Regulatory and legislative advisory

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Note:

Advisories describe how OSFI administers and interprets provisions of existing legislation, regulations or guidelines, or provide OSFI's position regarding certain policy issues. Advisories are not law; readers should refer to the relevant provisions of the legislation, regulation or guideline, including any amendments that came into effect

subsequent to the Advisory's publication, when considering the relevancy of the Advisory.

Introduction:

Determining whether a person controls an entity is relevant in various circumstances throughout the federally regulated financial institution (FRFI) statutesFRFI statutes refer to the *Bank Act*, the *Insurance Companies Act* and the *Trust and Loan Companies Act*. including, for example, provisions relating to ownership of a FRFI, investment rules, and the definition of a related party for the purposes of the self-dealing provisions. The definition of "control" in the FRFI statutes includes both the concepts of "control in law" (also known as *de jure* or legal control) and "control in fact" (also known as *de facto* control).

Subsection 3(1) of each of the FRFI statutes provides that there is control in law by a person where:

a. securities of the body corporate to which are attached more than 50 *per cent* of the votes that may be cast to elect directors of the body corporate are beneficially owned by the person and the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate;
b. more than 50 *per cent* of the ownership interests, however designated, into which the unincorporated entity, other than a limited partnership, is divided are beneficially owned by that person and the person is able to direct the business and affairs of the entity; and
c. the person is the general partner of a limited partnership.

Paragraph 3(1)(d) also defines control in fact as the control arising from a person having any direct or indirect influence that, if exercised, would result in control in fact of the entity. This Advisory provides guidance on factors that OSFI considers in determining whether control in fact exists in a particular situation. The factors reviewed in this Advisory are not exhaustive and no factor is necessarily definitive in making a determination.

When assessing the application of a person for the Minister's approval to acquire more than 10 *per cent* of a class of shares of a large bank, a federal credit union or certain large insurance companies, and formulating a recommendation in respect of such application, OSFI will consider the policy objectives set out in the Guidelines Respecting Control in Fact*Guidelines Respecting Control in Fact for the Purpose of Subsection 377(1) of the Bank Act*

(SOR/2002-163), *Guidelines Respecting Control in Fact for the Purpose of Subsection 377.2 of the Bank Act* (SOR/2012-278) and *Guidelines Respecting Control in Fact for the Purpose of Subsection 407.2(1) of the Insurance Companies Act* (SOR/2002-162). , taking into account the factors set out in these Guidelines.

Definitions:

In this Advisory,

"governors"

means a person or group of persons who, by legislation, contractual arrangement or otherwise, are vested with the power to manage or supervise the management of the business and affairs of an entity (e.g., board of directors, partners, trustees and their committees).

"ownership stake"

means shares held in a body corporate, ownership interests, however designated, held in an unincorporated entity or, in the case of a federal credit union, the votes that a person and all of the entities controlled by the person may exercise at an annual meeting or to elect directors.

"senior officer"

means

a. in relation to a body corporate, the chief executive officer, secretary, treasurer or controller, or any other natural person who is designated as an officer of the body corporate by the directors of the body corporate and who is reporting directly to the board of directors or to the chief executive officer; and

b. in relation to any other entity, any natural person who performs functions for the entity similar to those performed by a person referred to in paragraph (a), or any other natural person reporting directly to either the governors of the entity or to a person who performs functions for the entity similar to a chief executive officer of a body corporate.

Legislative References:

Paragraph 3(1)(d) of the *Bank Act*, the *Trust and Loan Companies Act* and the *Insurance Companies Act*.

Interpretation:

The provision in each of the FRFI statutesSee paragraph 3(1)(d) of the *Bank Act*, the *Trust and Loan Companies Act* and the *Insurance Companies Act*. that defines the concept of control in fact does not require control to actually be exercised; all that is required is the possibility that the person could exercise sufficient influence to control the entity. Where legislative or contractual constraints limit influence, OSFI may be of the view that the person has no such influence. In addition, where a person's influence is contingent upon the occurrence of an event that is outside of the person's control, OSFI is generally of the view that the person's influence does not materialize until the occurrence of the event.

Generally, if a person controls in law an entity, OSFI assumes that the person also controls in fact the entity, unless there are indicia that control in fact rests with one or more other persons.

OSFI generally considers the following types and degrees of influence in determining whether a person controls in fact an entity for the purposes of the FRFI statutes:

1. The types of influence that could lead to a person having control in fact of an entity, namely influence:
    i. exercised through the ownership of the entity;
    ii. over the governors of the entity;
    iii. over the operations of the entity;
    iv. based on economic dependence of the entity; and
    v. over the life of the entity.

2. The degree of direct or indirect influence that the person exercises. The determination of the degree of influence that, if exercised, would result in control of the entity is fact-specific. Accordingly, OSFI will make this assessment on a case by case basis taking into consideration the following indicia:

Influence exercised through ownership:

Any ownership stake confers some degree of influence to its holder. In assessing the degree of such influence, OSFI will generally consider:

i. **Ownership stake**: The size and/or value of the person's ownership stake, and the rights, privileges, restrictions and conditions (e.g., voting, non-voting, retractable) attached to the shares or other ownership interests beneficially owned by the person or entities controlled by the person. In this regard, OSFI is generally of the view that the ability to exercise voting rights attached to 25 *per cent* or less of the equity of an entity does not, in and of itself, result in control in fact of the entity. In contrast, OSFI is generally of the view that a person controls in fact an entity where the person has the ability to exercise voting rights attached to 35 *per cent* or more of the equity of the entity and the ability of any other person to exercise voting rights attached to the equity of the entity is negligible.

   A person may, however, have significant influence despite having a very small or even no ownership stake in the entity. For example, an individual who holds less than one *per cent* of the voting shares in an entity could be found to control in fact that entity if that individual's family members hold the remaining shares of the entity and, through shareholder resolutions, the individual has broad management powers over the operations of the entity, including signing, spending and borrowing authorities.

ii. **Ownership stakes of other persons**: The size and/or value of ownership stakes held by other persons, and the rights, privileges, restrictions and conditions attached to the ownership stakes held by these persons or entities controlled by them, including:
    i. the number of other persons with ownership stakes in the entity; and
    ii. the relationship (e.g., family, contractual or legal), if any, among these other persons.

iii. **Rights/options to increase an ownership stake**: Influence arising as a result of the person holding:
    i. options or rights to acquire additional shares of, or other ownership interests in, the entity that, if exercised, would materially increase the size and/or value of the person's ownership stake;
    ii. rights to cause the redemption or cancellation of shares of, or other ownership interests in, the entity that, if exercised, would materially increase the size and/or value of the person's ownership stake; or
    iii. rights to cause or effect changes in voting rights attached to the shares of, or other ownership interests in, the entity that, if exercised, would materially increase the person's voting rights.

iv. **Relationship with other owners**: The relationship (e.g., family, contractual or legal) between the person and other owners, which may allow the person to exert economic, financial or moral influence over other owners.

v. **Acting in concert**: When assessing whether a person controls in fact a FRFI, or an entity that controls a FRFI, OSFI will examine whether the person is acting in concert with one or more other persons. If so, those persons' influence will be aggregated. Where their aggregate ownership stake exceeds 50 *per cent*, those persons will be deemed to control in law the FRFI.Section 9 of the Bank Act, the Trust and Loan Companies Act and the Insurance Companies Act provide that where two or more persons are acting in concert, those persons are deemed to be a single person for the purposes of the ownership provisions. The mere fact that an agreement exists between two persons, however, does not necessarily mean they are acting in concert – see Ruling 2017-01 – Acting Jointly or in Concert where OSFI considered whether two shareholders were acting in concert. In all other cases, OSFI will assess the combined degree of direct and indirect influence that could be exercised by the group of persons, including their aggregate ownership stake.

Influence over the governors:

This refers to the influence a person has over the governors to have his or her will prevail (e.g., if the person is able to effect a significant change in the board of directors or the powers of the board of directors). In assessing the degree of such influence, OSFI will generally consider:

a. **Selection of the governors**: The ability of a person to appoint, block the appointment of, remove or replace one or more of the governors. For example, where a person has both a major ownership stake in an entity and the power to designate a significant number of governors, there is a greater likelihood that control in fact is present. Furthermore, where a person has the authority to remove and replace a majority of the governors, OSFI considers that this power could be used to substantially influence the governors.

b. **Committees of the governors**: The role and involvement of the person in committees of the governors having regard to the composition and structure of a committee, as well as the voting arrangements of a committee.

c. **Relationship with governors**: The relationship (e.g., family, contractual or legal) between the person and the governors, which may allow the person to exert economic, financial or moral influence over the governors.

d. **Special voting rights:** The attributes of the shares or other ownership interests, or the agreements between persons who have ownership stakes, that confer to the person any special rights for either the appointment of governors, the adoption of resolutions or decisions by the governors, or any special rights to block or veto decisions of the governors. While, in most cases, the ability to block or veto certain decisions will not alone constitute control in fact, there may be circumstances where the veto power is so broad as to influence the entity's actions, and could lead to a finding of control in fact. In addition, the possession of a casting vote (i.e., an additional vote given to break a voting stalemate) for decisions by the governors could be construed as control in fact.

Influence over the operations:

This refers to the ability of a person, other than a governor or senior officer, to materially shape the operations of the entity. In assessing the degree of such influence, OSFI will generally consider:

a. **Involvement in management**: The ability of the person to appoint, block the appointment of, remove or replace senior officers of the entity, as well as the person's role and involvement in:

   i. making strategic decisions regarding the business and affairs of the entity, including business plans, significant capital expenditures, dividend policies or the issuance of securities of the entity;

   ii. managing and running the day-to-day operations of the entity; or

   iii. determining or constraining the business activities of the entity.

b. **Relationship with senior officers**: The relationship (e.g., family, contractual, legal) between the person and senior officers, which may allow the person to exert economic, financial or moral influence

over senior officers. This would include whether one or more of the senior officers holds, or once held, similar positions with the person or entities controlled by the person.

c. **Involvement of others**: The role and involvement (or lack of involvement) in the business and affairs of the entity by other persons in a position of authority (e.g., senior officers, governors). For example, where two parties each have an ownership stake of 50 *per cent* in an entity and equal representation on the board of that entity, the party that actively participates in the operations of that entity could be found to control in fact the entity if the other party has little knowledge of, or involvement with, the operations of the entity.

d. **Integration of operations/reliance on services**: The relationship between the operations of the entity and those of the person. For example, a person that is a material service provider in relation to core aspects of the entity's operations could be found to have the degree of influence necessary to control in fact that entity.

e. **Involvement in the strategic decisions or "raison d'être" of the entity**: The role of the person in the creation of the entity (i.e., whether the person was a directing mind). For example, a person is more likely to exercise significant influence where the person played a key role in the development of the mission, purpose(s), objectives and activities of the entity or in setting out the legal or operational structure of the entity to secure all or substantially all the economic benefits of the entity.

Influence based on economic dependence:

This refers to a person's ability to exert economic pressure on the entity that could reasonably affect its future and/or its viability. In assessing the degree of such influence, OSFI will generally consider:

a. **Financial support**: The nature (e.g., retractable/redeemable securities, demand/term loans, subordinated debts) and size of the person's financial support to the entity as well as its terms and conditions and the potential impact on the entity of the withdrawal of that support. For example, a major creditor of an entity could have significant influence over the entity's management and operations such that it controls in fact the entity, particularly if the entity has difficulty finding other sources of funding.

b. **Business relationship**: The nature and extent of the business relationships and/or business arrangements (e.g., supply, management services, marketing, leasing or franchise arrangements) between the entity and the person or an entity controlled by the person. For example, a person who is the entity's sole customer or client or provides essential services to the entity could be in a position to exert sufficient pressure to have his or her will prevail in the business of the entity.

c. **Expertise**: Influence over an entity can arise as a result of the person having unique expertise required to operate the business of the entity.

Influence over the life of the entity:

This refers to the ability of a person to initiate the liquidation or the sale of all or substantially all of the business of the entity (i.e., the ability to terminate an entity's business), or to appropriate the entity's profits or property.

For examples of how OSFI has applied the influence considerations above to specific circumstances, please refer to:

- Ruling 2008-03 – Control in Fact – Major shareholder and service provider, where OSFI concluded that a person who beneficially owned 40 *per cent* of the common shares of an entity and provided material services to the entity did not control in fact that entity; and
- Ruling 2007-02 – Control in Fact – Trustee or manager, where OSFI concluded that the trustee of an investment fund did not control in fact the fund.