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The Financial Services Regulatory Report

Financial Institution Reforms Come Into Force

Bill C-37, An *Act to amend the law governing financial institutions and to provide for related and consequential matters (the "Act")*, became law on April 20, 2007. Changes include:

Disclosure

- ✓ The Act provides for the harmonization of online and in-branch disclosure requirements. In a press release the Government stated that the changes promote the interests of consumers since there will be more timely disclosure online and in financial institution branches in areas such as complaint handling procedures.

Registered Products

- ✓ Banks must disclose, in a manner set by regulations, information on:
  - all charges applicable to the registered product.
  - how a customer is to be notified of any increase in those charges and of any new charges applicable to registered products.
  - a bank's procedures relating to complaints about the application of any charge applicable to a registered product.

  Regulations defining the meaning of "registered product" and detailing the manner of disclosure are currently being developed in consultation with the industry members.

Amendment to the Bills of Exchange Act

- ✓ The Act amends the *Bills of Exchange Act* to provide an enabling framework to allow use of electronic cheque images in the cheque clearing and settlement system.

Ownership

- ✓ The Act raises the large bank equity threshold to $8 billion and increases the small bank equity threshold (i.e., the threshold below which banks may be closely-held) to $2 billion.

Credit Union and Caisses Populaires

- ✓ The Government reduced to two the minimum number of credit unions required for incorporation of a federally incorporated cooperative credit association (note: these institutions can provide products and services across provincial boundaries). In addition, a deposit insurance opt-out regime was created for cooperative credit associations which do not accept retail deposits.

Residential Mortgages Exceeding 80% of Property Value

- ✓ The Government raised the loan-to-value ratio on residential mortgages requiring insurance from 75% to 80%. Accordingly, there will no longer be a *statutory* requirement for residential mortgages with a loan-to-value ratio below 80% to be insured.

Directors Residency Requirement

- ✓ The residency requirement for directors was changed so that henceforth Canadian financial institutions can add more members to their boards who are not residents of Canada, as long as the majority of directors remain Canadian residents.

Foreign Bank Entry

- ✓ The Act removes "near banks" (those foreign entities that are not regulated as banks in their home jurisdiction but provide banking-type services such as consumer loans) from the foreign bank entry framework.

Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations

Bill C-25, *An Act to amend* the *Proceeds of Crime (Money Laundering) and Terrorist Financing* Act (the "Act") received Royal Assent in December, 2006. New *Proceeds of Crime (Money Laundering) and Terrorist Financing* regulations (the "Regulations") were published on June 27, 2007 implementing this legislation. These Regulations bring Canada's anti-money laundering and anti-terrorist regime in line with the new Financial Action Task Force standards. To provide financial institutions and intermediaries with sufficient time to change their systems and train their employees, most of the provisions will come into effect on June 23, 2008 while the remainder will be effective as of June 30, 2007.

In addition to enhancing existing client identification and transaction reporting requirements, the Regulations set up a registration scheme for money service businesses.

Under the Regulations, customer due diligence requirements are strengthened. For example, in response to new methods of delivering financial products and services (mainly electronic), new methods to ascertain the identity of a person in a non-face-to-face environment will be made available to all reporting entities. These methods include use of third party sources such as credit bureaus.

The Act currently requires reporting entities to conduct an assessment of money laundering and terrorist financing risks in the course of their business activities. The Regulations build on that obligation where it is determined that a client represents a higher risk taking into account the type of customer, product, delivery channels, geographic location, and other factors. In such a case, reporting entities must take reasonable steps to conduct ongoing monitoring of a client's transactions and keep its client records up to date. Furthermore, the risk assessment and the compliance policies and procedures that reporting entities are required to implement will have to be reviewed at least every two years.

The new Regulations will require also that all reporting entities obtain pertinent information on their clients whenever they have reasonable grounds to suspect that a transaction is linked to money laundering or terrorist financing activities or is an attempted suspicious transaction. Compliance with the new requirements will be assisted by sector-specific guidelines on what constitutes such a transaction.

To mitigate the terrorist financing risks associated with electronic fund transfers, money services businesses, financial entities, securities dealers and casinos will have to obtain information on the originator and beneficiary of any wire transfer of $1,000 or more and ensure that certain identifying information is transmitted along with the funds.

The Regulations also introduce new product, transaction or activity exemptions to the client identification and record-keeping requirements in low-risk situations.

Under the Regulations, some entities must take additional steps when entering into certain business relationships with an entity.

First, financial entities, securities dealers, life insurance companies, life insurance brokers and agents and money services businesses will have to take reasonable measures to obtain certain information on directors or partners of a corporation or other entity or on persons who own or control 25% or more of that corporation or entity.

Second, there will also be a duty to obtain from foreign financial institutions information and documentation on the nature and scope of their operations and to determine whether these institutions are shell banks before entering into a correspondent banking relationship with them.

Finally, financial entities, securities dealers, life insurance companies, life insurance brokers and agents and money services businesses will have a duty to determine whether account holders or persons sending large electronic fund transfers or making large payments are "politically exposed foreign persons" and, if so, to conduct enhanced scrutiny of such transactions and of their business relationships with such clients.

The Regulations also introduce new product, transaction or activity exemptions to the client identification and record-keeping requirements in low-risk situations.

The Regulations also expand the information contained in FINTRAC's disclosures to law enforcement and intelligence agencies to include the telephone number, type of account, name and address of persons authorized to give instructions on the account, and type of report.

Recent Supreme Court of Canada Decisions

Canadian Western Bank et al v. *Province of Alberta, 2007 SCC 22*

In a decision released on May 31, 2007 (*Canadian Western Bank et al* v. *Province of Alberta,* 2007 SCC 22), the Supreme Court of Canada held that the exclusive federal legislative authority on banks and banking does not prevent the Province of Alberta from making its insurance licensing and regulatory scheme applicable to banks offering insurance in Alberta. Currently, banks are permitted under the *Bank Act* and regulations to offer eight types of credit insurance as an adjunct to their banking services (insurance is an activity traditionally reserved to licensed insurance companies and Provincial regulation). The insurance offered by banks includes credit card insurance (covers damage to goods acquired with a credit card), creditor's disability insurance (insures the outstanding amount of a bank loan where borrower becomes disabled), mortgage insurance (insures against default by borrower) and loss of employment and death insurance.

Canada's top Court held that the Alberta legislation, i) does not affect a "vital" part of the business of banking since the credit insurances are optional, for the most part do not insure against default, and are not part of the basic credit and loan qualification process, and ii) the Alberta scheme in its purport and operation does not conflict with the banks' ability to promote their insurance lines. On the latter point, the Court noted that the federal law was essentially permissive and the Alberta scheme essentially regulatory: the two sets of laws could co-exist quite happily and consumer rights were enhanced, so what was the problem…?

The Court disapproved one of its own earlier decisions which would have invalidated any Provincial law that merely "affected" a federal exclusive area of jurisdiction; henceforth rather, for a Province's regulation of banking to be invalid, the Provincial scheme must "impair" if not indeed neutralise a significant or "core" aspect of banking activity.

The Court stated that its revised approach was really a return to the original way jurisdictional clashes between Provincial and Federal legislative authority were resolved. Still, the decision is being viewed by many lawyers and bankers as a sign that from now on Provinces will have a greater say in how aspects of banking business are conducted on their territory. This will cause greater uncertainty whether some provincial legislation applies to banks and may increase the banks' present compliance burden.

Provinces seeking to apply their legislation to banks nonetheless still must be careful not to regulate a traditional, essential part of banking business. An example would be prohibiting a bank from requiring certain types of collateral to offer loans in a Province. And, in areas where (as for the Alberta legislation considered in *Canadian Western Bank*) the Provinces are entitled to co-regulate with Ottawa, they must under the "double aspect" doctrine ensure that their laws do not conflict with a bank's powers. In the subject case, the banks had been complying for some years with the Alberta licensing and disclosure scheme without any apparent adverse effect on their ability to promote insurance lines in the Province. The Court considered, therefore, that there was no real conflict of jurisdiction.

In summary, this decision will tend to complicate banks' activities more and may, too, be another factor to consider for those thinking of incorporating or buying a bank. One of the traditional reasons to favour incorporating or buying a bank as opposed to utilising a Provincially-regulated financial institution is to subject the business to one regulatory regime. This advantage arguably has been lessened as a result of the decision in *Canadian Western Bank.*

***Pecore v. Pecore*, 2007 SCC 17**

***Brooks v. Saylor and Madsen*, 2007 SCC 1**

This pair of recent decisions, extensively commented on, involved the intention of a person who places funds or investments in a joint bank account. These arrangements often involve a parent naming a child (of minor age or otherwise), or a spouse naming the other spouse, as co-holder of the account. Joint accounts are often used for financial planning or management purposes including estate planning.

In both of these decisions, a parent transferred assets into such a joint account. In *Pecore,* the other joint owner was a daughter who relied for additional financial support on the transferor, her father. Also, she had been given a power of attorney over his affairs. On his death, she withdrew the balance left in the account for her own use. Her former husband claimed 50% of this amount because the deceased father's will stated that the residue of his estate must be shared by the daughter and the former husband. The will did not refer to the joint account.

The father had at one point written a letter stating he did not intend to make a gift to the daughter and therefore no capital gains tax was payable when the investments were put into the joint account. During his lifetime the father paid all the taxes due on the income derived from the account. Despite stating – in writing - no gift was intended, the Court held on all the evidence that he intended that his daughter receive the balance of the account at his death in her own right.

There essentially was no issue (in either court case) whether the daughter acquired the assets left in the account at her father's death: the question rather was whether the fathers intended that the monies be kept by the children for their own use ("beneficially" as lawyers say) or whether they were given the assets simply to hold for whomever constituted the general legatees or inheritors. At first sight, it might seem that creation of a typical "joint tenancy" arrangement resolves this question (survivor takes the balance for her own use). But this is not so because title can mean different things depending on what is intended when it is conferred. The position is complicated by old common law doctrines, such as that a person is not presumed to give away property gratuitously but on the other hand will be presumed to do so when property is gifted to a child, and what relevance such doctrines have in the modern world.

In *Pecore*, it was held that with an adult child, the father's intention to benefit his child personally was established from all the evidence. On somewhat similar facts the opposite result was however reached by the same Court in *Brooks v. Saylor and Madsen.* There, it was held the daughter took a survivorship right in the joint account but for the general heirs, not for herself. The specific factual background inclined the Court in that case to a different conclusion. (Cases are decided on their specific facts but the two cases appear on their face to some observers to be somewhat inconsistent). It appears from the legal discussion in the cases that the common law "presumption of advancement", by which a gratuitous transfer to a child is presumed to be made permanently for his or her benefit, will henceforth only apply to minor children, so that express evidence of intention regarding beneficial entitlement to the survivorship interest will become crucial in the future.

The bank documentation establishing the joint account stated, in both cases, that there was a right of survivorship. This meant, in accordance with the accepted meaning of an account held in joint tenancy under common law, that the survivor received all the monies in the account upon the death of the other holder(s).

However, the bank documents, drawn by the banks from their perspective, did not and would not commonly deal with the *beneficial* entitlement to a survivor's joint account interest. That is something of concern to the joint account survivor and possibly the general heirs of the estate but not the banks as such (subject to the proviso stated below). Therefore, these decisions, while of general interest to the banking community are (it is suggested) more of interest to clients of banks engaging in estate and other financial planning and their legal and other advisors.

Still, where a bank or one of its units is formally advising customers on financial planning matters and joint accounts are created as part of the scheme, bankers should consider whether they should raise with the customer the question of the beneficial entitlement of the joint account survivor. In light of the decisions discussed above and other legal principles, it is clear the bank will have a duty in many circumstances to do so. The duty may arise even where the bank is not advising formally on financial planning but e.g., participates closely with its customer and his advisors in this process. Forewarned is forearmed…

Report of the Privacy Commissioner of Canada – Complaint against SWIFT

In April of this year the Privacy Commissioner of Canada, Ms. Jennifer Stoddart, released her findings with regard to the complaint she initiated against SWIFT under section 11 of the Personal Information Protection and Electronic Documents Act (the "Act"). SWIFT is a service organization with international operations, including significant activity in Canada.

It is owned by a world-wide network of financial institutions including a number of Canadian banks. Its purpose is supply secure, standardized messaging services and software to almost 8,000 financial institutions in over 200 countries.

In performing this role, SWIFT is an intermediary for the purpose of transmitting secure and confidential financial messages. It does this on behalf of the financial institutions which own SWIFT and in effect, for their customers. SWIFT does not perform financial services and for example does not hold bank accounts or other assets, but it acquires information relevant to such matters to perform its mandate, including information pertaining to individuals.

In mid-2006, it was revealed the United States Treasury Department used subpoenas to access records from SWIFT in pursuance of terrorism investigations. Some of the information disclosed was personal information of individuals connected to customers of banks for which SWIFT was transmitting data. The Privacy Commissioner in her decision identified customer payments and cheques and collections and cash letters, and foreign exchange transfers relating to them, as most likely to contain personal information.

As a result of representations made to the Privacy Commissioner, she initiated her complaint against SWIFT under the Act and, in rendering her decision, made two key findings:

1) the Act applies to the operations of SWIFT in Canada; and

2) section 7(3)(c) of the Act, which provides that personal information may be disclosed without the consent of a person where this is required to comply with a subpoena or warrant or an order made by a court or body with jurisdiction, applied to the disclosure by SWIFT of personal information collected in Canada and remitted for storage to U.S. data bases. This was so even though the Act did not specifically refer to a subpoena, warrant or order made *in Canada.*

The Privacy Commissioner decided that due to the international operations of SWIFT it was consistent with the Act and its intended purpose and scope that such disclosure be permitted. Had SWIFT failed to respond to U.S. Treasury's lawful orders, it would have been in violation of legitimate laws in the U.S. The Commissioner held it was not foreseen by the Act that it would interfere with or challenge such foreign jurisdiction.

The Commissioner stressed her decision was based on a provision of the Act which specifically permitted disclosure of personal information without consent of the person to whom it related, and that for example the Act still operated to prohibit, anywhere, general unauthorized disclosure, for example, it would prohibit, "the non-consensual disclosure of personal information held by SWIFT in another country to a data broker or a marketing firm operating in that country".

Another factor in rendering the decision was that individuals using a Canadian financial institution to perform an international transaction could easily inform themselves, by reviewing the privacy policy of the bank that used the SWIFT system, that their personal information might be transferred to a third party such as SWIFT.

In an interesting aside, the Privacy Commissioner referred to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Canada). This law addresses how Canadian authorities can deal with the financing of terrorism. The Commissioner focused on the notion of transparency under this Act and how it requires the Financial Transactions and Reports Analysis Centre of Canada to ensure the protection of personal information. She also referred to efforts in the European Union to ensure that SWIFT can conduct its activities effectively while providing enhanced protection over the personal information held by that organization. She stated also she was encouraged that SWIFT and the United States government are working to have SWIFT certified under the European Union – United

States Safe Harbour Agreement, which would establish a framework of privacy principles applicable to SWIFT (this was prompted by findings in certain EU countries of a violation of European privacy laws as a result of U.S. Treasury accessing SWIFT records in the course of post-September 11, 2001 investigations).

A Data Privacy Working Group has been formed in SWIFT to address issues arising from the use of subpoena and other legal powers in the United States to compel production of personal information in pursuance of terrorism laws. The focus of the working group is to increase transparency in the way SWIFT deals with information conveyed in its messaging activities, promote the certification of SWIFT into the said safe harbour agreement, and generally find ways to lessen the adverse impact on privacy that SWIFT's compliance with U.S. and other national laws seeking to control terrorism might entail.

Recent press reports indicate in fact the likelihood of a deal to integrate SWIFT in the U.S. safe harbour agreement. The details include that the U.S. would use SWIFT bank data only for anti-terrorism purposes and would not keep it for longer than five years. Also, SWIFT has stated it will start implementing changes to ensure intra-EU information is not stored in its data banks in the U.S.

Canadian financial institutions should follow these developments with interest and should consider if their privacy policies provide adequate protection against the charge that personal information in their care has been misused by SWIFT or other of their agents

If you require assistance on how any of the above-noted matters will affect your organization please call Libby Gillman at 416.418.7204 or contact her at libbyg@lawgill.com

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