



Ruling

Category: Capital Structure

NOTICE*

Subject: Conversion of shares

No: 2001-01

Issue: A bank proposed to issue preferred shares fully paid for in money that may be converted at the option of the bank or the shareholder to common shares. The issue was whether the conversion of these preferred shares of the bank to common shares would constitute an issuance of shares of the bank for property that would require prior approval of the Superintendent pursuant to subsection 65(1) of the *Bank Act* (BA).

Background: The bank proposed to issue preferred shares, fully paid for in money, with terms and conditions providing that, at the option of the bank or the shareholder, the preferred shares could be converted to common shares. The bank was of the view that the conversion of preferred shares to common shares was an “issuance of common shares” and that the money paid into the bank’s stated capital for the preferred shares was the consideration for the issuance of such common shares. The bank was of the view that it did not require the Superintendent’s approval pursuant to subsection 65(1) of the BA when the conversion of the preferred shares (property) resulted in the issuance of common shares.

Considerations: OSFI concluded that, until a federally regulated financial institution (FRFI) or its shareholders exercise the conversion privilege attached to a class or series of shares of the FRFI, the shareholders only have a contingent right to the class or series of the shares of the FRFI that the shareholders will acquire on the exercise of the conversion privilege. This is supported by subsection 69(3) of the BA, which requires a bank to reserve sufficient authorized shares to meet the exercise of the conversion privileges attached to its issued and outstanding shares. Therefore, the conversion of a class or series of shares of a FRFI into another class or series of shares of the FRFI represents a new issue of shares.

OSFI further concluded that the consideration paid in respect of an issued and outstanding class or series of shares (of a FRFI) that has a conversion privilege could be the consideration paid in respect of the other class or series of shares that the FRFI will issue on the exercise of the conversion privilege. Thus, if the outstanding shares were paid for in money, the shares that the FRFI will issue on the exercise of the conversion privilege will be deemed to have been paid for in money. OSFI concluded that, since one bundle of rights is being substituted for another bundle of rights, the monies paid for the first bundle of rights can be said to have been paid in respect of the

second bundle of rights. This is supported by subsections 77(3) and (4) of the BA, which prescribe the adjustments that a bank must make to its stated capital account on the conversion of outstanding shares of the bank into shares of another class or series of the bank.

Conclusion: OSFI concluded that the subsequent issuance of common shares resulting from the conversion of the preferred shares that had been originally fully paid for in money does not require the Superintendent’s approval pursuant to subsection 65(1) of the BA. In addition, even if the issuance of preferred shares had been originally fully paid for with property that required the Superintendent’s approval at that time, no additional approval on their conversion to common shares would be required from the Superintendent pursuant to subsection 65(1) of the BA.

Legislative References:

Subsection 65(1) of the BA states that no share of any class of shares of a bank shall be issued until it is fully paid for in money or, with the approval of the Superintendent, in property.

Subsection 69(3) of the BA states that where a bank has granted privileges to convert any securities issued by the bank into shares, or into shares of another class or series, or has issued or granted options or rights to acquire shares, if the by-laws limit the number of authorized shares, the bank shall reserve and continue to reserve sufficient authorized shares to meet the exercise of such conversion privileges, options and rights.

Subsection 77(5) of the BA states that shares issued by a bank and converted into shares of another class or series, or changed under subsection 217(1) into shares of another class or series, become issued shares of the class or series of shares into which the shares have been converted or changed.

Table of Concordance:

Section Description	BA	TLCA	ICA	CCAA
Consideration for share	65	68	69	74
Conversion privileges	69	71	72	76
Adjustment of stated capital account	77	80	81	84

The table of concordance makes cross-references to other provisions of FRFI 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.