Draft guideline

Title	Materiality Criteria for Related Party Transactions – Draft guideline (2008)
Category	Prudential Limits and Restrictions
Date	August 31, 2008
Sector	Banks Life Insurance and Fraternal Companies Property and Casualty Companies Trust and Loan Companies
No	E-6

Table of Contents

Consultation status: Closed

I. Statement of Regulatory Principles

- Application of the Guideline

II. Criteria

III. Table of Nominal/Immaterial Value Transactions

Footnotes

Consultation status: Closed

Consultation closed October 15, 2008. We'll keep this draft on the site until the final guideline is released.

I. Statement of Regulatory Principles

1. This Guideline builds upon the following:

Self-dealing regime: The objective of the legislated self-dealing regime is to preclude transactions that could inappropriately benefit persons with influence over a federally regulated financial institution [1] (FRFI). Concerns fall into two categories:

1. that certain transactions result in owners and other related parties [2] drawing inappropriate benefits that could have a detrimental impact on the solvency of an FRFI, and
2. the perception that owners and other related parties drew inappropriate benefits from certain transactions because of their position of influence.

Consequently, subject to a number of specific exceptions in the FRFI legislation and regulations, FRFIs cannot directly or indirectly enter into a transaction with a related party [3] . (For example, the FRFI legislation specifically permits an FRFI to make a loan to a related party if the loan is fully secured by securities of or guaranteed by the Government of Canada or the government of a province [4] . Because the legislation specifically permits this transaction, this Guideline has no application in regard to this transaction.)

This Guideline deals with the exceptions to this general prohibition on related party transactions when measured by criteria that have been established by an FRFI's Conduct Review Committee (CRC) and approved in writing by the Superintendent [5] .

Given that nominal or immaterial transactions are an exception to the general prohibition on related party transactions, the criteria set out in this Guideline should be interpreted restrictively.

Application of the Guideline

2. This Guideline establishes criteria that the Superintendent considers appropriate for FRFIs to use in determining whether a transaction with a related party is nominal or immaterial. If the FRFI's CRC has established criteria at least as stringent as those set out in the *Table of Nominal/Immaterial Value Transactions* in Part III of this Guideline, these criteria will be deemed to have been approved by the Superintendent.

3. If an FRFI's CRC would like to establish other materiality criteria, OSFI will assess these individually. OSFI will require supporting information as described in the OSFI's Transaction Instruction on Related Party

Transactions of Nominal Value.

4. This Guideline also applies to the exception that permits FRFIs to enter into certain transactions with a "narrow group" of related parties that includes a director or senior officer of the FRFI or a spouse, common-law partner or child who is less than eighteen years of age of the director or senior officer or any entity controlled by a director or senior officer of the FRFI or a spouse, common-law partner or child who is less than eighteen years of age of the director or senior officer provided that the person or the entity is a related party **only** because of that connection [6] . The legislation requires board approval to exceed legislated aggregate exposure limits to this "narrow group" [7] ; however, the legislation does not require nominal or immaterial transactions to be included in the calculation of the aggregate exposure to the "narrow group" when measured by criteria established by the FRFI's CRC and approved in writing by the Superintendent [8] . In this context, transactions that are nominal or immaterial according to criteria established by the FRFI's CRC in accordance with this Guideline will be excluded from the aggregate exposure to the "narrow group" calculation.

II. Criteria

5. OSFI believes that virtually any act or agreement in which more than one person is concerned, and through which relations between the persons are altered, is a transaction. OSFI considers a series of payments related to the same commitment to be one transaction, and not separate transactions. For example, the acquisition or disposition of a $10 million asset that is spread over 20 payments of $500,000 constitutes a $10 million transaction. OSFI does not subscribe to the view that these are 20 individual transactions for the purposes of this Guideline. Further, OSFI believes that all transactions should be valued on a "gross" basis. OSFI considers it inappropriate for an FRFI to measure a transaction against materiality criteria based on the transaction's "net" impact. Accordingly, for example, the sale of a $10 million building to a related party for consideration of another building valued at $9.9 million and cash of $100,000 constitutes a $10 million transaction. OSFI does not subscribe to the view that these transactions have no net impact on the FRFI and hence, are immaterial to it.

6. For the purposes of the *Table of Nominal/Immaterial Value Transactions* in Part III of this Guideline:

    1. “Regulatory capital” is the financial year opening balance of “regulatory capital” as defined in the *Regulatory Capital Regulations*.
    2. “Security” means a security as defined in section 2 of the FRFI legislation and subsection 488(4) of the BA, subsection 476(4) of the TLCA, subsection 520(4) of the ICA and subsection 412(4) of the CCAA.
    3. “Loan” has the same meaning as defined in subsection 488(3) of the BA, subsection 476(3) of the TLCA, subsection 520(3) of the *ICA* and subsection 412(3) of the CCAA.
    4. “Securities of a related party” refers to securities issued by a related party.

7. The *Table of Nominal/Immaterial Value Transactions* in Part III of this Guideline divides related party transactions into 6 categories based on the nature of the transaction and the degree of associated risk.

8. Transactions at or under the "transaction threshold" are nominal or immaterial and are not included in calculating the "aggregate threshold".

9. Transactions over the "transaction threshold" are nominal or immaterial until the total value of all such transactions exceeds the "aggregate threshold".

10. No transaction over the “transaction threshold” may be entered into that would cause the “aggregate threshold” to be exceeded.

11. In assessing whether the value of a transaction is immaterial or nominal to the FRFI, the FRFI must assess the value of the transaction as if it had been carried out on market terms and conditions.

III. Table of Nominal/Immaterial Value Transactions

Category	Transaction Threshold	Aggregate Threshold
1. The purchase or provision of services from or to related parties.	Greater of $50,000 or 1/50 of 1% of regulatory capital.	Greater of $200,000 or 1/4 of 1% of regulatory capital per related party, per financial year.
2. Leasing to or from related parties.	Greater of $50,000 or 1/50 of 1% of regulatory capital.	Greater of $200,000 or 1/4 of 1% of regulatory capital per related party, per financial year.
3. The purchase or sale of assets, other than Securities, from or to a related party.	Greater of $100,000 or 1/10 of 1% of regulatory capital.	Greater of $250,000 or 1/2 of 1% of regulatory capital per related party, per financial year.
4. Where the related party transaction consists of: 1. **the acquisition of Securities of a related party;** 2. **the acquisition of Securities of a third party from a related party;** 3. **the disposition of Securities to a related party; or** 4. any of **the following transactions with an entity:** 1. **a Loan to the related party;** 2. **an endorsement or other guarantee of an obligation of the related party; or** 3. **taking an assignment or otherwise acquiring a Loan to such a related party.**	Greater of $250,000 or 1/10 of 1% of regulatory capital.	Greater of $750,000 or 1% of regulatory capital per related party per financial year.
5. Providing funding or credit to a related party who is a natural person, other than a full-time senior officer, by way of 1. **a Loan, endorsement or other guarantee;** 2. **taking an assignment or otherwise acquiring a Loan to such related party.**	$250,000	Greater of $500,000 or 1/50th of 1% of regulatory capital per related party per financial year.
6. Transactions not referenced in, or specifically excluded from, a criteria as referenced above.	Greater of $50,000 or 1/50 of 1% of regulatory capital.	Greater of $50,000 or 1/25 of 1% of regulatory capital per related party, per financial year.

Footnotes

1 Canadian banks, trust and loan companies, life insurance companies, property and casualty insurance companies, and cooperative credit associations incorporated or formed under an Act of Parliament

2 Parts XI of the *Bank Act* (BA), the *Trust and Loan Companies Act* (TLCA) and the *Insurance Companies Act* (ICA) and Part XII of the *Cooperative Credit Associations Act* (CCAA) define who are related parties of FRFIs, and set out rules for undertaking transactions with related parties.

3 The legislative summary in this Guideline is not intended to be a substitute for provisions of the legislation. The reader is advised to refer to the provisions of the legislation and not to rely solely on the interpretation of those provisions contained in this Guideline.

4 Subsections 491(a) of the BA, 479(a) of the TLCA, 525(a) of the ICA and 415(a) of the CCAA.

5 The permission for nominal or immaterial value transactions is found in section 490 of the BA, section 478 of the TLCA, section 522 of the ICA and section 414 of the CCAA. Furthermore, these nominal or immaterial criteria are used for the purposes of the exception set out at subsections 496(1) of the BA, 484(1) of the TLCA, 529(1) of the ICA and 420(1) of the CCAA

6 The permission is found in subsections 496(1) of the BA, 484(1) of the TLCA, 529(1) of the ICA and 420(1) of the CCAA. This narrow group may be larger if the Superintendent has designated a related party or if a person is deemed to be a related party by virtue of the legislation - subsections 486(3) and (5) of the BA, 474 (3) and (5) of the TLCA, 518(3) and (5) of the ICA and 410(3) and (5) of the CCAA.

7 The limit is found in sections 497 of the BA, 485 of the TLCA, 530 of the ICA and 421 of the CCAA.

8 The limit is found in subsections 497(3) of the BA, 485(3) of the TLCA, 530(3) of the ICA and 421(3) of the CCAA.