Banks in Canada: A primer

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The activities of foreign banks in Canada are regulated and restricted by the *Bank Act (Canada)* (the Bank Act). The Bank Act does not prevent foreign banks from carrying on any business activity in Canada: rather, the Bank Act restricts how such business activity takes place.

Constitution 101

A historical tension between the federal and provincial governments has existed in relation to the enactment of laws concerning banks, as illustrated in the landmark Supreme Court of Canada decision in the trilogy of cases known as Marcotte.[1]

Canada's constitution establishes a division of powers among the federal, provincial and territorial governments, distributing legislative power in relation to the making of laws in Canada. Consumer protection laws provide a shared responsibility over the financial system; however, Canada's federal government has exclusive constitutional jurisdiction over banks and banking, and the federal government uses the Bank Act to govern the business activity of foreign banks in Canada.

The Office of the Superintendent of Financial Institutions (OSFI) has stated that the public policy objective underlying the foreign bank rules is to foster greater competition in Canada's financial sector by encouraging the entry of foreign banks into Canada, while providing flexibility for foreign banks seeking to operate in Canada, or invest in or acquire Canadian entities.

Who is a "foreign bank"?

"Foreign bank" is defined broadly in the Bank Act to include:

a. regulated banking entities (i.e., entities regulated as banks in their home jurisdictions);
b. financial services entities affiliated with foreign banks; and
c. entities that carry on business in their home jurisdiction such that, if carried out in Canada, would be the "business of banking."

Additionally, the foreign bank rules extend to an "entity associated with a foreign bank," being an entity is associated with a foreign bank if the entity directly or indirectly controls, is controlled by, or is under common control with a foreign bank. The concept of control in the Bank Act is defined as control in law (*i.e.*, legal control) as well as control in fact (*i.e.*, *de facto* control arising from a person having any direct or indirect influence resulting in control in fact of the entity).

Lastly, an entity that does not meet the definition of an "entity associated with a foreign bank" may nonetheless be a Part XII entity if the entity is a member of a "material banking group," such group being a conglomerate of which banking assets or revenues comprise a prescribed material portion of the conglomerate's assets or revenues.

There are procedures to obtain a Ministerial exemption from the status of being a foreign bank, or an entity associated with a foreign bank. Such statutory relief is discretionary.

Business activity in Canada

Part XII of the Bank Act contains the foreign bank rules, prohibiting a foreign bank and an entity associated with a foreign bank from engaging in any business activity in Canada unless done in compliance with Part XII of the Bank Act. Such compliance requires either regulatory approval or for the business activity to take place within prescribed parameters.

In most circumstances, regulatory approval from OSFI and/or the Minister of Finance is required for a foreign bank, or an entity associated with a foreign bank, to conduct business activity in Canada, including in respect of a physical presence in Canada, which may be achieved by, *inter alia*:

a. the acquisition of a Canadian entity;
b. the incorporation of a subsidiary of the foreign bank (*i.e.*, a Schedule II bank, as such foreign bank subsidiaries are listed in Schedule II of the Bank Act);
c. a representative office limited to promoting the foreign bank's services; and
d. establishing a foreign bank branch.

Schedule II banks are generally authorized to conduct similar business activity as domestic Canadian banks, including retail banking and commercial banking.

There are many other business activities governed by the Bank Act, and regulatory approval is not always a prerequisite. A common question that arises is whether a foreign bank is prohibited from making loans to Canadians.

The foreign bank rules do not prohibit foreign banks from lending to Canadians, and such loans are commonly made to natural persons and entities in Canada. However, in these instances, the foreign bank's business activity must take place outside of Canada. Whether or not a foreign bank is carrying on business activity in Canada involves a combination of statutory considerations (i.e., the Bank Act) and jurisprudence. The Bank Act does not provide factors to be considered when determining "carrying on business in Canada," however the OSFI will apply certain factors identified in jurisprudence when considering whether a foreign bank is carrying on business activity in Canada.

Key bank regulators

Canadian banking regulators include the following.

Department of Finance. Foreign bank entry policy is dictated by the Department of Finance Canada who, *inter alia*, is responsible for financial sector policy, and developing laws and regulations that govern federally regulated financial institutions (FRFIs), including banks.

OSFI. The prudential regulator, OSFI, regulates and supervises FRFIs and pension plans. An independent agency of the federal government, OSFI's mandate includes ensuring FRFIs remain in sound financial condition. OSFI interprets the Bank Act and its application to banks, develops rules, and provides regulatory approval for prescribed transactions. Certain transactions under the Bank Act require the approval of the federal Minister of Finance.

The Financial Consumer Agency of Canada (FCAC). The FCAC monitors and supervises FRFIs and their compliance with federal consumer protection measures set out in legislation, public commitments, and codes of conduct.

The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). FINTRAC is Canada's financial intelligence unit, with a mandate to facilitate the detection, prevention and deterrence of money laundering, and the financing of terrorism.

Conclusion

The Bank Act is a complex regime. Foreign banks and entities associated with foreign banks must consider its application when entering the Canadian market, and whether any regulatory approvals are required for the contemplated business activity in Canada. OSFI publishes regulatory guidance detailing how OSFI determines the application of Part XII of the Bank Act, and transaction instructions concerning applications for regulatory approval where such approval is required for the contemplated banking activity in Canada.

For more information on foreign banking in Canada, reach out to the key contacts below or any lawyer from BLG's Banking & Financial Services Group.

Footnotes

[1] *Bank of Montreal v. Marcotte*, 2014 SCC 55, and two companion cases (*Amex Bank of Canada v. Adams*, 2014 SCC 56, and Marcotte v. Fédération des caisses Desjardins du Québec, 2014 SCC 57).

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