Establishing a financial institution in Canada

by Elizabeth (Liz) Breen and Meaghan Obee Tower, Stikeman Elliott LLP

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A Q&A guide to establishing a financial institution in Canada (Federal).

This Q&A is part of the global guide to establishing a financial institution in…. Areas covered include the main governing regulations, commonly used legal structures, licences and authorisations and the tax position.

For a full list of jurisdictional Q&As visit *global.practicallaw.com/ebi-guide*.

Market trends

1. What were the main trends in the financial services industry in the last 12 months?

Banking institutions

Mortgage lending activity by banks remains constrained by mortgage stress test rules introduced in 2018 for uninsured mortgages that require borrowers' finances to meet a specified threshold to qualify for a mortgage. The minimum qualifying rate is the greater of the five-year benchmark rate published by the Bank of Canada (Bank of Canada rate) and two percentage points higher than the contractual mortgage rate. The mortgage stress test has constrained banks' ability to lend to homebuyers, particularly first-time buyers in the high-priced Toronto and Vancouver markets. However, the mortgage stress test rules became slightly more lenient when the Bank of Canada rate dropped in July 2019 for the first time in almost three years.

Insurance institutions

Technology continues to have a large impact on the insurance sector as Canadian insurers and other stakeholders adapt to serve the needs of consumers. For example, the Canadian Government has carried out exploratory research into whether federal public servants should be offered electronic fitness-tracking devices to help reduce their health insurance premiums.

Ontario launched a consultation in early 2019 seeking input on reducing automobile insurance premiums in the province (which are among the highest in Canada) and modernising the sector. In September 2019, Ontario announced that drivers could now carry electronic proof of auto insurance on their smartphone or other device.

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Investment institutions

Since amendments to securities laws (Alternative Funds Amendments) came into force, there has been rapid growth of so-called "liquid alternative" mutual funds that permit retail investors to access hedge fund-like investment strategies. Before 3 January 2019, investment fund managers were required to apply to securities regulators for exemptive relief to offer mutual funds with alternative investment strategies such as leverage and short selling. Since the adoption of the Alternative Funds Amendments, many of Canada's leading investment fund managers have launched alternative mutual funds intended for retail investors.

The role of crypto asset regulation continues to be a major trend. In 2019, Canadian securities regulators and the self-regulatory organisation for investment dealers launched a consultation seeking input from the fintech community on how to tailor securities regulatory requirements for platforms that facilitate sales and transfers of crypto assets operating in Canada. With the ongoing bankruptcy proceedings related to QuadrigaCX, Canada's largest cryptocurrency exchange, the adaption of regulatory requirements to cryptocurrency will no doubt remain a priority for Canadian regulators.

Regulatory framework

2. What are the relevant principal regulations for financial services in your jurisdiction?

Banking institutions

Banks carrying on the business of banking are governed primarily by the following sources:

- The Bank Act and the federal regulations promulgated under it.
- Guidelines and advisories issued by the Office of the Superintendent of Financial Institutions (OSFI), the federal financial institutions regulator.
- Consumer protection legislation enacted by each of Canada's provinces and territories (collectively, provinces).

Trust and loan companies

Trust and loan companies are governed primarily by the following sources:

- The Trust and Loan Companies Act (TLCA) and the federal regulations promulgated under it.
- Guidelines and advisories issued by OSFI.

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- Provincial statutes and regulations permitting provincial incorporation (in certain provinces) and requiring trust and loan companies to be licensed by or registered with the provincial financial services regulators of the jurisdictions in which they carry on business in Canada.

Mortgage lenders

In certain provinces (such as Ontario, British Columbia and Nova Scotia), any person that lends money on its own behalf that is secured by real property is subject to regulation under provincial statutes and regulations. Further, most provinces regulate the activities of mortgage brokers (being those persons who solicit other persons to borrow or lend money secured by real property).

Exemptions from provincial licensing statutes are available in certain circumstances. For example, Ontario's Mortgage Brokerages, Lenders and Administrators Act, 2006 and the regulations promulgated under it exempt banks, credit unions, provincially-licensed insurers and loan and trust corporations, and persons trading in mortgages in connection with mortgage securitisation from the provincial licensing requirements.

Insurance institutions

Insurers are governed primarily by the following sources:

- The Insurance Companies Act (ICA), if the insurer is federally incorporated under the ICA or a foreign insurer who insures risk in Canada.
- Insurance Acts enacted by each of Canada's common law provinces (all provinces except Québec) and, in Québec, the Civil Code of Québec (collectively, Insurance Legislation).
- Guidelines and advisories issued by OSFI and provincial insurance regulators.

Investment institutions

Investment entities that provide capital markets services are governed primarily by the following sources:

- Securities Acts enacted by each of Canada's provinces.
- National Instruments promulgated by the umbrella organisation of Canada's provincial securities regulators, the Canadian Securities Administrators (CSA) and adopted locally by the provincial regulators.
- The rules promulgated by the two primary Canadian self-regulatory organisations for securities dealers, the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA).

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3. What are the principal regulatory bodies for financial services in your jurisdiction?

Office of the Superintendent of Financial Institutions

OSFI (*www.osfi-bsif.gc.ca*) is the only federal financial institutions regulator in Canada. Established by the Office of the Superintendent of Financial Institutions Act, OSFI carries out prudential regulation of banks, federally regulated insurance companies under the ICA, federally regulated trust and loan companies and private pension plans. OSFI also regulates authorised foreign insurers who insure risks in Canada.

Canada Deposit Insurance Corporation

The Canada Deposit Insurance Corporation (CDIC) (*www.cdic.ca*) is a federal Crown corporation established by the Canada Deposit Insurance Corporation Act. The CDIC provides deposit insurance up to CAD100,000 per eligible deposit against the loss of eligible deposits at its member institutions (including banks) in the event of a member institution's failure. The CDIC is funded by premiums paid by its member institutions.

Payments Canada

Payments Canada (*www.payments.ca/*) is the association established by the Canadian Payments Act (CPA), to operate national clearing and settlement systems for payments. Payments Canada operates the Automated Clearing Settlement System for retail payment transactions, the Large Value Transfer System for irrevocable payments between Canadian financial institutions and the US Dollar Bulk Exchange for payment items in US dollars drawn on a US dollar account at financial institutions in Canada but settled in the US. To fund its operation of the Canadian clearing and settlement systems, Payments Canada imposes transaction fees and annual dues on its members.

Provincial financial services regulators

Each province has established a provincial financial services regulator that oversees certain financial institutions (such as insurers, trust and loan companies and mortgage brokers) carrying on business in its jurisdiction. For example, the Financial Services Regulatory Authority (FSRA) (*www.fsrao.ca/*) is Ontario's independent regulator that administers Ontario's Insurance Act and Loan and Trust Corporations Act.

With respect to insurers, provincial regulators principally regulate market conduct and the licensing and supervision of insurance intermediaries (agents, brokers and adjusters). In some provinces, insurance brokers and agents are regulated in the same manner by the same regulator. In other provinces (for example, Ontario), agents are regulated by a governmental regulator (for example, the FSRA), while brokers are regulated by a self-regulatory body (such as the Registered Insurance Brokers of Ontario). In some provinces, all regulation of intermediaries is carried out by self-regulatory organisations with delegated powers.

The provincial insurance regulators together comprise an umbrella group called the Canadian Council of Insurance Regulators (CCIR). The CCIR seeks to facilitate harmonisation of insurance regulation across Canada. There also exists an umbrella group of insurance intermediary regulators, the Canadian Insurance Services Regulatory Organization, that seeks to harmonise regulation of insurance intermediaries across Canada.

The provincial regulators also oversee the licensing and registration of trust and loan companies incorporated under the TLCA or certain provincial statutes.

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Provincial securities regulatory authorities and the Canadian Securities Administrators

Under Canada's constitutional division of powers, securities regulation falls under provincial jurisdiction. Accordingly, unlike other OECD countries such as the US, Canada has no national securities regulator. Instead, each province has established a securities regulator in its jurisdiction. Given the prominence of Ontario, Québec, British Columbia and Alberta in Canada's capital markets, the key securities regulators are the Ontario Securities Commission (*www.osc.gov.on.ca*), the *Autorité des marchés financiers* (*www.lautorite.qc.ca*), the British Columbia Securities Commission (*www.bcsc.bc.ca/*) and the Alberta Securities Commission (*www.albertasecurities.com/*).

The provincial securities regulators have formed the CSA (*www.securities-administrators.ca/*) as an umbrella organisation whose objective is to coordinate and harmonise securities regulation across the provinces. The CSA achieve regulatory harmonisation by promulgating regulations in the form of "National Instruments" which are adopted locally by the provincial securities regulators.

Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association of Canada

IIROC is the national self-regulatory organisation which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC sets and enforces rules (IIROC Dealer Member Rules) regarding the proficiency, business and financial conduct of dealer firms and their registered employees. Trading activity on Canadian equity marketplaces is governed by IIROC's Universal Market Integrity Rules.

The MFDA is the national self-regulatory organisation for dealers in Canadian mutual fund securities. The MFDA is currently recognised as such by the provincial securities commissions in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan. Through a co-operative agreement with Québec's Autorité des marchés financiers, the MFDA also actively participates in the regulation of mutual fund dealers in Québec. The MFDA sets rules (MFDA Rules) regarding the proficiency, business and financial conduct of mutual fund dealers and their registered employees.

4. What financial services (if any) fall outside the scope of/are exempted from regulation?

Insurers can structure their activities in Canada to be exempt from provincial licensing requirements. Additionally, provincial securities legislation provides certain exemptions from the requirement to register with provincial securities regulatory authorities (*see* *Question 6*).

Legal structures

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5. What are the most commonly used legal structures for establishing a financial institution?

Local companies

A domestic bank (Schedule I Bank) can only be incorporated federally under the Bank Act by letters patent issued by the federal Minister of Finance (Finance Minister). A Schedule I Bank is authorised to engage in the business of banking and any related business. The "business of banking" is defined broadly in the Bank Act to include:

- Providing any financial service.
- Acting as a financial agent.
- Providing investment counselling services and portfolio management services.
- Issuing payment, credit or charge cards and, in cooperation with others including other financial institutions, operating a payment, credit or charge card plan.

Domestic trust and loan companies can be incorporated either federally under the TLCA by the issuance of letters patent or provincially under certain provincial statutes (for example, New Brunswick's Loan and Trust Companies Act).

To carry on business as a trust and loan company in Ontario, a trust and loan company must be incorporated under the TLCA. Most domestic trust and loan companies are incorporated federally under the TLCA.

Domestic insurers can be incorporated either federally under the ICA by the issuance of letters of patent or provincially under provincial corporate statutes.

Domestic securities dealers and investment advisors are most commonly established as either of the following:

- Corporations under either the federal Canada Business Corporations Act or provincial corporate statutes.
- Limited partnerships under provincial statutes.

Foreign companies

Foreign banks can establish a presence in Canada in one of two ways:

- Incorporation of a foreign bank subsidiary under the Bank Act (Schedule II Bank).
- Establishment of a local branch as either a full-service branch or a lending branch (Schedule III Foreign Bank Branch) (FBB).

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A Schedule II Bank is authorised to carry on the same banking activities as a domestic Schedule I Bank, including providing any financial service.

A full-service FBB has much of the same powers as a Schedule II Bank, subject to a prohibition on accepting "retail" deposits (those less than CAD150,000) and its deposits are not eligible for CDIC deposit insurance. A lending FBB has the same powers as a full-service branch but is prohibited from accepting deposits and borrowing money in Canada except from certain financial institutions.

A trust and loan company formed under the laws of a jurisdiction outside Canada can carry on the business of a trust and loan company by incorporating a Canadian subsidiary under either the TLCA or certain provincial statutes.

An insurer formed under the laws of a jurisdiction outside Canada can carry on insurance business in Canada by either incorporating a Canadian subsidiary under the ICA or obtaining an order from OSFI permitting it to operate in Canada.

Securities dealers and investment advisors formed outside Canada (such as a US limited liability company) can also carry on business in Canada subject to certain registration requirements and any applicable exemptions (*see Question 6*).

Authorisation or licensing

6. What licences or authorisations are required to provide financial services in your jurisdiction?

Banking institutions

While the application process varies depending on the type of bank in question, all banks require the approval of the Minster and OSFI in order to carry on business in Canada.

Schedule I and Schedule II Banks. To carry on business in Canada, a Schedule I or Schedule II Bank must obtain the following approvals:

- Letters patent of incorporation issued by the Finance Minister.
- An order by OSFI authorising the commencement and conduct of business.

The application process for banks is comprised of three phases (see "Guide for Incorporating Banks and Federally Regulated Trust and Loan Companies", published by OSFI (*https://www.osfi-bsif.gc.ca/Eng/fi-if/app/aag-gad/Pages/instguide.aspx*)).

Phase 1 (pre-application):

- Applicant meets OSFI to discuss the proposed application.

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- Applicant submits Phase-1 Information Requirements to OSFI for review and consideration.
- Applicant meets OSFI for a detailed discussion of its submissions and business plan for the proposed bank.
- OSFI issues a letter to the applicant setting out its preliminary views and expectations regarding the proposed application.

Phase 2 (letters patent):

- Applicant publishes a notice of intention to apply for letters patent once a week for four consecutive weeks in the *Canada Gazette* and in a newspaper in general circulation at or near the proposed head office of the bank.
- Applicant submits its formal applications for letters patent and an order to OSFI for review.
- OSFI will generally request further information or details from the applicant and will meet the applicant during the course of its review.
- OSFI submits its recommendation to the Finance Minister regarding the issuance of letters patent.

Phase 3 (order):

- If letters patent are issued by the Finance Minister, OSFI continues its review and consideration of the application with respect to the issuance of an order for the commencement and carrying on of business.
- OSFI will generally make additional requests for information or details and will have further meetings with the applicant.
- OSFI carries out a pre-commencement onsite review of the FRFI.
- If OSFI is satisfied that any material issues or concerns identified have been adequately addressed, it will issue an order for the commencement and carrying on of business.

CDIC membership. Schedule I and Schedule II Banks must usually be members of the CDIC if they intend to accept "retail" deposits that would be insured by CDIC (those less than CAD150,000). However, the CDIC can authorise a Schedule I or Schedule II Bank to accept retail deposits without being a CDIC member if:

- The aggregate of the bank's retail deposits is less than 1% of its total deposits.
- The bank informs depositors that it intends to accept deposits without being a CDIC member, and the bank has:
    - obtained an acknowledgement from each depositor that the deposit will no longer be insured by CDIC;
    - at the depositor's request, paid the principal amount of the deposit and interest to the depositor without any fee or penalty, or
    - obtained an agreement from another CDIC member institution to assume the liability in relation to the deposit on the same terms and conditions.

Schedule I and Schedule II Banks that become members of the CDIC must pay annual premiums to the CDIC.

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Foreign Bank Branches. A FBB must obtain the following approvals:

- An order from the Finance Minister authorising its establishment (Ministerial Order).
- An order from OSFI approving the commencement and carrying on of business in Canada (OSFI FBB Order).

The application process for Ministerial Orders and OSFI FBB Orders is similar to that required to establish a Schedule I or Schedule II Bank. (see "Guide to Foreign Bank Branching", published by OSFI (*https://www.osfi-bsif.gc.ca/Eng/Docs/fbb-2019.pdf*)).

Ministerial Order:

- Applicant provides introductory information to OSFI before an initial meeting.
- Applicant meets OSFI to discuss the proposed application.
- Applicant publishes notice of intention to apply for a Ministerial Order.
- Applicant submits its formal application for a Ministerial Order and an OSFI FBB Order to OSFI for review.
- OSFI will generally request further information or details from the applicant and will meet the applicant during the course of its review of the application.
- Once the analysis of all considerations the Finance Minister must take into account is complete, OSFI submits its recommendation to the Finance Minister regarding the making of a Ministerial Order.

OSFI FBB Order:

- If a Ministerial Order is made, OSFI continues its review and consideration of the application with respect to the issuance of an OSFI FBB Order.
- OSFI will generally make additional requests for information or details and can have further meetings with the applicant.
- OSFI carries out a pre-commencement review(s) of the applicant.
- If OSFI is satisfied that any material issues or concerns identified have been adequately addressed, OSFI issues the OSFI FBB Order.

Payments Canada membership. The CPA provides that every Schedule I Bank, Schedule II Bank and FBB is a member of Payments Canada from the day on which an order is made under the Bank Act approving its commencement and carrying on of business. Accordingly, each such bank will be responsible for the annual dues and transaction fees imposed by Payments Canada to cover the costs of maintaining the national payment clearing and settlement systems.

Trust and loan companies

Most trust and loan companies operating in Canada are incorporated federally under the TLCA and require the approval of both the Finance Minister and OSFI to carry on business. Trust and loan companies can also be

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incorporated under certain provincial corporate statutes. In either case, a trust and loan company must be licensed or registered in each province in which it carries on business.

Establishment under the TLCA. To carry on business in Canada, a trust and loan company incorporated under the TLCA must obtain the following approvals:

- Letters patent of incorporation issued by the Finance Minister.
- An order by OSFI authorising the commencement and conduct of business.

The three-stage application process for trust and loan companies is similar to that for establishing a Schedule I or Schedule II Bank (see "Guide for Incorporating Banks and Federally Regulated Trust and Loan Companies", as above under *Schedule I and Schedule II Banks*).

Provincial registration requirements. Provincial trust and loan company statutes require the licensing or registration of extra-provincial companies carrying on the business of a trust and loan company in the province. For example, any person carrying on the business of a trust and loan company in Ontario must register with the FSRA.

Insurance institutions

Domestic insurers. Most of Canada's domestic insurers are incorporated federally under the ICA and require the approval of both the Finance Minister and OSFI in order to carry on business. A number of smaller insurers are incorporated under provincial statutes. In either case, a domestic insurer is generally required to be licensed in each province in which it carries on business.

Establishment under the ICA. There are two main components involved in an application to establish an insurance company under the ICA:

- Obtaining letters patent from the Finance Minister incorporating the insurance company.
- Obtaining an order from OSFI authorising the commencement and carrying on of business.

OSFI has issued a "Guide for Incorporating Federally Regulated Insurance Companies" (*https://www.osfi-bsif.gc.ca/Eng/Docs/insguide.pdf*) which sets out the key steps in the application and approval process. The application process is similar to that for establishing a Schedule I or Schedule II Bank under the Bank Act (pre-application meetings with OSFI, publication of a notice of intention, submission of a formal application and an on-site review).

Concurrently with its establishment under the ICA, a domestic insurer must also comply with the applicable insurance legislation in each province in which it carries on business (*see below, Insurance institutions: Provincial licensing requirements*).

Foreign insurers. For a foreign insurer to carry on insurance business in Canada (other than by incorporating a subsidiary under the ICA), it must comply with the ICA and the applicable insurance legislation in each province in which it intends to carry on business. In each case, the specific circumstances of the applicant will be relevant in determining whether the proposed activity of the foreign insurer in relation to Canada or a particular province falls within the applicable definition of carrying on insurance business in the relevant jurisdiction that will require licensing under the ICA or an applicable provincial statute.

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The ICA provides that a foreign insurer must not insure a risk in Canada unless authorised to do so pursuant to an order made by OSFI. Whether a foreign insurer is insuring risks in Canada is a factual determination that depends on the circumstances of the particular foreign insurer's activities. OSFI has published an advisory (OSFI Advisory) which sets out the criteria for determining whether a company's business model would constitute insuring a risk in Canada and require authorisation order by OSFI. Under the OSFI Advisory, the greater the extent of the foreign insurer's business activities (solicitation, underwriting, servicing and so on) in Canada, the more likely that OSFI will consider that the foreign insurer is insuring a risk in Canada. It is possible for a foreign insurer to structure its business model with sufficiently minimal connection to Canada that, under the OSFI Advisory, it would not require authorisation.

Even if it is determined that a foreign insurer does not insure risk in Canada, its activities in Canada can still require the foreign insurer to obtain a licence under one or more provincial insurance statutes.

Provincial licensing requirements. The activities that constitute the carrying on of insurance business vary by province. For example, some statutes require an insurer to obtain a licence merely to promote its products, insure a person domiciled or resident, or provide insurance coverage on property situated, in the province.

Accordingly, OSFI advises applicants seeking to establish an insurance company under the ICA to review applicable provincial statutes. For example, the scope of carrying on insurance business in Ontario encompasses almost any activity associated with the business of insurance.

Investment institutions

Securities dealers and investment advisors are required to register with the securities regulator in each province in which they carry on business. The CSA have largely harmonised these provincial registration requirements in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103). Key registration categories for firms are investment dealer, mutual fund dealer, exempt market dealer, portfolio manager, and investment fund manager.

NI 31-103 provides certain exemptions from the registration requirements for foreign dealers and investment advisors, such as the international dealer and international adviser exemptions, which allow dealing and advising with respect to securities of an issuer incorporated, formed or created under the laws of a jurisdiction outside of Canada.

Additionally, international sub-advisers to registered Canadian investment dealers or advisers can rely on the international sub-adviser exemption if the sub-adviser is registered in a category similar to, and carries on business as, an adviser in the jurisdiction of the sub-adviser's head office or principal place of business. To qualify for the international sub-adviser exemption, the registered Canadian dealer or adviser and the sub-adviser must enter into a written agreement setting out the sub-adviser's obligations and duties and the registered Canadian dealer or adviser must enter into a written agreement with its clients agreeing to be responsible for any loss that arises out of the sub-adviser's breach of its fiduciary duties.

Any registered investment dealer must also be registered as a "dealer member" of IIROC and any registered mutual fund dealer must also be registered as a "member" of the MFDA. IIROC and the MFDA impose capital and proficiency requirements as conditions for membership.

Investment advisors are not required to register with any self-regulatory organisation.

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7. What approvals or licences are required for persons performing key roles at authorised financial institutions in your jurisdiction?

Banking institutions

No licence or prior approval from OSFI is required for directors or officers of banks. However, the Bank Act disqualifies certain persons from serving as a director of a Schedule I or Schedule II Bank (such as minors, bankrupts and agents or employees of foreign governments). Additionally, the Bank Act imposes residency requirements on directors and the chief executive officer of a bank.

In the case of a Schedule I Bank, a majority of the directors must be resident Canadians (determined for each director at the time of such director's appointment or election). To allow reasonable representation of a Schedule II Bank's foreign parent on the Schedule II Bank's board, a Schedule II Bank is only required to have half of its board comprised of resident Canadians. However, to ensure that senior management is present in Canada for regulatory oversight purposes, the chief executive officer of a Schedule I or Schedule II Bank must be "ordinarily resident" in Canada. The term "ordinarily resident" is not defined in the Bank Act.

Trust and loan companies

The TLCA imposes almost identical disqualifications and residency requirements for directors and the chief executive officer of federally-incorporated trust and loan companies as those imposed on banks under the Bank Act. Trust and loan companies formed in those provinces whose statutes permit provincial incorporation may be subject to disqualifications and residency requirements under such statutes. For example, British Columbia's Financial Institutions Act requires trust companies incorporated in British Columbia to have at least five directors, a majority of whom are ordinarily resident in Canada and at least one of whom must be ordinarily resident in British Columbia.

Insurance institutions

The ICA imposes almost identical disqualifications and residency requirements for directors and the chief executive officer of federally-incorporated insurance companies as those imposed on banks under the Bank Act. Agents and brokers of the insurance company are also prohibited from serving as directors.

Insurance companies incorporated under provincial statutes may also be subject to director residency requirements contained in the applicable corporate statute. For example, at least 25% of the directors of a corporation are required to be resident Canadians and, if the corporation has less than four directors, at least one director must be a resident Canadian.

The Insurance Legislation, related statutes (such as Ontario's Registered Insurance Brokers Act) and regulations enacted by the provinces require licensing of insurance agents, brokers and adjusters.

Investment institutions

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An individual cannot provide any dealer, underwriter or other investment activities or act as an advisor unless the individual is registered to do so. Registration requirements for individuals performing key functions with securities dealers and investment advisers are largely harmonised in NI 31-103. The key categories of registration for individuals are dealing representative, advising representative, ultimate designated person (UDP), and chief compliance officer (CCO).

Individuals who act as a dealer or underwriter in respect of a security that the individual's firm is permitted to trade or underwrite must be registered as a dealing representative.

Individuals who advise clients in respect of a security that the individual's firm is permitted to advise on must be registered as an advising representative.

Individuals registered as dealing or advising representatives of a registered firm must not act as an officer, partner or director, nor be simultaneously registered as a dealing or advising representative, of another non-affiliated firm registered in Canada.

NI 31-103 imposes education and proficiency requirements for registered individuals. The IIROC Dealer Member Rules and the MFDA Rules impose similar requirements for categories of "approved persons" (such as directors, executive UDPs and CCOs) of IIROC dealer members and mutual fund dealers. A dealing representative of an investment dealer that is a member of IIROC must be an "approved person" under the IIROC Dealer Member Rules. Similarly, a dealing representative of a mutual fund dealer that is a member of the MFDA must be an "approved person" under the MFDA Rules.

Each registered firm must designate an individual registered in the category of UDP who is the:

- Chief executive officer.
- Sole proprietor of the firm.
- Officer in charge of a division of the firm, if the activity that required the firm to register occurs only within that division and the firm has significant other business.

The UDP is required to supervise and be responsible for the activities of the firm that relate to its own, and its representatives', compliance with securities legislation.

Each registered firm must designate an individual registered as a CCO who must be either:

- An officer or partner of the firm.
- The sole proprietor of the firm.

The CCO is required to establish and maintain policies and procedures for compliance with securities legislation, monitor and assess compliance and report certain material instances of non-compliance to the UDP.

Registration exemptions for individuals required to be registered under NI 31-103 are also available in certain circumstances and are similar to the registration exemptions discussed in *Question 6*. Foreign individuals often rely on the international dealer, international adviser and international sub-adviser exemptions.

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8. Are there any alternatives to authorisation available for entities carrying on financial services in your jurisdiction?

Authorisation of the Finance Minister and OSFI is mandatory in all circumstances to carry on the business of banking in Canada or, for those companies incorporated under the TLCA, to carry on the business of a trust and loan company. Trust and loan companies must also be licensed or registered in each province in which they carry on business.

A foreign insurer that does not insure risk in Canada will not require OSFI authorisation to carry on business and may also be able to avoid certain provincial licensing requirements (*see Question 6*.

Securities dealers and asset managers can, if applicable, rely on the registration exemptions contained in NI 31-103 (*see Questions Question 6 and Question 7*).

Restrictions on ownership or control

9. Are there any restrictions on the ownership or control of financial institutions in your jurisdiction?

Banking institutions

Part VII of the Bank Act contains complex rules that restrict the ownership and control of banks. As a general prohibition, no person can have a significant interest (more than 10%) in any class of shares of a bank without the prior approval of the Finance Minister. Section 396 of the Bank Act sets out factors that the Finance Minister must consider in approving an application for a significant interest, including the character and integrity of the applicant. However, there are additional limits on ownership of a bank that depend on the equity of the specific bank:

- **Banks with equity of CAD12 billion or more: the "widely-held" requirement.** Larger banks are subject to the most restrictive ownership requirements. For a person to hold more than 10% of a class of shares in a bank with equity of CAD12 billion or more (CAD12 billion bank), the bank must be widely-held in that no person is a major shareholder of the bank. A "major shareholder" is defined as a person who owns either:
  - more than 20% of a class of voting shares; or
  - more than 30% of a class of non-voting shares of the bank.

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However, there is an absolute prohibition on any person exercising de facto control of a CAD12 billion bank. The determination as to whether a person exercises de facto control depends on the facts and circumstances of each case and the guidelines adopted by the Finance Minister for assessing de facto control should be consulted.

- **Banks with equity of CAD2 billion or more but less than CAD12 billion: the "public holding" requirement.** A person can hold a significant interest and can be a major shareholder in a bank with equity of CAD2 billion or more but less than CAD12 billion (CAD2 billion to CAD12 billion bank) provided that at least 35% of the bank's voting shares are:
  - listed for trading on a stock exchange in Canada; and
  - not owned by a major shareholder.

  The public holding requirement must be satisfied within three years after the day the bank comes into existence if it had more than CAD2 billion in equity on that day. Otherwise, it must be met within three years after the day of the first annual shareholder meeting after the bank's equity reaches CAD2 billion.

  Unlike CAD12 billion banks and subject to the public holding requirement, a person can exercise de facto control of a CAD2 billion to CAD12 billion bank with the Finance Minister's prior approval.
- **Banks with equity of less than CAD2 billion.** Small banks are subject to the least onerous restrictions on ownership and control. A person can hold a significant interest in a bank with equity of less than CAD2 billion. Such banks are not subject to the prohibition against having a major shareholder and are not required to satisfy any public holding requirements. A person can exercise de facto control of such a bank with the Finance Minister's prior approval.

Trust and loan companies

Given the similarities between banks and trust and loan companies, federally-incorporated trust and loan companies are subject to ownership restrictions found in Part VII of the TLCA which are nearly identical to the ownership restrictions imposed on banks. For example, the TLCA prohibits the ownership of a significant interest (more than 10%) in any class of shares of a trust and loan company without the prior approval of the Finance Minister. Similarly, there is a prohibition on the acquisition of de facto control and a public holding requirement similar to those applicable to banks under the Bank Act.

Trust and loan companies formed in those provinces whose statutes permit provincial incorporation may be subject to ownership and control restrictions pursuant to those statutes. For example, British Columbia's Financial Institutions Act prohibits the acquisition by a person and certain connected parties of such person of a substantial interest in a provincially-incorporated trust company (10% or more of the outstanding voting shares).

Insurance institutions

Federally-incorporated insurance companies are subject to the ownership restrictions found in Part VII of the ICA, which are similar in many respects to the ownership restrictions imposed on banks. For example, the ICA prohibits the ownership of a significant interest (more than 10%) in any class of shares of an insurance company without the prior approval of the Finance Minister. Similarly, there is a prohibition on the acquisition of de facto control of an insurance company without the Finance Minister's prior approval. Additionally, the ICA imposes a public holding requirement for 35% of the insurance company's voting shares that must be satisfied three years after the day that

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the insurance company comes into existence if it had more than CAD2 billion in equity on that day or three years after the day of the first annual shareholder and policyholder meeting after the insurance company's equity reaches CAD2 billion.

Insurance companies incorporated under provincial statutes are not subject to ownership or control restrictions.

Investment institutions

Subject to the requirement discussed in *Question 7* that registered dealers, advisers and investment fund managers appoint individuals to certain oversight and compliance positions within such firms, provincial securities regulations do not impose any ownership or control restrictions. However, the IIROC Dealer Member Rules for investment dealers require IIROC approval of the acquisition of 10% or more of an investment dealer.

Taxation

10. What main taxes are financial institutions subject to in your jurisdiction?

Financial institutions, like other corporations resident in Canada, are broadly subject to federal and provincial income tax under the Income Tax Act (Canada) (ITA) and corresponding provincial legislation, and are subject to additional rules to reflect the unique nature of the operations of financial institutions as financial intermediaries. The term "financial institution" is not generally defined in the ITA but for the purposes of the rules discussed under this heading, includes, among other things, a bank or a corporation licensed or otherwise authorised under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee.

Special rules under Part I of the ITA have been enacted with respect to the taxation of debt and equity securities held by financial institutions. These rules require financial institutions, as defined under section 142.2 of the ITA, to recognise current tax on "mark-to-market property" on an annual accrual basis rather than on a disposition. Mark-to-market property is broadly defined for tax purposes to include certain shares of a corporation, certain "specified debt obligations" and "tracking properties". The mark-to-market property held by the financial institution at the end of a taxation year must be valued at its fair market value and any accrued gain or loss from the valuation at the time of acquisition must be recognised on income account and not as capital gains and losses.

For specified debt obligations that are not mark-to-market property, special rules under Part I of the ITA permit a financial institution to claim a reserve in respect of doubtful or impaired debts to reflect the fact that even though the amount of the loan has not been included in income, the interest income on the loan includes compensation for the risk that the loan may not be fully repaid.

Under Part VI of the ITA, every corporation that is a financial institution, as defined under subsection 190(1) of the ITA, at any time during a taxation year, must pay a tax equal to 1.25% of the amount, if any, by which its taxable capital employed in Canada for the year exceeds the CAD1 billion capital deduction allowed each year. The taxable capital of a financial institution for a year is the amount by which its capital for the year exceeds the deduction allowed for the year in respect of its eligible investments in related financial institutions. The Part VI tax liability of a

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financial institution is further reduced by its Part I income tax payable for the year and any unused Part I tax credits and unused surtax credits that are claimed by the financial institution in the year.

Under the ITA, Canadian corporations can generally claim a deduction for dividends received from other Canadian corporations. Unlike other Canadian corporations, "specified financial institutions" (SFI), which again includes, among other things, a bank or a corporation licensed or otherwise authorised under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee, are denied a deduction with respect to dividends received on shares which meet certain conditions (generally certain preferred shares or shares that are subject to guarantee arrangements). Certain financial institutions can also be subject to a special tax on dividends received on certain preferred shares.

11.What is the tax position when profits are remitted abroad?

Canada does not generally restrict the movement of funds into or out of the country, but certain types of income remitted abroad will be subject to withholding tax under the ITA. Amounts paid or credited by a resident of Canada to a non-resident person with respect to most forms of passive income (including dividends, interest, rents and royalties) are generally subject to Canadian non-resident withholding tax on the gross amount of such payments. The rate of Canadian non-resident withholding tax under the ITA is 25%, subject to reduction under an applicable tax treaty. However, under the ITA, there is no non-resident withholding tax on interest paid or deemed to be paid by a Canadian resident person to a non-resident person where both the:

- Payer deals at arm's length with the debtor and the recipient of the interest.
- Interest is not considered to be "participating debt interest".

Participating debt interest is generally interest that is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation.

Canada has a wide network of tax treaties that reduce withholding tax rates on payments made from Canada to a foreign resident. Most of Canada's tax treaties reduce the rate of withholding tax from anywhere between 0% to 15%, depending on the country and form of income.

A private Canadian corporation can return capital to its shareholder(s) in lieu of paying a dividend. A return of capital is not subject to Canadian withholding tax provided that the capital returned does not exceed the "paid-up capital" (PUC) of the shareholder's shares. PUC is generally the amount that has been paid to the corporation to subscribe for shares. Accordingly, private Canadian corporations will typically return capital to non-resident investors up to the amount of their investment before paying dividends.

Proposals for reform

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12. Are there any impending developments or proposals for significant reform?

LIBOR replacement

Canadian dollar LIBOR was discontinued in 2013 after the LIBOR rigging scandal. In connection with the global effort to develop alternative benchmarks by the end of 2021, Canada has established the Canadian Alternative Reference Rate Working Group (CARRWG) to develop a Canadian dollar overnight benchmark rate. In July 2019, the Bank of Canada announced its intention to become the administrator of the enhanced Canadian Overnight Repo Rate Average (CORRA), a reference rate calculated using overnight repurchase transaction data provided by IIROC.

The Bank of Canada expects the enhanced CORRA to be implemented in the second quarter of 2020 and that it may potentially become the dominant Canadian interest rate benchmark, particularly in derivatives markets. Should CORRA become more widely adopted, the Canadian Dollar Offered Rate, the primary benchmark in Canadian loan transactions, may see its role diminished.

Anti-money laundering amendments

Amendments to Canadian federal anti-money laundering legislation (AML Amendments) intended to capture foreign money service businesses (MSBs) and virtual currency dealers are scheduled to come into force on 1 June 2020. The AML Amendments will amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act to require a person or entity "dealing in virtual currencies" to register as a MSB, addressing current regulatory ambiguities about whether registration is required for such persons.

The AML Amendments will require registration of foreign MSBs, defined as persons and entities that:

- Do not have a place of business in Canada.
- Are engaged in providing at least one of the regulated types of MSB services.
- Provide those services to their customers in Canada.

Foreign MSBs will be subject to the same registration and ongoing compliance requirements as Canadian MSBs.

Contributor profiles*

Elizabeth (Liz) Breen, Partner

Stikeman Elliott LLP
T + 1 416 869 5256

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F + 1 416 947 0866
E *ebreen@stikeman.com*
W stikeman.com
Areas of practice. Partner in the Mergers and Acquisitions, Capital Markets, Banking & Finance and Private Equity groups. Her practice focuses on mergers and acquisitions, debt and equity financings, and other major transactions.

Recent transactions. Acting for a significant number of foreign investors in respect of their Canadian strategic objectives.

Meaghan Obee Tower, Partner

Stikeman Elliott LLP
T + 1 416 869 5256
F + 1 416 947 0866
E *MObeeTower@stikeman.com*
W stikeman.com
Areas of practice. Partner in the Banking & Finance, Insurance & Reinsurance, Financial Products & Services, and Restructuring & Insolvency groups. Her practice focuses on secured and unsecured lending, debt financing, financial services regulation and corporate insolvency/restructuring.

Recent transactions.

- Extensive experience as counsel to borrowers, lenders and lending syndicates in acquisition financings, corporate finance, private equity leveraged acquisition financing, debtor-in-possession lending, asset based lending, and various other types of financing, both domestic and cross-border.
- Advising banks, trust companies and the insurance sector on regulation and compliance matters.

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