Canada has a highly concentrated financial sector with six large Canadian domestic banks holding 93 percent of all bank assets - one of the highest concentration levels in G7 countries. Perhaps because of this, there is a growing interest by U.S. and other foreign lenders to participate in the Canadian financial sector. Currently, 24 foreign bank subsidiaries and 27 foreign bank branches operate in Canada with a total of Can$185.9 billion assets in Canada, compared to Can$3,663 billion held by Canadian domestic banks. Foreign banks also participate in the Canadian financial sector by making cross-border bilateral and syndicated commercial loans to Canadian borrowers without maintaining an authorized presence in Canada. These cross-border lending activities have become more prevalent since 2008 after the Government of Canada eliminated the withholding tax on arm's length outbound interest payments made by Canadian borrowers to non-resident lenders. The purpose of the elimination of the withholding tax, as Canada’s Department of Finance put it, was to “increase access to foreign capital markets and reduce costs for Canadians and Canadian businesses that borrow from foreign lenders.”

Although this tax disincentive was eliminated, foreign banks without an authorized presence in Canada continue to face a broad legislative prohibition under the *Bank Act* (Canada) against carrying on business in Canada. As a result, such foreign banks are required to structure their lending activities with residents of Canada cross-border, by maintaining minimal “touch points” with Canada to ensure that they do not carry on business in Canada contrary to the *Bank Act*.

The discord between the policy reasons underlying the elimination of withholding tax in 2008 and the *Bank Act* prohibition against foreign banks carrying on business in Canada without an authorized presence reflects a long-standing policy tension in Canada between increasing

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5 SC 1991, c 46 [*Bank Act*].
competition in Canada’s financial sector on the one hand, and maintaining a level playing field between Canadian and foreign banks on the other.

**The Bank Act Prohibition**

Subsection 510(1) of the *Bank Act* includes the following broad prohibition:

**Prohibited activities**

510. (1) Except as permitted by this Part [XII], a foreign bank or an entity associated with a foreign bank shall not

(a) in Canada, engage in or carry on

   (i) any business that a bank is permitted to engage in or carry on under this Act, or

   (ii) any other business;

(b) maintain a branch in Canada for any purpose.

The effect of paragraphs 510(1)(a) and (b) is that a foreign bank or an entity associated with a foreign bank (as discussed below) is not permitted to engage in or carry on any business in Canada or maintain a branch in Canada, except as permitted by Part XII of the *Bank Act*.\(^6\) Part XII permits a foreign bank to establish a subsidiary or branch in Canada with the approval of the Minister of Finance, subject to satisfying applicable legislative and regulatory requirements.\(^7\)

The *Bank Act* prohibition is broadly drafted; however, it expressly applies to activities that are carried on “in Canada”. As a result, a distinction has been drawn between engaging in Canada in an activity (which is prohibited by subsection 510(1) of the *Bank Act*) and engaging in the same activity from outside Canada cross-border with residents of Canada (which is permitted). This distinction has been accepted by the Office of the Superintendent of Financial Institutions (“OSFI”) – Canada’s main banking regulator – in a variety of different circumstances. A number of OSFI rulings address this issue and provide guidance as to what factors are relevant, although each situation is dependent on the facts. Further, OSFI rulings have confirmed that some activity in Canada by or on behalf of the foreign bank is acceptable; provided that such activity is ancillary to the main business activity of the foreign bank undertaken from outside Canada. OSFI rulings also indicate that policy concerns may impact OSFI’s determination whether cross-border dealings with Canadians constitute the carrying on of business in Canada. Specifically, there is a heightened sensitivity in respect of transactions that include cross-border deposit

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\(^6\) There are also other prohibitions that apply to the activities and investments of a foreign bank in Canada.

\(^7\) Certain other exceptions under Part XII apply which, for the most part, are not relevant in connection with cross-border loans.

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taking. In addition, consumer lending programs generally have more connecting factors to Canada and raise consumer protection issues and, as a result, can be more difficult to structure across the border without contravening the Bank Act.

**Who is Subject to the Prohibition?**

The Bank Act prohibition applies to foreign banks and certain entities associated with foreign banks. For the purposes of this prohibition, the following entities are considered foreign banks:

- **a.** an entity that is a bank according to the laws of the jurisdiction of its incorporation or any jurisdiction in which it carries on business;

- **b.** an entity that is regulated as a bank or as a deposit-taking institution according to the laws of the jurisdiction of its incorporation or any jurisdiction in which it carries on business; or

- **c.** an entity that engages in the business of providing financial services and employs, the word “bank” or “banking” or any corresponding words in other languages to identify or describe its business.\(^8\)

The definition of an entity associated with a foreign bank is more complex. It is defined to include entities that control or are controlled by a foreign bank and entities that are controlled by the same person as the foreign bank.\(^9\) There are, however, important carve-outs from this broad definition for the purposes of the subsection 510(1) prohibition, some of which are tied to materiality thresholds established under the Bank Act.\(^10\) This is an area where care needs to be taken to consider whether a non-bank entity in a corporate group that includes a foreign bank is an “entity associated with a foreign bank” subject to the Bank Act prohibition before that entity carries on business in Canada.

The Bank Act prohibition also extends to the activities in Canada carried out by an agent or nominee of a foreign bank or an entity associated with a foreign bank.\(^11\) As a result, the foreign bank or the entity associated with the foreign bank cannot circumvent the Bank Act prohibition by enlisting agents or nominees in Canada and carrying out the prohibited activity through them. The term “agent” in this context refers to a common law relationship of agency, while the term

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\(^8\) Bank Act, supra note 5 at s 508(1)(a).

\(^9\) Bank Act, supra note 5 at s 507(2).

\(^10\) Bank Act, supra note 5 at ss 508(1)(b) and 508(2).

\(^11\) Bank Act, supra note 5 ss 510(2)-(3).
“nominee” does not have an established meaning in the jurisprudence and is open to broader interpretation.

If a lender is not a foreign bank or an entity associated with a foreign bank within the meaning of the *Bank Act*, then the lender would not be subject to the *Bank Act* prohibition, although certain licensing requirements under Canada’s provincial laws may apply.

**Relevant Considerations**

A number of considerations have emerged from OSFI rulings and caselaw that help determine whether a cross-border activity of a foreign bank or an entity associated with a foreign bank constitutes the carrying on of business in Canada contrary to the *Bank Act*. As previously noted, this determination is highly fact-specific and often a single connecting factor (or its absence) is not by itself dispositive of the issue. Rather, the considerations set out below outline the factors that OSFI will likely consider in determining if a foreign bank or an entity associated with a foreign bank is carrying on business in Canada in contravention of the *Bank Act*. For ease of reference, we use the term foreign bank to refer both to foreign banks and entities associated with foreign banks in the discussion below.

**Office or Employees in Canada:** Maintaining a place of business or establishment in Canada, such as an office that is regularly used for an extended period of time by a foreign bank’s employees or nominees or agents is a significant adverse factor in the carrying on business determination. Maintaining an office in Canada will also likely contravene the prohibition against opening a branch in Canada (other than an authorized branch), which is specifically prohibited by paragraphs 510(1)(a) and(b) of the *Bank Act*.

**Trips to Canada by Foreign Bank’s Employees:** Regular extended visits to Canada by the employees of a foreign bank are also an adverse factor. However, limited visits to Canada to conduct due diligence, audits and inspections or visits occasioned by realization situations are likely to be permitted. Even limited visits, however, when combined with other significant connecting factors may result in a carrying on business determination. Visits for the purpose of the solicitation of business are particularly sensitive, and call for careful analysis in light of any other expected commitments to Canada.

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13 *Club Resorts Ltd v Van Breda*, 2012 SCC 17 at para 87, [2012] 1 SCR 572 [Van Breda].

Contract Formation and Negotiations: OSFI will consider where the material business contracts are negotiated and executed. Material contracts will include loan documents, such as commitment letters, terms sheets, credit agreements, and security documents, as well as service agreements that a foreign bank enters into with Canadian service providers in certain permitted circumstances. Negotiations that take place in person in Canada will have a significant adverse impact on the carrying on business determination. Therefore, all material negotiations should be conducted by persons located outside of Canada at the times they are negotiating, such as by telephone or by electronic means of communication. Although the foreign bank may engage local Canadian legal counsel to assist with the cross-border transaction, the foreign bank should be careful not to delegate material decision-making authority on business matters to the Canadian counsel. This is to ensure that the Canadian counsel is not viewed as an agent or nominee negotiating in Canada on behalf of the foreign bank. In addition, because the common law rules of contract formation applicable in Canada consider a contract to be executed in the jurisdiction where it was last signed, the foreign bank should ensure that it signs all agreements outside Canada and, if the counterparty signs in Canada, the foreign bank should sign last. This may be difficult to accomplish in the era of email exchanges of PDF signature pages.

Servicing Contracts: OSFI has accepted that foreign banks may utilize services in Canada in connection with cross-border loans if the services are incidental to the lending otherwise carried on from outside Canada. This can be explained in two ways. First, the activity carried out in Canada by the local service provider is such that even if undertaken by the foreign bank, the activity would not amount to carrying on business in Canada. Second, in some cases, OSFI has recognized that because the services carried out in Canada by the local service providers are incidental in nature, the service providers are not considered as agents or nominees of the foreign bank. In such cases, in order for a servicing arrangement to be permitted, it should be carried out by independent Canadian service providers that are not affiliated with the foreign bank and do not work exclusively for the foreign bank. Other permitted services could include valuation services, receivership services and legal services. OSFI rulings also indicate that the use of Canadian service providers for certain aspects of loan servicing or enforcement alone would not be considered carrying on business in Canada. Further, the services provided by an independent

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18 OSFI Ruling 2004-06, ibid.
Canadian agent bank on a syndicated loan should fall within this category of permitted services, although this issue has not been specifically considered in OSFI rulings.

**Bank Accounts:** Maintaining bank accounts in Canada to advance loans and receive loan repayments is a significant factor in the carrying on business determination. To reduce the impact of this factor, foreign banks can ensure that loan advances and repayments are effected outside of Canada or through wire payments. Where this is not possible or impractical, such as when the loan is funded in Canadian currency, the foreign bank may consider using flow-through correspondent banking accounts, which will ensure that the foreign bank does not maintain general use accounts in Canada.

**Advertising:** Although Canadian courts have held that advertising in Canada does not by itself amount to carrying on business in Canada, advertising specifically directed at residents of Canada is a factor that OSFI will likely consider in the carrying on business determination. Therefore, while having a Website that is accessible from Canada is unlikely to influence a carrying on business determination, advertising or solicitation carried out specifically targeting Canadian borrowers will be a relevant factor.

Where a foreign bank engages in other type of cross-border activities, such as deposit-taking, trade finance or securities trading, other factual, policy and legal considerations may apply in determining whether the activity would be permitted.

**Penalties for Contravention**

The *Bank Act* and the *Office of the Superintendent of Financial Institutions Act (Canada)* provide for criminal and administrative penalties for contravening the *Bank Act* prohibition. The administrative penalties are up to Can$ 500,000, while criminal penalties on indictment can be as high as Can$ 5 million. However, criminal and administrative penalties are rarely imposed. Where a potential violation of subsection 510(1) of the *Bank Act* comes to the attention of OSFI, OSFI normally first requests the foreign bank to explain how its activities do not result in a violation. In the course of discussing such explanation, OSFI might identify particular aspects of the activity that should be changed. Alternatively, OSFI may conclude that the cross-border program as a whole is in breach of subsection 510(1) of the *Bank Act* and must be discontinued if it cannot be remedied by eliminating only some of the connecting points with Canada.

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19 *Van Breda, supra* note 13 at para 87.

20 RSC 1985, c 18 (3rd Supp), Part I.

21 *Ibid* at s 28(1).

22 *Bank Act, supra* note 5 at s 980.
OSFI Ruling Process

Contravening the *Bank Act* prohibition may have a significant disruptive effect on a foreign bank’s cross-border lending activities in Canada. OSFI is generally open to discussions with foreign banks on whether a proposed cross-border lending program will be permitted under the *Bank Act*. Foreign banks may also formally request a ruling from OSFI on the proposed program. Although it would be unusual to request a ruling in respect of straightforward commercial loans made to borrowers in Canada and many situations can be addressed by Canadian legal advisors, foreign banks that wish to consider more complex cross-border programs may initiate discussions with OSFI and potentially request a formal ruling on the proposed plan.