



Ruling

Category: Interpretation and Application **NOTICE***

Subject: Control in Fact – Major shareholder and service provider

No: 2008 - 03

Issue: The issue was whether, in the circumstances described below, a person who beneficially owned 40% of the common shares of an entity (the Entity) and who, among other things, provided distribution services generating approximately 70% of the Entity's revenues, controlled in fact the Entity.

Background: The Entity was established to provide products to the customers of its shareholders. The other particulars represented to OSFI were as follows:

Ownership

1. The Entity's share capital consists solely of common shares.
2. The Entity has four unrelated corporate shareholders, one of them beneficially owning 40% of the shares (the Major Shareholder) and the other three each beneficially owning 20% of them.
3. Each shareholder avails itself of the rights attached to the shares of the Entity.

Governance

4. The Entity's board of directors consists of seventeen directors.
5. Pursuant to a shareholders agreement (SA), the Major Shareholder nominates six individuals and the other three shareholders each nominates three individuals for election as directors, and the remaining two directors are nominated by all shareholders.
6. Each shareholder exercises its nomination and election rights independently of the other shareholders.
7. The Major Shareholder does not have significant relationships with any of the directors of the Entity, other than with those it has nominated.



Operational

8. Each shareholder is a distributor of the Entity's products and performs most of the functions relating to the promotion, sale and servicing of the products that it distributes.
9. Each shareholder is consulted with respect to the Entity's significant business decisions.
10. A corporate office agreement (COA) exists between the Major Shareholder and the Entity whereby the Major Shareholder subleases office space to the Entity and provides certain administrative, staffing and information technology services to the Entity. The COA is reviewed and approved annually by the directors nominated by the other shareholders to ensure, among other things, that it is on market terms and conditions. The Entity has a business recovery plan commensurate with the risk and impact of the Major Shareholder ceasing to provide part or all of its services.
11. The balance of the Entity's functions, including management, compliance, finance/accounting and the oversight of outsourced functions, are carried out by its own officers/employees, who have no significant relationships with the Major Shareholder.

Economic

12. No shareholder provides financial support to the Entity in the form of loans.
13. Each shareholder distributes the Entity's products within a designated geographical market. The SA provides each shareholder with a right to prevent the other shareholders from distributing the Entity's products in its designated market.
14. Given that approximately 70% of the Entity's revenues derive from the Major Shareholder's distribution channel, the Entity acknowledges that if the Major Shareholder were to cease to distribute its products, it would have to change its business plan. However, the Entity believes that there is a reasonable prospect that it could continue to operate.

Considerations: The federally regulated financial institutions statutes¹ (the FRFI Statutes) state that 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. Consistent with case law and past situations that it has examined, OSFI has developed [Advisory No. 2007-02 entitled Control in fact](#) that provides guidance on factors that it considers in determining whether control in fact exists in a particular situation.

From ownership and governance standpoints, the Major Shareholder's ownership interest is sufficient to prevent the passing of special resolutions and the SA confers upon it the right to nominate for election over one-third of the Entity's directors. The Major Shareholder is the sole shareholder with such rights. However, OSFI was of the view that these rights are not sufficient to result in control in fact of the Entity because, among other things, the Major Shareholder cannot unilaterally ensure the passing of ordinary or special resolutions. The three other

¹ Namely the *Bank Act*, the *Insurance Companies Act*, the *Trust and Loan Companies Act*, and the *Cooperative Credit Associations Act*.

shareholders hold the remaining 60% ownership interest and play active and independent roles in the affairs of the Entity.

From operational and economic standpoints, the Major Shareholder's distribution and administrative services are material to the Entity. However, OSFI was of the view that these services are, in and of themselves, not sufficient to result in control in fact of the Entity. In particular, they are not so unique to the Entity as to allow the Major Shareholder to "paralyze" the Entity by withdrawing them. For example, if the Major Shareholder were to cease to provide all of its services to the Entity, the Entity could take steps to reduce its operating costs, absorb the cost of migrating to other offices and to other providers of administrative services, and continue to generate business through support from its other shareholders. Furthermore, the influence of the Major Shareholder is constrained by the fact that (a) it has no significant relationships with the Entity's officers/employees, (b) the other shareholders play active and independent roles in the operations of the Entity, (c) the directors nominated by the other shareholders review and approve the COA annually and (d) each shareholder distributes, and has a veto over the distribution by others of, the Entity's products in its designated geographical market.

Conclusion: In these circumstances, OSFI concluded that the Major Shareholder did not control in fact the Entity.

Legislative References: Subsection 3(1) of the FRFI Statutes states that 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.

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.