Ruling

Category: **Foreign Banks** **NOTICE***

Subject: **Business in Canada – Access to the Canadian capital market**

No: **2007 – 01**

Issue: The issue is whether, for the purposes of Part XII of the *Bank Act* (BA), a foreign bank (FB), or an entity associated with a FB (EAFB), that from time to time, sells debt instruments to Canadian securities dealers (Dealers), is engaging in or carrying on business in Canada.

Background: FBs and EAFBs (Issuers) that are active issuers of debt instruments such as certificates of deposits, commercial paper and term notes (collectively Notes) to fund their own, or their affiliates', banking business have requested OSFI's view on whether their proposals to sell debt instruments to a number of Dealers (the Notes Program) would be subject to Part XII of the BA. Some of the Issuers either had a bank branch in Canada or were associated with a FB that had such a branch.

To carry out the Notes Program, the Issuers would enter into one or more Dealer Agreements and Notes Agreements with one or more Dealers as well as a Payment Agency Agreement with a Canadian financial institution (Payment Agent).

The Dealer Agreement would generally set out the understandings between the Issuer and the Dealer in connection with the issuance and sale of Notes. The Dealer will not act exclusively for the Issuer. In particular, the Dealer Agreement would provide for the purchase, as principal, of Notes by the Dealer from the Issuer, through a Note Agreement, for resale by the Dealer to its clients in accordance with provincial securities laws. It could also provide that the Dealer could terminate a commitment to enter into a Note Agreement, prior to the closing of the purchase, on the occurrence of specified material events.

The Payment Agency Agreement would set out the role and duties of the Payment Agent, who would, upon specific instructions of the Issuer, counter-sign (if applicable) and deliver the Notes to either CDS Clearing and Depository Services Inc. (CDS) or the Dealer, receive payment for the Notes, repay the Notes that come to maturity, and make interest payments.

Once the Issuer has entered into a Dealer Agreement and appointed a Payment Agent, the Notes Program would generally follow a process similar to the following:

1. As provided for in the Dealer Agreement, for each issue of Notes, either the Issuer would contact the Dealer from outside Canada to offer the Notes for sale, or the Dealer would contact a representative of the Issuer located outside Canada to indicate an interest in purchasing Notes from the Issuer. In the course of their interaction, the Dealer and Issuer would reach an agreement on the specified amount of each Note, its maturity and its interest rate or discount.

2. Where the Issuer is an EAFB, another member of the group may unconditionally guarantee the Notes.

3. In accordance with Canadian securities laws, the Notes will be issued either:
   (a) by way of prospectus;
   (b) pursuant to the commercial paper exemption; or
   (c) pursuant to the accredited investor exemption.

4. Once an agreement has been reached regarding the purchase of Notes by the Dealer, the Issuer would contact the Payment Agent to advise that the sale of the Notes has been concluded with the Dealer and instruct the Payment Agent to:
   (a) complete the Notes on the agreed terms and conditions;
   (b) counter-sign the Notes (if applicable); and
   (c) upon receipt of the money from the Dealer, deliver the Notes to CDS, if the Notes are in book entry form, or to the Dealer, if the Notes are certificated.

5. The Issuer would maintain bank accounts, in Canada, with the Payment Agent. The Payment Agent would only make payments out of these accounts as instructed by the Issuer from outside Canada.

6. The Dealer re-sells the Notes to investors in accordance with the applicable provincial securities laws.

7. Under any of these scenarios, the Notes may be sub-divided in denominations of less than $150,000.

Considerations: The BA provides that a FB or EAFB shall not, by itself or through a nominee or agent, engage in or carry on any business in Canada, except as permitted by Part XII of the BA.

The BA does not provide guidance on the factors that OSFI may take into account in determining whether a FB or EAFB is engaging in or carrying on business in Canada. As such, in making its determination, OSFI generally assesses the facts and circumstances of each case to determine whether there is a sufficient connection between the activities of a FB or EAFB and Canada. In making that determination OSFI considers factors comparable to those often considered by judicial bodies in interpreting the concept of "carrying on business in Canada" under other statutes such as the *Income Tax Act*.

OSFI recognizes that in certain circumstances, particularly for the purpose of the *Income Tax Act* where the notion of profit is a key consideration, borrowing alone may not constitute a business. However, OSFI is of the view that for the purpose of the *Bank Act*, where the protection of creditors, the maintenance of a level playing field, and the financial system's safety and soundness are key considerations, borrowing alone would constitute a business where the primary activity of the entity is to act as a financial intermediary (i.e., to borrow funds from a person to make loans or investments in stocks, bonds or other securities). In this context, OSFI examined whether the Notes Program would cause the FB or EAFB to carry on business in Canada. OSFI considered the following facts to be relevant.

1. Consistent with industry practice, Dealers establish relationships with Issuers to access investment products for resale to investors.

2. Employees of the Issuer would, from outside Canada:
    a) negotiate all of the terms and conditions of, and enter into all agreements, relating to the Notes Program; and
    b) make all key decisions relating to the administration and development of the Notes Program, namely the decision to issue the Notes, their terms and conditions, and the appointment of the Payment Agent.

3. However, employees of the Issuer may, in Canada:
    a) meet with Dealers to provide information about the Issuer and its Notes Program;
    b) meet with prospective payment agents to explain the Notes Program and the required role of the payment agent and meet with the payment agent from time to time to discuss administrative aspects of the Notes Program;
    c) provide assistance and advice to the Dealers and Payment Agent with respect to Canadian regulatory and compliance issues relating to the Notes Program; and
    d) where the Issuer has entered into a Dealer Agreement, meet the Dealer to provide information about the Notes.

4. The Issuer would not deal with investors that would ultimately hold the Notes.

5. The Dealer would not act as agent or nominee of the Issuer. In this regard, the Dealer would not deal exclusively with the Issuer and would purchase the Notes as principal from the Issuer for the purpose of reselling them to its clients or for inventory purposes. The decision to purchase the Notes would always remain at the Dealers' discretion.

6. The Payment Agent's activities in respect of the Notes Program would be limited to performing administrative functions for the Issuer upon specific instructions of the Issuer, which are given from outside Canada -- OSFI considers these activities to be ancillary to Note Agreements concluded by the Issuer on a cross-border basis.

In assessing this issue, OSFI concluded that the mode of issuance (prospectus, commercial paper exemption, or accredited investor exemption) did not have any bearing on the determination of whether the Notes Program constituted business in Canada.

Conclusion: OSFI concluded that, for the purpose of Part XII of the *Bank Act*, an Issuer that would establish a Notes Program in accordance with the facts set out above would not be engaging in or carrying on business in Canada, nor would it be doing so through a nominee or agent.

To avoid investor confusion, it is expected that appropriate measures will be taken to ensure that the Note holders are aware that the Notes are not issued in the course of the regulated Canadian operations of the Issuer, and are not deposits insured by the Canada Deposit Insurance Corporation.

Legislative References: Paragraphs 510(1)(a) and (b) of the BA provide that, except as permitted by Part XII of the BA, a FB or an EAFB shall not, in Canada, engage in or carry on any business that a bank is permitted to engage in or carry on under the BA, or any other business, or maintain a branch in Canada for any purpose;

Subsection 510(2) and (3) of the BA provide that, for the purposes of Part XII of the BA, a FB or an EAFB is deemed to be carrying out or have carried out anything prohibited by subsection (1) if it is carried out by a nominee or agent of the FB or EAFB acting as such.

Table of Concordance: The legislation of other federal financial institutions does not contain similar provisions.