

From Torrance J. Wylie

To: Mr. Purdy Crawford

January 5, 1988

Re: Discussion Draft of new Federal Trust and Loan Companies Act

1. As you are aware, the discussion draft was made public on December 21, 1987. It is a lengthy (254 pages) and extremely complex bill and we will only appreciate its full significance for Inasco once our lawyers have analyzed the bill in great detail. This process gets under way on January 6th at a joint meeting with Power Corporation. All observations, comments, suggestions for change are to be submitted to the Department of Finance by February 15, 1988.
2. Nevertheless, it is clear that the "discussion draft" contains a major policy shift from the position set out in the Blue Paper tabled December 18, 1986. The Blue Paper would have prohibited financial institutions with commercial links (eg. Canada Trust) from growing through either new start ups or acquisitions. This constraint is dropped in the "discussion draft" and is very welcome news indeed. Canada Trust is now free to compete and grow on the same basis as Canadian financial institutions that have no commercial links.
3. The "discussion bill" carries forward the requirement for a 65% ownership limit by December 31, 1991 and the prohibition on commercial corporations not now in financial services entering the sector.
4. A summary of the KEY PROVISIONS of the "discussion draft" follows:

KEY PROVISIONS

A. Ownership Policy

- As noted above, while the government has maintained the commercial link principle, it has modified its ownership policy as it applies to existing commercially linked financial institutions. This represents the most important change from the Blue Paper.
- Existing financial institutions with commercial links will be "grandfathered". With limited exception, commercial companies or intervening holding companies which own a majority interest in existing non-bank financial institutions will be unable to start up or acquire another financial institution; however, the

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downstream financial institution subsidiary (Canada Trust) will not be so constrained. It will have the same business powers as non-commercially linked trust and insurance companies and have the same flexibility to exploit these powers.

In future, commercial companies will not be permitted to acquire more than 10 per cent of any federal non-bank financial institution unless such ownership is permitted by the Minister of Finance. In the Blue Paper commercial companies were permitted to own up to 100% of a trust or insurance company provided that institution's capital did not exceed \$50 million. The government has now decided to prohibit commercial corporations and persons with commercial interests from acquiring significant interests (i.e. more than 10%) in a trust or loan company. The Blue Paper measure was supposedly designed to channel necessary start-up capital to fledgling financial institutions, but has been dropped in order to bring in a cut-and-dried grandfathering policy. It prevents a Bell Canada, for example, from getting its foot in the door.

At first glance the wording and definition used in the document, as they apply to grandfathering and the commercial link, seem ambiguous, even inadequate. The intent of the government's ownership policy is well-known, however, and our legal counsel is carefully reviewing the entire document, including this important section.

There do not appear to be any other significant departures on ownership policy from the Blue Paper in the draft legislation. For example:

- closely held ownership of a trust and loan company is permitted by an entity with no commercial links up to a level of \$750 million in capital;

- a company with capital exceeding \$750 million in capital must have at least 35% of its voting shares or its holding company voting shares widely held and publicly traded

- if a company over the \$750 million threshold is sold, no one may acquire more than a 10 per cent interest

- trust and loan companies with capital of \$50 million or more that now have commercial links must have 35% of their voting shares or their holding company's voting shares widely held and publicly traded

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- the 30% widely held requirements must be met by December 31, 1991 or within 5 years of reaching the thresholds.

b. Business Powers - fiduciary powers

- The Kings Paper and the "discussion bill" give federal trust and loan companies the power:
 - to hold or be held by other types of regulated financial institutions -- including banks, insurance companies and investment dealers -- or to be affiliated with such institutions under a common holding company;
 - to make consumer loans with no portfolio limit;
 - to make commercial loans with no portfolio limit provided the company has at least \$25 million in capital and has received supervisory approval; and
 - to network financial services provided by other financial institutions, with the exception of insurance retailing.
- The Kings Paper proposed to extend fiduciary powers to other financial institutions with some exceptions. One of these exceptions was the power to act as a stock transfer agent. This exception has disappeared so that all federally regulated institutions will be able to act as stock transfer agents.

c. Acquisitions: "Large Buyout Large"

- The Kings Paper encouraged a "build not buy" policy for institutions entering new business areas and particularly for large institutions and foreign owned institutions. This broad policy has been dropped except that "large" institutions will be discouraged from buying "large" institutions except large securities firms. The definition of large will be at ministerial discretion.

d. "Significant Interests"

- Under the complex sections dealing with the definition of "significant interest", the draft legislation gives greater importance to de facto control than did the Kings Paper.

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A. Self-Dealing

- Transactions with related parties are banned with certain exceptions. This follows the formula in Ontario's Bill 116.

B. Corporate Governance

- At least one third of the directors must be "unaffiliated"; the number of inside directors is limited (15%) and audit and conduct review committees must consist of a majority of unaffiliated directors.

C. Amount of Ministerial Discretion

- The amount of discretion allotted the Minister of Finance by the draft legislation is a cause for concern, particularly the number of provisions which permit the minister to approve or disallow a transaction according to the criterion of whether "it is in the best interests of the Canadian financial system". A related concern is the number of new provisions for which specific regulations have yet to be announced and will only be released later.

D. Venture Capital

- As was the case with the banks in 1980, trust and loan companies will be able to establish a venture capital corporation with the same constraints that are now applied to banks.

5. In summary, the "discussion bill" reflects almost completely the recommendations we have advanced in the past year for changes in the Blue Paper.

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 JWH/mso

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