



Ruling

Category: Investments **NOTICE***

Subject: Control in Fact – Trustee or manager

No: 2007 – 02

Issue: The issue was whether the trustee or manager of an investment fund has any direct or indirect influence that, if exercised, would result in control in fact of the fund.

Background: A foreign bank (FB) has an investment banking group that establishes and manages investment funds for sophisticated investors. Each fund is established in the form of a trust under foreign law. The funds invest in large infrastructure projects around the world. Certain of these funds develop, own or operate infrastructure projects in Canada. The FB requested a ruling on whether the investment funds were "entities associated with a foreign bank".

Since the FB has a financial establishment in Canada, if the investment funds are entities associated with a foreign bank, the funds could not acquire or hold control of, or a substantial investment in, a Canadian entity except in accordance with the rules governing investments in Canada by FBs with financial establishments in Canada, as set out in Divisions 4 and 5 of Part XII of the *Bank Act* (BA) (e.g., as a limited commercial entity, a temporary investment or a specialized financing entity).

In addition, if the investment funds are entities associated with the FB, the FB requires an approval under Part XII of the BA prior to the fund making such investments. Given the nature of the fund's infrastructure projects, the rules and limitations associated with temporary investments and specialized financing entities are not practical. The limited commercial entity rules require the FB to seek prior approval of the Minister every time a fund invests in an infrastructure project in Canada, and the approval may not be available in all cases¹.

The investment funds are managed by wholly owned subsidiaries of the FB, which are incorporated under a foreign law and serve as "responsible entities" (REs) for the funds. The RE's responsibilities flow from both the provisions of the law under which they were established and the terms of the arrangements creating the fund. In essence, the RE is responsible for managing the business and affairs of the fund. In particular, the applicable law provides that the

¹ Approval may only be sought where the Canadian entity does not engage in any leasing activities and engages or carries on business that is the same as, or similar, related or incidental to, the business outside Canada of the FB or an entity associated with a FB.

holders of units of the investment fund (unitholders) can remove and replace the RE. The FB and the RE have little or no economic interest in the equity of the fund.

Considerations: The investment funds would constitute “entities associated with a foreign bank” only if they are controlled by the FB or the RE. For the purpose of the *Bank Act* (BA), “control” includes both “de jure” and “de facto” control. Given that neither the FB nor the RE beneficially own more than 50% of the ownership interest in any of the funds, and given that the funds are not established as limited partnerships in respect of which the RE might act as a general partner, neither the FB nor the RE have “de jure” control of the funds. Therefore, the only issue in determining whether the investment funds are “entities associated with a foreign bank” is whether the RE controls the funds in fact.

Based on the representations of the FB and a review of the foreign law under which the RE is incorporated, OSFI determined that:

- (a) the RE cannot exercise influence over the investment fund through its ownership interest – it has little or no economic interest in the equity of the fund;
- (b) while the RE has the discretionary authority to manage the business and affairs of the investment fund and was appointed to manage the operations of the fund for a fee:
 - (i) the holders of the units of the investment fund have the authority to terminate the appointment of the RE;
 - (ii) the RE has clear fiduciary duties to the unitholders of the investment fund such that, the RE must act honestly and in good faith with a view to the best interests of the fund, be diligent in supervising and managing the fund’s affairs, and treat unitholders equally, and
 - (iii) the RE has no authority to amend the investment fund’s constating documents, except if the RE considers that the change will not affect unitholders’ rights and will be in the best interest of unitholders;
- (c) the RE has no right to any distribution of the property of the investment fund on liquidation of the fund, and
- (d) the RE has no right to terminate the investment fund, except if, as specifically stated in the terms of the arrangements creating the fund, the RE were to determine that as result of a legislative change it would be in the interest of the unitholders to terminate the fund, or the RE were to become liable to pay income tax or capital gains on income that it distributes to the unitholders of the fund.

Conclusion: Based on the preceding considerations, OSFI concluded that the RE does not control in fact the investment funds. Consequently, OSFI ruled that the funds are not “entities associated with a foreign bank”.

Legislative References: Paragraphs 3(1)(b), (c) and (d) of the BA provide, respectively, that a person controls an unincorporated entity if that person owns more than 50 per cent of the ownership interests of the entity and that person is able to direct the business and affairs of the entity, a general partner of a limited partnership controls the limited partnership, and a person controls an entity if the person has any direct or indirect influence that, if exercised, would result in control in fact of the entity.

Subsection 507(2) of the BA provides that an entity is associated with a FB if the entity controls the FB, is controlled by the FB, or, is controlled by a person that controls the FB.

Paragraph 522.22(1)(g) of the BA provides that a FB or an entity associated with a FB may not, without the prior written approval of the Minister, given by order, acquire or hold control of, or a substantial investment in, a "limited commercial entity" (i.e., a Canadian entity that a FB or an entity associated with a FB may control in accordance with section 522.09 of the BA).

Table of Concordance:

Section Description	BA	TLCA	ICA	CCAA
Control in fact	3(1)(d)	3(1)(d)	3(1)(d)	3(1)(e)

The table of concordance makes cross-references to similar provisions of other federal financial institutions legislation that may be of relevance to the reader.

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