

TORYS

Fundamentals of banking and insurance law – business & investment powers and federal players

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- Presentation will briefly provide
 - background on the *Bank Act (Canada)* and the *Insurance Companies Act (Canada)*
 - an overview on the business powers and constraints
 - including discussion of 2018 Budget Implementation Act amendments
 - an overview of the investment regime
 - including discussion of 2018 Budget Implementation Act amendments
 - an overview of the principal federal players
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- This overview is not remotely comprehensive
 - the *Bank Act* and the *Insurance Companies Act* (collectively, the Acts) each contain about 1000 sections and the Carswell consolidations have over 1000 additional pages of regs, guidelines and other regulatory documents
 - Historically, the Bank Act was required to be revised every 10 years and there was no sunset clause in the federal insurance legislation
 - In 1992 this was changed to every 5 years for the BA and added to the ICA
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- At the same time, the Acts received a significant modernization, and corporate provisions were incorporated from the CBCA
 - Corresponding or concurring sections to the *Trust and Loan Companies Act* and the *Cooperative Credit Associations Act* were introduced into those statutes at the same time

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- Classes of Insurance set out in Schedule to ICA
 - Names of Banks set out in Schedule to the BA
 - Schedule I - domestic banks
 - Schedule II - foreign bank subsidiaries
 - Schedule III - foreign bank branches
 - full services
 - lending

OVERVIEW OF THE BUSINESS POWERS AND CONSTRAINTS

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- Insurance companies and banks are given the capacity of a natural person and, subject to the respective Acts, the rights, powers and privileges of a natural person
- Subject to the respective Acts, an insurance company/bank has the power to carry on business outside of Canada to the extent permitted by the foreign laws

Main Business Powers (Part VIII)

- Subject to the ICA, an insurance company shall not engage in or carry on any business other than such business generally as appertains to the business of providing financial services (s. 440(1))
- The BA is similar in that a bank shall not engage in or carry on any business other than the business of banking and such business generally as appertains thereto (s. 409(1))

Very Broad Powers

- OSFI has ruled that an insurance company may provide another insurer with underwriting services, issue & decline requests for insurance coverage, handle customer service requests & supply the associated systems to support these services (Ruling 2003-1)
- Case law under the BA where the bank undertakes activities to promote its products and services, such as giveaways of toasters or iPads and allowing a professional photographer to take pictures at the bank branch as part of the business of banking (Laarakker v. Royal Bank of Canada et al., 1980 CanLII 1830 (ON SC))

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- For greater certainty, an insurance company may
 - act as a financial agent, receiver, liquidator or sequestrator;
 - provide investment counselling services and portfolio management services; and
 - issue payment, credit or charge cards and, in cooperation with others including other financial institutions, operate a payment, credit or charge card plan.
 - The BA is the same except that it explicitly permits a bank to provide “any financial service” (likely viewed as necessary as under the BA the business powers of banks merely reference the business of banking).
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- In addition, a company may
 - (a) act as an agent for vendors, purchasers, mortgagors, mortgagees, lessors or lessees of real property and provide consulting or appraisal services in respect of real property;
 - (b) hold, manage and otherwise deal with real property;
 - The BA includes the same power as (b) but only allows the activities referred to in (a) to be provided through a real property brokerage entity

ADDITIONAL BUSINESS POWERS...cont'd

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- In addition, a company may
 - provide information processing services in Canada that the company has developed for its own use and that are an integral part of the company's operations to entities in which the company has a substantial investment that do not provide information processing services to other entities (441(1)(c))
- No similar provision is in the BA – likely of limited use as the activities likely fall within the main business powers in any event

ADDITIONAL BUSINESS POWERS...cont'd

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- A company/bank may outside Canada or with the prior written approval of the Minister, in Canada, engage in any of the following activities:
 - collecting, manipulating and transmitting
 - information that is primarily financial or economic in nature
 - information that relates to the business of a permitted entity, or
 - any other information that the Minister may, by order, specify,
 - It is very cumbersome to obtain the approval of the Minister for these activities, particularly given how pervasive they are in today's business environment
 - The approvals tend to limit the activities to that which is specifically required in the application rather than providing a broad authority
 - No need to seek approval if the activities fall within the main business powers referred to above
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ADDITIONAL BUSINESS POWERS...cont'd

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- A company/bank may outside Canada or with the prior written approval of the Minister, in Canada, engage in any of the following activities:
 - Provide advisory or other services in the design, development or implementation of information management systems,
 - Design, develop or market computer software, and
 - Design, develop, manufacture or sell, as an ancillary activity to any activity referred to in any of subparagraphs (i) to (iii) that the company is engaging in, computer equipment integral to provision of information services related to the business of financial institutions or to the provision of financial services;
 - These additional sub-bullets are sometimes helpful, particularly in the ability to market computer software (however, Ministerial approval would be required for the same)
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ADDITIONAL BUSINESS POWERS...cont'd

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- A company/bank may with the prior written approval of the Minister develop, design, hold, manage, manufacture, sell or otherwise deal with data transmission systems, information sites, communication devices or information platforms or portals that are used
 - to provide information that is primarily financial or economic in nature,
 - to provide information that relates to the business of a permitted entity, or
 - for a prescribed purpose or in prescribed circumstances;
 - Note approval is required whether the activity is conducted inside or outside of Canada
 - Effectively allows companies to engage in commercial activities in the information and technology area
 - Nothing has been prescribed
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ADDITIONAL BUSINESS POWERS...cont'd

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- Budget Implementation Act Part I passed in June 2018
 - proposed amendments to “information processing” and “information technology” powers
 - intended to be broader than existing powers and no MOF approval
 - proposed additional power to allow in-house activities that the financial institutions engage in to be commercialized in subsidiaries and used outside of the financial services industry
 - specific power to provide authentication, verification and identification services (in force)

ADDITIONAL BUSINESS POWERS...cont'd

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- In addition, a company/bank may:
 - promote merchandise and services to the holders of any payment, credit or charge card issued by the company/bank;
 - Very broad power if the company/bank has issued any payment cards (which is not a defined term)
 - In addition, a company/bank may engage in the sale of tickets, including lottery tickets, on a non-profit public service basis in connection with special, temporary and infrequent non-commercial celebrations or projects that are of local, municipal, provincial or national interest, urban transit tickets, and tickets in respect of a lottery sponsored by a government
 - Not likely of much commercial importance
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- Restriction
 - Except as authorized by or under the respective Acts, a company/bank shall not deal in goods, wares or merchandise or engage in any trade or other business.
 - This provision has become somewhat challenging with some fintech investments/developments as the technology can be used in the non financial sector

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- A company/bank may:
 - act as agent for any person in respect of the provision of any service that is provided by a financial institution, permitted entity, or a prescribed entity;
 - enter into an arrangement with any person in respect of the provision of that service or
 - refer any person to such financial institution or entity
 - Intended to make clear the natural person power to refer clients to other entities
 - Has generally been interpreted by OSFI as a restriction (i.e. you cannot refer a customer to anyone except as permitted by the provision)
 - proposed new powers pursuant to 2018 BIA
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- Then the Acts set out a number of constraints
 - insurance companies cannot insure any risk other than classes of insurance which have been approved
 - insurance companies cannot accept deposits except as otherwise permitted by the ICA
 - cannot act as a trustee for a trust in Canada
 - cannot generally issue guarantees of unlimited amounts, except to subsidiaries
 - cannot deal in securities in Canada to the extent prohibited by the regulations

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- cannot provide operating leases or auto leases in Canada
 - cannot provide residential mortgages in Canada above a 80% loan-to-value ratio
 - cannot grant security interests except in accordance with the policy established by the board
 - cannot be a partner in a partnership or a general partner in a limited partnership
 - cannot directly or through a subsidiary hold shares in the company/bank or its holding company (insurance companies can hold shares in a seg fund which mirrors a recognized index)
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- banks cannot undertake the business of insurance (generally in Canada) except to the extent permitted by the regulations
 - cannot act as agent in Canada for any person in the placing of insurance
 - cannot lease or provide space in any branch in Canada to any person engaged in placing of insurance

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- Authorized Types of Insurance
 - may administer an authorized type of insurance
 - permitted to promote and provide advice on authorized types of insurance but not on other types of insurance
 - may, however, provide advice in respect of insurance policy that is not an authorized type of insurance if advice is general in nature; and not in respect of a specific risk, insurance policy or service, or any particular insurance company, agent or broker

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- Authorized types of insurance are
 - credit or charge card-related insurance
 - creditors' disability insurance
 - creditors' life insurance
 - creditors' loss of employment insurance
 - creditors' vehicle inventory insurance
 - export credit insurance
 - mortgage insurance, or
 - travel insurance

Other Insurance Restrictions for Banks

- bank cannot share customer information with, or promote, an insurance company, agent or broker
- bank cannot provide telecommunications device that is primarily for the use of customers in Canada and that links a customer with an insurance company, agent or broker

OVERVIEW OF THE INVESTMENT REGIME

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- Introduction/Key Concepts
 - Any acquisition of control of or substantial investments in an entity needs to be reviewed to determine if the acquisition is a permitted investment for the federally regulated financial institution (FRFI), and, if so, whether any approvals are required
 - Some acquisitions of control or a substantial investment are not permitted, some require approval from the Minister of Finance; others require approval from OSFI; and some require no approvals

OVERVIEW OF THE INVESTMENT REGIME...*cont'd*

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- Need to be sensitive to the acquisition of “control” or the acquisition of the substantial investment (greater than 10% of the votes or 25% of the equity or 25% of ownership interest in an unincorporated entity) in any entity
 - Below that level, the Acts do not generally restrict investments, although they would need to be in accordance with the investment policy established by the board and be within any applicable statutory aggregate limits
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OVERVIEW OF THE INVESTMENT REGIME ... *cont'd*

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- Control includes circumstances in which the FRFI would own a majority of the voting shares of the entity, but also if the FRFI has “direct or indirect influence that if exercised would result in control in fact of the entity” or is a general partner in a partnership.
- Substantial investment includes direct ownership and indirect – through entities controlled by the FRFI
- These concepts also flow into the definition of subsidiary, which does not need to be a body corporate or legally controlled

OVERVIEW OF THE INVESTMENT REGIME ... *cont'd*

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- Highlights Permitted Investment Rules
 - Permitted to own a broad range of financial services providers including banks, insurance companies, trust and loan companies, securities dealers, mutual fund entities, factoring companies, financial leasing entities, financial agents, etc.
 - In general, a FRFI is permitted to invest in any entity that carries on financial services activities or certain other activities that the institution is permitted itself to carry on (other than deposit-taking, fiduciary services, prohibited securities dealing activities, underwriting insurance etc.)
 - **proposed amendment to allow FIs to invest in entities that engage in non-permitted activities so long as the "majority" of the activities of the entity's business consists of financial service activities**
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OVERVIEW OF THE INVESTMENT REGIME ... *cont'd*

TORYS

- Highlights Permitted Investment Rules
 - Permitted to act as a service corporation to provide services exclusively to affiliated entities and other financial service providers
 - Permitted to act as a holding company or engage in activities of a mutual fund entity, mutual fund distribution entity and closed end fund

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- The ICA and BA permit investments to be made as “temporary investments” and for the institution to seek the approval after the fact, although there is a risk of not getting the approval and being required to divest the investment within a period of time

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- Specialized financing investments
 - ICA and BA permit investments in non permitted entities subject to certain limits and restrictions
 - aggregate limit of 10% of regulatory capital - does not permit certain investments (e.g., other financial institutions) - 13 years maximum holding period and individual investments capped at \$250 million each
 - in addition some permitted investments that need approval can be made as a specialized financing investment without approval (e.g., information services corporation)
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OTHER INVESTMENT RESTRICTIONS

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- Minority Investment Regs
 - Permits non-controlling substantial investments in entities that the FI is otherwise required to control
 - Aggregate limit of 50% of the bank or insurance company's regulatory capital
- Prudent Person Standard
- Exposure to one entity or associated group not to exceed 25% of regulatory capital

OTHER INVESTMENT RESTRICTIONS ... *cont'd*

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- Limit on the investments in real property interests of 10% of institution's total assets; on equity investments (excluding substantial investments in permitted entities) of 25% of institution's total assets; and 35% in the aggregate
 - exception for widely held institutions with equity over certain thresholds
 - Commercial loans cannot exceed >5% of total assets of the company
 - not applicable to banks
 - large companies may seek OSFI approval to increase threshold
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- Everyone has heard about OSFI or the Office of the Superintendent of Financial Institutions, but we thought it might be helpful to provide a little background on the role and responsibilities of the various federal regulatory bodies which impact on the bank in Canada
 - Presentation does not deal with provincial regulatory authorities such as the provincial securities commissions

PRINCIPAL FEDERAL PLAYERS – DEPARTMENT OF FINANCE

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- Department responsible for advice on Canada's economic and financial affairs
- Minister reports to Parliament on several key bodies, including OSFI, FCAC, Bank of Canada
 - by statute, has some discretionary authority (approvals)
- Financial Sector Policy Branch is the main participant within the Department
- Responsible for coordinating amendments to the Bank Act and the other financial institutions statutes

PRINCIPAL FEDERAL PLAYERS – OSFI

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- OSFI was formed in 1987 by combining the former Office of the Inspector General of Banks and the Department of Insurance
- Performs statutory duties under the four principal FRFI acts and the federal pension legislation
- Three central elements of its activity: (i) risk assessment and intervention, (ii) rule making (includes guidelines and input to legislation and regulations and (iii) approvals

PRINCIPAL FEDERAL PLAYERS – OSFI ... *cont'd*

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- OSFI's mandate is to regulate “so as to contribute to public confidence”
 - Specific recognition that regulation and supervision may reduce risk, but that failures may occur
 - Relationship managers for each institution provide a focused approach
 - Two main divisions
 - Supervision – based in Toronto
 - Regulation – based in Ottawa
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PRINCIPAL FEDERAL PLAYERS – OSFI ... *cont'd*

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- Both a “regulator” and a “supervisor”
 - *Regulation* – set rules of good prudential behavior
 - *Supervision* – assess safety and soundness of financial institutions and pension plans – analyze financial data and confirm existence of appropriate risk controls – and monitor the financial industry for systemic risks
- May issue directives or compliance orders, impose sanctions, or even take control, as detailed in the FI legislation

PRINCIPAL FEDERAL PLAYERS – FCAC

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- Since 2001, OSFI no longer administers the consumer provision that has been transferred to the Financial Consumer Agency of Canada (FCAC)
 - Its objects are to
 - supervise financial institutions to monitor compliance with the “consumer provisions” in the legislation
 - strive to protect rights/interests of consumers and the public
 - promote implementation of consumer provisions and voluntary codes of conduct
 - strengthen financial literacy of Canadians and promote consumer awareness
 - foster understanding of financial services and related issues
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PRINCIPAL FEDERAL PLAYERS – CDIC

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- Canada Deposit Insurance Corporation insures deposits in its member institutions (up to \$100,000 of savings insured when deposited in an eligible account)
 - Statutory objects, as set out in its legislation (CDIC Act), are to provide insurance against the loss of part or all of deposits, and to promote and otherwise contribute to the stability of the financial system in Canada
 - CDIC is Canada's resolution authority for banks, federally regulated credit unions and trust and loan companies
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PRINCIPAL FEDERAL PLAYERS – BANK OF CANADA

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- Bank of Canada has a broad mandate to promote the efficiency and stability of the financial system, and to manage and control risk in the financial system
 - forms and implements monetary policy
 - the government's fiscal agent
 - as the banks' banker, it manages settlement balances and provides liquidity to the payments system

PRINCIPAL FEDERAL PLAYERS – BANK OF CANADA...cont'd

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- The Bank of Canada promotes the stability and efficiency of the financial system by providing central banking services:
 - liquidity facilities;
 - overseeing key domestic clearing and settlement systems;
 - providing advice on financial system issues to various domestic and international policy-making bodies;
 - conducting and publishing research on policy issues affecting the financial system;
 - encouraging dialogue and awareness on systemic (macroprudential) issues important to Canada
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PRINCIPAL FEDERAL PLAYERS - SAC, FISC AND HEAD OF AGENCIES

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- Senior Advisory Committee (SAC) operates as an *ad hoc* consultative body on policy matters
 - Financial Institutions Supervisory Committee (FISC) is established pursuant to the *OSFI Act* for consultation on matters relating to the supervision of financial institutions
 - Members of both:
 - Deputy Minister of Finance
 - Superintendent
 - Chairman of CDIC
 - Governor of Bank of Canada
 - Commissioner of FCAC
 - Heads of Agencies deals with issues of shared interest between securities regulators and federal agencies (e.g. capital market issues)
 - Membership includes representatives from the CSA
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- Questions/Comments

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