

# WHITE PAPER ON FINANCIAL INSTITUTIONS REFORM - A COMMENTARY -



June 2006

On June 14<sup>th</sup>, the Department of Finance released its long-awaited *White Paper on Financial Sector Reform*, stating its intentions for the mandated legislative package, expected to be introduced into Parliament by the Fall. Since 1992, all federal financial sector legislation has a five year sunset, by which time the government must pass new legislation before the sunset date. The next sunset date is now April 2007.

The proposals can best be described as “a mid-course correction” between the major reforms of 2001 and presumably the next round in 2012. At the 2005 launch of the consultation process, the Department noted that the legislative review provided an opportunity to “refine” the legislative framework, but that no major overhaul was needed. Clearly nothing in the consultations changed their view.

The proposals, grouped into three broad categories, are summarized and analyzed in the commentary below.

Also....Campbell Strategies is pleased to announce that **FRANK SWEDLOVE**, former Assistant Deputy Minister for Financial Sector Policy in Canada's Department of Finance, has become associated with Campbell Strategies. See page 3 for announcement details.

## 1. ENHANCING INTERESTS OF CONSUMERS

Most of the proposals in this section relate to either clarifying existing disclosure requirements by banks or broadening disclosure requirements to other areas. For example, there will be separate disclosure requirements for deposit-type investment products such as index-linked GICs; disclosure of administration fees on registered plans; requirements for disclosure online, equivalent to what occurs in a branch; more disclosure of the ombudsman process; and other technical clarifications.

Interestingly, **the biggest impact for consumers relate to proposals that are neither legislated nor regulatory.** The

first is the very clear message from the Department that it wants the present **Code of Practice for Consumer Debit Card Services expanded to cover all electronic banking such as internet banking, telephone banking and stored value card systems.** Under the present voluntary code, consumers are generally protected if there are unexplained transactions at ATMs or point of sale machines. With the expansion of the code, this protection would be extended to all forms of electronic transactions. The code would be monitored for compliance by the Financial Consumer Agency of Canada which is part of their legislated mandate.

The second relatively major consumer benefit is in the area of **cheque holds.** Today, as a matter of practice, most banks apply a hold on cheques for ten business

days. Consumer groups have complained that in the world of computers and almost instantaneous communications, such hold periods are unreasonable. The banks have argued that the time is required to respond to increased fraud activity. The Government's willingness to allow cheque imaging (discussed below), allows for a breakthrough of this impasse. The banks have agreed to reduce their hold periods to 7 days immediately and 4 days once cheque imaging is fully implemented. To be sure the banks comply, the Government will put into the legislation its ability to legislate hold periods. Given the experience with other voluntary commitments (e.g., low cost accounts), this legislative "hammer" is unlikely to be ever used.

## **2. INCREASED LEGISLATIVE AND REGULATORY EFFICIENCY**

A number of the measures in this section are designed to reduce the cost of government regulation, at least in a small way, on financial institutions. **"Near banks" (generally companies that do not operate as banks in their home country) will be able to set up unregulated entities without seeking Ministerial approval.** This measure continues the ongoing attempts in recent banking legislation to encourage new entry, particularly from abroad. There will also be fewer Ministerial and Superintendent approvals needed, particularly for transactions that do not raise policy concerns, and **reinsurers will no longer be subject to consumer rules** (since they only deal with regulated companies).

There will be a small **amendment to the credit union legislation** that could have a substantial effect for some credit unions. Under present legislation, there must be at least 10 credit unions to form an "association". The minimum number is being reduced to two. An association is a

federally-regulated vehicle to allow credit unions from different provinces to come together to sell products jointly. This will allow only two credit unions from two different provinces to come together and offer retail products across provincial borders and indeed across the country. This assists credit unions to operate interprovincially in a fashion, until such time that a more meaningful co-op bank model can be explored.

One area where the Department has clearly stepped back from its original thinking relates to **residential mortgages**. As noted in the 2005 Budget Annex launching the consultations, the Department was considering removing the legislative provision that required mortgage insurance if the loan to value ratio exceeded 75%. Concerns expressed by the mortgage insurance community, mixed views expressed by the banks and uncertainty of the impact that elimination would have on what is perceived to be a well-functioning mortgage market in Canada, led to the decision to maintain the provision. However, the Government is proposing to increase the ratio to 80%, which is more in line with other countries, and to revisit the level in five years time.

## **3. ADAPTING THE FRAMEWORK TO NEW DEVELOPMENTS**

There are two proposals of interest in this section. **Banks and other deposit-taking institutions will be allowed to replace the physical delivery of cheques with an electronic image.** This will eliminate the need to fly cheques across the country every night to meet present minimum standards on processing and clearing of cheques. This is the biggest "win" for the banks in the White Paper, resulting in potentially millions of dollars of savings over time. As noted above, it also benefits the consumers in allowing the reduction of cheque hold periods.

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The second proposal of interest seems administrative in nature but could prove important in a financial services consolidation scenario. Under the present regime, whether a bank can be closely or widely held is dependent on its size. The “**large bank**” **threshold** where banks must remain widely held is now set at \$5 billion of equity. This number is being **increased** to \$8 billion to reflect the growth of the banking sector more generally. Similarly, for the “**medium bank**” category where 35% of the shares must be traded (unless an exemption is provided by the Minister), the **threshold is being increased** from \$1 billion of equity to \$2 billion. These increases provide **greater room for a bank to grow without having to contemplate wider ownership rules applying. It could also allow some banks to remain more welcome targets for an acquisition going forward.**

The **White Paper also includes a technical annex** that lists a considerable number of technical amendments to at least ten Acts. Many are categorized as “legislative streamlining” and others deal with operational

issues of the Canadian Payments Association and CDIC. Presumably, between now and the tabling of legislation other non-policy related amendments will be considered and added to the Bill.

### **A FINAL NOTE**

As interesting as what is in the White Paper is what is not in the White Paper. **The paper does not further the debate on consolidation/mergers in the financial sector.** This was to be expected, as the Minister of Finance, Mr. Flaherty, has stated that the merger issue is not a priority of this Minority Government. Also, despite extensive lobbying by the banking sector, there was **no mention of increasing insurance networking powers** of the banks. This too should not be a surprise, since the Conservative Party platform in the Election included the reference that no changes in the relevant regulations were contemplated.

**Stakeholders have until July 21<sup>st</sup> to provide comments to the Department.**

### **CAMPBELL STRATEGIES’ ANNOUNCEMENT**

*Barry Campbell, President of Campbell Strategies, is pleased to announce that **FRANK SWEDLOVE**, former Assistant Deputy Minister for Financial Sector Policy in Canada’s Department of Finance, has become associated with Campbell Strategies. A principal of Swedlove Consulting Inc., Mr. Swedlove served in the Department in a number of increasingly senior roles over the past 20 years. As ADM for Financial Sector Policy, Mr. Swedlove served as senior departmental advisor on financial sector issues to several Ministers of Finance. His responsibilities included the development and passage of financial sector legislation, the coordination of various regulatory agencies, and advice on the structure of the financial sector markets going forward.*

*Campbell Strategies provides a broad range of government relations and public policy advice covering all levels of government. Campbell Strategies assists clients to communicate effectively in the public sector environment by providing advice that helps to inform business strategies and enables our clients to manage regulatory and public policy challenges.*

*As a member of the **Campbell Strategies** team, Mr. Swedlove joins **Barry Campbell, Paul Brown and Mitchell Toker**. Campbell Strategies is associated with **Media Profile** and its President **Patrick Gossage** for assignments which have a communications dimension.*