

FINANCIAL INSTITUTIONS (REGULATORY) BULLETIN

June 2005

NEW LEGISLATION MODIFIES CORPORATE GOVERNANCE RULES FOR FEDERALLY REGULATED FINANCIAL INSTITUTIONS

On June 6, 2005, Minister of Finance Ralph Goodale introduced new legislation that will amend various statutes that affect the governance of federally regulated financial institutions. The objective of the new legislation is to modernize the corporate governance requirements for financial institutions and to align those requirements with the corporate governance standards for federally incorporated business corporations governed by the *Canada Business Corporations Act* (CBCA), which was amended in 2001 to update these governance standards. The proposed legislation also addresses several corporate governance issues that are unique to financial institutions. The statutes that will be affected by the changes are the *Bank Act*, *Insurance Companies Act*, *Trust and Loan Companies Act*, and *Cooperative Credit Associations Act*.

ROLES OF DIRECTORS AND OFFICERS

In line with the CBCA, the proposed amendments will clarify the roles of directors and officers, specifically as they relate to the duties and defences of directors and officers. For example, the directors and officers of a bank or a bank holding company currently have a defence against certain kinds of liability claims if they have justifiably relied in good faith on advice given to them by a professional. The proposed legislation expands the circumstances in which directors and officers of a bank or a bank holding company may avail themselves of a due diligence defence to avoid personal liability for certain actions taken in connection with the exercise of their powers as directors and officers. In addition, the proposed legislation clarifies the procedure for dealing with conflicts of interest and introduces expanded disclosure requirements for directors or officers who have or may have a conflict of interest.

SHAREHOLDERS' RIGHTS

Under the proposed legislation, as under the CBCA, shareholders of federally regulated financial institutions will have the ability to participate and vote electronically at shareholder meetings, whether by telephone or other electronic communication facility. Certain formal proxy requirements have also been relaxed to allow shareholders greater latitude in communicating amongst themselves.

DISCLOSURE OF CONFLICTS OF INTERESTS

Tied to the expanded disclosure requirements for directors is an expanded right of access for shareholders to minutes of meetings of directors or committees of directors and other documents that relate to a director's conflict of interest regarding material contracts or transactions. This proposed amendment is more controversial than the others in that it has raised a concern in the financial services industry that private confidential information could be divulged in the marketplace. For example, a bank director who also serves as an executive for a company that is a customer of the bank will be required to declare any conflict of interest created by a material contract or transaction between the bank and the company. Even if the proposed contract or transaction is confidential, the details relating to the conflict of interest (including the nature and extent of the interest) may

>>>

become accessible to shareholders. While federally incorporated companies have adapted to similar provisions, which are part of the governance rules for such companies, financial institutions are subject to common-law duties of secrecy in relation to their customers which may conflict with the new disclosure obligations.

HARMONIZATION OF GOVERNANCE PRACTICES

The proposed amendments introduce a going-private framework for federally regulated financial institutions that will ensure consistency with provincial securities laws and grant dissent rights to objecting shareholders. In addition, the modified provisions aim to bring insider reporting, proxy and prospectus rules in line with those of provincial regulatory bodies.

The changes also eliminate certain inconsistencies in the treatment of different types of federally regulated financial institutions and harmonize the legislation governing them. One example relates to the 35% public ownership requirement that applies to federally regulated financial institutions of a certain size. Currently, the Minister of Finance may grant an exemption from this requirement but only in the case of a bank. The proposed amendments extend the availability of this exemption to medium-sized insurance companies, insurance holding companies, and trust and loan companies. The proposed amendments also introduce greater flexibility by allowing the Minister to grant an exemption “if the Minister considers it appropriate to do so”.

ELECTRONIC COMMUNICATION

The amendments will also facilitate electronic communication between federally regulated financial institutions and their shareholders and the Superintendent of Financial Institutions.

*For further information about any of these provisions, please contact your
McMillan Binch Mendelsohn LLP lawyer or one of the lawyers listed below:*

Pat Forgione	416.865.7798	pat.forgione@mbmlex.com
Stephanie Robinson	416.865.7204	stephanie.robinson@mbmlex.com
Cheryl Stacey	416.865.7243	cheryl.stacey@mbmlex.com
E.K. (Ted) Weir	416.865.7050	ted.weir@mbmlex.com

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

© Copyright 2005 McMillan Binch Mendelsohn LLP

MCMILLAN BINCH MENDELSON

TORONTO | TEL: 416.865.7000 | FAX: 416.865.7048

MONTRÉAL | TEL: 514.987.5000 | FAX: 514.987.1213

www.mbmlex.com