultations is the marketing of insurance products by deposit-taking institutions through their branches. As announced in the *1996 Budget Speech*, the government has decided to maintain existing restrictions in that area. The government recognizes that the financial sector is still digesting many of the changes flowing from the extensive reform of the financial institutions legislation in 1992. The pressures of competition and rationalization are continuing today.

Stakeholders have pointed to several other areas where they would like to see changes. Consumer groups are asking the government to strengthen consumer protection provisions. Financial institutions have also noted a number of provisions in the legislation which do not function as well as intended or are not in keeping with industry trends. Stakeholders have also proposed changes to the *Canadian Payments Association Act* which is not expiring in 1997 but which has an impact on the operations of federal financial institutions.

The government recognizes that the issues raised are important and have significant implications for the smooth functioning of the financial sector. It also recognizes that the *Canadian Payments Association Act* has not been reviewed since 1980, and that the payments system landscape has changed dramatically since then.

After extensive consultation and detailed analysis, the government has decided that a number of important adjustments should be made. These adjustments would serve to:

- strengthen consumer protection,
- ease the regulatory burden on financial institutions, and
- keep the legislation current with evolving trends.

The government is also of the view that analysis of the regulatory framework of the payments system is warranted.

Specific proposals to strengthen consumer protection, and simplify and update legislation are outlined in the following chapters. Additional information about payments system issues is presented in Chapter 5.

At the same time, the government recognizes that there are broad trends at play, such as globalization of financial services markets, technological advances and a changing competitive landscape. In this environment of constant evolution, fundamental questions (brought forth by stakeholders on the structure of the industry and the role played by financial institutions) must all be addressed to ensure that we have the most efficient, secure and competitive financial sector for the next century. These fundamental questions are complex and must be addressed in a broad context.

Given the complexity of the task, the government will undertake a comprehensive review of the appropriate framework for the financial sector in the 21st century – one that will promote economic growth and job creation. A Task Force on the Future of the Canadian Financial Services Sector will be established to provide advice to the government on public policy issues related to the development of the framework. This study will shape the next round of amendments to the legislation which the government proposes take place no later than five years after the passage of the 1997 legislation.

CHAPTER 2

STRENGTHENING CONSUMER PROTECTION

The nature of the relationship between financial institutions and their clients is constantly evolving, due largely to the diversification of financial services and the ever-increasing use of technology in providing financial services.

In this context, consumers have expressed a desire for better protection in their dealings with financial institutions. This chapter describes proposals designed to provide that protection.

Privacy Safeguards

The protection of personal information is of utmost importance to this government. In today's environment, where technological advances permit easier access to and analysis of personal data, the government recognizes the importance to consumers of knowing why information is collected and how it will be used and stored. Consent is key if information is to be used for a new purpose or disclosed to outside parties. The government also understands that consumers want access to information held about them, and rights of recourse if information is misused.

Together with consumer and business groups, government representatives recently participated in the development of the Canadian Standards Association's (CSA) new Model Code for the Protection of Personal Information. The code represents considerable progress from previous practice.

In the financial sector, the collection and handling of personal information is a significant issue. Financial institutions rely on extensive amounts of often-sensitive information to market their services. The government acknowledges the efforts made by financial institutions to address privacy concerns over the past few years, including their participation in the development of the CSA code. The government intends to build on these successes with further improvements.

At the same time, any action in the financial services area should be consistent with the federal government's broader approach for privacy protection. The government recently announced that it is developing proposals for a legislative framework to protect personal data. At this time, the government wishes to take the opportunity of the review of the financial institutions legislation to take action on specific issues of concern to consumers of financial services.

The government proposes to introduce regulations governing the collection, use, retention, and disclosure of customer information by federal financial institutions.

More specifically, financial institutions would be required to:

- adopt a code of conduct governing the collection, use, retention and disclosure of information. The government encourages financial institutions to use the CSA code as a minimum standard in formulating their codes of conduct;
- designate a senior-level officer in each financial institution to implement procedures for dealing with consumer complaints;
- provide customers with written information on their privacy code and details of how customers can make complaints;
- report annually on the complaints received and the actions taken to respond to these complaints.

The Cost of Basic Financial Services

Consumers have raised concerns about the various service charges imposed by financial institutions and the difficulty of comparing charges across deposit-taking institutions. Banks and trust and loan companies currently offer a wide range of accounts to meet the different needs of consumers, including a variety of "no-frills" accounts with minimal charges. For example, most deposit-taking institutions offer accounts with unlimited free deposits and a number of free withdrawals monthly (varying from two to six). But many institutions also offer low-cost, monthly fixed fee packages with additional services.

It is the responsibility of consumers to determine the account that best meets their needs. But the government recognizes that comparing charges can be difficult.

The government will work with banks and trust and loan companies to simplify and improve the dissemination of information about fees.

The Availability of Basic Financial Services

At times, low-income individuals have difficulty accessing basic financial services, such as opening accounts and cashing cheques. Financial institutions' policies often mean that many individuals cannot qualify for basic financial services or find these services impractical. For example, identification requirements can exclude people who do not have a credit card or a driver's license. The financial services community is aware of these problems, and discussions are underway to address them.

The government will work with consumer and community groups as well as financial institutions to develop and implement a strategy to improve access to financial services for low-income Canadians.

Cost of Credit Disclosure

As part of the Internal Trade Initiative, federal and provincial governments are committed to harmonizing legislation dealing with the disclosure of the cost of credit for consumers. Federal and provincial governments are now finalizing proposals in this regard. The harmonization exercise is expected to benefit both consumers and lenders through enhanced and uniform disclosure practices across the country.

Following an agreement with the provinces, the federal government will amend the provisions on cost of credit disclosure in the financial institutions statutes.

Tied Selling

Choice, quality, and competitive prices are some of the benefits derived from a competitive, market-driven economy. However, market forces alone cannot always ensure competitive conduct. Effective competition laws are also needed.

The *Competition Act* provides a framework for business conduct in Canada. The Act provides for, among other things, remedies where firms engage in anti-competitive behaviour, which may involve tied selling. Tied selling occurs when a firm requires a customer to buy one product as a condition of purchasing another one. This could occur as a result of coercion. Alternatively, a firm might provide a lower price on one product if the customer buys another product and this could be beneficial to the consumer. If the Competition Tribunal finds that tied selling is lessening competition substantially, it may issue an appropriate order necessary to restore or stimulate competition.

The government believes that a balanced approach helps to achieve a competitive process in the marketplace. The approach recognizes that the offering of discounts and packages is beneficial to consumers who can acquire a series of products at cheaper prices than if they were purchasing them individually. It also recognizes that market forces generally prevent firms from forcing consumers to buy products that they do not want. However, the approach does not guarantee that firms will never attempt to coerce consumers into buying a product as a condition of purchasing another product, a behaviour that is obviously not to the advantage of consumers.

Concerns have been raised that the special nature of the relationship between financial institutions and their customers renders their customers especially vulnerable to coercion, and that market forces and the *Competition Act* may not provide sufficient safeguards for these consumers.

The government is prepared to explore with consumer groups, financial institutions, and other interested parties whether stronger measures are needed to protect consumers of financial products from coercion, and, if so, whether these measures could be implemented in a way that would not deny consumers the benefits of discounts and packaging of financial products.

Right to Prepay Mortgages

Current federal policy regarding loan prepayment differs according to the length of the mortgage term. Prepayment rights and penalties are legislated for mortgages with terms of more than five years, but not for those with terms of five years or less. This means that lenders do not have to offer prepayment of mortgages of five years or less, and can set penalties as they choose if they allow prepayment.

Concerns have been raised by consumers and other groups about this lack of legislation. Conversely, the maximum penalty in the *Interest Act* for mortgage terms of more than five years – three-months interest – is seen as inadequate by lenders to compensate for the risk of interest rate movements. It has been cited as a deterrent to the development of a longer-term mortgage market.

The government is prepared to consider amending the *Interest Act* to provide prepayment rights and a standardized approach to calculating maximum mortgage prepayment penalties for all new mortgages, regardless of the term. The government is also prepared to consider amending the financial institutions statutes to provide more explicit disclosure requirements for mortgage prepayment.

The government believes that these issues warrant further investigation and comment by consumer groups, mortgage providers and other interested parties to ensure that both borrowers and lenders are treated fairly.

Summary

As noted, consultations on the proposals listed above have and will take place. But the general direction of change is clear. The government will move forcefully to better protect the interests of consumers in their dealings with financial institutions. In particular, consumer privacy safeguards will be strengthened.

CHAPTER 3

EASING THE REGULATORY BURDEN ON FINANCIAL INSTITUTIONS

There is no question that regulations are required in the financial sector. Regulations not only protect the consumer, they set out the rules of the game so that the sector can operate smoothly. Having said this, there are a number of areas where regulations are not functioning as well as intended and should be simplified to ease the regulatory burden.

As stated in the February 27, 1996 Speech from the Throne, the government is committed to taking appropriate action to promote a proper climate for economic growth and jobs. In particular, the government wants to ensure that regulatory requirements are clearly defined, and that delays are minimized when regulatory approvals are required for businesses.

In this regard, there are five areas in the financial sector on which the government is focusing. These are: overlap and duplication between federal and provincial regulation; the self-dealing regime; the requirement to establish subsidiaries to carry on certain activities; the ability of opting out of the Canadian Deposit Insurance Corporation (CDIC) membership; and, the foreign bank entry regime.

In addition, the government is conducting a review of the approval process which will deal with the number of approvals required and who must provide them. This review will also lead to some technical changes designed to streamline administration of and compliance with the Acts.

Overlap and Duplication Between Federal and Provincial Regulation

The government continues to support reducing overlap and duplication in Canadian financial sector regulation, and is prepared to take action to meet this objective. Regarding the trust and loan sector, the government is committed to the ongoing harmonization discussions with the provinces. Some progress has been made over the past year in this area, and in order to encourage these discussions to a successful conclusion, the government proposes to amend the *Trust and Loan Companies Act* to reflect the work so far. For example, the government is prepared to refine the definition of a commercial loan to reflect agreement with the provinces on a harmonized definition. Discussions with the provinces will continue through 1996, and it is hoped that further progress can be made.

Another area of interest is Canadian securities regulation. At present, Canadian securities markets are subject to thirteen regulatory jurisdictions. The government is prepared to work with interested provinces towards the development of a Canadian Securities Commission. The establishment of such a Commission would promote efficient Canadian capital markets, reduce the cost of distributing securities and enhance the competitiveness of Canadian companies.

A third area relates to co-operative credit associations. The federal government regulates the Credit Union Central of Canada and some provincial credit union centrals. The provinces regulate local credit unions and their provincial centrals. At present, there are six provincial credit union centrals (in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Nova Scotia) which are registered under the federal *Cooperative Credit Associations Act*, an obvious example of overlap and duplication between federal and provincial regulation.

The federal government is prepared to explore with the provincial governments the possibility of amending the *Cooperative Credit Associations Act* to end federal regulation of provincial credit union centrals.

Self-Dealing Regime

A key part of the 1992 reform was the implementation of comprehensive controls on transactions between a financial institution and persons who are in positions of influence over, or control of, the institution (commonly known as the "self-dealing" regime). While the government believes that the basic framework remains sound, it agrees with the financial services industry that certain provisions of the regime have proven impractical and have imposed unnecessary costs on many financial institutions.

The government proposes a number of changes to streamline the self-dealing regime. These changes involve streamlining the operations of the Conduct Review Committee that has to be established by the board of each financial institution, narrowing the range of related parties, and allowing subsidiaries of a federal financial institution to transact with each other. Details are provided in Annex A.

Subsidiary Requirements

Under the current legislation, financial institutions can engage in certain types of business only through subsidiaries. The requirement to establish subsidiaries reflects various considerations, including the government's policy of maintaining a separation between the core activities of the different types of financial institutions as well as risk containment.

Financial institutions have asked that the requirement to establish subsidiaries for certain activities be removed to reduce costs to their operations. The government has reviewed the types of business that can only be carried out through subsidiaries, and concluded that the existing requirement could be relaxed for certain activities.

The government proposes to permit financial institutions to carry on both information processing and specialized financing activities in-house.

Allowing in-house specialized financing activities would enable financial institutions to manage their venture capital support for small business more cost-effectively and should therefore generate increased funding for this important sector. Other prudential rules currently applying to specialized financing activities would be maintained, with one exception. The rule requiring investments to be sold within 10 years would be extended to 13 years to allow greater flexibility for financial institutions to provide ongoing support to emerging companies.

Deposit Insurance Opt-Out

Foreign banks which specialize in serving large corporate customers have asked the government to allow them to apply for exemption from the current CDIC coverage. The rationale for allowing financial institutions serving the wholesale market to "opt out" of CDIC coverage is that the vast majority of their deposits are corporate accounts, with balances well in excess of the maximum for insurable deposits.

One of the key issues is how to define which institutions would qualify for the exemption. This could be done on the basis of the size of the deposit (e.g., over $200,000), the type of depositor (e.g., corporation, non-resident), or some combination of these two criteria. In designing the exemption regime, it would be important to ensure that consumers are informed of the uninsured status of deposits with exempt institutions, and that an appropriate transition framework is established for current CDIC member institutions which are granted an exemption.

The government proposes to allow financial institutions that do not take retail deposits to "opt out" of CDIC coverage, provided they are not affiliated with another CDIC member. The conditions under which financial institutions could make use of this provision will be discussed with affected parties.

Foreign Bank Entry Regime

Currently, the operations of foreign banks in Canada are governed by a series of rules which cover, among other things, the types of financial services they can offer and when regulatory approvals are required. Foreign entities have asked that some of these requirements be reviewed to reduce the regulatory burden they face and to ensure consistent treatment with domestic institutions.

The government proposes to modify its entry policy as follows:

For regulated foreign banks – entities which are regulated as banks in their home jurisdiction and for whom banking services constitute a large part of their operations – the key features would be:

- They would be permitted to carry on financial services activities in Canada only through subsidiaries which are federally regulated financial institutions. The one exception to this would be securities activities carried out by an entity that is subject to the regulatory regime applicable to these activities. Regulated foreign banks would have to seek the approval of the Minister of Finance prior to commencing operations in Canada.
- A regulated foreign bank which owns a Schedule II bank would no longer be required to hold other financial institution subsidiaries through the Schedule II bank. For example, a regulated foreign bank or bank holding company would be able to control its Canadian securities dealer affiliate as part of its foreign securities subsidiaries, separate from its banking subsidiaries in Canada and abroad. Appropriate undertakings would be required for access to information for supervisory purposes.

For "near banks" – entities which do not generally take deposits, are not regulated as banks in their home jurisdiction, but provide one or more banking-type services (e.g., consumer loans) – the key features would be:

- Once they have received approval under the *Bank Act* to enter the Canadian market, no further approvals would be required provided that their unregulated activities remain outside of retail funding.
- They would be allowed to hold any non-bank financial institution.

The existing Canadian operations of some foreign banks may be affected by these changes. The government understands the importance of having adequate transitional arrangements and will be discussing these arrangements with affected companies.

CHAPTER 4
FINE-TUNING THE LEGISLATION

There are a number of areas where changes were made in 1992, but where adjustments are required because the legislation is not working as well as it should. Changes are also necessary in other areas to keep the legislation current with evolving trends. This chapter describes key proposals to keep the financial sector legislation up-to-date.

Corporate Governance

1) General Provisions

The corporate governance provisions of the financial institutions statutes were updated in 1992, and are generally considered to be working well. Indeed, some of the rules introduced in the financial institutions statutes in 1992 have now become the norm for companies listed on the Toronto Stock Exchange.

The government proposes a number of changes in the area of corporate governance to encourage financial institutions to adopt appropriate corporate governance processes to manage risk, and to keep the legislation current with evolving standards.

The Office of the Superintendent of Financial Institutions (OSFI) will promote "best practices" for corporate governance and perform additional assessments of the effectiveness of corporate governance processes implemented by financial institutions. A best practices paper will be developed by OSFI addressing, among other things, the need for financial institutions to have appropriate structures and procedures in place to ensure that the board of directors can function independently from management. For example, at the option of the financial institution, the board of directors could appoint a chair of the board who is not a member of management. Alternatively, the board of directors could rely on a formal outside "lead director", or some other equivalent process.

It has been suggested that the statutory duty of the audit committee to "ensure that appropriate internal control procedures are in place" is vague, and that its effectiveness would be enhanced with better direction as to what is expected from the committee. The government proposes to clarify the statutory duty. The audit committee would require management to implement and maintain appropriate internal control procedures. In addition, the committee would review, evaluate and approve the internal controls of the financial institution.

It is also proposed that the circumstances under which a person is considered affiliated with a financial institution be expanded to include significant participants in share option schemes or pension plans, former Chief Executive Officers for a period of time, as well as directors of significant borrowers. This change would bring the concept of "unaffiliated director" flowing from the financial institutions legislation more in line with the definition of "independent director" recently developed for companies listed on the Toronto Stock Exchange.

In addition, the government proposes to allow the board of directors to conduct business by resolutions signed by all directors, in lieu of a board meeting. A minimum number of board meetings would have to take place.

Financial institutions increasingly have financial institution subsidiaries in different businesses. Transfers of assets between parent and subsidiary could benefit one group of creditors or one consumer protection plan at the expense of others. Yet, currently, the boards of directors of the parent and subsidiary institution which approve the transaction can be identical. Consideration is being given to limiting the use of these "mirror" boards where the financial institution's business is unlike the business of its parent.

There are a number of areas where changes are not proposed because they are currently under review in other fora. The government will follow these discussions closely. Upon conclusion of these discussions, the government will decide whether legislative amendments to the financial institutions statutes should be proposed. A short description of these areas is provided in Annex A.

2) Policyholders' Rights

In 1992, the rights of policyholders entitled to vote were substantially modernized. The new system recognizes that policyholders are not identical to shareholders. It also recognizes the costs of sending notices to a large number of policyholders, which may not even be of interest to many policyholders. In addition, the regime is designed so that a few policyholders cannot, by themselves, force fundamental changes in a mutual company. Overall, the system put in place in 1992 is working well and no major changes are proposed.

However, the government believes that it would be desirable to facilitate the disclosure of information and the participation of policyholders who are interested in the affairs of their companies. To this end, a number of proposals have been developed which will be the subject of further consultation with industry. These are contained in Annex B.

Joint Venture Arrangements

Joint venture arrangements can be extremely useful mechanisms for financial institutions wishing to expand into new areas of business. They are, however, currently subject to a number of rules which the financial services industry finds unduly restrictive. For example, there is a requirement that the eligible joint venture be controlled by a financial institution. Financial institutions claim that this requirement places them at a competitive disadvantage in foreign operations where their competitors have more flexibility for these types of arrangements. In its 1995 *Interim Report on the 1992 Financial Institutions Legislation*, the Standing Senate Committee on Banking, Trade, and Commerce identified the joint venture rules as an area where regulations inhibit competitiveness.

The government proposes to provide more flexibility to financial institutions seeking to enter into joint venture arrangements by removing the requirement that the eligible joint venture be controlled in fact by a financial institution. Details are provided in Annex B.

The proposed changes would enhance the ability of financial institutions to make alliances, enter new markets, and compete more effectively in Canada and abroad.

Access to Capital for Mutual Insurance Companies

Access to capital is key to the ability of mutual insurance companies to compete in Canada and abroad. In 1992, two measures were introduced in this regard. First, mutual companies were permitted to issue preferred shares. Second, small mutual life companies were allowed to "demutualize" or convert into stock companies.

Concerns have been expressed about the adequacy of these measures. Being restricted to preferred share financing is considered too inflexible to allow companies to respond to the changing needs and demands of the market. The process small mutual life insurance companies currently must follow to convert into stock companies is seen as complex and lengthy. Larger mutual life insurance companies have asked that a process for demutualization be introduced for them as well.

The government proposes a number of changes to enhance access to capital for mutual insurance companies. First, they will be permitted to issue participating shares. Second, the demutualization regime will be extended to apply to all mutual life companies, and added flexibility will be provided. Details are provided in Annex A.

Taking of Security Interest

Currently, there are inconsistencies between the *Bank Act* provisions and provincial security legislation relating to the taking of security interest. A working group has been established to examine whether legislative changes can be made to address these differences. The working group is expected to report shortly. The government will review the recommendations of the working group, and will consider legislative changes if a consensus is achieved.

Amendments to the *Bank of Canada Act*

The government proposes to use the opportunity of the legislative review to consider a limited number of technical amendments to the *Bank of Canada Act* to remove outdated impediments to certain activities of the Bank. For example, the changes include modernizing the range of instruments which the Bank may buy and sell; clarifying the ability of the Bank to carry on ancillary activities such as licensing anti-counterfeiting technology; and changing the threshold whereby unclaimed balances in deposit accounts that have been inactive for more than 20 years are sent to the Receiver General.

CHAPTER 5

REVIEWING THE PAYMENTS SYSTEM

A safe and sound payments system is a vital part of the operations of a modern sophisticated economy. Canada's payments system is administered by the Canadian Payments Association (CPA) which was established by legislation in 1980. Canada has one of the best paper-based payments systems in the world. However, the increasing use of technology is changing the payments system landscape, and it has been suggested that the framework developed twenty years ago should be reviewed.

For example, interested parties who have not traditionally played a significant role in the payments system would now like the opportunity to provide input into the future development of the system. Also, there have been recent concerns about whether or not Canada's payments system provides sufficient opportunity for competition and innovation.

The government recognizes that opening up the payments system to new players could introduce new risks to the system. Accordingly, it is critical that possible modifications to the payments system be examined carefully to ensure that the integrity of the system is not compromised.

Given the importance and the complexity of these issues, the Department of Finance will establish an advisory committee with a range of expertise in payments issues, including industry participants, academics, consumers, and other key users of the payments system. It is expected that the Department of Finance advisory committee will contribute significantly to the Task Force's work on the development of a suitable framework for the financial sector in the 21st century.

As part of its work on payments system issues, the Department of Finance will further explore its concern with unregulated entities issuing payment items permitting them to have indirect access to the payments system. These items, commonly known as payable-through drafts, are payment items that clear through the payments system via a CPA member. When issued by a non-CPA member, the decision to honour these items rests with the non-CPA member who may be an unregulated entity. Payable-through draft arrangements could have negative implications for the financial system. Accordingly, those who are contemplating entering into such arrangements should consider carefully the implications of doing so.

The government acknowledges that interested parties have a stake in rules made by the CPA, and recognizes the importance of the CPA's consultative processes. While a number of mechanisms have been put in place by the CPA to obtain the input of interested parties, more needs to be done. Accordingly, the government is calling upon the CPA to enhance its consultative mechanisms as soon as possible in order to ensure that the voices of all interested parties are heard.

CHAPTER 6

NEXT STEPS

The government has consulted extensively on most of the areas covered in this paper. The consultations helped shape the proposals.

The government is confident that the proposals for change are sound and will serve the best interests of the consumer and the financial sector. It welcomes comments on the details of the proposals to assist in the drafting of the required legislation.

Written comments regarding any element of this paper are invited and should be directed to the Financial Sector Division, Department of Finance, by August 30, 1996. All written comments received will be made available upon request to interested parties.

ANNEX A

SUPPLEMENTS TO CHAPTERS 3 AND 4

The following provides more detailed information on some of the proposals presented in Chapters 3 and 4 of the main document.

Self-Dealing Regime

The industry has indicated concerns with respect to the Conduct Review Committee that has to be established by the board of each financial institution. Currently, this Committee must approve in advance virtually all transactions with related parties. This is viewed as impractical. To address these concerns, the government proposes to refocus the role of the Conduct Review Committee. The Committee would have to establish appropriate internal procedures to comply with the self-dealing provisions, but would not have to review individual transactions. As is currently the case, the board of directors would continue to report annually to the Superintendent of Financial Institutions on the proceedings of the Conduct Review Committee.

It has been suggested that the definition of a related party (i.e. a person considered to be in a position of influence over the institution) is too broad. Under the current definition, many institutions have several thousand related parties. The requirement to maintain an up-to-date list of these related parties imposes a significant administrative burden for these institutions without, in many instances, conferring any real benefits – because transactions are unlikely to occur with many of the related parties, or be of any significance for the institution. Thus, the government proposes to narrow the definition of who is a related party as follows:

- Officers would only be considered related parties when they are the most senior officers of an entity. Currently all officers of a financial institution and of any entity which controls a financial institution are related parties.
- The business interests of natural persons who are related parties only because they are directors or officers would be related parties only when they are controlled by the natural person. Currently the business interests of these natural persons are related parties even if the natural person has only a substantial investment in the business rather than a controlling interest. The business interests of persons related because they are principal owners would remain as related parties down to the level of a substantial investment.
- The rule that deems a person to be a related party for one year after the person has ceased to be a related party would be eliminated.

The government proposes that transactions between subsidiaries of a federally regulated financial institution no longer be subject to the self-dealing regime. This means that subsidiaries of a given institution would not be

considered related parties. The self-dealing regime would continue to apply to transactions between a financial institution or any of its subsidiaries with related parties of the financial institution such as owners, officers and directors and their business interests.

Corporate Governance

As noted in Chapter 4, there are areas where changes are not proposed because they are currently under review in other fora. The government will follow these discussions closely. Upon conclusion of these discussions, the government will decide whether or not legislative amendments should be proposed.

The first area relates to civil liability for continuous disclosure. The Interim Report of the Toronto Stock Exchange Committee recommends that issuers and others who are responsible for continuous disclosure that is misleading be liable in civil actions.

There have also been representations to change the liability of auditors and actuaries from joint and several liability to a regime of liability proportionate to the defendant fault in causing damage. Although these may have merit, any changes to the requirements for financial institutions should be postponed until the preferred approach for business corporations generally is developed.

Finally, directors and officers have a duty to act in the best interests of the company. There is a view that this duty could be extended to other stakeholders, such as depositors and policyholders. In light of emerging trends in corporate law, it would be premature to expand directors' and officers' statutory duties. The government will be conducting further consultations on this issue.

Access to Capital for Mutual Insurance Companies

1) Share Financing

The government proposes to permit mutual insurance companies to issue participating shares with the following terms:

- Shareholders would be allowed to participate in the ongoing earnings of a mutual company on a basis proportional to their capital investment. Shareholders would also be entitled, on dissolution of a company, to the portion of the remaining property of the company attributable to the shares.
- These shares could confer on the holder the right to vote at meetings of the company in the event that a specified event has occurred or a specified condition has been fulfilled. In addition, shareholders would have the right to vote on certain "fundamental changes" affecting the company, such as amalgamation proposals.

- Companies would be required to establish a method for allocating earnings and expenses between policyholders and shareholders and the appointed actuary of the company would be required to opine on the fairness and equity of the allocation method. The method and the opinion would be filed with OSFI.

2) Demutualization

The demutualization regulations embody a number of key principles which are important to guiding the demutualization process, and which would be retained. These include a requirement to place a fair value on the company and to allocate that value to policyholders, along with a requirement that an independent expert provide an opinion on the fairness and equity of the value placed on the company and on the method and assumptions used to calculate that value. An independent actuary's opinion on the fairness and equity of the nature, amount and value of benefits to be provided to policyholders is also required. At the same time, it is recognized that more flexibility could be added to the regulations, for example, to remove the three-year restriction on issuing shares with conversion privileges to directors, officers and employees of the converted company. As well, the wording of the regulations would be altered to clarify that the value to be placed on the company should reflect prevailing market conditions.

As is contemplated in the current legislation, the larger mutual life insurance companies would be required to remain widely held after a conversion. Regulations to define the meaning of "widely held" would be promulgated to clarify that no person may have a significant interest in the converted company.

It is proposed that more flexibility be added to the demutualization regime in two other ways. First, the Superintendent would have the authority to exempt companies from specific aspects of the regulations on a case-by-case basis (e.g., documentation to be provided to policyholders). Second, the Minister of Finance would have the authority to exempt companies in financial distress from any aspect of the demutualization process. This authority could improve the chances of a company in financial distress finding a strategic partner and remaining a going concern, where appropriate. The government will consult with mutual life insurance companies on these proposed changes and on whether additional flexibility in the regulations is needed to accommodate other types of capital raising transactions.

ANNEX B

TECHNICAL AMENDMENTS

The following describes technical amendments to streamline the financial institutions legislation. They are the result of extensive consultations with industry representatives – a process that will continue as the legislative amendments are drafted.

The Annex is not a complete list of proposed technical amendments. A number of amendments that involve minor cross referencing errors, inconsistencies, amendments relating to the structure of the Acts or amendments that are non-substantive in nature are not included in this Annex, but will be part of the legislative package. A number of corporate governance amendments proposed by industry representatives involve matters that Industry Canada is currently reviewing in conjunction with proposed changes to the *Canada Business Corporations Act*. The changes to the CBCA will generally be incorporated into the *Bank Act*, *Trust and Loan Companies Act*, *Insurance Companies Act* and *Cooperative Credit Associations Act*.

In addition, amendments to the *Winding-up Act* may be required to ensure consistency with the *Bankruptcy and Insolvency Act*.

The annex is structured to contain amendments relating to all the relevant Acts; the *Bank Act* (BA), *Trust and Loan Companies Act* (TLCA), *Insurance Companies Act* (ICA) and *Cooperative Credit Associations Act* (COOP). It also contains one amendment to the *Bills of Exchange Act* and the *Office of the Superintendent of Financial Institutions Act*. FRFI stands for federally regulated financial institution.

The *Bank Act*, *Trust and Loan Companies Act*, *Insurance Companies Act* and *Cooperative Credit Associations Act*

General Provisions

ICA 2(1)

Subject: Definition of "Actuary"

Amendment: Amend the definition of an actuary so that the definition refers only to a natural person who is a Fellow of the Canadian Institute of Actuaries.

Explanation: This is a clarifying amendment that assists in streamlining the legislation and will result in certain consequential amendments to other provisions in the Act.

BA 11(1) TLCA 11(1) ICA 11(1)

Subject: Definition of "Distribution to the Public".

Amendment: Broaden the definition to include securities of an unincorporated entity.

Explanation: This change is required since the term "distribution to the public" is used in the above-referenced Acts in regard to the securities of both a body corporate and an unincorporated entity.

BA 14(5), 30, 37(2), 56(2), 229(3), 507(6), 514(6), 518(6), 532	TLCA 28, 35(2), 59(2), 234(3), 504	ICA 29, 36(2), 60(2), 251(3), 584(2), 585	COOP 29, 63(2), 232(3), 477

Subject: Publication in the Canada Gazette

Amendment: Amend the provisions so that periodicals or electronic media readily available to the public could be used as well as the Canada Gazette for providing public notices.

Explanation: It is anticipated that, with the advances in information-based technology, electronic media alternatives to publication in the Canada Gazette will become available. These may be more easily accessible by the public. This amendment is being included in the respective Acts in anticipation of using more effective and cost efficient means for the Superintendent to meet publication requirements.

BA New provision

Subject: Continuance as a Trust Company or a Loan Company

Amendment: Add a provision to the *Bank Act* allowing a bank to be continued under subsection 31(1) of the *Trust and Loan Companies Act*, subject to appropriate conditions being met prior to the Minister approving the discontinuance.

Explanation: This provides a further means for banks to cease operating as banks. Currently, a similar provision exists in the *Trust and Loan Companies Act* and *Insurance Companies Act* which permit these FRFIs to be continued under the *Bank Act*, subject to appropriate conditions. Consequently, this amendment is an extension of those discontinuance provisions to banks.

TLCA 38(2)(c)

Subject: Continuation as a Bank

Amendment: Amend the provision to allow transitional relief when a trust company is continued under the *Bank Act*.

Explanation: When a company is continued under the *Bank Act*, certain transitional provisions require Governor-in-Council approval. The amendment would allow such a trust company full use of the *Bank Act* transitional provisions. These provide for carrying on certain otherwise prohibited activities for 30 days or, if the activities are subject to an existing agreement, upon the expiration of the agreement.

ICA 65(1)

Subject: One Class of Shares – Mutual Insurance Companies.

Amendment: The provision will be changed to clarify that the by-laws of a mutual insurance company can provide for one class of shares.

Explanation: Although mutual insurance companies are permitted to issue preferred shares, the current drafting of subsection 65(1) permits them to only provide for more than one class of preferred shares. Such restriction was unintentional.

BA 66(2) TLCA 69(2) ICA 70(2) COOP 75(2)

Subject: Additions to Stated Capital

Amendment: Allow FRFIs the option to add to their stated capital all or only a part of the consideration received in respect of shares issued for non-cash considerations involving transactions that are not at arms' length.

Explanation: This will allow FRFI's the flexibility to account for part of the non-cash consideration in the stated capital account for transactions that are not at arms' length.

ICA 74

Subject: Indexed Segregated Funds

Amendment: Allow a life insurance company to own its or its parent's shares in a market-indexed segregated fund subject to regulatory approval.

Explanation: Currently, some life insurance companies are hampered in their ability to structure segregated funds based on market indexes due to the prohibition on a company owning its own shares or those of its parent. The amendment will remove this impediment.

ICA 145(1)

Subject: Special Business

Amendment: Add to the list of items not considered as special business the report of the actuary of the company and the description of the roles of the actuary and the auditor in preparing the annual financial statement.

Explanation: These items should not be considered as special business since they are part of a list of items that the directors of an insurance company must routinely place before the shareholders and policyholders at every annual meeting.

BA 163(2), 487(4) TLCA 167(2), 475(4) ICA 171(2), 519(4) COOP 411(4)

Subject: Canadian Financial Institutions and Financial Institutions Incorporated By or Under an Act of Parliament

Amendment: Add "other than the *Canadian Business Corporations Act*" (CBCA) to the sections.

Explanation: The subsections are to apply only to FRFIs. However, the use of the phrase "incorporated by or under an Act of Parliament" is broader in scope than anticipated as it also includes companies incorporated under the CBCA that meet the definition of a financial institution. The amendment will limit the scope of the exceptions as intended.

BA 168(3) TLCA 172(3) ICA 176(3)

Subject: Mandatory Cumulative Voting

Amendment: Revise the provision so that mandatory voting does not apply when all the outstanding shares of the FRFI are owned by a single shareholder or by wholly owned subsidiaries of the shareholder.

Explanation: Mandatory cumulative voting is provided for in the Acts to protect the rights of minority shareholders. When all the shares of a FRFI are directly or indirectly owned by a single shareholder or its wholly-owned subsidiaries, the protection is not needed.

BA 170, 171 TLCA 174, 175 ICA 178, 179 COOP 177, 178

Subject: Void Election of Directors

Amendment: Amend the sections so that should the election of the board of directors not meet either the Canadian resident composition requirements or the employee limits, a period of up to 45 days is allowed to develop a plan to rectify the non-compliance.

Explanation: This remedy is similar to the one currently available to FRFIs concerning the board of directors not meeting the unaffiliated composition requirements.

BA 177 TLCA 181 ICA 185

Subject: Directors' Appointments between Annual Meetings

Amendment: Add a provision to this section permitting the directors, if provided for in a FRFI's by-laws, to appoint up to 1/3 of the number of directors elected at the previous annual meeting for a term expiring at the close of the next annual meeting. The proposed amendment would not apply to FRFIs subject to cumulative voting requirements.

Explanation: This amendment is consistent with the provisions currently found in the CBCA and provides FRFIs with some flexibility in appointing directors between annual meetings.

COOP 199(2), 200(2)

Subject: Membership of Audit and Conduct Review Committees

Amendment: Remove the reference that prohibits the Chairperson of the Board of Directors of a co-operative association from being a member of either the Audit Committee or Conduct Review Committee.

Explanation: The Act currently requires that the committees' membership consist of a majority of unaffiliated directors and that none of the members can be officers involved in the day-to-day operations or employees of an association or its subsidiaries. As such the requirements in the Act for independent representation on committees are sufficient without prescribing that the Chairperson cannot be a member of either committee.

BA 186(2) TLCA 190(2) ICA 195(2)

Subject: Record of Attendance

Amendment: Amend the provisions so that the statement itemizing the total number of directors' meetings and directors' committee meetings attended by each director covers the immediately completed financial year and not the 12-month period immediately preceding the date of the notice of the annual meeting.

Explanation: The amendment will allow shareholders and policyholders in the case of insurance companies to be informed of directors' attendance at meetings in respect of the financial year of the FRFI instead of a period that can vary depending upon the date the notice of the annual meeting is sent.

BA 195(6) TLCA 199(6) ICA 204(6) COOP 200(6)

Subject: Conduct Review Committee Report

Amendment: Revise the subsection to limit the contents of the conduct review committee's report to its statutory duties.

Explanation: Many FRFIs delegate additional powers to their Conduct Review Committees that are unrelated to the committee's statutory obligations. The amendment clarifies that the directors' report to the Superintendent on the conduct review committee's proceedings needs include only matters related to the committee's statutory obligations.

BA 196(2)

Subject: Chief Executive Officer – Exemption

Amendment: Delete the subsection.

Explanation: The subsection exempts a bank that was owned by a credit union or a co-operative association prior to the coming into force of the Act from having to appoint a Chief Executive Officer who is a director of the bank. The exemption is not needed as no bank is held in this manner.

BA 203(1) TLCA 208(1) ICA 212(1) COOP 207(1)

Subject: Conflict of Interest

Amendment: Clarify that a director who has an interest in a material contract should not be present during discussions of that contract.

Explanation: The current wording of the provision leaves some doubt whether directors with conflicts of interest could be present for the discussion.

ICA 254

Subject: Transfer of Business

Amendment: In subsections (1) and (2) delete the expression “enter into an agreement to”.

Explanation: The removal of this expression from the two subsections will permit an insurance company to enter into an agreement prior to receiving ministerial approval. Such agreement would have no force or effect until approved by the Minister. In addition, the amendment will clarify that the Minister’s approval is restricted to transfer of business and does not involve an approval of the terms of the agreement itself.

ICA 254

Subject: Transfer of Business – Exemption

Amendment: Exempt from the Minister’s approval certain transfers that meet de minimus criteria.

Explanation: Currently all transfers of business other than transfers subject to agreements of reinsurance done in the ordinary course of business require the Minister’s approval. The government plans to consult with interested parties to determine the criteria that will be established to exempt certain transfers from the approval requirement.

ICA 254

Subject: Reinsurance

Amendment: Permit insurance companies to reinsure on an indemnity basis with designated provincial insurers.

Explanation: The amendment will allow federal insurance companies the flexibility to reinsure on an indemnity basis with provincial insurance companies. Federal insurance companies would continue to be responsible for satisfying these policyholders' claims.

BA 266 TLCA 271 ICA 289 COOP 261

Subject: First Insider Reports

Amendment: Revise the provision so that insiders are no longer required to file an insider report until the insider has acquired shares.

Explanation: The amendment is being made to reduce unnecessary filings and to be consistent with similar provisions in other jurisdictions.

BA 312 TLCA 317 ICA 335 COOP 296

Subject: Annual Financial Statement

Amendment: Provide the Superintendent authority to waive the requirement for a closely held FRFI to file its annual financial statements 21 days before the annual meeting.

Explanation: Currently the Acts permit shareholders to waive the requirement to provide audited financial statements to them. As permitted by the Acts, many financial institutions elect to hold shareholders meetings by resolution. As a result, the directors can meet to approve the audited financial statements but a shareholders' resolution cannot be executed for at least 21 days. By permitting the Superintendent to waive the requirement, a FRFI will be able to conduct most of its year-end affairs on the same day.

ICA 358, 359, 624

Subject: Qualifications of Actuary

Amendment: Delete sections 358, 359 and 624.

Explanation: These sections are no longer required due to a change in the definition of actuary in subsection 2(1).

BA 372, 377, 388 TLCA 375, 386 ICA 407, 418

Subject: Ownership Provisions – Control of a FRFI

Amendment: Amend the legislative provisions so that a person cannot acquire control of a FRFI without the approval of the Minister.

Explanation: Currently a person may acquire control in fact of a FRFI by means of a contractual arrangement thereby avoiding the need for the Minister's approval. The objective of the amendment is to prevent such occurrence.

BA 379 TLCA 377 ICA 409 COOP 356

Subject: Transfer of Ownership – Minister's Approval

Amendment: Clarify that the Minister's approval is required when ownership of a FRFI is transferred from one entity to another entity within a group even if they are ultimately controlled by the same person.

Explanation: The amendment is needed to ensure that the transfer of control of a FRFI within an ownership group is neutral in respect of its effect on the FRFI's depositors or policyholders. The government will consult with interested parties to determine whether criteria could be developed to eliminate the need for Ministerial approval of certain transfers.

BA 410(1)(a) TLCA 410(1)(b) ICA 441(1)(b) COOP 376(1)(a)

Subject: Real Property Management

Amendment: Include the word "manage" in defining the scope of the services that a FRFI can undertake as part of its in-house real property operations.

Explanation: The addition of the word is to clarify that a FRFI which is already allowed to hold and deal in real property is not precluded from managing such property.

ICA 441(1)(h)

Subject: Ancillary Business Activities

Amendment: Remove references in the paragraph to the specific activities.

Explanation: The current wording of the paragraph is broader in scope than desired as the activities listed do not necessarily need to be ancillary. The proposed wording removes reference to the activities and will clarify that the activities must be reasonably ancillary to the business of insurance carried on by the company. Grandfathering would be provided.

ICA 454, 594

Subject: Priorities – Security held on Assets of a Segregated Fund

Amendment: Revise the Act to clarify that creditors whose security is attached to specific segregated fund assets have priority over insurance creditors.

Explanation: The present wording is unclear as to which creditors have priority over specific assets in the segregated funds.

ICA 462, 463

Subject: Transfers from Participating Accounts

Amendment: With the approval of the Superintendent, permit transfers from a participating account of amounts that may reasonably be attributed to sources not related to the participating policies in respect of which the account is maintained.

Explanation: The amendment will allow insurance companies to transfer out of a participating account fund monies that initially originated from sources outside the participating account.

BA 414(2) TLCA 414(2) ICA 474(2), 477(2) COOP 379(2)

Subject: Guarantees

Amendment: Delete the subsection in the respective Acts.

Explanation: The subsection creates some uncertainty since it implies that the term “guarantee” could possibly include an indemnity.

BA 418 TLCA 418 ICA 469

Subject: Vendor Take-Back Mortgages

Amendment: Clarify the wording of the sections so that vendor take-back mortgages are exempt from the restriction that a loan cannot exceed 75 per cent of the value of the property at the time the loan is made.

Explanation: The amendment is consistent with the understanding that a vendor take-back loan is not subject to this provision since the lender is not worsening its credit position.

BA 445 TLCA 431

Subject: Disclosure Requirements – Means of Disclosure

Amendment: Amend the Acts and regulations to permit banks and trust and loan companies to utilize electronic means to disclose information to customers who have electronic access to their accounts.

Explanation: Currently the Acts require that certain information be provided in writing to customers or that customers must provide their signatures to open accounts. The increasing use of electronic services is not always compatible with these requirements for communicating with customers. The intended safeguards can be dealt with by electronic means.

TLCA 449(1) ICA 490(1) COOP 386(1)

Subject: Definition of "commercial loan"

Amendment: Make a number of amendments to the definition of a commercial loan that will:

- treat insured non-residential loans the same as non-insured non-residential loans by defining them as commercial loans where the property on which the loan is made does not meet the income requirements;
- clarify that the 75 per cent loan to value ratio applies when the loan is acquired by the FRFI if the loan was not originally made by the FRFI;
- clarify that the income test applicable to non-residential loans applies only when the non-residential loan is initially booked; and
- exclude from the definition loans to, debt obligations of and preferred shares of all subsidiaries.

Explanation: Some of the revisions and clarification to the definition of a commercial loan were subject to consultations with provincial regulators. These changes address certain inconsistencies.

BA 464(1) TLCA 449(1) ICA 490(1) COOP 386(1)

Subject: Definition of "Information Services Corporation"

Amendment: Modify the expression "design, development and implementation" in paragraph (b) and the expression "designing, developing and marketing" in paragraph (c) by substituting the word "or" for the word "and".

Explanation: The current wording of the definition implies that an information services corporation must conduct all three activities listed in either paragraph (b) or paragraph (c). The amendment will provide FRFIs with more flexibility by allowing an entity that is conducting only one or two of those activities listed in the respective paragraphs to qualify as an information services corporation.

BA 464, 468 TLCA 449, 453 ICA 490, 495 COOP 386, 390

Subject: Limited Liability Entities

Amendment: Extend the power of FRFIs to make permitted substantial investments in other forms of limited liability entities.

Explanation: This will provide FRFIs with additional flexibility to invest in limited liability entities other than body corporates.

BA 466(2)(b) TLCA 451(2)(b) ICA 493(2)(b) COOP 388(2)(b)

Subject: Indirect investments

Amendment: Revise paragraph (b) to apply the concept of substantial investment instead of limiting the acquisitions to ownership interests.

Explanation: This will provide for indirect acquisition in paragraph (b) in a similar way as is provided in paragraph (a).

BA 466(3) TLCA 451(3) ICA 493(3) COOP 387(3)

Subject: Substantial Investments by FRFIs

Amendment: Amend subsection (3) to clarify that the subsection does not prevent a FRFI from making a temporary investment in the permitted substantial investments.

Explanation: The current drafting can be read as either a limiting or enabling provision. The redrafting will clarify that it is an enabling provision.

BA 468 TLCA 453 ICA 495 COOP 390

Subject: Ownership Provisions – Control of FRFI's subsidiary

Amendment: Amend the legislative provisions so that control in fact of a subsidiary of a FRFI cannot be split from legal control.

Explanation: The Acts do not address the possibility where control in fact of a subsidiary of a FRFI has been ceded to another person by means of a contractual arrangement. The objective of the amendment is to prevent such occurrence.

COOP 390(1)(m)

Subject: Ancillary Business Corporations

Amendment: Clarify that an ancillary business corporation formed by a credit union central can provide services only to the central's members.

Explanation: The amendment clarifies that the ancillary business corporation of a central should not provide services to its members' members and is consistent with the primary purpose of a cooperative credit association which is to provide financial services to its members only, which are themselves co-operatives providing financial services to their members.

BA 468(1)(l) TLCA 453(1)(l) ICA 495(1)(h), (2)(e) COOP 390(1)(l)

Subject: Definition of "financial holding corporation"

Amendment: Amend the definition of a "financial holding corporation" so that when a FRFI is held by a financial holding corporation, the FRFI is not prevented from holding or acquiring those indirect investments that the Acts permit.

Explanation: Each Act provides an exception for a FRFI to make indirect investments that would otherwise not be permitted. However, because of the definition of a financial holding corporation, the power granted to the FRFI to make these indirect investments is not available to a FRFI whose parent is a financial holding corporation.

BA 468 TLCA 453 ICA 495 COOP 390

Subject: Substantial Investments by FRFIs

Amendment: Revise the Acts so that if a substantial investment can be categorized under more than one type of permitted investment that is subject to different legislative standards, then the substantial investment is categorized as the permitted investment subject to the higher standards.

Explanation: Often an investment by a FRFI can meet the definition of one or more types of permitted investments which are listed in the Acts. Any uncertainty regarding the legislative requirements that must be met for the substantial investment to be acquired in compliance with the Act can be removed by adding that the investment meets the higher legislative standards.

BA 468(3)(a) TLCA 453(3)(a) ICA 495(4)(a) COOP 390(3)(a)

Subject: Minority Investments

Amendment: Delete subsection (3) of the minority investment regulations of each Act with consequential amendments to the Acts.

Explanation: This will allow a FRFI to have a non-controlling interest without being restricted by the requirement of having another regulated institution control the joint venture.

BA 472, 473 TLCA 457, 458 ICA 499, 500 COOP 394, 395

Subject: Loan Workouts and Realization of Security Interests

Amendment: Extend from two years to five years the initial period that a FRFI can hold a substantial investment as a result of a default on a loan or a realization of a security interest.

Explanation: Increasing the period from two to five years will facilitate the restructuring of loans and is consistent with the *Income Tax Act* which requires a minimum five-year period for holding distress preferred shares.

BA 482 TLCA 470 ICA 512 COOP 406

Subject: Transfer of Assets – Loan Syndications

Amendment: Include syndicated loans exceeding 10 per cent of FRFI's assets in the list of transactions that do not require the Superintendent's approval.

Explanation: Syndicated loans that are subject to market forces and occur between parties acting at arm's length are not the type of transactions that require the Superintendent's approval.

ICA 540 to 570

Subject: Fraternal Benefit Societies

Amendment: Amend the provisions of the *Insurance Companies Act* relating to fraternal benefit societies. The scope and details of the amendments will be determined in consultation with industry representatives.

Explanation: A major review of the sections in the Act relating to fraternals is required as a number of inconsistencies and technical errors have been identified since the Act came into force.

ICA Part XIII, New provision

Subject: Transfer of Business – Foreign Companies

Amendment: Add a provision to Part XIII of the Act that requires a foreign insurance company to obtain approval when it transfers a block of its Canadian business.

Explanation: This amendment will provide Canadian policyholders of foreign insurance companies with similar protection to that offered to policyholders of Canadian insurance companies.

BA 521(1)(b)

Subject: Foreign Banks – Application to "Non-Bank Affiliates" operating in Canada prior to the 1992 Revision of the *Bank Act*

Amendment: Clarify that the provision does not apply to investments made prior to 1992 unless the investment contravened the former *Bank Act* at the time it was made.

Explanation: This will remove the potential retroactive effect of the wording of the current paragraph.

BA 531 TLCA 503 ICA 672 COOP 435

Subject: Confidential Information

Amendment: Add a subsection to the referenced provisions that would allow the Superintendent to disclose information to law enforcement agencies. Additional clarification will be made to the confidentiality provisions of all Acts related to financial institutions.

Explanation: The amendment is to give the Superintendent clear authority to provide a law enforcement agency with information during the course of an investigation.

BA 538(1) ICA 679(1)

Subject: Taking Control of Assets

Amendment: Provide that the authority to take control of assets extends to assets under administration.

Explanation: Both banks and insurance companies have the power to take assets under their administration. The Superintendent has authority to take control of the assets of a bank or an insurance company. This authority will be extended to assets administered by these FRFIs. That authority currently exists under the *Trust and Loan Companies Act* and the *Cooperative Credit Associations Act*.

ICA Schedule,
Classes of Insurance

Subject: Creditors' Loss of Employment Insurance

Amendment: Amend the Classes of Insurance Schedule to include creditors' loss of employment insurance under the life insurance class.

Explanation: The amendment will permit life insurance companies to underwrite creditors' loss of employment as an adjunct to a contract of creditor life insurance.

Policyholders' Rights

ICA 2(1)

Subject: Definition of "complainant"

Amendment: Include a policyholder entitled to vote in the definition of a complainant.

Explanation: This will give the same access to judicial remedy to such policyholder as is available to the registered holder or beneficial owner of a security of an insurance company or any of its affiliates.

ICA 142 & 149

Subject: Record date for policyholders entitled to vote at a meeting of policyholders

Amendment: Permit an insurance company to establish a record date for determining policyholders entitled to vote at a meeting.

Explanation: As an insurance company may have a very large number of policyholders, this will facilitate the making of a list of policyholders entitled to vote at a meeting.

ICA 147

Subject: Proposals by policyholders

Amendment: Allow policyholders to make proposals that may relate to the management of ordinary business and affairs of an insurance company, and reduce the number of policyholders that must sign a proposal for it to be circulated with notices of meeting.

Explanation: This will extend to policyholders rights similar to those enjoyed by shareholders in respect of proposals. It is suggested that, to be circulated, a policyholder's proposal which includes nominations for election of directors or which relates to special matters referred to in paragraph 143(1)(c) of the Act be signed by 100 policyholders; a policyholder, like a shareholder, will be allowed to make a proposal on other matters and have it circulated with notices of a meeting.

ICA 153, 154

Subject: Premium due on policy

Amendment: Amend the provisions to ensure that a policy that is in force entitles a policyholder to vote at a meeting of policyholders even though the premium may not be paid.

Explanation: It should be sufficient for the policy to be in force at the relevant time to confer on its holder this right.

ICA 164(1)

Subject: Triennial Solicitations of Policyholders

Amendment: Exempt insurance companies from having to contact policyholders every three years if they indicate in writing whether they want to receive notices of meetings.

Explanation: For policyholders who provide written instructions about their preferences, such instructions will remain valid until they notify the insurance company otherwise in writing. Policyholders that do not provide such instructions will continue to be solicited every three years by insurance companies.

ICA 164(1)(c) & 280 to 287

Subject: Policyholders' Proxies

Amendment: Allow insurance companies to solicit proxies from any policyholder entitled to vote provided the solicitation is accompanied by a management proxy circular and a notice of meeting, such proxies to be valid only for the meeting for which they are solicited.

Explanation: It is expected that proxies will generally be solicited only from policyholders that have indicated an interest in receiving notices of meeting and related material. It is unclear why different rules should apply to policyholders and shareholders.

ICA 262(7)

Subject: Copies of by-laws

Amendment: Permit a policyholder entitled to vote to obtain a copy of the by-laws of the insurance company once in a calendar year, free of charge.

Explanation: This will give such a policyholder the same right that a shareholder has in this regard.

ICA 331(5)

Subject: Reporting on Changes in Participating Accounts

Amendment: Remove the exemption for a mutual insurance company to report on changes in participating accounts in its annual statement.

Explanation: Information on changes in participating accounts is useful information for interested parties, whether the insurance company is a mutual company or a stock company.

ICA 334(2)

Subject: Waiver of Right to Receive Annual Statements

Amendment: Allow a policyholder to waive his or her right to receive annual statements.

Explanation: This provides similar treatment for policyholders and shareholders.

Bills of Exchange Act or a new act

Subject: Book-entry transfer of money-market instruments.

Amendment: Add provisions to the *Bills of Exchange Act* or introduce a new act.

Explanation: To provide statutory support for the book entry transfer of money-market instruments subject to the *Bills of Exchange Act*.

Office of the Superintendent of Financial Institutions Act

Subject: User Pay

Amendment: Revise section 23 of OSFI Act to permit the Superintendent to charge persons other than FRFIs an amount in compensation for work done by OSFI in administering the legislation for which it is responsible. In addition, the amendment will complement the current assessment of FRFIs in order to permit OSFI to be reimbursed for work undertaken on behalf of a particular FRFI or an identifiable group of FRFIs. This will involve situations where the benefits of the work accrue specifically to those on whose behalf the work is undertaken and the work is not part of the normal supervisory or regulatory obligations that OSFI performs for those FRFIs.

Explanation: Expenses incurred by OSFI in administering the legislation for which it is responsible are recovered by assessing FRFIs that are regulated or supervised by OSFI. In many cases, work done by OSFI either benefits non-regulated persons or only a limited group of FRFIs. In these cases, it is appropriate to charge on a user pay basis instead of charging the whole industry.