In Canada's federal system of government, legislative authority is shared between the federal government and ten provinces. The federal government has exclusive legislative authority over banking and incorporation of banks, while provinces retain jurisdiction over contract law, property and civil rights. As a result, both federal and provincial laws shape the regulation of banks and other financial institutions.

Federal regulation of banking and the dominant position of a small number of very large banks with nationwide branches have been the hallmarks of the Canadian banking system since its inception. The federal government's express constitutional authority over banks has allowed the development in Canada of national banks with diversified loan portfolios across Canadian regions and has enabled them to capture scale economies.

Incorporated only federally, banks are by far the most dominant form of organisation for financial institutions in Canada. The legislation recognizes three categories of banks in Canada: Canadian-incorporated domestic banks (listed in Schedule I to the Bank Act), Canadian-incorporated foreign bank subsidiaries (listed in Schedule II to the Bank Act), and Canadian branches of authorized foreign banks (listed in Schedule III to the Bank Act). As of March 2019, 35 Schedule I banks, 21 Schedule II banks, and 32 Schedule III banks operate in Canada.

Both Schedule I banks and Schedule II banks are Canadian-incorporated and regulated banks, except that a Schedule II bank is a subsidiary of a non-Canadian bank. Foreign banks have been permitted to operate in Canada through separately-incorporated Schedule II banks since 1980. Schedule II banks have substantially the same powers, and are subject to substantially the same restrictions, as domestic Schedule I banks. Specifically, Schedule II banks are permitted to accept deposits from Canadians, which are eligible for deposit insurance by the Canada Deposit Insurance Corporation (CDIC), subject to applicable limits. Schedule II banks must be individually capitalized and maintain in Canada Basel III-compliant adequate regulatory capital and liquid assets.

Foreign banks have been permitted to operate in Canada through a banking branch since 2001. The business powers of Schedule III foreign bank branches are in most respects similar to the powers of Schedule I and Schedule II banks. However, Schedule III banks are only permitted to accept wholesale deposits (that is, deposits of CAD$150,000 or more or deposits from large
corporates, financial institutions and government entities) and are not members of the CDIC. A Schedule III bank with a “lending” licence may accept deposits or borrow money only from financial institutions. Schedule III banks are not required to be separately capitalized, but must deposit unencumbered assets with a financial institution in Canada (“capital equivalency deposit”). The minimum capital equivalency deposit is set at five percent of the liabilities booked with the Canadian branch (although for a lending branch it is set at CAD$100,000).

A foreign bank may also maintain a representative office in Canada. A representative office may promote the services of the foreign bank in Canada or act as a liaison between clients of the foreign bank and other offices of the foreign bank, but is prohibited from carrying out any other business activity in Canada. As of May 2019, 23 foreign banks maintain a representative office in Canada.

Banks and foreign bank branches in Canada are supervised by The Office of the Superintendent of Financial Institutions (OSFI), Canada’s prudential financial regulator. OSFI’s primary role in regulating banks is to supervise their safety and soundness with a view to safeguarding depositors from loss and contributing to Canada’s financial stability. OSFI is a potent and proactive regulator with broad enforcement and supervisory powers over banks. It relies on legislation, its own regulatory guidance, and moral suasion to monitor and influence the management of risk by banks. OSFI favours a “close touch” approach to supervision and emphasizes the accountability of board of directors and management for the solvency of banks.

The Financial Consumer Agency of Canada (the FCAC) is the market conduct regulator for banks and enforces the "consumer provisions" of the Bank Act and to monitor compliance with industry voluntary codes and public commitments.

Canada’s Department of Finance – headed by the federal Minister of Finance – is responsible for the overall stability of the financial system in Canada and sets the financial sector policy in Canada. In addition, certain key approvals required under the Bank Act are delegated to the Minister of Finance. The Department of Finance works closely with OSFI and the FCAC.

The CDIC also plays a key role in the regulatory framework applicable to banks. A Crown corporation, the CDIC provides mandatory deposit insurance coverage to Schedule I and Schedule II banks and operates as the resolution authority for its member banks.

Other federal regulators with jurisdiction over banks include the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) and the Privacy Commissioner of Canada. FINTRAC is Canada's financial intelligence unit and is tasked with enforcing Canada's anti-money laundering and counter-terrorist financing regime under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act. It has jurisdiction over banks and other federal and provincial institutions.

The Privacy Commissioner is an officer of the Parliament of Canada and acts as an advocate for the privacy rights of Canadians. The Commissioner administers the Personal Information Protection and Electronic Documents Act.
What US Banks Need to Know About Banking Regulation in Canada

March 28, 2019

Moderator: Vladimir Shatiryan, Blake, Cassels & Graydon LLP 
Panelists: Neil Lacroix, MUFG Bank, Ltd., Canada Branch 
           Rob Fischer, Silicon Valley Bank 
           Sandra Mollet, HSBC Bank Canada
BANKING IN CANADA

Vladimir Shatiryan

Blake, Cassels & Graydon LLP
416 863 4154
Vladimir.shatiryan@blakes.com
Federal Jurisdiction

- Banking falls within exclusive federal jurisdiction
  - Banks and foreign bank branches may be established only federally
  - Provincially regulated deposit-taking institutions are primarily limited to credit unions, which are subject to cooperative governance and may operate only intraprovincially
Categories of Banking Organizations

Canadian Banks
- Schedule I Banks:
  - No foreign bank ownership
- Schedule II Banks:
  - Owned by a foreign bank

Foreign Bank Branches
- Full-Service Branch:
  - Wholesale deposit-taking power
- Lending Branch:
  - Generally, no deposit-taking power

Foreign Bank Representative Office:
- Limited Marketing and Liaison Powers
Current Landscape

• As of March 2019:
  – 35 Schedule I Banks
  – 21 Schedule II Banks
  – 28 Full-Service Foreign Bank Branches
  – 4 Lending Foreign Bank Branches
  – 23 Foreign Bank Representative Offices

• Six large Schedule I banks (Canadian DSIBs) hold approximately 93% of bank assets in Canada, according to the IMF
Schedule I Banks

- ADS Canadian Bank
- B2B Bank
- Bank of Montreal
- Bank of Nova Scotia
- Bridgewater Bank
- Caisse populaire acadienne ltée (UNI)
- Canadian Imperial Bank of Commerce
- Canadian Tire Bank
- Canadian Western Bank
- Coast Capital Savings Federal Credit Union
- Concentra Bank
- Continental Bank of Canada
- CS Alterna Bank
- DirectCash Bank
- Equitable Bank
- Exchange Bank of Canada
- First Nations Bank of Canada
- General Bank of Canada
- Haventree Bank
- Home Bank
- HomEquity Bank
- Laurentian Bank of Canada
- Manulife Bank of Canada
- Motus Bank
- National Bank of Canada
- President’s Choice Bank
- Rogers Bank
- Royal Bank of Canada
- Street Capital Bank of Canada
- Tangerine Bank
- Toronto-Dominion Bank
- Vancity Community Investment Bank
- VersaBank
- Wealth One Bank of Canada
- Zag Bank
Schedule II Banks

- Amex Bank of Canada
- Bank of China (Canada)
- Bank One Canada*
- BofA Canada Bank
- Cidel Bank Canada
- Citco Bank Canada
- Citibank Canada
- CTBC Bank Corp. (Canada)
- Habib Canadian Bank
- HSBC Bank Canada
- ICICI Bank Canada
- Industrial and Commercial Bank of China (Canada)
- J.P. Morgan Bank Canada
- J.P. Morgan Canada*
- KEB Hana Bank Canada
- Mega International Commercial Bank* (Canada)
- SBI Canada Bank
- Shinhan Bank Canada
- Société Générale (Canada)
- UBS Bank (Canada)
- Walmart Canada Bank
Schedule III Foreign Bank Branches – Full Service

- Bank of America, National Association
- Bank of China, Toronto Branch
- Bank of New York Mellon
- Barclays Bank PLC, Canada Branch
- BNP Paribas
- Capital One Bank (Canada Branch)
- China Construction Bank Toronto Branch
- Citibank, N.A.
- Comerica Bank
- Deutsche Bank AG
- Fifth Third Bank
- First Commercial Bank
- JPMorgan Chase Bank, National Association
- M&T Bank
- Maple Bank*
- Mega International Commercial Bank Co., Ltd.

- Mizuho Bank, Ltd., Canada Branch
- MUFG Bank, Ltd., Canada Branch
- Northern Trust Company, Canada Branch
- PNC Bank Canada Branch
- Rabobank Canada
- Société Générale (Canada Branch)
- State Street
- Sumitomo Mitsui Banking Corporation, Canada Branch
- U.S. Bank National Association
- UBS AG Canada Branch
- United Overseas Bank Limited
- Wells Fargo Bank, National Association, Canadian Branch
Schedule III Foreign Bank Branches – Lending

- Crédit Agricole Corporate and Investment Bank (Canada Branch)
- Credit Suisse AG, Toronto Branch
- Natixis Canada Branch
- Silicon Valley Bank
## Governance and Powers

<table>
<thead>
<tr>
<th>Governance</th>
<th>Canadian Bank</th>
<th>Foreign Bank Branch</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>A Canadian incorporated entity</td>
<td>Extension of the foreign bank in Canada (not a separate legal entity)</td>
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<tr>
<td></td>
<td>Must have a Canadian resident CEO and a board of directors that includes</td>
<td>Must fit within the foreign bank governance structure</td>
</tr>
<tr>
<td></td>
<td>outside, independent, and Canadian-resident directors</td>
<td>Canadian operations overseen by a Canadian resident Principal Officer</td>
</tr>
<tr>
<td>Deposits</td>
<td>Full retail deposit-taking capability</td>
<td>No CDIC deposit insurance</td>
</tr>
<tr>
<td></td>
<td>Deposits insured by CDIC (CAD$100,000)</td>
<td>Full-service branch: wholesale deposits only (CAD$150,000 minimum balance</td>
</tr>
<tr>
<td></td>
<td>Also possible to operate with limited deposit-taking power (without CDIC</td>
<td>requirement or deposits from large corporates and financial institutions)</td>
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<td></td>
<td>insurance)</td>
<td>Lending branch: no borrowing or deposit-taking, except from other financial</td>
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<tr>
<td></td>
<td></td>
<td>institutions</td>
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</table>
# Governance and Powers

<table>
<thead>
<tr>
<th>Capital</th>
<th>Canadian Bank</th>
<th>Foreign Bank Branch</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>- Individually capitalized</td>
<td>- Subject to a simpler capital equivalency deposit requirement (liquid assets held on deposit with a Canadian bank, subject to OSFI control)</td>
</tr>
<tr>
<td></td>
<td>- Must meet Basel III-based OSFI capital requirements</td>
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<tr>
<td></td>
<td>- Risk-based capital ratio</td>
<td>- Full-Service Branch: Minimum 5% of liabilities booked with branch</td>
</tr>
<tr>
<td></td>
<td>- Leverage ratio</td>
<td></td>
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<td></td>
<td>- TLAC (effective 2021 – applies only to Canadian DSIBs)</td>
<td>- Lending Branch: CAD$100,000</td>
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<tr>
<td></td>
<td>- Standardized approach (except if a Canadian DSIB)</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Liquidity</th>
<th>Must meet Basel III-based OSFI liquidity requirements</th>
<th>Home jurisdiction rules apply</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- LCR and NCCF</td>
<td></td>
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<tr>
<td></td>
<td>- NSFR (effective 2020 – applies only to Canadian DSIBs)</td>
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## Governance and Powers

<table>
<thead>
<tr>
<th></th>
<th>Canadian Bank</th>
<th>Foreign Bank Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Large Exposure Limit</strong></td>
<td>• Schedule I Banks: Limited to 25% of bank’s regulatory capital</td>
<td>• Limited to 25% of foreign bank’s global regulatory capital</td>
</tr>
<tr>
<td></td>
<td>• Schedule II Banks: Limited to 25% of bank’s regulatory capital</td>
<td></td>
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<tr>
<td><strong>Self-dealing</strong></td>
<td>• Broad prohibition against transactions with “related parties”, subject to narrow exceptions</td>
<td>• Self-dealing rules do not apply (home jurisdiction rules to be considered)</td>
</tr>
<tr>
<td><strong>Stress testing</strong></td>
<td>OSFI requirements apply (ICAAP)</td>
<td>• Home jurisdiction rules to be considered</td>
</tr>
</tbody>
</table>
## Governance and Powers

<table>
<thead>
<tr>
<th>Outsourcing</th>
<th>Canadian Bank</th>
<th>Foreign Bank Branch</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Certain functions and controls may be outsourced to parent/head office or other affiliates</td>
<td></td>
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<td></td>
<td>The arrangement must be meticulously documented under a service agreement (including a materiality assessment and due diligence)</td>
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<td></td>
<td>Service agreement must include OSFI-required contractual provisions and must otherwise comply with OSFI Guideline B-10</td>
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<td></td>
<td>Audit rights to OSFI</td>
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<td></td>
<td>For Schedule II banks, self-dealing rules must be considered</td>
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<td></td>
<td>Bank Act in-Canada recordkeeping requirements</td>
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</table>
## Entry Process

<table>
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<tr>
<th>Canadian Bank</th>
<th>Foreign Bank Branch</th>
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<tbody>
<tr>
<td>• Letters Patent issued by Federal Minister of Finance</td>
<td></td>
</tr>
<tr>
<td>• Order to commence issued by OSFI</td>
<td></td>
</tr>
<tr>
<td>• OSFI runs the application process and makes a recommendation to Minister</td>
<td></td>
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<tr>
<td>• OSFI conducts an onsite pre-commencement review</td>
<td></td>
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<tr>
<td>• Upfront capital injection</td>
<td></td>
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<tr>
<td>• Operational readiness (Canadian compliant policies, procedures, IT systems)</td>
<td></td>
</tr>
<tr>
<td>• Governance (Board, Senior Management, Control Functions)</td>
<td></td>
</tr>
<tr>
<td>• Meticulous documentation of outsourcing arrangements with parent/affiliates</td>
<td></td>
</tr>
<tr>
<td>• 24 to 36 month process</td>
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<table>
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<th>Foreign Bank Branch</th>
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<tr>
<td>• Order by Federal Minister of Finance establishing the Branch</td>
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<tr>
<td>• Order to commence issued by OSFI</td>
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<td>• OSFI runs the application process and makes a recommendation to Minister</td>
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<td>• OSFI conducts an onsite pre-commencement review</td>
<td></td>
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<tr>
<td>• Capital equivalency deposit</td>
<td></td>
</tr>
<tr>
<td>• Operational readiness (Canadian compliant policies, procedures, IT systems)</td>
<td></td>
</tr>
<tr>
<td>• Governance (Principal Officer, Head Office oversight, Control Functions)</td>
<td></td>
</tr>
<tr>
<td>• Meticulous documentation of outsourcing arrangements with head office/affiliates</td>
<td></td>
</tr>
<tr>
<td>• 18-24 month process</td>
<td></td>
</tr>
</tbody>
</table>
Legislative Framework

- Bank Act
- Proceeds of Crime (Money Laundering) and Terrorist Financing Act
- Personal Information Protection and Electronic Documents Act
- Canada Deposit Insurance Corporations Act
- Other laws of general application
Principal Regulators

- FCAC
- FINTRAC
- OSFI
- Department of Finance
- Privacy Commissioner
- Payments Canada
OSFI

- Office of the Superintendent of Financial Institutions
  - Single prudential federal banking regulator
  - Independent agency of the federal government
  - Advances a regulatory framework designed for banks to control and manage risk
  - Organized into: Supervision Sector and Regulation Sector
  - Has published a large body of risk-management guidelines supplementing the legislative requirements under the Bank Act
OSFI

• Has broad enforcement and supervision powers
  – Compliance examinations
  – Information requests
  – Directions of compliance
  – Prudential agreements
  – Power to disqualify officers
  – Administrative monetary penalties
  – Criminal prosecution
• Moral suasion is the most common tool of enforcement
• Early intervention: staging process
FCAC

• Financial Consumer Agency of Canada
  – Federal market conduct regulator
  – Enforces compliance with the “consumer provisions” of the Bank Act, some of which extend to commercial products
  – Enforces compliance with voluntary codes and public commitments
  – Requires periodic reporting of consumer complaints and systemic deficiencies
  – Broad examination powers
  – Authority to impose and publicize administrative monetary penalties
FINTRAC

- Financial Transactions and Reports Analysis Centre of Canada
  - Canada’s financial intelligence unit
  - Enforces Canada’s AML legislation, the Proceeds of Crime (Money Laundering) and Terrorist Financing Act
  - Requires reporting of suspicious transaction reports, terrorist property and threshold cash and international EFT transactions
  - Broad examination powers
  - Authority to impose and publicize administrative monetary penalties
CDIC

- Administers deposit insurance framework under CDIC Act
- Resolution authority for Schedule I and II banks that accept retail deposits
- Much less active a regulator than the FDIC
Department of Finance

- Responsible for the overall stability of the financial system in Canada
- Develop federal financial sector policy in Canada
- Drives legislative changes
- Leads drafting of regulations under the Bank Act
- Minister of Finance has approval powers under the Bank Act (new entry, change of control, threshold transactions)
- Works closely with federal financial regulators
Federal Privacy Commissioner

- Administers PIPEDA, the federal privacy legislation for private-sector organizations
  - Personal information includes information of employees and the individuals you deal with at customers, suppliers and elsewhere
  - New data breach notification obligation
Cross-Border Activities

• Foreign banks and their affiliates are subject to a broad prohibition on carrying on business:

510 (1) Except as permitted by this Part [XII], a foreign bank or an entity associated with a foreign bank shall not:
   (a) in Canada, engage in or carry on
       (i) any business that a bank is permitted to engage in or carry on under this Act, or
       (ii) any other business;
   (b) maintain a branch in Canada for any purpose
Cross-Border Activities

• This broad prohibition captures:
  – Foreign banks
  – All affiliates of a foreign bank (subject to limited exceptions)
• The prohibition does not apply to business booked with a Schedule II banking subsidiary or a Schedule III branch of a foreign bank
Cross-Border Activities

• Distinction between:
  – Carrying on business in Canada (prohibited)
  – Carrying on business with Canadians from outside Canada (permitted)

• Determination is made based on OSFI rulings and caselaw

• No single factor is determinative; the totality of circumstances is considered
Cross-Border Activities

• Fact-specific determination
  – Physical premises in Canada?
  – Employees in Canada?
  – Employees visiting Canada?
  – Credit decisions or other material decisions made in Canada?
  – Negotiations in Canada?
  – Execution or delivery of contracts in Canada?
  – Service-providers in Canada?
  – Promotional, marketing or advertising activities in Canada or directed at Canadians?
  – Secured property situated in Canada?
  – Bank accounts in Canada?
  – Other touch points in Canada?
Cross-Border Activities

• Consider touch points with Canada in connection with all of foreign bank’s activities with Canadians, not just touch points for a particular transaction or program

• Where the foreign bank maintains authorized presence in Canada (a subsidiary or branch), only the business booked with Canadian subsidiary or branch is exempt from the carrying-on business prohibition (branch/subsidiary cannot act as agent for non-Canadian branches and affiliates)
Cross-Border Activities

• Consequences of breaching prohibition
  – Bank Act provides for civil and criminal penalties – not typical
  – OSFI intervention – more likely
• Practical consequence
  – Disruption to business
• OSFI Ruling process
Panel Discussion

- **Neil Lacroix**, MUFG Bank, Ltd., Canada Branch
- **Rob Fischer**, Silicon Valley Bank
- **Sandra Mollet**, HSBC Bank Canada
## Options for a Foreign Bank to Establish Presence in Canada

<table>
<thead>
<tr>
<th>Expansion Option</th>
<th>Permitted Activities</th>
<th>Key Restrictions</th>
<th>Capital and Governance Requirements</th>
<th>Regulatory Approval</th>
<th>Pros/Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Banking Subsidiary</strong> <em>(Schedule II Bank)</em></td>
<td>Full commercial and retail banking capabilities, including deposit taking, lending and other traditional banking and credit services. Has the same powers as Canadian domestic banks.</td>
<td>None of the limits that apply to the other options below.</td>
<td>Subject to same requirements as those applicable to Canadian domestic banks. <strong>Capital:</strong> Must be locally capitalized: risk-weighted capital ratios and leverage ratio in accordance with Basel III and IFRS. <strong>Liquidity:</strong> Requirement to meet Basel III liquidity measures: liquidity coverage ratio and net cumulative cash flow. <strong>Governance:</strong> Must have a Canadian resident CEO and a board of directors that includes outside, independent, and Canadian-resident directors. <strong>Compliance:</strong> Must comply with Canadian laws and regulatory requirements. Canada-specific policies and procedures required.</td>
<td>Key Approvals: - letters patent issued from the Minister of Finance - authorizing order from the Office of the Superintendent of Financial Institutions (OSFI), following an onsite review</td>
<td><strong>Set up time:</strong> 24-36 months after submitting a full application</td>
</tr>
</tbody>
</table>

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1 plus a share of any excess supervision expenses (higher fee if the total assets of the banking subsidiary are above CAD $5 billion)
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<tr>
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</tr>
</thead>
</table>
| **Full-Service Branch** | **Lending Business:** Full commercial and retail lending powers, including credit cards, foreign exchange, and letters of credit.  
**Wholesale Deposit Taking:** May accept deposits so long as:  
- all deposit accounts for a client remain above CAD$150,000 (with some de minimis exceptions); or  
- the client is a “sophisticated party” (e.g., corporations with gross revenues above CAD$5,000,000, financial institutions, and government entities). | No retail deposit-taking permitted (i.e., no deposits below CAD $150,000 unless the client is a sophisticated party) | **Capital:** Initial capital-equivalency deposit (CED) of at least CAD$5,000,000 at a Canadian bank. By legislation, the CED must remain equal to 5% of all Canada branch liabilities, but OSFI will require a higher amount  
**Funding:** Funding can be through permitted wholesale deposits and also through intra-company/inter-branch allocations and lending (but not from retail deposits).  
**Governance:** Must have a principal officer resident in Canada responsible for the Canada branch. Some activities may be outsourced to home office, provided the home office has the necessary expertise for Canadian requirements.  
**Compliance:** Compliance with Canadian laws and regulatory requirements. Certain Canada-specific policies and procedures required. | **Key Approvals:**  
- Order of the Minister of Finance establishing Canada branch  
- Authorizing order from OSFI, following an onsite review | **Set up time:** 18-24 months after submitting a full application  
**Regulatory Fees:**  
- CAD$32,000 application fee charged by OSFI  
- Annual OSFI fee of CAD$10,000 to $50,000² | **Pros:**  
- Wholesale deposit-taking ability  
- Large exposure limit based on home office regulatory capital level  
- No restriction on related-party transactions  
- No Canadian-incorporated and locally-capitalized subsidiary required (but see the CED requirement) | **Cons:** No retail deposit taking permitted. |

² plus a share of any excess supervision expenses (higher fee if the total assets booked with the branch are above CAD $5 billion)
<table>
<thead>
<tr>
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<th>Regulatory Approval</th>
<th>Pros/Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lending Branch</strong></td>
<td><strong>Lending Business:</strong> Full commercial and retail lending powers, including credit cards, foreign exchange, and letters of credit. <strong>Deposit Taking:</strong> May only accept deposits and borrow money from financial institutions. No retail or commercial client deposits permitted.</td>
<td>No deposit taking other than from financial institutions.</td>
<td><strong>Capital:</strong> CED of CAD$100,000. <strong>Funding:</strong> Through intra-company/inter-branch allocations, borrowing from financial institutions (but not from commercial or retail deposits). <strong>Governance:</strong> Must have a principal officer resident in Canada responsible for Canada branch. Some activities may be outsourced to home office, provided the home office has the necessary expertise for Canadian requirements. <strong>Compliance:</strong> Compliance with Canadian laws and regulatory requirements. Certain Canada-specific policies and procedures required.</td>
<td><strong>Key Approvals:</strong> - Order of the Minister of Finance establishing Canada branch - Authorizing order from OSFI, following an onsite review <strong>Set up time:</strong> 18-36 months after submitting a full application <strong>Regulatory Fees:</strong> - CAD$32,000 application fee charged by OSFI - Annual OSFI fee of CAD$10,000</td>
<td><strong>Pros:</strong> - Broad commercial and retail credit business powers – a relatively cost-effective way to enter the Canadian banking market - Large exposure limit based on home office regulatory capital level - No restriction on related-party transactions - No Canadian-incorporated and locally capitalized subsidiary required (other than the CAD$10,000 CED requirement) <strong>Cons:</strong> No commercial or retail deposit taking permitted.</td>
</tr>
<tr>
<td>Expansion Option</td>
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<td>Capital and Governance Requirements</td>
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</table>
| **Representative Office** | In-country marketing only: may promote services of the foreign bank and affiliates in Canada and act as a liaison between clients in Canada and foreign. branches of the bank. | May not carry on business in Canada. May not generate any revenue directly in Canada. No negotiating or closing of deals/signing documents permitted in Canada. | No capital requirement, but supervision by home office required. | **Key Approvals:** Order by OSFI  
**Set up time:** 6-8 months after submitting a full application  
**Regulatory Fees:**  
- CAD$4,800 application fee charged by OSFI  
- Annual OSFI fee of CAD$2,500 | **Pros:** A cost-effective way to carry out in-Canada marketing.  
**Cons:** A representative office is only a marketing unit and may not carry on business in Canada. All business must be carried out from outside Canada, cross-border. |
| **Non-Banking Subsidiary** | Lending, other financial services (except deposits), subject to potential provincial regulation | May not accept deposits under provincial laws  
If the subsidiary will engage in money services business activities, it must comply with the ongoing requirements of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (KYC, recordkeeping). | None. This is not a regulated financial institution. If engaging in money services business activities, must implement anti-money laundering policies and appoint a chief anti-money laundering officer. | **Key Approvals:**  
- If the foreign bank has no presence in Canada, the approval of the Minister of Finance authorizing the bank to have financial establishment in Canada  
- If the subsidiary will engage in money services business anywhere in Canada, registration with FINTRAC (Canadian anti-money laundering regulator) | **Pros:** Avoids the more time-consuming and effortful process for setting up a banking subsidiary or a branch.  
**Cons:** Not a regulated financial institution. Restriction on deposit-taking. Directly subject to application of provincial laws. |

3 A foreign bank may also establish a securities dealer subsidiary in Canada, which is not addressed in this chart.
<table>
<thead>
<tr>
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<th>Capital and Governance Requirements</th>
<th>Regulatory Approval</th>
<th>Pros/Cons</th>
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<tr>
<td>No Presence</td>
<td>A foreign bank and its affiliates are not permitted to carry on business in Canada, except through an authorized presence. Any services provided to Canadian must be properly structured cross-border.</td>
<td>Reporting and monitoring) and Quebec’s Money-Services Businesses Act.</td>
<td></td>
<td>- If the subsidiary intends to engage in money services business in Quebec, registration with Autorité des marchés financiers (AMF, Quebec’s financial regulator)</td>
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<td>- Other provincial approvals may be required depending on the nature of business (such as mortgage lender or consumer lender)</td>
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<td><strong>Set up time:</strong> 4-8 months after submitting a full application to OSFI (and to FINTRAC and AMF, if money services business registrations are sought)</td>
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<td><strong>Regulatory Fees:</strong></td>
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<td>- CAD$8,000 application fee charged by OSFI</td>
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<td>- No annual OSFI fees</td>
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<td>- Additional regulatory fees for other licences sought</td>
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CROSS-BORDER LENDING TO CANADA: BANK ACT PRIMER FOR FOREIGN BANKS
03/15/2016

Paul Belanger, Dawn Jetten and Vladimir Shatiryan

Canada has a highly concentrated financial sector with six large Canadian domestic banks holding 93 per cent of all bank assets — one of the highest concentration levels in G7 countries, according to the International Monetary Fund. Perhaps because of this, there is a growing interest by foreign lenders to participate in the Canadian financial sector. Currently, 24 foreign bank subsidiaries and 29 foreign bank branches operate in Canada with a total of C$239-billion assets in Canada, compared to C$4.773-trillion held by Canadian domestic banks, as of December 2015. Foreign banks also participate in the Canadian financial sector by making cross-border bilateral and syndicated loans to Canadian borrowers without maintaining an authorized presence in Canada. In this bulletin, we discuss how Canadian banking laws regulate cross-border lending and how foreign banks and their affiliates can properly structure their lending activities to ensure compliance with Canadian laws and avoid disruptive adverse regulatory action in Canada.

UNDERSTANDING COMPETING POLICY OBJECTIVES

Foreign banks have made loans cross-border to borrowers located in Canada for many years, but the practice became much more prevalent after 2008 when the Government of Canada eliminated the withholding tax on arm’s-length outbound interest payments made by Canadian borrowers to non-resident lenders. The purpose of the elimination of the withholding tax, as Canada’s Department of Finance put it, was to “increase access to foreign capital markets and reduce costs for Canadians and Canadian businesses that borrow from foreign lenders.”

Although this tax disincentive was eliminated, foreign banks without an authorized presence in Canada continue to face a broad legislative prohibition under the Bank Act (Canada) against carrying on business in Canada. As a result, such foreign banks are required to structure their lending activities with residents of Canada cross-border, by maintaining minimal “touch points” with Canada to ensure that they do not carry on business in Canada contrary to the Bank Act.

The discord between the policy reasons underlying the elimination of the withholding tax in 2008 and the Bank Act prohibition against foreign banks carrying on business in Canada (without an authorized presence) reflects a long-standing policy tension between increasing competition in Canada’s financial sector on the one hand, and maintaining a level-playing field between Canadian and foreign banks on the other.

BANK ACT PROHIBITION

The prohibition in respect of foreign bank activities in Canada is set out in the Bank Act, the principal banking legislation. It reads, in relevant parts, as follows:

“510 (1) Except as permitted by this Part [XII], a foreign bank or an entity associated with a foreign bank shall not
(a) in Canada, engage in or carry on

(i) any business that a bank is permitted to engage in or carry on under this Act, or

(ii) any other business;

(b) maintain a branch in Canada for any purpose.”

The effect of this provision is that a foreign bank or an entity associated with a foreign bank is not permitted to engage in, or carry on, any business in Canada or maintain a branch in Canada, except as permitted by Part XII of the Bank Act. Part XII permits a foreign bank to establish certain types of business in Canada or to establish a Canadian branch, subject to satisfying applicable legislative and regulatory requirements. However, where a foreign bank or an entity associated with a foreign bank does not wish to establish authorized presence in Canada, cross-border structuring must be considered.

Although the Bank Act prohibition is broadly drafted, it expressly applies to activities that are carried on in Canada. As a result, a distinction has been drawn between engaging in Canada in an activity (prohibited by the Bank Act) and engaging in the same activity from outside Canada cross-border with residents of Canada (permitted by the Bank Act). This distinction has been accepted by Canada’s principal banking regulator — the Office of the Superintendent of Financial Institutions (OSFI) — in a variety of circumstances. A number of OSFI rulings address this issue and provide guidance as to what factors are relevant, although each situation is dependent on the facts. Further, OSFI rulings have confirmed that some activity in Canada by, or on behalf of a foreign bank is acceptable, provided that the activity is ancillary to the main business activity of the foreign bank undertaken from outside Canada. OSFI rulings also indicate that policy concerns may impact OSFI’s determination whether cross-border dealings with Canadians constitute the carrying on of business in Canada. Specifically, in our experience, there is a heightened sensitivity in respect of transactions that include cross-border deposit taking. In addition, consumer lending programs generally have more connecting factors with Canada and they also raise consumer protection issues. For these reasons, consumer lending can be more difficult to structure across the border.

WHO IS SUBJECT TO THE PROHIBITION?

The Bank Act prohibition applies to foreign banks and certain entities associated with them. The following entities are considered foreign banks for the purposes of the prohibition:

1. An entity that is a bank according to the laws of the jurisdiction of its incorporation or any jurisdiction in which it carries on business;
2. An entity that engages in the business of providing financial services and employs, the word “bank” or “banking” or any corresponding words in other languages to identify or describe its business;
3. An entity that is regulated as a bank or as a deposit-taking institution in the jurisdiction of its incorporation or any jurisdiction in which it carries on business. OSFI has indicated that it will generally view an entity to be a foreign bank under this criterion if the entity’s core business comprises deposit-taking or lending activities, and it is subject to a regulatory framework aimed at protecting depositors or other creditors.

The definition of an entity associated with a foreign bank is more complex. It is defined to include entities that control or are controlled by a foreign bank and entities that are controlled by the same person as the foreign bank. There are, however, important carve-outs from this broad definition, some of which are tied to materiality thresholds established under the Bank Act. This is an area where care needs to be taken to consider whether a non-bank entity that
has a foreign bank in its corporate group would be viewed as an “entity associated with a foreign bank” under the Bank Act before engaging in any business in Canada.

The Bank Act prohibition also extends to the activities in Canada carried out by an agent or nominee of a foreign bank or an entity associated with a foreign bank. As a result, the foreign bank or the entity associated with the foreign bank cannot circumvent the Bank Act prohibition by enlisting agents or nominees in Canada and carrying out the prohibited activities through them. The term “agent” in this context refers to a common-law relationship of agency, while the term “nominee” does not have an established meaning in the Canadian jurisprudence and may be interpreted more broadly.

Importantly, the Bank Act prohibitions discussed above apply only to foreign banks and entities associated with them. If a lender is not a foreign bank or an entity associated with a foreign bank within the meaning of the Bank Act, then the lender would not be subject to the Bank Act prohibition, although certain licensing requirements under Canada’s provincial laws may apply.

### RELEVANT CONSIDERATIONS

A number of considerations have emerged from OSFI rulings and case law that help determine whether a cross-border activity of a foreign bank or an entity associated with a foreign bank constitutes the carrying on of business in Canada contrary to the Bank Act. As previously noted, this determination is highly fact-specific and often a single connecting factor (or its absence) is not dispositive of the issue. Rather, the considerations set out below outline the factors that OSFI will likely consider in determining whether a foreign bank or an entity associated with a foreign bank is carrying on business in Canada in contravention of the Bank Act. For ease of reference, we use the term foreign bank to refer both to foreign banks and entities associated with foreign banks in the discussion below.

**Office or Employees in Canada**

Maintaining a place of business or establishment in Canada, such as an office that is regularly used for an extended period of time by a foreign bank’s employees, nominees or agents is a significant adverse factor in the carrying on business determination. Maintaining an office in Canada will also likely contravene the Bank Act prohibition against opening a branch in Canada (other than an authorized branch).

**Trips to Canada by Foreign Bank’s Employees**

Regular visits to Canada by the employees of a foreign bank are also an adverse factor. However, limited visits to Canada to conduct due diligence, audits and inspections or visits occasioned by realization situations are likely to be permitted. Even limited visits, however, when combined with other significant connecting factors, may result in a carrying on business determination. Visits for the purpose of the solicitation of business are particularly sensitive and call for careful analysis in light of any other expected commitments to Canada.

**Contract Formation and Negotiations**

OSFI will consider where the material business contracts are negotiated and executed. Material contracts will include loan documents, such as commitment letters, terms sheets, credit agreements, and security documents, as well as service agreements that a foreign bank enters into with Canadian service providers in certain permitted circumstances. Negotiations that take place in person in Canada will have a significant adverse impact on the carrying on business determination. Therefore, all material negotiations should be conducted by persons located outside of Canada at the times they are negotiating, such as by telephone or by electronic means of communication. Although the foreign bank may engage local Canadian legal counsel to assist with the cross-border transaction, the foreign bank should be careful not to delegate material decision-making authority on business matters to the Canadian counsel. This is to ensure that the Canadian counsel are not viewed as agents or nominees negotiating in Canada on behalf of the foreign bank. In addition, because the Canadian common-law rules
of contract formation generally consider a contract to be executed in the jurisdiction where it was last signed, the foreign bank should ensure that it signs all agreements outside Canada and, if the counterparty signs in Canada, the foreign bank should sign last. The importance of this distinction has, however, diminished in the era of email exchanges of PDF signature pages.

**Servicing Contracts**

OSFI has accepted that foreign banks may utilize limited services in Canada in connection with cross-border loans if the services are incidental to the lending otherwise carried on from outside Canada. This can be explained in two ways. First, the activity carried out in Canada by the local service provider is such that even if undertaken by the foreign bank, the activity would not amount to carrying on business in Canada. Second, in some cases, OSFI has recognized that because the services carried out in Canada by the local service providers are incidental in nature, the service providers are not considered as agents or nominees of the foreign bank. In such cases, in order for a servicing arrangement to be permitted, it should be carried out by independent Canadian service providers that are not affiliated with the foreign bank and do not work exclusively for the foreign bank. Other permitted services could include valuation services, receivership services and legal services.

The services provided by an independent Canadian agent bank on a syndicated loan should also fall within the foregoing category of permitted services, although this issue has not been specifically considered in published OSFI rulings.

**Realization**

OSFI rulings also indicate that the use of Canadian service providers for certain aspects of loan servicing or enforcement alone would not be considered carrying on business in Canada. Specifically, in a 2004 ruling, OSFI held that a foreign bank offering secured commercial loans to Canadian borrowers from outside Canada did not breach the *Bank Act* by reason only that the foreign bank appointed a Canadian receiver to liquidate the assets in Canada of a defaulting Canadian borrower. OSFI held that these measures taken by the foreign bank to realize on its security in Canada were ancillary to the foreign bank’s lending activities outside Canada and were therefore permitted. However, a foreign bank that considers realizing on security in Canada by directly taking ownership of assets in Canada should seek legal advice from Canadian counsel on possible implications for the carrying on business determination and the *Bank Act* investment restrictions.

**Bank Accounts**

Maintaining bank accounts in Canada to advance loans and receive loan repayments is a significant factor in the carrying on business determination. To reduce the impact of this factor, foreign banks should ensure that loan advances and repayments are made outside of Canada or through wire payments. Where this is not possible or practical, such as when the loan is funded in Canadian currency, the foreign bank may consider using flow-through correspondent-banking accounts, rather than general-use accounts, with financial institutions in Canada.

**Advertising**

Although Canadian courts have held that advertising in Canada does not by itself amount to carrying on business in Canada, advertising that is specifically directed at Canadian residents is a factor that OSFI will likely consider in the carrying on business determination. Therefore, while having a website that is accessible from Canada is not problematic, advertising or solicitation carried out specifically targeting Canadian borrowers will be a relevant factor.

**OTHER CROSS-BORDER ACTIVITIES**

Where a foreign bank engages in other types of cross-border activities, such as deposit-taking, trade finance or securities trading, OSFI will take into account other factual, policy and legal considerations in determining whether the activity would be permitted. In addition, cross-border
financial activities may trigger regulatory obligations under other Canadian legislation. For example, while the Bank Act focuses on the type and frequency of activities that foreign banks and their associated entities engage in in Canada, the provincial securities legislation in Canada takes broader jurisdiction over cross-border securities transactions. In particular, cross-border securities trading, underwriting or investment advisory activities that are conducted by a foreign institution entirely from outside Canada with a customer or counterparty ordinarily resident in Canada are activities that could be subject to provincial securities regulation. To trade in securities with a resident of Canada, a foreign institution must normally be registered as a dealer in Canada or obtain a registration exemption. Although exemptions are available in many instances, these require specific filings, fees and other obligations. Where a foreign bank lends against real property, it is also necessary to consider the requirements of mortgage-broker legislation in some Canadian provinces, where a licence (or an exemption) is required to hold a loan secured by real property. Depending on the nature of the cross-border financial activity, therefore, considerations outside the Bank Act regime may also be relevant.

**PENALTIES FOR CONTRAVENTION**

Contravention of the Bank Act prohibitions is punishable by civil and criminal penalties. In particular, a foreign bank or an entity associated with a foreign bank contravening the Bank Act prohibition may be subject to administrative monetary penalties of up to C$500,000 or may face up to C$5-million in criminal penalties on indictment. Criminal prosecutions, however, are rare, and civil penalties are not normally OSFI’s preferred enforcement tool in dealing with the carrying on business prohibition. Rather, where a potential violation of section 510 of the Bank Act comes to OSFI’s attention, OSFI normally first requests the foreign bank to explain how its activities do not result in a violation. In the course of discussing such explanation, OSFI may identify particular aspects of the activity that should be changed. Alternatively, OSFI may conclude that the cross-border program as a whole is in breach of the Bank Act and must be discontinued if it cannot be remedied by eliminating only some of the connecting points with Canada.

**OSFI RULING PROCESS**

Contravening the Bank Act prohibition may have a significant disruptive effect on a foreign bank’s cross-border lending activities in Canada. OSFI is generally open to discussions with foreign banks on whether a proposed cross-border lending program will be permitted under the Bank Act. Foreign banks may also formally request a ruling from OSFI on the proposed program. Although it would be unusual to request a ruling in respect of straightforward commercial loans made to borrowers in Canada and many situations can be addressed by Canadian counsel, foreign banks that wish to consider more complex cross-border programs may initiate discussions with OSFI and potentially request a formal ruling on the proposed plan.

The measures discussed above are aimed at ensuring that cross-border lending activities with Canadian borrowers are structured in accordance with Canada’s banking legislation and the expectations of the bank regulator. Properly implemented, these measures can minimize the likelihood and the severity of an adverse regulatory action. Proactive planning in this area normally requires less time and resources than responding to a potentially disruptive OSFI investigation.

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or any other member of our Financial Services Regulatory group.