



Banking Regulation

in 26 jurisdictions worldwide

2014

Contributing editor: David E Shapiro



Published by
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Contributing editor:
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Wachtell, Lipton, Rosen & Katz

Getting the Deal Through is delighted to publish the seventh edition of *Banking Regulation*, a volume in our series of annual reports, which provide international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 26 jurisdictions featured. New jurisdictions this year include Canada and Russia.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are referring to the latest print edition or to the online version at www.gettingthedealthrough.com.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We would also like to extend special thanks to contributing editor David E Shapiro of Wachtell, Lipton, Rosen & Katz for his continued assistance with this volume.

Getting the Deal Through

London
 April 2014

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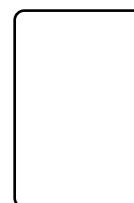
Published by
Law Business Research Ltd

87 Lancaster Road
 London, W11 1QQ, UK
 Tel: +44 20 7908 1188
 Fax: +44 20 7229 6910

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 First published 2008
 Seventh edition
 ISSN 1479-3210

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Printed and distributed by
 Encompass Print Solutions
 Tel: 0844 2480 112



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Canada

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Regulatory framework

- 1 What are the principal governmental and regulatory policies that govern the banking sector?

Canada has a centrally regulated banking system with a focus on macroprudential regulation and stability of the financial system. The Bank Act, the principal federal statute governing all aspects of banking, indicates its main purposes as fostering a strong and efficient banking sector comprising competitive and resilient institutions, protecting the interests of depositors and consumers, and maintaining stability and public confidence in the financial system. The Bank of Canada (the central bank) exercises a monetary policy focusing on an inflation-control target of around 2 per cent and a policy of non-intervention in a flexible foreign exchange rate.

Canada is a strong supporter of the Financial Stability Board (FSB) and has been a leading jurisdiction in the adoption of the Basel III international regulatory framework. The Office of the Superintendent of Financial Institutions (OSFI), Canada's primary bank regulator, introduced revised capital adequacy requirements in 2011, which came into effect in 2013. The revised capital adequacy requirements are consistent with Basel III and have an aggressive schedule in lockstep with the Basel III timeline for the planned implementation.

The thrust of Canadian banking regulation is guided by principles-based regulation as opposed to bright-line rule making. OSFI has issued guidelines on capital adequacy, prudential limits, accounting and disclosure, and sound business and financial practices that are considered 'best' or 'prudent' practices for banks and set industry standards for the financial services sector as a whole.

To ensure the safety and protection of the Canadian banking system, Canada also imposes a public ownership requirement on banks, requiring large domestic banks to be 'widely held' by the public and listed on a prominent Canadian stock exchange and medium-sized domestic banks to be at least 35 per cent publicly owned and listed. Similarly, Canadian banks are prohibited from engaging in any business other than the 'business of banking' through various ownership restrictions resulting in a separation between banking, insurance, auto leasing and securities dealing sectors of the economy.

As of February 2014, there are 29 domestic banks, 24 foreign banks, and 29 foreign bank branches operating in Canada. There are also 23 foreign bank representative offices established to represent foreign banks in Canada. Canada's six largest banks, being Royal Bank of Canada, Toronto-Dominion Bank, Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and National Bank of Canada, have been identified by OSFI as domestic systemically important banks (D-SIBs).

- 2 Summarise the primary statutes and regulations that govern the banking industry.

Regulation of the banking industry falls under the exclusive jurisdiction of the federal government. Although provincial governments have jurisdiction to incorporate and regulate certain deposit-taking institutions, such as credit unions, only a financial institution incorporated under the Bank Act can conduct business as a 'bank' in Canada.

The Bank Act regulates domestic banks (listed on Schedule I of the Bank Act), foreign subsidiary banks that are controlled by eligible foreign institutions (Schedule II) and bank branches of foreign institutions (Schedule III). The Bank Act regulates, inter alia, the ownership, capital and corporate governance structures of banks, prohibits certain business undertakings and associations, prescribes capital and liquidity adequacy requirements, and regulates consumer disclosure, transparency and record-keeping.

The Bank Act also contains a sunset clause that provides for a statutory review and update of the Act every five years. New legislation tabling the Bank Act together with any proposed amendments must be brought into force by March 2017.

The Bank Act is also supplemented by numerous regulations that set out various banking requirements, regarding, for example, the disclosure of charges and interest on banking services, the cost of borrowing for loans under a credit agreement, and notice of uninsured deposits. OSFI publishes guidelines and advisories (discussed further below) to provide participants more guidance and clarity.

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA) also forms an important part of the Canadian regulatory landscape for banks.

- 3 Which regulatory authorities are primarily responsible for overseeing banks?

The federal government enacted the Office of the Superintendent of Financial Institutions Act, which established OSFI as the primary regulator of banks in Canada. OSFI administers the Bank Act and supervises banks in accordance with its published Supervisory Framework, which involves assessing the safety and soundness of banks, providing feedback, and intervening when necessary. Under the Supervisory Framework, OSFI's primary supervisory goal is to safeguard depositors against loss. As such, OSFI focuses on material risks to banks on a consolidated basis, which involves an assessment of all of a bank's material entities (including subsidiaries, branches and joint ventures), both in Canada and internationally.

Where OSFI identifies issues that may impact the stability of the financial system, it reports those issues to the Financial Institutions Supervisory Committee (FISC). The FISC comprises representatives from the federal Department of Finance, the Bank of Canada, OSFI, the Canada Deposit Insurance Corporation (CDIC) and the Financial Consumer Agency of Canada (FCAC). The FISC meets

regularly to share information, coordinate actions and advise the federal government on financial system issues.

The FCAC is an independent agency of the government of Canada and is responsible for, inter alia:

- supervising and monitoring compliance with federal consumer protection measures;
- promoting the adoption by financial institutions of policies and procedures designed to implement voluntary codes of conduct designed to protect the interests of their customers;
- monitoring the implementation of voluntary codes of conduct that have been adopted by financial institutions;
- promoting consumer awareness about the obligations of financial institutions and of external complaints bodies under consumer provisions applicable to them;
- fostering, in cooperation with other government departments and participants, an understanding of issues relating to financial services; and
- monitoring trends and issues that may impact consumers of financial products and services.

The FCAC is also similarly responsible for supervising payment card network operators.

The CDIC, a Canadian federal Crown corporation, insures eligible deposits held at member financial institutions to protect consumers in the event of a bank failure.

Additionally, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), Canada's financial intelligence unit, oversees compliance with the PCMLTFA and its regulations. FINTRAC's mandate is to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities. As such, FINTRAC requires all banks to keep and retain prescribed records, to submit reports for certain types of transactions, to take specific steps to identify prescribed individuals or entities, and to implement a compliance programme.

- 4** Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

CDIC insures eligible deposits up to \$100,000 (principal and interest combined) per depositor per institution. In order to qualify as an eligible deposit, the deposited funds must be in Canadian dollars and payable in Canadian currency. Eligible deposits include savings and chequing accounts, term deposits repayable no more than five years after the date of deposit, accounts holding funds to pay realty taxes on mortgaged properties, and money orders, bank drafts, certified cheques and travellers' cheques issued by a member institution. CDIC does not protect against fraud or theft and does not insure debentures, treasury bills or investments in mortgages, stocks, bonds, or mutual funds.

As of February 2014, 79 financial institutions, including 37 banks, are CDIC members. CDIC members fund CDIC deposit insurance through premiums paid on the insured deposits they hold. CDIC members are required to display CDIC signage, file annual returns and comply with additional member requirements set out in the Canada Deposit Insurance Corporation Act, the Financial Administration Act and the CDIC by-laws.

Neither the federal government nor any provincial government has taken any ownership interest in banks or other financial institutions.

- 5** Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Subject to certain limited exceptions under the Bank Act, a bank cannot enter into any transactions with a related party, including providing a guarantee on behalf of a related party, making an investment in the securities of a related party, assuming a loan owed by the related party or taking a security interest in the securities of a related party. A related party includes a person holding a significant interest in the bank, an entity into which the person who controls the bank has a significant investment, and directors or senior officers of the bank or a bank holding company.

Federally regulated banks are prohibited from engaging in any business other than the business of banking and such business as generally appertains thereto, except as specifically permitted under the Bank Act. The business of banking includes the provision of financial services, investment counselling and portfolio management, acting as financial agent, and issuing of payment and credit cards. Also, a Canadian bank or a major shareholder or parent of a Canadian bank may not hold a substantial investment in entities engaging in fiduciary activities (unless such subsidiary is a federally registered trust company), certain restricted securities activities, restricted leasing activities (such as automobile leasing), restricted residential mortgage activities (such as high loan-to-value mortgages) or certain insurance activities. Foreign governments and agencies or entities controlled by them (other than foreign banks) cannot incorporate a bank in Canada or acquire a significant ownership interest in a Canadian bank.

- 6** What are the principal regulatory challenges facing the banking industry?

The primary regulatory challenge facing the Canadian banking industry is OSFI's implementation of the Basel III capital and liquidity requirements and the systems, administration and accounting changes that result from the imposition of these requirements. OSFI's Basel III implementation is further discussed in question 7.

Canadian banks are also affected by regulatory changes taking place in the United States, both as a result of conducting a considerable amount of business in the United States but also because of the potential extra-territorial reach of certain US laws. The recent adoption of the Foreign Account Tax Compliance Act in the US has been a cause for concern for the Canadian banks. Similarly, the Volker Rule and the related set of US laws have meant that large Canadian banks with US subsidiaries have to deal with two very different regulatory environments on cross-border and transnational business lines.

- 7** How has regulation changed in response to the 2008 financial crisis (eg, changes in law, changes in practices by the regulatory authorities)?

OSFI's implementation of the Basel III requirements represents one of the greatest changes in the Canadian regulatory landscape since the 2008 financial crisis. OSFI's revised capital adequacy guidelines, which adopted the Basel III capital adequacy requirements almost entirely, came into effect on 1 January 2013. Also, OSFI issued for comment a liquidity adequacy requirements guideline in November 2013 (which includes the Basel III liquidity coverage ratio and net stable funding ratio) and has confirmed its commitment to implementing that guideline in accordance with the timeline set out in Basel III.

OSFI has also renewed its focus on corporate governance within banks. The new corporate governance guidelines, released by OSFI in January 2013, address both the role of a bank's board of directors

and the board's audit committee and endorses the creation of a chief risk officer, a risk management committee of the board and a risk appetite framework for larger banks. Banks are required to notify OSFI before implementing any changes at the board of director or senior management level and OSFI can request a meeting with any new candidates for board or senior management positions before their appointment is confirmed.

- 8** In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The Canadian banking regulatory landscape will continue to evolve towards more principles-based regulation and oversight of individual banking institutions and the banking industry as a whole. Regulatory policy resulting from OSFI's ongoing implementation of Basel III and increased attention to corporate governance, discussed above, will continue to develop over the next few years. As noted above, the Bank Act contains a five-year sunset clause that ensures that legislators review the legislation and update it as required by March 2017.

Supervision

- 9** How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

OSFI requires disclosure from all federally regulated banks on a monthly, quarterly and annual basis. For example, banks must file consolidated balance sheets, deposit liabilities and interbank exposures as at the last day of each month; income statements, statements of mortgage loans and non-mortgage loans, and a statement of retail portfolio on a quarterly basis; and an impairment charge filing on an annual basis. Additionally, the Bank Act requires OSFI to conduct an examination of every bank on an annual basis to determine compliance with regulations and assess its financial condition.

- 10** How do the regulatory authorities enforce banking laws and regulations?

The Bank Act contains penalty and sanction provisions that can be exercised by OSFI. In practice, however, OSFI does not generally exercise these penal powers and instead relies on other mechanisms such as entering binding compliance agreements or issuing compliance directives. In addition, the FCAC and CDIC also have limited enforcement powers. The FCAC's consumer protection powers are briefly discussed in response to the next question. CDIC has the authority to be appointed as a receiver over a troubled member bank with significant CDIC-insured deposits, but this power has not been exercised in the past decade.

OSFI has a four-stage intervention framework that enables OSFI – and, where appropriate, CDIC – to work collaboratively with a bank to develop a process to bring the bank into full compliance with regulations or improve the bank's financial viability. The first stage entails an early-warning system whereby senior management may be required to meet with OSFI and may be subject to site visits, and OSFI may issue public supervisory letters calling on the bank to undertake certain measures. In the second stage, OSFI can require mandatory implementation of corrective measures and increase its monitoring of the bank. OSFI may also engage an auditor to undertake an external audit of the procedures, processes and reporting mechanisms of the bank. The third stage anticipates a future failure of the bank and involves assessing asset quality, full-time on-site monitoring and enhanced planning for full regulatory administration of the bank. The fourth stage denotes that the bank is no longer viable. OSFI will take over the affairs of the bank and commence restructuring under the Winding-Up and Restructuring Act, which

likely results in the sale of assets of the bank to another institution approved by federal government.

- 11** What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Based on the information released by OSFI, FINTRAC and the FCAC, there are no recurring regulatory compliance issues or common enforcement measures related to the banking industry in Canada. Supervisory and regulatory bodies rarely initiate enforcement action with the exception of smaller scale consumer protection issues that arise from time to time and are dealt with by the FCAC. In 2012, the FCAC opened a total of 77 cases against banks related to credit card issues, account fee charges or refusal to open an account. The FCAC issued a total of five violations and imposed related penalties in the aggregate amount of C\$275,000 (total for all financial services entities including insurance companies, payment card operators, etc).

Recently, OSFI released an advisory note indicating its intention to begin regulating the benchmarking of CDOR (the Canadian dealer-offered rate – the Canadian equivalent of Libor); however, this seems to be in response to international banking investigations related to Libor. There has been no commentary to suggest any manipulation of CDOR by Canadian banks.

- 12** How has bank supervision changed in response to the 2008 financial crisis?

There have been no significant changes to Canada's bank supervision regime since the financial crisis. The financial crisis resulted in a heightened emphasis on regulatory oversight and sound capital management. OSFI's intention to implement the Basel III requirements is not a significant departure from its supervision and oversight approach of banking institutions prior to 2008.

Resolution

- 13** In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders (depositors, shareholders, creditors, employees, others) treated?

While the government is under no legal obligation to take over a failing bank, there is a widely held assumption that the government would not permit a large Canadian bank to fail due to the negative impact on the greater Canadian economy. Banks may be taken over by OSFI or the CDIC in cases of insolvency or regulatory non-compliance. The OSFI four-stage intervention process described above, and the establishment by CDIC of a 'bridge-bank', described at question 16, are tools that these regulatory authorities may use to take over a bank.

Bank failures are very rare in Canada and consequently, government or regulatory authority intervention by way of bank takeover is also very rare. The Bank of Canada and the Canadian Mortgage and House Corporation provided liquidity support during the recent financial crisis, including short-term loans, purchasing mortgage-backed securities and providing guarantees for Canadian banks. The government was not, however, required to intervene in the Canadian banking industry to the extent witnessed in other jurisdictions, nor did the government take an equity stake in any Canadian bank during the crisis.

Canadian banking regulation is strongly focused around the protection of depositors. This is demonstrated by CDIC's insuring of a depositor's first C\$100,000 of funds in a given bank. OSFI recently implemented more stringent capital requirements designed to better protect depositors by providing additional funds in a bank crisis scenario, including requiring the inclusion of non-viable

contingent capital (NVCC) provisions in non-common share capital instruments.

- 14** What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document (ie, living will)?

If OSFI takes control of a bank pursuant to the four-stage intervention process, directors' legal roles are suspended until either the period of control expires or a winding-up is requested. Once a liquidator is appointed by the court pursuant to a bank's winding-up proceedings, the directors' powers are vested in the liquidator.

Currently, banks are not required to have a resolution or 'living will' plan that sets out the protocol for a failure or recovery following a failure, but OSFI and the CDIC have been working with financial institutions to implement such plans from a prudential standpoint. In March 2013, OSFI designated Canada's six largest banks as D-SIBs and require each of these banks to establish a resolution plan. In addition, the CDIC recently proposed amendments to its by-laws, whereby deposit-taking CDIC-insured institutions would be required to provide certain information on an annual and on-request basis to facilitate resolution planning.

- 15** Are managers or directors personally liable in the case of a bank failure?

Officers or directors are not personally liable in the case of a bank failure, but directors may be liable for certain actions that could result in a bank failure. Directors are liable for any breach of a duty imposed under the Bank Act or other applicable legislation or a duty under common law. For example, directors may be liable under the Bank Act if the directors authorised subordinate indebtedness or a reduction in stated capital when there were reasonable grounds for believing that the bank was, or the reduction would cause the bank to be, in contravention of capital adequacy provisions or liquidity provisions. There is a two-year limitation period from the date the resolution passed authorising the prohibited action after which directors would no longer be liable. There are several defences available to directors including the 'business judgement rule', whereby a director would not be found liable for properly informed business decisions made in good faith and in the absence of conflicts of interest, fraud or illegality.

In the event of a bank failure, directors are also jointly and severally liable for up to six months of unpaid wages for each employee. There is a six-month limitation period from the date wages are owed but go unpaid, a winding-up order is issued or liquidation proceedings have commenced, and a two-year limitation period after the director ceases to be in that role. Banks can purchase directors' and officers' insurance in order to ensure indemnification for such claims.

- 16** How has bank resolution changed in response to the recent crisis?

In response to the financial crisis, bank resolution options were introduced that are designed to reduce the likelihood of taxpayer-funded bail-outs, as seen in other jurisdictions. One such resolution technique is the use of 'bridge-banks' introduced through amendments to the Canada Deposit Insurance Corporation Act (the CDIC Act), which allows CDIC to take over the deposits and healthy assets of a troubled bank with the ultimate goal of effecting a private sale of the bank.

More recently, further requirements were introduced to eliminate the perceived 'moral hazard' that arises when banks are bailed out by government funds and thereby become incentivised to take risks. OSFI implemented contractual NVCC requirements consistent with the Basel III capital regime. Any bank issuing preferred shares or subordinated debt after 1 January 2013 is required to provide a

mechanism within the document by which the non-common capital would be converted into equity or be written off should the bank become non-viable.

In March 2013, the Government of Canada announced its plan to introduce the concept of a bank 'bail-in' plan. In the event that one of the D-SIBs were to deplete its capital, certain liabilities and the 'unsecured and uninsured creditor claims' of that bank would be converted into capital. It is not yet clear how the NVCC and bank 'bail-ins' would work together in the event that a bank becomes non-viable.

Capital requirements

- 17** Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The Bank Act requires banks to maintain adequate capital and permits OSFI to establish guidelines setting out these requirements. The current Capital Adequacy Guidelines implement the Basel III Accord. The Capital Adequacy Guidelines require banks to have capital requirements that meet or exceed the Basel III minimums. Among those requirements, Canadian banks must have total capital ratios of 8 per cent, which will gradually increase to 10.5 per cent by 2019 through the phase-in of a capital conservation buffer starting in 2016. Banks that issue preferred shares or subordinated debt must contractually provide for the conversion of such instruments into common equity should the institution become non-viable, as discussed above. OSFI has committed to implementing a leverage ratio consistent with Basel III once finalised. In the interim, OSFI requires that a bank's asset-to-capital ratio not exceed a maximum leverage ratio of 23:1, although OSFI typically establishes lower leverage ratios for individual banks depending on a number of factors including size of bank and the number of years it has been operating.

Banks are required to establish and maintain policies relating to liquidity consistent with OSFI's current liquidity guideline. These policies must be approved by the board of directors and reviewed annually. As discussed in question 7, OSFI issued a draft liquidity adequacy requirement guideline consistent with Basel III, including the liquidity coverage ratio and net stable funding ratio. This liquidity adequacy requirement guideline is expected to come into effect in January 2015 and will supplement the current liquidity guideline.

Foreign banks carrying on business through a foreign subsidiary incorporated in Canada are subject to the same capital requirements and regulatory framework as domestic banks. Foreign banks operating through a foreign bank branch (whether through a full-service branch or a lending branch) are not subject to Canadian capital requirements. The rationale for this approach is that foreign banks operating through a foreign bank branch are subject to capital requirements and regulation in their home jurisdiction; full-service branches are, however, required to hold a capital equivalency deposit (CED) of C\$5 million or 5 per cent of their branch liabilities, whichever is greater, with an approved Canadian financial institution. A lending branch is only required to hold a CED of \$100,000.

- 18** How are the capital adequacy guidelines enforced?

Section 628 of the Bank Act obliges banks to provide OSFI with such information, at such time and in such form as OSFI may require. OSFI requires banks to submit quarterly reports detailing compliance with capital adequacy requirements. If issues are identified, OSFI will subject the bank to the four-stage intervention process described above.

19 What happens in the event that a bank becomes undercapitalised?

Undercapitalisation may result in OSFI requiring a bank to increase its capital. OSFI has the ability to intervene through its four-stage intervention process. Ultimately, OSFI has the ability to take control of a bank's assets or take control of a bank for an interim period. Also, the federal government is permitted to invest in the shares of a bank if it believes it will assist in stabilising the financial industry.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Once OSFI controls a bank, it may request that the Attorney General apply to wind up the bank under the Winding-Up and Restructuring Act (WURA). A liquidator of a bank must be a trustee licensed under the CDIC Act or the Bankruptcy and Insolvency Act. The statutory duties of a liquidator are set out in WURA and include controlling all property of the bank, carrying on business that is beneficial during the winding up, repaying indebtedness and distributing assets.

The CDIC Act permits CDIC to take certain measures if a CDIC-insured bank becomes insolvent. Such measures include requesting an order vesting the shares of the bank with CDIC so as to be sold to a third party and also the option to request the establishment of a 'bridge-bank' from the Minister of Finance such that the bank's viable assets could be sold to a third party.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As described above, the Basel III capital adequacy requirements have been implemented for Canadian banks through the revised Capital Adequacy Requirements Guidelines. In addition, as previously noted, in March 2013, OSFI designated the six largest Canadian banks as D-SIBs and announced a 1 per cent common equity surcharge for all D-SIBs. As of 1 January 2016, D-SIBs will be required to meet the target common equity Tier 1 (CET 1) ratio of 7 per cent of risk-weighted assets that all institutions are already required to meet, plus the additional 1 per cent due to its D-SIB designation. Such restrictions were implemented in recognition of the importance of D-SIBs to the Canadian economy as the largest six banks account for more than 90 per cent of total banking assets.

Ownership restrictions and implications**22** Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Limitations on the ownership or control of Canadian banks will vary depending on the size of a bank's equity. Banks are divided into three categories for the purposes of determining the applicable ownership rules:

- 'large banks', which have equity capitalisation of C\$12 billion or more;
- 'medium banks', which have equity capitalisation of between C\$2 and C\$12 billion; and
- 'small banks', which have equity capitalisation of less than C\$2 billion.

Large banks must be widely held, such that no single shareholder may own more than 20 per cent of any class of voting shares, or more than 30 per cent of any class of non-voting shares. A bank holding company may control a large bank, so long as the bank holding company is itself widely held.

Medium banks may be closely held, so long as at least 35 per cent of the voting shares of the bank are listed on a recognised stock exchange in Canada and are publicly held.

Small banks are not subject to ownership limits as long as the Minister of Finance is satisfied with the character and integrity of the applicant or, for a corporate applicant, its reputation for being operated in a manner that is consistent with the standards of good character and integrity.

In addition to these constraints on ownership, no person may acquire or increase a 'significant interest' in a bank without the consent of the Minister of Finance. A significant interest equals 10 per cent or more of any class of shares of a bank.

23 Are there any restrictions on foreign ownership of banks?

Subject to limited exceptions, there are no restrictions on foreign ownership of banks.

If a foreign bank that is not a national of a World Trade Organization member country wishes to acquire or increase a significant interest in a bank, as part of the application, OSFI will determine whether banks are treated similarly in the jurisdiction in which the applicant principally carries on business, either directly or through a subsidiary.

The government of a foreign country and any political subdivision thereof, and any agent thereof, cannot acquire shares of a Canadian bank.

24 What are the legal and regulatory implications for entities that control banks?

An entity that seeks approval from the Minister of Finance to acquire or increase a 'significant interest' in a bank must provide a range of information that enables the regulator to investigate the applicant, including information that demonstrates that the applicant has sufficient resources to provide continuing financial support to the bank, and that the applicant's business record and experience is appropriate. The proposed ownership structure will be scrutinised.

An application for approval of a significant interest in a bank must also include an acknowledgement in writing of OSFI's expectation that the applicant will provide ongoing financial, managerial and operational support to the bank if such support becomes necessary. The 'Support Principle' letter articulates the expectation of the regulator but does not create a legally binding obligation on the applicant. Such ongoing support may take the form of additional capital, the provision of managerial expertise or the provision of support in such areas as risk management, internal control systems and training for bank employees.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

See question 24.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The Support Principle sets out the expectation of the regulator, but does not impose a legal obligation and does not constitute a basis for a legal claim by the regulator against a controlling entity. Shares issued by a bank are non-assessable, so a controlling entity is not liable to the bank or its creditors by virtue of holding such shares. OSFI will take over the affairs of an insolvent bank or commence restructuring under the WURA (or both), which will likely result in a sale of assets of the bank to another approved institution. In the event of liquidation, a controlling entity would likely lose the entire value of its investment since depositors and other creditors rank ahead of shareholders in a distribution of the proceeds from the liquidation.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The Minister of Finance must approve the acquisition of, or increase in, a 'significant interest' in a bank, which equals 10 per cent or more of the outstanding shares of a class of shares. In addition, the Minister must approve the acquisition of control of a small or medium bank. With limited exceptions, no person may control a large bank.

For this purpose, 'control' means control in fact – not necessarily legal control. Many factors are relevant in determining whether an entity has 'control in fact' of another entity, and a specific analysis is required in each case to make a determination.

OSFI will review an application and then make a recommendation to the Minister.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Subject to limited exceptions, there are no restrictions on foreign ownership of banks.

If a foreign bank that is not a national of a World Trade Organization (WTO) member country wishes to acquire or increase a significant interest in a bank, as part of the application, OSFI will determine whether banks are treated as favourably in the jurisdiction in which the applicant principally carries on business, either directly or through a subsidiary, and will scrutinise the vigour of the regulatory regime of that jurisdiction.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

OSFI and the Minister will assess whether an applicant is suitable to control a bank, and will make this determination by obtaining a range of information from the applicant and assessing its character, expertise and financial resources to determine whether the applicant is 'fit and proper'. A variety of factors are considered, and are outlined in the transaction instructions published by OSFI.

Update and trends

The trend towards increased banking supervision and regulation that began after the global financial crisis will continue to play out in the near future. There was increased activity by OSFI in 2013, including continued progress towards the implementation of Basel III and a focus on bank corporate governance. OSFI also updated its long-standing frameworks on the Assessment of Financial Institutions Regulations and the Administrative Procedures for the Late and Erroneous Filing Penalties indicating its intent to continue to play an even more active role in the supervision of Canadian banks. Canadian banking regulation will continue to gradually evolve towards increased oversight, regulation, transparency and disclosure over the coming year. Deputy OSFI Superintendent Mark Zelmer recently indicated that an important issue in the next round of bank reforms will be the focus on the role of bank models in setting bank capital requirements. The extraterritorial aspects of US banking regulation and the implementation of the Volcker rule and FATCA will likely also be active discussion topics in the coming year.

30 Describe the required filings for an acquisition of control of a bank.

The transaction instructions describe the information to be included with an application to OSFI, and provide administrative guidance about the application process. In addition to certain basic information about the applicant, the applicant is also expected to provide information that will help OSFI make a determination about whether the applicant is 'fit and proper' to control a bank – including a business plan and financial information. Background and security assessments must be conducted for certain key individuals of the applicant, and an OSFI security information form must be submitted for each such individual for this purpose. The applicant must submit an acknowledgement of the Support Principle (see question 24 above).

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Applicants should always ensure that an application is complete, and that an OSFI security information form is submitted as early as possible in the application process, as OSFI does not control how long it takes to complete these background assessments. Most applications will receive a response within three to six months. Where an applicant is a WTO-member foreign bank, additional information may be requested and the process may take longer.

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